

CATERPILLAR'S OFFSHORE TAX STRATEGY

HEARING

BEFORE THE

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
OF THE

COMMITTEE ON
HOMELAND SECURITY AND
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE
ONE HUNDRED THIRTEENTH CONGRESS

SECOND SESSION

APRIL 1, 2014

Available via the World Wide Web: <http://www.fdsys.gov>

Printed for the use of the
Committee on Homeland Security and Governmental Affairs



CATERPILLAR'S OFFSHORE TAX STRATEGY

CATERPILLAR'S OFFSHORE TAX STRATEGY

HEARING

BEFORE THE

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
OF THE

COMMITTEE ON
HOMELAND SECURITY AND
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE
ONE HUNDRED THIRTEENTH CONGRESS

SECOND SESSION

APRIL 1, 2014

Available via the World Wide Web: <http://www.fdsys.gov>

Printed for the use of the
Committee on Homeland Security and Governmental Affairs



U.S. GOVERNMENT PRINTING OFFICE

89-523 PDF

WASHINGTON : 2014

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512-1800; DC area (202) 512-1800
Fax: (202) 512-2104 Mail: Stop IDCC, Washington, DC 20402-0001

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

THOMAS R. CARPER, Delaware, *Chairman*

CARL LEVIN, Michigan	TOM COBURN, Oklahoma
MARK L. PRYOR, Arkansas	JOHN MCCAIN, Arizona
MARY L. LANDRIEU, Louisiana	RON JOHNSON, Wisconsin
CLAIRE McCASKILL, Missouri	ROB PORTMAN, Ohio
JON TESTER, Montana	RAND PAUL, Kentucky
MARK BEGICH, Alaska	MICHAEL B. ENZI, Wyoming
TAMMY BALDWIN, Wisconsin	KELLY AYOTTE, New Hampshire
HEIDI HEITKAMP, North Dakota	

RICARD J. KESSLER, *Staff Director*
KEITH B. ASHDOWN, *Minority Staff Director*
LAURA W. KILBRIDE, *Chief Clerk*
LAUREN M. CORCORAN, *Hearing Clerk*

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

CARL LEVIN, Michigan, *Chairman*

MARK L. PRYOR, Arkansas	JOHN MCCAIN, Arizona
MARY L. LANDRIEU, Louisiana	RON JOHNSON, Wisconsin
CLAIRE McCASKILL, Missouri	ROB PORTMAN, Ohio
JON TESTER, Montana	RAND PAUL, Kentucky
TAMMY BALDWIN, Wisconsin	KELLY AYOTTE, New Hampshire
HEIDI HEITKAMP, North Dakota	

ELISE J. BEAN, *Staff Director and Chief Counsel*
DAVID H. KATZ, *Senior Counsel*
DANIEL J. GOSHORN, *Counsel*
HENRY J. KERNER, *Minority Staff Director and Chief Counsel*
JACK THORLIN, *Counsel to the Minority*
BRAD M. PATOUT, *Senior Advisor to the Minority*
SCOTT D. WITTMAN, *Research Assistant to the Minority*
MARY D. ROBERTSON, *Chief Clerk*

CONTENTS

Opening statements:	Page
Senator Levin	1
Senator McCain	7
Senator Johnson	17
Senator Paul	33
Senator Portman	34
Prepared statements:	
Senator Levin	93
Senator McCain	98

WITNESSES

TUESDAY, APRIL 1, 2014

Bret Wells, Esq., Assistant Professor of Law, University of Houston Law Center, Houston, Texas	8
Reuven S. Avi-Yonah, Esq., Irwin I. Cohn Professor of Law, The University of Michigan School of Law, Ann Arbor, Michigan	10
Thomas F. Quinn, Tax Partner, PricewaterhouseCoopers LLP, Chicago, Illinois; accompanied by James G. Bowers, Tax Partner, PricewaterhouseCoopers LLP, Dallas, Texas and Steven R. Williams, Managing Director, PricewaterhouseCoopers, LLP, McLean, Virginia	25
Julie A. Lagacy, Vice President, Finance Services Division, Caterpillar Inc., Peoria, Illinois; accompanied by Robin D. Beran, Director, Global Tax and Trade, and Rodney Perkins, Former International Tax Manager, Caterpillar Inc., Peoria, Illinois	58

ALPHABETICAL LIST OF WITNESSES

Avi-Yonah, Reuven S. Esq.:	
Testimony	10
Prepared statement	106
Beran, Robin D.:	
Testimony	58
Prepared statement	129
Bowers, James G.:	
Testimony	25
Prepared statement	116
Lagacy, Julie A.:	
Testimony	58
Prepared statement	129
Perkins, Rodney:	
Testimony	58
Prepared statement	129
Quinn, Thomas F.:	
Testimony	25
Prepared statement	116
Wells, Bret, Esq.:	
Testimony	8
Prepared statement	99
Williams, Steven R.:	
Testimony	25
Prepared statement	116

IV

Page

APPENDIX

Report of the Permanent Subcommittee on Investigations' Majority Staff entitled "Caterpillar's Offshore Tax Strategy," April 1, 2014	160
--------------------------------------------------------------------------------------------------------------------------------------------	-----

EXHIBIT LIST

1. a. <i>Caterpillar Ownership of CSARL</i> , chart prepared by the Permanent Subcommittee on Investigations.	276
b. <i>CSARL Legal Structuring</i> , chart prepared by PricewaterhouseCoopers.	277
c. <i>Profit Split: CSARL's Parts Profit versus Caterpillar's Royalty Fee from CSARL</i> , chart prepared by the Permanent Subcommittee on Investigations.	278
d. <i>CSARL Offshore Replacement Parts Sales</i> , chart prepared by the Permanent Subcommittee on Investigations.	279
e. <i>The Caterpillar 797</i> , chart prepared by the Permanent Subcommittee on Investigations.	280
f. <i>Caterpillar Replacement Parts</i> , chart prepared by the Permanent Subcommittee on Investigations.	281
g. <i>Caterpillar Organizations, Performing Key Functions Related to Parts</i> , chart prepared by the Permanent Subcommittee on Investigations.	282
h. <i>Corporate Income Tax as a Percent of Total Revenue</i> , chart prepared by the Permanent Subcommittee on Investigations.	283
Documents Related to Caterpillar Transfer Pricing:	
2. PricewaterhouseCoopers tax consulting and audit fees. [PSI-PWC-22-000001-003]	284
3. <i>History of Significant Changes in International Operations (Not Inclusive of Financing Arrangements) 1997-2002</i> . [PSI-TWLF-02-000422-436]	287
4. a. Excerpts from <i>Caterpillar Inc. Evaluation of Arm's Length Pricing for Intercompany Transactions, Year Ended December 31, 1994, Prepared by Price Waterhouse LLP, FINAL REPORT, April 28, 1996</i> . (P&SS sells the requisite replacement parts to the marketing company, which then sells to dealers, who in turn sell to the customer. *** Cat Inc. has the largest role with regard to market and dealer development, . . . *** The dealer network and parts distribution are the two keys to after-sales service. . . . Cat Inc., as the designer of the system and owner of the Morton parts center, has the greatest strategic role. *** All companies with marketing responsibilities are actively involved in dealer administration. These include Cat Inc. and the three principal marketing companies.). [PwC PSI CAT 00008634, 672-674, 684-687, 698-699]	302
b. Excerpts from <i>Caterpillar Inc. Evaluation of Arm's Length Pricing for Intercompany Transactions, Year Ended December 31, 1995, Prepared by Price Waterhouse LLP, Final Report, December 19, 1996</i> (Cat Inc. has the largest role with regard to market and dealer development . . . *** The dealer network and parts distribution are the two keys to after-sales service. . . . Cat Inc., as the designer of the system and owner of the Morton parts center, has the greatest strategic role. *** All companies with marketing responsibilities are actively involved in dealer administration. These include Cat Inc. and the three principal marketing companies. *** Prime Product Profit Centers Motivate to create machine populations with high degree of proprietary components which have high parts margins ***. P&SS Motivate to: Drive overall parts profit). [PwC PSI CAT 00008881, 929-932, 958-959, 963]	312
c. Excerpts from <i>Caterpillar Inc. Evaluation of Arm's Length Pricing for Intercompany Transactions, Year Ended December 31, 1996, Final Draft Report, Prepared by Price Waterhouse LLP, January 26, 1998</i> (Cat Inc. has the largest role with regard to market and dealer development, . . . *** The dealer network and parts distribution are two keys to after-sales service. The marketing companies have responsibility for the dealer network, while P&SS performs the primary management activity for the parts distribution network. Cat Inc., as the designer of the system and owner of the Morton parts center, has the greatest strategic role.). [PwC PSI CAT 00009105, 155-156]	320

	Page
d. Excerpts from <i>Caterpillar Inc. 1997 Documentation Report, Final Report, September 15, 1998, Prepared by PricewaterhouseCoopers LLP</i> (Cat Inc. has the largest role with regard to market and dealer development, . . . *** The dealer network and parts distribution are the two keys to after sales service. . . . Cat Inc., as the designer of the system and owner of the Morton parts center, has the greatest strategic role. *** All companies with marketing responsibilities are actively involved in dealer administration. These include Cat Inc. and the three principal marketing companies.). [PwC PSI CAT 00009339, 392-394]	323
5. Excerpts from <i>Caterpillar Fiscal Year 2000 U.S. Transfer Pricing Documentation Report, September 17, 2001.</i> (Cat Inc. is the parent company and is the most complex entity. Cat Inc. operates as an entrepreneur, a marketer and an intangible owner. Cat Inc. is the parent company of the global enterprise. Since Cat Inc. is the most complex Cat entity it was not selected as a tested party in this report. *** Although Cat SARL is a complex entity, it is a simpler entity than Cat Inc. . . . we will test Cat SARL's results against the results of a set of independent European manufacturers.). [PwC PSI CAT 00004975, 5008-009, 027-033]	327
6. Excerpts from <i>Caterpillar Inc. Global Tax Optimization Case for Action, September 1998 (Negative Tax Rate Drivers: U.S. 'centric' profile . . . U.S. ownership of intangibles . . . Conformity of tax and management books. *** Migrate income from the U.S. to lower-tax jurisdictions; Obtain/maintain U.S. tax deferral *** Description of Idea: Remove Caterpillar Inc. from the chain of title passage for purchased finished parts (from U.S. or foreign sources) sold to foreign marketers. The foreign marketers would then buy from and sell to unrelated parties. Benefits/Costs: Eliminates Subpart F character of foreign marketers profits on purchased finished parts sales. Relatively simple re-invoicing requirements.)</i> [PwC PSI CAT 00004632, 636, 640, 646, 674, 675]	337
7. Excerpts from <i>Caterpillar GTOP Summary of Ideas - PricewaterhouseCoopers, 1998 (Cat Inc. Out of Chain, Recharacterize Marketing Company Income to Achieve U.S. Tax Deferral Description of Idea: Remove Caterpillar Inc. from the chain of title passage for purchased finished parts (from U.S. or foreign sources) sold to foreign marketers. The foreign marketers would then buy from and sell to unrelated parties. Benefits/Costs: Eliminates subpart F character of foreign marketers profits on purchased finished parts sales. Relatively simple re-invoicing requirements.)</i> . [PwC PSI CAT 00004566, 618-619]	343
8. <i>COSA as Entrepreneur: European Sold Parts, High-Level Target Design, charts excerpted from Caterpillar Inc. Operational Feasibility Analysis, High Level Target Designs: Migration/Deferral (This will cause the accumulation of parts profit in COSA that was previously accumulated in CAT Inc. ... In addition, the parts profit retained in COSA will be enhanced to better reflect the contributions of the functions, risks and dealer network intangibles controlled by COSA. *** Invoicing from suppliers will be changed from CAT HE and Morton HE to COSA "HE." Supply contracts will be changed to COSA.)</i> . [PwC PSI CAT 00004548, 550-552]	346
9. <i>Caterpillar Inc. Global Tax Optimization Risk Adjusted Benefit Analysis, Working Papers - Draft 1, December 1998 (Purpose: Increase shareholder value through tax optimization *** Solution Benefits and Costs: Migrate profits from Cat Inc to low-tax marketing companies . . . Risk: change from current intercompany pricing method and documentation. *** We are effectively more than doubling the profit of parts.)</i> . [PwC PSI CAT 00001336, 338, 341-342, 344-346, 348, 362, 386, 408-409, 411-415]	350
10. <i>Economic Analysis of Royalty Rates and Transfer Prices, charts excerpted from Caterpillar Inc. Global Value Enhancement Project, Economic Analysis of SARL, Intercompany Transactions with Cat Inc. in the COSA Territory, Draft October 5, 1999.</i> [PwC PSI CAT 00004483, 508-509] ..	367
11. <i>Parts: COSA - Cost Benefit Analysis, chart excerpted from Caterpillar Inc. - Global Value Enhancement - Develop Phase Status Report, May 28, 1999.</i> [PwC PSI CAT 00004349, 365]	370

Documents Related to Marketing Intangibles:

12. Caterpillar email, dated July 2007, re: *Caterpillar: value of marketing intangibles (The point is that CSARL (or its predecessor COSA, or CFEL, or CACO) has spent decades building up the dealer network around the world. And has spent decades building the brand name through advertising. Caveat is that in 2001, we said in another transaction that there is no significant marketing intangibles other than workforce in place).* [PwC PSI CAT 00122483-484] 372
13. Excerpts from *Caterpillar Inc. Economic Analysis of Intangible Assets Transferred by Caterpillar Americas CO. to Caterpillar Americas SARL (Based on our analysis of the Intangible Assets Transferred we conclude that they are routine and common to most distribution and marketing companies. These assets have only limited economic life, and could be effectively reproduced by a new start-up company with sufficient investment of time and resources).* [PwC PSI CAT 00142353-367] 374
14. Excerpt from *Caterpillar Inc. Summary Meeting Notes, Geneva, March 7-9, 2005. CSARL Profitability and Royalty (Should we expand profit split analysis – additional income to CSARL for parts responsibility, dealers/marketing intangible (but consider agreements in LAD restructuring stating that dealer IP is not very valuable)?).* [PwC PSI CAT 00150469] 389

Documents Related to Swiss Tax Rate:

15. Charts from:
 - *Presentation to Caterpillar Inc. Audit Committee, June 2004:*
 - *Purchased Finished Parts Distribution - Prior to Establishing CSARL;*
 - *Purchased Finished Parts Distribution - Post CSARL;*
 - *Tax Exposures Reserved at end of 2003;*
 - *ETR - Causes of “Low-Taxed” Non-U.S. Earnings (Switzerland provides favorable tax rulings that many U.S. companies utilize.);*
 - *Background - Pre-2001 (Before Caterpillar S.A.R.L.); and*
 - *Background - 2002-2004 (Effect of Caterpillar S.A.R.L.). (The CAT S.A.R.L. initiative deferred the U.S. taxation of Purchased Finished Replacement Parts sales outside the U.S., but only if the earnings are not repatriated).* [CAT-001899, 905, 906, 912, 920, 934, 935] 390
16. Excerpts from *Delivering Vision 2020, Value Transformation: An After-tax View (The single largest factor driving Caterpillar’s effective tax rate below the U.S. statutory rate is the ability to maintain deferral of earnings outside the U.S. Most of these deferred earnings are located within the Caterpillar S.A.R.L. (“CSARL”) organization. The two primary operational drivers of the CSARL deferral are (1) purchases of replacement parts from suppliers directly by CSARL for marketing regions outside the US and (2) product management benefits for assemblies at the Grenoble and Gosselies facilities (i.e., toll manufacturing).* [PwC PSI CAT 00058419, 429, 449-452] 397
17. Excerpt from *Caterpillar Global Finance and Strategic Support, Global Tax & Trade Update, Audit Committee, April 13, 2010 (Effective Tax Rate has dropped to lowest in the Dow 30 *** 2009 Effective Tax Rate - Drivers: Losses in high-tax rate countries, Profits in low).* [PwC PSI CAT 00205974-979, 984-985] 403

Documents Related to Parts Business:

18. *Caterpillar Board of Directors Minutes Excerpts. (2/8/12: Mr. Gosselin began by explaining that the “seed, grow, harvest” business model ingrained in the organization was a catalyst to aftermarket parts sales and services, creating an annuity continuing long after original equipment sales and generating customer loyalty, PINS and profits. *** 4/7/09: Mr. Larson then noted that the key points regarding the Logistics Division are that it is driving transformational change in the Transportation, Manufacturing Logistics and the Cat parts business that will deliver significant value . . .).* [CAT-001855-858, 860, 863-864] 411
19. Caterpillar email, dated August 2007, re: *Caterpillar parts history (This showed that more than 50% of parts sales were for parts originally placed in service more than 10 years prior. And to capture 80% of parts sales, you had to go back 20 years. (ie, in a given year, Cat still sold 20% of replacement parts that were first placed in service more than 20 years prior....).* [PwC PSI CAT 00024439-440] 418

VII

	Page
20. <i>Cat Parts Desired State, excerpt from Caterpillar February 2012 Board of Directors Meeting</i> , [CAT-001885-889, 891-898]	420
21. <i>Caterpillar dealer push may drive some out, Levenick says, Reuters</i> , March 6, 2014.	433
Documents Related to Tax Risk Guardrails:	
22. Caterpillar Audit Committee Presentation, December 13, 2005, <i>Global Tax Management (Audit Committee Risk Guard Rails)</i> . [PSI-TWLF-16-000167-180]	435
23. Caterpillar email, dated February 2006, re: <i>Tax Risk Guardrails - audex (Dave, I have a solid draft of the guard rails done. I have not polished it into a presentation because it was not included on the agenda. I feel comfortable that if Gene demanded to see something today and you came and got me, I could present the draft and get the Aud Comm comfortable that we are meeting our commitments.)</i> . [PSI-TWLF-04-000078]	449
24. Caterpillar email, dated February 2006, re: <i>A/C meeting (We had a two day offsite last week to finalize the guardrails. We have two more days next week to plot the tax positions on the guardrails. This will be done in April if the agenda changes.)</i> [PSI-TWLF-04-000089]	450
25. a. <i>Tax Risk Guardrails</i> , 03/21/06. [PSI-TWLF-04-000382]	451
b. <i>Tax Risk Guardrails</i> , 10/15/07. [PSI-TWLF-04-000383]	452
1Ac. <i>Tax Risk Guardrails</i> , 03/18/08. [PSI-TWLF-04-000384]	453
d. <i>Tax Risk Guardrails Criteria (draft)</i> , 02/08/06. [PSI-TWLF-04-000381] .	454
26. <i>Caterpillar Income Tax Update, June 13, 2006 (Audit Committee - Risk Guard Rails . . . Escalation Triggers - Risk positions clearly outside the guardrails trigger communication to the Audit Committee for guidance and possible remediation)</i> . [CAT-001949-952, 954, 956-965]	455
27. Caterpillar email, dated July 2006, re: <i>fyi only - Update to Legal 6S team on regulatory compliance (Provided overview of Tax Risk Guard Rails yesterday to a 6S team from legal working specifically on a deep dive into regulatory compliance risks. . . . They encouraged us to continue with the process and explain our current tax risk profile to the audit committee to get their approval. *** Good work, Dan. . . . Can discuss further, but current chart puts one area at high. Assuming guidance is to stay below high in all areas, how could we utilize?)</i> [PSI-TWLF-04-000368]	470
28. Caterpillar email, dated August 2006, re: <i>Tax Risk Guard Rails (FYI, Tax Council will be meeting in near future to update TRGRs. The pressure/question I am getting is focused on reducing the risk shown on the guard rails. ... I need to understand where you want to go with the TRGRs. Are we going to stop where we are at which is just informing the board about the process we went through to create the guard rails, or are we going to show the board the results and have a meaningful discussion explaining our risk profile and to determine the board's comfort with it?)</i> . [PSI-TWLF-04-000127]	471
29. <i>Caterpillar Global Finance and Strategic Support, Global Tax Update, April 8, 2008 (High risk areas are actively managed.; Higher Risk Areas; CSARL - Product Management - Operational; CSARL - Parts Distribution - Management & Reputation)</i> . [CAT-002087, 090-098, 102]	472
Documents Related to Economic Substance:	
30. <i>P&SS Availability & Inventory Management (85% of worldwide parts inventory is managed from Morton-moving toward 100% *** Morton knows if Grimbergen sold a part, received part, scrapped a part-information goes into Morton global parts forecast calc)</i> [PwC_PSI_CAT_00179037-038]	483
31. <i>Purchasing Transportation and Technical Support (P&SS has developed (over 12 years) network of suppliers for non current that is independent of current production suppliers)</i> . [PwC_PSI_CAT_00179035-036]	485
32. Excerpt from <i>The Deposition of Sally A. Stiles</i> , February 24, 2011 (Q: <i>Is it fair to say that the driving force behind Glove or CSARL was the tax department and not any business unit? A: Yes.</i>) [PSI-TWLF-11-000008, 113-114]	487
33. Excerpt from <i>The Deposition of Robin Beran</i> , March 15, 2011, (Q: <i>Well, other than paper issues that were caused by the entities that became involved, were there any other changes to the physical flow of purchased finished replacement parts? A: Physical flow, probably not substantially.</i>) [PSI-TWLF-12-000008, 177-178]	490

VIII

	Page
34. Excerpt from <i>The Deposition of Rodney Perkins, March 10, 2011, (Q: Was there any business advantage to Caterpillar, Inc., to have this arrangement put in place other than the avoidance or deferral of income taxation at higher rates? A: No, there was not.)</i> [PSI-TWLF-10-000004, 113-115]	493
35. Excerpt from <i>The Deposition of Janie Copeland, May 5, 2011, (Do you know if the accounting for purposes of the consolidated books and records of Caterpillar, Inc., is done the same way with respect to Swiss operations now as it was before CSARL? . . . Q: So would operating profit still be the same? A: Yes. Q: But earnings after taxes would be differently? A: Right.)</i> [PSI-TWLF-15-000007, 017, 018]	497
36. Caterpillar email, dated June 2005, re: <i>Authorization to proceed with planning and ABP cost adjustment (Due to the successful planning from prior years, significant low taxed earnings (over \$1.5 billion) have accumulated in CSarl. This cash is now increasing at about \$70 million per month at tax rates of about 10%. This is resulting in offshore cash balances that can no longer be managed through intercompany loans and purchases without triggering significant additional tax costs, and an increase in CAT's effective tax rate.)</i> [PSI-TWLF-12-000315-316]	500
37. Caterpillar Sarl - Pop Quiz, chart excerpted from <i>Caterpillar Sarl Overview</i> , July 30, 2008. [PwC PSI CAT 00065585, 589]	502
38. Caterpillar Memorandum, dated May 2004, re: <i>Tax Concerns Raised by an Unnamed Source (Caterpillar's transfer pricing policy is the result of detailed analysis of the functional activities of the various entities in strict accordance with required Treasury Regulations. *** The basic operations of Caterpillar SARL are no different than any other valid and legal partnership operating anywhere in the world. *** I do not believe Caterpillar's transfer pricing practices (past and present) meet the IRS' tests. The Officers and Board of Directors need to examine the transfer pricing issue before Caterpillar ends up in court and in the press.)</i> [PSI-TWLF-02-001393-396]	504
39. Caterpillar email, dated January 2007, re: <i>7th Cir. Cases (To my knowledge there is no one in CSARL managing the parts business or managing the sub-contracting of all the activity to Inc.)</i> [PSI-TWLF-02-000349-352] ..	508
40. Caterpillar email, dated April 2008, re: <i>Pls review again before we sent in AM (With all due respect, the business substance issue related to CSARL Parts Distribution is the pink elephant issue worth a Billion dollars on the balance sheet.)</i> [PSI-TWLF-07-000022]	512
Documents Related to Substance Added:	
41. Caterpillar slides entitled <i>Product Management Alignment - Recommendation; Product Management Alignment - CSARL Benefits - Based on 2008 Results; Product Management Alignment - Enhance & Optimize (While technically appropriate, creates optics concerns - Taxation in CSARL with minimal business substance); Product Management Alignment - CSARL Benefits - Based on 2009 ATs).</i> [PwC PSI CAT 000063338-341]	513
42. Caterpillar email, dated November 2008, re: <i>Exec Office Slides - Business Alignment attaching slides entitled Caterpillar Inc. Machine Business Alignment: Update Briefing, November 11, 2008, Purpose: Leverage business realignment to preserve and enhance CSARL benefits. (Risks & Challenges: Failure to take action weakens current CSARL structure).</i> [PwC PSI CAT 00033241-252]	517
43. <i>Caterpillar Inc CSARL 2009 activities, Report to Audit team, January 2010. (During 2009: . . . "Worldwide Parts Manager": establish group in CSARL Geneva with worldwide parts responsibilities Benefit: \$300m ("Preserve").</i> [PwC PSI CAT 00003830-832, 847-848, 855, 871]	529
44. Caterpillar email, dated May 2010, re: <i>WW Parts Manager.</i> [PwC PSI CAT 00213059-064]	536
45. <i>Worldwide Parts Management Group Key Responsibilities, excerpt from Caterpillar Inc. Worldwide Parts Management, Final Closing Book, Draft Version as of March 15, 2010.</i> [PwC PSI CAT 00003876, 906-907]	542

46. Caterpillar email, dated November 2008, re: *is tomorrow really the only shot with DBB? (PMs in US will put some pressure on the parts profit model. These guys are really bought into the PM is king concept. We are going to have to create a story that will put some distance between them and parts (eg, all the parts that are noncurrent) to retain the benefit. Get ready to do some dancing. *** What the heck. We'll all be retired when this comes up on audit. Bodnam and chris Dunn will have to solve it. Baby boomers have their fun, and leave it to the kids to pay for it.)* [PwC_PSI_CAT_00033157-159] 545

Other Miscellaneous Documents:

47. *Summary of Caterpillar Operations and Restructuring of Caterpillar Sarl.* [PSI-Caterpillar-04-000002-009] 548
48. *CSARL Legal Structuring, CSARL 2009 activities, PricewaterhouseCoopers.* [PwC_PSI_CAT_00003411] 556
49. *Introduction of Caterpillar North America S.A.R.L. (CNAmSARL was created and implemented with the understanding that there be no impact on Caterpillar's accountable profit center reporting systems. While significant changes were made to our legal entity reporting systems, the objective of zero accountable impact was met.* [PSI-TWLF-10-000172-174] 557
50. a. Excerpts from November 26, 2013 responses received from Caterpillar Inc. to questions posed by the Permanent Subcommittee on Investigations. [CAT-000267-269] 560
- b. Excerpts from December 3, 2013 responses received from Caterpillar Inc. to questions posed by the Permanent Subcommittee on Investigations. [CAT-000276-277, 279-280, 295-298] 563
- c. Excerpts from January 14, 2014 responses received from Caterpillar Inc. to questions posed by the Permanent Subcommittee on Investigations. [CAT-000300-302] 571
- d. Excerpt from March 7, 2014 responses received from Caterpillar Inc. to questions posed by the Permanent Subcommittee on Investigations. [CAT-001866] 574
- e. Excerpts from March 13, 2014 response received from Caterpillar Inc. to questions posed by the Permanent Subcommittee on Investigations. [CAT-0002265] 575
51. *License Agreement*, as of January 1, 2011, between Caterpillar, Inc. and CSARL. [CAT-000306-318] 576
52. *Fifth Amended and Restated Services Agreement*, as of September, 1999, between Caterpillar Inc. and Caterpillar S.A.R.L. [CAT-000653-663] 589
53. PricewaterhouseCoopers document discussing intangible assets transferred by Cat Inc. to COSARL, undated but likely 1999 (*Scanning the list, it appears that the following items are relevant to the replacement parts license: Patents, designs, trademarks, contracts, systems, procedures, know-how, methods, forecasts, estimates, and technical data.*). [PwC_PSI_CAT_00199858-862] 600
54. Responses to supplemental questions for the record from Steven Williams, PricewaterhouseCoopers LLP. 605
55. Responses to supplemental questions for the record from James Bowers, Caterpillar, Inc. 614
56. a. Memorandum to File from the Permanent Subcommittee on Investigations' Majority Staff, August 28, 2014, regarding *Ownership of Caterpillar's Non-U.S. Parts Warehouses* 628
- b. Memorandum to File from the Permanent Subcommittee on Investigations' Majority Staff, August 28, 2014, regarding *Testimony Related to CSARL's Non-U.S. Parts Employees* 631
- c. Memorandum to File from the Permanent Subcommittee on Investigations' Majority Staff, September 11, 2014, regarding *False Testimony Related to IRS' Position on Caterpillar's Tax Liability*. 633
57. *Document Locator List* and documents cited in footnotes to *Caterpillar's Offshore Tax Strategy*, the Report released in conjunction with the Subcommittee hearing on April 1, 2014. The *Document Locator List* provides the bates numbers of the documents cited in the Report and the hearing record page number where the document can be located. Not included are documents related to Subcommittee interviews, which are not available to the public, and widely available public documents. 649

CATERPILLAR'S OFFSHORE TAX STRATEGY

TUESDAY, APRIL 1, 2014

U.S. SENATE,
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS,
OF THE COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 9:31 a.m., in room SD-342, Dirksen Senate Office Building, Hon. Carl Levin, Chairman of the Subcommittee, presiding.

Present: Senators Levin, McCain, Johnson, Portman, and Paul.
Staff present: Elise J. Bean, Staff Director and Chief Counsel; Mary D. Robertson, Chief Clerk; David H. Katz, Senior Counsel; Daniel J. Goshorn, Senior Counsel; Henry J. Kerner, Staff Director and Chief Counsel to the Minority; Jack Thorlin, Counsel to the Minority; Brad M. Patout, Senior Advisor to the Minority; Scott Wittmann, Research Assistant to the Minority; Adam Henderson, Professional Staff Member; Joel Churches, Detailee (IRS); Admad Sarsour, Detailee (FDIC); Heidi Keller, Congressional Fellow; Samira Ahmed, Law Clerk; Harry Baumgarten, Law Clerk; Jacob Rogers, Law Clerk; Tom McDonald, Law Clerk; Shannon Kellman and Michael Tash (Sen. Levin); Eamon Walsh (Sen. Heitkamp); Ritika Rodrigues (Sen. Johnson); and Brandon Brooker (Sen. Paul).

OPENING STATEMENT OF SENATOR LEVIN

Senator LEVIN. Good morning, everybody. The Subcommittee for many years has investigated how some of our most profitable corporations exploit loopholes in the U.S. tax code to shift income and profits to offshore tax havens, thereby denying tax revenue to Uncle Sam. Corporate income tax revenue accounts for a smaller and smaller share of Federal receipts and today is down to about 10 percent of Federal revenue, despite the fact that corporate profits are at an all-time high. Tax avoidance through the use of dubious tax loopholes costs the treasury tens of billions of dollars each year, making it harder for us to invest in the education, innovation, and infrastructure that promote our prosperity, and to adequately fund our national security, while at the same time increasing the tax burden on families and businesses who cannot employ an army of tax lawyers.

The subject of our report and the subject of today's hearing is Caterpillar Inc. Caterpillar is an American success story that produces iconic industrial machines. But it is also a member of the corporate profit-shifting club that has transferred billions of dollars offshore to avoid paying U.S. taxes. We will examine Caterpillar's

tax strategy at today's hearing. But first I want to thank Caterpillar and its accounting firm, PricewaterhouseCoopers (PwC), for their cooperation with our Subcommittee.

Headquartered in Peoria, Illinois, Caterpillar designs and builds a wide range of heavy construction equipment, power generators, and engines, assembling most of them here in the United States. On work sites around the world, its bright yellow machines are symbols of U.S. manufacturing excellence. Its revenues exceeded \$120 billion over the last 2 years.

In addition to manufacturing machines, Caterpillar operates a lucrative replacement parts business, selling Caterpillar-branded parts to customers around the world. It is this aspect of their business, specifically its foreign sales of replacement parts, on which this hearing will focus.

Caterpillar machines are known for their durability and dependability; they last literally for decades, a testament to their quality. To ensure their machines keep running well, Caterpillar works to deliver needed parts anywhere in the world within 24 hours of an order. This commitment limits the amount of time a machine is out of service as well as extending its life. Its parts operation helps the company maintain its reputation for building equipment that keeps working—a reputation that is key to its success.

The parts operation is also highly profitable. In many years, the parts business accounts for a majority of Caterpillar's profits despite making up just a fraction of sales. Caterpillar maximizes its parts profits by designing machines that can be repaired and maintained only with Caterpillar parts, ensuring decades of parts sales and profits.

Caterpillar-branded parts are manufactured primarily by independent companies in the United States and shipped by Caterpillar around the world. Until 1999, Caterpillar Inc.—or Caterpillar U.S., as we sometimes call it—was the initial buyer of these parts. When they were shipped to its foreign dealers, Caterpillar U.S. typically first passed title to marketing companies that it had created, including one in Switzerland called Caterpillar Overseas S.A.(COSA). Despite taking title, COSA never took physical delivery or even saw the parts that it marketed.

COSA served as Caterpillar's marketing company and parts distributor in Europe, Africa, and the Middle East (EAME), acting as a liaison between Caterpillar U.S. and the foreign dealers, helping those dealers with training, marketing campaigns, servicing issues, and parts inventory management. In exchange, COSA was allocated about 15 percent of the parts foreign sales profits. Until 1999, the vast majority of the remaining profits from those offshore sales, usually 85 percent or more, were included in Caterpillar Inc.'s U.S. tax returns.

But starting in 1999, its parts operation assumed a new and key role in Caterpillar's tax strategy. That is when Caterpillar paid PwC to design and implement a Swiss tax strategy, at an eventual cost of more than \$55 million. After Caterpillar put that strategy in place, it went from reporting about 85 percent or more of its foreign parts profits on its U.S. tax return to reporting 15 percent or less to Uncle Sam, and shifting the remaining profits offshore to its Swiss affiliate. In Switzerland, Caterpillar had negotiated a special

effective Swiss tax rate varying from 4 percent to 6 percent, which was below the Swiss statutory rate of 8.5 percent.

This strategy left the real-world operation of its parts business virtually unchanged; in fact, the only significant real-world impact of this arrangement was an instant major drop in Caterpillar's U.S. tax bill. From 2000 to 2012, the Swiss tax strategy shifted \$8 billion in profits from Caterpillar U.S. to its affiliate in Switzerland. This cut Caterpillar's U.S. tax bill by \$2.4 billion during that period.

The law says that transfer pricing agreements between related parties must have an economic substance—meaning a business purpose other than lowering taxes. But when one of Caterpillar's key tax managers responsible for implementing the Swiss tax strategy, Rodney Perkins, was asked, under oath, whether there was any business advantage to the Swiss transaction other than the deferral or avoidance of corporate income taxes, he stated: "No, there was not."

Though the lion's share of Caterpillar's international parts profits shifted to its Swiss affiliate, the heart and soul of Caterpillar's parts business stayed right here in the United States. Only a shadow of the parts business took place in Switzerland. A few statistics showing the disparity are depicted on this chart.¹

Of Caterpillar employees who handle parts, 4,900 work in the United States; less than 100 work in Switzerland.

Of the company's 125 manufacturing plants, 54 are in the United States; none are in Switzerland.

Of the company's 19 parts warehouses, 10 are in the United States; none are in Switzerland.

Today there are 1.5 billion parts stored in Caterpillar's U.S. warehouses; none are stored in Switzerland.

Put another way, despite the fact that Caterpillar now allocates only a small percentage of its worldwide parts profits to the United States, from the moment a part is first designed to when that part reaches a customer, Caterpillar U.S. is the engine behind the company's parts business:

Parts design is centered here, with nearly 80 percent of the research and development dollars used to design Caterpillar machines and parts spent in the United States.

Once designed, Caterpillar's replacement parts are manufactured primarily by third-party suppliers in the United States, under the supervision of U.S. Caterpillar personnel. In 2012, those U.S. suppliers manufactured nearly 70 percent of the Caterpillar replacement parts sold offshore.

Once the parts are built, the technology, expertise, and management behind a highly efficient distribution system are all here in the United States. Parts are distributed through Caterpillar's parts logistics operation, which provides Caterpillar with one of its key competitive advantages. That operation is managed and run from the United States.

Caterpillar's Inventory Management Group, located in Illinois, uses complicated algorithms to forecast parts demand and ensure parts are manufactured in the quantities needed.

¹ See Exhibit No. 1f, which appears in the Appendix on page 281.

Caterpillar's largest parts warehouse is in Morton, Illinois, where it stores and coordinates the movement of parts around the world, helping Caterpillar's dealer network maintain inventory levels that meet customer demand and delivering even hard-to-find parts within 24 hours of an order anywhere in the world.

In short, most of Caterpillar's parts executives are here, most of its parts employees are here, most of its parts are designed here, most of its parts are built here, most of its parts are stored here, most of its orders are filled here, and most of its parts are shipped from here. Yet most of its international parts profits go to Switzerland.

Now, in 2012—that is just a year ago—minutes of the Caterpillar Board of Directors (BOD) meetings describe the company's parts distribution operations as “U.S. centric.” So if the parts business is U.S. centric, how do most of the profits end up at Caterpillar's wholly owned Swiss affiliate? Here is how.

In 1999, PricewaterhouseCoopers provided the company, with a list of 49 potential tax strategies to lower its taxes, including a plan to avoid or defer U.S. taxes on the foreign sales of its parts. The transaction Caterpillar adopted was legally complex but straightforward. Caterpillar created a new Swiss affiliate called Caterpillar SARL (CSARL). CSARL replaced COSA as Caterpillar's leading Swiss affiliate, and Caterpillar gave CSARL a license to distribute all of the company's replacement parts outside of the United States.

This arrangement changed nothing in the actual operation of the parts business, but caused a massive change in how profits on parts sales were split. Because CSARL lacks the personnel, infrastructure, or expertise to actually run the parts business, it reimburses Caterpillar U.S. its costs and a small service fee to continue running the operation. CSARL also pays Caterpillar U.S. a so-called royalty payment equal to about 15 percent of the profits on international parts sales, with CSARL keeping the other 85 percent.

Now, although Caterpillar spent 90 years working to build up its international parts business, the license provided Caterpillar with no compensation for the assets transferred. That license gives CSARL the rights to use Caterpillar's patents and trademarks; contracts with suppliers with whom Caterpillar had built relationships; it gives CSARL proprietary computer systems; and the know-how, methods and data used to manage the parts business. Caterpillar U.S. receives only the 15 percent of future profits from the operation it developed and continues to run. So Caterpillar in the United States did the lion's share of the work building the business and does most of the work of operating the business, while Caterpillar in Switzerland gets 85 percent of the profit from the most profitable part of Caterpillar's business.

The law says that transfer pricing agreements between related parties must meet an arm's-length transaction standard. In an arm's-length transaction, no company would turn over a profitable business that took decades to develop without receiving compensation. Similarly, in an arm's-length transaction, no business would relinquish 85 percent of the ongoing profits in exchange for 15 percent of the profits.

Not only did the arrangement change nothing about the actual operation of the parts operation, it changed nothing on the financial statements that Caterpillar shows the public and investors. That is because Caterpillar and CSARL are related companies, with the parent company issuing a consolidated financial statement. So Caterpillar still shows the 85 percent of the profits sent to CSARL as its own profits on the consolidated public financial statement, while telling Uncle Sam that those profits belong to its Swiss affiliate CSARL.

Caterpillar has provided several justifications for this change in profit allocation which appear to be inconsistent with the economic reality of its operations.

Caterpillar claims that the company merely cut out a redundant middleman—Caterpillar U.S.—and arranged for its third-party suppliers to sell directly to its Swiss affiliate. The fact is that Caterpillar U.S. is not a redundant middleman in its parts business. Caterpillar U.S. continues to play the vital role of managing and leading its non-U.S. parts business the same way it always had. Caterpillar U.S. is still designing parts for Caterpillar machines, forecasting parts demand, getting the parts built, and storing and shipping the parts to dealers and customers around the world.

Caterpillar also contends that shifting 85 percent of the parts profits to CSARL made sense because its Swiss affiliate provided so-called intangible marketing services whose substantial value had not been recognized in the past and deserves the lion's share of profit.

But that explanation for sending most of its international parts profits to Switzerland is also inconsistent with how Caterpillar itself has valued the kind of services that CSARL provides. Prior to 1999, COSA, CSARL's predecessor as Caterpillar's Swiss affiliate, was one of many marketing companies that Caterpillar had around the world, each performing essentially the same function of working with Caterpillar's foreign dealers to sell and service Caterpillar parts and machines. In 1999, as part of the Swiss tax strategy, Caterpillar consolidated several of those marketing companies into CSARL. Just a few years later, in 2002, Caterpillar merged into CSARL another of its marketing companies called CACO, which represented Caterpillar with its dealers in Latin America, the Caribbean, and Canada. In connection with the CACO merger, PwC, the same firm that designed the CSARL transaction, evaluated the intangible marketing assets being transferred from CACO to CSARL and concluded they had little value. The same intangible marketing assets were concluded to have little value just 2 years later in 2001.

So, in other words, when CSARL was the recipient of the marketing intangibles from CACO, Caterpillar said the value was negligible. But when valuing those same intangibles as provided by CSARL, Caterpillar claimed they were so valuable that they justified transferring 85 percent of its profits.

Now, that is not all. For many years, Caterpillar used an internal profit allocation system that it called "accountable profits" to help it decide how to award incentive pay, such as bonuses, to employees in its various divisions. Beginning in 1992, Caterpillar awarded each of its marketing companies an accountable profits

share totaling about 13 percent of the parts profits within their regions. But when CSARL began receiving 85 percent or more of the profits related to parts, supposedly in recognition of how valuable CSARL's functions were, CSARL's employees stayed at the 13 percent profit figure internally when it came to allocating bonuses. In other words, Caterpillar again told one thing to Uncle Sam and another to its employees about the proportionate value of CSARL's work.

The unreality of Caterpillar's current profits split can be illustrated by an example. Caterpillar builds a type of mining truck, the 797, shown in the chart we are going to put up there, which works in mines around the world, for instance, in the Alberta tar sands in Canada.¹ Major components are designed, manufactured, and assembled in the United States. The engine is manufactured by Caterpillar in Indiana; the transmission is manufactured by Caterpillar in Illinois; the axles are manufactured by Caterpillar in North Carolina; the tires are manufactured by a third-party supplier in South Carolina; the driver's cab is manufactured by a third-party supplier in Illinois. When those mining trucks are assembled and sold to those mines in Alberta, they are exported from the United States, and 100 percent of the profits from those sales are reported on its U.S. tax return by Caterpillar. But when an order for finished replacement parts comes in to service those trucks, again, even though the parts are manufactured in the United States, stored at a Caterpillar U.S. warehouse, and shipped by Caterpillar U.S. employees to Alberta, the profits on those parts go to Switzerland.

Switzerland has nothing to do with those trucks from start to finish. There is no economic basis for allocating those parts profits to Switzerland, yet that is where they go.

And there is more. The unreality of the Swiss strategy can also be seen in Caterpillar's so-called virtual inventory system. Caterpillar maintains a second set of parts inventory books solely for tax purposes. CSARL has \$525 million worth of parts stored here in the United States. None are stored in Switzerland. The parts CSARL purportedly owns here in the United States are completely commingled with the parts owned by Caterpillar U.S. So when a U.S. warehouse employee fills an order for a part, that employee has no way of knowing which part is owned by which company. The part is just shipped.

After the fact, Caterpillar's virtual inventory system flags the parts shipped outside of the United States and retroactively indicates that they are CSARL-owned. For hundreds of thousands of parts shipped abroad each year, however, the parts that were shipped actually belonged to Caterpillar U.S. When that happens, the virtual inventory system nevertheless shows the part as owned by CSARL, indicates it was borrowed from Caterpillar U.S. at cost, and later replaces the part when new parts are added to the warehouse inventory. This after-the-fact virtual ownership system is one more sign of how transparent the whole Swiss tax strategy is.

What is real is the U.S. tax revenue that the Swiss strategy erases. From 2000 to 2012, Caterpillar shipped—shifted \$8 billion

¹ See Exhibit No. 1e, which appears in the Appendix on page 280.

in profits to its Swiss affiliate, reducing Caterpillar's U.S. tax bill by \$2.4 billion.

At the bottom, the Caterpillar case study centers on a tax strategy purchased by its tax department whose purpose was tax avoidance. It used a licensing agreement that no company would enter into with an unrelated third party. It relied on a virtual inventory system that did not track ownership of parts. It allocated profits for tax purposes that bore no relationship to the profit allocations made for its own business purposes, including bonuses.

Now, I am about as big a supporter of U.S. manufacturing as you will find. But the Caterpillar case study demonstrates that offshore profit shifting is not reserved for those high-tech companies that transfer intellectual property to themselves offshore. Some manufacturers, too, use offshore tax strategies to avoid paying taxes. The revenue lost to those strategies increases the tax burden on working families here in the United States; it reduces our ability to make investments in education and training, research and development, trade promotion, intellectual property protection, infrastructure, national security and more—investments, all of those, on which Caterpillar and other U.S. companies depend for their success. It is long past time to stop offshore profit shifting and to ensure that profitable U.S. multinationals meet their U.S. tax obligations.

Senator McCain.

OPENING STATEMENT OF SENATOR MCCAIN

Senator MCCAIN. Thank you, Mr. Chairman. After decades of growth, Caterpillar has built a global business in which 70 percent of its sales come from overseas. It is my information that at the core of Caterpillar's overseas subsidiaries is an independent dealer network that informs the company about local demand and keeps it globally competitive. The Majority's Report states that many significant functions of Caterpillar's overseas parts business are managed from the United States. But I think two important questions should be asked before that observation can be properly evaluated today: First, what activities are most important in generating Caterpillar's overseas sales? And, second, where are those activities conducted?

In this case, an important factor in Caterpillar's overseas sales seems to be its independent dealer network, which is overseen and managed by Caterpillar's subsidiary in Switzerland. I understand that this Subcommittee has many important questions to ask about how Caterpillar chose to structure itself globally. I look forward to hearing from today's witnesses so that we will be better informed as to the actual operations of Caterpillar and their policy implications.

Today, the fact is that the United State of America has the highest corporate tax rate of any country in the world. There is no doubt that this is a factor in moving operations overseas and, as we have seen from previous hearings, parking those profits overseas rather than bringing them back to be subjected to a 35-percent corporate tax rate.

This makes a compelling argument for broader tax reform in order to ensure our tax code is fair, competitive, and a vehicle for

economic growth. I want to thank Chairman Levin for his continuing passion on this issue, particularly, and on others, and I look forward to today's hearing.

Thank you, Mr. Chairman.

Senator LEVIN. Thank you so much, Senator McCain, and I want to thank you and your staff for the bipartisan work which is the hallmark of this Subcommittee.

And Senator Johnson, thank you.

Let me now call upon our first panel of witnesses: Professor Bret Wells, Assistant Professor of Law at the University of Houston Law Center, Houston, Texas; and Professor Reuven Avi-Yonah, the Irwin I. Cohen Professor of Law at the University of Michigan Law School in Ann Arbor, Michigan. We appreciate both of you being with us this morning. We look forward to your testimony. We appreciate your sharing your legal expertise today, and we look forward, again, to your perspective on the offshore profit shifting.

Pursuant to Rule 6, all witnesses who testify before the Subcommittee are required to be sworn, so at this time I would ask both of you to please stand and to raise your right hand. Do you swear that the testimony you are about to give before this Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. WELLS. I do.

Mr. AVI-YONAH. I do.

Senator LEVIN. We are using a timing system today, and about 1 minute before the red light comes on, you will see the lights change from green to yellow, which will give you an opportunity to conclude your remarks. Your written testimony will be printed in the record in its entirety. We would appreciate your limiting your oral testimony to 7 minutes.

Professor Wells, we are going to have you go first, followed by Professor Avi-Yonah, and then we will turn to questions about both of you have testified. Professor Wells.

TESTIMONY OF BRET WELLS,¹ ESQ., ASSISTANT PROFESSOR OF LAW, UNIVERSITY OF HOUSTON LAW CENTER, HOUSTON, TEXAS

Mr. WELLS. Very good. Thank you. My name is Bret Wells, and I am an Assistant Professor of Law at the University of Houston Law Center. I have over 20 years of experience in the tax area, much of that time in industry but also in academia. And I have published repeatedly on the topic of international taxation.

I would like to thank both Senator Levin and Senator McCain for inviting me to testify. I am testifying in my individual capacity, and so my testimony does not necessarily reflect the views of the University of Houston Law Center or of the University of Houston.

In the interest of time, I want to make a few opening remarks.

First, when we think about Caterpillar, we are thinking about a very successful manufacturing business. The U.S. tax rules should properly characterize how to think about where the economic profits of that business come from.

¹ The prepared statement of Mr. Wells appears in the Appendix on page 99.

When we think about Caterpillar, we also need to recognize that it has created a remarkable spare parts business system that explains much of its profitability. In this regard, once a CAT machine is sold, it represents an annuity for Caterpillar because the customer will come back to Caterpillar dealerships—for customized replacement parts to keep this machine working.

Caterpillar management treats its proprietary spare parts business and the logistics surrounding this spare parts business as a core business of the company. Caterpillar's integrated business system allows it to sell spare parts to a customer within 24 hours anywhere in the world, thus creating a sales opportunity at the exact moment when Caterpillar can extract substantial profit margins on proprietary spare parts sales. Consequently, the sale of a Caterpillar machine creates a future captive market for proprietary spare part sales, and Caterpillar's logistical capabilities explain its ability to generate profitability in that business line.

Prior to 1999, the profits related to the spare parts business were shared between Caterpillar Inc. and the independent dealers. A Swiss affiliate earned a routine profit. The routine profit earned by the Swiss affiliate was appropriate because its minimal profit was commensurate with its minimal functional contribution to the supply chain and to the factors that were creating the residual profits. In 1999, Caterpillar engaged in a supply chain restructuring exercise. In this restructuring, a new Swiss affiliate was designated as the entity that would now be entitled to reap substantially all of the annuity value of the spare parts business that Caterpillar and its independent dealers had carefully created.

After CSARL's formation, Caterpillar claimed that CSARL had newly discovered marketing intangibles that justified drastically increasing the profits allocable to Switzerland. To the extent that these intangibles originated from U.S. affiliates at the time of CSARL's formation, CSARL should have paid a super royalty every year thereafter under Section 367(d) to compensate the U.S. affiliate in an amount commensurate to the newfound profitability of that contributed U.S. intangible, but the Subcommittee was provided no evidence that this was done or is currently being done.

Caterpillar Inc. remained the creator and developer of the equipment designs, and Caterpillar maintained key operational control over the spare parts product design, procurements, logistics, and inventory management processes. However, although nothing in the spare parts business functionally, economically, changed from an operational perspective as a result of the 1999 tax restructuring exercise, the dominant share of residual profits from the spare parts business was gratuitously shifted to Caterpillar's Swiss affiliate CSARL.

The supply chain restructuring implemented by Caterpillar is premised on a transfer pricing mistake. The mistaken notion is that Caterpillar's residual profits attributable to the integrated spare parts business system can be allocated away from the functions that economically generate those profits and instead simply assign to a Swiss entrepreneur entity whose functions did not meaningfully contribute to the annuity value of the Caterpillar proprietary spare parts market, nor meaningfully participated in its ongoing development.

It is Caterpillar Inc. and the Caterpillar foreign dealerships that deserve to share the residual profits because the functions that contribute to customer loyalty in the foreign marketplace are attributable to Caterpillar Inc.'s excellent manufacturing and logistical capabilities developed in the United States and to the customer relationships created by the Caterpillar independent dealers. CSARL's role is that of a minimal risk distributor that possesses no external customer contacts and no significant manufacturing intangible. In this posture, CSARL's profit margin should approach a cost-plus return.

A court should look through the Caterpillar supply chain restructuring exercise and see that CSARL should not receive a share of the residual profits of the parts business. But even though a court has ample means at its disposal to reach the correct substantive transfer pricing result, current law provides less guidance than it should because Section 482 does not explicitly mandate a specific transfer pricing methodology.

So Congress should make clear that any allocation of residual profits to a foreign affiliate must be justified using a residual profit split analysis. Allowing residual profits to simply migrate to a tax haven entrepreneur without further explanation is a mistake. If all of the non-routine functions that create residual profits reside in the United States, then all the residual profits should be allocated to the United States.

As a second point, I would like to state that the fact that nothing operationally changed as a result of Caterpillar's 1999 tax restructuring represents a potentially fatal implementation flaw because the operational activities among Caterpillar Inc. and CSARL appear to have created a de facto U.S. partnership that has its own U.S. taxable presence, which in turn creates a U.S. taxable presence for CSARL in the United States. In my written testimony, I set forth a much more expansive view of why that is so.

Let me conclude by saying that the Subcommittee is to be commended for taking the time to understand these international profit-shifting practices. Profits attributable to U.S.-created intangibles should not end up in a jurisdiction without substance, nor should they end up in an entity that did not meaningfully contribute to their generation.

Thank you for allowing me to speak.

Senator LEVIN. Thank you so much, Professor Wells.

Professor Avi-Yonah, welcome back.

**TESTIMONY OF REUVEN S. AVI-YONAH,¹ ESQ., IRWIN I. COHN
PROFESSOR OF LAW, THE UNIVERSITY OF MICHIGAN
SCHOOL OF LAW, ANN ARBOR, MICHIGAN**

Mr. AVI-YONAH. Thank you very much. Thank you, Senator Levin and Senator McCain, for inviting me to speak here today about the Caterpillar tax strategy. I will try to make four points briefly.

First is that this is, as the Subcommittee knows, part of a more general phenomenon. We have already had a couple of other hearings before this. There are \$2 trillion more or less of profits that

¹ The prepared statement of Mr. Avi-Yonah appears in the Appendix on page 106.

are offshore in the case of American multinationals, and out of this \$2 trillion, a significant portion relates to activities that economically take place in the United States, either in the form of developing intangibles or in this case in the form of developing replacement parts, logistical networks, and so on.

Congress has been aware of this for a long time and has tried several times to legislate in order to prevent the shifting of profits from the United States overseas. Originally Subpart F in 1962 was intended precisely to prevent this kind of shifting, and there was a big part of Subpart F that was addressed specifically to the shifting from the United States to Switzerland. The so-called base company rule was designed to address a case in which Dupont shifted significant profits from the United States to Switzerland using similar strategies to the ones that are used here by Caterpillar.

Then in 1996, Congress, being aware that the existing laws did not work very well, enacted the super royalty rule that Professor Wells mentioned, which says that every time you transfer an intangible from the United States to a foreign jurisdiction, there has to be a royalty paid that is "commensurate with the income" that is attributable to that intangible, which was designed to shift all of the profits back to the United States. To the extent that what Caterpillar did was to shift such an intangible, then it should have paid a super royalty.

Third, I also think that in this case, Caterpillar's transaction in 1999 did not have the economic substance that is required under the tax law. Under the tax law, as it is now codified in Section 7701(o) but was also the law before that, an transaction has to have economic substance in order to be upheld by the Internal Revenue Service (IRS) and in a court, and economic substance requires two things: It requires a subjective intent to make a profit and an objective ability to make a profit. In this case, we have sworn testimony from Caterpillar executives as well as extensive documentation that the Subcommittee has discovered in its investigation that we have reviewed that indicates that there was no business purpose to the transaction other than the shifting of taxable income from the United States to Switzerland. And in addition, it is hard to see what the objective business purpose of the transaction or the objective profit potential could be in a transaction in which 85 percent of profit is shifted from the United States to Switzerland without any actual change taking place on the ground, with everything still being done in the United States just like it has been before. So I think that the IRS should have attacked this transaction on economic substance grounds. It should have also asked itself whether there should have been a super royalty paid. It should also have perhaps attacked it on assignment of income grounds because if the sale of parts represents an annuity out of the sale of the machines, then the income from the sale of parts should go to the same place the income from the sale of the machine goes. So there are all of these opportunities that the IRS had to go after this transaction, and unfortunately they didn't.

So what are my conclusions?

First of all, I think that the IRS should do a better job in addressing these transactions. Of course, we now in this case have the advantage of an extensive Subcommittee investigation of inter-

nal, properly documented, maybe the IRS did not have at the time, but it should have, I think, addressed itself more to this kind of transaction, which, as we heard, shifted \$8 billion in profits resulting in \$2.4 billion less in taxes paid over the years, and, of course, it is still going on.

Second of all, I think that Congress should address the issue, and I think the simplest way of addressing this is to fix the problem that we already tried fixing in 1962. At the moment there is an exercise going on in the Organisation for Economic Co-operation and Development (OECD) called the base erosion and profit-shifting (BEPS) exercise, under which all of these countries, especially the G-20, the largest 20 economies in the world, are concerned about this kind of profit shifting. None of the G-20 has a tax rate below 20 percent. They all have effective tax rates that are similar to that. There is no competitive disadvantage that would result from Congress reducing the U.S. tax rate and taxing these offshore profits currently.

There certainly can be no competitive disadvantage in Congress taxing the \$2 trillion that are currently accumulated because this income, these profits have already been accumulated, and no behavioral incentive or no competitive disadvantage can result from taxing them. So, in my opinion, Congress should tax this \$2 trillion immediately and in the future should reduce the corporate rate and tax all offshore profits of U.S. multinationals on a current basis.

Thank you very much.

Senator LEVIN. Thank you very much.

Why don't we start with a 7-minute first round, and we can have a number of rounds.

The tax strategy which we have started to discuss this morning was proposed, designed, and implemented over several years by tax consultants of PwC working with Caterpillar's Tax Department. Caterpillar paid PwC more than \$55 million.

In evaluating the CSARL transaction, my question is: Is it relevant that the transaction was initiated and driven by tax personnel at Caterpillar rather than by business personnel and involved paying a large amount of money for an explicit tax strategy to lower the company's taxes? Is that relevant, Professor Wells?

Mr. WELLS. I think it is relevant. I do not think it is dispositive, but I think it is relevant. And I think what is also relevant is the inconsistent stories as it is being implemented, where the taxpayer says in more contemporaneous documents to the time that there are no marketing intangibles in CSARL. Sure, the independent dealers are adding a lot of value. They deserve a share of residual profits. But the Swiss affiliate is performing nothing but a routine function.

When the CACO transaction was done, PwC had said that there was nothing in Switzerland that could not be easily replicated, it had no significant marketing intangibles. In earlier transfer pricing reports, they said that CAT played the largest role in developing the market and dealer development, it was the originator of the basic marketing system designs, and they said CAT was the designer of the systems and the owner of the Morton spare parts business.

All of that comes together as far as credibility of the witness. A judge is going to look at this case, and the judge is going to say, "Where did the economic profits really come from? The person that is testifying to me today seems to be making inconsistent statements from everything else that is happening. Why did that story come up? Why is the story being postulated in front of me?"

And a judge, a trier of fact, is going to look at the overall evidence, and they are going to try to determine what are the functions that create residual profits. When the strategy comes from a tax department and it is divorced from the business itself, then that is a significant fact that a judge is going to look at when the judge is charged with trying to determine what are the economics consequences, where are the economic profits truly being generated.

Senator LEVIN. And if the transaction is designed for the purpose of lowering taxes, that is a relevant fact to the judge?

Mr. WELLS. It should be a relevant fact. Again, it is going to be a combination of facts.

Senator LEVIN. But that is one relevant fact.

Mr. WELLS. That is a relevant fact.

Senator LEVIN. OK. Now, since 1999, Caterpillar has allocated about \$8 billion in non-U.S. parts sales income to Switzerland and so far avoided paying about \$2.4 billion in U.S. taxes. Is it fair to call that "profit shifting"?

Mr. WELLS. I think that is a fair thing to say given the record that is in front of the Subcommittee today about this specific taxpayer and the functions that generated those \$8 billion in profits.

Senator LEVIN. Professor Avi-Yonah, we codified the economic substance doctrine in 2010 and we stated that the IRS can invalidate transactions that create no meaningful change in the economic position of the taxpayer and have no "substantial purpose other than to achieve a tax effect." Is that right? Must there be economic substance in a transfer pricing transaction between related parties?

Mr. AVI-YONAH. So the IRS—

Senator LEVIN. Put your mic on, if you would.

Mr. AVI-YONAH [continuing]. Making sure that you meet both prongs—that is, the objective prong and the subjective prong; whereas, before, some courts held that you only needed to meet one.

And, in addition, the IRS said that in a true arm's-length transaction, they will not apply the economic substance; that is, if a transaction meets the arm's-length standard of Section 482, they will not apply economic substance.

However, in my judgment, a transaction in which you transfer 100 percent of the profit in exchange for 15 percent, it is essentially you are transferring 85 percent of the profit to a related party, would never have been done on an arm's-length basis, and, therefore, I do not think the arm's-length standard applies here. And I think the economic substance doctrine can be applied to this transaction.

Senator LEVIN. Now, Caterpillar, in its written statement submitted to the Subcommittee, says that even if it were stipulated that the changes made in 1999 were motivated primarily by tax

considerations and generated primarily tax effects, the economic substance doctrine would still not apply.

Now, do you agree with the statement that the economic substance doctrine would not apply if the changes in 1999 were motivated primarily by tax considerations and generated primarily tax effects and the transaction did not meet the “arm’s-length standard,” which is a transaction that would not be made with an unrelated third party?

Mr. AVI-YONAH. No, I think in this case the economic substance doctrine would apply to invalidate the transaction.

Senator LEVIN. Professor Wells, is it true that the law requires in every case that a transfer pricing agreement must meet the arm’s-length standard, it must be a transaction that Caterpillar would enter into with an unrelated party?

Mr. WELLS. That is exactly right. In fact, current law makes it clear that even if there are multiple transfer pricing methodologies, you must choose the best method, and the best method under existing Treasury regulations is the one that is the most reliable in putting the profits in the functions that generated those profits. So even if we have a debate between one method or a different method, a court is going to ask the question: What would an arm’s-length party have done?

Senator LEVIN. And would any reasonable business have entered into the type of exchange that occurred here?

Mr. WELLS. No, because what occurred here was a failure to recognize that there was a captive spare parts market. If we use the words of Caterpillar, “seed,” “grow,” and “harvest,” when they are talking to the stock analyst about how to value their company, they said, “When we sell the Caterpillar machine, it is like seed and growing and the harvesting is the spare parts, which we get to do once that machine breaks down. And nobody would let someone come in at harvest time after the crop has been seeded, grown, and is ready for harvest, nobody except a related party that does not care about the profit shifting.

Senator LEVIN. Do you agree with that, Professor?

Mr. AVI-YONAH. Yes, I agree.

Senator LEVIN. Thank you. Senator McCain.

Senator MCCAIN. Thank you, Mr. Chairman, and I thank the witnesses.

To the witnesses, this restructuring took place, it is my understanding, in 1999, and yet no case has been brought against them by the government for what you view as a clear violation of law. Do you have an explanation for that?

Mr. AVI-YONAH. I think it is partly because some of the information that was provided to the Subcommittee would not have been available to the IRS, which relates to internal tax planning documents that are privileged. That is not obvious on its face from the outside.

In addition, some of the information was based on a whistleblower that also was not available to the IRS at the time, who was a senior tax person inside the company. So we, today, have much more information to evaluate this transaction than was available to the IRS at the time.

In addition, in my opinion, the IRS is simply overburdened, and it has too many companies—even though it audits all the large companies, it has too many companies. These transactions are very complicated. They are extensively documented. The IRS has to go through thousands of pages of data. They just have a hard job to do. Nevertheless, I do think that they should have done a better job in this particular case.

Senator MCCAIN. So the IRS looked at this restructuring, reached a conclusion that was a failure of the IRS to gather all the sufficient information or did not hear from a whistleblower. Wouldn't that be a reason for the IRS to reopen the case?

Mr. AVI-YONAH. I suspect that by the time the whistleblower case became public, these years have been closed already in the IRS—

Senator MCCAIN. Well, nothing prevents them from reopening it.

Mr. AVI-YONAH. No. If a year is closed, that is, if the statute of limitations had run on a year, then they cannot reopen the year. They have settled with the company.

Senator MCCAIN. They are operating today under a scheme that you view as illegal. Since when does the statute of limitations affect that?

Mr. AVI-YONAH. I mean, there are two arguments here. There is the economic substance argument that relies to the original transaction. The original transaction, I believe, is closed, and they cannot go after that. There are other arguments. There is Professor Wells' partnership argument. There is the question of whether there should be a super royalty under the transfer pricing rules. There is a question of whether there was an assignment of income. All those theories are still available to the IRS, and I would encourage the IRS to closely examine what is going on now between the company and CSARL and see whether they cannot criticize them on the basis of one of those theories.

Senator MCCAIN. Did you have an additional comment, Professor?

Mr. WELLS. I think it is an important public service to show the IRS, in hearings like this, the results of a thorough investigation of a factual record like this. At a time when companies are concerned and taxpayers are concerned about base erosion and profit shifting, one thing I would hope the Senate could all agree on is the following: Whatever reform needs to be made, currently law needs to make sure that the transfer pricing rules allow taxpayers and the government to be confident that taxes are paid on the profits that are economically earned in the United States. There may be other reform measures that the Senate may not be able to agree on, but I think Congress needs to agree on at least this goal. And I think the IRS needs to think about what do they need to do in order to do a better job of getting the facts in a detailed way like this Subcommittee has done.

Senator MCCAIN. So when there is something this egregious going on, it requires a congressional hearing to get the IRS to carry out their responsibilities. It is my information that the IRS received an anonymous letter with allegations in 2004, 5 years after the restructuring, looked into it, and brought no charges. So the

American people and I do not have a lot of confidence in the IRS, but now we have less.

Mr. WELLS. I think that is an important point, and I think it is hard to come up with good legislative reforms, Senator McCain, if we do not have detailed case studies like this. Congress needs to develop legislation in light of the current reality, not divorced from the current reality. So I think that is an important point.

Senator MCCAIN. And, Professor, I think you would agree that there is at least—am I correct—\$1.5 trillion that is parked overseas at this time?

Mr. WELLS. My knowledge on that is only from publicly available information, but that is consistent with what I have read in the public.

Senator MCCAIN. And some years ago, we did kind of a, whatever you call it, repatriation in the hopes that it would create more jobs and boost our economy, and I think the evidence shows that basically it went to pay salaries and stockholders.

Mr. WELLS. I think that is a fair characterization of the empirical data.

Senator MCCAIN. So any reform that we make or steps we may take in order to try to repatriate some of this money, this time maybe we should have requirements for job creation and how that—on funds that are returned. But also isn't the larger question here, as I mentioned in my opening statement, if you are going to bring money home and pay 35 percent corporate tax, which is the highest in the world, you are going to try to find ways not to have to pay taxes on it, legally you are going to have to try and find a way, or in a gray area, or in violation of at least the spirit if not the letter of the law.

So if you had a recommendation to Congress to address this issue and prevent future—no matter how you feel about this particular case or not—what would you recommend that Congress do to try to make sure that there is adequate taxation and a disincentive for this kind of activity that this Subcommittee has investigated on numerous cases? Could both of you give us a response? Either one first, I do not care.

Mr. AVI-YONAH. If we cut the corporate tax rates to 20 to 25 percent, we could apply it to all of the overseas profits of U.S. multinationals without putting them at a significant competitive disadvantage because that is the same rate that our—

Senator MCCAIN. And that would be sufficient incentive, you think, for them to bring that home, a 20-percent rate, roughly?

Mr. AVI-YONAH. I think so, yes.

Senator MCCAIN. Thank you very much, Professor.

Senator LEVIN. Thank you, Senator McCain.

Mr. WELLS. My main point is when we talk about repatriation, tax rates, and whatever, I think the public may have a different point of view, Senator McCain, whether or not the profits are really U.S. origin profits that have migrated away and are circling back, or if they really are profits that are functionally created and attributable to activities that occur outside the United States. I think that before you look at any reform, Section 482 needs to be absolutely clear that you cannot just designate an entrepreneur to just take the profits of an multinational corporation (MNC). We need to

have rules that say that the profits are going to be scored in the right jurisdiction economically first. And then what we do with foreign income after that will be a next question.

But I do not think that the public would be excited or happy about having profits end up as foreign income that are truly U.S. origin profits and get a different tax rate than what the general American has to pay for the taxes that they really are having to pay based on their wages earned in the United States. I think Section 482 is the first place that we need to make very sure is protected.

Senator McCAIN. OK. Thank you.

Thank you, Mr. Chairman.

Senator LEVIN. Thank you, Senator McCain. Senator Johnson.

Senator JOHNSON. Thank you, Mr. Chairman.

Professor Wells, my information is that Caterpillar sells roughly 70 percent of its total sales overseas and claims roughly 70 percent of its profits overseas. Is that pretty accurate?

Mr. WELLS. That sounds pretty accurate.

Senator JOHNSON. And, of course, transfer pricing allocation of profits is a pretty complex process, correct?

Mr. WELLS. Not when you get the facts in front of you. When you get the question of excessive profitability related to spare parts, you then have to go through a complicated question of factually determining, Senator Johnson—

Senator JOHNSON. OK, and I got that from your testimony. So let me just ask a little bit—you have done an awful lot of practicing in tax law with large multinational corporations, I imagine. Talk to me a little bit about how the IRS works with a large multinational company like Caterpillar. What is that relationship like?

Mr. WELLS. That is likely to be a better question for your next panelists. I have no specific information on how the Caterpillar audit worked.

Senator JOHNSON. My understanding is Caterpillar in this case probably has about 12 full-time IRS agents auditing them—does that sound reasonable to you? Is that your understanding of it?

Mr. WELLS. It could be. That sounds reasonable and consistent with my experience.

Senator JOHNSON. I would think if you have full-time IRS agents, that is my experience as well—looking at your tax returns, poring over it, talking to tax managers in that business about how they are working to comply with the laws, that is a pretty ongoing monitoring and ongoing thorough investigation of the tax situation.

Mr. WELLS. But, generally, the process at an audit level is through an information disclosure request (IDR), where a question is asked and answered. Subpoena power is very little used in an IRS and it—like the subpoena process used by this Subcommittee. So that when you ask for all documents, I want to know what are the relevant documents other than just the specific statement you want me to know, that is oftentimes not given over to the IRS.

And so when cases go to trial or get docketed for trial, there may well be a complete set of documents handed over. But the IRS at the audit level typically will just be asking questions and will not be given all of the responsive documents or the emails or the internal documents or the internal—

Senator JOHNSON. My experience with the IRS is they are pretty detailed, and they ask a lot of pretty good questions, and they require you to provide an awful lot of documentation on how you fill out your tax returns and how you reported income.

Let us assume that Congress can address this situation and write a law to address what Caterpillar is doing here. With 70 percent of Caterpillar's sales going overseas, what could Caterpillar do functionally to make sure that even if we change the law, the economically earned profits are actually earned overseas so they can take advantage of certainly lower tax jurisdictions than what we find here in the United States right now?

Mr. WELLS. Yes, that is an excellent question.

Senator JOHNSON. They could move operations overseas, couldn't they? They could start manufacturing overseas.

Mr. WELLS. Yes.

Senator JOHNSON. Which probably, if we do this, would be exactly what large corporations like Caterpillar would do. They would stop manufacturing in the United States, and they would start manufacturing overseas so that they are matching their economic activity with their actual sales overseas.

Mr. WELLS. Well, if what you are asking—

Senator JOHNSON. How would that benefit the United States?

Mr. WELLS. If what you are asking is we want taxpayers to report their taxes consistent with the economic truth, then that is a worthy goal. If Congress wanted to promote in subsidies and some other way, then that is fine. But what we should not have, Senator Johnson, is have average Americans report on their tax returns taxes that they economically believe are due here. But sophisticated taxpayers are able to, through complex transactions ignore that truth.

Senator JOHNSON. Through laws that Congress passes to incentivize manufacturers to stay here in the United States, provide jobs here, and yet export overseas. So then when you have a company like Caterpillar actually doing that, manufacturing here, exporting product overseas, now we are going to do a thorough investigation, as opposed to have this adjudicated in a tax court with tax law, we are going to hold a trial here against a company that is manufacturing and exporting, which is what everybody here, all these politicians here in Washington want us to do. I mean, does that sound just a little crazy to you?

Mr. WELLS. It does not sound crazy to me if your goal is to know what the current reality is so that your laws for the Nation actually describe the truth, and so—

Senator JOHNSON. So we can change that law, we can change that reality, and then companies like Caterpillar will start manufacturing overseas. Does that make any sense to you at all?

Mr. WELLS. I believe that Caterpillar, if they are benefiting from the U.S. economy, should avoid paying their fair share of taxes related—

Senator JOHNSON. They are paying 29 percent effective rate, are they not—

Mr. WELLS [continuing]. To their profits here, and allocating profits to a subsidiary that did not economically perform those

functions or create the residual profits; that is not an appropriate answer.

Senator JOHNSON. So it is true that Caterpillar pays an effective tax rate of 29 percent, correct?

Mr. WELLS. That is correct.

Senator JOHNSON. In multinationals, that is a pretty high effective tax rate, correct?

Mr. WELLS. Depending on who your benchmarking against, but—

Senator JOHNSON. I mean we—

Mr. WELLS. But if all of the functions that create the residual profits are in the United States, then I think it is not a high tax rate under current law. If what you are asking me, Senator Johnson, is should we reduce the corporate tax rate from 35 to 25, I think that is a fine suggestion. But whatever the tax rate is, we should not just say I can skim the rate down—

Senator JOHNSON. Well, no. You talked about fair share, and I am just saying when you have a corporation, a multinational paying 29 percent effective rate, I think that is generally—relative to other multinationals, that is a pretty high effective tax rate. I would be literally talking to my tax manager and going, “What are you potentially doing wrong here?”

Let me just quickly ask the differentiation between tax avoidance and tax evasion.

Mr. AVI-YONAH. So tax evasion is illegal and tax avoidance is legal. Neither of us I think would say that what was done here was tax evasion. This was tax avoidance. The question is whether it complies with the law.

Senator JOHNSON. But I think you both said that what Caterpillar was doing was probably illegal and that the IRS should challenge it.

Mr. AVI-YONAH. Well, I think that the IRS should challenge it, and I think that a court would hold that it violated the economic substance doctrine, which would still make it tax avoidance and not tax evasion.

Senator JOHNSON. So, again, that is my final point. If Caterpillar is doing something wrong, the proper venue would be a court of law, tax court, and have the IRS adjudicate this thing, not Congress. Thank you.

Senator LEVIN. Thank you, Senator Johnson.

Let us have a second round. Professor Wells, I think your main point here is that if Caterpillar has 57 or 54 manufacturing facilities here and its economic functions are principally carried out here, that it should not pretend that it is in Switzerland. Is that basically right?

Mr. WELLS. That is exactly right, and that in order to have the confidence that our laws are working correctly, what we should say is that you cannot just nominate a Swiss tax entrepreneur. The residual profits, if it is billions of dollars, and there is only a couple of million dollars in SG&A costs in that entity, if it is far in excess of what function it is actually performing, that is problematic.

Senator LEVIN. Now, you have made reference to what you called, I think, “CACO.” I think they describe “C-ACO,” so I am

going to keep calling it “C-ACO.” Maybe the Caterpillar folks can give us the correct way to pronounce that acronym.

But at any rate, in 1999, Caterpillar, as we indicated, hired Pricewaterhouse to review its business operations to reduce its taxes. And they, at that time, claimed that it identified that CSARL has certain marketing intangibles that were so valuable that they justified dramatically increasing the portion of non-U.S. profits sent to Switzerland, and you have discussed that is not the case in your judgment. And I have indicated that in my judgment, and I think our report makes it clear, that your judgment is indeed the correct one.

But here is my question. In 2001, Caterpillar decided to transfer the same type of marketing intangibles from CACO to CSARL, and then Pricewaterhouse, found that those same marketing intangibles had little value. Here is what they said in 2001 relative to the same type of a transfer. They described the intangibles being transferred now to CSARL from CACO as existing contracts with dealers; training programs; order tracking software, which was originally developed by Caterpillar U.S.; written sets of procedures and manuals, which were originally developed by Caterpillar U.S.; marketing brochures and a Web site, both of which were originally developed by Caterpillar U.S.; any other marketing-related intangibles such as customer and dealer lists; goodwill and going-concern.

They found that particular marketing company, which was doing the same kind of marketing as CSARL, dealing with customers, dealing with the dealers, they found that those CSARL-like marketing intangibles were routine. Have you seen that exhibit, by the way?

Mr. WELLS. Yes, I have seen the exhibit, and I have it in front of me.

Senator LEVIN. All right. I think it is Exhibit 13.1A¹ Is that correct?

Mr. WELLS. Yes, it is Exhibit 13.

Senator LEVIN. All right. Now, they also said that these intangibles are common to most distribution and marketing companies, they only had limited economic life, easily reproduced, had little or no value on a stand-alone basis.

Now, are those positions reconcilable?

Mr. WELLS. No, they are not reconcilable. And PwC, I think, in a subsequent email on page 92 of your Report, they, after the fact, tell you that it is not reconcilable, where they say, caveat, that in 2001 we said in another transaction there is no significant marketing intangibles. So even after they were maintaining that marketing intangibles magically or newly discovered intangibles were found, they recognized that making that argument, it was inconsistent and continues to be inconsistent with the CACO transaction, Senator Levin.

And what I want to make sure that you and Senator McCain understand, that as to the CACO transaction, Section 367(d) gives a continuing, ongoing obligation every year for the next 20 years after that transaction to true it up.

¹ See Exhibit No. 13, which appears in the Appendix on page 374.

Senator LEVIN. Now, there is another issue which has been referred to briefly, but I want to go into it, and that has to do with what was done from 1992 to 1998, which was to assign a routine profit to the divisions that performed routine business services and to assign the larger residual profit, called the “entrepreneurial profit,” to the divisions that contributed directly to the creation of those residual profits.

According to Caterpillar’s internal management books, Caterpillar treated CSARL’s predecessor, COSA, as a routine parts distributor and gave it only a routine share of non-U.S. parts profits in the range of 15 percent. That is before this transaction. But now after the transaction, after the CSARL transaction, Caterpillar maintained the same practice. On their internal management books to determine bonuses, CSARL continued to receive credit only for the type of routine profits allocated to a parts distributor, about 15 percent.

So when it comes to paying income tax, Caterpillar reports to Uncle Sam that CSARL received about 85 percent of the profits for the parts business, but when it comes to bonuses, internal financial practices, that was not the case.

Now, let me ask you both, does the fact that the accountable profits for bonus purposes did not change affect—it would affect, I guess, anybody—as to which Caterpillar business functions created value and profit in the non-U.S. parts business?

Mr. AVI-YONAH. It seems to me that is the most important indicator because that is what shows internally what the company valued it at, and I think that the IRS should look at these kind of compensation-related factors as a very important way to measure what the true profit assignable to each of their related companies is.

Senator LEVIN. Professor Wells.

Mr. WELLS. Yes, we are getting to the same question, Senator Levin, and a court will use a number of data points to determine what are the real functions and what will it take for—what contribution of those functions to the overall profits. And so that would be another important data point.

Senator LEVIN. OK. My time is up.

Senator MCCAIN. [Sen. McCain nodded that he had no questions at this time.]

Senator LEVIN. All right. One of the common reasons that is offered for shifting profits under a licensing agreement to an offshore subsidiary in a tax haven is a claim by the U.S. parent that it also shifted the business risks to its offshore affiliate. The U.S. parent asserts, could assert that because the risk has been transferred, the offshore affiliate is entitled to the lion’s share of the business profits. But here, using that line of reasoning, Caterpillar has claimed that CSARL now has the risk for the parts business because it “owns the inventory.” But Caterpillar also issues a consolidated financial statement that includes all of CSARL’s financial results, which seems to me to indicate that Caterpillar retains the risk for the business. If something happens to that inventory, Caterpillar bears the risk, not just CSARL.

So let me ask you both for your analysis on this point. Was the business risk really transferred to CSARL? Professor Avi-Yonah.

Mr. AVI-YONAH. I do not think you can transfer this kind of business risk. I mean, the risk to the parts business is the risk to the overall Caterpillar business. They build machines that only take these parts. To the extent that there is a risk to the parts business, it is a risk to the machines business, which is still centered in Caterpillar U.S. So there is no specific risk here that can be transferred. It is not like a situation where you develop an intangible and the research may succeed or may not succeed and you are putting that risk offshore. In this case, there was no risk independent of the risk of the entire business, and that remains in the United States.

Mr. WELLS. Senator Levin, they shifted the risk until they did not. You remember the virtual inventory in your opening statement? I think it said it was, well, we want to claim that one company is the sole owner except when the part is needed somewhere else, and then it is assigned over back and forth. Over 10 percent of the parts shift seamlessly back and forth.

So the course and conduct of the parties would be necessary to look to. So, I think I would answer you in two parts. One, when you say I have the risk of the parts, but the parts are managed and controlled by Caterpillar Inc., and whenever Caterpillar Inc. wants to use the part for any other purpose, they can, and it seamlessly shifts back and forth, I think it takes away that defined, immediate ownership. Point No. 1.

The second point I would argue is that even if there is a routine profit for being an entrepreneur, the value here has nothing to do with that entrepreneur function. It has to do with the business system. It has to do with what the independent dealers created, the logistics capability, the manufacturing, and the spare parts that are specially designed to work in equipment and are being sold and can get to that customer at a moment when there is an urgent need by the customer to pay for those parts. It is that business system that was created by Caterpillar Inc. that explains the residual profits. That is the intangible that needs to be valued.

So if CSARL deserves some entrepreneur profit for speculating in spare parts, strip out the proprietary aspect of the spare parts; strip out the logistics residual profits related to the sophisticated logistical exercise and the algorithms and all the rest; strip out those to the appropriate functions, and allocate the profits to the functions that create those aspects of the residual value. And when you do, you will find that there is very little left for CSARL other than what Pricewaterhouse said in their CACO report that there is nothing other than a routine function that CACO performs compared to everything else that is building this mousetrap.

Senator LEVIN. If the value of the CACO transfer was treated the same as CSARL's intangibles were, as claimed by Pricewaterhouse, doesn't that create a huge tax liability? In other words, if they were treated the same way, the CACO transfer, in terms of intangibles, don't you have a situation then where you have an ongoing tax liability for CACO and that means for America?

Mr. WELLS. Yes, that is true. And the point that Congress dealt with when they enacted Section 367(d) is that if marketing intangibles do leave the U.S. taxpayer, the U.S. taxpayer needs to be paid a royalty commensurate with the income created from that mar-

keting intangible. So as the company says that we have found this newly discovered value, then the royalty would have to be upticked by a commensurate amount.

Senator LEVIN. And I guess I would restate the question a little bit more clearly, by the way. If their analysis of the value of those intangibles carried the day when they discovered those intangibles in CSARL, well, now when CACO transfers those same intangibles, and if the same valuation method is used, then that would be a major transfer, would it not?

Mr. WELLS. It would.

Senator LEVIN. And then would that not have an on going tax impact to Caterpillar because CACO is in the United States?

Mr. WELLS. That is true. And what is also true, Senator Levin, is we would also have to ask the question, these newly discovered intangibles, did they come from a U.S. company in another transaction? Did they matriculate over to CSARL? And if so, then there needs to be a super royalty for those as well.

Senator LEVIN. All right. Would you agree with that?

Mr. AVI-YONAH. Yes.

Senator LEVIN. OK. Just my last question, and this has to do with the question that PwC, as Caterpillar's tax consultant, proposed, designed, and implemented this tax strategy that led to the formation we have just described. Now, at the same time, Pricewaterhouse performs two functions; in other words, it is Caterpillar's independent auditor, but it is also its tax consultant, advising on Swiss tax strategy. So one of the auditors responsible for advising on tax issues, on the audit, at the same time spent about a third of his time working with his tax consultant colleagues on the Swiss tax strategy.

So during this several-year period, Caterpillar paid PwC's tax consulting service over \$80 million, including more than \$55 million for the Caterpillar Swiss tax strategy, while paying PwC's auditing service more than \$200 million.

Now, when an independent auditor approves the tax strategy proposed by its own colleagues, it creates an appearance of a conflict of interest, and I want to be clear that Sarbanes-Oxley permits an accounting firm to provide tax consulting service while acting as a company's auditor if the company's board of directors gives its approval. And I want to be clear that the Caterpillar Board of Directors provided that approval. So there is no suggestion here that there was any violation of Sarbanes-Oxley. That is not my question.

The question is: Should that be allowed? Because I think that is something we can perhaps get some expert testimony from you on this. Should a board of directors approve this kind of arrangement? They did, and I am not suggesting a violation of Sarbanes-Oxley, because they did approve it. But I just want to spend 1 minute before we turn to our next panel on this subject, because this goes to whether or not we should change the law in this regard. Professor Avi-Yonah.

Mr. AVI-YONAH. I think we should. I do not think this should be allowed. I think there is an inherent apparent conflict of interest when the independent auditor is also the person that is devising the tax strategy that the independent auditor is supposed to pass

on. And under our new FIN 48 and its successor rules, there has to be an opinion that a tax strategy is more likely than not to succeed in order not to take a reserve on the financials, and when it is the same person doing both, then obviously you would reach that level more easily than when it is an independent person evaluating it. So I think we should change the law to make this kind of situation impossible.

Senator LEVIN. Professor Wells.

Mr. WELLS. I do not disagree with that, but I do want to say that, again, under current law, I think that Pricewaterhouse and Caterpillar, from what I have seen, did everything they needed to do to appropriately inform their board to get the appropriate permission.

Senator LEVIN. Right.

Mr. WELLS. So I want to make clear that—

Senator LEVIN. I made it clear in my question.

Mr. WELLS. You did, and I just want to make it clear in my response that I do not think under current law there was any ethical or legal violation of Sarbanes-Oxley. I think that looking at having more silos between the person that is proposing tax strategies and the independent auditor is a fine thing to think through and perhaps needs to be recommended.

Senator LEVIN. All right. And, again, I think it was clear that we were not suggesting otherwise.

We had a picture up there of a mining truck where the parts profits go to Switzerland but that is about the only relationship that Switzerland had, the profits. There was no manufacturer of anything other than, United States, and it was sold in Canada, this mining equipment. So the question is whether or not you can assign income that way. Is there not a judicial doctrine that prohibits an inequitable distribution of profits that results from a taxpayer separating the fruit, or the income, as I think Professor Wells talked about, from the tree on which it grew? Can you explain how an assignment of income doctrine might apply to the facts in this case study?

Mr. AVI-YONAH. So if you think of the sale of a part as something that is inextricably related to the sale of the machine that the parts fit into—and this is the way that both the company and PricewaterhouseCoopers described it, both in the board discussion where it discusses it as an annuity that flows out of the sale of the machine, in the seed-grow-harvest model that Professor Wells alluded to, in the PwC transfer price interpretation, the parts are always linked to the sale of the machines. If that is the case—and I think the IRS can make a good argument and a court may well accept an argument that the profit from the sale of the parts is inextricably linked to the profit from the sale of machines, and if that is the case, if the sale of the machines continues to be—the machines continue to be made in the United States and exported from the United States, the profit from the sale of the parts should go with the machine, including in the case of these mining trucks.

Senator LEVIN. Professor Wells, do you have anything more to add on that?

Mr. WELLS. Other than I agree with the statement that Professor Avi-Yonah said.

Senator LEVIN. Thank you. You are excused. We will move to our second panel.

We will now call our second panel of witnesses for today's hearing: Thomas F. Quinn, a tax partner at PricewaterhouseCoopers in Chicago, Illinois; Steven Williams, a managing director at PricewaterhouseCoopers in McLean, Virginia; and James Bowers, a tax partner at PricewaterhouseCoopers in Dallas, Texas. We appreciate all of you being with us today. We look forward to your testimony, and I think as you have heard, pursuant to Rule 6, all witnesses who testify before the Subcommittee are required to be sworn. I would ask that you now just stand and raise your right hands.

Do you swear that the testimony you are about to give before the Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. QUINN. I do.

Mr. BOWERS. I do.

Mr. WILLIAMS. I do.

Senator LEVIN. Thank you.

We will be using the timing system today, which means that about a minute before the red lights comes on, you will see a light change from green to yellow. That will give you an opportunity to conclude your remarks. Your written testimony, of course, will be printed in the record in its entirety, and we would ask that your oral testimony be 1 minute less.

And understand, Mr. Quinn, that you are going to be presenting the PricewaterhouseCoopers statement, so please proceed, with our thanks for being here today.

TESTIMONY OF THOMAS F. QUINN,¹ TAX PARTNER, PRICEWATERHOUSECOOPERS LLP, CHICAGO, ILLINOIS; ACCOMPANIED BY JAMES G. BOWERS, TAX PARTNER, PRICEWATERHOUSECOOPERS LLP, DALLAS, TEXAS; AND STEVEN R. WILLIAMS, MANAGING DIRECTOR, PRICEWATERHOUSECOOPERS, LLP, MCLEAN, VIRGINIA

Mr. QUINN. Thank you. Good morning, Chairman Levin, Ranking Member McCain, and Members of the Subcommittee. I am going to make some brief oral remarks, but I will ask that my written statement be placed in the record.

Senator LEVIN. And it will.

Mr. QUINN. My name is Thomas Quinn. I am a Certified Public Accountant (CPA) and a partner at PricewaterhouseCoopers. I began my career with PwC in 1984 and have been advising companies with respect to their Federal income tax obligations for over 30 years. I am joined by James Bowers, who also is a CPA and a partner in PwC's tax practice. Having joined PwC in 1976, Mr. Bowers has been advising clients with respect to their tax obligations for over 37 years. I am also joined by Steven Williams, a managing director with PwC. Mr. Williams is an economist and holds a master's degree with a concentration in international economics. He has been with PwC since 1982 and has specialized in transfer pricing for 28 years.

¹ The prepared statement of Mr. Quinn appears in the Appendix on page 116.

I understand that today's hearing relates to the tax implications of a business reorganization that Caterpillar Inc. began almost 15 years ago. I was one of the PwC partners who provided tax advice to Caterpillar and its outside law firm, McDermott Will & Emery, in connection with that matter. Mr. Bowers is a tax partner who assisted PwC's audit team with its audit of the tax aspects of Caterpillar's financial statements. And Mr. Williams provided Caterpillar with assistance regarding transfer pricing rules.

At the outset, let me say on behalf of PwC that we recognize both the longstanding interest of this Subcommittee in corporate tax issues and the importance of those issues. In that spirit, PwC has cooperated fully with the Subcommittee throughout this inquiry and has willingly accepted your invitation to testify here this morning.

Before addressing our engagement with Caterpillar, allow me to provide an overview of PwC's tax practice. PwC is the leading provider of tax services worldwide in terms of both the size and scope of our tax practice and, we believe, in terms of our reputation. We strive to combine our specialized tax knowledge in national and local jurisdictions with a deep understanding of our clients' business and economic environments in order to assist them with their tax compliance obligations across the globe.

In working with multinational businesses, we routinely evaluate issues of international taxation, which can be particularly complex.

Caterpillar is one of the world's largest manufacturers of construction and mining equipment, diesel and natural gas engines, and industrial gas turbines. Caterpillar and its subsidiaries sell more than 300 different types of products to customers in 180 countries from facilities on six continents.

Caterpillar and its subsidiaries sell both machines as well as replacement parts for those machines. Machine sales lead to parts sales, and parts sales support and encourage machine sales. There is no separate parts business. It is an integrated activity organized around Caterpillar's product groups, and it is designed to maximize both value to its customers and Caterpillar's profitability.

Demand for replacement parts is derived from the independent dealer network and the field population of machines. That demand is then fulfilled through its logistics organization.

Caterpillar's business has been expanding throughout the world to meet increasing global demand. In the late 1990s, sales outside the United States accounted for more than 50 percent of consolidated sales. Today more than 65 percent of sales are outside of the United States. To meet that demand, Caterpillar has established subsidiaries outside the United States to market its products and provide product support abroad.

Caterpillar also has expanded subsidiary manufacturing facilities worldwide to meet global demand for its products. Today the Caterpillar Group manufactures products in more than 20 countries. In short, Caterpillar has transformed itself from a U.S.-based manufacturer of machines and parts for sale to U.S. dealers into a global manufacturer of products and parts for dealers around the world.

In 1998, as the globalization of Caterpillar's business continued to evolve, Caterpillar engaged McDermott and PwC to advise the company with respect to its international tax position. To develop

our advice, PwC tax professionals first engaged in an extensive study of Caterpillar's organization and its global operating footprint, spending considerable time at Caterpillar's operating facilities all over the world. We observed that this business organization as it existed in 1998 failed to capture the evolution of the true economics of the business and subjected to current U.S. income taxation income earned from the sale of products to foreign customers largely as a result of the Subpart F rules.

Working with Caterpillar's operations group, its tax department, and McDermott, we analyzed alternatives that would better align the true economics of the business with Caterpillar's operations and positively affect its global effective income tax rate.

After reviewing the information provided by McDermott and PwC, and in light of the evolution of its global operating footprint, Caterpillar decided to undertake a significant reorganization of its foreign operations.

Considering the growth of its foreign operations, Caterpillar determined that it made business sense to centralize within one company the manufacture and distribution of products outside of the United States. Through Caterpillar Overseas, Caterpillar already had a substantial business presence in Switzerland, with hundreds of personnel based in a multi-story facility in Geneva, including a number of key corporate executives.

Beginning in 1999, Caterpillar Overseas transferred its assets and its operations to Caterpillar SARL, a company based in Switzerland. Over the next few years, Caterpillar SARL took over operations across the globe to handle sales of machines and parts outside of the United States. Caterpillar Inc. continued to handle sales of parts and machines in the United States.

From its outset, Caterpillar SARL carried the business and market risks and received the profits or losses from being the owner and seller of the machines and purchased finished replacement parts (PFRPs), in the international markets. Caterpillar SARL purchased finished parts directly from third-party suppliers and sold finished parts directly to third-party dealers. Because the sales no longer involved a related-party transaction between Caterpillar and its foreign affiliates, or between foreign affiliates themselves, they were subject to the fundamental U.S. tax rule that foreign business income is not taxed until the income is remitted to Caterpillar in the United States. The reorganization culminated in changes to roles and responsibilities, had significant operating, legal, and economic effects, and resulted in significant tax savings.

After the global business reorganization, Caterpillar Inc.'s role included acting as a service provider for certain purchases made by Caterpillar SARL in exchange for a service fee. Caterpillar also licensed its rights to Caterpillar SARL to make machines, to purchase and distribute replacement parts, and to use Caterpillar technology and trademarks on those products for sale outside the United States in exchange for a license fee.

Because Caterpillar and Caterpillar SARL were related companies, these payments were subject to IRS transfer pricing rules. PwC tested these prices annually, not only under the Best Method, as required by U.S. law, but also under each of the other relevant transfer pricing methods prescribed by the Treasury regulations.

Each analysis supported the arm's-length nature of Caterpillar's related-party pricing.

In addition to providing these tax services, PwC has also been auditing Caterpillar's financial statements for many years. We have been asked to address the applicable auditor independence rules.

The delivery of tax consulting services to audit clients subject to applicable safeguards has long been permitted by the rules of the Securities and Exchange Commission (SEC), the Public Company Accounting Oversight Board (PCAOB), and the American Institute of Certified Public Accountants (AICPA). PwC's tax and audit services to Caterpillar complied with these independence standards. PwC assessed its independence on a quarterly and yearly basis and disclosed to Caterpillar's Audit Committee any relationship that bore on our independence. PwC's provision of tax services to Caterpillar as our audit client was entirely appropriate.

Chairman Levin and Members of the Subcommittee, thank you again for this opportunity to testify about PwC's tax services with respect to Caterpillar. We firmly believed then, and firmly believe today, that the tax services we provided and the positions that Caterpillar took in that regard complied with the law and were entirely appropriate. Likewise, we believe that our tax and audit engagements satisfied both the letter and the spirit of the independence rules that govern our practice.

We would be happy to answer any questions you have.

Senator LEVIN. Thank you very much, Mr. Quinn. We understand you are giving the statement for all three. Is that correct?

Mr. QUINN. That is correct.

Senator LEVIN. All right. Thank you so much, and thank you again for being here and your cooperation with our Subcommittee.

Mr. Quinn, I gather you were the lead partner for PwC tax consulting. Did Mr. Williams report to you at that time?

Mr. QUINN. That is correct.

Senator LEVIN. And Mr. Bowers was in the auditing shop. Is that correct?

Mr. QUINN. Mr. Bowers is a tax partner who assisted the audit practice with their audit of the financial statements of Caterpillar.

Senator LEVIN. OK. And the key contacts in Caterpillar for you were the people in the company's Tax Department. Is that correct?

Mr. QUINN. In part, Senator, that is true. We also had significant contact with individuals in the Operations Department of Caterpillar. The tax strategy that was developed was dependent very much on the understanding of the operations of the business, and contact with them was critical.

Senator LEVIN. OK. Now, prior to the tax consulting engagement, Caterpillar had been reporting most of the income from the sale of its replacement parts outside of the United States on its U.S. tax return. Is that correct?

Mr. QUINN. That is correct.

Senator LEVIN. And that is when it sold parts to Caterpillar's non-U.S. dealers. Is that correct?

Mr. QUINN. Yes.

Senator LEVIN. And so 85 percent or more of its non-U.S. parts sales income was included on Caterpillar's U.S. tax return. Is that correct?

Mr. QUINN. That is correct.

Senator LEVIN. After Caterpillar executed the CSARL transaction, starting in 1999, is it correct that Caterpillar basically reversed those percentages and allocated 15 percent or less of the non-U.S. parts income to itself in the United States and 85 percent or more to CSARL in Switzerland, which had an effective tax rate of somewhere between 4 and 6 percent? Is that correct?

Mr. QUINN. That is correct. In terms of the arrangement that Caterpillar had with respect to its relationship with Caterpillar SARL, it was, in fact, a business arrangement that included a license for more than just the parts activities themselves, but it included the entire business activities undertaken by Caterpillar SARL, which included their manufacturing machines in France and Belgium as well.

Senator LEVIN. All right. But the basic, in terms of the profits on the parts themselves, there was a shift between 85/15 to basically 15 and 85. Is that correct? Just looking at the parts.

Mr. QUINN. Yes, that is correct.

Senator LEVIN. OK. Now, if you would take a look at Exhibit 7.¹ [Pause.]

Mr. QUINN. OK. Yes, I have that, Senator.

Senator LEVIN. All right. Well, before we get to the fact that you were hired in 1998 by Caterpillar through its tax advisor, McDermott Will & Emery, to review Caterpillar's operations and to recommend ways to lower Caterpillar's overall tax payments—is that correct, by the way?

Mr. QUINN. Yes, that is correct.

Senator LEVIN. OK. Is it not true that PwC had an ongoing program called Global Tax Optimization Program (GTOP), to reduce corporate taxes? Is that true?

Mr. QUINN. Yes, correct.

Senator LEVIN. And PwC approached a number of U.S. corporations to talk to them about a GTOP program. Is that correct?

Mr. QUINN. That is correct.

Senator LEVIN. So that your tax strategy—the Caterpillar tax strategy was a result of a PwC GTOP effort. Is that correct?

Mr. QUINN. If I could—

Senator LEVIN. It followed that presentation.

Mr. QUINN. It followed that presentation, yes.

Senator LEVIN. All right. Now, the tax consultants, PwC, conducted a review of Caterpillar's operations and in 1998 gave Caterpillar a list of 49 possible ways to lower its taxes, one of which was the Swiss tax strategy that involved assigning non-U.S. parts profits to a Swiss affiliate, and that is Exhibit 7. Is that correct?

Mr. QUINN. This Exhibit 7 is from that report and is part of that original investigation, yes.

Senator LEVIN. OK. And was this the strategy that was adopted finally?

Mr. QUINN. In very simplified form, yes.

¹ See Exhibit No. 7, which appears in the Appendix on page 343.

Senator LEVIN. All right. Now, if you will take a look at the top of that exhibit, this is labeled 4618 at the bottom—the purpose was to get CAT Inc. out of chain. That is the top headline: “Recharacterize Marketing Company Income to Achieve U.S. Tax Deferral.” Do you read that line?

Mr. QUINN. Yes.

Senator LEVIN. That was its purpose. Right?

Mr. QUINN. Yes, that is correct.

Senator LEVIN. OK. And the description of the idea was to, “Remove Caterpillar Inc. from the chain of title passage for purchased finished parts (from U.S. or foreign sources) sold to foreign marketers. The foreign marketers would then buy from and sell to unrelated parties.”

So this was the description of the idea, your own description.

Mr. QUINN. Yes, correct. This is a PwC document.

Senator LEVIN. That is correct, to “Remove . . . from the chain of title . . . for purchased . . . parts.”

The benefits: “Eliminates subpart F character of foreign marketers profits on purchased finished parts sales.” And, “Relatively simple re-invoicing requirements.” Do you read those words there?

Mr. QUINN. I do.

Senator LEVIN. Did I read those correctly.

Mr. QUINN. I would also reflect on those, Senator, that in light of—this was done at the beginning of the project in terms of providing ideas in response to Caterpillar’s Tax Department with respect to our investigation.

Senator LEVIN. Right.

Mr. QUINN. I could tell you, reading these words, “Relatively simple re-invoicing requirements,” that following the implementation of this, those relatively simple re-invoicing requirements took probably 3 to 4 years of very difficult work by Caterpillar’s systems team in order to implement.

Senator LEVIN. All right. Well, we will also get to the implementation in a minute.

From 1999 to 2004, PwC was paid about, what, \$55 million to implement this tax strategy? Is that correct?

Mr. QUINN. That is correct.

Senator LEVIN. Now, is it fair to say that you and Mr. Williams helped design and implement this strategy from the very beginning in 1999 and that Mr. Bowers worked at the same time that he provided tax advice to the audit team, he was working with you? Is that correct?

Mr. BOWERS. That is correct, Senator.

Senator LEVIN. And, Mr. Quinn, were you the lead partner for PwC tax consulting services on this matter?

Mr. QUINN. Yes, I was.

Senator LEVIN. And did Mr. Williams report to you?

Mr. QUINN. Yes.

Senator LEVIN. And you mentioned some of the key contacts at Caterpillar. Among them were Robin Beran—I am asking you, were they Robin Beran, the tax director; Rodney Perkins, senior international tax manager?

Mr. QUINN. Yes, we had regular interaction.

Senator LEVIN. All right. My first round time is over. Senator Johnson.

Senator JOHNSON. Thank you, Mr. Chairman.

Mr. Quinn, in the earlier panel I was asking the professors the basic relationship—how does the IRS interact with a large multinational corporation. I would like to expand that not to a large multinational corporation like Caterpillar but also to a large accounting firm like yourselves. Can you describe how the IRS interacts during the whole tax year?

Mr. QUINN. So the IRS' interaction at Caterpillar in particular during the entire year is a continuous audit exercise, as you described earlier. They do maintain a continuous presence onsite. They actively engage with Caterpillar personnel directly. We do not have direct interaction with the IRS, only through Caterpillar, and when invited in by Caterpillar to assist them in those matters.

Senator JOHNSON. Was there any consulting done, as you were working with Caterpillar, to obviously comply with the law but potentially lower their tax burden, was there any contact with the IRS by either yourself or Caterpillar during that point in time?

Mr. QUINN. No, I had no contact with the IRS.

Senator JOHNSON. Do you know whether Caterpillar did?

Mr. QUINN. I do not know that.

Senator JOHNSON. You are obviously familiar with Enron and a firm that used to be called Arthur Andersen?

Mr. QUINN. I am.

Senator JOHNSON. Would you say most CPAs or most accounting firms are pretty familiar with that situation?

Mr. QUINN. Yes.

Senator JOHNSON. Would you say what happened to Arthur Andersen, which no longer exists because of the Enron scandal, is that something that in general disciplines the accounting profession?

Mr. QUINN. Absolutely. I think in reflection upon those events, it has been—in terms of my involvement in the profession, that was a considerable change following that activity.

Senator JOHNSON. Can you talk a little bit about tax avoidance versus tax evasion?

Mr. QUINN. Sure. I think the earlier panel described that accurately, correctly: that tax evasion is illegal, tax avoidance is appropriate in terms of managing your overall costs associated with your business, as long as it is done within the rules and regulations as provided by the tax authorities.

Senator JOHNSON. So in light of obviously what happened to Arthur Andersen with the Enron scandal, you are preparing these types of documents, now they are being shown in a Senate hearing. Would these concern you if all of a sudden the IRS were to take a look at this and your interaction? Do you think this is basically what accountants do in working with their clients to comply with the tax code?

Mr. QUINN. Yes, I do. Earlier, Senator, I think you had made a statement to the last panel about if you saw a tax rate of 29 percent, what would be your response to your manager of your Federal tax function? At the time that we started this project, Caterpillar's tax rate was 35, 36 percent, effective tax rate, and that is exactly

what management was asking in the Caterpillar Tax Department and its service providers.

Senator JOHNSON. That was actually the next question I was going to ask. How does that relate to other large multinational manufacturers? Well, first of all, 35, 36 percent, where is that in the range of effective tax rates for a multinational?

Mr. QUINN. I would think that based upon my study in this area that 35, 36 would be not unusual for a manufacturing company which had its sales based all within the United States. When we take a look at those domestic companies that do not have extensive international operations, a tax rate between 35 and 39 percent is very much the rule.

Senator JOHNSON. Again, that is when all your operations and all your sales are in the United States.?

Mr. QUINN. Yes, correct.

Senator JOHNSON. And then what happens, of course, if you are a multinational and you have 65 to 70 percent of your sales going overseas?

Mr. QUINN. That would depend on how you would organize those transactions and those affairs. As was addressed, again, in the earlier panel many times those operations are subject not only to tax in the foreign jurisdiction, but because of the way they have been organized, they may be subject to U.S. tax at the same time. This document that we just looked at, this exhibit, is a good example of that, where Caterpillar did, in fact, have an extensive amount of international operations, but the way that the business had been structured, the way that the Operations Department had put in place the relationships it had in moving product to the international markets created a cost which could be avoided.

Senator JOHNSON. And there is nothing wrong with any taxpayer trying to comply with the tax code and trying to lower their tax burden, correct?

Mr. QUINN. That is correct.

Senator JOHNSON. Can you talk a little bit about the types of tax laws that have been enacted by Congress to incentivize manufacturers to export product overseas? Can you just name some of the tax treatments that this body has actually enacted to induce that exact type of behavior that Caterpillar was engaged in?

Mr. QUINN. Yes, certainly. That history goes back many years. Back when I first started practicing in the 1980s, the Domestic International Sales Corporation was promoted as an export incentive. That was succeeded by the Foreign Sales Corporation, which was a tremendous benefit for U.S. exporters, U.S. manufacturers, including Caterpillar.

Senator JOHNSON. Exactly what did that do?

Mr. QUINN. It incentivized companies to do manufacturing in the United States. With respect to the income that was earned on those transactions, it reduced their effective tax rate as much as 5 percent. So rather than paying 35 percent on that income, it would be closer to 30 percent.

Senator JOHNSON. I had an earlier discussion with the previous panel that if we tried to change the tax law to try and capture more of the income on foreign sales, what would a large multinational corporation at least consider doing?

Mr. QUINN. I think exactly what you suggested: They would move operations offshore. They would move those functions and those jobs to foreign locations outside of the United States. The differential in tax rate is so great that you could not ignore that as a steward of the corporate assets.

Senator JOHNSON. Are you aware of other businesses, maybe other of your clients, have done exactly that?

Mr. QUINN. They have, in fact, yes.

Senator JOHNSON. Do you care to name any examples? Or probably not the appropriate place to do it.

Mr. QUINN. I would prefer not to.

Senator JOHNSON. OK. Thank you very much, Mr. Quinn.

Thank you, Mr. Chairman.

Senator LEVIN. Thank you, Senator Johnson.

Senator Paul.

Senator PAUL. Thank you. I would like to take my time to apologize to Caterpillar for this proceeding. I think rather than having an inquisition, we should probably bring Caterpillar here and give them an award. They have been in business for over 100 years. It is not easy to stay in business. It is not easy to start a business, but to keep a business employing 52,000 people for over 100 years is a remarkable achievement, and we should be complimenting Caterpillar and perhaps giving them an award.

Caterpillar not only employs 52,000 people but pays \$600 million in taxes every year. So, really, we have the wrong people on trial here. The tax code needs to be on trial here. It would be malpractice for PricewaterhouseCoopers to give advice to Caterpillar saying, well, we are not going to tell you how to minimize your taxes, but here is how to maximize your taxes. They would actually—they probably could be sued for giving bad advice on how not to minimize tax costs.

So I think we are making a great mistake here, and we have to understand that behavior, legal behavior, to minimize your taxes is really your responsibility if you have stockholders. You have to do that. It is a requirement that you try to minimize your costs. So rather than chastising Caterpillar, we should be complimenting them.

It is a big error not to know where the problem is here. The problem is in the tax code. Money is said to go where it is welcome. Some money is going overseas. For decades we have been lamenting the loss of American jobs overseas. Why? Because it is the tax code. We have the highest corporate tax rate in the world. Canada is now down to 15 percent. So you can see how what we are doing is pushing people and pushing people and pushing people, and then we bring them forward for ridicule and to swear an oath and to pry into every nook and cranny of their legal tax behavior. It is insulting to American business, and it should not occur. We should be doing the opposite. We should be giving an award to an American business that creates 52,000 jobs.

There are some policy matters that we could address. Why don't we lower the corporate income tax? We are at 35, give or take, throw in the State, 39-percent rate. Why don't we lower the corporate income tax if we want businesses to stay here? If we want to encourage profit earned overseas to come home, why don't we

have a low repatriation tax, 5-percent repatriation tax? When we did it in 2005, \$20, \$30 billion in revenue and hundreds of billions of dollars in income came back to the country to create jobs. Why don't we do that instead of vilifying people for legal behavior?

I guess my question ultimately would be: Do you have a legal responsibility to offer to companies that ask you or advice, are you legally responsible for offering advice that would minimize their tax costs? If you were to not tell a company about a legal option to reduce their taxes, could a company potentially sue you for not giving you complete advice?

Mr. QUINN. I think, Senator, that is our professional proposition to our clients and their expectation is that when they come to us, we have an expertise in understanding the tax law, the rules, the regulations, and we can help them understand that so that they can take a look at their bona fide business transactions and understand what the tax cost is that is associated with those.

So, yes, that is a client's expectation of what we are bringing them, and even if it were not a legal issue, it would be from the standpoint of professionalism, I think, would be less than what was expected.

Senator PAUL. Thank you.

Senator LEVIN. Are you done, Senator Paul?

Senator PAUL. Yes.

Senator LEVIN. OK. Senator Portman.

Senator PORTMAN. Thank you, Mr. Chairman, and I appreciate you all being here. I know we have another panel coming up, and I would like to have the opportunity to talk with them as well. But to me, the problem here is not Caterpillar. It is a broken tax code. And I think this is not just an important matter; I think it is an urgent matter.

In response to the question Mr. Johnson asked earlier, you indicated that some of your other clients are actually moving some of their operations overseas. It is happening as we sit here today. And it is a fiduciary responsibility if you are a publicly traded company, as was said earlier, to look where you can maximize your profits for the stakeholders. I am very concerned about it. In my own State of Ohio, we have companies that have left our State to be domiciled somewhere else because of the tax laws. One company merged with a company one-quarter its size in Ireland in order to take advantage of the lower rates in Ireland. Their headquarters is now not in Cleveland, Ohio; we lost one of our Fortune 500 companies to Ireland.

I am a beer drinker. If you want to try an American beer, good luck. Luckily, I like Sam Adams and Yuengling. They are the biggest now. They have 1-percent market share each. Every other beer company is now foreign owned. And when I ask people why, including the folks who purchased these companies, they tell me it is the tax code. And this is a big deal. It is not just the loss of jobs, although that happens. It is also the loss of corporate headquarters, which has an intangible impact on all of our communities, including a lot of the good work that our companies do here for nonprofits and to help make a better way of life for everybody in those communities.

So this is not just an important matter. It is an urgent matter. For that, I thank the Chairman for holding this hearing because I hope it will shine a light on the fact that we have a broken code, not just the highest rate among all the developed countries now, which is not a No. 1 you want to have. Now that Japan has lowered its rate, we are No. 1. The fact is that we have an international tax code system that is so non-competitive and so complicated that it is driving jobs, investment, and capital overseas.

Of our OECD partners, the other developed countries, almost all of them have gone, as you know, to territorial systems. If you could talk about that for a second, I would appreciate it. Mr. Quinn, you may be the right person, but you all decide. What impact is this having on your clients as they look at what their options are going forward? Because of the U.S. tax law being so antiquated, inefficient, and non-competitive, what impact does it have on them? And specifically if you could address not just the rate being so high but the fact that we have a worldwide tax system that makes it difficult for them to be able to do business overseas and easier for them to move their businesses overseas?

Mr. QUINN. Yes, it is the issue that is at the forefront of many decisions and many conversations that are taking place within corporate tax departments throughout the population of U.S.-based multinational companies, that this debate around how the United States has decided to tax foreign earnings is one that is of critical importance. As U.S. companies continue to grow and expand offshore, that cost becomes an increasingly larger portion of their overall cost structure for their business and impacts their ability to compete with foreign companies.

As you said, we are one of the few, if not the last remaining country which still taxes worldwide earnings, that does not employ a territorial system. And that is a considerable competitive disadvantage when companies are trying to compete against companies that do not have the same tax burden, even in the United States, that a U.S.-based MNC might have.

Senator, a lot of the debate that I hear, the discussions that take place among my clients, a lot of it has to do with rate as well. It is not just the basis of taxation but the rate that applies. And I think there was some questioning earlier about, well, what is the right rate that would incent this type of activity or cause this activity to go away. I think if the U.S. corporations could be subject to a rate of tax of 20 percent or less, there would probably be very little incentive to continue moving business activities outside of the United States.

If you think about the opportunity now and express it in percentage terms, the opportunity to move from a 35-percent tax rate to a 10-percent tax rate is a 25-percentage-point improvement. That is material. When you start talking about a 20-percent tax rate moving to a 10-percent tax rate, that is only 10 percentage points, and it becomes, when you look at the costs and the relative benefits, much more of a push. So I think that companies might be looking at both sides of that question, both the basis of taxation in terms of the need for a territorial system, as well as the tax rate that would apply. Their feeling is that you might actually, at a lower tax rate, bring more income into the U.S. tax net.

Senator PORTMAN. I think that is very likely. In fact, you would see a lot of repatriation, wouldn't you, of the nearly \$2 trillion that is now tied up overseas? People are not going to bring it back at the high rate. So the two are combined.

Let me just make the obvious point, which is that we have done this before.

Mr. QUINN. We have.

Senator PORTMAN. In the 1980s, we looked at our tax code and said let's end up with a rate that is below the average to be competitive. And this was in the 1986 Tax Reform Act, and we took the rate, as you recall, down to 34 percent, thinking that that was getting us below the average. To get to below the average now, we would have to be, when you include our States corporate rates, as you indicate, somewhere in the low 20s probably; 25 is the rate that some of us talk about. But you need to get at least to that, which is probably right in the middle.

Since 1980s, isn't it true that every other one of our competitors around the world—all the other countries have reformed their codes. Every one of them has, except us. We are the ones left on the sidelines, and those reforms have included, as you indicate, going to a system of taxation that is more territorial, but also lowering the rates. And that combination of our competitiveness allowing companies to pay their income taxes where their earnings occur and a lower rate has made us non-competitive.

So I think the United States, frankly, has waited way too long to make these reforms while every other country in the world that we compete with has moved ahead and gotten a more competitive tax system. And that is why it is urgent that we act now.

By the way, on the international side, it has been since the 1960s. So since the 1960s, we have not changed; whereas, all of our own OECD countries, all our developed competitiveness have adjusted.

I hope that you can be in a position in the next few years to be able to tell your clients, "You know what? There is a new tax code that actually encourages you to stay in America and create your jobs here, and that is why we at PwC think you ought to stay here in America and take advantage of a better environment for success."

Thank you, Mr. Chairman.

Senator LEVIN. Thank you very much, Senator Portman.

First of all, without doubt we have to reform our tax code. It is long overdue. Congress has been dawdling on this subject for a long time. You can argue what the corporate tax rate is currently. A Government Accountability Office (GAO) study says the effective corporate tax rate in the United States is 13 percent. But in any event, the use of all these tax loopholes, many of which give incentives to shift your profits to tax havens—not your operations, your profits to tax havens—is totally unacceptable. We ought to close those tax loopholes and not wait for a total reform of the tax code because that could be an endless wait. We cannot tolerate the loss of our taxable revenue the way it is currently lost to Uncle Sam, which is the use of these tax loopholes, which are unjustified and which are exploited and pushed over the limit at times. And we have had hearing after hearing which shows that. And I do not think we ought to accept it.

Of course, this company is a terrific company. That is not the question. And, of course, it pays taxes. That is not the question. The question is whether or not it properly avoided paying \$300 million a year in taxes, which is what its tax saving is now as a result of this strategy. That is the question. We are very happy it pays \$600 million a year in taxes. Should it pay \$900 million? That is the question. That is a heck of a lot of money. But that is the issue, and we are not going to be distracted by the fact that this is one terrific American company. That is not the issue. The issue is: Was there a tax strategy here which was put in place which is justified under the current tax code? Change the code, I am all for it. But the question—we are going to come back to it now and not be distracted by the argument about whether or not this is a great company—it is—or whether or not it pays a lot of taxes—it does—or whether or not the effective tax rate in this country is 13 percent as distinguished from the statutory tax rate of over 30 percent, or whether we ought to change the tax code.

So now let me get back to the subject of the hearing. Obviously you can structure a business to minimize taxes, but would you agree with me, Mr. Quinn, that when you send profits to a related party in a tax haven, that transaction must meet an arm's-length standard? Do you agree with that?

Mr. QUINN. Absolutely, Senator.

Senator LEVIN. No matter how much you pay in taxes.

Mr. QUINN. Yes. When you talk about the arm's-length standard, what that requires is a measurement and an understanding of what functions exist offshore, what risks have been accepted offshore, what property exists offshore.

Senator LEV

[Pause.]in. All right. But it must meet that standard.

Mr. QUINN. And the exercise is then to align profit with those functions—

Senator LEVIN. Exactly right. Regardless of how many taxes you currently pay or do not pay, that must be met. Is that correct?

Mr. QUINN. Absolutely.

Senator LEVIN. And must you meet a business purpose standard?

Mr. QUINN. I think in order to support the transfer pricing result, you would want to make sure that when we take a look at the functions and the risks and the property that has been evaluated, that it does, in fact, make sense within the business and how it has been operated.

Senator LEVIN. All right. Now, take a look at Exhibit 33,¹ if you would. We are trying to figure out what the annual parts benefits was from this structure, this strategy that was put in place. Do you have Exhibit 33?

Mr. QUINN. I do. That is a district court document.

Senator LEVIN. No, it is a Caterpillar—sorry did I say 43?

Mr. QUINN. Oh, sorry.

[Pause.]

Yes, a PwC document.

Senator LEVIN. All right. And it is entitled, if you look at No. 3, it has a mark of 2449 at the bottom, January 2010, Slide 19. It is

¹ See Exhibit No. 33, which appears in the Appendix on page 490.

No. 3, “WW [worldwide] Parts Management in Geneva.” Do you see that?

Mr. QUINN. Yes, I have it.

Senator LEVIN. Take a look at the bottom line.

Mr. QUINN. Sure.

Senator LEVIN. “The WW”—worldwide—“Parts Management Structure provides further substance to preserve annual parts benefit of \$300m [\$300 million.]” Do you see that?

Mr. QUINN. I do.

Senator LEVIN. So that is the benefit, tax benefit, as a result of this tax strategy. Is that correct?

Mr. QUINN. That is accurate.

Senator LEVIN. OK. Now, take a look at Exhibit 6,¹ if you would, Mr. Quinn.

Mr. QUINN. A PwC document, Global Tax Optimization Case for Action.

Senator LEVIN. Right. And if you will take a look at the number of Caterpillar at the bottom, 4646, do you see that? This was the document that laid out 32 tax strategies for Caterpillar, PwC.

Mr. QUINN. Yes.

Senator LEVIN. Page 12, it says, “Strategy for Caterpillar.” Do you see that?

Mr. QUINN. Yes.

Senator LEVIN. “We have developed a strategy that we believe will achieve tax optimization for Caterpillar. This strategy can be summarized as follows:”

“Migrate income from the U.S. to lower-tax jurisdictions.” Do you see that?

Mr. QUINN. Yes.

Senator LEVIN. And do you see below that, “Global Income Migration”?

Mr. QUINN. Yes, I do.

Senator LEVIN. All right. Now, on that strategy is there any reference there at all to hiring new people, moving people, or changing operations? Do you see that anywhere—

Mr. QUINN. Oh, it can only be the consequence—

Senator LEVIN. Oh, I am sure of that, but do you see it anywhere on this document what you now say are the consequences?

Mr. QUINN. Right, It is not in this document, Senator.

Senator LEVIN. Was it on any document at the time that they would have to move people?

Mr. QUINN. Yes, it certainly would have been.

Senator LEVIN. How many people would they have to have moved? If they had less than 100 people working in parts—right?

Mr. QUINN. If I can ask what particular part of the reorganization you might be referring to?

Senator LEVIN. In Switzerland.

Mr. QUINN. In Switzerland as it relates to the overall business?

Senator LEVIN. No, the parts business.

Mr. QUINN. The parts business.

Senator LEVIN. Yes.

Mr. QUINN. So our view—

¹ See Exhibit No. 6, which appears in the Appendix on page 337.

Senator LEVIN. Did they have less than 100 before? Did they have less than 100 after?

Mr. QUINN. Our view then and our view now and our view at the time that we put this together is that the substance that exists with respect to the parts business is provided through the marketing organization, that those individuals, those thousands of individuals that are managed out of the organization based in Switzerland now that comprises the marketing company outside the United States for Caterpillar products and replacement parts associated with those are the substance which creates the demand for those products. They have nurtured the dealer relationships. They have created the field population upon which the demand is created for replacement parts activity as well as reflect the integrated nature that is taking place in the business, both selling parts as well as machines, going back to my opening statement, where this is, in fact, an integrated activity.

Senator LEVIN. We understand. Did anybody have to move?

Mr. QUINN. In order to support the parts planning?

Senator LEVIN. No. As a result of this proposal that you were making here, which was adopted, did anybody have to move?

Mr. QUINN. Yes, there were people that had to move as a result of it.

Senator LEVIN. How many had to move?

Mr. QUINN. A dozen.

Senator LEVIN. Out of thousands?

Mr. QUINN. Senator, that is because people were already—

Senator LEVIN. Whatever the cause is, if you could answer the question, that would be a dozen out of thousands. Is that correct? You just talked about thousands. I am just asking you a direct question.

Mr. QUINN. Yes, correct. In terms of people that had to move—

Senator LEVIN. Is that a dozen out of thousands?

Mr. QUINN [continuing]. To support the addition—the structure or the substance that was already in place, it was just the dozen.

Senator LEVIN. So that structure, which was already in place—

Mr. QUINN. That is correct.

Senator LEVIN [continuing]. Which then led to the shift from 15 percent of the profits going to Switzerland to 85 percent of the profits going to Switzerland, that—

Mr. QUINN. No, Senator, that—

Senator LEVIN. Oh, you want to use 70 percent instead of 85 percent?

Mr. QUINN. No—

Senator LEVIN. OK.

Mr. QUINN. I will not argue with the percentages.

Senator LEVIN. OK.

Mr. QUINN. I will argue with what creates the “income shift,” as you call it, and that can only result as a result of the measurement of what has been taking place with respect to the functions, where those exist, the risks where those have been accepted, and the property where it exists in the company. And our evaluation of that within the context of this planning was that when we looked at substance and when we looked at economic substance, that we used rules which have been provided to us in case law as well as in the

Internal Revenue Code and its underlying regulations that say in order to evaluate that appropriateness of an income shift, first we have to look at what functions exist, what risks are in place, and what property exists. And then we align the income with that. We never shift income.

Senator LEVIN. Well, I am talking about the allocation of profits was shifted. Is that correct? Following all that assessment.

Mr. QUINN. The allocations of profits changed as a result of that.

Senator LEVIN. Was changed, shifted, from approximately 15 percent to Switzerland to 85 percent. Is that true? Based on your assessment—

Mr. QUINN. Again, with respect to the parts business—

Senator LEVIN. Yes.

Mr. QUINN [continuing]. Because we did view—

Senator LEVIN. Yes, with respect to the parts business. After your assessment, the allocation of profits shifted from 15 percent to approximately 85 percent. Is that true?

Mr. QUINN. That is correct.

Senator LEVIN. OK.

Mr. QUINN. But what is—

Senator LEVIN. No people, but a few had to shift. It was just your assessment which looked at the whole operation, and in your judgment what had already existed justified the shift of profits from 15 percent to 85 percent to Switzerland.

Mr. QUINN. It absolutely does.

Senator LEVIN. OK. Thank you.

Senator Johnson.

Senator JOHNSON. Thank you, Mr. Chairman. I just want to make a quick point and ask one question.

Mr. Chairman, you stipulated that, yes, Caterpillar is one terrific American company and that is not what this hearing is about. I think that is exactly what this hearing is about. As Senator Portman mentioned, our concern about our uncompetitive tax code is that we actually want to maintain Caterpillar as an American company, and far too many American businesses are choosing not to remain an American company and far too few global manufacturers are willing to relocate here in America to create those types of jobs.

Let us face it. When you have Canada with a top marginal tax rate, corporate tax rate, of 15 percent and Detroit at 35 percent, if you are a German manufacturer wanting to come here to take advantage of the world's largest market, take advantage of relatively reasonably priced energy prices, are you going to locate your manufacturing facility for North America in Toronto at 15 percent or Detroit at 35?

So, no, this hearing is all about what do we need to do in America to make America an attractive place for global business investment, business expansion, and job creation? So I just disagree in terms of the purpose of this hearing. I think the purpose of this hearing is exactly that. Let us keep American companies American. Let us try and incentivize investment of global companies into America. And we are not doing a very good job that way.

Mr. Quinn, I hear the term all the time, and it is like fingernails on a chalkboard, talking about tax loopholes. Is there such a term in the tax code as a tax loophole? It is a political term, correct?

Mr. QUINN. That is correct.

Senator JOHNSON. Can you define some tax loopholes for me? What are we talking about when politicians use the term “tax loophole”?

Mr. QUINN. Generally they are either incentives which were deliberately placed in the tax code or they are——

Senator JOHNSON. I mean, just give us a couple pretty good examples of where it made some sense to create an incentive in the tax code to incentivize manufacturers or drilling or just give us a couple examples that might actually work.

Mr. QUINN. Well, so we had talked about some earlier in the course of the hearing here. One was the old rules which existed around foreign sales corporations. I think that was characterized as well many times, inappropriately, as a loophole that was created for corporations that exported product.

More recently, we talked about the Homeland Repatriation Act where companies had an opportunity to bring earnings back into the United States at a 5-percent effective tax rate. This was back in the early 2000s. And that as well was viewed as a loophole.

Senator JOHNSON. Was it also safe to say that a lot of times people typified timing differences as a loophole? In other words, it is true that corporations account for things differently. There is book accounting, there is tax accounting. A lot of that has to do with timing differences, correct? For example, if you have a piece of machinery and you know it is going to wear out in 5 years, according to Generally Accepted Accounting Principles (GAAP) accounting, you depreciate it over that 5 years. But tax accounting made to incentivize investments in plant and equipment might grant you a 10-year depreciation schedule, correct?

Mr. QUINN. Correct, yes.

Senator JOHNSON. What about oil drilling, a pretty risky venture? I am hearing all these subsidies for big oil. Can you just kind of speak a little bit about what those subsidies really are? And are those loopholes or are those incentives written into the tax code to give people the incentive to risk their capital to drill oil?

Mr. QUINN. I think as someone who reviews the tax code regularly and understands the legislative process around it, I know that those are incentives, and many of those are put in there very deliberately to incent activity.

Senator JOHNSON. Specifically, can you talk to some of these timing issues specifically? How oil companies have to account for their risk capital when they are investing? I know it is a little off subject, but I think it is exactly on point, because what we are talking about is how do you comply with a tax code that has been written by Congress that is trying to incentivize behavior? And, by the way, I would like to scrap the current tax code. I would like to just raise the revenue we need and stop economic and social engineering through the tax code. But that is the system we have right now, and companies take advantage of and respond to those incentives, correct?

Mr. QUINN. Yes, that is correct. And in terms of an example that you are looking for that would also apply not just to oil companies but to the particular facts at hand in this case study, the U.S. system with respect to foreign earnings works that way as well. When we think about the deferral opportunity that exists for foreign earnings, that is, in fact, a timing issue. And that timing issue can be affected either through paying a dividend back to the U.S. company, at which time that income then becomes immediately taxable; or it can happen as a result of the application of Subpart F, which takes a look at certain classes of income and says, despite the fact that you did not return that cash to the United States, the income is going to be immediately taxable. That is an example of a deferral strategy. It is also one where there are very deliberate actions that have been taken by Congress and by the Treasury Department in putting in place regulations in that area to respond to known business issues.

Senator JOHNSON. When I took tax law in college, one of the tenets of tax law really was the ability to pay. I think most Americans assume that when a corporation or a business spends money, they get to deduct it. That is not the case, right?

Mr. QUINN. That is correct. Absolutely.

Senator JOHNSON. I mean, in so many cases businesses invest money. They pay out the cash. They may have to borrow it, but they are spending the money—

Mr. QUINN. It becomes capitalized.

Senator JOHNSON. They are forced to capitalize, and then they have to amortize or depreciate that over—

Mr. QUINN. Sometimes it is not even amortizable.

Senator JOHNSON [continuing]. A long period of time, correct.

Mr. QUINN. Sometimes it is not even amortizable. Sometimes it is held up on the balance sheet, your tax balance sheet, forever.

Senator JOHNSON. So let us say you have \$100 and you decide to invest \$100 in capital equipment—or let us say a million, you invest a million. If you make a profit that year, where is the money going to come from to pay the tax?

Mr. QUINN. You will borrow it.

Senator JOHNSON. You are going to have to borrow it, correct? So that is not real incentivizing from the standpoint—

Mr. QUINN. No.

Senator JOHNSON [continuing]. Having people risk their capital.

So, again, I just think it is extremely important for people to understand really how our tax code operates, the incentives that Congress has written into the law, the disincenting nature of high tax rates, of forcing businesses to capitalize cash that is spent, not being able to recover that for years. That is not a loophole. That is actually economically very disincentivizing and it is very harmful in terms of job creation.

OK. Thank you. Thank you, Mr. Chairman.

Senator LEVIN. Thank you very much, Senator Johnson. Senator Portman.

Senator PORTMAN. Mr. Chairman, thanks very much, and I just had a couple questions to followup on how the international tax code works, specifically as it relates to Caterpillar.

You talked earlier about the fact that U.S. companies are competing globally at a disadvantage given that we have a relatively high rate and because we are taxing on a worldwide basis rather than what they call a territorial basis, meaning if you have active income earned abroad, it is taxed at U.S. rates.

What does that do to a company, Caterpillar is an example, but any U.S. company, that wants to take advantage of the international marketplace and that wants to be competitive in terms of acquisitions as they come up? Eighty percent of the purchasing power in this world is outside the United States; 95 percent of the consumers are outside the United States. We want our companies to access those consumers, that purchasing power, in order to create more jobs here, right?

Mr. QUINN. That is correct.

Senator PORTMAN. And with regard to Caterpillar in particular, do you have any idea how many of their 51,877 U.S.-based employees are dependent to some extent on their international sales? I understand their revenue is about 67 percent from overseas. So how many of the people who work here, over 50,000 people, have their jobs because Caterpillar does business overseas?

Mr. QUINN. I do not know the exact number, Senator, but I would expect it is a large portion of those who support the export nature of the business.

Senator PORTMAN. You had some testimony that some of your colleagues gave that 14 years ago you estimated that exports supported 16,000 U.S. Caterpillar jobs here and another 30,000 U.S. supplier jobs here.

Mr. QUINN. I would not find that unreasonable.

Senator PORTMAN. So that number is going to be a lot bigger than that now, now that they have more employees and they do more internationally, correct?

Mr. QUINN. Correct.

Senator PORTMAN. So we are talking about U.S. jobs here being supported by U.S. companies having access to foreign markets. That is something we want to encourage, not discourage, because it creates more jobs here in America.

Again, if there is an acquisition that comes up, let's say there is a company that becomes available and the competitors, let's say, are a German company, a French company, a Brazilian company, a Chinese company, a Korean company, and Caterpillar is in the mix. What is the relative advantage or disadvantage based on the tax laws for those acquisitions?

Mr. QUINN. What they will be looking at whenever an acquisition is made is what is the earnings opportunity in the future, and that earnings opportunity is going to be viewed on an after-tax basis. So they will take a look at the tax costs that will be associated with the earnings in that business as well. I am sure the example you gave earlier of the company within your State took a very similar approach to it. Just the hard economics of looking at what is that after-tax cost of operating as a U.S.-based MNC or a foreign-based multinational company.

Senator PORTMAN. What I am hearing from the companies in Ohio, and I am sure the same is true in Michigan and Wisconsin, is that they are not just at a competitive disadvantage globally, but

in terms of these acquisitions, other companies can pay a premium because of those after-tax profits that they are looking at.

Mr. QUINN. That is correct.

Senator PORTMAN. In other words, we are having to not just compete head to head, but we are shrinking as American companies, relative to the size we should be, because of our tax code, because other companies can come in who are domiciled somewhere else and say, "Hey, I will pay you a premium." So we are not expanding as we should be and, therefore, not taking advantage of international opportunities that create jobs here in America.

Who are CAT's biggest foreign competitors, do you know?

Mr. QUINN. Certainly Komatsu, which is a Japanese-based company. Steve [Williams], would you have any others to add?

Mr. WILLIAMS. Volvo, which is a Swedish company. Now some Chinese companies are competitors.

Mr. QUINN. And from Korea as well.

Mr. WILLIAMS. From Korea, Samsung, and others.

Senator PORTMAN. Volvo is their top competitor in Europe, I am told, by far; Komatsu probably in Asia, and the Chinese companies are growing their market share. Volvo is in Sweden where the top rate is 22 percent, so it is 17 points lower than the combined U.S. corporate rate of 39.1, which would be the combined State and Federal rate. Based on the public financial statements for both companies, CAT's effective tax rate was 28.5 percent last year. Do you know what Volvo's effective tax rate was last year?

Mr. WILLIAMS. Certainly lower than that, I would think.

Senator PORTMAN. Do you have a guess?

Mr. WILLIAMS. Low 20s.

Senator PORTMAN. Twenty percent. So 28.5 percent for CAT; Volvo, their biggest European competitor, 20 percent. So it sounds to me like Caterpillar spent lots of money coming up with a tax strategy last year that did not even allow it to come close to achieving tax parity with its primary rival in Europe. Is that accurate?

Mr. QUINN. That is a characterization—

Senator PORTMAN. You should not feel guilty about it. I mean, that—

Mr. QUINN. Yes, it is accurate, Senator.

Senator PORTMAN. That is the reality.

I would also say that there is a big issue here as to the ability to deploy resources to their most efficient uses. So it is not just the fact that the Volvos of the world have a lower rate. It is the fact that because they work on a territorial basis rather than a global basis, they can move capital around to where they need it, which is a huge advantage. And Komatsu has the same advantage.

Mr. QUINN. Yes.

Senator PORTMAN. So, the Japanese have a 95-percent exemption rate, as you know, meaning that they allow their companies to do business in the United States, but then bring those profits back home and to deploy them in Japan or elsewhere without any tax penalty.

I know this is about Caterpillar today, and I know that the Chairman is raising some specific points about our current code. But this all just cries out for reform, and if we do not do that, we are going to continue to see an erosion of U.S. jobs, U.S. capital

going overseas, a lack of investment here in this country, and an inability for U.S. companies to expand as they should be able for the reason we stated earlier, that they are not as competitive on these acquisitions.

So I really appreciate you all being here today, and I hope that, again, in the next few years you will be in a position to tell your clients that the United States now has a competitive tax structure and you ought to stay right here and build your jobs and build your investments in the United States of America.

Thank you, Mr. Chairman.

Senator LEVIN. Thank you very much, Senator Portman.

I have to agree with Senator Portman about the need for the tax code to be totally reformed, and now let us talk about the tax strategy which Caterpillar used to save \$300 million a year. And that is ongoing.

Would Caterpillar have offered this deal to anybody but a related company? Would they have offered this license to anybody but a related company?

Mr. QUINN. That was not what we were asked to opine on or under the tax—

Senator LEVIN. In your judgment. You do an awful lot of this for decades.

Mr. QUINN. So there is some recent—

Senator LEVIN. I am just asking you the very simple, straightforward question. Caterpillar has created this very strong company, 90 years to buildup. It turns over to its own—to itself in a tax haven 85 percent of the future profits on parts. OK? It does not get any pay for it. It does not get any compensation for it, any consideration for it.

Mr. QUINN. I—

Senator LEVIN. Well, let me just finish.

Mr. QUINN. I am sorry.

Senator LEVIN. OK. And the deal is on future parts you over there, my wholly owned subsidiary, you are going to get 85 percent of the profits on these parts; I am going to keep 15 percent. I am asking you just a very simple question based on your experience. Is there any way in heaven that Caterpillar would transfer its rights to those profits to a company that was not related to itself? That is all I am asking. I am not asking you whether it has to. I am just asking you would in your experience—

Mr. QUINN. What is—

Senator LEVIN. No compensation, no consideration. It loses 85 percent of the profits it had been receiving. It continues to operate the company. It has to continue under the agreement the same operations in Illinois. So it keeps doing the same thing it has always done, but it is turning over 85 percent of the parts profits worldwide and gets nothing, no consideration for it.

Mr. QUINN. Well, it—

Senator LEVIN. Yes or no.

Mr. QUINN. As a hypothetical, what Caterpillar would look at is exactly what you are expressing. What is the return it would receive for that?

Senator LEVIN. My question is: Would it offer that to a non-related company? That is my question.

Mr. QUINN. I do not know.

Senator LEVIN. Sure you know.

Mr. QUINN. What I——

Senator LEVIN. Sure you know. You have been in this business for a long time. I am asking you a straight question. Do you not think it is incredible to believe that Caterpillar would hand over 85 percent of its worldwide profits on parts, keep 15 percent, continue to operate in Illinois the way it always has and everywhere else around the world where it does, get no consideration for that transfer, do you think that in any way they would offer that——

Mr. QUINN. They would never do it for no consideration——

Senator LEVIN [continuing]. For a non-related company?

Mr. QUINN [continuing]. The rules that we were required to use were ones which did, in fact, evaluate the compensation that Caterpillar received and determined that——

Senator LEVIN. I am just asking you, is there any way in your experience that Caterpillar would make this deal with a non-related company? This was a deal it made with itself to shift profits to Europe. You say it was legitimate. I do not. But that is beside the point at the moment. That is not my question. My question is: Is there any way that they would make this deal with a non-related company? That is my question.

Mr. QUINN. I am sorry. I cannot answer that. I do not——

Senator LEVIN. You cannot or you will not? You have an opinion on that, don't you, after all your years of experience?

Mr. QUINN. I see companies that dispose of business operations all the time. Caterpillar has done it as well. Caterpillar has done it within their logistics organization.

Senator LEVIN. You know what the deal was here: 85 percent of the profits were shifted to a related company in Switzerland. The tax savings are \$300 million a year as a result of that strategy. That is why it was done. You have conceded that. Everybody has conceded that. That is why it was done. That is why you sold it to them.

Mr. QUINN. Senator, I am focused on the question of value that you are asking as well, that Caterpillar would do that——

Senator LEVIN. I am focused on a simple question.

Mr. QUINN [continuing]. If they understood the value was appropriate.

Senator LEVIN. No. I am focused on a simple question, and I am asking you to give us an honest answer.

Mr. QUINN. Were the economics of that deal appropriate? Yes, they would.

Senator LEVIN. I am asking you a question——

Mr. QUINN. I cannot——

Senator LEVIN. Whether or not——

Mr. QUINN. I cannot answer without that qualification. It would have to be based upon their believing that they were receiving a return in exchange for that——

Senator LEVIN. It would have to believe——would any rational company believe they are getting a return, handing over 85——

Mr. QUINN. Oh, if, in fact, they were being relieved of all the risk associated with that, if they were relieved of the capital——

Senator LEVIN. They are operating the company. They continue to operate the company in Illinois. It is the same operations. No people are shifted. Five thousand people—a dozen people have to shift. Five thousand people work for Caterpillar. Less than 100 people work in parts in Switzerland. Nothing changes, maybe 12 people move. I am just——

Mr. QUINN. But it is not all——

Senator LEVIN. I am asking you for an honest answer. Is there any rational company that would give up 85 percent of ongoing profits in a business that has been highly profitable put together over 70 years, a highly profitable company, is there any way that this would be sold, given away, no consideration, 85 percent of the profits on the ongoing parts business, hand it over to——

Mr. QUINN. Yes, the answer is yes, under the economic circumstances which Caterpillar accepted. We cannot——

Senator LEVIN. I am just asking you would they accept that with a non-related company, an arm's-length transaction?

Mr. QUINN. Yes, that is the standard that we have to apply.

Senator LEVIN. Not the standard. I am asking you in the real world would a company do that. I am just asking you a simple, straightforward question.

Mr. QUINN. It is——Senator, in the real world, that is a hypothetical that would also still be based upon an economic analysis.

Senator LEVIN. OK. Take a look, if you would, Mr. Williams, at Exhibit 4a.¹

[Pause.]

Mr. WILLIAMS. Yes, sir, I have that.

Senator LEVIN. This is a document from 1994. Pricewaterhouse looked at the intangibles for all of Caterpillar, including its Swiss marketing company, COSA, which was CSARL's predecessor. Now, here is what PwC described as the relative roles of Caterpillar and its marketing companies in developing the dealer network. This includes COSA as a marketing company: "Cat Inc. has the largest role with regard to market and dealer development." Do you see that word there?

Mr. WILLIAMS. It is on page 8685.

Senator LEVIN. Do you see that on page 8685?

Mr. WILLIAMS. Yes, I do see it.

Senator LEVIN. OK. "Cat Inc. has the largest role with regard to market and dealer development, since 1) it has the largest single market, 2) it was the originator of the basic marketing systems and concepts, 3) it continues to be involved with the development and oversight of worldwide marketing programs and approaches." And then it says, "The marketing companies"—that includes CSARL—"also have major responsibility for market development; in fact, this is their primary responsibility" is to do that. OK?

So CAT Inc. in the description of Pricewaterhouse has the largest role in 1994 with regard to market and dealer development. Was that true?

Mr. WILLIAMS. What I said there was that the dealer network was developed first, the concept, in the United States, in the 1920s, 1930s. It originated it. That is what it says there. And it continued

¹ See Exhibit No. 4a, which appears in the Appendix on page 302.

to be involved with the oversight. However, COSA and other marketing companies employed those concepts, developed those concepts, expanded the dealer network, and had the daily interaction with dealers all over the rest of the world.

Senator LEVIN. Where do you see that?

Mr. WILLIAMS. It is implied in the last——

Senator LEVIN. Not implied. Where do you see that?

Mr. WILLIAMS. That is my knowledge of the company.

Senator LEVIN. No, where do you see that? I am reading from a document.

Mr. WILLIAMS. It does not say that on the page. I was explaining——

Senator LEVIN. Thank you. Now let us go back to this document. “Cat Inc. has the largest”—this is what you said in 1994. It has “the largest role with regard to market and dealer development,” OK, and then it gives the three reasons. The marketing companies also have a major responsibility, but the largest role, you said in 1994, was Caterpillar. Was that true?

Mr. WILLIAMS. That was the way Caterpillar viewed it——

Senator LEVIN. Was that the way you viewed it?

Mr. WILLIAMS. That was my understanding at the time.

Senator LEVIN. All right. So you believe it was true.

Mr. WILLIAMS. That was what we wrote, and I believed that at the time.

Senator LEVIN. OK. Now, then if you take a look at 1995 transfer pricing documentation, Exhibit 4b,¹ Bates page 8930, “Cat Inc. had the largest role with regard to market and dealer development,” in 1995. Right? Was that true?

Mr. WILLIAMS. That is what it says in this text, yes, sir.

Senator LEVIN. Did you write that text?

Mr. WILLIAMS. I was certainly involved in——

Senator LEVIN. Was it true when you wrote it?

Mr. WILLIAMS. I am sorry?

Senator LEVIN. Was it true when you wrote it?

Mr. WILLIAMS. That was how the company viewed it at the time.

Senator LEVIN. Did you believe it was true when you wrote it?

Mr. WILLIAMS. Yes, that was how the company viewed it, and——

Senator LEVIN. Did you believe it was true when you wrote it?

Mr. WILLIAMS. At the time Caterpillar, starting in 1994, changed——

Senator LEVIN. I understand all that. I am just asking you whether that statement was true when you wrote it in 1995.

Mr. WILLIAMS. That is my understanding, yes.

Senator LEVIN. Now, was it true when you said the same thing in 1997?

Mr. WILLIAMS. Senator, we used much of the same language in these reports as they were updated each year, so I had the same——

Senator LEVIN. And did you believe it was true?

Mr. WILLIAMS. I used that language in 1997.

¹ See Exhibit No. 4b, which appears in the Appendix on page 312.

Senator LEVIN. It is a pretty straightforward question. Did you believe it was true when you wrote it?

Mr. WILLIAMS. Based on the facts at the time, yes, I believed that.

Senator LEVIN. Thank you. Senator McCain.

Senator MCCAIN. I thank the witnesses again.

Mr. Quinn, your job is to advise companies and corporations how they can maximize their profits and keeping with the existing tax code as it is written. Is that true?

Mr. QUINN. That is true, particularly with respect to their operations.

Senator MCCAIN. So this restructuring obviously resulted in increased profits for Caterpillar, right?

Mr. QUINN. I believe the increased profits largely resulted from the expansion of their markets. This provided the opportunity for them to expand their markets using a different base.

Senator MCCAIN. To this day, do you believe that there is any violation of the tax code as it was written then—And I do not know how much it has changed since—that you were completely in compliance with existing law and regulations?

Mr. QUINN. Yes, that is my belief. That is my firm's belief.

Senator MCCAIN. I thank you, Mr. Chairman.

Senator LEVIN. Thank you, Senator McCain. Senator Johnson.

Senator JOHNSON. No more.

Senator LEVIN. Thank you.

Mr. Williams, during the 1990s, Caterpillar assigned a 13 percent profit to its marketing companies, so it indicated it viewed them as having some value, which I think everybody concedes, but not a lot of value. That was before the 1999 tax strategy was implemented. So now let us look at what Caterpillar did after the tax strategy was implemented. Let us look at 2001.

Would you please look at Exhibit 13¹?

[Pause.]

Senator LEVIN. Do you have it?

Mr. WILLIAMS. Yes, sir, I have it.

Senator LEVIN. Thank you. This is a 2001 economic analysis prepared by PwC valuing the marketing intangibles of Caterpillar Americas. Do you pronounce it "C-ACO"?

Mr. WILLIAMS. Caterpillar always called it "C-ACO."

Senator LEVIN. OK. And this is a Miami-based U.S. company that was transferring its assets to CSARL. Now, CACO had served as Caterpillar's marketing company for the dealer network in Latin America, the Caribbean, and Canada. Did you work on this analysis?

Mr. WILLIAMS. Yes, I participated in this analysis.

Senator LEVIN. OK. PwC describes CACO's responsibilities. They are virtually identical to the functions of CSARL. They include signing contracts with independent dealers in the region, purchasing products and parts from the U.S. parent, reselling them to the dealers, helping with logistics support, maintaining minor parts inventories, helping dealers identify performance issues, providing dealers with marketing information and sales training, helping

¹ See Exhibit No. 13, which appears in the Appendix on page 374.

them with financing, and conducting monitoring and oversight activities to ensure compliance by dealers with the terms of dealer sales and service agreements. That is all from this document.

Now, on page 4, PwC lists the marketing intangibles at CACO. They consist of: CACO's relationship with Caterpillar's independent dealers, its training programs, its order tracking software, various procedures and manuals, market brochures, its Web site, its goodwill and its going-concern value, and any other marketing-related intangibles. Sounds familiar because these are the same as CSARL's.

Then on page 6, Mr. Williams, take a look at the description of all these markets intangibles. Do you see at the bottom there, "Functional Analysis Conclusions"? o you see that?

Mr. WILLIAMS. Yes, I have that.

Senator LEVIN. "Based on our analysis of the Intangible Assets Transferred, we conclude that they are routine and common to most distribution and marketing companies. These assets have only limited economic life and could be effectively reproduced by a new startup company with sufficient investment and time resources."

"Therefore, we conclude that the Intangible Assets Transferred have very limited economic value and this value is mostly related to its assembled workforce in place."

Was that true?

Mr. WILLIAMS. That was the analysis we wrote, and I would like to explain——

Senator LEVIN. Well, finish that sentence, if you would.

Mr. WILLIAMS. I am sorry, sir?

Senator LEVIN. Would you finish the sentence? "This was the analysis that . . . ?"

Mr. WILLIAMS. That we wrote, and I would like to expand on it.

Senator LEVIN. All right. Was it true, is what I am asking you? I know you would like to expand on it now in front of this hearing. I understand that. I am just asking you: Was that true when you wrote it? That is all I am asking.

Mr. WILLIAMS. That was an understanding we had at the time. I think it was—as you pointed out, it was partially inconsistent with some of the other language we said. The reason for that is these were different analyses under different times and actually looking at different assets and different values.

Senator LEVIN. I see. These are not basically those same intangibles?

Mr. WILLIAMS. These were looking at——

Senator LEVIN. Were these basically the same intangibles of CSARL's?

Mr. WILLIAMS. These were looking at the intangibles that were inside the United States.

Senator LEVIN. I understand that.

Mr. WILLIAMS. It did not include——

Senator LEVIN. Were these basically——

Mr. WILLIAMS [continuing]. The intangibles outside the United States.

Senator LEVIN. But were these basically—when you described these intangibles, they are pretty much the same as CSARL's, were they not?

Mr. WILLIAMS. CSARL created a lot of intangibles outside the United States, and many of CACO's field and service reps were also outside the United States, working with the dealers who were outside the United States.

Senator LEVIN. I understand, but these were basically the same intangibles, were they not, that you had previously described as CSARL intangibles?

Mr. WILLIAMS. I think they are——

Senator LEVIN. Are they basically the same intangibles?

Mr. WILLIAMS. No, they are not basically the same.

Senator LEVIN. They are not? They are different intangibles?

Mr. WILLIAMS. They are different——

Senator LEVIN. The ones I just read are different from CSARL's?

Mr. WILLIAMS. These are the intangibles without the activities of the individuals who deploy those intangibles.

Senator LEVIN. And your judgment——

Mr. WILLIAMS. The activities are offshore—the activities are performed by the non-U.S. employees.

Senator LEVIN. And this was the marketing company for Latin America, Canada, and the Caribbean?

Mr. WILLIAMS. That is correct.

Senator LEVIN. And these were the intangibles that they had—is that correct? You identified these intangibles.

Mr. WILLIAMS. These were the identified intangibles, yes.

Senator LEVIN. OK. We can compare them one for one. I have already done that to the best—I think accurately, but nonetheless, my question is: When you said that those intangibles—and I will read it to you again. Those intangibles that I read have very limited economic value, and this value is mostly related to its assembled workforce in place, I am just asking you this question: Was that true?

Mr. WILLIAMS. I think that is not totally complete. Tom, [Quinn] would——

Senator LEVIN. No. Do not refer to somebody else. You wrote this thing. So what you are saying is it was true but incomplete?

Mr. WILLIAMS. I said I would prefer to expand on it by talking about the assets that CSARL—I am sorry, CACO had offshore with its employees.

Senator LEVIN. Yes, I am sure you would, but this is the assessment that you made at the time. Is that correct?

Mr. WILLIAMS. That is the assessment I made at the time.

Senator LEVIN. All right.

Mr. QUINN. Senator, I think I could offer some further explanation that might be helpful for you to understand——

Senator LEVIN. No, I think the explanation—someone else, if they want, can ask you for it, but I am asking what was said at the time about these intangibles. And in 1999, you attributed huge value to similar intangibles, OK, you can say they are not similar. We will let the record speak for itself. We have read them, and you can—we will have someone else determine, reading them side by side, whether those intangibles, which were given huge value rel-

ative to CSARL's value, but given no value when it came to transferring these intangibles from the American company. I am just going to——

Mr. QUINN. This report reviews those intangibles absent of the services that support them. It is a completely different context, Senator.

Senator LEVIN. All right. OK. We will let anyone reading those two documents decide. He said—Mr. Williams—it was incomplete. Was it incomplete? Mr. Quinn, was it incomplete?

Mr. QUINN. He did not have the opportunity to——

Senator LEVIN. No. Was this assessment incomplete?

Mr. QUINN. Oh, this assessment is complete with respect to the asset it is evaluating.

Senator LEVIN. OK.

Mr. QUINN. It is not evaluating the same asset that you are referring to from the earlier report.

Senator LEVIN. OK. In other words, this does not list all the intangibles that CSARL had.

Mr. QUINN. It is two different bases. This is looking just at the intangible asset itself, and the way that the rules and regulations require that we value an asset is separate and apart from the services that might support those. When we take a look at the earlier report, it was clear that is trying to evaluate the income potential and the income being generated by Caterpillar SARL. In that case, it adds to the asset the service itself. So it is comparing apples and oranges.

Senator LEVIN. Both were intangibles, right, in both cases? CSARL——

Mr. QUINN. No. In one case, you had an intangible. In the second case, you had an intangible plus its enabling service.

Senator LEVIN. But both were listed as intangibles. Is that correct? When the transfer was made, they were both intangibles. Is that correct?

Mr. QUINN. No, that is not correct.

Senator LEVIN. OK. Then we are going to let the record speak for itself.

Now, if you would turn to Exhibit 12,¹ Mr. Williams? This is now 2007.

[Pause.]

Do you see that, Mr. Williams?

Mr. WILLIAMS. Yes, I have that, sir.

[Pause.]

Senator LEVIN. Is that not an email from you to a Mr. Matthews?

Mr. WILLIAMS. Yes, it is, sir.

Senator LEVIN. OK. You were talking about CSARL, that they spent decades building up the dealer network around the world, which is what a marketing company does; building the brand name through advertising. And then you say this. You say that—it is about the second or third paragraph from the bottom.

Mr. WILLIAMS. Yes, sir.

¹ See Exhibit No. 12, which appears in the Appendix on page 372.

Senator LEVIN. It says there is a caveat: “. . . in 2001”—this is what you said—“we said in another transaction”—that is CACO, right?

Mr. WILLIAMS. I believe that refers to CACO, yes, sir.

Senator LEVIN [continuing]. “That there is no significant marketing intangibles other than the workforce in place.”

Mr. WILLIAMS. No significant U.S. marketing intangibles because the—

Mr. WILLIAMS. It does not say United States. It says “no significant marketing intangibles.”

Mr. WILLIAMS. It does not include the word “United States,” but the marketing intangibles were a part of CACO’s efforts offshore already—

Senator LEVIN. Well, then, what is the caveat?

Mr. WILLIAMS. The caveat was that I was recognizing that—

Senator LEVIN. There was an inconsistency here?

Mr. WILLIAMS. I was recognizing that in two different transactions under different circumstances and different approaches, different assets being valued, that there was a different conclusion.

Senator LEVIN. Is that what you said here? You do not say there is—what is the caveat? Why do you have to say a caveat? Is there not an apparent inconsistency that you are worried about?

Mr. WILLIAMS. There is an apparent inconsistency because of the differences in the transactions, and that was what I was advising my staff, is that we needed to reconcile those different approaches.

Senator LEVIN. So you yourself saw that there was an apparent inconsistency at that time?

Mr. WILLIAMS. I would use the word “apparent,” yes, sir.

Senator LEVIN. OK. Now, take a look—Mr. Quinn, you were responding to an email of Mr. Williams. Take a look at Exhibit 46,¹ please.

Mr. QUINN. It is an internal email. I have that.

Senator LEVIN. I would like both you and Mr. Williams to look at this email exchange between the two of you regarding what you both seem to see as a problem regarding CSARL’s ability to justify receiving the lion’s share of the non-U.S. parts profits in Switzerland.

In the first email, Mr. Williams, you wrote to Mr. Quinn, in the last sentences, “. . . just curious—say they decide most PMs [product managers]”—“stay in the U.S. How do we retain CSARL parts profit if those ‘US entrepreneurs’ claim both machine AND parts profit?”

Mr. WILLIAMS. If I can, sir, the PM there refers to product managers.

Senator LEVIN. Product. I am sorry. Did I say “parts”? I mean product manager. Now, did you have a concern here, Mr. Williams, about whether the product managers located in the United States might claim the parts profits related to the parts that they designed?

Mr. WILLIAMS. Sir, my point was related to—

Senator LEVIN. Could I ask you this question just directly? Did you have a concern here about whether product managers located

¹ See Exhibit No. 46, which appears in the Appendix on page 545.

in the United States might claim the parts profits related to the parts that they designed, was that a concern of yours?

Mr. WILLIAMS. The concern was relocating the product managers from Switzerland back to the United States. I was concerned that by taking those entrepreneurial functions out of Switzerland and relocating them back to the United States, that would give me a concern.

Senator LEVIN. Is the answer then it was not—the answer is, “No,” to my question?

Mr. WILLIAMS. There was a concern, yes, sir, about the relocation—

Senator LEVIN. No. I am saying that they might claim the parts profits. That is what I am asking, whether product managers—I am going to ask you again. Was there a concern that product managers located in the United States might claim the parts profits related to the parts that they designed? Yes or no.

Mr. WILLIAMS. No. I was concerned about the relocation of the individuals from Switzerland back to the United States.

Senator LEVIN. All right. Now, Mr. Quinn, you responded to Mr. Williams in the next email: “PMs [Product managers] in US will put some pressure on the parts profit model. These guys are really bought into the [idea that] PM is king concept. We are going to have to create a story that will put some distance between them and parts . . . to retain the benefit. Get ready to do some dancing.”

Mr. QUINN. Is there a question there?

Senator LEVIN. Yes. What did you mean you were going to have to tell “a story” and “get ready to do some dancing”? Now, let me just ask you this question: Was it not the fact that product managers who designed parts here in the United States normally get the profits related to those parts but that you were going to have to justify sending most of the parts profits to Switzerland where they have few product managers? Is that not the case?

Mr. QUINN. This was a—

Senator LEVIN. Is the answer yes or no to that?

Mr. QUINN. I am not sure could you repeat the question, please?

Senator LEVIN. Yes. Was it the fact that product managers who designed parts here in the United States normally get the profits related to those profits, but that you were going to have to justify sending most of the parts profits to Switzerland where they have few product managers?

Mr. QUINN. No, that is not the intention of this statement.

Senator LEVIN. What did you mean by “dancing” then?

Mr. QUINN. Senator, that was a very poor choice of words, but this was, in fact, the first time I had knowledge of a restructuring that Caterpillar was proposing in 2008, which would change some of the substance that was put in place back in the earlier reorganization that began in 1999. My concern here was that, in fact, that would change some of the circumstances that we rely upon in terms of our economic analysis, and that we needed to make sure that management understood the consequences, the tax consequences of their actions.

Senator LEVIN. Mr. Williams, this says, “. . . say they decide most PMs [product managers] stay in US.” Now, that is consistent

with what you just said, which was about product managers moving to the United States.

Mr. WILLIAMS. There were product managers in Geneva who were supervising important products outside the United States. This reorganization announced at the end of 2008 to take effect in 2009 would have relocated those product managers to the United States and taking with them the significant entrepreneurial responsibilities. That was our concern.

Senator LEVIN. But you said, “. . . say they decide most PMs [part managers] stay in US [the United States],” not “move to the United States,” “stay in US.” Is that not your memo?

Mr. WILLIAMS. The word says “stay.” Out of the——

Senator LEVIN. Yes.

Mr. WILLIAMS. Out of the 15 or 20 product managers, they were proposing that all of them be in the United States. That is the meaning of the word “stay.”

Senator LEVIN. But you are saying the concern was that they move to the United States. That is not what the concern was in this memo.

Mr. WILLIAMS. We were——

Senator LEVIN. Why did you use the word “stay” instead of “move”?

Mr. WILLIAMS. Because we knew what the existing location of them was, and the recommendation was to have them all in the United States. So that is what we mean by “stay.”

Senator LEVIN. You were worried about “move” to the United States. Is that right?

Mr. WILLIAMS. Move and staying in the United States. in the future, no longer having those positions in Switzerland, staying in the United States instead.

Senator LEVIN. Didn't you just say that the concern was that they would move in the United States? Isn't that what you just testified?

Mr. WILLIAMS. I said to you “stay”—I said to you “move.”

Senator LEVIN. To the United States?

Mr. WILLIAMS. Yes.

Senator LEVIN. The email says the concern was that they stay in the United States. I am just asking you. Do you see——

Mr. WILLIAMS. At that time already there were several important product managers in Switzerland. The point here is stay in the United States in 2009 and future. So the reorganization would have put and stayed everyone in the United States, and we were concerned about that reorganization and its effect on the tax benefits. We were needed to assist Corporate Tax to explain to the Executive Office the tax effect of their proposed reorganization.

Senator LEVIN. Mr. Williams, you responded, “What the heck. We'll all be retired when this comes up on audit.”

Mr. WILLIAMS. Yes, sir, that was also an inappropriate use of words in an attempt at humor. My point was it——

Senator LEVIN. Is this humor: “Ed Bodham and Chris Dunn will have to solve it”?

Mr. WILLIAMS. No, that is not humor, sir.

Senator LEVIN. Would that be humorous to them?

Mr. WILLIAMS. No, that would not be humorous to them.

Senator LEVIN. Mr. Bowers, you were on the audit team. Did you know that Mr. Quinn and Mr. Williams had to figure out a story, that they had these views, that they were going to do some dancing, that they had plans to be retired when the whole issue came to a head? Were you aware of that? You were on the audit team.

Mr. BOWERS. Mr. Chairman, I was not aware of these emails.

Senator LEVIN. And, Mr. Bowers, did you know that PwC's tax consultants had taken inconsistent positions regarding the value of marketing intangibles at CSARL and CACO?

Mr. BOWERS. Mr. Chairman, I believe the——

Senator LEVIN. Were you aware of that apparent——

Mr. BOWERS [continuing]. Intangibles——

Senator LEVIN. But were you aware of that apparent inconsistency?

Mr. BOWERS. Well, I do not agree with that inconsistency.

Senator LEVIN. So you do not believe there was an apparent inconsistency.

Mr. BOWERS. That is correct.

Senator LEVIN. OK. Mr. Bowers, one of our experts today said he had never heard of a company keeping two sets of inventory books using a virtual inventory system separate and apart from the company's general inventory system—one to track the parts for the business enterprise, the other to keep track of inventory for tax purposes. Prior to Caterpillar's use of the inventory system, had you ever heard of a virtual inventory system?

Mr. BOWERS. Senator, different management books from—or legal books are very common.

Senator LEVIN. I am not talking about that. I am asking about inventory systems. Had you ever heard of a virtual inventory system prior to Caterpillar's use of an inventory system? Had you ever heard of it?

Mr. BOWERS. That particular term I had not heard of.

Senator LEVIN. No, put aside that, have you ever heard of a virtual inventory system?

Mr. BOWERS. An inventory system similar to what has been referred to as "virtual" I have seen before.

Senator LEVIN. You have?

Mr. BOWERS. Mm-hmm.

Senator LEVIN. You have seen it. But you just never heard it described as a virtual one?

Mr. BOWERS. Yes, it is difficult to understand an inventory bin is a very physical thing.

Senator LEVIN. Is that what you told our staff, by the way? We asked you specifically if you had ever heard of a virtual inventory system or similar system. You said no, before you saw this system. Did you not tell our staff you had never heard of it?

Mr. BOWERS. It depends upon how the question gets asked, sir.

Senator LEVIN. The way I just asked it.

Mr. BOWERS. A virtual inventory system I have not heard of, but when you think about what that sentence says, an inventory bin is a very real thing.

Senator LEVIN. Therefore?

Mr. BOWERS. Therefore——

Senator LEVIN. If it is all merged?

Mr. BOWERS. Very straightforward to have an inventory bin full of parts, some parts belong to one owner, other parts belong to another owner.

Senator LEVIN. Are they usually identified some way?

Mr. BOWERS. Why would that be the case?

Senator LEVIN. They do not need to identify them?

Mr. BOWERS. No.

Senator LEVIN. OK. Did you have discussions with the PwC audit team or the consultant for Caterpillar about tax risks associated with this virtual inventory? Did you ever have discussions about tax risks in doing what they were doing?

Mr. BOWERS. I did have conversations about tax risks. That is my role to provide assistance and advice to the audit partner.

Senator LEVIN. Did you have concerns?

Mr. BOWERS. Not with respect to this inventory system.

Senator LEVIN. And so you never discussed any concerns about this inventory system with them?

Mr. BOWERS. I explained this inventory system to him, and—

Senator LEVIN. I am just asking: Did you ever have concerns about it?

Mr. BOWERS. I did not have concerns about it.

Senator LEVIN. OK. Thank you all very much. We appreciate your testimony and your cooperation with this Subcommittee.

Let me now call our final panel of witnesses for today's hearing: Julie Lagacy, Vice President of the Finance Services Division of Caterpillar; Robin Beran, Chief Tax Officer at Caterpillar; and Rodney Perkins, a former Senior International Tax Manager at Caterpillar.

Thank you all for being with us today. Thank you for your cooperation with this Subcommittee. And pursuant to Rule 6, all witnesses who testify before the Subcommittee must be sworn, so we would ask you to please raise your right hand as you stand. Do you solemnly swear that the testimony you are about to give to this Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Ms. LAGACY. I do.

Ms. BERAN. I do.

Mr. PERKINS. I do.

Senator LEVIN. Thank you. A minute before the red light comes on on the timer, you will see a light change from green to yellow, giving you an opportunity to conclude your remarks. Your written testimony will be printed in the record in its entirety, and please limit your oral testimony to 10 minutes. And I understand, Ms. Lagacy, that you are going to be presenting the statement for Caterpillar. Is that correct?

Ms. LAGACY. Yes, I will.

Senator LEVIN. Please proceed.

TESTIMONY OF JULIE A. LAGACY,¹ VICE PRESIDENT, FINANCE SERVICES DIVISION, CATERPILLAR INC., PEORIA, ILLINOIS; ACCOMPANIED BY ROBIN D. BERAN, DIRECTOR, GLOBAL TAX AND TRADE, AND RODNEY PERKINS, FORMER INTERNATIONAL TAX MANAGER, CATERPILLAR INC., PEORIA, ILLINOIS

Ms. LAGACY. Good afternoon, Chairman Levin and Senator McCain. Thank you for the opportunity to appear before the Subcommittee today. My name is Julie Lagacy, and I am the Vice President of the Finance Services Division at Caterpillar, which includes its tax and accounting functions.

On my left is Caterpillar's Director of Global Tax and Trade, Robin Beran, a 24-year Caterpillar employee, and on my right is Rod Perkins, who retired in 2009 as one of our international tax managers after 35 years of service. We are proud to represent Caterpillar before you today.

Caterpillar is a great American company, and our reputation is one of our greatest assets. I want to emphasize, Caterpillar complies with the U.S. tax laws, and we pay everything we owe. We are proud of what we do. We are proud of the men and women who make it possible. And we are equally proud of our U.S. and worldwide heritage.

Our average effective tax rate is 29 percent. That is one of the highest for a multinational manufacturing company, 3 percentage points higher than the average effective rate for U.S. corporations. This is particularly high when you consider that more than 65 percent of our sales and revenues are abroad. Over the last 15 years, we have increased employment in the United States by 35 percent to nearly 52,000 jobs, and we have more than tripled our exports to \$16 billion.

Caterpillar enjoys a strong legacy, and, in fact, my family has a long history with this company. Both of my grandfathers worked at Caterpillar. During World War II, my grandmother stepped up to work in the factory to help build the machines our servicemen relied upon. My father, whose career spanned 38 years, began as an apprentice and worked his way up to manage one of our factories in East Peoria. Along the way he met my mother, who worked a decade at Caterpillar. All told, three generations of my family have more than 140 years of service at Caterpillar, and I am a current steward of this tradition.

At Caterpillar, stories like mine are not uncommon. For nearly 90 years, Caterpillar has helped build the world, including the backbone of modern America. What began with two American inventors now employs over 118,000 people worldwide, and nearly 52,000 of those people are right here in the United States. When you consider our independent dealer and supplier networks, the worldwide reach of our company is even greater. At our roots, we are an American company. Our equipment was there to build the Golden Gate Bridge and create the interstate highway system. Caterpillar products, dealers, and employees also show up after tragedy strikes. In Oklahoma City, at Hurricane Katrina, and Ground

¹ The prepared statement of Ms. Lagacy appears in the Appendix on page 129.

Zero, we joined the first responders in cleaning up, powering up, and paving the way for recovery.

We are proud that many of our products are “Made in America.” Along the Illinois River in our East Peoria factories, we make the machine on which our company was founded: The track-type tractor, better known as the bulldozer. Just down the road in Decatur, Illinois, is the only place in the world where we make the world’s largest mining truck, which stands 2½ stories tall and can carry 400 tons. Eight out of 10 large mining trucks made in Decatur are shipped outside of the United States. There are other examples like this across the country—from engines rolling off the line in Texas, to the locomotives we are building in Indiana, or the excavators made in Georgia. Our customers depend on Caterpillar’s unmatched products, services, solutions, and the reliability of our machines.

We grow and build near our customers worldwide, not only because it is what they demand but because remaining globally competitive helps create jobs right here at home. Growing where our business is means growing where our customers are located, not just in the United States but throughout the world. Most importantly, while more than 65 percent of our sales and revenues come from outside the United States, Caterpillar remains committed to our manufacturing roots here in America. That is why we continue to invest here at home with 69 manufacturing and logistic facilities and CAT dealers from coast to coast.

Remaining globally competitive helps create jobs right here at home. In the past 15 years, we have increased our U.S. employment by more than 13,000. Many of these jobs came from our exports, which last year alone totaled \$16 billion. As you may remember, our effort to grow U.S. manufacturing jobs was highlighted by President Obama in his 2013 State of the Union address.

I want to emphasize again that Caterpillar has fully complied with U.S. tax law. For 2013, we estimate that Caterpillar incurred approximately \$700 million in income, property, sales, and use taxes to U.S. Federal, State, and local governments. Additionally, our wages accounted for approximately \$1.7 billion in U.S. Federal, State, and local employment taxes.

Over the last 8 months, Caterpillar has responded to several Subcommittee questionnaires and other information requests, has produced thousands of pages of documents, has voluntarily permitted and facilitated 11 separate Subcommittee staff interviews of current and former personnel, and has cooperated in every way possible with the Subcommittee’s inquiry. We understand the Chairman and his staff are interested in one aspect of our company’s business: parts sales outside of the United States.

Caterpillar’s philosophy is that our business structure drives our tax structure. We do not invent artificial tax structures. When we identify options that align with our business structure, comply with the tax laws, and generate tax savings, we pursue those opportunities. The restructuring of Caterpillar SARL, or CSARL for short, was one of those opportunities.

Decades ago, Caterpillar had the vision to see new opportunities worldwide that would drive our business growth in the United States and globally, so Caterpillar established a subsidiary in Ge-

neva, Switzerland, that would be responsible for putting in place a robust network of employees, independent dealers, and suppliers. That subsidiary is now known as CSARL. By the 1990s, CSARL had thousands of people supporting the business and almost 500 employees in Geneva, Switzerland, alone.

CSARL is a vital business subsidiary responsible for manufacturing, marketing, and selling machines, engines, and parts outside of the United States. The Geneva entity has held these responsibilities since 1960. The 1999 restructuring further refined this role. One result of this restructuring was that CSARL streamlined its process and began buying parts directly from U.S. suppliers.

Prior to the restructuring, Caterpillar Inc. acted as an unnecessary middleman, buying these parts from independent suppliers and selling them to CSARL, which then sold them to dealers outside the United States. Prudent, lawful business planning required us to eliminate the unnecessary middleman from the transaction flow. We cannot remain competitive, we cannot create jobs, and we cannot increase exports by incurring unnecessary expenses. Americans pay the taxes they owe, but not more. And as an American company, we pay the taxes we owe, not more.

In planning and implementing the restructuring, Caterpillar appropriately relied on the advice of two of the world's leading tax advisory firms: PricewaterhouseCoopers, a leading Big Four U.S. and international accounting firm; and the law firm McDermott Will & Emery, renowned for its international tax practice. Both firms provided the advice that the changes were appropriate under the tax laws, and both stand behind that advice. This advice was consistent with the experience and judgment of Caterpillar's Tax Department. Caterpillar's in-house tax professionals and outside advisors manage tax risk every day, and we remain convinced that the restructuring and subsequent transactions comply with the tax law.

CSARL's purchases and sales of parts have more than sufficient business substance to be respected for tax purposes. The 1999 restructuring of parts purchases and sales did not in any way violate generally applicable judicial doctrines in the tax area. An independent expert, Professor John Steines, of the New York University School of Law, confirms this conclusion. Professor Steines' report was provided to the Subcommittee staff on March 10, 2014.

CSARL pays Caterpillar Inc. an arm's-length royalty for all intangible property, including intellectual property made available by Caterpillar Inc. to CSARL as well as arm's-length service fees for all activities performed by Caterpillar Inc. for CSARL. So even with respect to parts that are sold to dealers located outside the United States, a portion of the resulting income is subject to current basis U.S. tax.

CSARL's direct purchase of its parts inventory reflects nothing more than the standard business operations and tax planning that any prudent business would employ in conducting its operations and complying with U.S. tax laws.

In closing, I would like to emphasize again that Caterpillar is a great American company—an iconic company, you might say—publicly listed since 1929. We have steadily grown by working our business model day in and day out. Caterpillar does a significant

amount of business around the world, creates jobs, invests in the communities where we do business, and bears one of the highest effective tax rates for a multinational manufacturing company. Caterpillar complies with its legal obligations with respect to payment of taxes.

We are happy to answer your questions. Thank you.

Senator LEVIN. Thank you, Ms. Lagacy.

My first question is for you. Were you involved in the implementation of the CSARL transaction in 1999?

Ms. LAGACY. No, I was not.

Senator LEVIN. Mr. Perkins, at the time of the 1999 CSARL transaction, you were working for Caterpillar in Peoria. You were serving as its Tax Department's main point of contact with PwC. Is that correct?

Mr. PERKINS. Mr. Chairman, that is correct.

Senator LEVIN. And, Mr. Beran, you or Mr. Perkins, I believe—what was your role in 1999?

Mr. BERAN. I was and am the head of the Tax Department.

Senator LEVIN. OK. And you worked directly on the CSARL transaction?

Mr. BERAN. I was involved with its formulation, yes. The implementation, other people did much more work than I.

Senator LEVIN. So you were involved in the formulation of it.

Mr. BERAN. Yes.

Senator LEVIN. And would you look at Exhibit 7,¹ please. This was the way in which PwC recommended that Caterpillar could reduce its taxes. It is one page from the document, and here is what it says. Purpose: Take "CAT Inc. out of chain. Recharacterize Marketing Company Income to Achieve U.S. Tax Deferral."

And then if you look further down, the description of—and the chart there shows how it was simply done. As you point out, Caterpillar was, as you said, Ms. Lagacy, taken out of the chain as an unnecessary middleman. We will get into that in a minute as to just how unnecessary Caterpillar may have been. But at any rate, the direct purchase, so-called, went to COSA in Geneva from these suppliers. Is that correct so far, Mr. Beran?

Mr. BERAN. Yes, sir.

Senator LEVIN. All right. Mr. Perkins, is that correct?

Mr. PERKINS. Yes, it is.

Senator LEVIN. All right. Now, was it the Caterpillar Tax Department that came up with the idea to remove Caterpillar Inc. from the title chain, or was that a PwC idea?

Mr. PERKINS. Mr. Chairman, I can respond to that. The original idea or the genesis of that was within the Caterpillar Tax Department.

Senator LEVIN. All right.

Mr. PERKINS. Predated the PwC proposed changes by at least a half a dozen years.

Senator LEVIN. OK. Now, take a look at Exhibit 32,¹ if you would. By the way, before we leave Exhibit 7, I will repeat it again. One of the benefits and costs was this change in the title, "rel-

¹ See Exhibit No. 7, which appears in the Appendix on page 343.

¹ See Exhibit No. 32, which appears in the Appendix on page 487.

actively simple re-invoicing requirements”; in other words, the parts never went to Switzerland. Is that correct, Mr. Beran?

Mr. BERAN. The parts would be distributed all over the world.

Senator LEVIN. But they did not go to Switzerland.

Mr. BERAN. Many of them went to one of the—well, they went to warehouses that—

Senator LEVIN. Switzerland itself.

Mr. BERAN. They went to the warehouses that CSARL oversees.

Senator LEVIN. And how many warehouses are there in Switzerland?

Mr. BERAN. None in Switzerland.

Senator LEVIN. How many warehouses in the United States, do you know?

Mr. BERAN. I do not know the exact number. It varies.

Senator LEVIN. Ten, does that sound about right?

Mr. BERAN. In the range.

Senator LEVIN. In the range, OK. Now let us get to Exhibit 32. This is February 2011. It is a deposition of Sally Stiles under oath. Do any of you know who Sally Stiles is? Let me ask you, is she the Caterpillar director of global tax, do you know, Mr. Beran?

Mr. BERAN. She is the director of global tax operations now.

Senator LEVIN. OK. So she is now the director of global tax. Here is what she said in her deposition:

“Question:”—this is Exhibit 32. “Is it fair to say that the driving force behind . . . CSARL was the tax department and not any business unit”? And her answer is: “Yes.” Was that correct?

Mr. BERAN. Senator, the context is that the Tax Department has to continually adapt to the way the business is run.

Senator LEVIN. I understand.

Mr. BERAN. And that is what we were doing.

Senator LEVIN. I understand. Was her statement correct, that the Tax Department was the driving force?

Mr. BERAN. At the point in time we were aligning our tax reporting with the way the business was run, yes, we have to propose that, business—

Senator LEVIN. I am not arguing with you. I am just asking you whether or not the Tax Department was the driving force behind the CSARL transaction. That is all I am asking.

Mr. BERAN. Yes.

Senator LEVIN. OK. Now, according to information which PwC has provided us, from 1999 to 2003 Caterpillar paid PwC \$55 million to design, develop, and implement the Swiss tax strategy involving CSARL, which Caterpillar called the Global Value Enhancement (GloVE), program. Does that match what you know, Mr. Beran?

Mr. BERAN. I believe that is in the range.

Senator LEVIN. All right. Mr. Perkins, does that match your understanding, too?

Mr. PERKINS. Yes, it does.

Senator LEVIN. All right. So from the beginning, the decision to use CSARL and direct Caterpillar’s non-U.S. profits to Switzerland was to shift profits to a low-tax jurisdiction. Is that correct?

Mr. BERAN. Senator, as I said, it was to align the profit recognition where the business was being run and managed.

Senator LEVIN. But wasn't the purpose to shift profits for tax purposes to a low-tax jurisdiction. Is that correct?

Mr. BERAN. We had to get the profits where they were earned.

Senator LEVIN. Well, I am asking you——

Mr. BERAN. So it was not a shift. It was to get them to where they were earned. I mean, it changed the location, but the point was to get them to where they were earned.

Senator LEVIN. Take a look at page 4619 in Exhibit 7.¹ Do you have that page. It says at the head of the page, "Increase Profit Associated with Marketing, U.S. Tax Deferral." Do you see that?

Mr. BERAN. Yes.

Senator LEVIN. OK. And then look at "Benefits/Costs," where it says, "Migrates profits from CAT Inc. to low-tax marketing companies." Do you see that?

Mr. BERAN. Yes.

Senator LEVIN. OK. Was that accurate? Was that a benefit?

Mr. BERAN. Yes, it is a benefit to earn income in low-tax jurisdictions.

Senator LEVIN. All right.

Ms. LAGACY. Senator, could I add that——

Senator LEVIN. Well, let me just finish. To migrate the profits from CAT Inc. to a low-cost marketing company. Is that what it says?

Mr. BERAN. Yes.

Senator LEVIN. And this was the plan that you put in place. Is that correct?

Mr. BERAN. That is PwC's choice of terms, I guess.

Senator LEVIN. Whose?

Mr. BERAN. PricewaterhouseCoopers' choice of wording.

Senator LEVIN. That is their choice of wording.

Mr. BERAN. Yes.

Senator LEVIN. Fair enough. And that is what your company bought?

Ms. LAGACY. And, Senator, could I add, please?

Senator LEVIN. Well, I just want first Mr. Beran; then you will have a chance.

Mr. BERAN. We paid them for their services, yes.

Senator LEVIN. So you bought their plan, their strategy.

Do you want to add something there, Ms. Lagacy?

Ms. LAGACY. Yes, just that, again, keep in mind that CSARL and its predecessor company, COSA, were in business since 1960. At the time of this realignment, we had approximately 500 employees in our Geneva office, but perhaps more importantly, thousands of employees outside the United States doing the work to help sell parts on machines.

Senator LEVIN. Oh, sure. Those employees were all Caterpillar's employees, were they not?

Ms. LAGACY. No. There are Caterpillar employees and also CSARL employees.

Senator LEVIN. How many employees did Caterpillar have?

Ms. LAGACY. In 1999?

¹ See Exhibit No. 7, which appears in the Appendix on page 343.

Senator LEVIN. No, at the time—the moment you just talked—you just said——

Ms. LAGACY. I do not know the exact number of total Caterpillar employees.

Senator LEVIN. How many employees did CSARL have?

Ms. LAGACY. CSARL had thousands of employees. We had 500 employees at that time in Geneva, Switzerland.

Senator LEVIN. Right.

Ms. LAGACY. But many other employees around the world. CSARL is not just in Geneva, Switzerland. It is the effort that markets—does also manufacturing and sells machines, engines, and parts outside of the United States.

Senator LEVIN. And you had another 400 or so in Singapore, but all of the employees around the world, other than that, are working for Caterpillar or Caterpillar-owned companies. Is that not correct?

Ms. LAGACY. CSARL——

Senator LEVIN. Take a look at your own numbers of employees, total number of Caterpillar employees around the world are in the——

Ms. LAGACY. We have over 118,000 employees around the world today; 52,000 of those employees are in the United States. So more than half of our employment is outside of the United States.

Senator LEVIN. Of course, but that is Caterpillar's offshore employees.

Ms. LAGACY. But I——

Senator LEVIN. Is that not true?

Ms. LAGACY. No.

Senator LEVIN. OK. Let me give you the numbers, and then if you can tell me where we are wrong——

Ms. LAGACY. OK.

Senator LEVIN. These numbers came in a letter to the Subcommittee. Total Caterpillar employees globally, 118,000. Caterpillar U.S. employees, 52,000. Caterpillar offshore employees, including CSARL, 66,000.

Now let us get down to CSARL. CSARL employees global, 682. CSARL employees Switzerland, 400.

Is that wrong? That is a letter that came into the Subcommittee from you?

Ms. LAGACY. There are also employees that I believe you have not included there from Singapore and some other areas.

Senator LEVIN. We give you the total Caterpillar employees, so how many of the 118,000 employees then would you attribute to Singapore?

Ms. LAGACY. I do not have those exact numbers, but, again, if I could get that document, I can research that and check that, please.

Senator LEVIN. OK. We will get you this document that you sent to us. OK?

Ms. LAGACY. OK. Thank you. And, again, those non-U.S. employees we talked about, they are working for entities that report up to CSARL.

Senator LEVIN. They are—you say “report to CSARL.” But they are Caterpillar employees, are they not?

Ms. LAGACY. I do not understand the distinction you are making there exactly, but again——

Senator LEVIN. Do they get a check from CSARL?

Ms. LAGACY. There are definitely employees of CSARL, many employees outside the United States supporting the work of CSARL.

Senator LEVIN. Well, we are going to look at your chart.¹ We are going to give you your chart.

Ms. LAGACY. OK.

Senator LEVIN. According to what we take off your document, CSARL employees globally are 682. Is that wrong?

Ms. LAGACY. I do not recognize that number, so I would like to review the chart, if I could.

Senator LEVIN. Do you know how many employees of CSARL in Switzerland?

Ms. LAGACY. I know that in 1999 there were about 500.

Senator LEVIN. All right. So at least in Switzerland there are 500 CSARL employees. We think there are 400 now, but we will not argue over 100. OK?

Ms. LAGACY. I think that is probably right.

Senator LEVIN. All right. And the total number of Caterpillar U.S. employees are 52,000. Is that correct?

Ms. LAGACY. Yes.

Senator LEVIN. And the total number of parts employees globally, according to your letter, 8,300. Does that sound right?

Ms. LAGACY. Again, it depends on how you define parts, because we do not have a parts business——

Senator LEVIN. OK.

Ms. LAGACY [continuing]. And we do not identify that separately. I do not agree that those are all the employees working on parts now.

Senator LEVIN. Will you take a look at Exhibit 50b?

I will stop here because I have gone over my time. But just take a look at Exhibit 50b, answer number 10. This is the question: “With regard to replacement parts business, for each year from 1999 through 2012, please provide the following information: The percentage of your company’s worldwide headcount and payroll assigned to the PFRP [purchased finished replacement parts] business and located in the U.S. The percentage . . . assigned to [that] business and located in Switzerland.”

Your answer is that you do “not have employees assigned to a replacement parts business, however there are organizations throughout the enterprise that support purchase, storage, movement, and sales of replacement parts. In the chart below, we have identified divisions participating in these activities and provided U.S. based and non-U.S. based headcount statistics for the years 2006 through 2012.”

And here is what you say: parts distribution, parts pricing, parts marketing. So on that chart you identify a certain number of employees related to parts distribution, and you show US Headcount, Total US Headcount, 3,619; Non-US Headcount Hourly, Non-US Headcount Management; and then your Total non-US Headcount, 2,027. And then you identify Geneva four or five lines down, Parts

¹ See Exhibit No. 50b, which appears in the Appendix on page 563.

Pricing. You have—it is all parts, parts, parts, parts, parts. You got four in Geneva, you got six more in Geneva. Then you got Parts Marketing Support. And then you show these non-US Headcounts and so forth. So these are your numbers. So the chart that I read you is your numbers, but that means there are 4,900 parts-related employees in the United States, 66 in Geneva. Those are the totals from this chart.

Ms. LAGACY. Senator, could I comment on that?

Senator LEVIN. Of course.

Ms. LAGACY. Just referencing our earlier questions, there is a line here for total non-U.S. headcount of 2,027, and then within purchasing another total non-U.S. headcount of 1,080. And, of course, as you referenced, there are some in Geneva. So it does appear to be thousands of employees outside of the United States.

Senator LEVIN. Of course. That is what we said, and we believe those are all not CSARL employees but Caterpillar employees, and treat themselves as Caterpillar employees. Senator McCain.

Senator MCCAIN. Thank you, Mr. Chairman.

The U.S. corporate tax rate is 35 percent, but I understand that the effective tax rate that Caterpillar paid was 29 percent, which is 3 percent higher than the average effective tax rate for U.S. corporations. How does that happen? And does that include the overseas subsidiary income?

Ms. LAGACY. Yes, Senator McCain, that does include—it is a rate that is an average rate on our global business, and so our overall average effective tax rate is 29 percent. That does include our global business.

Senator MCCAIN. So even though there are significant profits made by your overseas operation, you still pay an overall effective tax rate of 29 percent?

Ms. LAGACY. Yes, that is correct.

Senator MCCAIN. How do you account for that?

Ms. LAGACY. We do publish in our financial statements and our 10-K, if we look at the most recently completed year, we start with the U.S. statutory tax rate of 35 percent. About 5 points or so comes off of that due to all of our business outside the United States, not just CSARL, of course, but all business outside the United States.

There are then some provisions like the R&D credit and the production deduction that are part of U.S. tax law. You would then add some back in for State and local taxes. At the end you come up to 29 percent.

Senator MCCAIN. Again, I just am curious why it is that you would pay—even with the overseas profits, that you would still pay a higher effective tax rate than most other corporations.

Ms. LAGACY. And we do think that that is significant, especially considering 65 percent of our business is outside of the United States.

Senator MCCAIN. Mr. Beran, when and how often since 1999 has the IRS audited Caterpillar?

Mr. BERAN. Senator, we are under continuous examination. The IRS literally sits right outside my office. In that timeframe, we have closed 1999, 2000, 2001, 2002, 2003, 2004, 2005, 2006—

Senator MCCAIN. What haven't you closed? What year?

Mr. BERAN. Two-thousand seven and later years are still under exam.

Senator MCCAIN. They are still under examination. So you are under constant auditing from the IRS?

Mr. BERAN. Yes, we are.

Senator MCCAIN. And they have not claimed you are in violation of IRS regulations?

Mr. BERAN. Each year's return provides substantial information, including transfer pricing information related to our international businesses. They have proposed no adjustments.¹

Senator MCCAIN. You heard that the first panel of witnesses said that the IRS was not doing their job. Would you agree with that?

Mr. BERAN. Well, they ask extensive questions about our business. We provided a lot of information to them, answered a lot of questions, reviewed our transfer pricing processes with them. I think they have been pretty diligent.

Senator MCCAIN. Maybe you could submit for the record the number of audits and the specific reasons for investigations by the IRS that they gave when they audited you. Could you do that?

Mr. BERAN. Certainly, Senator.

Senator MCCAIN. Caterpillar obviously can deliver a replacement part anywhere in the world in 24 hours or less. What role does the Swiss subsidiary and its dealer network play in making the 24-hour replacement parts delivery possible?

Ms. LAGACY. CSARL plays a significant role in that, so at CSARL, who is administering dealers outside the United States, they first helped develop that dealer network; now they administer those dealers. So they are working regularly with dealers on how best to serve our customers around the world, which includes forecasting the needs of the customers, developing merchandising and marketing programs, etc.

Senator MCCAIN. The parts come from the United States, or where?

Ms. LAGACY. Parts come from all over the world. Specifically CSARL does purchase about 70 percent of their purchased finished parts from the United States. They do get parts from other parts of the world, also.

Senator MCCAIN. Well, I thank you. I thank the witnesses.

Thank you, Mr. Chairman.

Senator LEVIN. Thank you very much, Senator McCain. Senator Johnson.

Senator JOHNSON. Thank you, Mr. Chairman.

Just getting back to your relationship with the IRS, Mr. Beran you said that they are sitting right outside your office. How many are sitting right outside your office, on average?

Mr. BERAN. On average, two or three work outside my office but several others, three or four work offsite. They have a number of members assigned, but they are in and out.

Senator JOHNSON. Full-time. So you closed out through 2006, 2007?

Mr. BERAN. Two-thousand six.

¹ See Exhibit No. 56c, Memorandum to File from the Permanent Subcommittee on Investigations' Majority Staff regarding *False Testimony Related to IRS' Position on Caterpillar's Tax Liability*, which appears in the Appendix on page 633.

Senator JOHNSON. Are they all just looking at 2007 now, or are they looking at all those years in kind of compilation?

Mr. BERAN. They typically do 2- or 3-year audit cycles. If they get behind, they extend.

Senator JOHNSON. In the closed-out audits, you said they looked to transfer pricing. I mean, that encompasses this entire relationship with CSARL and, again, because they have proposed no adjustments, they have basically given their blessing to what you have done here from the standpoint of compliance with tax law, correct?

Mr. BERAN. That is the way I have taken it. There is extensive documentation that is provided every year, and we know they ask questions about it.¹

Senator JOHNSON. Ms. Lagacy, in the scheme of things, in terms of the expenses of Caterpillar, what is your largest expense? Labor? Material?

Ms. LAGACY. Yes, it would be the cost to build and make our products, yes.

Senator JOHNSON. OK. In that hierarchy of costs, where does the tax expense fall?

Ms. LAGACY. It is not the primary driver of our costs.

Senator JOHNSON. But it is a large—

Ms. LAGACY. Yes.

Senator JOHNSON. It is a large cost center, correct?

Ms. LAGACY. Yes.

Senator JOHNSON. Certainly something that any responsible management team would take a look at managing, just like you manage labor, just like you manage material purchases, that type of thing.

Ms. LAGACY. Correct.

Senator JOHNSON. There is nothing nefarious in trying to minimize that tax burden?

Ms. LAGACY. No, absolutely not.

Senator JOHNSON. You had a whistleblower say that you did not report \$2 billion worth of income tax to the United States. Let us say legally, properly or improperly, let us just stipulate that you saved yourself \$2 billion in tax expense to the U.S. Government by complying with the U.S. tax code. What did Caterpillar do with that \$2 billion or any tax savings that you may have enjoyed because of your compliance with the tax code?

Ms. LAGACY. Well, I would like to say that we did have a former employee—he did file an employment lawsuit. That was resolved, and all of his concerns were taken seriously, and all of the experts, both internally and externally, PricewaterhouseCoopers and McDermott Will & Emery, found there to be no merit in his concerns.

But to answer your question regarding what we do with that, we have continued to invest that in our business, and that is why we have seen the growth that we have seen. So in 1999, we were a \$20 billion company. Last year our sales were \$56 billion. Our exports and our U.S. business grew over that time period.

¹ See Exhibit No. 56c, Memorandum to File from the Permanent Subcommittee on Investigations' Majority Staff regarding *False Testimony Related to IRS' Position on Caterpillar's Tax Liability*, which appears in the Appendix on page 633.

Senator JOHNSON. So you did not stuff any kind of tax savings in a mattress or a pillow case. I mean, you actually put that to use——

Ms. LAGACY. Correct.

Senator JOHNSON [continuing]. Growing your business, creating jobs.

Ms. LAGACY. Correct.

Senator JOHNSON. Both domestically as well as overseas.

Ms. LAGACY. Yes, exactly.

Senator JOHNSON. So those tax savings—I mean, we can quibble over who should have claimed those dollars. I mean, certainly had we taken them here in the Federal Government, we would have spent it somewhere. But you actually spent it putting people to work.

Ms. LAGACY. We put it into our business, to grow our business, yes.

Senator JOHNSON. Let us say we were able to pass a law here and capture a bigger share of Caterpillar's income. What options would Caterpillar have under that scenario if the tax burden just became too competitive and you could not compete with your global competitors?

Ms. LAGACY. I think that is really the key, Senator. It is really important that we have a tax code that allows us to compete fairly in the global marketplace. We are not looking for a free lunch, but we are looking for the ability to compete fairly with companies inside and outside of the United States.

Senator JOHNSON. Can you just speak to the relative competitiveness of what you are paying tax-wise to your competitors, the ones that were mentioned earlier in the hearing? And maybe just name the competitors that are your primary——

Ms. LAGACY. Yes. Again, we talked about Volvo earlier in the hearing, who had a much lower effective tax rate; Komatsu is another one of our primary competitors outside the United——

Senator JOHNSON. Do you know their exact tax rate? Can you give us the relative difference there?

Ms. LAGACY. I do not have their exact tax rates.

Senator JOHNSON. Mr. Beran.

Mr. BERAN. It varies year by year, depending upon profitability and their mix of income, just as it does with us. But they now have a lower Japanese statutory rate. But on top of that, they now have a territorial system that allows them to earn money in lower-tax environments and can move it wherever they can best employ it in their business.

Senator JOHNSON. Do you feel that Caterpillar is at a competitive disadvantage because of the U.S. tax system? And can you be specific in terms of exactly what is the worst part of it?

Mr. BERAN. One of the worst parts is the international regime, which taxes much more foreign activity income than any of our competitor nations. So a business like CSARL would not tax that business at all back in their home country. You just pay the Swiss tax. And then the complexity of the U.S. rules that cause us to have to do much greater effort to be able to move money across our foreign subsidiaries, particularly back to the United States.

Senator JOHNSON. Are you specifically aware of any maybe large contracts you have lost and potentially believe that it was because of our uncompetitive tax system?

Mr. BERAN. I could not say that we have lost contracts that way. It would probably come up more if we were looking to buy a company and a foreign competitor could bid more for that company.

Senator JOHNSON. OK. So it puts you at a disadvantage in terms of M&A activity.

What total percentage of your sales is parts?

Mr. BERAN. I do not know.

Senator JOHNSON. Anybody on the panel know?

Ms. LAGACY. Yes, we actually, Senator, do not separate our parts business, so we do not have a separate parts business. It is very integral to our products and our machine products. So it is our business model.

Senator JOHNSON. OK. I was just trying to get a little bit better feel for the headcount issue that Senator Levin was talking about. I kind of view—and this is just my assumption, that CSARL in Geneva is kind of a headquarters, with a limited headcount, but you have people with other divisions internationally, either with direct reporting responsibility that may not be called CSARL but they are basically either directly reporting into CSARL or there is a dotted line of reporting.

Ms. LAGACY. Correct.

Senator JOHNSON. Can you describe that a little bit? Is that a correct assumption?

Ms. LAGACY. Yes, exactly. That is a very correct assumption. We have a lot of key decisionmakers and a number of employees outside the United States who do as you just suggested. They understand our customers, they understand the needs of our customers. They work with our dealers on everything from financing to inventory management to understanding what the needs are to best serve the customers in that territory.

Senator JOHNSON. So, again, I was trying to interpret the schedule that Senator Levin was talking about in terms of headcount, but I guess—maybe it is not direct. Maybe it was not answered because you were being very specific in terms of CSARL. But there are thousands of employees that really in some way, shape, or form are reporting or certainly contributing to—

Ms. LAGACY. Yes.

Senator JOHNSON [continuing]. The activities of CSARL. Is that an accurate statement?

Ms. LAGACY. Yes. That is true.

Senator JOHNSON. OK. Well, thank you for your testimony. Thank you, Mr. Chairman.

Senator LEVIN. Are you saying that CSARL has thousands of employees?

Ms. LAGACY. Again, there are—

Senator LEVIN. I know there are a lot of people who communicate with CSARL. I am just asking you, are you saying CSARL has thousands of employees?

Ms. LAGACY. Again, if you are asking very specifically on the legal entity structure of CSARL and it has a number of subsidiaries, I know that there are thousands of employees doing the work

of administering the dealers, manufacturing, selling machines, etc., that are part of CSARL.

Senator LEVIN. I do not know—"part of?"—You are saying a lot of people communicate with CSARL. Are you actually saying CSARL has—we know how many employees Caterpillar has, right?

Ms. LAGACY. Yes.

Senator LEVIN. We have the number. How many employees does CSARL have?

Ms. LAGACY. I do not have the exact number——

Senator LEVIN. Do you have an approximate——

Ms. LAGACY [continuing]. Of CSARL employees.

Senator LEVIN. Do you have an approximate number?

Ms. LAGACY. Again——

Senator LEVIN. Just do you have an approximate number?

Ms. LAGACY. No.

Senator LEVIN. Now, let me ask you about what Caterpillar does. Take a look, if you would, at Exhibit 52.¹ This is the servicing agreement between Caterpillar and CSARL, because Caterpillar just kept doing what it was always doing, a parent corporation, most of the employees by far, CSARL with very few employees, relatively, and here is what——

Mr. RYAN. Mr. Chairman, could we just get to the exhibit?

Senator LEVIN. Sure.

Mr. RYAN. We are not on the exhibit yet.

Senator LEVIN. OK. And who is that just spoke?

Mr. RYAN. I apologize, Your Honor. Stephen Ryan. I am counsel to the company. The witnesses were looking.

Senator LEVIN. Thank you. I was just wondering, since you spoke, for our reporter to know who it was.

Mr. RYAN. Thank you, sir.

Senator LEVIN. So at the back of this Exhibit 52 is Schedule 1 that has a number 661 on it, "Schedule of Services to be Provided by Caterpillar." This is the list of what they do. Have we got it?

Ms. LAGACY. I am looking for Schedule 1.

Senator LEVIN. OK.

Ms. LAGACY. Yes, I have it.

Senator LEVIN. It includes the following: creating and translating services manuals and materials for replacement parts; provides inventory availability management; provides parts custom service to dealers; processes dealer parts returns; maintains information systems; provides marketing consulting services to dealers; provides strategic planning and accounting services.

Now, for the U.S. warehouses, Caterpillar—and, again, CSARL has no warehouses. Caterpillar agrees to manage and monitor inventory levels worldwide and perform expediting services, arrange for transportation of CSARL parts, perform general warehousing services and provide warehousing facilities, perform inventory management services. And for all those services, on the last page, Caterpillar gets reimbursed its costs plus 5 percent of those costs.

So basically Caterpillar agreed to keep running the program for CSARL. CSARL has 65 employees handling parts, according to your charts, no warehouses, no parts suppliers, no parts inven-

¹ See Exhibit No. 52, which appears in the Appendix on page 589.

tories, no forecasting or other software being administered from CSARL.

My question: Would Caterpillar perform all of these same services for a third party at cost plus a small service fee while giving up 85 percent of its profits? Ms. Lagacy, would you do that?

Ms. LAGACY. Yes, and I would like to——

Senator LEVIN. You would?

Ms. LAGACY. Your question——

Senator LEVIN. You are offering to a third party——

Ms. LAGACY. No, I thought you asked me if I would answer the question.

Senator LEVIN. No, I was asking you whether you would offer this—I thought you were making an offer right now to a third party to buy all that.

Ms. LAGACY. No. I was attempting to answer your question. So, first, you said CSARL kept doing what it was doing, and, again, CSARL and its predecessor company were in business since 1960 doing this work of supporting our dealers and selling parts, marketing parts, machines and engines in the territory——

Senator LEVIN. You have gone into what CSARL has done, and I am——

Ms. LAGACY. So I think that is significant.

Senator LEVIN [continuing]. Just now telling you what your documents say Caterpillar is doing. That is all. Did I read it correctly?

Ms. LAGACY. Yes, you read the document correctly.

Senator LEVIN. OK. Now, take a look at Exhibit 18,¹ Caterpillar Board of Directors Minutes. If you look at the first line in the second paragraph—do you have it? Exhibit 18, did you get it?

Ms. LAGACY. I am on Exhibit 18.

Senator LEVIN. OK. Second paragraph——

Ms. LAGACY. Which page?

Senator LEVIN. It says, “Mr. Larson.” Who is that?

Ms. LAGACY. I do not see that in the document.

Senator LEVIN. OK. Is this a Board of Directors meeting you have, the minutes?

Ms. LAGACY. Caterpillar Board of Directors Minutes Excerpts.

Senator LEVIN. Yes.

Ms. LAGACY. It starts with page 5?

Senator LEVIN. Well, look at 1857 at the bottom, page 8.

Ms. LAGACY. OK.

Senator LEVIN. “Larson,” do you see that there?

Ms. LAGACY. Yes.

Senator LEVIN. “Larson next described the efforts underway to transform the parts distribution business from a United States centric model”—this is 2012, there are “efforts underway to transform the parts distribution business from a United States centric model.” So in February 2012, about a year ago, your parts distribution business is called “United States centric.” That is what was told to the Board of Directors. Are you aware of that?

Ms. LAGACY. No, I am reading those words on this page. I was not involved in this meeting, so I do not know the context under which this discussion occurred. But, again, I can tell you that we

¹ See Exhibit No. 18, which appears in the Appendix on page 411.

have employees and parts being handled all around the world by a number of people today and have for many years.

Senator LEVIN. I am sure of that. That is not the question. The question is whether 85/15 is an appropriate split of profits on your parts, international parts deal, business.

Ms. LAGACY. I would like to respond to that, if I could, Mr. Chairman.

Senator LEVIN. Well, let me keep to these questions. "Mr. Larson next described the efforts underway to transform the parts distribution business from a United States centric model"—this is a year ago, and you are not aware of that description to the Board of Directors. Is that correct, you are not aware of that by Mr. Larson?

Ms. LAGACY. No. I mean, I was not a part of this.

Senator LEVIN. This is the first you have seen that?

Ms. LAGACY. If I have seen it at all, it has been simply for preparation for this hearing.

Senator LEVIN. All right. Now, there was a discussion here at the board meeting, according to the title there, on "Parts Growth and Distribution Facility Footprint Expansion." That was at the board meeting. Did you know that the board was going to be discussing that in February 2012?

Ms. LAGACY. I did not.

Senator LEVIN. OK. Now, let me ask you, Mr. Beran, information which has been provided to the Subcommittee by Caterpillar shows that 70 percent of all purchased finished replacement parts sold offshore were manufactured in the United States. That is a chart we are going to put up. That is Exhibit 1f,¹ which is the same thing as the chart. And I think, Ms. Lagacy, you used the same figure a moment ago. Is that correct?

Ms. LAGACY. Yes, approximately 70 percent—

Senator LEVIN. Of all purchased finished replacement parts sold offshore manufactured in the United States, correct?

Ms. LAGACY. Yes.

Senator LEVIN. OK. Mr. Beran, would you—

Ms. LAGACY. Purchased finished, replacement parts again, by suppliers, yes.

Senator LEVIN. Right. Do you agree with that, Mr. Beran?

Mr. BERAN. Yes.

Senator LEVIN. And how many purchased finished replacement parts are manufactured in Switzerland, Mr. Beran?

Mr. BERAN. Narrowing things down to Switzerland does not describe—

Senator LEVIN. I am just asking you a question. You would ask yourself a different question. How many parts are manufactured in Switzerland?

Mr. BERAN. CSARL manages—

Senator LEVIN. Could you answer my question, please, and I am not asking you what you think they manage. We have gone through that. I am asking you a simple, direct question.

Mr. BERAN. They do not have any manufacturing in Switzerland.

¹ See Exhibit No. 1f, which appears in the Appendix on page 281.

Senator LEVIN. Thank you. Now, what percentage of how many warehouses are there in Switzerland, Caterpillar warehouses or CSARL warehouses? Do you know?

Mr. BERAN. None, to my knowledge.

Senator LEVIN. Do you know how many warehouses there are in the United States, Caterpillar warehouses?

Mr. BERAN. I think we discussed earlier there are around 10, but I do not know the exact number.

Senator LEVIN. Is it true, Mr. Beran, that Caterpillar has its largest parts warehouse and manages its global parts inventory in Morton, Illinois? The largest parts warehouse of Caterpillar in Morton, Illinois. That is my question.

Mr. BERAN. Morton has a very sizable facility. I think it is the largest.

Senator LEVIN. Thank you.

Mr. BERAN. But we have large ones in Belgium, in Singapore, in—

Senator LEVIN. None in Switzerland.

Mr. BERAN. None in Switzerland. All of them are owned by CSARL or one of its subsidiaries.

Senator LEVIN. I understand. You say “owned”? CSARL owns those?

Mr. BERAN. Owns—

Senator LEVIN. Who owns CSARL?

Mr. BERAN. CSARL owns all of the—excuse me?

Senator LEVIN. Who owns CSARL?

Mr. BERAN. Ultimately it is owned by Caterpillar Inc., but every government in the world expects us to report by legal entity.

Senator LEVIN. Right. So CSARL is owned by Caterpillar.

Mr. BERAN. That is correct.

Senator LEVIN. You say CSARL owns those warehouses?

Mr. BERAN. CSARL either owns the warehouses or owns the entity that owns them.

Senator LEVIN. Right, and who owns the entity that owns CSARL?

Mr. BERAN. Ultimately Caterpillar Inc.

Senator LEVIN. Fine. Are the names Stuart Levenick, Stephen Gosselin, Stephen Larson, and Barbara Hodel—are those names familiar to you?

Mr. BERAN. I recognize those names, yes.

Senator LEVIN. Do you know those names, Ms. Lagacy?

Ms. LAGACY. Yes, I do.

Senator LEVIN. Do they work in the United States? Do you know?

Ms. LAGACY. Could you read the list again? I am sorry. Stu Levenick—

Senator LEVIN. Stuart Levenick?

Ms. LAGACY. Yes.

Senator LEVIN. Stephen Gosselin, Stephen Larson, and Barbara Hodel.

Ms. LAGACY. Yes, all of them work in the United States.

Senator LEVIN. Are they key leaders of Caterpillar’s parts business?

Ms. LAGACY. They are key leaders, but, again, keep in mind we do not have a parts business.

Senator LEVIN. I am sure, but are they key leaders in the parts part of your business?

Ms. LAGACY. They are key leaders of Caterpillar.

Senator LEVIN. And do they work heavily in the parts part of Caterpillar, even though it is not signified as parts separately?

Ms. LAGACY. They have, again, especially Stu Levenick would have multiple responsibilities that would go well beyond parts, but he does have some responsibilities there also.

Senator LEVIN. And how about Stephen Gosselin? Does he have significant—

Ms. LAGACY. He has significant overall product support responsibilities, but, again, not all of those—

Senator LEVIN. Does that include parts?

Ms. LAGACY. Yes.

Senator LEVIN. Stephen Larson.

Ms. LAGACY. Stephen Larson has retired.

Senator LEVIN. OK. Barbara Hodel?

Ms. LAGACY. Barb Hodel works in our parts distribution area, logistics.

Senator LEVIN. Does she work in the United States?

Ms. LAGACY. Yes, she does.

Senator LEVIN. OK. Do you know how many parts approximately are warehoused in the United States?

Ms. LAGACY. I do not.

Senator LEVIN. Do you know, Mr. Beran?

Mr. BERAN. The number of parts—

Senator LEVIN. Approximately, within a hundred million or so, warehoused in the United States. Would you know, Mr. Perkins?

Mr. PERKINS. No, I do not.

Senator LEVIN. How about within half a billion?

Ms. LAGACY. I would say in total I believe we have just under a million serviceable replacement parts. I do not know how many of those are stocked in the United States.

Senator LEVIN. Would it surprise you to know that there is about a billion and a half parts, not types of parts but parts, that are warehoused in the United States?

Ms. LAGACY. I do not know that number.

Senator LEVIN. OK. It would not surprise you?

Ms. LAGACY. Individual, so not part numbers but just individual numbers of parts, I frankly have no idea how many there might be housed in the United States.

Senator LEVIN. OK. Would you take a look, please, at Exhibit 53?¹

Ms. LAGACY. I do not have an Exhibit 53 in my book.

Senator LEVIN. OK.

Ms. LAGACY. Thank you.

Senator LEVIN. Do you have it now?

Ms. LAGACY. Yes.

Senator LEVIN. OK. I want to talk to you about the value of what was transferred to CSARL as part of the license: "What intangible

¹ See Exhibit No. 53, which appears in the Appendix on page 600.

property will be transferred from CAT Inc. to COSARL under the replacement parts license?" "Under the replacement parts license," that is what we are talking about, replacement parts, not machines, replacement parts license.

So, first, please note that the document talks about parts, not machines, and "COSARL" refers to what we have been calling "CSARL."

So here is what was planned to be transferred: patents and designs; parts, including patented elements; trademarks; parts sold under CAT trademark; contracts; buying from suppliers Caterpillar already has screened, qualified, negotiated prices with; systems and procedures; CAT proprietary LogNet information; know-how, methods, forecasts, estimates.

Now, if you take a look at Exhibit 51,¹ if you would, page 2 under "Intellectual Property." This was transferred. Intellectual property includes, but is not limited to, know-how, processes, designs, specifications, engineering standards, trade secrets, inventions, patent applications, patents, copyrights, trademarks, Caterpillar production system, customer lists, supplier lists, systems and more.

So the economic rights to use that were transferred to your subsidiary in a tax haven. Would you have transferred all that to anyone but a related party? Now you have a chance to answer that question. Ms. Lagacy.

Ms. LAGACY. Keep in mind that again I do not agree with your characterization of a tax haven, but——

Senator LEVIN. You do not think Switzerland is a tax haven?

Ms. LAGACY. I do not really know the definition of a "tax haven."

Senator LEVIN. Oh, OK. But you said you disagreed with my definition.

Ms. LAGACY. Right, so I would not——

Senator LEVIN. Obviously you do not know what a definition is.

Ms. LAGACY. It is where we have done business and where we had headquarters since 1960.

Senator LEVIN. All right. But it is a low-tax jurisdiction under your own documents, and that was one of the purposes of these transfers. Under your own documents, to a low-tax jurisdiction. That is what it says: "Migrate profits to a low-tax jurisdiction."

Ms. LAGACY. We, again, have had a headquarters in Geneva since 1960 and found it to be a good base from which to grow our business outside the United States, and we have been fairly effective——

Senator LEVIN. Well, I am sure you said that, but take a look again at Exhibit 7:² "Benefits: Migrates profits from CAT Inc. to low-tax marketing company." It is not irrelevant, is it, that it was a low-tax marketing company? Or is it irrelevant? That is your own document. I have read it to you three times.

Ms. LAGACY. Right. This is——

Senator LEVIN. Exhibit 7, page 3 at the end: Before: "Migrate profits from CAT Inc. to low-tax marketing companies."

¹ See Exhibit No. 51, which appears in the Appendix on page 576.

² See Exhibit No. 7, which appears in the Appendix on page 343.

Ms. LAGACY. Yes, and this is a PwC document, I believe. But I certainly would agree that the tax rate in Switzerland is much lower than the tax rate in the United States.

Senator LEVIN. OK. So you use words, too, “low-tax [marketing] countries”? Don’t you ever use those words? Doesn’t Caterpillar use those same words? Yes or No.

Ms. LAGACY. We do not use the word “tax haven,” but there are certainly—

Senator LEVIN. How about “low tax” and “high tax”?

Ms. LAGACY [continuing]. Countries that are lower tax than others.

Senator LEVIN. How about “low tax”? Do you ever use those words? Take a look at Exhibit 17.¹ The number at the bottom is 5979. It has a CAT number at the bottom. Do you see it, page—I think it may be page 6 on your—do you see that?

Ms. LAGACY. Starting—the title—

Senator LEVIN. Effective tax drivers.

Ms. LAGACY [continuing]. Is “2009 Effective Tax Rate—Drivers.”

Senator LEVIN. Yes, do you see that in that oval at the right, “Losses in high tax rate countries, profits in low”? Do you see that?

Ms. LAGACY. I do see that.

Senator LEVIN. OK. My question is: Would you have transferred all that, all of that that was in the licensing agreement to anybody but a related party?

Ms. LAGACY. Again, to answer that question, keep in mind that everything that we have done has been at an arm’s-length standard, so all of that—

Senator LEVIN. Well, that is my question. Would you sell that to an unrelated party? Would you give a license to an unrelated party? That is my question.

Ms. LAGACY. That would require a business decision based on the economics of that situation. I cannot simply answer that yes or no.

Senator LEVIN. You cannot answer that no?

Ms. LAGACY. No, I cannot.

Senator LEVIN. OK. I think it is you would not answer that no. But you can answer it no because nobody in their right mind would sell to an unrelated party what Caterpillar transferred in that license agreement for nothing.

Ms. LAGACY. I think it would be—

Senator LEVIN. No company will do that.

Ms. LAGACY. And, again, it was not for nothing, of course. There is a royalty—

Senator LEVIN. Well, not for nothing. They kept 15 percent of the profits and transferred 85 percent of the profits in the future, but there was no consideration for the transfer.

Ms. LAGACY. And, again, if you look at the 15-percent number, if you consider CSARL’s full—I do not think it gives a total picture because if you consider CSARL’s total licensed business, that number is slightly above 30. And if you then add on to that the service fees and the Subpart F income, it is actually more than half of the income from CSARL that incurs U.S. tax rates.

¹ See Exhibit No. 17, which appears in the Appendix on page 403.

Senator LEVIN. My question to you is: Do you think any company would transfer with no consideration what was in that license? Are you not able to answer that? I think every corporate executive in the world would answer that, but you in front of this Subcommittee. There is no way you would transfer that to an unrelated company. Is that not true?

Ms. LAGACY. Keep in mind—

Senator LEVIN. OK. You cannot answer that. Is that right? You cannot give a yes or no answer to that?

Ms. LAGACY. I am trying to answer your question.

Senator LEVIN. Are you able to give a yes or no answer to that question?

Ms. LAGACY. I cannot give a yes or no answer to that question without understanding the full situation and the economics of what you are talking about. I think it would be irresponsible—

Senator LEVIN. I am talking about the license that was given to CSARL. That is what I have been talking about.

Ms. LAGACY. Right. There was a license granted to CSARL, and CSARL was the organization that had developed the dealer network and continued to work with the dealer network to—

Senator LEVIN. Had developed the dealer network? You mean Caterpillar never developed the dealer network?

Ms. LAGACY. COSA, CSARL's predecessor company, COSA, was in business since 19—

Senator LEVIN. Of course. I am not saying they did not help develop a dealer network, but according to your own transfer documents, the major developer was Caterpillar. I am not saying CSARL did not help develop a network.

Ms. LAGACY. Right.

Senator LEVIN. Of course they did.

Ms. LAGACY. COSA, the predecessor company to CSARL, COSA, developed that dealer network outside of the United States.

Senator LEVIN. They helped develop, but Caterpillar was the major developer of markets everywhere, according to your transfer agreement, your transfer documents, which I have read before.

Ms. LAGACY. Again, I do not agree with the statement.

Senator LEVIN. OK. All right. Are patents, trademarks, know-how, are they not crown jewels of a company?

Ms. LAGACY. Those are very important, yes.

Senator LEVIN. They were transferred to CSARL, the economic rights to those? Is that not true?

Ms. LAGACY. So, again, there was a license agreement—

Senator LEVIN. I am just asking you if it is true.

Ms. LAGACY. There was a royalty paid.

Senator LEVIN. I am just asking you if it is true.

Ms. LAGACY. My colleague Mr. Beran may be able to talk more precisely about specifically what was included in the CSARL license.

Senator LEVIN. Well, I read it to him once before. I read the patents, trademarks—OK? I read that to all of you. Are those not crown jewels of a company?

Mr. BERAN. What was transferred was the right to use them.

Senator LEVIN. Of course.

Mr. BERAN. Caterpillar did not give them up. Caterpillar Inc. continued to receive compensation——

Senator LEVIN. How much?

Mr. BERAN [continuing]. For the utilization of those.

Senator LEVIN. You are just talking about the parts profits that they retained.

Mr. BERAN. No, the patents were related not just to the parts activities but——

Senator LEVIN. I understand. I am talking about patent parts——

Mr. BERAN [continuing]. To the overall——

Senator LEVIN. Come on, Mr. Beran. We are talking about patents relating to parts.

Mr. BERAN. The patents were related to all Caterpillar IP related to product design and parts.

Senator LEVIN. And parts. That is what we are talking about. That is what the strategy related to, was parts.

Mr. BERAN. It is an overall license for the entirety of the business.

Senator LEVIN. Including the parts.

Mr. BERAN. Parts are an integral element of our overall——

Senator LEVIN. That is why I say “including the parts.”

Mr. BERAN [continuing]. Product strategy.

Senator LEVIN. That is why I said “including the parts.”

Mr. BERAN. Yes, it includes the parts.

Senator LEVIN. OK. The tax strategy, related to parts, did it not?

Mr. BERAN. It related to the overall business. We were aligning with how the product managers and the other managers of the company ran the business.

Senator LEVIN. No, I understand what you are repeating here, but I am just reading document, after document, after document, after document, parts, parts, parts, parts. That tax strategy related to parts, did it not? That is my question.

Mr. BERAN. If you talk——

Senator LEVIN. Did the tax strategy relate to parts? That is my question.

Mr. BERAN. It included parts.

Senator LEVIN. All right. It did not relate to parts. It included parts. Did you see anything other than parts? Did you ever see anything other than parts related on the documents that I have read?

Mr. BERAN. Well, Senator, if you select documents prepared by people from our logistics business, they will primarily talk about parts.

Senator LEVIN. And do you have documents with you that say that what was transferred was something other than parts?

Ms. LAGACY. Well, again, CSARL is an integrated entrepreneur——

Senator LEVIN. I know. I am just asking you——

Ms. LAGACY. That does include——

Senator LEVIN. You are talking about the documents which we got. I am just asking you, do you have other documents?

Mr. BERAN. I did not bring any documents.

Senator LEVIN. Take a look at Exhibit 7.¹ I am going to just go back to this one more time. This was the proposal that you accepted and implemented for this tax strategy in Switzerland: “Recharacterize marketing company income”—recharacterize it, mind you—“to achieve U.S. tax deferral.” And look what is said down here. What is left out? “Out of chain.”

Ms. LAGACY. I am still—

Senator LEVIN. Are you having trouble finding it?

Ms. LAGACY. Could you help me see—I am at the bottom it is 4619. Is that the—

Senator LEVIN. No.

Ms. LAGACY. OK.

Senator LEVIN. 4618.

Ms. LAGACY. OK.

Senator LEVIN. Do you see where it says, “Remove Caterpillar Inc. from the chain of title for purchased finished parts . . .”? Do you see that?

Ms. LAGACY. Yes.

Senator LEVIN. That is the strategy. I am going to read it to you for the last time, because this is the strategy, is to “Remove Caterpillar Inc. from the chain of title passage for purchased finished parts . . .” OK? I do not know—

Ms. LAGACY. But I believe—

Senator LEVIN. I know. I understand there was more than that, but I am just talking about—

Ms. LAGACY. Right, it was more than that.

Senator LEVIN. I am talking about the tax strategy.

Ms. LAGACY. Well, again, the tax strategy was established to follow the business strategy. CSARL was set up as an integrated entrepreneur, and it did include more than parts. It did also include manufacturing facilities and other things.

Senator LEVIN. All right. Mr. Perkins, if you take a look at Exhibit 34,² this is a deposition that you provided under oath in 2010 about the Swiss tax strategy designed by Pricewaterhouse for Caterpillar involving CSARL and the non-U.S. parts profits. When you were asked in that deposition, “Was there any business advantage to Caterpillar Inc. to have this arrangement”—meaning the CSARL transaction—“put in place other than the avoidance or deferral of income taxation at higher rates?” you responded under oath, “No, there was not.” Was that truthful?

Mr. PERKINS. Mr. Chairman, at the time that I gave that deposition in the employment lawsuit, it was a couple years after I had retired. In terms of the response to that specific question, that is a true statement. But I would like to have the opportunity to clarify what I did not say at that time. The activities associated with the removal of CAT Inc. from the supply chain did, in fact, have significant business activities accompanying them. When I responded to this question, I responded negatively, but the point is I—

Senator LEVIN. I know what the point is now. I am asking you was it true that, when you said to the question, was there any

¹ See Exhibit No. 7, which appears in the Appendix on page 343.

² See Exhibit No. 34, which appears in the Appendix on page 493.

business advantage to Caterpillar to have this arrangement put in place other than the avoidance or deferral of income taxation at higher rates, your answer: “No, there was not.” And my simple question to you—and I know what you would like to say now. My simple question to you is: Was that true when you said it?

Mr. PERKINS. When I responded, I am responding from a tax viewpoint, and I look at things from a financial impact, first upon legal entity, then upon the business unit, certainly from a legal entity standpoint there was a financial advantage, that legal entity changes are transparent to our business units. And so any after-tax benefit that was generated creating a financial advantage to the enterprise, that was not reflected on the business unit’s performance.

Senator LEVIN. “Question: What was the benefit to Caterpillar Inc. to have CSARL purchase finished replacement parts instead of having Caterpillar Inc., buy them and sell them to CSARL?”

Your answer: “It would alter the character of the income from CSARL from includable deemed distribution income to the U.S. [United States].”

Was that true?

Mr. PERKINS. Again, from—

Senator LEVIN. I am just asking, was your answer true?

Mr. PERKINS. Yes, it was.

Senator LEVIN. “Question:”—same deposition under oath—“So the advantage to Caterpillar Inc. would be that it would pay less Federal income tax?”

“Answer: Yes.”

Was that true when you said it?

Mr. PERKINS. Yes.

Senator LEVIN. Mr. Beran, are CSARL’s financial results included within Caterpillar’s U.S. consolidated financial statement?

Mr. BERAN. Yes, they are.

Senator LEVIN. Are any CSARL losses that might come to pass ultimately then be reflected in that financial statement?

Mr. BERAN. They would be in the financial statements; they would not necessarily be reflected in the U.S. tax returns.

Senator LEVIN. Of course. But in that financial statement, they would be included?

Mr. BERAN. In our—

Senator LEVIN. Consolidated financial—

Mr. BERAN [continuing]. Consolidated financial statements, yes, they would.

Senator LEVIN. Any of CSARL’s losses are in that consolidated Caterpillar, as the parent, financial statement. Please take a look, if you would, at Exhibit 17.¹

[Pause.]

On page 5984, it says “Cash Management, ‘Crossover’ cash build-up in Geneva.” Do you see that page?

Ms. LAGACY. Yes.

Senator LEVIN. OK. “Caterpillar Definition: Crossover occurs when offshore cash no longer can be accessed in the United States without incremental U.S. tax cost.” In other words, if you tried to

¹ See Exhibit No. 17, which appears in the Appendix on page 403.

bring that offshore cash back to the United States, you would have to pay taxes on it. And even with a credit for taxes paid in Geneva, it indicates you would have to pay 25 percent on that cash.

At the bottom it says you are working to “develop tax efficient repatriation strategies.” And then on page 12, it lists some of those strategies, with a goal of repatriating \$3 billion. It talks about loans, tax-efficient dividends, prepaying royalties, and goods prepayment.

Did you work on those strategies, do you know, Ms. Lagacy?

Ms. LAGACY. I was not there at that time, but I think I can shed some light on this general topic. We are, again, about a \$56 billion company—

Senator LEVIN. Well, I am not talking about at that time. I am saying have you continued to work—let me put it in the present—on those tax strategies?

Ms. LAGACY. We have approximately \$3.5 billion offshore at this point outside of the United States, and that is available for general corporate use and can be repatriated without significant additional U.S. tax. Most of that money is outside the United States because it is needed to run our businesses outside the United States. Again, 65 percent of our \$56 billion in sales and revenues comes from outside of the United States.

Senator LEVIN. And how much, if you repatriated, would be subject to tax here?

Ms. LAGACY. Again, because of previously taxed income, transactions that have already been taxed at the U.S. rate, a substantial sum can be returned, significant amounts can be returned, nearly all of that, without any substantial income tax in the United States.

Senator LEVIN. All right. Is there any part of that which you would have to pay a tax on, U.S. tax?

Ms. LAGACY. There might be some very minor, but it would be very insignificant. It is available for general corporate use and could be brought back to the United States without any additional significant tax burden in the United States.

Senator LEVIN. What does this mean, “tax-efficient repatriation strategies,” and why can’t you just—it says \$3 billion. Why can’t you just bring it back to the United States?

Ms. LAGACY. Again, I believe this is a 2010 document, and I am not exactly sure of the situation back in 2010 with cash. But, again, I am telling you that today I know you have situations of companies that you have talked to that have significant amounts of cash outside the United States that cannot be repatriated, but we are not one of those companies.

Senator LEVIN. All right. So, in other words, you said \$17 billion? How much did you have in cash?

Ms. LAGACY. No. We have \$3.5 billion in cash as of the end of 2013.

Senator LEVIN. And you could repatriate all of that without paying any U.S. tax on it?

Ms. LAGACY. What I said was it is available for general corporate use, and that cash could come back without significant additional U.S. tax. There may be some small amounts there.

Senator LEVIN. No. You answered the question.

Ms. LAGACY. OK.

[Pause.]

Senator LEVIN. I had made a reference before to documents that were written in the 1970s which said that CAT Inc. had the largest role with regard to market and dealer development. Do you agree with that? These are Caterpillar documents. I have read them before, today, and you were here, I believe. Exhibit 4a,¹ if you want to look at it again.

Ms. LAGACY. Yes, Exhibit 4a. Oh, this is a Pricewaterhouse document?

Senator LEVIN. Yes. The same thing was said in 1996, 1995, 1994, and 1997.

Ms. LAGACY. Right. That was stated by Pricewaterhouse.

Senator LEVIN. Right. I am just asking you, it says here, "Cat Inc. has the largest role with regard to market and dealer development," gives the reasons, it acknowledges or says that the marketing companies also have major responsibility for market development. In fact, this is their primary responsibility. That is what they do. But it says that the largest role with regard to market and dealer development is CAT Inc. Do you agree with that statement? That is what I am asking.

Mr. BERAN. Senator, at that time the U.S. market was over half the world, so by definition it would have the largest responsibility related to that.

Ms. LAGACY. But, again, as we have said, COSA had the primary responsibility, the predecessor company to CSARL, to developing that network outside of the United States.

Senator LEVIN. All right. By the way, it says it has the largest role with regard to that for three reasons. The third is, "it continues to be involved with the development and oversight of worldwide marketing programs and approaches." Did you agree with that statement?

Ms. LAGACY. Could you point me to the page that you are on now.

Senator LEVIN. The same page.

Ms. LAGACY. OK. Thank you.

Senator LEVIN. No. 3, "it continues to be involved with the development and oversight of worldwide marketing programs and approaches." Do you agree with that?

Ms. LAGACY. I would say that most of the specific marketing programs and discounting and merchandising programs and such that happen outside of the United States are driven by CSARL today.

Senator LEVIN. OK. My understanding, Ms. Lagacy, is that a dealer cannot be added or dropped from the Caterpillar network or significantly change its territory without permission from Caterpillar executives in the United States. Is that correct?

Ms. LAGACY. We have 178 dealers around the world, and I do not know that for a fact. That seems reasonable to me, but I do not know that for a fact. Or we have very little attrition—

Senator LEVIN. Do either of these other two witnesses know whether that is true?

Mr. BERAN. I do not.

¹ See Exhibit No. 4a, which appears in the Appendix on page 302.

Senator LEVIN. OK.

Mr. PERKINS. Neither do I.

Senator LEVIN. OK.

Ms. LAGACY. We have very little attrition in our dealer network around the world, so that would not happen frequently.

Senator LEVIN. Well, that I know, but I am just saying it is my understanding that a dealer cannot be added or dropped from the Caterpillar network or significantly change its territory without permission from Caterpillar executives in the United States, and you have no reason not to believe that. Is that—

Ms. LAGACY. I have no reason not to believe that. I do not know it for—

Senator LEVIN. But that is what was told to us by Caterpillar.

Ms. LAGACY. OK.

Senator LEVIN. Now, in February, Caterpillar launched a major effort to toughen oversight of its dealers around the world. Are you familiar with that, Ms. Lagacy?

Ms. LAGACY. Yes. I believe you are referring to our across-the-table initiative.

Senator LEVIN. Well, I am not sure of the name of it, but let us keep going.

Ms. LAGACY. OK.

Senator LEVIN. It required “underperforming dealers” to submit by the end of 2014 a plan for improving their sales. Is that the same initiative?

Ms. LAGACY. You said it was launched in February of this year? Yes.

Senator LEVIN. Does that sound like what you just—

Ms. LAGACY. Yes, it does sound like that.

Senator LEVIN. OK.

Ms. LAGACY. Yes.

Senator LEVIN. Now, the plan has to be submitted to and approved by Caterpillar in the United States. Is that correct?

Ms. LAGACY. I do not know—

Senator LEVIN. You do not know for sure?

Ms. LAGACY. I actually do not know that.

Senator LEVIN. Well, then let me tell you that it does, and if it is not true, you can correct for the record what I am saying. OK?

Ms. LAGACY. OK.

Senator LEVIN. It has to be approved by Stuart Levenick. Who is he?

Ms. LAGACY. He is one of our group presidents.

Senator LEVIN. Is he the group president of Caterpillar’s customer and dealer support?

Ms. LAGACY. Yes.

Senator LEVIN. He works out of Illinois?

Ms. LAGACY. He does.

Senator LEVIN. So dealers whose plans are approved then have 3 years to meet their sales targets, or they may be dropped from the network. Is that correct?

Ms. LAGACY. I do not know all the specifics of the program. The intention of the program is benchmarking amongst our dealers and looking at the dealers that are the highest performing around the

world in a number of different elements and helping to improve the performance of all of our dealers around the network.

Senator LEVIN. Right. And those dealers then have to get their plan approved or they have to meet the sales, as I understand it, targets or they may be dropped. Is that true or not?

Ms. LAGACY. I do not know. Stu Levenick's organization does include the distribution groups that are headquartered—one vice president in Geneva, one vice president in Singapore, and one vice president in the United States. And they have the distribution services responsibilities which will be coordinating the work with each of the dealers. I do not have all the details on that program.

Senator LEVIN. But he is head of the whole thing, right?

Ms. LAGACY. They report to Stu Levenick, those three distribution—

Senator LEVIN. Right, and he is in Illinois, right?

Ms. LAGACY. Yes, he is.

Senator LEVIN. OK. So it is being run out of the United States. That is the top of it, that is the responsibility for it. It is not run by CSARL, is it?

Ms. LAGACY. Well, but keep in mind—

Senator LEVIN. I know CSARL is part of it. You just told us. I am just simply—

Ms. LAGACY. Yes, but the—

Senator LEVIN. I know CSARL is part of it and so are the other distribution companies—I am just asking you, the head of this effort, the driver of this effort, the one who is going to decide whether or not a dealer stays in or is not going to be allowed to stay in is Mr. Levenick in Illinois. Is that correct?

Ms. LAGACY. Mr. Levenick will hold his vice presidents accountable—

Senator LEVIN. I am sure he will.

Ms. LAGACY [continuing]. To work with the dealers in their region, so those vice presidents have that accountability and responsibility, and, yes, they do work for Stu Levenick.

Senator LEVIN. OK. They do not work for CSARL. The head of CSARL is not the guy who makes the decision, right? It is Mr. Levenick?

Ms. LAGACY. Again, working—

Senator LEVIN. OK. That is OK?

Ms. LAGACY. OK.

Senator LEVIN. Are the Caterpillar dealers independent outfits?

Ms. LAGACY. Caterpillar dealers are—they are an independent dealer network, yes.

Senator LEVIN. All right. And who is in charge of the oversight efforts?

Ms. LAGACY. In terms of overall dealer administration, that reports into our distribution groups, of which we have three—one in Geneva, one in Singapore, and one in the United States—and their employees.

Senator LEVIN. All right. Prior to the 1999 transaction, Caterpillar U.S. had been buying purchased finished replacement parts, mostly from manufacturers here in the United States, transferring them to its Swiss affiliate, which then transferred them primarily to Caterpillar's non-U.S. dealers. Is that right? Prior to 1999.

Ms. LAGACY. Correct.

Senator LEVIN. Caterpillar reported most of the sales income on its U.S. tax return, international parts sales income on its tax return. Is that correct?

Ms. LAGACY. Mr. Beran.

Senator LEVIN. Is that right?

Mr. BERAN. Until?

Senator LEVIN. Until 1999.

Mr. BERAN. Caterpillar Inc. would have reported most of it, though a significant portion was paid out to the, what we call "commercial entities" that were responsible for manufacturing. Not all of those were in CAT Inc. or in the United States.

Senator LEVIN. Right, but most of that income would have been shown on the U.S. tax return.

Mr. BERAN. I believe most of it was, yes.

Senator LEVIN. Is it true that until 1999, 85 percent or more of its international replacement parts sales income was included on Caterpillar's U.S. tax return and about 15 percent of the income was reported as Swiss income? Is that correct? In Switzerland. In other words, would not have been reported in the United States. Is that correct?

Mr. BERAN. I do not remember the exact ratio.

Senator LEVIN. OK. Well, let us assume for the purpose of this discussion it was about that. Is that fair enough?

Mr. BERAN. OK.

Senator LEVIN. OK. So Caterpillar had a method of keeping track of profits for business purposes, something known as "accountable profits." Is that correct?

Ms. LAGACY. Yes.

Senator LEVIN. And the accountable profits which Caterpillar tracked on its internal management systems allocated income to each of the business groups throughout Caterpillar, and incentive pay was based on each group's accountable profits results.

So far are you with me? Is that true?

Ms. LAGACY. Yes.

Senator LEVIN. OK. Prior to the 1999 transaction, the accountable profits on parts sales matched the results for tax purposes. About 85 percent of the accountable profits stayed with the business groups in the United States which had designed and built and tracked and shipped the parts, while 15 percent, approximately, of the accountable profits were allocated to Switzerland in exchange for their marketing efforts. Is that correct, Mr. Beran? Roughly, in other words, the accountable profits matched the legal entity's tax reporting. Is that correct?

Mr. BERAN. I am not really familiar with the accountable profit numbers.

Senator LEVIN. Is anybody here?

Ms. LAGACY. The accountable profit system is not intended to be the same as what we report legal entity. It is an internal organizational method of helping to drive behavior. So I do not believe that we are understanding the relationship you are making.

Senator LEVIN. Well, is it not true that 85 percent approximately of the accountable profits stayed with business groups in the United States before 1999? Is that true?

Ms. LAGACY. I do not know that.

Senator LEVIN. All right. Now, the 1999 transaction significantly changed how profits were allocated for tax purposes. Would you agree with that?

Ms. LAGACY. I would say that it did not change how profits were allocated; rather, it correctly identified in 1999 where the profits were earned.

Senator LEVIN. And was that a major change from the way it was previously identified?

Ms. LAGACY. The major change was removing the unnecessary middleman in the transaction—

Senator LEVIN. I understand.

Ms. LAGACY [continuing]. Because that work had always been done by CSARL.

Senator LEVIN. Right.

Ms. LAGACY. So in setting up the—

Senator LEVIN. I understand the theory of it, and the “unnecessary middleman” is absurd—to call Caterpillar Inc. an “unnecessary middleman” is utterly absurd. You have heard that from me, and I have heard from you your explanation. But in any event, was there a major change after 1999? You just described a major change.

Ms. LAGACY. Again, so if I could be clear, the work being done in CSARL prior to 1999 and after 1999 was not a major change. The change—

Senator LEVIN. All right. I am not saying the work was—

Ms. LAGACY [continuing]. That came about—

Senator LEVIN. Listen to my question, please. I am not saying that the work was changed after 1999. It obviously was not. What I am asking you is: Did that have an impact on the allocation of—did that have an impact on the tax return?

Ms. LAGACY. Yes, in 1999, with the establishment of the license agreement, the royalty, and the service fees, and taking CAT Inc. out of the chain, there was an impact on taxes.

Senator LEVIN. OK.

Ms. LAGACY. Yes.

Senator LEVIN. OK. Now, was it understood at the time that that transaction was not going to have a negative impact on the U.S. division’s accountable profits? Was that understood, Mr. Perkins? Let me ask you.

Mr. PERKINS. Mr. Chairman, there are significant differences between legal entities and business units and accountable profits. I cannot answer that question.

Senator LEVIN. You are saying that you do not know whether or not at that time there was an understanding that that transaction was not going to have a negative impact on the U.S. division’s accountable profits?

Mr. PERKINS. Mr. Chairman—

Senator LEVIN. You do not know?

Mr. PERKINS. I do not know. I was a tax person. I was involved—

Senator LEVIN. You do not know whether there was any such understanding?

Mr. PERKINS. I do not know.

Senator LEVIN. Do you know, Mr. Beran?

Mr. BERAN. I do not really recall.

Senator LEVIN. Well, then let me tell you—do you know, Ms. Lagacy?

Ms. LAGACY. I am not aware—

Senator LEVIN. Was there an understanding?

Ms. LAGACY. I am not aware—I mean, generally what I can tell you is that the accountable profit system that we use internally to drive behavior is a before-tax system, so it typically is not including after-tax measurements.

Senator LEVIN. OK. But it is a way, is it not, of rewarding divisions for their work?

Ms. LAGACY. It is a way—

Senator LEVIN. It affects people's bonuses, does it not?

Ms. LAGACY. It is a way of establishing goals and driving business behavior, which ultimately can impact the incentive pay.

Senator LEVIN. And rewards. "Incentive pay," that is good enough.

Ms. LAGACY. Yes, it is an accountable system to drive the organization.

Senator LEVIN. OK. And is it not true that the U.S. business divisions kept about the same proportion of that accountable parts profits after the CSARL transaction?

Ms. LAGACY. I do not know that.

Senator LEVIN. Do you know, Mr. Perkins?

Mr. PERKINS. As I said earlier, as a tax person, I focused on—

Senator LEVIN. No, I am just saying, do you know?

Mr. PERKINS. I do not know.

Senator LEVIN. Do you know?

Mr. BERAN. No. The accountable system was really independent of the legal entities reporting.

Senator LEVIN. I am just asking you the question whether or not you are aware of the fact that the U.S. business divisions kept the same percentage of accountable parts profits after the transaction as they had before the transaction. They got about the same amount. Are you not aware of that? Did you not tell our staff that?

Ms. LAGACY. I think that, again, part of the confusion—

Senator LEVIN. No, no, no. Mr. Beran. Excuse me. Mr. Beran, did you not tell our staff that?

Mr. BERAN. We were not directly impacting the accountable system, so I do not know exactly what—

Senator LEVIN. That is a pretty good answer, that this, whatever we want to call it, but that transaction, that CSARL transaction and license, did not affect the accountable profits issue. Is that—

Mr. BERAN. The accountable system was not aligned with international tax law. It was—

Senator LEVIN. I understand.

Mr. BERAN [continuing]. To drive behavior. So—

Senator LEVIN. Of course it was. I am just asking you a question. It was not impacted by that major change in how the taxes were going to be paid. Is that correct?

Mr. BERAN. Not to my knowledge.

Senator LEVIN. OK. Mr. Perkins, while you were working on the CSARL structure in 1999, was it your understanding that it was

not supposed to change the operational functioning of the parts business in any significant way, just the invoicing system? Was that your understanding?

Mr. PERKINS. The invoicing system with respect to unrelated suppliers to CSARL did——

Senator LEVIN. Except for the invoicing system, my question to you is: While you were working on the CSARL structure, was it your understanding that it was not supposed to change the operational functioning of the parts business in any significant way? With that exception of invoicing, was that your understanding?

Mr. PERKINS. No. There were significant changes, both legal, accounting, as well as tax. Legal externally in terms of the contractual relationships——

Senator LEVIN. I am not saying legal. I am talking about operational functioning. My question to you has to do with the operational functioning. Was it your understanding that there was not going to be any significant change in the operational functioning of the parts business? That is my question.

Mr. PERKINS. Physical goods moved the same way after the restructuring as it did prior to the restructuring.

Senator LEVIN. Thank you.

[Pause.]

Well, there has been plenty of talk here today of suggesting that by enforcing the current tax laws, that somehow or other we are going to endanger American manufacturing. Well, I am as enthusiastic a supporter of American manufacturing as there is. At least there is no one who is more enthusiastic. But if Caterpillar has ideas for how our tax code can better support manufacturers, I am all ears. So is everybody else. It is pretty obvious that everyone on this Subcommittee would be very welcoming of such suggestions.

I am a strong supporter of R&D tax credits. I am a strong supporter of advanced manufacturing tax credits. I am a strong supporter of accelerated depreciation and energy efficiency tax credits and other tax policies that help American manufacturing. So I support tax policies that help Caterpillar and other manufacturers compete around the world.

What I do not support is making this a competition to see who has the most creative tax lawyers. I do not support tax loopholes that other manufacturers either are not positioned to exploit or refuse to exploit. We need more policies to support manufacturing, but that is not what we have here at this investigation.

Caterpillar's Swiss strategy is not the result of conscious policy-making to support American manufacturing. It is just simply a tax loophole, actual or perceived. And allowing it to continue is unfair to other companies, to American families who do not have an army of lawyers and accountants at their disposal.

So I cannot support what is going on here. I know Caterpillar is an American success story, and they have every right to be proud of that success. It is an American company. Its headquarters are here. Most of its executives are here. Most of its parts are made here. Most of its parts are stored here. Most of its parts are shipped from here. Most of its parts, forecasting, inventory management, and logistics are handled here.

But since 1999, most of its international parts profits go to Switzerland. And the contrast between Caterpillar U.S. and Swiss parts operations is dramatic. Switzerland does not manufacture any Caterpillar parts. The United States manufactures 70 percent of the parts sold abroad. Switzerland does not have a single parts warehouse. The U.S. stores one and a half billion parts. Only 65 Swiss employees handle parts versus 5,000 in the United States. Caterpillar's Swiss operation does not have the personnel, does not have the infrastructure or expertise to run a global parts business.

They have a role, obviously, in promoting parts and in working with dealers, but they do not have the personnel, the infrastructure, or the expertise to run a global parts business.

Now, everyone knows what happened here. The documents could not be clearer. It is a tax deal. Caterpillar used to pay taxes on almost all of its parts profits. That was before 1999. In 1999, Caterpillar transferred a license to its wholly owned subsidiary CSARL, which allowed it to sell Caterpillar parts, more Caterpillar parts overseas in more places. It got back a royalty equal to 15 percent of the parts profits, which meant the other 85 percent stayed in Switzerland, where, by the way, Caterpillar had negotiated a special low tax rate of 4 to 6 percent. The usual Swiss tax rate is 8.5 percent. Caterpillar used the licensing agreement to shift profits of \$8 billion to Switzerland while avoiding U.S. taxes of \$2.4 billion and counting. That is an ongoing number. It is about \$300 million a year now in tax avoidance that is going to Switzerland instead of here.

Caterpillar was not compensated for turning over its parts business to CSARL—no compensation. Even though it had spent 75 years developing the business and allowed CSARL to use its patented parts, supplier base, state-of-the-art parts tracking, forecasting, ordering and management systems it got paid less than nothing, by the way, since it traded \$1 of profits to CSARL for 15 cents in return. And at the same time, Caterpillar kept doing all of the work—that is what it was doing, that was the deal—and it continued to bear economic risk, all of the economic risk. As the parent corporation, it is a consolidated return.

No reasonable business would have transferred its crown jewels to an unrelated party for less than nothing, keep doing all the work and continuing to bear the economic risk. It is clear that the Caterpillar licensing transaction fails the arm's-length standard. It also fails the economic substance test because it had no business purpose other than tax avoidance. It started as a tax strategy, and Caterpillar paid over \$55 million to Pricewaterhouse to design and to implement it.

Yet Caterpillar asserts it acted in compliance with U.S. tax laws, and that issue is up to someone else to decide. But if Caterpillar is right, our laws need even more strengthening than I think they do. The IRS has to step up its enforcement to stop the multinational offshore profit shifting and needs to start requiring transfer pricing agreements that disclose and justify the profit splits between U.S. parents and their tax haven subsidiaries. It needs to clarify that the economic substance law applies to transfer pricing agreements, and Congress needs to pass the Stop Tax Haven Abuse

Act, which I and others have introduced, to shut down the existing offshore tax loopholes.

Thanks to all of our panelists, and again our thanks to Caterpillar and to Pricewaterhouse for their cooperation with the Subcommittee. We stand adjourned.

[Whereupon, at 2:31 p.m., the Subcommittee was adjourned.]

A P P E N D I X

Opening Statement of Senator Carl Levin Senate Permanent Subcommittee on Investigations Hearing on Caterpillar's Offshore Tax Strategy April 1, 2014

This Subcommittee for many years has investigated how some of our most profitable corporations exploit loopholes in the U.S. tax code to shift income and profits to offshore tax havens, thereby denying tax revenue to Uncle Sam. Corporate income tax revenue accounts for a smaller and smaller share of federal receipts, and today is down to about 10% of federal revenue, despite the fact that corporate profits are at an all-time high. Tax avoidance through the use of dubious tax loopholes costs the treasury tens of billions each year, making it harder for us to invest in the education, innovation and infrastructure that promote our prosperity, and to adequately fund our national security, while at the same time increasing the tax burden on families and businesses who can't employ an army of tax lawyers.

The subject of our report and of today's hearing is Caterpillar Inc. Caterpillar is an American success story that produces iconic industrial machines. But it is also a member of the corporate profit-shifting club that has transferred billions of dollars offshore to avoid paying U.S. taxes. We will examine Caterpillar's tax strategy at today's hearing. But first I want to thank Caterpillar and its accounting firm, PricewaterhouseCoopers (PWC), for their cooperation with the Subcommittee.

Headquartered in Peoria, Illinois, Caterpillar designs and builds a wide range of heavy construction equipment, power generators, and engines, assembling most of them here in the United States. On worksites around the world, its bright yellow machines are symbols of U.S. manufacturing excellence. Its revenues exceeded \$120 billion over the last two years.

In addition to manufacturing machines, Caterpillar operates a lucrative replacement parts business, selling Caterpillar-branded parts to customers around the world. It is this aspect of their business, specifically its foreign sales of replacement parts, on which this hearing will focus.

Caterpillar machines are known for their durability and dependability; they last literally for decades, a testament to their quality. To ensure their machines keep running well, Caterpillar works to deliver needed parts anywhere in the world within 24 hours of an order. This commitment limits the amount of time a machine is out of service as well as extending its life. Its parts operation helps the company maintain its reputation for building equipment that keeps working – a reputation that is key to its success.

The parts operation is also highly profitable. In many years, the parts business accounts for a majority of Caterpillar's profits despite making up just a fraction of sales. Caterpillar maximizes its parts profits by designing machines that can be repaired and maintained only with Caterpillar parts, ensuring decades of parts sales and profits.

Caterpillar branded parts are manufactured primarily by independent companies in the United States and shipped by Caterpillar around the world. Until 1999, Caterpillar Inc., or Caterpillar U.S., as we sometimes call it, was the initial buyer of these parts. When they were shipped to its foreign dealers, Caterpillar U.S. typically first passed title to marketing companies it had created, including one in Switzerland called COSA. Despite taking title, COSA never took physical delivery or even saw the parts it marketed.

COSA served as Caterpillar's marketing company and parts distributor in Europe, Africa, and the Middle East, acting as a liaison between Caterpillar U.S. and the foreign dealers, helping those dealers

with training, marketing campaigns, servicing issues, and parts inventory management. In exchange, COSA was allocated about 15% of the parts' foreign sales profits. Until 1999, the vast majority of the remaining profits from those offshore sales, usually 85% or more, were included in Caterpillar Inc.'s U.S. tax returns.

But starting in 1999, its parts operation assumed a new and key role in Caterpillar's tax strategy. That's when Caterpillar paid PWC to design and implement a Swiss tax strategy, at an eventual cost of more than \$55 million. After Caterpillar put that strategy in place, it went from reporting about 85% or more of its foreign parts profits on its U.S. tax return to reporting 15% or less to Uncle Sam, and shifting the remaining profits offshore to its Swiss affiliate. In Switzerland, Caterpillar had negotiated a special effective Swiss tax rate varying from 4% to 6%, which was below the Swiss statutory tax rate of 8.5%.

This strategy left the real-world operation of its parts business virtually unchanged; in fact, the only significant real-world impact of this arrangement was an instant major drop in Caterpillar's U.S. tax bill. From 2000 to 2012, the Swiss tax strategy shifted \$8 billion in profits from Caterpillar U.S. to its affiliate in Switzerland. This cut Caterpillar's U.S. tax bill by \$2.4 billion during that period.

The law says that transfer pricing agreements between related parties must have an economic substance — meaning a business purpose other than lowering taxes. But when one of Caterpillar's key tax managers responsible for implementing the Swiss tax strategy, Rodney Perkins, was asked, under oath, whether there was any business advantage to the Swiss transaction other than the deferral or avoidance of corporate income taxes, he stated: "No, there was not."

Though the lion's share of Caterpillar's international parts profits shifted to its Swiss affiliate, the heart and soul of Caterpillar's parts business stayed right here in the United States. Only a shadow of the parts business took place in Switzerland. A few statistics showing the disparity are depicted on this chart.

- Of Caterpillar employees who handle parts, 4900 work in the United States; less than 100 work in Switzerland.
- Of the company's 125 manufacturing plants, 54 are in the United States; none are in Switzerland.
- Of the company's 19 parts warehouses, 10 are in the United States; none are in Switzerland.
- Today, there are 1.5 billion parts stored in Caterpillar's U.S. warehouses; none are stored in Switzerland.

Put another way, despite the fact that Caterpillar now allocates only a small percentage of its worldwide parts profits to the United States, from the moment a part is first designed to when that part reaches a customer, Caterpillar U.S. is the engine behind the company's parts business:

- Parts design is centered here, with nearly 80% of the research and development dollars used to design Caterpillar machines and parts spent in the United States.
- Once designed, Caterpillar's replacement parts are manufactured primarily by third party suppliers in the United States, under the supervision of U.S. Caterpillar personnel. In 2012, those U.S. suppliers manufactured nearly 70% of the Caterpillar replacement parts sold offshore.
- Once the parts are built, the technology, expertise, and management behind a highly efficient distribution system are all here in the United States. Parts are distributed through Caterpillar's

parts logistics operation, which provides Caterpillar with one of its key competitive advantages. That operation is managed and run from the United States.

- Caterpillar's Inventory Management Group, located in Illinois, uses complicated algorithms to forecast parts demand and ensure parts are manufactured in the quantities needed.
- Caterpillar's largest parts warehouse is in Morton, Illinois, where it stores and coordinates the movement of parts around the world, helping Caterpillar's dealer network maintain inventory levels that meet customer demand and delivering even hard-to-find parts within 24 hours of an order anywhere in the world.

In short, most of Caterpillar's parts executives are here, most of its parts employees are here, most of its parts are designed here, most of its parts are built here, most of its parts are stored here, most of its orders are filled here, and most of its parts are shipped from here. Yet most of its international parts profits go to Switzerland.

In 2012, minutes of the Caterpillar Board of Directors meetings describe the company's parts distribution operations as "U.S. centric." So if the parts business is U.S. centric, how do most of the profits end up at Caterpillar's wholly owned Swiss affiliate?

Here's how.

In 1999, PWC provided the company with a list of 49 potential tax strategies to lower its taxes, including a plan to avoid or defer U.S. taxes on the foreign sales of its parts. The transaction Caterpillar adopted was legally complex, but straightforward. Caterpillar created a new Swiss affiliate called Caterpillar SARL, or "CSARL." CSARL replaced COSA as Caterpillar's leading Swiss affiliate, and Caterpillar gave CSARL a license to distribute all of the company's replacement parts outside of the United States.

This arrangement changed nothing in the actual operation of the parts business, but caused a massive change in how profits on parts sales were split. Because CSARL lacks the personnel, infrastructure or expertise to actually run the parts business, it reimburses Caterpillar U.S. its costs and a small service fee to continue running the operation. CSARL also pays Caterpillar U.S. a so-called royalty payment equal to about 15% of the profits on international parts sales, with CSARL keeping the other 85%.

Although Caterpillar spent 90 years working to build up its international parts business, the license provided Caterpillar with no compensation for the assets transferred. That license gives CSARL the rights to use Caterpillar's patents and trademarks; contracts with suppliers with whom Caterpillar had built relationships; proprietary computer systems; and the know-how, methods and data used to manage the parts business. Caterpillar U.S. receives only the 15% of future profits from the operation it developed and continues to run. So Caterpillar in the U.S. did the lion's share of the work building the business, and does most of the work of operating the business, while Caterpillar in Switzerland gets 85% of the profit from the most profitable part of Caterpillar's business.

The law says that transfer pricing agreements between related parties must meet an arm's length transaction standard. In an arm's length transaction, no company would turn over a profitable business that took decades to develop without receiving compensation. Similarly, in an arm's length transaction, no business would relinquish 85% of ongoing profits in exchange for 15% of the profits.

Not only did the arrangement change nothing about the actual operation of the parts operation, it also changed nothing on the financial statements Caterpillar shows the public and investors. That's because Caterpillar and CSARL are related companies, with the parent company issuing a consolidated

financial statement. So Caterpillar still shows the 85% of the profits sent to CSARL as its own profits on the consolidated public financial statement, while telling Uncle Sam that those profits belong to its Swiss affiliate CSARL.

Caterpillar has provided several justifications for this change in profit allocation which appear to be inconsistent with the economic reality of its operations.

Caterpillar claims that the company merely cut out a redundant middleman – Caterpillar U.S. – and arranged for its third-party suppliers to sell directly to its Swiss affiliate. The fact is that Caterpillar U.S. is not a redundant middleman in its parts business. Caterpillar U.S. continues to play the vital role of managing and leading its non-U.S. parts business the same way it always did. Caterpillar U.S. is still designing parts for Caterpillar machines, forecasting parts demand, getting the parts built, and storing and shipping the parts to dealers and customers around the world.

Caterpillar also contends that shifting 85% of the parts profits to CSARL made sense, because its Swiss affiliate provided so-called “intangible marketing” services whose substantial value had not been recognized in the past and deserves the lion’s share of profit.

But that explanation for sending most of its international parts profits to Switzerland is also inconsistent with how Caterpillar itself has valued the kind of services that CSARL provides. Prior to 1999, COSA, CSARL’s predecessor as Caterpillar’s Swiss affiliate, was one of many marketing companies Caterpillar had around the world, each performing essentially the same function of working with Caterpillar’s foreign dealers to sell and service Caterpillar parts and machines. In 1999, as part of the Swiss tax strategy, Caterpillar consolidated several of those marketing companies into CSARL. Just a few years later, in 2001, Caterpillar merged into CSARL another of its marketing companies called CACO, which represented Caterpillar with its dealers in Latin America, the Caribbean, and Canada. In connection with the CACO merger, PWC, the same firm that designed the CSARL transaction, evaluated the intangible marketing assets being transferred from CACO to CSARL, and concluded that they had little value. In other words, when CSARL was the recipient of the marketing intangibles from CACO, Caterpillar said the value was negligible. But when valuing those same intangibles as provided by CSARL, Caterpillar claimed they were so valuable they justified transferring 85% of its profits.

That’s not all. For many years, Caterpillar used an internal profit allocation system it called accountable profits, to help it decide how to award incentive pay, such as bonuses, to employees in its various divisions. Beginning in 1992, Caterpillar awarded each of its marketing companies an accountable profits share totaling about 13% of the parts profits within their regions. But when CSARL began receiving 85% or more of profits related to parts, supposedly in recognition of how valuable CSARL’s functions were, CSARL’s employees stayed at the 13% profit figure internally when it came to allocating bonuses. In other words, Caterpillar again told one thing to Uncle Sam and another to its employees about the proportionate value of CSARL’s work.

The unreality of Caterpillar’s current profits split can be illustrated by an example. Caterpillar builds a type of mining truck, the 797, shown in this chart, which works in mines around the world, for instance in the Alberta tar sands in Canada. Major components are designed, manufactured, and assembled in the United States. The engine is manufactured by Caterpillar in Indiana; the transmission is manufactured by Caterpillar in Illinois; the axles are manufactured by Caterpillar in North Carolina; the tires are manufactured by a third party supplier in South Carolina; and the driver’s cab is manufactured by a third party supplier in Illinois. When those mining trucks are assembled and sold to those mines in Alberta, they are exported from the United States, and 100% of the profits from those sales are reported on its U.S. tax return. But when an order for finished replacement parts comes in to service those trucks, even though the parts are manufactured in the United States, stored at a Caterpillar U.S. warehouse, and shipped by Caterpillar U.S. employees to Alberta, the profits on those parts go to Switzerland.

Switzerland has nothing to do with those trucks from start to finish. There is no economic basis for allocating those parts profits to Switzerland, yet that's where they go.

There's more. The unreality of the Swiss strategy can also be seen in Caterpillar's so-called "virtual inventory system." Caterpillar maintains a second set of parts inventory books solely for tax purposes. CSARL has \$525 million worth of parts stored here in the United States. None are stored in Switzerland. The parts CSARL purportedly owns here in the United States are completely commingled with the parts owned by Caterpillar U.S. So when a U.S. warehouse employee fills an order for a part, that employee has no way of knowing which part is owned by which company. The part is just shipped.

After the fact, Caterpillar's virtual inventory system flags the parts shipped outside of the United States and retroactively marks them as CSARL-owned. For hundreds of thousands of parts shipped abroad each year, however, the parts that were shipped actually belonged to Caterpillar U.S. When that happens, the virtual inventory system nevertheless shows the part as owned by CSARL, indicates it was borrowed from Caterpillar U.S. at cost, and later replaces the part when new parts are added to the warehouse inventory. This after-the-fact virtual ownership system is one more sign of how transparent the whole Swiss tax strategy is.

What is real is the U.S. tax revenue that the Swiss strategy erases. From 2000 to 2012, Caterpillar shipped \$8 billion in profits to its Swiss affiliate, reducing Caterpillar's U.S. tax bill by \$2.4 billion. At bottom, the Caterpillar case study centers on a tax strategy purchased by its tax department whose purpose was tax avoidance. It used a licensing agreement that no company would enter into with an unrelated third party. It relied on a virtual inventory system that didn't track ownership of parts. It allocated profits for tax purposes that bore no relationship to the profit allocations made for its own business purposes.

I am as big a supporter of U.S. manufacturing as you will find. But the Caterpillar case study demonstrates that offshore profit shifting is not reserved for those high tech companies that transfer intellectual property to themselves offshore. Some manufacturers, too, use offshore tax strategies to avoid paying taxes. The revenue lost to those strategies increases the tax burden on working families, and it reduces our ability to make investments in education and training, research and development, trade promotion, intellectual property protection, infrastructure, national security and more – investments on which Caterpillar and other U.S. companies depend for their success. It is long past time to stop offshore profit shifting and start ensuring that profitable U.S. multinationals meet their U.S. tax obligations.



AS PREPARED FOR DELIVERY:
Tuesday, April 1, 2014

Contact: Brian Rogers or Rachael Dean
(202) 224-7130

**OPENING STATEMENT BY SENATOR JOHN McCain AT PSI
HEARING ON CATERPILLAR'S OFFSHORE TAX STRATEGY**

Washington, D.C. – U.S. Senator John McCain (R-AZ), Ranking Member on the Permanent Subcommittee on Investigations (PSI), today delivered the following remarks at the subcommittee's hearing on Caterpillar's offshore tax strategy:

"Thank you, Mr. Chairman. After decades of growth, Caterpillar has built a global business in which 70 percent of its sales come from overseas. It is my information that at the core of Caterpillar's overseas subsidiaries is an independent dealer network that informs the company about local demand and keeps it globally competitive. The Majority's report states that many significant functions of Caterpillar's overseas parts business are managed and run from the United States. But, in my view at least, two important questions should be asked before that observation can be properly evaluated today – first, what activities are most important in generating Caterpillar's overseas sales? And, second, where are those activities conducted?

"In this case, an important factor in Caterpillar's overseas sales seems to be its independent dealer network, which is overseen and managed by Caterpillar's subsidiary in Switzerland. I understand that this committee has many important questions to ask about how Caterpillar chose to structure itself globally. I look forward to hearing from today's witnesses so we will be better informed as to the actual operations of Caterpillar and their policy implications.

"Today, the fact is that the United State of America has the highest corporate tax rate of any country in the world. There is no doubt that is a factor in moving operations overseas and, as we have seen from previous hearings, parking those profits overseas rather than bringing them back to be subjected to a 35 percent corporate tax rate.

"This makes a compelling argument for broader tax reform to ensure our tax code is fair, competitive, and a vehicle for economic growth. I thank Chairman Levin for his continuing passion on issues such as this and look forward to today's hearing. Thank you."

###

**TESTIMONY OF PROFESSOR BRET WELLS BEFORE THE
US SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS OF THE
COMMITTEE OF HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
AT THE HEARING ON CATERPILLAR'S OFFSHORE TAX STRATEGY**

April 1, 2014

My name is Bret Wells, and I am an Assistant Professor of Law at the University of Houston Law Center. I hold a JD (with honors) from the University of Texas School of Law. I have over twenty years of experience in the tax area and have published repeatedly on the topic of international taxation.

I would like to thank Senators Levin and McCain and the Subcommittee Staff for inviting me to testify¹ on the problem of homeless income and profit shifting. The Subcommittee and its staff should be commended for pursuing this important investigation on how to address profit-shifting strategies of global enterprises. The revenue lost to base erosion and profit shifting is hard to estimate due to the lack of publicly available information, but as past witnesses have testified there is a strong belief that the amount lost is substantial.² The Subcommittee's effort to protect the U.S. tax base from inappropriate base erosion is an important public service because revenue lost from profit shifting strategies exacerbates the deficit and undermines public confidence in the fairness of the tax system. We should not over-tax our multinational corporations, but Congress should ensure that our tax laws collect the nation's fair share of tax on the economic profits generated from business activities occurring within the United States.

I. Caterpillar's business strategy.

My testimony discusses the information developed by the Subcommittee Staff regarding Caterpillar's international tax planning. It is clear that Caterpillar is a highly successful company. The Caterpillar brand conveys to customers that its equipment and service is reliable, durable, and of high quality. Caterpillar's documentation confirms that the research and development related to the creation and design of the CAT equipment all occurred from within the United States. Thus, when we think about Caterpillar, we are thinking about a very successful American manufacturing business that has created remarkable equipment over a long period of time, but Caterpillar has also created a remarkable business system. In this regard, once a CAT machine is sold, it represents "an annuity" for Caterpillar because the customer will come back to Caterpillar dealerships for replacement parts to keep this machine working. In fact, a substantial portion of Caterpillar's consolidated profits is attributable to the sale of spare parts to its existing customers. Caterpillar management treats its spare parts business, and the

¹ My testimony is at the request of the Subcommittee, by letter dated March 13, 2014 from Chairman Carl Levin and Ranking Member John McCain. I am testifying in my personal capacity. My testimony does not represent the views of the University of Houston Law Center or the University of Houston.

² See Testimony of Stephen Shay Before the Senate Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affairs at the Hearing on Offshore Profit Shifting and the Internal Revenue Code at 1 (May 21, 2013).

logistics surrounding this spare parts business, as a “core business” of the company. Outside suppliers are provided the exact specifications for manufacturing spare parts, and they are provided the design specifications for their production runs. Product managers are encouraged to incorporate proprietary part designs into the Caterpillar machines whenever possible to prevent Caterpillar machines from being easily repaired with generic parts. Caterpillar personnel monitor their suppliers’ personnel to ensure that the spare parts are made to their specifications.

Caterpillar commits to its customers that it will get them a spare part anywhere in the world within 24 hours, and its ability to execute on that promise represents a key competitive advantage for the company. Caterpillar claims that its logistics organization is the best in the world. The spare parts purchasing algorithms related to this spare parts business were developed in the United States, and the information technology necessary to administer this complex logistical exercise was also developed in the United States and spearheaded by personnel located at Caterpillar’s state-of-the-art warehouse in Morton, Illinois. The careful management of its spare parts inventory, the speed of its execution in getting spare parts to any customer faster than its competitors, and Caterpillar’s tight control over the quality of its supplier network all work together to create customer satisfaction and customer loyalty.

When a Caterpillar machine breaks down, the customer’s motivation is to get this idled equipment back into operation as quickly as possible. Caterpillar’s integrated business system gives Caterpillar the ability to deliver spare parts to a customer within 24 hours anywhere in the world, thus creating a sales opportunity at the exact moment when Caterpillar can extract substantial profit margins on spare parts sales. Consequently, the sale of the Caterpillar machine creates an annuity for the company in the form of a future captive market for spare part sales, and Caterpillar’s ability to execute in this environment represents a significant source of profitability.

The other core value driver for the company is its independent dealer network. Caterpillar does not sell its equipment or spare parts to customers directly. These market development efforts are handled by the independent Caterpillar dealerships that were developed on average more than 40 years ago. This dealer network is intensely loyal (the CAT dealers “bleed yellow”). The dealer network develops the brand value of the company in the local marketplace, responds to customer needs, rents and leases Caterpillar equipment, and provides repair services for Caterpillar equipment. The Caterpillar dealers have direct access to the home office whenever there is a quality problem, and they are the frontline support for the company with its customers. Internal documents provided to the Subcommittee substantiate that Caterpillar’s Customer and Dealer Support Network business segment located in the United States serves the central role in the development of the dealer networks, in the design of the marketing systems, and in overseeing the marketing functions. The Caterpillar dealerships are independently owned, but Caterpillar integrates them fully into the company’s logistical effort with respect to its spare parts strategy. The close relationship between Caterpillar and its independent dealer network creates a significant competitive advantage for the company - one that is difficult at this point for its competitors to replicate.

In combination, the above elements serve to create a business system that represents an intangible asset, and it is this intangible asset that explains the residual profits that can be generated from the sale of spare parts that are custom designed to fit the CAT equipment.

Caterpillar is an American manufacturing success story, and the objective of the US international tax rules, and specifically the U.S. transfer pricing rules, should be to ensure that the multinational profits of this successful company are allocated appropriately to the country where those profits are created and generated.

II. Caterpillar's tax structure for its business system.

Prior to 1999, Caterpillar, Inc. purchased U.S.-origin spare parts directly from its suppliers. Caterpillar, Inc. then sold the exported spare parts to a Swiss affiliate which then on-sold those parts to the Caterpillar foreign dealerships. The profits related to the spare parts business were shared between Caterpillar, Inc. and its independent dealers. The Swiss affiliate earned only a routine profit, all of which was taxable under the Subpart F rules. The routine profit earned by this Swiss affiliate was appropriate because this minimal profit was commensurate with its minimal functional contribution in the company's supply chain.

In 1999, Caterpillar engaged in a supply chain restructuring exercise. In this restructuring, a new Swiss affiliate ("CSARL")³ would purchase spare parts directly from the Caterpillar part suppliers, thus cutting Caterpillar, Inc. out of the trading pattern. CSARL would then resell the spare parts to Caterpillar's independent foreign dealerships.⁴ CSARL acquired other internal marketing entities, and Caterpillar assigned almost no value to these marketing functions at the time Caterpillar made an outbound transfer of marketing functions to CSARL. Yet, after CSARL was created and the restructuring exercise completed, Caterpillar claimed it had found "newly discovered" marketing intangibles in the hands of CSARL that justified drastically increasing the profits allocated to Switzerland. To the extent that these intangibles originated from contributions from US affiliates, CSARL should have paid a super royalty under Section 367(d) to compensate the US affiliate in an amount commensurate to the newfound profitability of these contributed US intangibles, but the Subcommittee was provided no evidence that this was done. Caterpillar, Inc. executed an intercompany agreement to license intangibles related to the spare parts business to CSARL, and the information

³ CSARL is a partnership for US tax purposes that is owned by Caterpillar Overseas S.A., Caterpillar Overseas Credit Corporation S.A.R.L., Caterpillar Overseas Investment Holding S.A.R.L., Caterpillar Commercial Holding S.A.R.L., Caterpillar Asia Pacific L.P. and Caterpillar Product Development S.A.R.L.). For purposes of my testimony, I refer to CSARL as the relevant entity for clarity even though for some purposes under US law it is a pass-through entity for US tax purposes.

⁴ To evidence the assignment of the intangibles related to this spare parts business strategy to CSARL, Caterpillar, Inc. entered into an intercompany license agreement whereby Caterpillar, Inc. assigned all intangibles with respect to its spare parts business to CSARL in exchange for a 15% royalty. The company indicates that the royalty rate on this intercompany licensing agreement was determined so that Caterpillar, Inc. would receive only half of the residual profits related to its spare parts business. The company later reduced the royalty rate from 15% down to 4% to 6% applied on a bundled basis machine sales.

provided to the Subcommittee indicates that approximately 85% of the profits from the parts business was allocated to CSARL⁵ while less than 15% of the combined profits was allocated to Caterpillar, Inc. Statements from company personnel to the Subcommittee Staff indicates that nothing changed from a business perspective in the way that the business was operationally run as a result of this tax restructuring exercise. Caterpillar, Inc. remained the creator and developer of the equipment designs, and Caterpillar, Inc. maintained operational control over the logistics business related to the spare parts product design, procurement, and inventory management process. During this period, Caterpillar, Inc. publicly stated that its management of spare parts and its logistical capabilities represented a critical competitive advantage for the company. However, although nothing operationally changed as a result of the 1999 tax restructuring exercise, the allocation of residual profits arising from the spare parts business changed significantly. Even though the substantive functions that created the residual profits remained in Caterpillar, Inc., more than \$8 billion in profits (resulting in approximately \$2.4 billion in tax savings) was shifted away from Caterpillar, Inc. to CSARL over a twelve year period. Because CSARL bought from unrelated part supplies and sold to unrelated Caterpillar independent dealers under the new supply chain strategy, the company claimed that CSARL's income was not taxable under the Subpart F rules.⁶

III. Policy Implications.

A. Reform Proposal One: Require residual profits to be allocated under a residual profit split basis with rigorous proof needed to show that non-US affiliates provided nonroutine contributions in the creation of residual profits.

The supply chain restructuring implemented by Caterpillar and its tax advisors is premised on a transfer pricing mistake. The mistaken notion is that Caterpillar's residual profits attributable to its business system can be allocated away from the functions that generate these profits and instead allocated to a Swiss "entrepreneur entity" whose functions did not meaningfully contribute to the generation of those residual profits. The functions that contribute to customer loyalty in the foreign marketplace are attributable to Caterpillar, Inc.'s logistical capabilities developed in the United States and to the customer relationships created by the Caterpillar independent dealers. Thus, CSARL's role is that of a minimal-risk distributor that possesses no significant external customer contacts and no significant manufacturing function. In this posture, CSARL's profit margin should approach a cost-plus return. Statements from company personnel indicate that there was no functional business advantage in having CSARL inserted into the supply chain. No operational changes relative to the parts business occurred after the creation of CSARL. The only meaningful change that appears to have occurred was that product line managers were moved to Geneva, but internal documents provided to the

⁵ Over an eight year period, CSARL paid royalties to Caterpillar, Inc. representing only 9% to 16% of its reported parts profits, with an overall average of 13%. These figures imply that CSARL retained 91% to 84% of the parts each year, leading to an eight-year average of 87%.

⁶ See §954(d)(1).

committee indicate that those product line managers had a minimal role in the significant functions that contributed to the value of the spare parts business.⁷

A court should look through this supply chain restructuring exercise and see that CSARL should not receive a share of the residual profits of the parts business. But, even though a court has ample means at its disposal under current law to reach the correct substantive transfer pricing result in the Caterpillar case study, current U.S. tax law provides less guidance than it should because Section 482 does not explicitly mandate a specific transfer pricing methodology. Instead, current law leaves it to the parties and ultimately to a court to decide upon which transfer pricing methodology is the most appropriate.⁸ In Caterpillar's situation, the company took the position that no nonroutine intangibles existed when functions were transferred to CSARL, but thereafter Caterpillar inconsistently claimed that these same functions deserve a share of residual profits. This is where Congress should step in. Congress needs to make clear that residual profits cannot be allocated under any methodology that departs from a profit-split methodology and that every transfer pricing result must be confirmed by the use of a profit-split analysis.⁹ Allowing residual profits to simply migrate to a "tax haven entrepreneur" is a mistake. If all of the functions that create residual profits reside in the United States, then all the residual profits should be allocated to the United States. The residual profit split methodology¹⁰ ensures that this is done because that specific transfer pricing methodology requires that all residual profits be allocated solely to the substantive nonroutine functions that create residual profits and requires an affirmative showing that the foreign affiliate made a substantial contribution toward the creation of the business system that generates those residual profits as a condition precedent to receiving a share of residual profits.

The Caterpillar case study presents a base erosion problem by a U.S. multinational company, but the base erosion opportunities afforded by aggressive supply chain restructuring transactions are equally available to foreign-owned multinational companies as well. So, reform should apply even-handedly and must work in both the inbound and outbound context. To achieve an even-handed reform, Congress must fix the U.S. transfer pricing rules.

B. Caterpillar's unwillingness to make operational changes as part of the 1999 restructuring may have created a de facto partnership.

The fact that nothing operationally changed as a result of Caterpillar's 1999 tax restructuring exercise represents a potentially fatal implementation flaw. All inventory is initially purchased in the name of CSARL, and the US-destined portion of the inventory

⁷ A representative internal email stated as follows:

Yes. We actually view it as almost no change in that the Geneva based PMs never had WW responsibility to begin with. But, we worry about making it sound like the Geneva based PMs have very little authority going forward, or that we publicly state the Geneva management isn't very involved in managing these products.

⁸ See Treas. Reg. §1.482-1(c).

⁹ See Treas. Reg. §1.482-6(c).

¹⁰ See Treas. Reg. §1.482-6(c).

is then immediately resold over to Caterpillar, Inc. at cost. This division of the common inventory is based on a projection of where the spare parts will actually be used. Tax advisors to the company told the Subcommittee Staff that they had originally suggested that the company physically segregate the inventory so that this bifurcated ownership would be clearly defined from the outset, but this suggestion (in the advisor's own words) was "laughed out of the room." Although the company's spare parts inventory is purchased entirely for CSARL, a substantial portion of the spare parts is bought by CSARL with the expectation that it will be sold to Caterpillar, Inc. at cost. Furthermore, after the inventory is initially divided up, the inventory is regularly shared back and forth among CSARL and Caterpillar, Inc. on an ongoing basis as inventory is needed in different locations. So, both parties (Caterpillar, Inc. and CSARL) have an expectation to jointly profit from the unsold inventory, and the course-of-conduct among the parties indicates that both affiliates share the financial benefits of this unsold inventory based on which territory the products are ultimately needed, not based on which affiliate is designated as the owner of the physical inventory at any particular time. If the inventory is needed in the United States, then CSARL simply assigns the inventory back to Caterpillar, Inc. Thus, from a factual perspective, the ongoing operational conduct of the Caterpillar affiliates demonstrates that this property is seamlessly treated as a co-ownership arrangement where the property is co-managed for the mutual profit of both entities.

When a common pool of inventory property is owned and co-managed jointly for the mutual benefit of two entities as a joint enterprise, the courts have found that a de facto U.S. partnership arrangement has been created using a substantive facts and circumstance inquiry.¹¹ The IRS has recently argued that the internal cooperation of two related affiliated companies created an informal partnership in the domestic context, and the facts that led the IRS to that conclusion appear to be analogous to the Caterpillar case study.¹² Thus, although this issue is ultimately a factual question, a case can be made that the spare parts inventory business is being run as a joint activity for the mutual benefit of Caterpillar, Inc. and CSARL given how this virtual inventory is operationally managed.¹³

If the joint management of inventory has created a de facto U.S. partnership between Caterpillar, Inc. and CSARL, then the US partnership is likely to have a US permanent establishment.¹⁴ The existence of a U.S. permanent establishment on the part of the de facto U.S. partnership creates a U.S. taxable presence for each of the partners,

¹¹ See *Commissioner v. Culbertson*, 337 U.S. 733 (1949) (stating that relevant inquiry is to determine whether the parties in good faith and acting with a business purpose intended to join together in the present conduct of a joint enterprise for profit). The Tax Court has set forth a list of factors that other courts have used to evaluate this factual inquiry. See *Luna v. Commissioner*, 42 T.C. 1067 (1964).

¹² See CCA 201323015 (June 7, 2013) (where the IRS found that the working relationship among the affiliates created a deemed partnership among related party affiliates).

¹³ Caterpillar wants to claim that the inventory owned by CSARL should be separately respected, but then Caterpillar regularly conducts its operations in a manner that disregards the independent and exclusive ownership of that inventory, and so the operational demands of the logistics group does not match up with a fundamental precept of the 1999 tax restructuring exercise.

¹⁴ The permanent establishment is created due to Caterpillar, Inc. selling the co-managed inventory on behalf of the US partnership in the US marketplace with contract concluding authority.

including CSARL.¹⁵ Under this construct, all profits from the inventory regardless of which “partner” sold the inventory would be computed at the US partnership level.¹⁶ CSARL’s profits, therefore, would be assigned to the US partnership and subjected to US taxation since they are attributable to a US partnership that has a US taxable presence. The allocation of the profits (after-US tax) related to the foreign sales of the partnership’s inventory would represent a partnership allocation to CSARL to which US branch profits tax at a rate of 5% would apply.¹⁷ Consequently, the effect of a de facto U.S. partnership is that Caterpillar actually may be subject to a higher US tax result versus the tax results that would have occurred if Caterpillar had never conducted its 1999 tax restructuring exercise in the first place.

IV. Conclusion.

The Subcommittee is to be commended for taking the time to understand the international tax practices of multinational enterprises. These practices and strategies are not easily discernable from public filings, and Congress needs to understand this background information before it can properly formulate reform proposals that fit the current reality. The learning derived from this hearing and other similar hearings hopefully will inform Congress that base erosion and profit shifting is an important problem that needs to be addressed, and part of the solution would be to mandate that all transfer pricing results use a profit-split analysis as the primary transfer pricing methodology or as a required confirmatory check to any other methodology. Profits attributable to US-created intangibles should not end up in a jurisdiction without real substance, nor should they end up in an entity that did not meaningfully contribute toward the generation of the residual profits.

Thank you for allowing me to speak. I would be happy to answer any of your questions.

¹⁵ The sales of the common inventory into the U.S. territory by Caterpillar, Inc. on behalf of the de facto U.S. partnership creates a permanent establishment for the de facto partnership. See Article 5(5) of the Swiss-U.S. bilateral income tax treaty (1996). A permanent establishment of the de facto U.S. partnership creates a permanent establishment for each of the partners of the de facto U.S. partnership, including CSARL’s owners. See §875(1); *Donroy, Ltd. v. United States*, 301 F.2d 200 (9th Cir. 1962); Rev. Rul. 90-80, 1990-2 C.B. 170 (same).

¹⁶ All of the profits of both Caterpillar, Inc. and CSARL arising from the sale of the spare parts inventory, wherever sold, are likely to be attributed to the de facto U.S. partnership. See Article 7(2) of the Swiss-U.S. bilateral income tax treaty (1996).

¹⁷ See Article 10(7) of the Swiss-U.S. bilateral income tax treaty (1996).

**AVI-YONAH TESTIMONY FOR HEARING ON PROFIT SHIFTING
US SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
April 1, 2014**

My name is Reuven S. Avi-Yonah. I am the Irwin I. Cohn Professor of Law and Director of the International Tax Master of Law Program at the University of Michigan Law School. I hold a JD (magna cum laude) from Harvard Law School and a PhD in History from Harvard University. I have over twenty five years of full and part time experience in the tax area, and have been associated with or consultant to leading law firms like Wachtell, Lipton, Rosen & Katz and Cravath, Swaine & Moore. I have also served as consultant to the US Treasury Office of Tax Policy and as member of the executive committee of the NY State Bar Tax Section. I am a former Chair of the AALS Tax Section and of the ABA Tax Policy Committee, a trustee of the American Tax Policy Institute, a member of the Steering Group of the OECD International Network for Tax Research, a member of the American Law Institute and of the American College of Tax Counsel, and a Nonresident Fellow of the Oxford University Center on Business Taxation. I have published eleven books and over 100 articles on various aspects of US domestic and international taxation, and have twenty years of teaching experience in the tax area at Harvard, Michigan, NYU and Penn Law Schools.

I would like to thank Senators Levin and McCain and the Subcommittee staff for inviting me to testify today on the shifting of profits offshore by US multinational corporations and on the tax strategy employed by Caterpillar, Inc. ("Caterpillar") to shift profits from the U.S. to Switzerland.

1. The Caterpillar Profit Shifting Strategy

Caterpillar is "the world's leading manufacturer of construction and mining equipment, diesel and natural gas engines, industrial gas turbines and diesel-electric locomotives."¹ Founded in 1925, "[f]or more than 85 years, Caterpillar Inc. has been making progress possible and driving positive and sustainable change on every continent."²

A major reason for Caterpillar's success has been its ability to service the equipment that it sells worldwide. Caterpillar promises to deliver any replacement part anywhere in the world within 24 hours from when a customer requests it. This logistical feat puts Caterpillar far ahead of its competitors and is also a major source of profitability.³ While Caterpillar's profit margin on selling equipment is typically below

¹ www.caterpillar.com.

² www.caterpillar.com/history.

³ "Caterpillar Logistics Services, Inc. (Cat Logistics) has leveraged its relationship with parent company Caterpillar Inc. in developing true global supply chain management capabilities. Cat Logistics has grown to be the sixth largest North American based 3PL with \$1.1 billion in net revenues in 2003. It has been attracting significant external business; Caterpillar, Inc. now accounts for approximately 50% of the Cat Logistics revenues. Plans are to grow external business at a compound annual growth rate of 26% over the next five years." Evan Armstrong, Caterpillar Logistics, a True Global Supply Chain Manager, Morton, Illinois, January 11, 2005. According to an internal CAT email from 2007, machines can consume

10%, its profit margin on parts is typically over 50%.⁴ In some years, 80% of Caterpillar's profits derived from parts sales.⁵

Caterpillar's business model is based on a network of independent dealers, some of whom have been selling the company's products for over sixty years. Currently, there are 178 dealers worldwide, 48 of whom are outside the US, and they employ 162,000 people. Caterpillar's dealer network is tightly controlled from the US, and the company has recently announced that it will centralize its supervision of the dealer network even more tightly than before.

Before 1999, Caterpillar's purchased finished parts business was run primarily from Morton, Illinois, where the company maintains its main parts warehouse.⁶ When a part was manufactured in the US or overseas, it would be shipped to Morton, and from Morton it would be shipped either directly to a customer or to a dealer.⁷ Caterpillar owned the parts in the Morton warehouse. This business model enabled Caterpillar to control the flow of parts and to ensure that its promise of delivering parts to customers within 24 hours would be kept.

In September 1998, PriceWaterhouseCoopers ("PwC"), Caterpillar's auditor, presented a plan to Caterpillar management that was explicitly designed to reduce Caterpillar's US effective tax rate. The first recommendation in the PwC plan was to restructure the parts business.⁸ Under the pre-1999 structure, any profit that Caterpillar made from selling parts directly to customers in the US or overseas was taxed by the US. Moreover, any profit that Caterpillar's foreign subsidiaries made on selling parts they acquired from Caterpillar to their customers was also taxed by the US because it was "Subpart F income" and therefore resulted in a deemed dividend to Caterpillar under IRC sections 951-960. About 85% of the total profits were earned directly by Caterpillar, while the other 15% were Subpart F income.

PwC proposed to set up a Swiss entity, Caterpillar Sarl ("CSARL"), which would be treated as a corporation for Swiss tax purposes but as a partnership for US tax purposes (this was possible under the newly adopted "check the box" regime for classifying foreign entities for US tax purposes). The partners in CSARL were two Swiss subsidiaries of Caterpillar. CSARL would then assume ownership of the parts in the Morton warehouse. If those parts were intended for the US market, CSARL would sell them to Caterpillar at no profit, and Caterpillar would resell them and report the profits on its US tax return like it did before 1999. However, if the parts were intended for customers overseas, CSARL would sell them to independent dealers, which would resell

profitable replacement parts for up to 20 years, and there was little or no competition for such parts.

⁴ According to a PwC study from October 1999, Caterpillar's return on sales on "prime", or equipment, was 2%, while its return on purchased finished parts was 21%.

⁵ CSARL 2006 Royalty Rate Study (11/14/05).

⁶ In 1999, 83% of Caterpillar's worldwide parts were exported from the US.

⁷ The majority of the parts suppliers are in the US. Steines testimony, 3.

⁸ PwC, Caterpillar Plan, Appendix C, Solution 1 (September, 1998). Overall, PwC was paid about \$55 million for its contribution to reducing Caterpillar's US taxes.

to the non-USA customers, with the bulk of the profit going to CSARL.⁹

The purpose of this structure was to avoid paying US tax on the profits from the sale of parts to non-US customers by eliminating Caterpillar from the supply chain. The parts would be purchased directly by CSARL from suppliers and sold directly by CSARL to the independent dealers overseas, without ownership passing through Caterpillar. This would avoid Subpart F because it does not apply to sales by CSARL to unrelated parties outside Switzerland unless the parts were acquired from a related party (i.e., Caterpillar).

However, physically nothing was changed. The parts were still shipped by the suppliers to Morton and shipped by Caterpillar from Morton to the independent dealers, without any involvement by CSARL.¹⁰ Caterpillar still ran the logistics business as it did before, except that it did so as an agent for CSARL, the owner of the parts destined for foreign markets. CSARL had no warehouse or inventory management system, and the parts business remained “US centric.”¹¹ Moreover, there was no physical distinction at Morton between parts destined for the US market (and therefore sold to Caterpillar at zero profit) and parts destined overseas. All the parts were inventoried by Caterpillar as before, except that a “virtual inventory” was created to track for tax purposes whether any given part was owned by Caterpillar or by CSARL at any given moment.¹² Moreover, if a part intended for the US or overseas was missing, Caterpillar would “borrow” the part from CSARL, or vice versa, and restore it later as new parts came in (of course, without affecting the physical movement of any part).¹³ Currently, nearly 70% of the purchased finished parts Caterpillar sells overseas come from the US, and the parts business continues to be led and managed from the US.¹⁴

⁹ For example, if before the restructuring Caterpillar would buy a part from a supplier for 2 and sell it to a Swiss marketing subsidiary for 8, who would in turn sell to a customer or dealer outside Switzerland for 10, the result would be that Caterpillar would pay US tax on 8 (6 of its own profit and 2 Subpart F deemed dividend from the Swiss subsidiary). After the restructuring CSARL would buy the part from the supplier for 2 and sell directly to a dealer outside Switzerland for 10, and the resulting profit of 8 would belong to CSARL and not be Subpart F income because under Subpart F base company income does not include profits from sales for resale if both transactions are with unrelated parties.

¹⁰ According to Craig Barley, a senior CAT manager, in the early 2000s 85% of Cat’s worldwide parts inventory was managed from Morton, and 296 of the 300 employees involved in the parts business were located at Morton. The aim, however, was to increase the inventory managed from Morton to 100%. PWC-PSI-CAT00179037. A February 2012 memo to the board described the “as is” parts business as worldwide suppliers shipping parts to the “master distribution center” in Morton, from which they were shipped to distributors both in the US and overseas. The memo discusses future plans to open more warehouses overseas (e.g., in Dubai) to reduce the shipping costs of this US-centric structure.

¹¹ Caterpillar board minutes, February 8, 2012. For example, all of the inventory in the Grimbergen facility overseas was controlled from Morton, 5,000 and 8,000 employees involved in the parts business were in the US, and 5 of 8 parts warehouses were in North America. CAT 001896 (Feb. 2012); CAT 0002791 (December 2013). CSARL has 400 employees, or less than 0.5% of Caterpillar’s workforce (Steines report, 4).

¹² Physically, the parts were indistinguishable and kept in the same bin. Stiles deposition.

¹³ Over time, CSARL also acquired parts from Caterpillar facilities in France and Belgium, which were shipped directly from these facilities to CSARL’s customers. The French and Belgian suppliers were reimbursed on a contract manufacturing basis so once again the bulk of the profit was allocated to CSARL as the “entrepreneur” in this transaction.

¹⁴ CAT 001866 (March 7, 2014); Steines report, 5.

This “business restructuring” enabled Caterpillar to shift over \$8 billion in the period from 2000 to 2012 from the US to Switzerland without affecting the actual way in which the parts business was run.¹⁵ In fact, it was important to Caterpillar not to change the successful business model of its parts and parts delivery business, and therefore the tax department reimbursed the parts and parts delivery segments of Caterpillar for any added costs resulting from the restructuring. This resulted in maintaining the “accountable profits” of each segment of the business as if the restructuring had not taken place, which was crucial to achieving cooperation since accountable profits formed the basis for setting compensation levels.¹⁶ Nor were any personnel involved in the parts business moved to CSARL when it took over as nominal owner of all the parts in Morton.¹⁷

In order to defend this restructuring from a transfer pricing challenge by the IRS, PwC calculated a royalty rate of 15% (later reduced to 4% to 6%) to be paid by CSARL to Caterpillar to compensate it for any value inherent in its contribution to CSARL’s parts related profits. The royalty rate was based on a comparability study performed by PwC.¹⁸ If this royalty rate could be defended in court, the result would be a successful shift of 85% of the total profit from parts business from the US (30.5% effective tax rate on Caterpillar) to Switzerland (4% effective tax rate on CSARL). The total tax benefit to Caterpillar from this shift over the period from 2000 to 2012 was approximately \$2.4 billion.

2. Potential IRS Responses

There are three potential IRS lines of attack on the Caterpillar restructuring:
Economic substance, assignment of income and transfer pricing.

a. Economic Substance

The economic substance doctrine was a well-established part of tax law long before it was codified as IRC section 7701(o) in 2010. As developed by the courts, in order for a transaction to be respected for tax purposes, it must satisfy either or both prongs of the economic substance test, which are (a) the subjective prong, i.e., that the taxpayer or its agents believe that the transaction has a valid non-tax business purpose, and (b) the objective prong, i.e., that the transaction has a reasonable possibility of generating a profit regardless of the tax consequences.

¹⁵ Copeland deposition, Rapp deposition.

¹⁶ Springer deposition.

¹⁷ Stiles deposition.

¹⁸ See PwC Transfer Pricing Documentation for Caterpillar, September, 2001. The fixed royalty rate assumes that Caterpillar did not transfer any intangibles to CSARL and therefore was not subject to the “super royalty” rule of IRC sections 367(d) and 482 (which would require an adjustable royalty commensurate with the income attributable to a transferred intangible unless a cost-sharing agreement was in effect).

The IRS could argue that the Caterpillar restructuring fails to meet either prong (under the codified version it must satisfy both). On the subjective prong, the PwC documentation from 1998 onward is clear that the main purpose of the restructuring was to reduce Caterpillar's effective tax rate by removing the parent company from the parts supply chain, thereby avoiding Subpart F deemed dividends and achieving deferral for CSARL's profits.¹⁹ Moreover, a senior Caterpillar executive was asked under oath "was there any business advantage to CAT to have this arrangement put in place other than the avoidance or deferral of income taxation at a higher rate," and he answered in the negative.²⁰

On the objective prong, while CSARL's parts business is very profitable, it is hard to see what the non-tax reason could be for changing the structure from sales by Caterpillar to sales by CSARL. The entire restructuring was done so as not to change the business model of the parts business. No significant employees were moved to CSARL, the parts continued to be shipped to and from Morton by Caterpillar, and the physical parts were indistinguishable. Moreover, steps were taken to separate the ownership for tax purposes under the "virtual inventory" from the actual inventory, which remained in Caterpillar. It is true that over time CSARL assumed ownership of more parts that were not shipped through the US, but it is still hard to see what was and is the business purpose of CSARL nominally owning the parts shipped via Morton, including the parts it sells at cost to Caterpillar.

Caterpillar did subsequently try to bolster CSARL against a potential IRS challenge by moving some employees (including a "worldwide parts manager") to Geneva to "provide added entrepreneurial substance" and to "reinforce CSARL's role as entrepreneur for global parts sales."²¹ But these late efforts, coming ten years after the restructuring, only reinforce the sense that the original transaction lacked economic substance, especially since the parts business continued to be managed from the US.²²

Caterpillar could attempt to rebut the IRS challenge by relying on the *UPS* case, an 11th Circuit decision from 2001.²³ In *UPS*, the taxpayer transferred its lucrative package insurance business to an unrelated insurer, which then reinsured it with the taxpayer's affiliate in Bermuda. The net result was to shift the profits of the business (which were very high since UPS almost never loses packages) from the US to Bermuda. The Court of Appeals accepted the taxpayer's argument that since the underlying business was profitable this satisfied the objective prong, without regard to whether the transfer was

¹⁹ See PwC documentation from September 1998, December 1998 and September 1999; see also Caterpillar, *Delivering Vision 2020* (2009), which explains the tax advantage of the restructuring.

²⁰ Perkins deposition.

²¹ CSARL 2009 report to audit team (January, 2010); CSARL chronology (2010).

²² Steines report, 5.

²³ *United Parcel Service of America Inc. v. Commissioner*, 87 AFTR2d Par. 2001-1051 (11th Cir. 2001).

motivated by anything other than tax considerations. But *UPS* is distinguishable because of the intervening unrelated insurer and because there was nothing left in the US, whereas in the Caterpillar restructuring CSARL remained heavily involved in the US and in fact the Caterpillar and CSARL parts businesses were completely intermingled after the transaction.

In addition, it is far from clear that *UPS* remains good law. There have been many economic substance cases since then which took a broader view of the doctrine, and in particular the recent STARS cases indicate that you cannot imbue a tax driven transaction with economic substance by using profitable investments as part of it because the key question is whether these profits would have been earned without the transaction, which is clearly true in Caterpillar's case.²⁴

Thus, in my opinion the IRS would have had a good case to challenge Caterpillar's original restructuring on economic substance grounds.²⁵

Prof. John Steines argues in his expert opinion that the IRS is "very unlikely" to be able to prevail in a such an economic substance challenge because "Caterpillar's restructuring is of an entirely different realm [than the typical transaction struck down as lacking economic substance]- a sensible business decision to remove a redundant middleman between supplier and customers fully within the text and spirit of Subpart F."²⁶ But Caterpillar did not remove the middleman; it remained in the middle in every physical way, so that the substance of the business (managed entirely from the US with 70% of the parts shipped overseas from the US) remained entirely discrete from its form (ownership of all parts by CSARL). This situation is entirely distinct from *UPS*, which Prof. Steines heavily relies on, because in *UPS* nothing remained in the US. Moreover, Prof. Steines ignores the holding of the more recent STARS cases that cast doubt on *UPS*. Finally, Stanley Surrey, who devised Subpart F, would have been astonished to learn that a transaction designed to shift 85% of the profits from a line of business from the US to Switzerland was "fully within the text and spirit of Subpart F," since Subpart F was designed precisely to combat such tax avoidance by US companies like Dupont who shifted profits from the US to Switzerland.²⁷

²⁴ Salem Financial Inc. v. United States, No. 1:10-cv-00192 (United States Court of Federal Claims, SEPTEMBER 20, 2013); Bank of New York Mellon Corp. et al. v. Commissioner, 140 T.C. No. 2 (FEBRUARY 11, 2013).

²⁵ Since the restructuring took place in 1999/2000 these years are presumably closed and barred from further audit.

²⁶ Steines report, 16.

²⁷ The legislative history of the codification of the economic substance doctrine does indicate that the IRS will not apply it to cases in which related parties are dealing with each other at arm's length. JCX-18-10, at 152-3; IRS Guidelines for Examiners, July 16, 2012. But a transaction in which 100% of the profit is shifted for 15% compensation can hardly be said to meet this guideline.

b. Assignment of Income

Another basic tax doctrine that like economic substance dates back to the 1930s is assignment of income. Under *Lucas v. Earl* and other Supreme Court cases, a taxpayer cannot separate the income “fruit” from the “tree on which it grew” by assigning it to someone else.²⁸

One of Caterpillar and PwC’s basic assertions for transfer pricing purposes is that it is not possible to separate the parts business from the underlying sales of equipment (the “prime” business). Caterpillar acknowledged that the “sale of replacement parts is dependent on the sale of machines”.²⁹ PwC stated in 1999 that “the field population of CAT prime products creates the demand for CAT replacement parts.”³⁰ A senior Caterpillar executive testified under oath that product managers were encouraged to design machines “that would enable us to maximize parts sales,” which were much more profitable than machine sales.³¹ Former Caterpillar CEO Donald Fites has characterized the sale of parts as an “annuity” that flows from the sale of machines.³²

If that is the case, the IRS could argue that any time Caterpillar sells a machine from the US, it is also economically creating the future stream of income that is generated by selling replacement parts for this machine. In that situation the assignment of income doctrine would assign the profit from the sale of parts to Caterpillar, which sold the original machine. You cannot separate the parts fruit from the machine tree.

c. Transfer Pricing

PwC’s restructuring proposal and subsequent documentation were designed to defend Caterpillar against a transfer pricing challenge by arguing that the 15%/6% royalty adequately compensates Caterpillar for whatever value it provides to CSARL.

²⁸ *Lucas v. Earl*, 281 US 111, 114-5 (1930) (“There is no doubt that the statute could tax salaries to those who earned them and provide that the tax could not be escaped by anticipatory arrangements and contracts however skillfully devised to prevent the salary when paid from vesting even for a second in the man who earned it. That seems to us the import of the statute before us and we think that no distinction can be taken according to the motives leading to the arrangement by which the fruits are attributed to a different tree from that on which they grew.”)

²⁹ CSARL Chronology (2010).

³⁰ PwC, GLOVE economic analysis (October 1999).

³¹ Springer deposition.

³² “Donald Fites has an interesting take on this. He considers the sale of a Caterpillar machine to a customer to be analogous to an annuity that continues to pay dividends over time. Machines must be serviced and will require parts, both of which will generate business for CAT and its dealers over time. During the Great Recession of 2008-2009, this enduring source of revenue was vitally important to both CAT and its dealers because sales of some machines plummeted as much as 62 percent.” *The Caterpillar Way* (2013), p. 120; see also CAT board minutes from February 2012, referring to the sale of parts as an “annuity.”

In response to the Subcommittee staff questions, Caterpillar acknowledged that Caterpillar provides CSARL with packaging, warehousing, management of suppliers, consulting on choice of suppliers, visiting suppliers, negotiating terms for purchase and sale of parts, transportation, delivery, quality inspection and customs support. In effect, CSARL does nothing to justify its billions in profits except bear the theoretical entrepreneurial risk, which is minimal since Caterpillar's parts business is so well run. In fact, the main risk borne by CSARL is that something bad will happen to Caterpillar's equipment business, and that too is primarily a risk for Caterpillar.

In exchange for the 15%/6% royalty, Caterpillar provides CSARL with its brand name and well-known trademark, its supplier base, the entire logistics of the parts business, and its well-established distribution network. The IRS can and should argue that 15%/6% royalty is not sufficient. Specifically, the IRS should argue that the shift of 85% of the parts profits from Caterpillar to CSARL represents the transfer of a valuable intangible that is covered by the "super-royalty" rule of IRC section 367(d). Under that rule, any outbound transfer of an intangible must be compensated by a royalty "commensurate with the income" from the intangible, resulting in a shifting of the entire profit back to Caterpillar.

However, it should be noted that the IRS has not generally been successful in transfer pricing litigation and that the Caterpillar business restructuring follows a common model that many other US and foreign multinationals have adopted. Under this model, the entrepreneurial risk is located in a low tax jurisdiction and the production and distribution functions are assigned to low profit contract manufacturers and commissionaires in high tax countries. It is not clear that the IRS can succeed in challenging such structures under current law. This suggests that current law should be changed, which is a job for Congress.

3. Potential Congressional Responses

The obvious response to all attempts by US multinationals to shift profits out of the US is to abolish deferral. If US-based multinationals were taxed currently on all of their foreign source income, whether earned directly or through subsidiaries, Congress could lower the corporate tax rate dramatically and still achieve revenue neutrality. Moreover, because the OECD is currently considering ways to combat Base Erosion and Profit Shifting (BEPS), such a unilateral move by the US is likely to be followed by similar moves by other OECD countries, which need the revenues more than we do, and the resulting race to the top would alleviate any concerns about putting US-based multinationals at a competitive disadvantage.³³

³³ For a fuller exposition of this argument see Reuven S. Avi-Yonah, *Hanging Together: A Multilateral Approach to Taxing Multinationals* (2013), available on SSRN.

Such a move seems politically unlikely at present. Thus, it is interesting to consider how Caterpillar would fare under the various competing international tax reform proposals being considered by Congress.

Under President Obama's proposal, all foreign profits of US-based MNEs would be taxed currently at a minimum rate that has not been specified. Presumably, it would be higher than CSARL's 4% effective rate in Switzerland, but lower than the full 35% US rate. This will reduce but not eliminate the potential to shift.

Under Rep. Camp's proposal, Caterpillar would pay tax at between 3.5% and 8.75% on its past profits (payable in installments without interest), and then be able to repatriate them without further tax. Future profits can be repatriated for a tax of 1.25%, except that since the Swiss rate is only 4%, the effective tax rate on "Foreign Base Company Intangible Income" would be raised to 15%. This proposal will also reduce but not eliminate the shifting potential since the US rate will be 25%.

Under Sen. Baucus' proposal, CSARL's past profits would be subject to tax at 20% (payable in installments) and its future profits would be exempt from US tax except to the extent that they fall under one of the two anti-profit shifting options. Under option Z, only 60% of CSARL's profits would be subject to tax because they represent "modified active income." Modified active income is defined as "active foreign market income", which is the aggregate of all items of income "attributable to economically significant activities with respect to a qualified trade or business" and derived in connection with goods sold for consumption or disposition outside the US or services provided outside the US with respect to persons or property located outside the US. "Economically significant activities" means activities performed outside the US by officers or employees who are part of the management and operational functions of the CFC and which make a substantial contribution to the production of the income. "Qualified trade or business" means manufacturing, producing, growing, or extracting property outside the US or providing services outside the US, including making a substantial contribution to a qualified trade or business. CSARL seems to qualify under this definition so 40% of its future income would be exempt from tax even when repatriated.

Under option Y of Senator Baucus' proposal, CSARL's future income would be subject to tax at 80% of the US rate because the proposal includes as subpart F income all income of a CFC (other than income from sales into the US, which CSARL does not have) that is taxed by the foreign jurisdiction at less than 80% of the US rate. Assuming that the new US tax rate is 30%, this means that CSARL's future income would be taxed by the US at 24%. Because of this result I believe Sen. Baucus' option Y is the most promising politically realistic way of combating profit shifting schemes like the Caterpillar restructuring.

4. Conclusion

This series of hearings on profit shifting by major US multinationals has revealed a pattern in which the companies successfully move profits that are economically generated in the US to low-taxed foreign affiliates. The question is what should be done to protect the US corporate tax base and to ensure that US-based multinationals bear a fair share of the tax burden.

In my opinion the best way to address the profit shifting issue is to abolish deferral, since in the context of the OECD BEPS project this can be done on a multilateral basis, which will not put US-based multinationals at a competitive disadvantage. Such a move should be combined with a significant reduction in the US corporate tax rate. But if this option is considered politically unfeasible, the second best option is to adopt Senator Baucus' plan with option Y. That option aligns US international tax law with the laws of our major trading partners and will significantly reduce the ability of companies like Caterpillar to shift profits out of the US.

**WRITTEN TESTIMONY OF THOMAS F. QUINN
OF PRICEWATERHOUSECOOPERS LLP**

**BEFORE THE
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS OF THE
COMMITTEE ON HOMELAND SECURITY & GOVERNMENTAL AFFAIRS**

HEARING ON CATERPILLAR'S OFFSHORE TAX STRATEGY

April 1, 2014

INTRODUCTION

Good morning Chairman Levin, Ranking Member McCain, and Members of the Subcommittee.

My name is Thomas Quinn. I am a certified public accountant, and a partner at PricewaterhouseCoopers LLP ("PwC"). I began my career with PwC in 1984, and have been advising companies with respect to their federal income tax obligations for 30 years. I am joined by James Bowers, who also is a certified public accountant and a partner in PwC's tax practice. Having joined PwC in 1976, Mr. Bowers has been advising clients with respect to their tax obligations for over 37 years. I am also joined by Steven Williams, a Managing Director with PwC. Mr. Williams is an economist who holds a master's degree with a concentration in international economics. He has been with PwC since 1982, and has specialized in transfer pricing, that is, evaluating related-party transactions, for 28 years.

I understand that today's hearing relates to the tax implications of a business reorganization that Caterpillar, Inc. ("Caterpillar") began almost 15 years ago. I was one of the PwC partners who provided tax advice to Caterpillar and its outside law firm, McDermott Will & Emery ("McDermott") in connection with that matter. Mr. Bowers assisted PwC's audit team with its audit of the tax aspects of Caterpillar's financial statements. And Mr. Williams provided

Caterpillar with assistance regarding the application of the transfer pricing rules to transactions between affiliated companies.

At the outset, let me say on behalf of PwC, that we recognize both the longstanding interest of this Subcommittee in corporate tax issues and the importance of those issues. In that spirit, PwC has cooperated fully with the Subcommittee throughout this inquiry and willingly has accepted your invitation to testify here this morning.

PWC'S INTERNATIONAL TAX SERVICES PRACTICE

Before addressing our engagement with Caterpillar, allow me to provide an overview of PwC's tax practice in the United States. PwC is the leading provider of tax services worldwide in terms of both the size and scope of our tax practice, and we believe, our reputation. We strive to combine our specialized tax knowledge in national and local jurisdictions across the globe with a deep understanding of our clients' business and economic environments. As tax laws become increasingly complex and tax considerations more challenging, we assist companies to understand and meet their compliance obligations, identify and reduce tax risks, and consider tax alternatives that complement their business and operational objectives. To that end, we provide a full array of federal, international, state and local tax services to large multi-national businesses, middle-market companies, and individuals. In working with multi-national businesses, we routinely evaluate issues of international taxation. Many of our multi-national clients are subject to the tax systems of both the United States and the foreign countries in which they operate. These contexts are complex, and often the rules of various jurisdictions overlap.

We take pride in our role as an essential and productive part of global tax administration and compliance. Our policy specialists advise regulators, governments, corporations, and supra-national bodies worldwide on the technical and practical aspects of developing and implementing

tax policy initiatives. And we understand the responsibility of the Internal Revenue Service and other tax authorities to collect the revenue required by law.

**U.S. TAXATION OF FOREIGN PROFITS GENERALLY
IS DEFERRED UNTIL PROFITS ARE REMITTED TO THE U.S.**

U.S. tax laws regarding international income can be particularly complex. Generally, domestic corporations must pay corporate income tax to the Internal Revenue Service on all profits earned worldwide -- not just in the United States. Foreign corporations, on the other hand, generally pay income tax to their home country's government on income earned in their home country, and pay U.S. tax only on income from sources within the United States, and income that is effectively connected with a U.S. business. Generally, U.S. tax laws allow domestic parent companies to defer corporate income tax on profits earned by their foreign subsidiaries until the profits are remitted to the parent company in the United States. There are certain exceptions to this rule, however. For example, according to a part of the Internal Revenue Code known as Subpart F, current U.S. income tax is applied on the income of a foreign subsidiary if the income is derived from the sale of goods acquired from related parties. Under Subpart F, the U.S. tax consequences are distinctly different if a foreign subsidiary acquired property from a related party, or acquired property directly from an unrelated third-party supplier. On the other hand, generally income of a foreign subsidiary derived from the sale of goods to unrelated parties is not subject to current U.S. income tax, but rather deferred until remitted to the United States. In short, Subpart F overrides the general rule that a foreign subsidiary's foreign profit is not subject to tax until it is remitted to the United States.

CATERPILLAR'S GLOBAL OPERATIONS

With that background, I will now briefly discuss Caterpillar's operations, which provide the background for our tax work. Headquartered in Peoria, Illinois, Caterpillar and its

subsidiaries (“the Caterpillar group”) are one of the world’s largest manufacturers of construction and mining equipment, diesel and natural gas engines, and industrial gas turbines. Caterpillar equipment is sold to customers around the globe and used to build and maintain critical infrastructure, including highways, dams, airports, and the like. The Caterpillar group sells both machines, such as bulldozers, mining trucks, excavators, and other heavy equipment, as well as replacement parts for those machines. The integrated nature of the machines business and parts business is fundamental to Caterpillar’s sales proposition to its customers: reliability. Machine sales lead to parts sales, and parts sales support and encourage machine sales. Because of the machines’ intensive use and longevity, replacement parts are a critical component of the total package offered to customers. The Caterpillar group manufactures machines and some replacement parts. It also purchases replacement parts from third-party suppliers. Replacement parts manufactured by the Caterpillar group are called “worked parts,” while parts that the group purchases from third-party suppliers are referred to as “purchased finished replacement parts.” The Caterpillar group sells these products through an independent dealer network, having recognized early on that a strong, independently owned dealer organization was key to differentiating its products from the competition. In 2012, the Caterpillar group sold more than 300 different types of products to customers in 180 countries from facilities on six continents across the globe.

Since forming as the Caterpillar Tractor Co. in 1925, Caterpillar’s business has been expanding throughout the world to meet increasing global demand. In the early 1960s, sales outside the United States comprised only 37 percent of Caterpillar’s consolidated sales. Five decades later, the situation had reversed: sales outside of the United States accounted for more than 65 percent of consolidated sales. To meet that demand, Caterpillar has established

subsidiaries outside the United States to market its products and provide product support abroad. Caterpillar formed its first overseas subsidiary, Caterpillar Tractor Co. Ltd., in the United Kingdom in 1951. This company was staffed by 125 personnel who would inspect, store and distribute parts to dealers. In the 1960s, Caterpillar formed Caterpillar Overseas SA ("Caterpillar Overseas") in Switzerland, which served Europe, Africa, and the Middle East. Caterpillar also established marketing subsidiaries in other countries, including Caterpillar Brasil SA, Caterpillar Australia Pty. Ltd., and Caterpillar Far East, Ltd. By the late 1990s, Caterpillar owned interests in approximately 300 subsidiaries and other companies around the world.

Consistent with the increasing sales outside the United States, Caterpillar's independent dealer network has expanded globally. In 1970, about 46 percent of the independent dealer network was based outside the United States. Thirty years later, almost 70 percent of the company's dealers operated outside the United States. The company's workforce has followed suit. In 1970, only about 20 percent of the Caterpillar group's personnel were based outside the United States. In 2000, almost 60 percent of employees were located outside the United States. Still, in 2000, exports were responsible for 16,000 U.S. jobs and 30,000 U.S. supplier jobs, according to Caterpillar estimates.

In addition to establishing marketing facilities across the globe, Caterpillar has expanded its manufacturing facilities worldwide to meet global demand for its products. Throughout the first half of the last century, Caterpillar manufactured its products exclusively in the United States. During the post-war period, in the 1950s and 1960s, Caterpillar began establishing subsidiary manufacturing operations outside the U.S., including in the United Kingdom, Belgium, France, Brazil, and Australia. Today, the Caterpillar group manufactures products in more than a dozen states and 20 countries. In short, Caterpillar has transformed itself from a

U.S.-based manufacturer of machines and parts for sale to U.S. dealers to a global manufacturer of products and parts for dealers around the world.

**PwC'S ENGAGEMENT TO ANALYZE CATERPILLAR'S
OPERATIONS AND INTERNATIONAL TAX ALTERNATIVES**

As the globalization of Caterpillar's business continued to evolve, in 1998, Caterpillar engaged McDermott, which in turn engaged PwC, to advise the company with respect to its international tax position. By this time, we had been providing tax services to Caterpillar for over a decade. To develop our advice, PwC tax professionals first engaged in an extensive study of Caterpillar's organization and global operating footprint, spending considerable time at Caterpillar's operating facilities. For example, we interviewed the leadership of marketing units for Europe, the Asia-Pacific region, and Latin America, and on multiple occasions visited regional marketing headquarters in Switzerland, Singapore, China, Japan, Canada, and the United States, to gain a deeper understanding of the interaction with foreign joint venture partners, the role of the dealer network, and the importance of the field population of machines. We also interviewed the leadership of key business units, including Engines, Track Type Tractors, Wheel Loaders, Excavators, Forestry, and Building and Construction Products, to understand the Product Manager's role and the current and future strategies that would impact Caterpillar's sales and operational footprint. On multiple occasions we visited manufacturing facilities in France, Belgium, Brazil, the United Kingdom, Mexico, and the United States to understand the scale and scope of manufacturing operations. We also made site visits to parts warehousing facilities in Belgium, Australia, Singapore, and the United States to observe the fulfillment and logistics activities.

By directly observing the functioning of the global business, we gained an understanding of the operations, including the financial and market risks faced by the global business. We

observed that this business organization, as it existed in 1998, both failed to capture the evolution of the true economics of the business, and subjected to current U.S. taxation income earned from the sale of products to foreign customers, largely under the Subpart F rules. Working with Caterpillar's tax department and McDermott, PwC analyzed alternatives that would better align Caterpillar's operations with the true economics of the business and positively affect its global effective income tax rate.

**CATERPILLAR REORGANIZED ITS OPERATIONS
TO REFLECT THE GLOBALIZATION OF ITS BUSINESS**

After collecting and analyzing substantial information about Caterpillar's global operations, McDermott and PwC presented Caterpillar with an understanding of the tax implications of its current global operating footprint, as well as alternatives to reorganize aspects of the business to better reflect current and anticipated future operations. After reviewing the information provided by McDermott and PwC, Caterpillar decided to undertake a significant reorganization of its foreign operations.

Broadly speaking, this global reorganization involved two categories of business activity. The first was the sale of machines, and the second was the sale of purchased finished parts. With respect to machine sales, prior to the reorganization, the company's machine manufacturers outside the United States sold products to affiliates outside the United States for resale to dealers outside the United States, such as Caterpillar Overseas. Even though these machines were not manufactured or sold in the United States, their sales were captured by the Subpart F rules, and the income therefrom was taxed currently to Caterpillar as constructive dividends, regardless of whether the profits were ever remitted to the United States.

Sales of worked parts followed a similar business model. Caterpillar and its affiliates (such as Caterpillar Belgium and Caterpillar France) sold the parts to other foreign affiliates

(such as Caterpillar Overseas) for ultimate resale to third-party dealers abroad. The profits generated from both the intercompany and third-party sales fit within the Subpart F rules, and were taxed currently to Caterpillar, even when the profits were not transferred back to the United States.

With respect to sales of purchased finished replacement parts, which accounted for the bulk of foreign parts sales, Caterpillar purchased certain parts from third-party suppliers and immediately resold the parts to Swiss-based Caterpillar Overseas, which used a warehouse in Belgium. Even though many finished replacement parts were purchased originally from suppliers outside the United States, and distributed to dealers outside the United States, Caterpillar's momentary ownership subjected the resale profits of Caterpillar Overseas to current U.S. taxation under the Subpart F rules.

Considering the growth of its foreign operations, Caterpillar determined that it made business sense to centralize within one company the manufacture and distribution of products outside of the United States. This global reorganization involved substantial changes in the organizational structure of the Caterpillar group, including the transfer of functions, modification of purchase and sale activities, a shift of economic risk and opportunity, and relocation of personnel. The reorganization affected multiple entities, lines of business, and internal systems, and cut across multiple jurisdictions.

Beginning in 1999, Caterpillar Overseas transferred its assets to Caterpillar SARL, a company based in Switzerland that was largely akin to a U.S. limited liability company. Through Caterpillar Overseas, Caterpillar already had a substantial business presence in Switzerland, with hundreds of personnel based in a multi-story facility in Geneva, including a number of key corporate executives. Over the next several years, the remaining foreign marketing companies

integrated themselves into Caterpillar SARL. For example, the manufacturing and distribution operations in Singapore were transferred to Caterpillar SARL. Caterpillar SARL also engaged Caterpillar Belgium and Caterpillar France as toll manufacturers. Over the next few years, Caterpillar SARL began handling sales of machines and parts outside of the United States, while Caterpillar continued to handle sales of machines and parts in the United States. After the global business reorganization, Caterpillar SARL (i) initiated purchase orders for machines (such as medium track type tractors, wheel loaders, and hydraulic excavators) and finished replacement parts, (ii) paid for and held title to the machines and purchased finished replacement parts, (iii) bore the risk of loss (including market risk) with respect to the machines and parts, and (iv) bore the operational expenses of the sales operations. The reorganization yielded a tangible economic benefit, as Caterpillar SARL became a risk-bearing entrepreneurial company and its margins increased consistent with the increase of functions and risks.

In sum, from its outset, Caterpillar SARL carried the business and market risks and received the profits or losses from being the owner and seller of the machines and purchased finished replacement parts in the international markets. Caterpillar SARL purchased finished parts directly from third-party suppliers, and sold finished parts directly to third-party dealers. Because the sales no longer involved related-party transactions between Caterpillar and its foreign affiliates, or between foreign affiliates themselves, they were subject to the fundamental U.S. tax rule that foreign business income is not currently taxed until the income is remitted to Caterpillar in the United States. The culmination of these changes resulted in an overall increase to the operational efficiency for the Caterpillar group and significant tax savings, while allowing Caterpillar to keep jobs and assets in the United States. Caterpillar's annual effective tax rate averaged about 29 percent during the time-period.

**PWC'S EVALUATION OF CATERPILLAR SARL'S ROYALTY
RATE PURSUANT TO IRS TRANSFER PRICING RULES**

After the global business reorganization, Caterpillar's role in the reorganized business included serving as a service provider for certain purchases made by Caterpillar SARL. Caterpillar also licensed its rights to Caterpillar SARL to make machines, to purchase and distribute replacement parts, and to use Caterpillar technology and trademarks on those products for sale outside the United States. U.S. tax rules required that Caterpillar be compensated for those rights and services with an arm's length payment, which was subject to current U.S. taxation.

Because Caterpillar and Caterpillar SARL were related companies, the payment of royalties and services compensation by Caterpillar SARL to Caterpillar was subject to IRS transfer pricing rules. These rules generally address the method of testing and determining the arm's length nature of the transfer of goods, intangibles, and services to a related-party. The arm's length range of prices must reflect the prices that would have been charged in a comparable transaction between unrelated parties.

There is not one accepted method for determining whether a price falls within the arm's length range. Rather, the tax rules provide for a number of alternatives that may be considered to test the arm's length nature of prices between related parties. Under U.S. rules, the taxpayer must apply the method that will yield the most reliable result, given the facts and circumstances of the transactions, known as the "Best Method Rule." One method for determining an arm's length range in connection with the transfer of property is the Comparable Profits Method. This method analyzes objective measures of profitability, that is, whether the related party's profits fall within the range of profits earned by unrelated parties engaged in similar business activities

under similar circumstances. The Treasury regulations also require multinational entities to develop and maintain documentation memorializing their transfer pricing analysis.

Beginning in 1994, Caterpillar engaged PwC to assist the company with its analysis of the arm's length nature of certain transactions, including the royalty rate and licensing fees paid by Caterpillar SARL to Caterpillar, in order to satisfy U.S. transfer pricing documentation requirements. After evaluating each of the relevant transfer pricing methods contained in the Treasury regulations, and based on the facts and circumstances of Caterpillar's business, PwC concluded and advised Caterpillar that the Comparable Profits Method was the most reliable method. This method revealed that Caterpillar SARL's operating margins were consistent with the operating margins earned by unrelated parties engaged in similar business activities under similar circumstances. In addition to conducting this analysis under the Comparable Profits Method, PwC also analyzed these prices under each of the other relevant transfer pricing methods prescribed by the Treasury regulations. Each analysis supported the arm's length nature of Caterpillar's related-party pricing. PwC's analysis and conclusions were detailed in reports that PwC prepared for Caterpillar.

PWC'S AUDIT SERVICES TO CATERPILLAR

In addition to providing Caterpillar with various tax services as described above, PwC also has been auditing Caterpillar's financial statements for many years. We have been asked to explain how the concurrent delivery of these tax and audit services to Caterpillar complied with applicable independence rules. The delivery of tax consulting services (including tax structuring and transfer pricing advice) to audit clients subject to applicable safeguards has long been permitted by the rules of the Securities and Exchange Commission ("SEC"), the Public Company Accounting Oversight Board ("PCAOB"), and the American Institute of Certified Public

Accountants. For example, in the 2002 Sarbanes-Oxley Act, Congress endorsed the delivery of permissible tax services to audit clients, with pre-approval from the client's audit committee. In 2003, the SEC "reiterate[d] its long-standing position that an accounting firm can provide tax services to its audit clients without impairing the firm's independence."¹ Accordingly, accountants may continue to provide tax services (such as tax compliance, tax planning, and tax advice) to audit clients, subject to the normal audit committee pre-approval requirements under 2-01(c)(7). At the same time, the PCAOB Chairman made clear that: "Neither the [Sarbanes Oxley] Act nor the SEC's rules prohibit tax services that are preapproved by the company's audit committee," with the exception of certain specified categories.² Policy makers have been well aware of arguments for and against having independent audit firms also provide tax advice to the same client, and after revisiting the issue more than once, always have concluded that providing tax advice should be a permitted service, if properly approved and subject to certain safeguards.

PwC's tax and audit services to Caterpillar complied with these independence standards. PwC assessed independence before the commencement of new services and on a quarterly and yearly basis. In addition, because of our position as auditor, PwC disclosed to Caterpillar's Audit Committee any relationship that in our professional judgment bore on our independence, including our tax services. PwC also complied with the Audit Committee's policies regarding pre-approval of both audit and non-audit services, including tax services. Furthermore, during the global business reorganization, Caterpillar – not PwC – made its tax accounting and business decisions. And PwC continues to firmly believe that its tax advice and Caterpillar's tax positions

¹ SEC Final Rule, *Strengthening the Commission's Requirements Regarding Auditor Independence*, Release No. 33-8183; 34-47265; 35-27642; IC-25915; 1A-2103; FR-68, File no. S7-49-02 (effective May 6, 2003).

² Testimony of William J. McDonough, Chairman, PCAOB, before the U.S. Senate Committee on Finance (Oct. 21, 2003).

were correct under applicable tax laws. In sum, PwC's provision of tax services to Caterpillar as our audit client was entirely appropriate.

CONCLUSION

Chairman Levin, Ranking Member McCain, and Members of the Subcommittee, thank you again for this opportunity to testify about PwC's tax services with respect to Caterpillar. We firmly believed then, and firmly believe today, that the tax services we provided, and the positions that Caterpillar took in that regard, complied with the law and were entirely appropriate. Likewise, we believe that our tax and audit engagements satisfied both the letter and the spirit of the independence rules that govern our practice. We would be happy to answer any questions you have.

Statement of

Julie A. Lagacy
Vice President, Finance Services Division
Caterpillar Inc.

Accompanied by

Robin D. Beran
Director, Global Tax and Trade
Caterpillar Inc.

and

Rodney Perkins
Retired, Formerly an International Tax Manager
Caterpillar Inc.

Before the

U.S. Senate Homeland Security and Governmental Affairs Committee
Permanent Subcommittee on Investigations

Tuesday, April 1, 2014
9:30 A.M.

Good morning Chairman Levin, Ranking Member McCain, and Members of the Subcommittee. Thank you for the opportunity to appear before you today. My name is Julie Lagacy, and I'm the Vice President of Caterpillar's Finance Services Division, which includes its tax and accounting functions. I am accompanied today by Caterpillar's Director of Global Tax & Trade, Robin Beran, a 24-year Caterpillar employee, and Rod Perkins, who retired in 2009 as one of Caterpillar's International Tax Managers after 35 years of service. We are proud to represent Caterpillar before you today.

Caterpillar is a great American company, and our reputation is one of our greatest assets.

Caterpillar complies with its legal obligations with respect to the payment of taxes. We are proud of what we do. We are proud of our men and women who make it possible. And we are equally proud of our U.S. and worldwide heritage.

Our average effective tax rate of 29 percent is one of the highest for a multinational manufacturing company, and 3 percentage points higher than the average effective income tax rate for U.S. corporations, according to the U.S. Department of the Treasury. This is particularly high when you consider that more than 65 percent of our sales and revenues are abroad. Over the last 15 years, we've increased U.S. jobs by 35 percent to nearly 52,000. And we've more than tripled our exports to \$16 billion in 2013.

Over the last eight months, Caterpillar has responded to several Subcommittee questionnaires and other information requests, has produced roughly 2,000 pages of documents, has voluntarily permitted and facilitated 11 separate Subcommittee staff interviews of current and former personnel, and has sought to cooperate in every way possible with the Subcommittee's inquiry.

Background on Caterpillar

For nearly 90 years, Caterpillar has helped build the world, including the backbone of modern America. What began with two American inventors now employs over 118,000 people worldwide – and nearly 52,000 of those people are right here in the United States. When you consider our independent dealer and supplier networks, the worldwide reach of our company is even greater. At our roots, we are an American company. Our equipment was there to build the Golden Gate Bridge and create the interstate highway system. Caterpillar products, dealers and employees also show up after tragedy strikes. In Oklahoma City, at Hurricane Katrina and Ground Zero, we joined the first responders in cleaning up, powering up and paving the way for recovery.

We are proud that many of our products are "Made in America." Along the Illinois River in our East Peoria factories, we make the machine on which our company was founded – the track-type tractor, better known as the bulldozer. Just down the road in Decatur, Illinois, is the only place in the world where we make the world's largest mining truck, which stands two-and-a-half stories tall and can carry 400 tons. Eight out of ten large mining trucks made in Decatur are shipped outside the United States. There are other examples like this across the country – from engines rolling off the line in Texas, to the locomotives we are building in Indiana, or the excavators made in Georgia.

Our customers depend on Caterpillar's unmatched products, services, solutions, and the reliability of our machines. Caterpillar is the world's leading manufacturer of construction and mining equipment, diesel and natural gas engines, industrial gas turbines and diesel-electric locomotives. Throughout our history, we have always served worldwide customers, who turn to Caterpillar to help them develop infrastructure, energy and natural resource assets.

We grow and build near our customers worldwide, not only because it's what they demand but because remaining globally competitive helps create jobs right here at home. Growing where our business is means growing where our customers are located, not just in the United States but throughout the world. Most importantly, while more than 65 percent of our sales and revenues come from outside the United States, Caterpillar remains committed to our manufacturing roots here in America – that is why we continue to invest here at home with 69 facilities in 23 states and Caterpillar dealers from coast-to-coast.

In the past 15 years, we have added more than 13,000 U.S. jobs, growing from 38,000 in 1999 to nearly 52,000 in 2013. Many of these jobs came from our exports, which last year alone totaled \$16 billion. We in Peoria thought we were doing exactly what the Congress was encouraging companies like us to do. Our effort to grow U.S. manufacturing jobs was highlighted by President Obama in his 2013 State of the Union address.

Caterpillar's Approach to Taxes

You have invited us here today to discuss taxes. We would like to explain very clearly how we view our responsibility with respect to taxes, what we do, and what we don't do. Caterpillar takes very seriously its obligation to comply with the tax laws enacted by the Congress, by the states, and by all of the many jurisdictions in which we conduct business.

Caterpillar's effective income tax rate averages about 29 percent, as Caterpillar has operations and customers worldwide. Considering that the average statutory corporate income tax rate among OECD countries is 25 percent, and the average effective income tax rate for U.S. corporations is 26 percent, a 29 percent effective tax rate is a relatively high blended rate.

Caterpillar in particular is proud to pay its fair share of taxes right here in the United States.

- For the last three years, Caterpillar's average Federal income tax liability has been approximately \$600 million, for a three-year total of approximately \$1.8 billion of Federal income taxes.
- Over the same period, Caterpillar also has incurred on average approximately \$215 million in U.S. state and local income, property, and sales and use taxes, for a three-year total of approximately \$645 million in U.S. state and local taxes paid.
- Caterpillar also has remitted on average nearly \$1.8 billion in U.S. Federal and state employment taxes in each of the last three years, for a three-year total of over \$5 billion, reflecting Caterpillar's commitment to creating and maintaining U.S. jobs.

We want to emphasize that Caterpillar has fully complied with U.S. tax law with respect to the restructuring and transactions that you have asked us to discuss today. These transactions

involve the purchase of replacement parts for Caterpillar machines and engines from our suppliers and the sale of those parts to our dealers.

Specifically, the supply chain that you have asked us to address relates to purchases of replacement parts for Caterpillar machines and engines from third-party suppliers **and** sales of those parts to independent dealers outside the United States. These purchases and sales are generally made by Caterpillar's non-U.S. affiliates. As such, the affiliates' income from these sales is subject to non-U.S. tax on a current basis, and is subject to U.S. tax on a deferred basis. This is a standard multinational business structure entirely consistent with the letter and spirit of U.S. tax law.

This also has nothing to do with Caterpillar's income from sales in the *U.S.* market or with Caterpillar Inc.'s income from export sales, all of which is subject to U.S. tax on a current basis. Caterpillar does not seek or obtain any benefit of lower foreign tax rates or deferral of U.S. taxes on this sales income. In addition, some of the benefit of lower foreign tax rates on Caterpillar's non-U.S. operations accrues not to Caterpillar but instead to the U.S. Treasury, in the form of reduced foreign tax credits on income that is subject to current-basis U.S. tax.

Business Context of the Supply Chain Restructuring

Caterpillar has four reportable business segments in which separate profitability is determined. The reportable segments include Construction Industries, Resource Industries, Energy & Transportation, and Financial Products. Each of the first three segments is led by a Group President accountable for the end-to-end businesses that they manage. That is, each aspect of the product included in that segment, from design, to manufacture, to sale, and to provision of replacement parts and servicing is determined by the Group President through appointed VPs and product managers assigned to the business in that segment. Replacement parts are a key facet of each of Caterpillar's machine and engine businesses, as Caterpillar equipment is built to last for decades.

Caterpillar reaches customers through a network of independent dealers and works closely with these dealers to deliver machines, engines, and parts to the market, and to ensure a high level of customer service.

Many sales of replacement parts into non-U.S. markets are made by a Caterpillar affiliate based in Geneva, Switzerland, known as Caterpillar Sarl, or CSARL. CSARL and its predecessor entity have had a large marketing and sales presence in Geneva for more than 50 years working with dealers located outside the United States. Geneva was initially chosen as an ideal base from which to serve European markets in the postwar era, and it continues to offer advantages of geographic location and access to the talented, multicultural, and multilingual workforce that Caterpillar needs to operate effectively in the region. CSARL is no mere shell, but rather a major operating company employing hundreds of personnel in Geneva, including many of the people who perform the strategically critical work of interfacing with dealers in non-U.S. markets.

CSARL's Geneva-based employees make pricing and discounting decisions, monitor dealer financial and customer service performance, and intervene as needed when dealer performance

issues arise. Over a period of decades, these Geneva-based employees have developed the network of independent dealers that comprise the Caterpillar marketing and distribution channel in Europe, Africa, and the Middle East. The same is true of the hundreds of Singapore-based CSARL branch employees who carry out these functions and have developed the dealer network for markets in the Asia-Pacific region. These employees perform strategically critical work in enabling Caterpillar to execute its business model around the world, and their functions could not be carried out effectively from the United States.

As part of a restructuring carried out in 1999 and the early 2000s, CSARL took on additional entrepreneurial functions related to the purchase and manufacture of machines, engines, and parts, including some functions that had previously been performed in other non-U.S. locations. Since this time, CSARL has purchased replacement parts that it sells to non-U.S. dealers from unrelated suppliers both within and outside the United States and has manufactured machinery and equipment through contract manufacturing arrangements. Prior to 1999, CSARL's predecessor purchased replacement parts from Caterpillar Inc. and then on-sold them to the dealers. The removal of Caterpillar Inc. from the transactional flow has produced a simpler supply chain that better reflects the reality that CSARL is a true entrepreneur for sales of machines, engines, and parts in its territories. Caterpillar's tax reporting consistently reflects the fact that CSARL is the entrepreneur for all of these transactions, regardless of whether the result is to report high margins, low margins, or losses on CSARL's transactions—there is no “cherry picking” of winners.

The fact that this adjustment to the supply chain also eliminated unnecessary related-party transactions that were accelerating U.S. taxation of the non-U.S. sales income under the “Subpart F” anti-deferral rules does not in any way render CSARL's purchases and sales suspect under long-established tax principles. Nor does the fact that some of CSARL's inventory is commingled in U.S. warehouses with physically identical inventory owned by Caterpillar Inc.—as U.S. tax law specifically allows and indeed encourages foreign ownership of inventory in the United States for subsequent export, as well as physically commingling this inventory with identical inventory owned by others, provided inventory ownership by each relevant entity is carefully tracked, as it has been in this case.

Application of Judicial Doctrines to the Restructuring and Subsequent Supply Chain Transactions

It is universally agreed that a transaction's form must be consistent with the transaction's substance in order to be respected for tax purposes. The relevant transactions in the present inquiry are the routine purchases and sales of parts by CSARL from and to unrelated suppliers and dealers—these are the transactions by which CSARL earns the relevant income, in the ordinary course of its business. As a matter of both form and substance, CSARL purchases and sells these parts in millions of transactions with entirely unrelated parties. CSARL obtains not only legal title to these parts, but also full beneficial and economic ownership in the sense of enjoying upside potential and bearing downside risk.

The “substance over form” case law and the recently codified economic substance doctrine provide absolutely no basis for recharacterizing third-party supply chain transactions of this nature—CSARL unquestionably is the purchaser and seller for tax purposes. The fact that

CSARL may not take physical possession of some of the products, and may rely on affiliates and third parties to perform some ancillary purchasing and logistics services, does not undermine CSARL's status as purchaser, beneficial owner, and seller of the parts for tax purposes—there is ample case law establishing this proposition. Incidentally, this would be true even if CSARL did not have hundreds of employees carrying out strategically important functions directly contributing to the earning of the income in question—CSARL actually has much more “substance” than is necessary for its supply chain transactions to be respected for tax purposes.

None of the various judicial doctrines, including the economic substance doctrine, apply to disregard CSARL or recharacterize its transactions. Again, the relevant transactions are the millions of purchases and sales of parts by CSARL from and to unrelated parties, and these transactions are unquestionably respected for tax purposes.

The change in Caterpillar's contracting practices in 1999 to remove Caterpillar Inc. from the CSARL purchase-and-sale chain for foreign-bound parts is not, in and of itself, an income-generating transaction and thus is not the proper focus of any “substance” analysis under the various judicial doctrines. Case law has long established that the mere decision to pursue a business opportunity through a foreign subsidiary rather than through a U.S. entity is not subject to examination under the economic substance doctrine.

This is so because the law provides specific rules addressing the tax policy issues presented by the pursuit of business opportunities by foreign subsidiaries of U.S. corporations—the anti-deferral rules of Subpart F, and the transfer pricing rules of Code section 482 and the regulations thereunder. Thus, even if it were stipulated that the changes made in 1999 were motivated primarily by tax considerations and generated primarily tax effects, the economic substance doctrine still would not apply.

The economic substance doctrine prevents taxpayers from engaging in unnecessarily complicated transactions in order to accomplish tax results that could not be specifically foreseen by tax policy makers due to the unpredictable interactions between various tax rules as applied to a particular highly engineered set of transactions. It does not prohibit corporations from engaging in bona fide, economically based business transactions.

When relevant, the doctrine requires some demonstration of a meaningful change in economic position due to the various steps of a transaction and/or a non-tax business purpose for the various steps. The doctrine is not relevant to supply chain restructurings that actually simplify the relevant transaction flows and produce no tax savings other than those specifically contemplated and controlled by detailed tax rules. The doctrine is not relevant in determining whether a business should use a domestic or foreign corporation to pursue foreign markets. *Sam Siegel v. Commissioner*, 45 T.C. 566 (1966), *acq.* 1966-2 C.B. 7. Instead, the transfer pricing and Subpart F rules govern the allocation and deferral of income resulting from these basic supply chain arrangements.

The Congress explicitly confirmed this point when it codified the economic substance doctrine. See Joint Committee on Taxation, *Technical Explanation of the Revenue Provisions of the “Reconciliation Act of 2010,” as Amended, in Combination with the “Patient Protection and Affordable Care Act,”* JCX-18-10 (Mar. 21, 2010), at 152-53 (noting that, “under longstanding

judicial and administrative practice,” certain basic business decisions are respected even if “largely or entirely based on comparative tax advantages,” including “a U.S. person’s choice between utilizing a foreign corporation or a domestic corporation to make a foreign investment” and “the choice to utilize a related-party entity in a transaction, provided that the arm’s length standard of [Code] section 482 and other applicable concepts are satisfied”); *see also* Internal Revenue Service, LB&I Directive for Industry Directors, *et al.* regarding Guidance for Examiners and Managers on the Codified Economic Substance Doctrine and Related Penalties (LB&I-4-0711-015), July 15, 2011 (confirming same). In other words, decisions of this nature generally are not subject to second-guessing under the economic substance doctrine, even if based primarily on tax considerations, because the resulting structures are already policed by other highly developed legal regimes (*i.e.*, the Subpart F and transfer pricing rules).

Moreover, courts have explicitly interpreted, and the Congress has endorsed, the economic substance doctrine to mean that businesses are allowed to structure and restructure their foreign operations, even when motivated primarily by tax considerations and resulting primarily in tax benefits. In *United Parcel Service of America (“UPS”) v. Commissioner*, 254 F.3d 1014 (11th Cir. 2001), the taxpayer restructured its business by transferring its package insurance program to a Bermuda affiliate and then distributing the shares of that entity in a taxable dividend to the UPS shareholders. Even though the Bermuda company had no facilities or employees in Bermuda, the 11th Circuit concluded that the arrangement did not violate the economic substance doctrine. In reaching this conclusion, the court focused on the millions of transactions engaged in by the Bermuda company being challenged by the IRS, and not on the business restructuring that preceded them.

The appropriate analysis is whether CSARL’s post-restructuring transactions had substance. Applying *UPS*, CSARL and its transactions had more than ample substance. CSARL has and had several hundred employees, numerous warehouses to hold inventory for sale to its dealers, and office facilities in Geneva. Significantly, CSARL engaged in millions of transactions with third parties by purchasing replacement parts from third party suppliers and manufacturers, and selling the parts to third party dealers.

In connection with the Subcommittee’s inquiry, Caterpillar sought and received an independent review of the CSARL restructuring. Professor John Steines, a professor of tax law at New York University, reached the same conclusions that the various judicial doctrines, including the economic substance doctrine, do not apply to the restructuring. Professor Steines’s report is attached to this testimony.

If any well-advised business decided to expand today from serving purely domestic markets to serving global markets, it would establish a structure that looks like the current CSARL structure. It would conduct its foreign business through a foreign entity, and that entity would pay its U.S. parent fees for services and licensed intellectual property. The foreign entity, not the U.S. parent, would purchase whatever the entity needed in terms of inventory and other material inputs. Courts would respect this arrangement so long as the foreign corporation engaged in bona fide, economically based transactions (*Northern Indiana Public Service Co. v. Commissioner*, 115 F.3d 506 (7th Cir. 1997)). This result is clearly contemplated in the case law (*e.g.*, *UPS, Sam Siegel*) and the codification of the economic substance doctrine.

The various judicial doctrines, including the economic substance doctrine, simply do not apply to the CSARL restructuring and subsequent supply chain transactions.

Application of Transfer Pricing Regulations to the Restructuring and Subsequent Intercompany Transactions

U.S. tax law, like the tax laws of most U.S. trade and investment partners, requires that related parties price their transactions as if they were unrelated parties dealing at arm's length. The lengthy and complex transfer pricing regulations under Code section 482 set forth the methods that a taxpayer must use in determining the appropriate price for a related-party transaction. The regulations require that a taxpayer adopt the "best method" by using the method that provides the most reliable measure of an arm's length result under the facts and circumstances. A taxpayer is required to document its related-party transactions at the time of filing of the tax return in order to avoid exposure to penalties under Code section 6662, and the IRS routinely requests this documentation at the beginning of an audit. Similarly, the country where the other related party is located generally requires documentation for the same transaction. These rules apply to transactions between entities in high-tax countries (*e.g.*, United States and France), as well as in transactions between a U.S. entity and an entity in a low-tax jurisdiction.

Unlike the judicial doctrines discussed above, the transfer pricing rules obviously did and continue to apply to the transactions that the Subcommittee has asked Caterpillar to address in this hearing. The provision of intangible property rights and services to CSARL by Caterpillar Inc. is subject to the arm's length standard. Any possibility that income might be inappropriately shifted from Caterpillar Inc. to CSARL through these license and services transactions is addressed by the requirement that the royalties and service fees comply with the arm's length standard. Caterpillar has executed, documented, and priced these intercompany transactions in a manner that fully complies with the arm's length standard.

As all transfers of property rights and services are accounted for under these pricing arrangements, U.S. law does not require any separate charge or "exit fee" for the mere decision to allow CSARL to pursue a business opportunity that was previously pursued by Caterpillar Inc. Moreover, since CSARL did not purchase these property rights outright, it pays a royalty to Caterpillar Inc. and will continue to do so until the license either expires or is terminated. Although there are OECD projects and U.S. legislative proposals circulating that would impose exit fees in a wider range of circumstances, these proposals are not present law (and Caterpillar certainly could not have been expected in 1999 to foresee and apply such proposals to its own transactions).

The inapplicability of the "substance over form" and economic substance doctrines to the situation at hand represents no loophole or unintended outcome—any income-shifting concerns that structures like this could possibly present are anticipated and addressed by the transfer pricing rules and the related documentation requirement.

Application of Subpart F Law and Policy to the Restructured Supply Chain

The CSARL parts transactions also fully comply with the letter and spirit of the Subpart F anti-deferral rules.

As explained above, the sales income at issue is earned by CSARL from the purchase of parts from unrelated suppliers and the sale of these parts to unrelated foreign dealers. CSARL legally contracts with the suppliers for the purchase of parts, and the suppliers transfer to CSARL legal title, risk of loss, and other commercial risks relating to the parts in millions of routine third-party commercial transactions. CSARL markets and sells these parts to unrelated foreign dealers, with CSARL directly carrying out strategically critical marketing and selling functions through CSARL's workforce of hundreds of employees, who have developed this dealer network over the course of several decades. CSARL takes entrepreneurial risks and is exposed to entrepreneurial upside and downside. CSARL obtains important intangible property rights and services from related parties, and CSARL remunerates these related parties with substantial intercompany royalties and service fees that comport with the arm's length standard.

Since 1962, it has been perfectly clear under Subpart F that a foreign subsidiary's income from the sale of personal property cannot be Subpart F foreign base company sales income if the subsidiary, acting on its own behalf, both purchases the personal property from an unrelated person and sells the personal property to an unrelated person, as is the case for CSARL's purchases and sales of the parts at issue in today's hearing.

Subpart F provides that other factors, such as location of the manufacturing of the property, or the location where the property will be used, may be relevant to the application of Subpart F, but only in situations in which the foreign subsidiary makes the related-party purchase or sale of property necessary to implicate the Subpart F sales rules in the first place. Subpart F does not require any inquiry whatsoever into the location of manufacture, the identity of the manufacturer, or the location of the customer markets in situations involving unrelated-to-unrelated purchases and sales of inventory. Simply stated, the Congress quite clearly provided that "unrelated-to-unrelated" purchases and sales of personal property do not give rise to Subpart F income, even if the foreign subsidiary in question has nothing at all to do with the production of the property and is organized in a country other than the country of manufacture and the country of sale and ultimate use of the property. Subpart F thus imposes no requirement that CSARL employees carry out any particular activities in dealing with its suppliers, or indeed any activities at all—the fact that hundreds of CSARL employees do in fact carry out activities that are strategically important to the earning of CSARL's income means that CSARL has much more substance than Subpart F requires.

Nothing about the CSARL replacement parts supply chain or tax result offends any Subpart F policy, in view of the unmistakable clarity with which the Congress has provided that unrelated-to-unrelated purchase and sale structures do not give rise to Subpart F income, not to mention the fact that the activities directly performed by CSARL employees with respect to the marketing and sale of the products in question are far more substantial than is the case for other structures commonly observed in the marketplace (and considered without any substance-over-form objections in various court cases). If CSARL stands out among the hundreds of large multinational structures prevalent in the marketplace, it would be for the unusually *high* degree of business substance in the buying and selling entity, when in fact the law requires very little in this regard.

Subpart F also specifically envisions that a foreign subsidiary might own inventory in U.S. warehouses, for export to foreign markets. Code section 956(c)(2)(B) provides an export

property exception, establishing that a foreign subsidiary's mere ownership of inventory located in the United States does not constitute a taxable investment in U.S. property by the subsidiary, provided the property is held for export to or use in foreign markets. To do otherwise would discourage engaging U.S. suppliers in the export markets. Thus, CSARL's ownership of parts located in the United States is also entirely consistent with the law and policy of Subpart F.

Caterpillar's Use of External and Internal Tax Expertise

In planning and implementing the restructuring, Caterpillar relied on the advice of two of the world's leading tax advisory firms, as well as on the experience and judgment of its own tax department.

Suggesting that Caterpillar did not properly manage tax risk based on a reading of materials generated as part of Caterpillar's brief experiment with a so-called "guardrails" format for quantifying and describing tax risk, marketed by management consultants, would be incorrect. Caterpillar's in-house tax professionals and outside advisors manage tax risk every day, and all remain convinced that the restructuring and subsequent transactions comply with the tax code and case law dealing with the need for transactional form to comport with transactional substance. Caterpillar has never had any reservation about any fundamental "substance" issue relating to CSARL's purchases and sales of replacement parts, and nothing in the guardrails reflects any such concern.

Caterpillar further notes that the restructuring was in no way a tax shelter and was not originated as an idea by PricewaterhouseCoopers. In addition, the fact that Caterpillar's audit firm, PricewaterhouseCoopers, advised on these matters violated no law, regulation, or ethical standard, either before or after the enactment of Sarbanes-Oxley years after the restructuring.

Conclusion

In sum, the fact that CSARL now directly purchases its parts inventory reflects nothing more than the standard business operations and tax planning that any prudent multinational enterprise would employ in conducting its operations and complying with applicable tax laws around the world. The entity in question has considerable business substance and is fully entrepreneurial as a matter of both functional reality and contractual form. CSARL and its predecessor developed the dealer networks in much of the world outside the United States. The amount of income and eligibility for deferral of U.S. tax are well policed by existing transfer pricing and Subpart F rules. The structure complies with existing law and offends no U.S. tax policy. Caterpillar stands by this structure.

We look forward to an open dialogue with the Subcommittee and will be happy to answer your questions. Thank you.

United States Senate
Committee on Homeland Security and Governmental Affairs
Permanent Subcommittee on Investigations

In the Matter of

Caterpillar Inc.

Expert Witness Report

of

John P. Steines, Jr.
Professor of Law
New York University

March 7, 2014

Introduction

I am Professor of Law at New York University School of Law. My specialty is U.S. income taxation.

I have been a full-time faculty member at New York University for thirty-five years and have taught a wide variety of courses in the LL.M. program in Taxation, concentrating in those covering domestic and international aspects of corporate and partnership taxation, including the particular issues addressed in this report. I am a former editor-in-chief of the *Tax Law Review*. I have authored a casebook on international aspects of U.S. taxation, which includes chapters on subpart F, transfer pricing, and accumulated offshore funds, and articles on various international, corporate, and partnership tax issues. I have also spoken on most of these subjects at professional conferences. I am Counsel to the law firm of Cooley LLP, where my practice generally involves the same areas of specialization.¹ Prior to affiliating with Cooley, I was a consultant to Deloitte & Touche from 2001 to 2004 and Counsel to the law firm of Weil, Gotshal & Manges LLP from 1984 to 2001. A copy of my curriculum vitae is appended, which includes a list of my publications and other engagements in which I have served as an expert witness.

I have been engaged by counsel to Caterpillar Inc. ("Caterpillar") to report to the Permanent Subcommittee on Investigations ("Subcommittee") as an expert witness in taxation on behalf of Caterpillar. Specifically, I have been asked to address the Subcommittee staff's concern that Caterpillar's supply chain restructuring executed in 1999 through the early 2000's, pursuant to which its Swiss affiliate, Caterpillar SARI ("CSARL"), purchases finished replacement parts from unrelated U.S. suppliers and sells them to unrelated dealers and customers abroad, may have lacked sufficient economic substance. I understand that the Subcommittee may have other areas of inquiry, but I do not address those here.

The opinions expressed in the report are based upon my specialized professional knowledge. I confirm that I have included in the report all matters within my knowledge and expertise relevant to the matters on which I have been asked to report. I have made all the

¹ Cooley does not represent Caterpillar, nor did it have any involvement in the restructuring that is the subject of this report. In filing this report, I am acting only in my capacity as Professor of Law, not on behalf of Cooley. My role as expert in this matter is not a conflict of interest.

inquiries that I believe are appropriate and no matters of significance that I regard as relevant have, to my knowledge, been withheld from me or the report.

The report comprises three parts: a summary of conclusions; a statement of facts; and an analysis of the issues I was asked to report on.

Summary of Conclusions

As elaborated below, in my professional judgment, it is extremely unlikely that Caterpillar's supply chain restructuring and the countless ensuing sales conducted pursuant to the restructuring are vulnerable to attack for lack of economic substance.

Summary of Essential Facts

The report is based on my understanding of the essential elements of the supply chain restructuring described below. This understanding is drawn primarily from information provided by Caterpillar to the Subcommittee at its request and, to a lesser degree, on conversations with Caterpillar and its counsel.

The Parties

Caterpillar is the parent company of the Caterpillar group. Where relevant, references to Caterpillar include references to Caterpillar's affiliated U.S. subsidiary companies. CSARL is a limited liability company organized under Swiss law in 1997 as the successor to a Caterpillar company that had conducted overseas operations for decades. CSARL is treated as a partnership for U.S. tax purposes and is owned directly or indirectly (through disregarded entities) by controlled foreign corporations that are directly or indirectly owned by Caterpillar.

Pre-Restructuring Supply Chain in Brief

Before the restructuring, Caterpillar purchased replacement parts for its various products—purchased finished replacement parts ("PFRP")—from unrelated suppliers located in the United States and sold a portion of them to CSARL ("outbound PFRP"), which in turn sold them to unrelated dealers and customers in foreign markets. Caterpillar's profits from outbound

PFRP sales were taxable in the United States. CSARL's profits were also taxable in the United States as foreign base company sales income (under Section 954(d) of subpart F).

Post-Restructuring Supply Chain in Brief

After the restructuring, CSARL purchased outbound PFRP directly from the unrelated U.S. suppliers and sold them to unrelated dealers and customers in foreign markets. The restructuring simply removed Caterpillar from the outbound PFRP supply chain. As a result, Caterpillar earned no profits (other than royalties and fees paid by CSARL described below) from outbound PFRP sales, and CSARL's profits were no longer taxable under subpart F because there was no longer a related party (Caterpillar under the old structure) in the supply chain, which Section 954(d) requires as a condition of foreign base company sales income.

Elements of the Restructuring

Since at least 1960, Caterpillar's primary non-U.S. marketing center has been located in Switzerland. For several decades, CSARL (and its predecessor) have had several hundred employees in Switzerland, currently approximately 400, engaged in activities involved in manufacturing, marketing, sales, and support of Caterpillar machines, engines, and parts. Swiss-based managers have been instrumental in Caterpillar's international expansion. As the Asia Pacific market developed, CSARL developed a similar regional center in Hong Kong, which was later relocated to Singapore and currently is home to approximately 400 employees and the site of Caterpillar's Asia-Pacific aftermarket distribution center and remanufacturing facility. Presently, roughly 70 percent of the Caterpillar group's sales are to foreign dealers and customers.

The restructuring entailed a broad realignment of many of the Caterpillar group's various functions in foreign markets. An important objective was to facilitate CSARL's functioning as the principal in contract (toll) manufacturing arrangements. Another objective was to remove Caterpillar from the outbound PFRP supply chain in order to eliminate an unnecessary middleman between the supplier and customer and in the process to eliminate unnecessary subpart F income.

Prior to the restructuring, outbound PFRP functions were divided. Caterpillar employees located in the U.S. engaged with U.S. suppliers on design, production, and pricing matters, whereas marketing to foreign customers was carried out by CSARL employees in Switzerland or Singapore. CSARL, operating as a distributor with limited exposure to market risk, earned a relatively small gross profit (approximately four percent of sales revenue).

The restructuring added to CSARL's exposure to market risk by essentially placing it in the position previously occupied by Caterpillar—the entrepreneur between suppliers and customers. In order to take on purchasing functions previously discharged by Caterpillar, CSARL needed continuing support from Caterpillar and the right to use Caterpillar's intellectual property necessary to engage with suppliers and customers (*i.e.*, production technology and trade name). To that end, CSARL entered into a licensing agreement with Caterpillar entitling CSARL to use relevant Caterpillar intellectual property, pursuant to which CSARL pays annual royalties to Caterpillar equal to four to six percent of sales revenue. In addition, CSARL reimburses Caterpillar, at cost plus a five to seven percent mark-up, for various engineering and logistical services provided by Caterpillar personnel located in the United States involved in engaging with suppliers and storing and managing inventory in U.S.-situs warehouses. The adequacy of these royalties and fees is subject to normal audit review under the arm's length principles and rules of Section 482's transfer pricing regime. Although CSARL hired or reassigned two high-level purchasing managers located in Switzerland after the restructuring, much of the purchasing and logistical functions relating to outbound PFRP continued after the restructuring to be carried out by Caterpillar personnel located in the United States.

After the restructuring, some outbound PFRP was shipped directly from suppliers to customers or through unrelated packagers. The balance was stored, intermingled with Caterpillar's goods, in Caterpillar's U.S. warehouses. As a mutual accommodation, if CSARL's or Caterpillar's inventory ran out, the inventory control system ("ITAS") permitted the short party to use the other's inventory and later replenish it from future purchases. Also, because U.S. suppliers did not want to deal with more than one purchaser, CSARL purchased not only outbound PFRP but also goods destined for U.S. dealers and customers. In order to accomplish such inbound sales, CSARL would transfer title ("flash title") to Caterpillar at no mark-up, enabling Caterpillar to close sales to U.S. dealers and customers.

The net U.S. tax effect of the restructuring on outbound PFRP profits, taking into account royalty and service agreement payments made by CSARL to Caterpillar, was to convert some percentage, which varies year-by-year, of the profits from income subject to current U.S. income taxation (either because Caterpillar earned it or it was subpart F income to CSARL) to CSARL's income subject to deferred U.S. taxation.

Economic Substance Requirements

I understand that some members of the Subcommittee staff may be of the view that continued storage of outbound PFRP in the United States (perhaps aggravated by the inventory warehousing features discussed above), combined with continued supplier engagement and inventory warehousing being conducted by Caterpillar personnel located in the United States, means that the restructuring did not accomplish a sufficient change in economic substance to be respected for U.S. income tax purposes. The staff's view may be premised on one or both of two related judicial doctrines: the doctrine that substance prevails over form; and the economic substance doctrine. I will address both doctrines as well as relevant historical policies behind present law, concluding that the restructured outbound PFRP supply chain offends neither the case law nor the relevant underlying statutory purposes.

Substance over Form and Economic Substance in General

The various doctrines employed by courts to police what is perceived as overly aggressive tax planning are somewhat overlapping and draw common support from the bedrock notions that substance generally prevails over form where they conflict and, in addition, economically meaningless transactions devoid of business purpose other than tax avoidance are generally not respected.² Given the potential breadth of these principles, however, it is important to remember that many routine transactions that may superficially seem suspect, such as issuing debt instead of equity in order to obtain an interest deduction or forming a subsidiary to conduct activity instead of operating in branch form or acquiring a target company for stock in a tax-free

² See *Gregory v. Helvering*, 293 U.S. 465 (1935); *Knetsch v. United States*, 364 U.S. 361 (1960); *Frank Lyon Co. v. United States*, 435 U.S. 561 (1978).

reorganization instead of purchasing it for cash in a taxable transaction, are unquestionably above reproach in the vast majority of situations.³

Therefore, in order to put Caterpillar's restructuring in proper perspective, in the following pages I begin with indisputable economic substance principles established by the courts and Congress, then describe cases countenancing legitimate international tax planning, and, finally, catalog some of the transactions that courts of late have unabashedly struck down as objectionable under either the substance-over form doctrine, which holds that economic substance trumps inconsistent formalism, or the economic substance doctrine, which holds that a taxpayer must have a nontax business purpose for entering into a transaction (the "subjective" factor) and/or the transaction must exhibit economic effects other than tax savings (the "objective" factor).⁴ I provide only enough detail to show the contrast between transactions condemned by courts and Caterpillar's restructuring.

Indisputable Judicial Principle Respecting Separateness of Corporation and Shareholder

Seventy years ago, in *Moline Properties*,⁵ the Supreme Court, rejecting the taxpayer's argument that his wholly owned corporation was merely his *alter ego*, established that a corporation cannot be ignored if it engages in even minimal economic activity. The corporation in that case owned real property formerly owned by the shareholder and transferred to the corporation at the insistence of creditors. The corporation sold the property at a gain, which the taxpayer unsuccessfully argued was taxable to him, not the corporation.

From that point on, courts refused to ignore the separate existence of a corporation, even though tax-motivated, unless it was a sham, engaged in no economic activity, or represented itself to be merely an agent. For example, in the *Siegel* case, cited with approval by the Joint

³ See, e.g., *Kraft Foods Co. v. Comm'r.*, 232 F.2d 118 (2d Cir. 1956); Joint Comm. on Tax'n, *Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in Combination with the "Patient Protection and Affordable Care Act."* JCX-18-10 (Mar. 21, 2010), at 152-53.

⁴ The recently codified economic substance doctrine, enacted in 2010, requires a taxpayer to show both a meaningful change in its economic position as a result of the transaction in question and a non-tax business purpose for it. I.R.C. § 7701(o). Pre-codification doctrine, depending on the circuit in which the case arose, sometimes required taxpayers to make both showings, sometimes only one, and sometimes fused the two prongs into one. See David P. Hariton, *When and How Should the Economic Substance Doctrine Be Applied?*, 60 Tax L. Rev. 29 (2006); Martin J. McMahon, *Living with the Codified Economic Substance Doctrine*, 128 Tax Notes 731 (2010); JCX-18-10, *supra* note 3, at 153-54.

⁵ *Moline Properties, Inc. v. Comm'r.*, 319 U.S. 436 (1943).

Committee on Taxation as beyond attack under the economic substance doctrine,⁶ the Tax Court rejected the government's argument that the taxpayer's wholly owned Panamanian corporation, which entered into a farming joint venture in Cuba, where the taxpayer operated as a food broker, should be ignored for lack of economic substance simply because the arrangement deferred U.S. tax, provided the taxpayer had some non-tax reason for using the corporate form (e.g., insulation from liability to creditors, protection of licenses and reputation).⁷ Another oft-cited example is *Northern Indiana Public Service Company*,⁸ where the Court of Appeals refused to ignore the separate existence of a U.S. parent corporation's Netherlands-Antilles subsidiary, which had borrowed funds in the Eurobond market and on-loaned them at a slightly greater rate of interest to the parent company. The subsidiary's retention of the interest rate spread and the need to employ such a structure in order to reduce borrowing costs (by not having to pay increased interest to cover the U.S. withholding tax that would have been due had the parent borrowed directly from the Eurobond market) was enough business justification to fend off an economic substance challenge.

Legislative History

Congress has been equally respectful of the separateness of corporation and shareholder. When subpart F was enacted in 1962, with the approach that only certain types of income ("subpart F income") earned by a controlled foreign corporation would be currently taxable to its U.S. shareholders, it was obvious that other kinds of income could not also be rendered currently taxable through the expedient of simply ignoring the separate existence of the controlled foreign corporation on substance-over-form or related grounds. Legislative history of the codification of the economic substance doctrine in 2010 restates this reality unambiguously:

"The provision is not intended to alter the tax treatment of certain basic business transactions that, under longstanding judicial and administrative practice are respected, merely because the choice between meaningful economic alternatives is largely or entirely based on comparative tax advantages. Among these basic transactions are . . . a U.S. person's choice between utilizing a foreign corporation or a domestic corporation to make a foreign investment . . . and . . . the choice to

⁶ See JCX-18-10, *supra* note 3, at 153.

⁷ *Siegel v. Comm'r*, 45 T.C. 566 (1966).

⁸ *Northern Indiana Public Service Co. v. Comm'r*, 115 F.3d 506 (7th Cir. 1997).

utilize a related-party entity in a transaction, provided that the arm's length standard of section 482 and other applicable concepts are satisfied."⁹

Also noteworthy is Congress's decision not to trigger taxation under subpart F merely because a controlled foreign corporation holds goods in the United States that are destined for export.¹⁰ This exception to the definition of "United States property" in Section 956, which dates back to the initial enactment in 1962, was justified by Congress as follows:

"Generally, earnings brought back to the United States are taxed to the shareholders on the grounds that this is substantially the equivalent of a dividend being paid to them. The exceptions . . . , however, are believed to be normal commercial transactions without intention to permit the funds to remain in the United States indefinitely"¹¹

Taxpayer Victories in International Tax Planning Cases

Consistent with the foregoing principles, taxpayers have prevailed in cases exhibiting considerable international tax planning.

Relocation of Business Offshore

The most germane of these cases involved United Parcel Service's transfer of its package insurance business to a foreign affiliate. UPS, which had previously conducted the business itself, moved the business (and resulting profit) to its Bermuda sister corporation (which it had formed and spun off to shareholders) by engaging an independent insurance company to accept the insurance risk, in exchange for premiums collected by UPS from customers, followed by a reinsurance agreement between the insurer and the Bermuda sister that passed the premiums and risk on to the Bermuda sister (less a fee for the insurer). The government challenged the arrangement on economic substance grounds, complaining that nothing in substance had changed (UPS continued to administer customer claims) except that UPS's profits were now earned by the Bermuda sister. The court disagreed, finding that the restructuring of an existing, bona fide business with involvement of an independent third-party insurer satisfied the economic substance doctrine, notwithstanding the tax avoidance motive.¹²

⁹ JCX-18-10, *supra* note 2, at 152-53.

¹⁰ See I.R.C. § 956(c)(2)(B).

¹¹ Sen. Rep. No. 1881, 87th Cong., 2d Sess., at 794.

¹² *United Parcel Service of America, Inc. v. Comm'r*, 254 F.3d 1014 (11th Cir. 2001).

Of all the cases mentioned in this report, the one closest to the Caterpillar restructuring is *UPS*. Like the Caterpillar restructuring, it involved dealings between the taxpayer and independent parties (the insurer in *UPS* and unrelated suppliers and customers in this case), and it was a restructuring of an existing, mature business, as opposed to a one-time adventure into unfamiliar terrain motivated exclusively by a desire to generate tax benefits in order to shelter tax on unrelated income.

Hybrid Financing Arrangements

Two recent cases illustrate the degree of international planning permitted under the substance-versus-form doctrine, each involving cross-border tax arbitrage (inconsistent classification by two countries of either an entity or a financial instrument, resulting to some degree in income being taxed in neither country). In the first, a formal debt instrument issued by a domestic reverse hybrid entity (a corporation for U.S. tax purposes), which, if respected, would have resulted in a U.S. interest deduction but little or no taxation in the U.K. due to the issuer's status as a partnership for U.K. purposes, was indeed respected as debt, contrary to the government's argument.¹³ In the second, a hybrid instrument issued by a Dutch subsidiary to its U.S. parent was treated as equity for U.S. purposes, notwithstanding that it was treated as debt for Dutch purposes, resulting in an interest deduction in the Netherlands but asymmetrical tax treatment in the United States (*e.g.*, return of stock basis or dividend sheltered by foreign tax credits).¹⁴

Government Victories in Economic Substance and Substance-Over-Form Cases

In contrast to instances of tax planning sanctioned by the courts and Congress, transactions too heavily freighted with tax-avoidance have been stuck down. These cases demonstrate that, wherever the line drawn by the substance-over-form and economic substance doctrines may be, the Caterpillar restructuring falls easily on the safe side.

SILO/LILO Transactions

Sale-in-lease-out ("SILO") and lease-in-lease-out ("LILO") transactions typically involve a lease (head lease) of a public or quasi-public facility (*e.g.*, a municipal railroad or sewage system or hydroelectric plant) by a U.S. taxpayer from a tax-indifferent user (*e.g.*, a foreign or

¹³ *NA General Partnership v. Comm'r*, T.C. Memo. 2012-172.

¹⁴ *PepsiCo Puerto Rico v. Comm'r*, T.C. Memo. 2012-269.

U.S. municipality) that historically operated the facility, followed by a lease of the facility back (sublease) to the user for continued operation, but for a term shorter than the head lease. Upon expiration of the sublease, the user is generally economically compelled, though not for absolute certain, to exercise an option to reacquire the facility from the taxpayer. The taxpayer has no business interest or acumen in the facility and plays no role in its operation. Rent on the head lease is prepaid, funded approximately one fifth by the taxpayer's equity and four fifths by nonrecourse financing taken out by the taxpayer. Aside from a fee retained by the user to enter into the transaction, the prepaid rent is set aside in special-purpose ("defeasance") accounts dedicated, via rental payments on the sublease, to servicing the taxpayer's nonrecourse financing and to fund the repurchase option, meaning that the taxpayer's equity (net of the user's fee) is returned, the loan is repaid, and ownership of the facility reverts to the user. Because rent on the head lease is prepaid, giving rise (prior to certain changes in the Code) to an immediate deduction for rent (LIFO) or a depreciation stream (SIL), there is a timing advantage due to the relatively deferred inclusions of rental income (net of interest deductions on the loan) from the sublease. As an economic matter, the tax benefit from this deferral is offset by the user's fee and transaction expenses.

Courts have consistently denied the tax benefits of SILs and LIFOs on substance-over-form grounds, more particularly that the taxpayer did not acquire the economic benefits and burdens of ownership, and in some cases for lack of economic substance as well.¹⁵

The chasm separating Caterpillar's restructuring from SIL/LIFO transactions is obvious. Outbound PFRP is central to Caterpillar's business, there was no use of an indifferent financier to accommodate the restructuring, and the restructuring made permanent economic changes in the relationships among Caterpillar affiliates.

Foreign Tax Credit Generators

"Foreign tax generators" come in many varieties and can be exceedingly complicated.¹⁶ Although there are variations, most generators are duplicate-benefit financing transactions in

¹⁵ *BB&T Corp. v. United States*, 523 F.3d 461 (4th Cir. 2008); *Altria Group, Inc. v. United States*, 658 F.3d 276 (2d Cir. 2011); *Wells Fargo & Co. v. United States*, 641 F.3d 1319 (Fed. Cir. 2011); *Consol. Edison Co. of N.Y., Inc. & Subs. v. United States*, 703 F.3d 1367 (Fed. Cir. 2013); *AWG Leasing Trust v. United States*, 592 F. Supp.2d 953 (N.D. Ohio 2008); *John Hancock Life Insurance Co. (USA) v. Comm'r*, 141 T.C. No. 1 (Aug. 5, 2013).

¹⁶ Yaron Z. Reich, *International Arbitrage Transactions Involving Creditable Taxes*, 85 *Taxes* 53 (2007); Gregory May, *Getting Realistic About International Tax Arbitrage*, 85 *Taxes* 37 (2007).

which a U.S. corporation, usually a financial institution (acting either as borrower or lender), holds a security issued by a foreign special purpose entity (“SPV”) through which the loan proceeds pass and which incurs foreign tax on profits from investment of the loan proceeds (usually a loan to an affiliate of the SPV). Securities issued by the SPV are also owned by a foreign counterparty to the deal, and, with the help of inconsistent classification or ownership of the securities by the United States and the foreign counterparty’s home country, the tax incurred by the SPV is effectively reversed (where the counterparty is the borrower) or is a substitute for tax that the counterparty would have incurred in a straightforward loan (where it is the lender). That being the case, the counterparty is willing to bear, through the pricing of the securities and various associated deals (*e.g.*, interest rate and currency swaps), most of the economic burden of the tax incurred by the SPV. The U.S. corporation obtains a credit for avoidable tax economically borne by the counterparty. In these transactions, it can be demonstrated, by comparison to a straightforward loan, how the U.S. corporation and foreign counterparty (and usually the counterparty’s home country) all benefit at the expense of the U.S. treasury. In result, foreign tax generators are open to attack as a tax shelter in the sense that two parties trade disparate tax positions for their mutual after-tax benefit at the expense of the fisc with virtually no risk.

Regulations invalidating credits for taxes incurred in generator transactions were issued in temporary form in 2008 and finalized in 2011.¹⁷ The government challenged deals pre-dating the regulations in court on several grounds, including substance-over-form and economic substance. Several cases have been decided, all but one in favor of the government, mostly on economic substance grounds.¹⁸

Similar to the comparison with SII/O/LII/O transactions, the differences between generator transactions and the Caterpillar restructuring are stark. Nothing in the restructuring smacks of a U.S. taxpayer contracting with a tax-indifferent foreign counterparty to their mutual

¹⁷ T.D. 9416, 2008-2 C.B. 1142; Treas. Reg. § 1.901-2(e)(5)(iv).

¹⁸ *Pfaff v. United States*, 816 F. Supp. 2d 693 (S.D. Iowa 2011) (economic substance and partnership anti-abuse grounds); *Hewlett-Packard Co. v. Comm’r*, 103 T.C.M. (CCH) 1736 (2012) (debt-equity grounds, finding that HP’s investment in Dutch SPV was debt, destroying its claim to indirect credits); *Bank of New York Mellon Corp. v. Comm’r*, 140 T.C. No. 2 (2013) (economic substance grounds); *Salem Financial, Inc. v. United States*, 112 Fed. Cl. 543 (2013) (economic substance grounds); *American Int’l Group, Inc. v. United States*, 2013-1 USTC ¶ 50,255 (S.D. NY 2013) (rejected taxpayer’s motion for summary judgment on economic substance grounds). But see *Santander Holdings USA, Inc. v. United States*, 2013-2 USTC ¶ 50,564 (D. Mass. 2013) (granting taxpayer’s motion for summary judgment on profit element of economic substance).

advantage to deprive the United States of revenue it would have earned in a straightforward substitute transaction.

Structured Partnership Financings

Subject to the requirement that partnership allocations must have substantial economic effect (Section 704(b)), partnerships offer the potential for taxable partners to deflect income to tax-indifferent partners and, conversely, for tax-indifferent partners to transfer tax benefits to taxable partners. In structured partnership financing transactions, as a general proposition, the accommodating partner earns a debt-like return on its contribution to the partnership with very little economic risk or upside potential beyond a fixed return. The return is somewhat above market where the accommodating partner is tax-indifferent and absorbs income deflected by the taxable partner and somewhat below market where the accommodating partner is allocated a valuable tax benefit deflected by a tax-indifferent partner.

The first wave of these transactions invalidated by the courts on economic substance grounds involved partnerships of U.S. and foreign parties (often banks) where the partnership purchased and sold securities with little economic gain or loss and employed peculiar basis recovery rules (under the installment method of accounting) to allocate gain to tax-indifferent foreign partners followed by an offsetting allocation of loss to taxable partners.¹⁹

Next came a series of two lower court decisions in favor of General Electric and two reversals by the Court of Appeals involving a partnership among GE and foreign banks.²⁰ GE contributed low-basis airplanes to the partnership, and allocations to the banks of rental income from the planes and largely offsetting amounts of book depreciation had the effect of temporarily shifting gain inherent in the airplanes from GE to the foreign banks. The two appellate decisions, sounding a blend of substance-over-form and economic substance criteria, rested on the finding that the lower court erred in rejecting the government's claim that the foreign banks were not bona fide equity partners.

A recent case in which a Dow Chemical Company affiliate formed a partnership with foreign banks reveals a similar pattern.²¹ Dow contributed low-basis patents and operating

¹⁹ See, e.g., *ACM Partnership v. Comm'r.*, 157 F.3d 231 (3d Cir. 1998). Several subsequent cases with similar facts were also won by the government.

²⁰ *TIFD III-E, Inc. v. United States*, 342 F.Supp.2d 94 (D. Conn. 2004); *rev'd and rem'd*, 459 F.3d 220 (2d Cir. 2006); 660 F.Supp.2d 367 (D. Conn. 2009); *rev'd*, 666 F.3d 836 (2d Cir. 2012).

²¹ *Chemtech Royalty Associates, L.P. v. United States*, 2013-1 U.S.T.C. ¶50,204 (M.D. La. 2013).

facilities to the partnership and paid royalties and rents to the partnership in order to retain use of the assets. Dow deducted the royalty and rent payments, but partnership royalty income from the patents was disproportionately allocated to the banks and partnership rental income from the facilities allocated to Dow was sheltered by a special partnership basis adjustment (under Section 734(b)). Finding that the transaction had no purpose other than tax avoidance, the court invalidated the arrangement on economic substance grounds and on the finding that the banks were not bona fide equity partners. Finally, a partnership between an arm of the State of New Jersey and Pitney Bowes, where Pitney Bowes earned a low, relatively fixed return on its contribution to the partnership but was allocated virtually all of the partnership's historic rehabilitation credits, was invalidated on the ground that Pitney Bowes was not a bona fide equity partner.²²

The gulf between the Caterpillar restructuring and the foregoing structured partnership financing arrangements resembles the differences noted above regarding SIO/LILO transactions and foreign tax credit generators. Here too, the Caterpillar restructuring exhibits none of the fatal features condemned by the courts.

Repatriation Strategies

Strategies to repatriate earnings and profits from controlled foreign corporations without imposition of residual U.S. tax failed in two recent cases. In the first, Schering-Plough entered into an interest rate swap and sold the receivables leg of the swap to its foreign subsidiary in exchange for a lump sum payment, which would effectively be repaid to the subsidiary as Schering-Plough made payments on the pay leg of the swap to its counterparty (a foreign bank), which in turn would make payments on the receivables leg to the foreign subsidiary. Had the foreign subsidiary simply loaned funds to Schering-Plough, Schering-Plough would have been taxable under Section 956 (investments in U.S. property by a controlled foreign corporation), which the structure was designed to avoid. The lower court treated the transaction as a loan by the subsidiary to Schering-Plough on substance-over-form grounds and also held that the

²² *Historic Boardwalk Hall, LLC v. Comm'r*, 694 F.3d 425 (3d Cir. 2012), *rev'g*, 136 T.C. 1 (2011), *cert. denied*, 186 L.Ed.2d 192 (2013).

transaction violated the economic substance doctrine. The Court of Appeals affirmed only on substance-over-form grounds.²³

In the second case, one controlled foreign corporation (*A*) transferred cash to an affiliated, newly formed controlled foreign corporation (*B*) in exchange for stock of the transferee (*B*), and the transferee (*B*) then transferred the cash and its own stock to a newly formed U.S. sister corporation (*C*) in exchange for the sister's stock. The sister (*C*) then loaned the funds to the U.S. parent company (*D*). The taxpayer took the position, based on a revenue ruling, that *B*'s basis in the *C* stock was zero and, therefore, *B* had not made a taxable investment in U.S. property under Section 956. The court, employing substance-over-form criteria, concluded that transferring the cash from *A* to *D* through *B* and *C* had no business purpose and, consequently, characterized the series of transactions as a dividend from *A* to *D*.²⁴

These attempts at tax-free repatriations were recharacterized because, as the courts assessed the transactions, they employed complicated arrangements to accomplish through a multitude of steps the simple (and taxable) act of paying dividends to the U.S. parent companies. There is no such use of numerous transactions in substitution of a simpler, single transaction in the Caterpillar restructuring. Indeed, the restructuring simplified Caterpillar's business by removing a redundant middleman.

Application of Principles to Caterpillar Restructuring

Legislative history of the codification of the economic substance doctrine makes clear that the decision to remove Caterpillar from the outbound PFRP supply chain did not violate the economic substance doctrine. And case law interpreting the substance-over-form and economic substance doctrines reveals that they are primarily reserved for highly engineered transactions, frequently unrelated to the taxpayer's core business and involving tax-indifferent parties with no stake in the outcome other than a fixed return, that Congress would not have countenanced as consistent with the purpose of the statutes it enacted – in other words, transactions that most impartial tax professionals would concede are tax shelters.

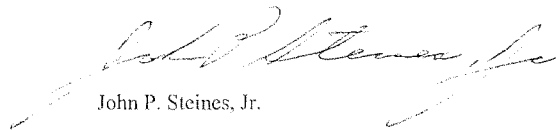
²³ *Schering-Plough Corp. v. United States*, 651 F.Supp. 219 (D. N.J. 2009), *aff'd sub. nom.*, *Merck & Co., Inc. v. United States*, 652 F.3d 475 (3d Cir. 2011).

²⁴ *Barnes Group, Inc. v. Comm'r*, T.C. Memo 2013-109.

Caterpillar's restructuring is of an entirely different realm—a sensible business decision to remove a redundant middleman between supplier and customer, fully within the text and spirit of subpart F, notwithstanding that it deferred some U.S. tax. The inventory accommodation and flash title features of Caterpillar's inventory control system are pragmatic business solutions to normal business problems and do not approach what would raise a problem under the case law digested above.

In my professional judgment, it is extremely unlikely that a court adjudicating with fidelity to the law presented in this report would find that the restructuring or the countless ensuing outbound PFRP transactions offend the doctrines of substance over form or economic substance.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read "John P. Steines, Jr.", is written over a horizontal line. The signature is fluid and cursive, with a large initial "J" and a long, sweeping underline.

John P. Steines, Jr.

John P. Steines, Jr.

March 2014

New York University School of Law
40 Washington Square South
New York, New York 10012
(212) 998-6167
john.steines@nyu.edu

Cooley LLP
1114 Ave. of Americas
New York, New York 10036-798
(212) 479-6084
jsteines@cooley.com

Employment

Professor of Law, New York University, 1985-present (on faculty since 1978). Specialty: taxation, with emphasis on corporate, partnership and international matters.

Counsel, Cooley LLP (formerly Kronish, Lieb, Weiner & Hellman), New York, 2004-present, practice in corporate, partnership, and international tax matters.

Consultant, Deloitte & Touche LLP, New York, 2001-2004, practice in mergers and acquisitions, partnerships, and international tax matters.

Counsel, Weil, Gotshal & Manges LLP, New York, 1984-2001, practice in wide variety of tax matters, with emphasis on partnerships and joint ventures.

Associate, Miller, Johnson, Snell & Cummiskey, Grand Rapids, Michigan, 1974-78.

Industrial Engineer, General Motors Corporation, 1970-71.

Education

Graduate study in Economics, New York University, 1982.

LL.M. (in Taxation), New York University School of Law, 1978. Gerald L. Wallace Scholar.

Juris Doctor, *summa cum laude*, The Ohio State University College of Law, 1974. Order of the Coif.

Bachelor of Industrial Engineering, General Motors Institute, 1971.

Miscellaneous Positions

Editor-in-Chief, Tax Law Review, 1980-82.

Committee on Taxation of Partnerships and Other Pass-Through Entities, Association of the Bar of the City of New York, 1990-92.

Personal Information

Age 65, born Warren, Ohio. Married, three children.

Expert Witness

Deutsche Finance New Zealand Limited v. Commissioner of Inland Revenue (on behalf of taxpayer before High Court of New Zealand, 2007).

4145356 Canada Limited v. Her Majesty the Queen (on behalf of government of Canada before Tax Court of Canada, 2009 - 2011).

TD Securities (USA) LLC v. Her Majesty the Queen (on behalf of taxpayer before Tax Court of Canada, 2009 - 10).

GE Capital Finance Australasia Pty Ltd v. Commissioner of Taxation (on behalf of government of Australia, 2010).

Centocor Ortho Biotech Inc. v. Schering-Plough Corporation (on behalf of Centocor in arbitration, 2010).

Mars Australia Property Ltd. v. Commissioner of Taxation (on behalf of government of Australia, 2011).

Citibank Overseas Investment Corporation v. Holmann (on behalf of Citibank in arbitration, 2011).

Tidewater Inc. v. Bolivarian Republic of Venezuela (on behalf of Venezuela in arbitration, 2011 - 12).

Heritage Oil and Gas Ltd. v. Uganda Revenue Authority (on behalf of government of Uganda, 2012-13)

Stop and Shop Supermarket Company v. Massachusetts Dep't of Revenue (on behalf of Mass. DOR, 2012-13)

In the Matter of AMCI Investments Pty Ltd (on behalf of Australia Taxation Office, 2012 -- 13)

United States v. Alavi Foundation (on behalf of Alavi Foundation in U.S. District Court, 2013)

Books

Federal Income Taxation of Corporations and Shareholders (Warren, Gorham & Lamont 7th ed.). Was successor to Boris I. Bittker and James S. Eustice from October 2011 through February 2013.

International Aspects of U.S. Income Taxation (4th ed. 2009).

International Aspects of U.S. Income Taxation (3rd ed. 2007).

International Aspects of U.S. Income Taxation (2nd ed. 2005).

International Aspects of U.S. Income Taxation (2004).

Articles

The Foreign Tax Credit at 95: Bionic Centenarian, 67 Tax L. Rev. 545 (2013).

Foreign Tax Credit Reform, 32 Tax Notes Int'l 1213 (Sept. 29, 2003), 101 Tax Notes 134 (Oct. 6, 2003).

Whether, When, and How To Tax the Profits of Controlled Foreign Corporations, International Tax Policy in the New Millennium, 26 Brooklyn Journal of International Law 1595 (2000).

- Income Tax Implications of Free Trade*, 49 Tax Law Review 675 (1994).
- Unneeded Reform*, 47 Tax Law Review 239 (1991).
- Partnership Allocations of Built-in Gain or Loss*, 45 Tax Law Review 615 (1990).
- Income Tax Allowances for Cost Recovery*, 40 Tax Law Review 483 (1985).
- Taxation of Corporation Distributions -- Before and After TEFRA*, 68 Iowa Law Review 937 (1983).
- A Reappraisal of the Taxation of Wealth Transfers Incident to Divorce*, 56 Washington Law Review 217 (1981).
- Policy Considerations in the Taxation of B Reorganizations*, 31 Hastings Law Journal 993 (1980).

Papers and Lectures

- NYU Panel Discussion on Chairman Camp's Proposal to Unify Pass-through Taxation (April 2013).
- NYU/UCLA Symposium on 100th Anniversary of Income Tax, Foreign Tax Credit (October 2012).
- Leiden University, International Tax Center, LL.M. program---teaching course in international aspects of U.S. tax law (May 2012).
- NYU/KPMG Lecture Series, Outbound Transfers of Intangibles (April 2012).
- International Fiscal Association (New York), International Tax Reform (December 2011).
- Vienna University of Economics and Business Administration, Postgraduate International Tax Law---teaching course in international aspects of U.S. tax law (December 2011).
- NYU/IRS CLE Program, Foreign Tax Credit (Winter, 2011).
- NYU/IRS CLE Program, Dual Consolidated Loss and Foreign Currency Issues (Spring, 2010).
- NYU/IRS CLE Program, Cross-Border Acquisitions and Reorganizations (Winter, 2010).
- NYU/IRS CLE Program, Foreign Tax Credit and Subpart F (Fall, 2009).
- Vienna University of Economics and Business Administration, Postgraduate International Tax Law---teaching course in international aspects of U.S. tax law (February 2009).
- NYU/Univ. Conn. EC Tax Policy Conference, European Tax Policy in a Global Context (Spring 2008).
- NYU/IRS CLE Program, Cross-Border Reorganizations and Foreign Currency Issues (Spring, 2008).
- NYU/IRS CLE Program, Foreign Tax Credit and Subpart F (Fall, 2007).
- NYU/IRS CLE Program, Taxation of Inbound Transactions (Fall, 2006).
- NYU Wallace-Lyon Graduate Tax Workshop, International Tax Developments (May, 2006).
- 1st Annual NYU/IBA International Tax Law Conference, President's Advisory Panel on Federal Tax Reform (December, 2005).

NYU National Tax Workshop, International Taxation (February, 2005)

ABA/IBA Second International Tax Institute, Optimizing Tax, Financial Accounting, and Cash Management in Multinational Operations (June 2004).

NYU National Tax Workshop, International Taxation (February, 2004)

NYU Seminar for Government, Foreign Tax Credit Reform (February, 2003).

KPMG/NYU Panel Discussion on Electronic Commerce (October, 2000).

NYU Graduate Tax Workshop, International Transactions (February, 2000).

NYU/Tax Analysts Seminar for Government, Deferral and Subpart F (February, 2000).

NYU/IRS CLE Program, Selected Issues in the Substantive Law and Federal Income Tax Treatment of Intangible Property (Autumn, 1999).

Deloitte Touche & Tohmatsu Training Conference on Outbound Mergers, Acquisitions, and Restructurings (July, 1998).

NYU/IRS CLE Program, International Joint Ventures (Autumn, 1997).

State Bar of Michigan, Taxation Section, Summer Tax Conference: Replicating a Corporation Through a Partnership: Cross-Border Transactions After NAFTA (June, 1995).

Tax Law Review, Colloquium on NAFTA and Taxation (September, 1994).

NYU/IRS CLE Program, Seminar on International Joint Ventures (Fall, 1993).

NYU/IRS CLE Program, Partnership Taxation (Spring, 1992).

Tax Law Review, Colloquium on Partnership Taxation (June, 1991).

NYU Graduate Tax Workshop, Restructuring Insolvent Corporations (June, 1991).

NYU Inst. on Fed Tax'n, Partnerships and S Corporations -- Workouts and Bankruptcy (July, 1990).

NYU Graduate Tax Workshop, Restructuring Insolvent Corporations (May, 1990).

NYU Inst. on Fed Tax'n, Corporate Acquisitions (April, 1990).

NYU Seminar for Government, Asset Tracing (March, 1990).

Corporate Tax Planning for Today (NYU) (San Francisco), Restructuring Insolvent Corporations (October, 1989).

NYU Graduate Tax Workshop, Restructuring Insolvent Corporations (June, 1989).

NYU/IRS CLE Program, Partnership Taxation (Summer, 1988).

NYU Graduate Tax Workshop, Partnership Taxation -- Passive Loss and Investment Interest Limitations (June, 1988).

NYU Graduate Tax Workshop, Partnership Taxation -- Debt and Risk-Sharing Issues (August, 1986).

NYU/IRS CLE Program, Seminar on Partnership Taxation Issues (June, 1986).

NYU Graduate Tax Workshop (San Francisco), Partnership Allocations Attributable to Contributed Property (October, 1985).

NYU Graduate Tax Workshop, Partnership Allocations Attributable to Contributed Property (August, 1985).

Advanced Tax Techniques in Real Estate Transactions (NYU), Partnership and Corporate Strategies (May, 1985).

NYU Graduate Tax Workshop (San Francisco), Partnership Taxation Issues (February, 1985).

NYU Graduate Tax Workshop, Partnership Taxation After the Tax Reform Act of 1984 (August, 1984).

Advanced Tax Techniques in Real Estate Transactions (NYU), Corporate Entities -- Problems and Pitfalls (June, 1984).

NYU Graduate Tax Workshop, Changes in the Treatment of Corporate Distributions (August, 1983).

NYU Graduate Tax Workshop, Tax Shelter Problems (August, 1982).

NYU Seminar for Government, Marital Breakups -- Legislative Proposals (May, 1982).

Practising Law Institute, Organization of the Corporation and Tax Benefits of Doing Business as a Corporation (April, 1982).

NYU Graduate Tax Workshop, Tax Planning in Divorce and Separation (August, 1981).

NYU Graduate Tax Workshop, Debt versus Equity Characterization (August, 1980).

NYU Graduate Tax Workshop, Corporate Liquidations (August, 1979).

United States Senate
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
Committee on Homeland Security and Governmental Affairs
Carl Levin, Chairman

CATERPILLAR'S OFFSHORE TAX STRATEGY

MAJORITY STAFF REPORT

**PERMANENT SUBCOMMITTEE
ON INVESTIGATIONS**

UNITED STATES SENATE



**RELEASED IN CONJUNCTION WITH THE
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
APRIL 1, 2014 HEARING**

SENATOR CARL LEVIN
Chairman

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

ELISE J. BEAN
Staff Director and Chief Counsel
DAVID H. KATZ
Senior Counsel
DANIEL J. GOSHORN
Counsel

ADAM HENDERSON
Professional Staff Member
HEIDI KELLER
Congressional Fellow
ANGELA MESSENGER
Detailer

SAMIRA AHMED
Law Clerk
HARRY BAUMGARTEN
Law Clerk
TOM McDONALD
Law Clerk

MARY D. ROBERTSON
Chief Clerk

CATERPILLAR'S OFFSHORE TAX STRATEGY

TABLE OF CONTENTS

I. EXECUTIVE SUMMARY	1
A. Subcommittee Investigation	3
B. Investigation Overview	4
C. Findings and Recommendations	6
Findings:	
(1) Operating a U.S. Centric Business	6
(2) Reversing U.S.-Swiss Allocation of Parts Profits	7
(3) Generating \$2.4 Billion in Tax Benefits	7
(4) Using Contradictory Valuations	7
(5) Employing a Tax-Motivated "Virtual Inventory"	7
(6) Creating a Potential Conflict of Interest	7
Recommendations:	
(1) Clarify IRS Enforcement	8
(2) Rationalize Profit Splitting	8
(3) Participate in OECD Multinational Corporate Tax Effort	8
(4) Eliminate Auditing and Tax Consulting Conflicts of Interest	8
II. BACKGROUND	9
A. Taxation and Deferral	11
B. Shifting Income to Offshore Subsidiaries	11
C. Anti-Deferral Provisions and Subpart F	14
D. Foreign Base Company Sales Income – Manufacturing Exception	16
E. Economic Substance	18
F. Export Exception	19
III. CATERPILLAR CASE STUDY	21
A. Caterpillar In General	21
B. Caterpillar's Dealer Network	25
C. Caterpillar's Replacement Parts Business	29
(1) Parts Business In General	30
(2) Role of the United States in Caterpillar's Parts Business	34
D. Caterpillar in Switzerland	43
IV. EMPLOYING A SWISS TAX STRATEGY TO AVOID U.S. TAXES	47
A. Adopting the Swiss Tax Strategy	48
B. Shifting Profits from United States to Switzerland	53

(1) Altering the Legal Title Chain for Finished Parts	55
(2) Licensing Intangible Rights In Exchange for Royalties ...	59
(3) Constructing a Virtual Parts Inventory	64
(4) Making Paper, Not Operational, Changes	67
(5) Managing the Offshore Cash Buildup	70
C. Identifying the Swiss Tax Strategy as High Risk	72
D. Swiss Tax Strategy Policy Concerns	80
(1) Economic Substance Concerns	80
(2) Arm's Length Transaction Concerns	92
(3) Assignment of Income Concerns	95
(4) Virtual Inventory System Concerns	97
(5) Intangible Valuation Concerns	101
(6) Conflicting Profit Allocation Concerns	107
(7) Transfer Pricing Concerns	109

✧ ✧ ✧

CATERPILLAR'S OFFSHORE TAX STRATEGY

I. EXECUTIVE SUMMARY

For the last decade, the Permanent Subcommittee on Investigations of the U.S. Senate Homeland Security and Government Affairs Committee has examined how U.S. multinational corporations have exploited and, at times, abused or violated U.S. tax statutes, regulations, and accounting rules to shift profits and valuable assets offshore to avoid U.S. taxes. The Subcommittee's ongoing investigation has resulted in a series of hearings and reports.¹ Two recent hearings presented case studies of how some U.S. multinational corporations have employed complex transactions and licensing agreements with offshore affiliates to exploit tax loopholes, shift taxable income away from the United States to tax haven jurisdictions, and indefinitely defer paying their U.S. taxes, even when using some of that offshore income to run their U.S. operations.

This investigation offers another detailed case study of a U.S. multinational shifting taxable profits to a foreign affiliate in a tax haven to defer or avoid paying U.S. taxes. While the earlier investigations focused on corporations in the high tech field, this inquiry focuses on a manufacturing company with a substantial U.S. presence. It shows how an iconic American corporation, Caterpillar Inc. (Caterpillar), a U.S. manufacturer of construction equipment, power generators, and sophisticated engines, paid millions of dollars for a tax strategy that shifted billions of dollars in profits away from the United States and into Switzerland, where Caterpillar had negotiated an effective corporate tax rate of 4% to 6%.

Where Caterpillar once reported on its U.S. tax returns the vast majority of its worldwide profits from the sale of Caterpillar-branded replacement parts to non-U.S. customers – parts that were manufactured by third party suppliers located primarily in the United States – after the adoption of a Swiss tax strategy in 1999, it reported 15% or less of those profits in the United States and shifted 85% or more of the profits to Switzerland. Caterpillar accomplished that profit shift without making

¹ See, e.g., U.S. Senate Permanent Subcommittee on Investigations, "Fishtail, Bacchus, Sundance, and Slapshot: Four Enron Transactions Funded and Facilitated by U.S. Financial Institutions," S.Prt. 107-82 (Jan. 2, 2003); "U.S. Tax Shelter Industry: The Role of Accountants, Lawyers, and Financial Professionals," S.Hrg. 108-473 (Nov. 18 and 20, 2003); "Tax Haven Abuses: The Enablers, The Tools and Secrecy," S.Hrg. 109-797 (Aug. 1, 2006); "Repatriating Offshore Funds: 2004 Tax Windfall for Select Multinationals," S.Prt. 112-27 (Oct. 11, 2011); "Offshore Profit Shifting and the U.S. Tax Code – Part 1 (Microsoft and Hewlett-Packard)," S.Hrg. 112-781 (Sept. 20, 2012); "Offshore Profit Shifting and the U.S. Tax Code – Part 2 (Apple Inc.)," S.Hrg. 113-90 (May 13, 2013).

any real changes in its business operations. It continued to manage and lead the parts business from the United States.

Caterpillar also executed that profit shift despite the fact that its U.S. operations continued to play a far larger role in the parts sold to non-U.S. customers than its Swiss operations. The company's U.S. presence as a whole is far larger than its Swiss presence. Caterpillar's worldwide headquarters has long been in Peoria, Illinois, and all of its most senior executives are located there. Of its 118,500 employees worldwide, about 52,000, or nearly half, work in the United States, while only 400 employees, less than one-half of one percent, work in Switzerland. Of its 125 manufacturing facilities worldwide, 54 are in the United States, while none are located in Switzerland. In 2012, of the \$2 billion Caterpillar spent on research and development, 80% was spent in the United States, while less than 10% was spent in Switzerland.

The same contrast applies to Caterpillar's parts business. Of the nearly 8,300 Caterpillar employees specializing in parts, about 4,900 work in the United States, including almost all of the senior parts executives. Switzerland has about 65 employees working on parts, with one division head managing parts distribution in Europe and one worldwide parts manager who reports to a division head in the United States. Of the Caterpillar replacement parts manufactured by third parties for sale outside of the United States, nearly 70% are manufactured in and shipped from the United States; none are manufactured in or shipped from Switzerland. Of the company's 19 parts warehouses and distribution facilities worldwide, 10 are located in the United States storing 1.5 billion parts, including its largest distribution center in Morton, Illinois; no warehouses are located in Switzerland. Caterpillar's parts inventory is also managed and operated primarily from the United States using U.S.-run worldwide parts tracking, forecasting, and delivery systems that have no counterparts in Switzerland. In 2012, Caterpillar Board minutes described its parts distribution business as "U.S. centric."

Despite the fact that its parts business is managed and led primarily from the United States, Caterpillar used a series of complex transactions to designate a new Swiss affiliate called CSARL as its "global parts purchaser," and license CSARL to sell Caterpillar third party manufactured parts to Caterpillar's non-U.S. dealers. Caterpillar also signed a servicing agreement with CSARL in which it agreed to keep performing the core functions supporting the non-U.S. parts sales, including overseeing the U.S. parts supplier network, forecasting parts demand, managing the company's worldwide parts inventory, storing the parts, and shipping them from the United States. Caterpillar agreed to perform those functions in exchange for a service fee equal to its costs

plus 5%. As a result of those licensing and servicing agreements, over the next thirteen years from 2000 to 2012, Caterpillar shifted to CSARL in Switzerland taxable income from its non-U.S. parts sales totaling more than \$8 billion, and deferred or avoided paying U.S. taxes totaling about \$2.4 billion.

Within the company itself, two professionals in the tax department warned that the Swiss tax strategy lacked economic substance and had no business purpose other than tax avoidance, raising their concerns to officers at the highest levels of the company through an anonymous letter in 2004, and a series of emails and memoranda by the company's Global Tax Strategy Manager beginning in 2007. In 2008, the Global Tax Strategy Manager wrote to the head of the Caterpillar tax department: "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." By 2010, Caterpillar's finance department calculated that, as a result of the Swiss tax strategy, the company's "Effective Tax Rate ha[d] dropped to lowest in the Dow 30."

Caterpillar paid over \$55 million to PricewaterhouseCoopers (PWC), one of the largest accounting firms in the world and Caterpillar's longtime auditor, to develop and implement the Swiss tax strategy, which was designed explicitly to reduce the company's taxes. In the 1999 planning documents, under a benefits analysis, PWC wrote that the CSARL transaction "will migrate profits from CAT Inc. to low-tax marketing companies." PWC added that, by doing so: "We are effectively more than doubling the profit on parts." In 2010, Caterpillar's tax department touted the company's lower tax rate, explaining company operations had been structured so that: "Losses in high-tax rate countries, Profits in low." By simultaneously acting as both auditor and tax consultant for the company, PWC audited and approved the very tax strategy sold by the firm to Caterpillar, raising significant conflict of interest concerns.

A. Subcommittee Investigation

The Caterpillar case study came to the Subcommittee's attention after a civil lawsuit was filed by a former Caterpillar employee who had served as Caterpillar's "Global Tax Strategy Manager," a position created specifically for him by the Chief Financial Officer.² The lawsuit alleged that Caterpillar had sold and shipped replacement parts for its machines from a warehouse in Illinois, while improperly attributing billions of dollars of profits from those sales to a related Swiss affiliate. According to the lawsuit, around 1999, Caterpillar designated a Swiss affiliate known as Caterpillar SARL (CSARL) as the company's "global

² *Schlicksup v. Caterpillar Inc.*, Case No. 09-1208 (C.D. Illinois, Peoria Division 2009).

purchaser” of third party manufactured replacement parts instead of Caterpillar Inc., the U.S. parent corporation, and then began attributing profits from the non-U.S. parts sales to Switzerland instead of the United States, substantially lowering its tax bill.

According to the lawsuit, when Caterpillar designated CSARL as the company’s global parts purchaser, it made no changes in its business operations to justify shifting the parts profits to Switzerland, but retained management and control of the replacement parts business in the United States. The lawsuit further alleged that the CSARL transaction was improper, because it had no legitimate business purpose, but was done solely for tax reasons. The lawsuit also alleged that Caterpillar executives were well aware of the tax risks associated with aspects of the CSARL transaction, noting that senior tax officials had rated the risk as “high.” In 2012, the lawsuit was settled out of court, for an undisclosed sum.

As part of its investigation, the Subcommittee reviewed numerous corporate documents filed and depositions taken in connection with the lawsuit. In addition, the Subcommittee collected and reviewed over 150,000 pages of documents from Caterpillar and its auditor PricewaterhouseCoopers, obtained additional detailed information from Caterpillar through a questionnaire and other information requests, and reviewed publicly available information, including the company’s U.S. Securities and Exchange Commission (SEC) filings. The Subcommittee also conducted 15 interviews of current and former Caterpillar executives and managers, as well as PWC partners, including two PWC tax consultants who helped design the Swiss tax strategy and the PWC tax partner who reviewed Caterpillar’s tax status. The Subcommittee also spoke with academic tax experts and reviewed materials related to offshore profit shifting and transfer pricing issues. Both Caterpillar and PWC cooperated with Subcommittee requests for information.

B. Investigation Overview

Like other multinational corporations examined by the Subcommittee, Caterpillar is an American success story. Launched almost 90 years ago, Caterpillar is a quintessential American company with its worldwide headquarters in Peoria, Illinois, over 52,000 U.S. employees, and facilities located across the country. The company is a world leader in the manufacture of industrial equipment and engines, has significant sales in the United States, and is also one of the United States’ largest exporters. The Caterpillar case study focuses on how this U.S. industrial manufacturer used tax planning techniques to direct billions of dollars in profits to a related affiliate in a tax haven.

The Subcommittee's investigation shows how Caterpillar paid over \$55 million to PWC to develop and implement a tax strategy designed to lower its taxes by sending more profits from its parts business to Switzerland, where the company had negotiated an effective tax rate between 4% and 6%. As part of that tax strategy, Caterpillar replaced its leading Swiss affiliate with a new Swiss affiliate, CSARL, and then used a series of licensing transactions with CSARL to enable it to sell Caterpillar's third party manufactured replacement parts to its non-U.S. dealers and customers without showing the parts profits as U.S. income. Caterpillar had previously purchased those parts directly, primarily from its U.S. third party suppliers, and sold the parts to its Swiss affiliate which, in turn, had sold the parts to Caterpillar's non-U.S. dealers in Europe, Africa, and the Middle East. After the Swiss tax strategy was implemented, Caterpillar was removed from the legal title chain for the non-U.S. parts. Instead, its U.S. third party suppliers typically sold Caterpillar brand parts directly to CSARL which then sold them either to Caterpillar or Caterpillar's non-U.S. dealers.

The removal of Caterpillar from the legal title chain did not, however, otherwise change how Caterpillar's replacement parts business functioned on the ground. Caterpillar retained the central role in managing its parts supply chain, and its replacement parts business continued to function as a U.S.-centric business that was led and managed primarily from the United States, with little operational assistance from Switzerland. Today, over 70% of the third party manufactured parts sold abroad are manufactured in, stored in, and shipped from the United States. Most parts are designed and have their patents registered in the United States, and carry the Caterpillar brand. Caterpillar's U.S. personnel continue to develop, support, and oversee its U.S. supplier network. They also forecast parts demand, monitor inventory levels, and store and ship parts abroad to meet customer orders and the company's pledge to deliver replacement parts anywhere in the world within 24 hours. Caterpillar's U.S. personnel also continue to develop, support, and oversee its worldwide dealer network and, in coordination with its marketing companies such as CSARL, help those dealers stock and sell parts to Caterpillar customers. The documents associated with CSARL's licensing transactions show that they were not designed to change those operational details or to achieve any business advantage other than lowering Caterpillar's effective tax rate.

For a transfer between related parties of valuable assets, such as licensing rights, to be valid under the tax code, the transfer must meet an arm's-length standard, including compensating the transferring party as though the transfer were a sale to an unrelated third party. In this case, Caterpillar received royalty payments that resulted in its receiving only 15% or less of the profits from the sale of those replacement parts, while

85% or more of the profits went to CSARL in Switzerland. Prior to the CSARL transaction, those percentages were essentially reversed, with Caterpillar receiving 85% or more of the non-U.S. parts profits.

Caterpillar's replacement parts business was described internally as a "perpetual profit machine" analogous to an "annuity" that would continue to generate profits for as long as Caterpillar machines were in operation, a time period that averages 20 years per machine. Caterpillar Inc., which created, designed, and developed its replacement parts business over a period of nearly 90 years, not only gave up its right to 85% or more of the profits from its non-U.S. parts sales, it did so without receiving any compensation, such as a super royalty or lump sum payment, for turning over to CSARL the replacement parts business it had spent decades building and for foregoing future profits.

At the same time it gave away the vast majority of its profits from the non-U.S. parts sales and declined to seek compensation from CSARL for turning over that business, Caterpillar Inc. continued to perform the core business functions in exchange for a service fee equal to its costs plus 5%. Caterpillar Inc. also continued to bear the ultimate economic risks associated with the non-U.S. parts business because, even though CSARL took paper ownership of the parts inventory, CSARL's financial results were consolidated with those of the U.S. parent, which meant Caterpillar Inc. would be responsible for any CSARL losses. It is difficult to understand how these arrangements, when viewed in their totality, meet the arm's-length standard.

The purpose of the Subcommittee's investigation and this Report is to describe Caterpillar's offshore tax strategy and its relation to the company's non-U.S. parts business, compare the resulting U.S.-Switzerland profit split to the business functions performed in each country, and examine the policy implications of its transfer pricing arrangements. The investigation also examines the role and policy implications of PricewaterhouseCoopers' acting as both Caterpillar's auditor and tax consultant. In addition, the Report offers recommendations to close some of the offshore tax loopholes and address some of the transfer pricing weaknesses that enable some U.S. multinational corporations to defer or avoid paying substantial U.S. taxes.

C. Findings and Recommendations

Findings. Based on the Subcommittee's investigation, the Report makes the following findings of fact.

- (1) Operating a U.S. Centric Business.** Caterpillar's third-party manufactured replacement parts business, which provides the company with its highest profit margins, is managed and led primarily from the United States.
- (2) Reversing U.S.-Swiss Allocation of Parts Profits.** Caterpillar negotiated a 4% to 6% effective tax rate with Switzerland and, in 1999, executed a tax strategy in which the company stopped allocating 85% or more of its non-U.S. replacement parts profits to the United States and 15% or less to Switzerland, and instead allocated 15% or less of those profits to the United States and 85% or more to Switzerland.
- (3) Generating \$2.4 Billion in Tax Benefits.** After executing its Swiss tax strategy, over a 13-year period beginning in 2000, Caterpillar allocated more than \$8 billion in non-U.S. parts profits to its Swiss affiliate, CSARL, and has so far deferred paying \$2.4 billion in U.S. taxes on those profits.
- (4) Using Contradictory Valuations.** To justify sending 85% of its non-U.S. parts profits to its Swiss affiliate, CSARL, Caterpillar asserted that CSARL's development and support of its offshore dealer network was highly valuable, but when it later transferred to CSARL another marketing company performing the same functions, Caterpillar treated the value of those functions as negligible.
- (5) Employing a Tax-Motivated "Virtual Inventory."** To track CSARL-owned parts stored in Caterpillar's U.S. warehouses, Caterpillar devised a "virtual inventory" system that used "virtual bins" of commingled CSARL and Caterpillar parts and only retroactively, after a sale, identified the specific parts belonging to CSARL. The virtual inventory system created a second set of inventory books for tax purposes and operated in addition to Caterpillar's global inventory system which tracked parts for business purposes.
- (6) Creating a Potential Conflict of Interest.** By acting as both Caterpillar's independent auditor and tax consultant, PricewaterhouseCoopers (PWC) auditors audited and approved the very Swiss tax strategy sold by

PWC tax consultants to the company, creating an apparent, if not actual, conflict of interest. PWC was paid over \$55 million for developing and implementing Caterpillar's offshore tax strategy.

Recommendations. Based upon the Subcommittee's investigation, the Report makes the following recommendations.

- (1) **Clarify IRS Enforcement.** When reviewing multinational corporate transfer pricing transactions to evaluate their compliance with Section 482 of the tax code, the IRS should analyze, in accordance with 26 U.S.C. 7701(o), whether the transactions have economic substance apart from deferring or lowering a multinational's U.S. taxes. The IRS should also clarify what types of transfer pricing transactions, if any, are not subject to an economic substance analysis.
- (2) **Rationalize Profit Splitting.** The IRS transfer pricing regulations should require the U.S. parent corporation to identify and value the functions of the related parties participating in a transfer pricing agreement and, in the agreement, identify, explain, and justify the profit allocation according to which parties performed the functions that contributed to those profits.
- (3) **Participate in OECD Multinational Corporate Tax Effort.** The U.S. Treasury Department and IRS should actively participate in the ongoing OECD effort to develop better international principles for taxing multinational corporations, including by requiring multinationals to disclose their business operations and tax payments on a country-by-country basis, stop improper transfers of profits to tax havens, and stop avoiding taxation in the countries in which they have a substantial business presence.
- (4) **Eliminate Auditing and Tax Consulting Conflicts of Interest.** Congress and the Public Company Accounting Oversight Board (PCAOB) should prohibit public accounting firms from simultaneously providing auditing and tax consulting services to the same corporation, and prevent the conflicts of interest that arise when an accounting firm's auditors are asked to audit the tax strategies designed and sold by the firm's tax consultants.

172

9

II. BACKGROUND

In a globalized world where some U.S. corporations conduct much of their business in multiple countries and draw revenues from overseas as well as from U.S. sales and services, it has become increasingly difficult to determine appropriate allocations of taxable income between U.S. parents and their overseas subsidiaries. At the same time, while the percentage of tax revenues collected from corporations has declined for years, the U.S. federal debt has continued to swell, now surpassing \$16 trillion. The result is a greater burden on individual taxpayers and future generations. According to a report prepared for Congress:

“At its post-WWII peak in 1952, the corporate tax generated 32.1% of all federal tax revenue. In that same year the individual tax accounted for 42.2% of federal revenue, and the payroll tax accounted for 9.7% of revenue. Today, the corporate tax accounts for 8.9% of federal tax revenue, whereas the individual and payroll taxes generate 41.5% and 40.0%, respectively, of federal revenue.”³

A 2013 analysis found that, during the late 1960s and early 1970s, large U.S. companies listed on the current Dow 30 index routinely cited U.S. federal tax expenses that were 25% to 50% of their worldwide profits. By 2013, however, most were reporting less than half that percentage.⁴ Over that same period, the percentage of corporate profits earned overseas increased.

The decline in corporate tax revenues is due in part to more corporate income being reported abroad in low-tax jurisdictions. A number of studies show that U.S. multinational corporations are moving income out of or away from the United States into low or no tax jurisdictions, including tax havens such as Ireland, Bermuda, and the Cayman Islands.⁵

³ 12/8/2011 “Reasons for the Decline in the Corporate Tax Revenues,” Congressional Research Service, Mark P. Keightley, at 1. See also “Tax Havens and Treasure Hunts,” *New York Times*, Nancy Folbre, (April 4, 2011), <http://economix.blogs.nytimes.com/2011/04/04/tax-havens-and-treasure-hunts/>.

⁴ “Tax Burden for the Dow 30 Drops,” *Washington Post*, Darla Cameron & Jia Lynn Yang (3/26/2013), http://www.washingtonpost.com/business/economy/post-analysis-of-dow-30-firms-shows-declining-tax-burden-as-a-share-of-profits/2013/03/26/3dfe5132-7b9a-11e2-82e8-61a46c2cde3d_story.html.

⁵ See, e.g., two hearings before the U.S. Senate Permanent Subcommittee on Investigations, “Offshore Profit Shifting and the U.S. Tax Code – Part 1 (Microsoft and Hewlett-Packard),” S. Hrg. 112-781 (9/20/2012), and “Offshore Profit Shifting and the U.S. Tax Code – Part 2 (Apple Inc.),” S. Hrg. 113-90 (5/21/2013). See also 3/8/2011 “The Revenue Effects of Multinational Firm Income Shifting,” *Tax Notes*, Kimberly A. Clausing (estimating that “income shifting of multinational firms reduced U.S. government corporate tax revenue by about \$90 billion in 2008, approximately 30% of corporate tax revenues”); 6/5/2010 “Tax Havens: International Tax Avoidance and Evasion,” Congressional Research Service, Jane Gravelle, at 15 (citing multiple studies); 3/8/2010 “Drug Company Profits Shift Out of the United States,” *Tax Notes*, Martin

One study showed that foreign profits of controlled foreign corporations (CFCs) of U.S. multinationals significantly outpaced the total GDP of some tax havens.⁶ For example, profits of CFCs in Bermuda were 645% and in the Cayman Islands were 546% as a percentage of GDP, respectively. In a recent research report, JPMorgan expressed the opinion that the transfer pricing of intellectual property “explains some of the phenomenon as to why the balances of foreign cash and foreign earnings at multinational companies continue to grow at such impressive rates.”⁷

The erosion of the corporate tax base caused by the shifting of profits into tax havens is not just a U.S. tax problem. In July 2013, the Organisation for Economic Co-operation and Development (OECD), which consists of 34 member countries with advanced economies including the United States, developed an action plan to assist governments with the growing challenge of multinational corporations engaging in base erosion and profit shifting to avoid paying tax where profits are earned.⁸ The OECD noted that profits reported in tax havens or low-tax jurisdictions were becoming increasingly disproportionate to the location of actual business activity. The action plan was endorsed by the G20 world leaders during the global G20 Summit in September

Sullivan, at 1163 (showing that nearly 80% of pharmaceutical company profits were offshore in 2008, compared to about 33% ten years earlier, and concluding “aggressive transfer pricing practices as the likely explanation for the shift in profits outside the United States”); 2/27/2006 “Governments and Multinational Corporations in the Race to the Bottom,” *Tax Notes*, Rosanne Altshuler and Harry Gruber; 9/13/2004 “Data Show Dramatic Shift of Profits to Tax Havens,” *Tax Notes*, Martin A. Sullivan; “Exporting Profits Imports U.S. Tax Reductions for Pfizer, Lilly, Oracle,” Bloomberg, Jesse Drucker, (5/13/2010), <http://www.bloomberg.com/news/2010-05-13/exporting-profits-imports-u-s-tax-reductions-for-pfizer-lilly-oracle.html>; “Google 2.4% Rate Shows How \$60 Billion Lost to Tax Loopholes,” Bloomberg, Jesse Drucker, (10/21/2010), <http://www.bloomberg.com/news/2010-10-21/google-2-4-rate-shows-how-60-billion-u-s-revenue-lost-to-tax-loopholes.html>; “Yahoo, Dell Swell Netherlands’ \$13 Trillion Tax Haven,” Bloomberg, Jesse Drucker (1/23/2013), <http://www.bloomberg.com/news/2013-01-23/yahoo-dell-swell-netherlands-13-trillion-tax-haven.html>; “IBM Uses Dutch Tax Haven to Boost Profits as Sales Slide,” Bloomberg, Alex Barinka & Jesse Drucker (2/3/2014), <http://www.bloomberg.com/news/2014-02-03/ibm-uses-dutch-tax-haven-to-boost-profits-as-sales-slide.html>; and “G.E.’s Strategies Let It Avoid Taxes Altogether,” *New York Times*, David Kocieniewski, (3/24/2011), http://www.nytimes.com/2011/03/25/business/economy/25tax.html?ref=butnobodypaysthat&_r=0.

⁶ See 6/5/2010 “Tax Havens: International Tax Avoidance and Evasion,” Congressional Research Service, Jane Gravelle, at 14.

⁷ 5/16/2012 “Global Tax Rate Makers,” JPMorgan Chase, at 2 (based on research of SEC filings of over 1,000 reporting issuers).

⁸ See “About BEPS,” on the OECD website, <http://www.oecd.org/tax/beps-about.htm>. BEPS stands for “Base Erosion and Profit Shifting,” which was the subject of two OECD reports in 2013. The OECD website explains that the BEPS project is intended to address issues related to gaps in national laws that “can be exploited by companies who avoid taxation in their home countries by pushing activities abroad to low or no tax jurisdictions.” *Id.* The OECD has issued an “Action Plan” to “develop a new set of standards to prevent double non-taxation” by corporations operating in multiple countries, and “a multilateral instrument to amend bilateral tax treaties” to quickly implement BEPS solutions. *Id.* See also 5/29/2013 “Declaration on Base Erosion and Profit Shifting,” OECD, [http://www.oecd.org/tax/C-MIN\(2013\)22-FINAL-ENG.pdf](http://www.oecd.org/tax/C-MIN(2013)22-FINAL-ENG.pdf).

2013; they stressed the importance to all developing and developed economies of combating multinational corporate tax avoidance.⁹

A. Taxation and Deferral

U.S. corporations are subject to a U.S. statutory tax rate of up to 35% on their worldwide income, which is the highest statutory rate among OECD countries and among the highest in the world. However, the effective tax of U.S. corporations has been estimated at less than half that much, 13%, reduced through a variety of mechanisms, including tax provisions that permit multinational corporations to defer U.S. tax on active business earnings of their offshore subsidiaries until those earnings are brought back to the United States.¹⁰ The ability of a U.S. firm to earn foreign income through overseas subsidiaries without paying U.S. tax until the subsidiaries' earnings are repatriated is known as "deferral."

Deferral has created incentives for U.S. firms to report earnings offshore by subsidiaries in low-tax or no-tax jurisdictions to defer or avoid U.S. taxes and increase their after tax profits.¹¹ Many U.S. multinational corporations have become engaged in finding ways to shift large amounts of income in low-tax foreign jurisdictions, according to a 2010 report by the Joint Committee on Taxation.¹² Current estimates indicate that U.S. multinationals have more than \$1.7 trillion in undistributed foreign earnings and keep 50% to 60% of their cash overseas.¹³ The large amounts of undistributed foreign earnings contribute to greatly-reduced corporate effective tax rates.¹⁴

B. Shifting Income to Offshore Subsidiaries

A major method used by multinationals to shift profits from high-tax to low-tax jurisdictions, and then defer the resulting income from U.S. taxation, is through the transfer of profitable business income, operations, or assets to offshore subsidiaries.

⁹ 9/6/2013 "G20 Leaders' Declaration" after St. Petersburg Summit, at 12, https://www.g20.org/sites/default/files/g20_resources/library/Saint_Petersburg_Declaration_ENG.pdf.

¹⁰ See, e.g., 5/2013 "Corporate Income Tax: Effective Tax Rates Can Differ Significantly from the Statutory Rate," Government Accountability Office (finding that, in tax year 2010, profitable U.S. corporations that filed a Schedule M-3 had an effective U.S. federal income tax rate of about 13%), <http://gao.gov/products/GAO-13-520>.

¹¹ See, e.g., 12/2000 "The Deferral of Income Earned through U.S. Controlled Foreign Corporations," Office of Tax Policy, U.S. Department of Treasury, at 12 (finding tax haven deferral was done for tax avoidance purposes).

¹² 7/20/2010 "Present Law and Background Related to Possible Income Shifting and Transfer Pricing," Joint Committee on Taxation, (JCX-37-10), at 7. See also studies cited in footnote 5.

¹³ See, e.g., 5/16/2012 "Global Tax Rate Makers," JP Morgan Chase, at 1; 4/26/2011 "Parking Earnings Overseas," Credit Suisse; U.S. Senate Permanent Subcommittee on Investigations, "Offshore Funds Located Onshore," 12/14/2011 Addendum to "Repatriating Offshore Funds: 2004 Tax Windfall for Select Multinationals," S.Prt. 112-27 (Oct. 11, 2011).

¹⁴ See 5/2013 "Corporate Income Tax: Effective Tax Rates Can Differ Significantly from the Statutory Rate," Government Accountability Office, <http://gao.gov/products/GAO-13-520>.

Transfers between different subsidiaries of a single multinational corporation can happen for a variety of reasons. One part of the company may need to make use of an asset owned by a different portion of the company, for example. In order to account for the value transferred, Congress and the IRS set up a system of transfer pricing regulations to ensure that multinational corporations accurately assess the value of what is being transferred and do not use such transfers to avoid taxation.

Because of the complexity of intangible asset transfers, companies can be tempted to use intangible asset transfers to circumvent transfer pricing regulations and lower their tax liability. One common tactic is for a U.S. parent to transfer the rights to intangible property to a related party in a low-tax jurisdiction in exchange for a royalty or other payment. Intangible property transfers can involve patents, brand names, marketing rights, the right to use certain business practices, or similar assets. If the royalty payment is lower than the true value of the license, income will effectively be shifted to the low-tax jurisdiction, where U.S. income tax payments can then be deferred or avoided. Principles addressing these transfers are codified under Section 482 and Section 367 of the Internal Revenue Code and largely build upon the requirement that the transfers must be conducted as if they were arm's length dealings between unrelated parties.¹⁵

IRS regulations provide various economic methods that can be used to test the arm's length nature of transfers between related parties as well as evaluate any exchange of value or allocation of profits.¹⁶ In many cases, the U.S. parent will transfer intangible property to an offshore subsidiary in exchange for an upfront payment or ongoing revenue stream. For some types of intangible property, such as the right to use established business practices, comparable values may have been established in the market and can guide proper valuation of the transfer. However, many intangibles relate to unique inventions or business assets, practices, or operations for which comparable transactions do not exist, making it very difficult to establish an arm's length price. Transfers involving unique intangible property are therefore difficult for the IRS to evaluate and challenge.

The Joint Committee on Taxation has stated that a "principal tax policy concern is that profits may be artificially inflated in low-tax countries and depressed in high-tax countries through aggressive transfer pricing that does not reflect an arms-length result from a related-party

¹⁵ An "arm's length transaction" is a transaction that is conducted as though the parties were unrelated, thus avoiding any semblance of conflict of interest. Barron's Dictionary of Finance and Investment Terms (7th ed. 2010).

¹⁶ See 26 CFR § 1.482-4.

transaction.”¹⁷ A study by the Congressional Research Service raised the same issue: “In the case of U.S. multinationals, one study suggested that about half the difference between profitability in low-tax and high-tax countries, which could arise from artificial income shifting, was due to transfers of intellectual property (or intangibles) and most of the rest through the allocation of debt.”¹⁸ A Treasury Department study found that the potential for improper income shifting was “most acute with respect to cost sharing arrangements involving intangible assets.”¹⁹

The transfer pricing regulations permit taxpayers to use several methods to satisfy the arm’s-length standard. The valuation techniques can produce highly variable results, often because of the unique nature of the assets involved. This pricing variability is used by some multinationals to skew transfer pricing analyses in such a way as to increase reported income in low-tax jurisdictions. For example, if a technique provides a range of acceptable prices, the company may choose the lower end of the range for compensation to the U.S. parent corporation or use other aggressive transfer pricing practices. The Economist has described these aggressive transfer pricing tax strategies as a “big stick in the corporate treasurer’s tax-avoidance armoury.”²⁰ Edward Kleinbard, a professor at the University of Southern California and former chief of staff at the Joint Committee on Taxation, has described the valuation problems as “insurmountable.”²¹

There are several ways intangible property can be transferred to a foreign affiliate, and the method chosen frequently dictates whether the authority for determining the compensation received by the U.S. person in the transaction is under Section 482 or Section 367(d) of the tax code. Generally, a license or a sale of intangible property, or the provision of a service that uses intangible property, is subject to Section 482. However, an exchange of intangible property from one controlled foreign corporation to another is subject to Section 367(d).²² Section 367(d) applies, for example, if the transfer of intangible property

¹⁷ 7/20/2010 “Present Law and Background Related to Possible Income Shifting and Transfer Pricing,” Joint Committee on Taxation, (JCX-37-10), at 5.

¹⁸ 6/5/2010 “Tax Havens: International Tax Avoidance and Evasion,” Congressional Research Service, Jane Gravelle, at 8 (citing 3/2003 “Intangible Income, Intercompany Transactions, Income Shifting and the Choice of Locations,” National Tax Journal, vol. 56.2, Harry Grubert, at 221-42).

¹⁹ 7/20/2010 “Present Law and Background Related to Possible Income Shifting and Transfer Pricing,” Joint Committee on Taxation, (JCX-37-10), at 7 (citing November 2007 “Report to the Congress on Earnings Stripping, Transfer Pricing and U.S. Income Tax Treaties,” U.S. Treasury Department).

²⁰ 2008 “An Introduction to Transfer Pricing,” New School Economic Review, vol. 3.1, Alfredo J. Urquidí, at 28 (citing “Moving Pieces”), The Economist, (2/22/2007).

²¹ “IRS Forms ‘SWAT Team’ for Tax Dodge Crackdown,” Reuters, Patrick Temple-West, (3/20/2012), <http://www.reuters.com/article/2012/03/20/us-usa-tax-irs-transfer-idUSBRE82J10W20120320> (quoting Edward Kleinbard).

²² See 7/20/2010 “Present Law and Background Related to Possible Income Shifting and Transfer Pricing,” Joint Committee on Taxation, (JCX-37-10), at 21.

involves an exchange of stock under Sections 351 and 361. Where Section 367(d) applies, the transfer must include imputed income from annual payments over the useful life of the intangible as though the transferor had sold the intangible, a payment that is colloquially referred to as a “super royalty.”²³ The appropriate amounts of those imputed payments are determined under Section 482 and its regulations.

The Subcommittee’s previous investigations, as well as government and academic studies, have shown that some U.S. multinationals use transfer pricing to move income associated with intangible property to CFCs in tax havens or low tax jurisdictions, while they continue to attribute expenses to their U.S. operations, further lowering their taxable income at home.²⁴ This ability to artificially shift income to a tax haven can provide multinationals with an unfair advantage over U.S. domestic corporations by providing the multinationals not only with lower taxes, but also a taxpayer subsidy for their onshore operations.

C. Anti-Deferral Provisions and Subpart F

As early as the 1960s, according to one international tax expert, “administration policymakers became concerned that U.S. multinationals were shifting their operations and excess earnings offshore in response to the tax incentive provided by deferral.”²⁵ At that time, circumstances were somewhat similar to the situation in the United States today. “The country faced a large deficit and the Administration was worried that U.S. economic growth was slowing relative to other industrialized countries.”²⁶ To help reduce the deficit, the Kennedy Administration proposed to tax the current foreign earnings of subsidiaries of multinationals and offered tax incentives to encourage investments at home.²⁷

Although the Kennedy Administration initially proposed to end deferral of foreign source income altogether, a compromise was struck instead, which became known as Subpart F.²⁸ Under the Subpart F compromise, in general, “passive” income generated through investments or funds transfers (such as royalty payments, dividends, or

²³ Id., at 22-23.

²⁴ See, e.g., U.S. Senate Permanent Subcommittee on Investigations, “Offshore Profit Shifting and the U.S. Tax Code – Part I (Microsoft and Hewlett-Packard),” S.Hrg. 112-781 (Sept. 20, 2012).

²⁵ 6/26/2006 “The Evolution of U.S. International Tax Policy - What Would Larry Say?,” Tax Notes International, Paul Oosterhuis, at 2.

²⁶ Id.

²⁷ Id. (citing 1/11/1962 “Annual Message to Congress on the State of the Union,” President John F. Kennedy, 1 Pub. Papers, at 13-14).

²⁸ 6/26/2006 “The Evolution of U.S. International Tax Policy - What Would Larry Say?,” Tax Notes International, Paul Oosterhuis, at 3.

interest) would be taxed currently in the United States, while “active” income (such as revenue from overseas manufacturing activities) would not be taxed until the money was brought into the United States. Subpart F was enacted by Congress in 1962, and was designed in substantial part to address the tax avoidance techniques being utilized today by U.S. multinationals in tax havens. In fact, to curb tax haven abuses, Congress enacted anti-tax haven provisions, despite extensive opposition by the business community.²⁹

Subpart F explicitly restricts the types of income whose taxation may be deferred. The Subpart F rules are codified in tax code Sections 951 to 965, which apply to certain income of CFCs.³⁰ When a CFC earns Subpart F income, the U.S. parent as shareholder is treated as having received the current income. Subpart F was enacted to deter U.S. taxpayers from using CFCs located in tax havens to accumulate earnings that could have been accumulated in the United States.³¹ “[S]ubpart F generally targets passive income and income that is split off from the activities that produced the value in the goods or services generating the income,” according to the Treasury Department’s Office of Tax Policy.³² In contrast, income that is generated by active, foreign business operations of a CFC is permitted to continue to be deferred. But, again, deferral is not permitted for passive, inherently mobile income such as royalty, interest, or dividend income, as well as income resulting from certain other activities identified in Subpart F.³³ Income reportable under Subpart F is currently subject to U.S. tax, regardless of whether that income has been formally repatriated.

At the same time, regulations, temporary statutory changes, and certain statutory exceptions have undercut the intended application of Subpart F. For example, “check-the-box” tax regulations issued by the Treasury Department in 1997, and the CFC “look-thru rule” first enacted by Congress as a temporary measure in 2006 and subsequently renewed, have significantly reduced the effectiveness of the anti-deferral rules of Subpart F and have further facilitated the increase in offshore profit shifting which has gained significant momentum over the last 15 years. In addition, certain statutory exceptions have also weakened important

²⁹ See, e.g., 12/2000 “The Deferral of Income Earned through U.S. Controlled Foreign Corporations,” Office of Tax Policy, U.S. Department of Treasury, at 21.

³⁰ A CFC is a foreign corporation more than 50% of which, by vote or value, is owned by U.S. persons owning a 10% or greater interest in the corporation by vote (“U.S. shareholders”). “U.S. persons” include U.S. citizens, residents, corporations, partnerships, trusts and estates. IRC § 957.

³¹ See, e.g., *Koehring Company v. United States of America*, 583 F.2d 313 (7th Cir. 1978). See also 12/2000 “The Deferral of Income Earned through U.S. Controlled Foreign Corporations,” Office of Tax Policy, U.S. Department of Treasury, at xii.

³² 12/2000 “The Deferral of Income Earned through U.S. Controlled Foreign Corporations,” Office of Tax Policy, U.S. Department of Treasury, at xii.

³³ IRC § 954(c).

provisions of the law, including regulations implementing the “manufacturing exception.”

D. Foreign Base Company Sales Income – Manufacturing Exception

A key type of taxable Subpart F offshore income is referred to in the tax code as Foreign Base Company Sales (FBCS) income. FBCS income generally involves a CFC which is organized in one jurisdiction, used to buy goods, typically from a manufacturer in another jurisdiction, and then sells the goods to a related CFC for use in a third jurisdiction, while retaining the income resulting from those transactions. The FBCS provision is meant to tax the retained profits of the intermediary CFC which typically sits in a tax haven. More specifically, taxable FBCS income is income attributable to related-party sales of goods made through a CFC if the country of the CFC’s incorporation is neither the origin nor the destination of the goods and the CFC itself has not “manufactured” the goods.³⁴ In other words, for the income to be considered taxable foreign base company sales income, the goods must be both produced outside the CFC’s country of organization and distributed or sold for use outside that same country, and an entity related to the CFC must be a party to the transaction.³⁵

The purpose of taxing FBCS income under Subpart F was to discourage multinationals from splitting their manufacturing function from their sales function and then assigning the sales function to a subsidiary in a tax haven. The legislative history, in fact, describes precise scenarios intended to be included under Subpart F. For instance:

“The technique that is used for diverting profits from one company to another among European affiliates is also used to divert income from U.S. companies to foreign affiliates. Income that would normally be taxable by the United States is thrown into tax haven companies with the object of obtaining tax deferral. This is done, for example, by placing in a Swiss or Panamanian corporation the activities of the export division of a U.S. manufacturing enterprise.”³⁶

The FBCS income rules also, however, contain an exclusion known as the “manufacturing exception.” Under this exception, the income retained by the intermediary CFC is not taxable under Subpart F, if the CFC itself is a manufacturer and added substantive value to the

³⁴ IRC § 954(d)(1).

³⁵ *Id.*

³⁶ Statement by Hon. Douglas Dillon, Secretary of the Treasury, before the House Committee on Ways and Means, at 163-66 (May 3, 1961).

goods.³⁷ While this exception was originally restricted to CFCs engaged in physical manufacturing, in 2009, the regulations governing the manufacturing exception were liberalized to make it much easier for a foreign affiliate to claim the exception. As explained by the Joint Committee on Taxation, the 2009 regulations provided:

“A CFC can qualify for the manufacturing exception if it meets one of three tests. The first two [are] physical manufacturing tests: the substantial transformation test and the substantial activity test. The third test [is] the substantial contribution test.”³⁸

Moving from a requirement that the CFC demonstrate that it performed a manufacturing activity to demonstrating that it made a “substantial contribution” to the goods being sold transformed the manufacturing exception into another possible loophole to shield offshore income from Subpart F taxation.³⁹

³⁷ Id.; 26 CFR § 1.954-3(a)(4)(i) (providing that FBCSI income excludes the income of a CFC derived in connection with the sale of goods that were “manufactured, produced or constructed” by the CFC).

³⁸ 7/20/2010 “Present Law and Background Related to Possible Income Shifting and Transfer Pricing,” Joint Committee on Taxation, (JCX-37-10), at 38. See also 2/2/2009 “Guidance Regarding Foreign Base Company Sales Income,” 2009-5 I.R.B., T.D. 9438, <http://www.irs.gov/pub/irs-irbs/irb09-05.pdf>, in which the IRS describes the manufacturing exception before and after the 2009 amendments as follows:

“The existing regulations further define FBCSI [foreign base company sales income] and the applicable exceptions from FBCSI, including the exceptions to the FBCSI rules for personal property that is: (1) manufactured, produced, constructed, grown, or extracted within the CFC’s country of organization (same country manufacture exception); (2) sold for use, consumption or disposition within the CFC’s country of organization; and (3) manufactured, produced, or constructed by the CFC (the manufacturing exception). See § 1.954-3(a)(2)-(4).

The existing regulations set forth certain tests to determine whether a CFC satisfies the manufacturing exception: the ‘substantial transformation test’ of § 1.954-3(a)(4)(ii) and the ‘substantive test’ and safe harbor of § 1.954-3(a)(4)(iii). For purposes of this preamble, the requirements of § 1.954-3(a)(4)(ii) and 1.954-3(a)(4)(iii) will be referred to collectively as the ‘physical manufacturing test’ and the satisfaction of either test will be described as ‘physical manufacturing.’

The proposed regulations provide a third test for satisfying the manufacturing exception, which may apply when a CFC is involved in the manufacturing process but does not satisfy the physical manufacturing test. In particular, the proposed regulations provide that a CFC will satisfy the manufacturing exception if the facts and circumstances evince that the CFC makes a substantial contribution through the activities of its employees to the manufacture, production, or construction of personal property (substantial contribution test). The proposed regulations also propose other modifications to the existing regulations to address the treatment of contract manufacturing arrangements under the FBCSI rules.”

³⁹ The 2009 regulations were made effective for taxable years that began after June 30, 2009. In addition, the IRS allowed taxpayers to apply the new test retroactively to any open taxable year. 2/2/2009 “Guidance Regarding Foreign Base Company Sales Income,” 2009-5 I.R.B., T.D. 9438, <http://www.irs.gov/pub/irs-irbs/irb09-05.pdf>.

Through deferral and various regulatory and statutory exceptions, the tax code has created multiple incentives for multinational corporations to move income offshore to low or no tax jurisdictions and provided multiple methods to avoid current tax on those offshore transfers. A key objective of the Subcommittee's ongoing investigation is to examine these exceptions and loopholes in action, and find an effective way of closing them where transactions have little or no economic substance other than tax avoidance.

E. Economic Substance

Efforts by taxpayers to structure their business in a way that avoids taxation may result in transactions with little or no economic substance. Beginning with a Supreme Court case in 1935, the federal courts have developed an "economic substance doctrine" to determine whether a transaction has enough substance to be respected for tax purposes.⁴⁰ The 1935 case, Gregory v. Helvering, involved a woman who owned one company, transferred its stock to a second company she had just created, then three days later dissolved the second company, took back the first company's shares and sold them. The taxpayer claimed to have engaged in a tax free corporate reorganization and assigned a high cost to the stock she sold to minimize her taxable gain. The Supreme Court ruled against her and for the IRS, finding that her actions had no business purpose other than tax avoidance, and attempted to elevate form over substance, using a company that was entirely paper based, with no employees or business activities.

In 2010, Congress codified the judicial doctrine.⁴¹ Using the case law as its guide in determining whether a transaction had economic substance, the statute established a two part test: the transaction must change the taxpayer's economic position in a meaningful way, and the transaction must have a substantial non-tax purpose.⁴² The statute harmonized a split in the federal circuits as to whether both prongs had to be satisfied, or only one of them. It did not change the applicability of the economic substance doctrine, stating in 26 U.S.C. § 7701(o)(1) that the statute would apply "[i]n the case of any transaction to which the economic substance doctrine is relevant," while leaving the determination of relevance to the common law tests.⁴³ Under common

⁴⁰ See Gregory v. Helvering, 293 U.S. 465 (1935). See also 3/7/2014 "In the Matter of Caterpillar Inc.," Caterpillar Expert Witness Report, John P. Steines, Jr., Professor of Law, New York University, PSI_Caterpillar_17_000003 - 023, at 008 ("[E]conomically meaningless transactions devoid of business purpose other than tax avoidance are generally not respected.").

⁴¹ See § 1409(a) of the Health Care and Education Reconciliation Act of 2010, P.L. 111-152, codified at 26 U.S.C. § 7701(o).

⁴² 26 U.S.C. § 7701(o)(1).

⁴³ 3/21/2010 "Technical Explanation Of The Revenue Provisions Of The 'Reconciliation Act of 2010,' As Amended, in Combination With The 'Patient Protection and Affordable Care Act,'" prepared by the Joint Committee on Taxation, JCX-18-10, at 152-3.

law, the courts have held that the economic substance doctrine was not relevant in some circumstances.⁴⁴ One of those circumstances was described in a Joint Committee on Taxation analysis which said the doctrine may not be relevant to the “decision to utilize a related-party entity in a transaction, provided that the arm’s length standard of section 482 and other applicable concepts are satisfied.”⁴⁵

In July 2011, the IRS issued guidance to help its examiners determine when a transaction had economic substance under the statute.⁴⁶ The guidance provided 18 indicia and four circumstances indicating when a transaction had economic substance and 17 indicia indicating when it did not. For example, the IRS guidance recommended concluding that transactions between related parties that met the arm’s length pricing standards of Section 482 were likely to meet economic substance requirements.⁴⁷ The guidance also recommended finding that a transaction lacked economic substance if the transaction had been “promoted/developed/ administered” by the corporation’s tax department or outside tax advisors.

Because the economic substance doctrine was codified less than four years ago and applies only to transactions after March 2010, only a limited number of cases have interpreted the statute to date.⁴⁸

F. Export Exception

A final issue relevant to the Caterpillar case study is the tax treatment of goods held in the United States under the name of a foreign affiliate. Generally, if the foreign affiliate of a U.S. parent corporation holds inventory in the United States, it can do so without creating a taxable presence. Tax code Section 956(c)(2)(B) excludes from taxable U.S. property any goods located in the United States which were purchased in the United States for export to a foreign country. This export exception allows a foreign company (or a foreign affiliate of a U.S. company) to buy U.S. goods for export, route foreign goods through a U.S. port, or execute routine export functions, without incurring U.S. taxation as a U.S. business. However, there are limits to the scope of the export exception. If the export property is held in a

⁴⁴ Id.

⁴⁵ Id.

⁴⁶ Id.

⁴⁷ Id.

⁴⁸ Id. See also 26 CFR § 1.482-4.

⁴⁸ In several U.S. Tax Court opinions, the court has noted that “Congress codified the economic substance doctrine mostly as articulated by the Court of Appeals for the Third Circuit in ACM Partnership v. Commissioner, 157 F.3d 231, 247-48 (3d Cir. 1998).” The codified doctrine did not apply, however, to the cases at issue under its effective dates. See Crispin v. Commissioner, T.C. Memo. 2012-70, 2012 WL 858406, at 6, n.14; Blum v. Commissioner, T.C. Memo. 2012-16, 2012 WL 129801, at 17, n.21; Rovakat, LLC v. Commissioner, T.C. Memo. 2011-225, 2011 WL 4374589, at 27, n.11.

common pool of inventory for the benefit of multiple parties as a joint enterprise, U.S. courts have held that, based on the facts and circumstances of the case, a de facto U.S. partnership may be created that would subject the individual partners to U.S. taxes.⁴⁹

⁴⁹ See Commissioner v. Culbertson, 337 U.S. 280 (1949) (stating that relevant inquiry is to determine whether the parties in good faith and acting with a business purpose intended to join together in the present conduct of a joint enterprise for profit). The Tax Court has set forth a list of factors that other courts have used to evaluate this factual inquiry. See Luna v. Commissioner, 42 T.C. 1067 (1964).

III. CATERPILLAR CASE STUDY

A. Caterpillar In General

Caterpillar Inc. (Caterpillar) is a multinational corporation headquartered in the United States. It is a publicly traded company registered with the U.S. Securities and Exchange Commission and is listed on exchanges in the United States, France, and Switzerland.⁵⁰ Caterpillar stock is one of the 30 listed in the Dow Jones Industrial Average. Caterpillar is the parent company for approximately 450 subsidiaries or affiliates in 57 countries.⁵¹

Caterpillar is an iconic American company with a strong U.S. presence. Its worldwide headquarters is in Peoria, Illinois, the heartland of the country. Out of 118,500 employees worldwide, about 52,000, or roughly 44%, are located in the United States.⁵² Out of 125 manufacturing facilities worldwide, 54 are located in the United States, far more than in any other country; the remaining 71 manufacturing facilities are located overseas.⁵³ The majority of the company's research and development activity and information technology planning and development occurs in the United States.⁵⁴ In 2012, Caterpillar spent about \$2 billion on research and development, 80% of which was conducted in the United States.⁵⁵ Caterpillar also holds title to most of the intellectual property for its products in the United States, where it coordinates its global registration and enforcement strategy.⁵⁶ Most of Caterpillar's senior executives are in the United States, including its Chief Executive Officer (CEO), Chief Financial Officer (CFO), and Chief Legal Officer, as well as most of the heads of its business segments and divisions.⁵⁷ The current Chairman of the Board and CEO is Douglas Oberhelman.⁵⁸

Caterpillar is the world's leading manufacturer of construction and mining equipment, diesel and natural gas engines, industrial gas turbines, and diesel-electric locomotives.⁵⁹ In 2012, Caterpillar

⁵⁰ 9/15/2011 "Caterpillar Inc. Transfer Pricing Analysis and Report For fiscal year ended December 31, 2010," PwC_PSI_CAT_00007795 - 8204, at 815.

⁵¹ Id.

⁵² Caterpillar Inc. Presentation to the Senate Permanent Subcommittee on Investigations (2/21/2014), at PSI-Caterpillar-14-000001 - 010, at 002.

⁵³ Id. See also Caterpillar Inc. Annual Report (Form-10K), at 20 (12/31/2010).

⁵⁴ Craig T. Boucharde & James V. Koch, *The Caterpillar Way*, at 91 (2014).

⁵⁵ 8/30/2013 Caterpillar response to Subcommittee Questionnaire, CAT-000066 - 108, at 076.

⁵⁶ Subcommittee interview of Thomas Quinn, PwC, Tax Partner (12/17/2013). See also 1/1/2001 Second Amended and Restated License Agreement, CAT-000306 - 699, at 373; 9/23/2013 letter from Caterpillar to Subcommittee, PSI-Caterpillar-04-000001 - 009, at 004.

⁵⁷ See 10/1/2013 "Chairman's Operating Council Organizational Chart," prepared by Caterpillar Inc. and on its website, <http://s7d2.scene7.com/is/content/Caterpillar/C10101108>.

⁵⁸ "2010 Year in Review," prepared by Caterpillar, at 18, <http://s7d2.scene7.com/is/content/Caterpillar/C10005394>.

⁵⁹ Caterpillar Inc. Annual Report (Form-10K), at 1 (2/19/2013).

generated record revenues of \$65.9 billion, earning it a ranking of number 46 on the Fortune 500 list of the largest American corporations.⁶⁰ In 2013, Caterpillar's revenues dropped to \$55.7 billion, a 16% decline.⁶¹ Even with that drop, over that two-year period, Caterpillar's revenues exceeded \$120 billion. As of the end of 2013, Caterpillar had total assets of \$85 billion, of which \$17 billion, or 20%, were indefinitely reinvested earnings held offshore.⁶²

The entity that became Caterpillar Inc. was organized in 1925, in the State of California, when the Holt Manufacturing Company and the C.L. Best Tractor Company merged to form the Caterpillar Tractor Company.⁶³ By 1931, Caterpillar had perfected the diesel tractor engine and redesigned many of its old tractors, and witnessed a steady growth in its sales throughout the decade.⁶⁴ In 1967, Caterpillar's worldwide headquarters moved to Peoria, Illinois. On its website, the company has written that "Caterpillar has deep roots in Peoria," and "[s]ince the beginning when the company expanded its manufacturing from the West coast to the Midwest, [its] presence has deepened across the region."⁶⁵ In 1986, the U.S. parent company was reorganized as Caterpillar Inc. in the State of Delaware.⁶⁶

Caterpillar has five principal business segments: Construction Industries, Energy and Power Systems, Resource Industries, Financial Products, and Customer and Dealer Support.⁶⁷ Construction Industries (CI) is focused on producing machinery used to construct infrastructure and buildings, such as railways, roads, schools and hospitals.⁶⁸ Caterpillar equipment produced by this segment includes backhoe loaders, small tractors, and mini-excavators. Energy and Power Systems (EP) produces energy-related engines, turbines, and related equipment. Its products include power plant generators, turbines, and locomotives serving such industries as the electric power, petroleum, and rail

⁶⁰ See "Fortune 500, Our annual ranking of America's largest corporations," *CNN Money*, (May 21, 2012), http://money.cnn.com/magazines/fortune/fortune500/2012/full_list/. See also 8/14/2013 Caterpillar response to Subcommittee Questionnaire, CAT-000001 - 065, at 001.

⁶¹ "Caterpillar Popping on Better-Than-Expected Profit, Outlook," *Forbes*, Maggie McGrath, (1/27/2014), <http://www.forbes.com/sites/maggiemcgrath/2014/01/27/caterpillar-popping-on-better-than-expected-profit-outlook/>.

⁶² Caterpillar Inc. Annual Report (Form-10K) (2/18/2014); March 2014 "Foreign Indefinitely Reinvested Earnings: Balances Held by the Russell 1000; A Six-Year Snapshot," Audit Analytics, at 4.

⁶³ "Caterpillar Tractor Co. List of Deals," Lehman Brothers Collection, Harvard Business School Baker Library Historical Collections.

http://www.library.hbs.edu/lehman/company.html?company=caterpillar_tractor_co.

⁶⁴ *Id.*

⁶⁵ 10/18/2013 "Peoria – The Home of Caterpillar," Caterpillar website, <http://www.jointeamcaterpillar.com/cda/layout?m=612335&x=333&id=4507617>.

⁶⁶ Caterpillar Inc. Annual Report (Form-10K), at 1 (2/19/2013).

⁶⁷ "2012 Year in Review," prepared by Caterpillar and on its website, at 33, <http://s7d2.scene7.com/is/content/Caterpillar/C10005383>.

⁶⁸ *Id.*

businesses. Resource Industries (RI) focuses on producing equipment that harvests natural resources such as coal, minerals, and lumber.⁶⁹ Its products include large mining trucks, underground mining equipment, and tunnel boring equipment.⁷⁰ The responsibilities of CI, EP, and RI include the design, manufacturing, marketing, and sales of their respective products.⁷¹ Caterpillar's Financial Products segment is involved in the financing of dealers, suppliers, and customers to support the producing, purchasing, and leasing of Caterpillar products.

The fifth and final business segment, Customer and Dealer Support, focuses on customer service and dealer development.⁷² The head of Customer and Dealer Support is Stuart Levenick, a Caterpillar group president based in Illinois.⁷³ Among other responsibilities, the segment is responsible for key aspects of Caterpillar's parts business, including supplying both third party replacement parts and Caterpillar's own worked parts for the machines sold by the CI, EP, and RI segments. Within the segment, the current head of the Customer Services Support Division is Stephen Gosselin, who is charged with "growing Caterpillar's aftermarket parts and services business."⁷⁴ He is based in Illinois. Another key person is Barbara Hodel, Director of Parts Distribution, who is also based in Illinois.⁷⁵

Since the early 1990s, Caterpillar's five business segments have been further organized into various Business Divisions, each of which is led by a Vice President who reports to the Caterpillar Executive Office.⁷⁶ "[A] Business Division can include several subsidiaries or branches ('legal entities') or a legal entity can contain the activities of several Business Divisions."⁷⁷ The scope and role of Caterpillar's individual Business Divisions have evolved over time.⁷⁸ As of 2013, Caterpillar had 30 Business Divisions, which can be categorized into seven types including: Construction Industries, Resource Industries, Energy and Power Systems, and Customer and Dealer Support.⁷⁹ The Customer and Dealer Support divisions include a number that play key roles in the replacement parts business, including the Customer Services

⁶⁹ Id.

⁷⁰ Id.

⁷¹ Id.

⁷² Id.

⁷³ See "Stuart L. Levenick," Caterpillar officer profile prepared by Caterpillar, <http://www.caterpillar.com/en/company/governance/officers/stuart-l-levenick.html>.

⁷⁴ See "Stephen A. Gosselin," Caterpillar officer profile prepared by Caterpillar, <http://www.caterpillar.com/en/company/governance/officers/stuart-l-levenick/stephen-a-gosselin.html>.

⁷⁵ Subcommittee interview of Deborah Kraft, Caterpillar, Accounting Manager (2/5/2014).

⁷⁶ 9/15/2011 "Caterpillar Inc. Transfer Pricing Analysis and Report For fiscal year ended December 31, 2010," PWC_PSI_CAT_00007795 - 8204, at 817.

⁷⁷ Id.

⁷⁸ Id.

⁷⁹ See 10/1/2013 "Chairman's Operating Council Organizational Chart," prepared by Caterpillar Inc. and on its website, <http://s7d2.scene7.com/is/content/Caterpillar/C10101108>.

Support Division and the Distribution Divisions for the Asia Pacific region, the Europe, African and Middle East region, and the Americas.⁸⁰

Caterpillar credits its business model as “the foundation of [its] success.”⁸¹ The company’s business model focuses on the maintenance, repair, and operations component of its business, which the company views as helping to smooth its revenue stream and lock in its customer base.⁸² Caterpillar describes its business model as operating in three phases: seed, grow, and harvest.⁸³ It seeds the business with its initial sale of its products, taking a “life cycle perspective” during product development, with Caterpillar’s differentiated and proprietary parts being a key part of that perspective.⁸⁴ During the grow phase, Caterpillar grows the business by building the largest global field population of products, which in turn helps the company sell parts and services.⁸⁵ Caterpillar states that, by supporting its customers in the long run, it then harvests the opportunities created in the first two phases of the model.⁸⁶ Commenting on the company’s seed, grow, harvest business model, Stuart Levenick, head of the Customer and Dealer Support business segment, recently said: “The harvest part of that is once you create all this population, we’re much more vertical and we have a much more captive control of components and parts than anyone else in our business.”⁸⁷ Caterpillar’s strong focus on aftermarket parts and service is a vital element in all three phases of its business model.⁸⁸

Caterpillar is a leading U.S. exporter, providing more than 300 products to customers in approximately 180 countries around the world.⁸⁹ From 2008 through 2012, Caterpillar exported more than \$82 billion in products from the United States.⁹⁰ In 2011, exports from the

⁸⁰ Caterpillar’s divisions have had a variety of names. For example, the divisions handling parts distribution and logistics have been variously known as the Parts & Services Support Division, CAT Logistics, Parts Distribution & Logistics Division, and Parts Distribution & Diversified Products Division. Subcommittee interview of Deborah Kraft, Caterpillar (2/5/2014); 4/13/2013 “Caterpillar Announces New Organization to Drive Sustained Improvements in Customer Deliveries and Operational Efficiencies and to Build on Recent Product Quality Improvements,” Caterpillar press release, <http://www.caterpillar.com/en/news/corporate-press-releases/h/caterpillar-announces-new-organization-to-drive-sustained-improvements-in-customer-deliveries-and-operational-efficiencies-and-to-build-on-recent-product-quality-improvements.html>.

⁸¹ “2010 Year in Review,” prepared by Caterpillar and on its website, at 18, <http://s7d2.scene7.com/is/content/Caterpillar/C10005394>.

⁸² Craig T. Bouchard & James V. Koch, *The Caterpillar Way*, at 168 (2014).

⁸³ 2010 Year in Review,” prepared by Caterpillar, at 18, <http://s7d2.scene7.com/is/content/Caterpillar/C10005394>.

⁸⁴ *Id.*

⁸⁵ *Id.*

⁸⁶ *Id.*

⁸⁷ 5/1/2013 “The Big Interview: Caterpillar’s Stuart Levenick,” Construction Week Online, Stian Overdahl, <http://www.constructionweekonline.com/article-22168-the-big-interview-caterpillars-stuart-levenick/1/print/>.

⁸⁸ 2010 Year in Review,” prepared by Caterpillar and on its website, at 18, <http://s7d2.scene7.com/is/content/Caterpillar/C10005394>.

⁸⁹ 9/23/2013 letter from Caterpillar to Subcommittee, PSI-Caterpillar-04-000001 - 009, at 002.

⁹⁰ *Id.*

U.S. made up \$19.4 billion or about one-third of its \$60 billion in consolidated sales.⁹¹ While in 1963, only 43% of the company's consolidated sales and revenues came from international customers, in recent years most of Caterpillar sales come from international sales.⁹² In 2013, the company reported that 67% of Caterpillar's revenues came from sales outside of the United States.⁹³ While most sales now occur outside the United States, most of Caterpillar's machines and parts are still built in the United States; for example, as discussed below, in 2012, about 70% of finished Caterpillar replacement parts sold offshore were manufactured in the United States.⁹⁴

B. Caterpillar's Dealer Network

To sell its machines and support the operation of those machines over time, Caterpillar has an extensive network of independent dealers in the United States and around the world. Caterpillar and independent analysts credit the worldwide dealer network as one of its most important competitive advantages. Its dealers have extensive knowledge of Caterpillar products, are focused on the needs of the country or region in which the dealer is located, and provide independent marketing judgment and business efficiencies. In addition to selling machines, Caterpillar dealers typically offer repair services, including providing Caterpillar replacement parts. Many dealers keep an inventory of replacement parts on site.

On average, Caterpillar dealers have been in operation for 50 years, and turnover is rare.⁹⁵ In 1993, Caterpillar had a total of 183 Caterpillar dealers worldwide, with 65 dealerships located in the United States and 118 located outside the United States.⁹⁶ The overall number of dealers is now slightly lower, with 178 dealers worldwide, of which 48, or 27%, are located in the United States and four, or about two percent, located in Switzerland.⁹⁷

Caterpillar's Customer and Dealer Support business segment, headed by Stuart Levenick in Illinois, is responsible for supporting and overseeing Caterpillar's worldwide dealer network. Among other

⁹¹ Craig T. Bouchard & James V. Koch, *The Caterpillar Way*, at 80 (2014); Caterpillar Inc. Annual Report (Form-10K), at 1 (12/31/2011).

⁹² *Id.* at 50.

⁹³ Caterpillar Inc. Annual Report (Form-10K), at 8 (2/19/2013).

⁹⁴ 3/7/2014 Caterpillar response to Subcommittee Questionnaire, CAT-001866 - 264, at 866 - 867.

⁹⁵ 9/17/2001 "Caterpillar Fiscal Year 2000 Transfer Pricing Documentation Report." PwC_CAT_PSI_00004975 - 5162, at 008 and 032.

⁹⁶ Caterpillar Inc. Annual Report (Form-10K), at 2 (12/31/1993).

⁹⁷ 2/21/2014 "Caterpillar Inc. Presentation to the Senate Permanent Subcommittee on Investigations," PSI_Caterpillar_14_000001 - 010, at 002; "Find Your Dealer," Caterpillar worldwide dealer locator service on its website, http://www.cat.com/en_US/support/dealer-locator.html.

responsibilities, it evaluates dealer performance and determines whether a dealer should be added or dropped from the network. In February 2014, the Customer and Dealer Support segment announced an initiative to improve the sales performance of Caterpillar's independent dealers. A media article described that initiative as follows:

“‘This is not a plan to cull our dealers or drive consolidation – although you can expect that some of that will occur,’ Levenick told Reuters in an interview on Wednesday.

‘But we do expect results. If you are not aligned, if you’re not progressing towards those results, then you can expect us to move judiciously to make changes ... They all get that.’

Caterpillar used to organize its global business – including dealer relations – regionally rather than by product category or customer type. So dealers were, in Levenick's words, ‘measured against the guy down the street’.

That changed when the company reorganized a few years ago. The far-flung dealer network was put under one executive in Peoria, Illinois, who began comparing the performance of dealers across the globe.

The disparities, Levenick says, were jaw-dropping. So, too, were the money-making possibilities – if the laggards sold machines, parts and services as efficiently as dealers in the top half of the dealer performance rankings. ...

Under the plan, underperforming dealers have until the end of 2014 to come up with a plan for raising key metrics. Once the plan is approved by Caterpillar, they have three years to meet the targets.”⁹⁸

This new dealer oversight effort, which is being run from the United States, may result in some of the 178 dealers being removed from the Caterpillar network.⁹⁹ Before a new dealer may be removed or added to the network or significantly change its territory, including dealers outside of the United States, approval must be obtained from Caterpillar Inc. executives in the United States, including CEO Doug Oberhelman.¹⁰⁰

⁹⁸ “Caterpillar dealer push may drive some out, Levenick says,” *Reuters*, James B. Kelleher (3/6/2014), <http://www.reuters.com/article/2014/03/06/us-caterpillar-dealers-idUSBREA250AZ20140306>.

⁹⁹ *Id.*

¹⁰⁰ Subcommittee interview of David Picard, Caterpillar Product Support and Sales Operations Director for EAME Region (3/4/2014).

Several divisions within the Customer and Dealer Support business segment provide dealer support. For example, the Customer Services Support Division is responsible, among other tasks, for handling “dealer operational capability development and deployment support.”¹⁰¹ That division is headed by Stephen Gosselin who is located in Illinois.¹⁰²

Also within the Customer and Dealer Support segment, Caterpillar has three regional “Distribution Services” divisions, each headed by a Vice President located in the relevant region, and each responsible for dealer support and market development in the region in which it is based.¹⁰³ The “Americas Distribution Services” Division is headed by Pablo Kozner, who is located in the United States. The “EAME Distribution Division” is headed by Nigel Lewis, who is located in Switzerland at CSARL. The “Asia Pacific Distribution” Division is headed by James Johnson, who is located in Singapore. These three divisions are also often referred to as “marketing companies” since they focus on market development in their respective regions. In its most recent business re-alignment, the three marketing companies were part of a business group within Caterpillar’s Customer and Dealer Support segment known as the Center of Excellence.¹⁰⁴ Like their division heads, the key marketing company personnel for North and South America are located in the United States. The key marketing company personnel for Europe, Africa, and the Middle East are located in Switzerland at CSARL. The key marketing company personnel for Asia and the South Pacific are located in Singapore.

Caterpillar prides itself on its dealers having superb local knowledge of their markets and maintaining superior customer service in the areas in which they operate. Overseas dealers are recommended and also developed, administered, and supported by CSARL and its subordinate companies.¹⁰⁵ According to Caterpillar, dealer recommendations from CSARL and other marketing companies are almost never overruled; one Caterpillar employee intimately involved in the dealer network said that he had never seen the Customer and Dealer Support personnel in Illinois challenge a locally made dealer decision.¹⁰⁶

¹⁰¹ “Stephen A. Gosselin,” profile prepared by Caterpillar, <http://www.caterpillar.com/en/company/governance/officers/stuart-l-levenick/stephen-a-gosselin.html>.

¹⁰² See “Find Your Dealer,” http://www.cat.com/en_US/support/dealer-locator.html.

¹⁰³ 9/17/2001 “Caterpillar Fiscal Year 2000 Transfer Pricing Documentation Report,”

PwC_CAT_PSI_00004975 - 5162, at 028.

¹⁰⁴ 9/15/2011 “Caterpillar Inc. Transfer Pricing Analysis and Report For fiscal year ended December 31, 2010,” PwC_PSI_CAT_00007795 - 8204, at 819.

¹⁰⁵ Subcommittee interview of David Picard, Caterpillar (3/4/2014).

¹⁰⁶ Id.

The marketers at Caterpillar in most instances do not sell directly to customers.¹⁰⁷ Instead, the marketers serve as local Caterpillar representatives responsible for administering and maintaining local dealer relationships. For example, they assist dealers with sales calls, help handle delivery of service issues, and communicate Caterpillar sales goals and other objectives.¹⁰⁸ Another responsibility is helping local dealers develop marketing programs and providing training to their sales personnel as well as training on dealer information systems.¹⁰⁹ Marketing companies may also help a dealer address import or export issues, or apply for financing from Caterpillar or the marketing companies themselves to purchase more inventory or expand its facilities. In addition, they oversee dealer compliance with the terms and conditions of their sales and service agreements with Caterpillar.

While its marketing companies, including CSARL's predecessor in Switzerland, Caterpillar Overseas, S.A. (COSA) which was formed in 1960, helped develop its dealer network, Caterpillar Inc., the U.S. parent, played the largest role in developing the company's worldwide network.¹¹⁰ The majority of the 178 dealers in operation today were established prior to the 1990s.¹¹¹ Using identical language, Caterpillar's 1994, 1995, 1996, and 1997 transfer pricing reports described the relative roles of the U.S. parent and its marketing companies in developing its dealer network as follows:

"Cat Inc. has the largest role with regard to market and dealer development, since 1) it has the largest single market, 2) it was the originator of the basic marketing systems and concepts, and 3) it continues to be involved with the development and oversight of worldwide marketing approaches. The marketing companies also have major responsibility for market development; in fact, this is their primary responsibility."¹¹²

Today, Caterpillar executives in the United States, through the Customer and Dealer Support business segment, continue to oversee and support the company's worldwide dealer network, which continues to be seen as playing a critical role in Caterpillar's success.

¹⁰⁷ 9/17/2001 "Caterpillar Fiscal Year 2000 Transfer Pricing Documentation Report, PwC_CAT_PSI_00004975 - 5162, at 029.

¹⁰⁸ Id. at 027.

¹⁰⁹ Id. at 028.

¹¹⁰ 12/19/1996 "Caterpillar Inc. Evaluation of Arm's Length Pricing for Intercompany Transactions Year Ended December 31, 1995," PwC_CAT_PSI_00008881 - 9104, at 930; See also 1/26/1998 "Caterpillar Inc. Evaluation of Arm's Length Pricing for Intercompany Transactions Year Ended December 31, 1996," PwC_PSI_CAT_00009105 - 334, at 155; 9/15/1998 "Caterpillar, Inc. 1997 Documentation Report Final Report," PwC_PSI_CAT_00009335 - 612 at 392.

¹¹¹ Caterpillar Inc. Annual Report (Form-10K), at 2 (12/31/1993).

¹¹² 4/18/1996 "Caterpillar Inc. Evaluation of Arm's Length Pricing for Intercompany Transactions Year Ended December 31, 1994," PwC_CAT_PSI_00008634 - 880, at 685.

C. Caterpillar's Replacement Parts Business

Caterpillar machines are known for dependability and durability.¹¹³ In fact, the average age of a Caterpillar machines in operation around the world is over 20 years old.¹¹⁴ Caterpillar is also known for its first class customer service. Customers rely on the company to service and repair its machines quickly, minimizing downtime for consumers and contributing to the company's reputation for dependability.¹¹⁵

A key part of its customer service and repair operations is supplying and delivering replacement parts. Caterpillar considers its parts business to be a key competitive advantage.¹¹⁶ Stuart Levenick, head of the Customer and Dealer Support business segment, has said: "Once someone buys a Caterpillar product, the single biggest driver of loyalty to Cat is parts availability."¹¹⁷

Replacement parts also represent a critical aspect of Caterpillar's profitability. Caterpillar machines are often sold at low profit margins, and the company then depends upon the machine's long service life to create long-term customer demand for replacement parts which Caterpillar can sell at higher profit margins.

¹¹³ 11/6/1998 PWC memorandum from John Hatch to Charles Larson and Steven Williams, "Subject: CAT and COSA," PwC_PSI_CAT_00169827 - 838. See also 8/29/2007 email from Steven R. Williams, PWC, to Clifford Mangano, PWC, PwC_PSI_CAT_00024439 - 440 (indicating Caterpillar machines operate for 20 years or longer).

¹¹⁴ Subcommittee interview of William Springer, Caterpillar, Vice President of Product Support (11/7/2013).

¹¹⁵ 11/6/1998 PWC memorandum from John Hatch to Charles Larson and Steven Williams, "Subject: CAT and COSA," PwC_PSI_CAT_00169827 - 838.

¹¹⁶ See, e.g., Caterpillar presentation, "Parts Growth & Distribution Network Transformation," by Caterpillar executives Steve Gosselin and Steve Larson, Feb. 2012 Caterpillar Board of Directors meeting, CAT-001885 - 898, at 886; 4/18/1996 "Caterpillar Inc. Evaluation of Arm's Length Pricing for Intercompany Transactions Year Ended December 31, 1994," PwC_CAT_PSI_00008634 - 880, at 684 ("parts distribution is one of Caterpillar's most important competitive advantages in the marketplace"). At times, Caterpillar has denied to the Subcommittee that it has a "parts business," explaining that "parts" is not one of its reportable business segments. It is clear, however, that Caterpillar views its parts business as critical to the company's success. For example, in minutes from a 2002 board meeting, the parts business was described as "Critical Success Factor #4." The minutes described "the parts business value chain" and stated in part that "the company has recently focused on parts sales and increased investment in parts products development, parts and service systems." 12/11/2002 minutes from Caterpillar Board of Directors meeting, CAT_001855 - 865, at 855. See also, e.g., 12/8/2009 Caterpillar presentation to Caterpillar Board of Directors, CAT-001868 - 884, at 871 (stating, in an update on a business "enterprise alignment," that an "area for continued focus" was the "Parts Business"); 2/8/2012 minutes from Caterpillar Board of Directors meeting, CAT-001855 - 865, at 857 ("Mr. Levenick invited Mr. Gosselin and Larson to discuss the Company's parts business."); 5/1/2013 "The Big Interview: Caterpillar's Stuart Levenick," [Construction Week Online](http://www.constructionweekonline.com/article-22168-the-big-interview-caterpillars-stuart-levenick/1/print/), Stian Overdahl, <http://www.constructionweekonline.com/article-22168-the-big-interview-caterpillars-stuart-levenick/1/print/> (Mr. Levenick states: "That's the good thing about the parts business -- it's really steady when you're in the bottom of a cycle. It's a very important business for us and for the dealers").

¹¹⁷ 5/1/2013 "The Big Interview: Caterpillar's Stuart Levenick," [Construction Week Online](http://www.constructionweekonline.com/article-22168-the-big-interview-caterpillars-stuart-levenick/1/print/), Stian Overdahl, <http://www.constructionweekonline.com/article-22168-the-big-interview-caterpillars-stuart-levenick/1/print/>.

(1) Parts Business In General

Caterpillar documents indicate that, while the company typically earns only a relatively small profit margin from the sales of its machines, its replacement parts business has been a steady generator of major profits for Caterpillar.¹¹⁸ For instance, in some years, Caterpillar's profit margins on machines were in the single digits, while profit margins on some parts exceeded 30%.¹¹⁹ Parts profits also make up a significant portion of the company's profits, despite being only a small portion of its revenues. In one year, 80% of CSARL's profits came from replacement parts sales, despite making up only 20% of its sales revenues.¹²⁰

Donald Fites, Chairman and CEO of Caterpillar between 1990 and 1999, has characterized the sale of a Caterpillar machine to a customer as analogous to the generation of an annuity that continues to pay dividends over time, due to the revenues generated from machine repair and parts.¹²¹ A 2012 company presentation given to the Caterpillar Board of Directors put it this way:

“The ‘seed, grow, harvest’ business model ingrained in the organization was a catalyst to aftermarket parts sales and services, creating an annuity continuing long after original equipment sales and generating customer loyalty, PINS, and profits.”¹²²

In a Subcommittee interview, William Springer, who recently served as President of Caterpillar Third Party Logistics and as Vice President of Product Support, described the parts business in the same way, explaining that 2.5 million Caterpillar machines were in the field with an average life cycle of about 20 years, generating an ongoing demand for replacement parts and thereby creating a “parts annuity.”¹²³ Caterpillar

¹¹⁸ Id.

¹¹⁹ 10/5/1999 “Caterpillar Inc. Global Value Enhancement Project Draft,” PwC_PSI_CAT_00004483 - 530, at 508; Subcommittee interview of William Springer, Caterpillar (11/7/2013).

¹²⁰ 11/14/2005 “Caterpillar SARL 2006-2012 Royalty Rate: Options and Implications,” PwC_PSI_CAT_00133127 -180, at 148.

¹²¹ Craig T. Bouchard & James V. Koch, *The Caterpillar Way*, at 120 (2014).

¹²² 2/8/2012 minutes from Caterpillar Board of Directors meeting, CAT-001855 - 865, at 857. Caterpillar's auditor, PricewaterhouseCoopers also compared the company's business model to that of “razors and razorblades,” referring to companies that give away a razor for free, knowing consumers will pay for the replacement blades. See undated PWC Planning document, PwC_PSI_CAT_00004506 - 631, at 619. PINS is an Caterpillar acronym for “Percent Industry New Sales” and represents market share for new equipment.

¹²³ Subcommittee interview of William Springer, Caterpillar (11/7/2013). But see 5/1/2013 “The Big Interview: Caterpillar's Stuart Levenick,” *Construction Week Online*, Stian Overdahl, <http://www.constructionweekonline.com/article-22168-the-big-interview-caterpillars-stuart-levenick/1/print/> (“there are approximately 3.5 million Caterpillar machines and engines in use through-out the world”).

has also described the replacement parts business as a “perpetual profit machine.”¹²⁴

Demand for replacement parts for a Caterpillar machine can last for decades. For example, one 2007 analysis showed that roughly half of all replacement parts sold by Caterpillar went to service machines that had been in the field for ten years.¹²⁵ In addition, a substantial amount replacement parts sold by Caterpillar were used to service machines that were 20 years old or more.¹²⁶ Since some Caterpillar machines have parts that wear out and require frequent replacement, as much of 90% of some parts’ total production is sold in the aftermarket, rather than in new equipment.¹²⁷

A 2014 book about Caterpillar observed that Caterpillar’s customers may frequently spend two to three times more on service and parts than they spend on the original equipment itself.¹²⁸ The book also cited a recent analysis which determined that, during the financial crisis of 2008-2009, parts revenue proved vitally important to both Caterpillar and its dealers as sales of some machines dropped by as much as 62%, but parts sales continued.¹²⁹ Stuart Levenick, Customer and Dealer Support head, has said: “That’s the good thing about the parts business – it’s really steady when you’re in the bottom of a cycle. It’s a very important business for us and for the dealers, it really helps even out those swings in the business cycles.”¹³⁰

Parts Design. Because of the revenue implications, aftermarket parts sales for a machine represent a very important set of design considerations for the company.¹³¹ The Subcommittee was told that Caterpillar machines are designed on an individual basis, with a single Product Manager ultimately responsible for the design and production of all components of a particular machine.¹³² The majority of Caterpillar’s worldwide Product Managers are located in the United States.¹³³ To protect Caterpillar’s replacement part revenue stream, Product Managers

¹²⁴ 3/15/2010 “Caterpillar Inc. Worldwide Parts Management Final Closing Book, Draft Version as of March 15, 2010,” PwC_PSI_CAT_00003876 – 168, at 912.

¹²⁵ 8/29/2007 email from Steven Williams, PWC, to Clifford Mangano, PWC, PwC_PSI_CAT_00024439 - 440, at 439.

¹²⁶ *Id.*

¹²⁷ Subcommittee interview of William Springer, Caterpillar (11/7/2013).

¹²⁸ Craig T. Bouchard & James V. Koch, *The Caterpillar Way*, at 218 (2014).

¹²⁹ *Id.*, at 120, citing “Fall in Sales in the Great Recession: Rachel Potts, Caterpillar Public Affairs.”

¹³⁰ 5/1/2013 “The Big Interview: Caterpillar’s Stuart Levenick,” *Construction Week Online*, Stian Overdahl, <http://www.constructionweekonline.com/article-22168-the-big-interview-caterpillars-stuart-levenick/1/print/>.

¹³¹ Subcommittee interview of William Springer, Caterpillar (11/7/2013).

¹³² *Id.*

¹³³ *Id.*; Subcommittee interview of Steven Williams, PWC (2/19/2014). See also 11/4/2008 email from Steven Williams, PWC, to Thomas Quinn, PWC, “is tomorrow really the only shot with DBB,” PwC_PSI_CAT_00033157 (“Also, just curious – say they decide most PMs stay in US.”).

are encouraged to incorporate proprietary parts into Caterpillar machines whenever possible and to prevent Caterpillar machines from being repaired with generic parts from competitors.¹³⁴ According to a 2012 presentation to the Caterpillar Board of Directors, product design emphasizing proprietary parts was a key factor driving the company's future parts growth.¹³⁵ Caterpillar has registered numerous patents for its parts, most of which are in the United States.

Third Party Parts Suppliers. Caterpillar's aftermarket machine parts are produced primarily by third party suppliers as "purchased finished replacement parts" (PFRPs).¹³⁶ Parts produced by third party suppliers in the United States almost always carry the Caterpillar brand and are packaged as Caterpillar products. While Caterpillar does not own most of its major parts suppliers, it exercises oversight of them to maintain parts quality and protect its brand. At times, it stations Caterpillar personnel on site at supplier plants to oversee operations and promote Six Sigma compliance.¹³⁷ Currently, approximately half of Caterpillar's 48,000 third-party suppliers that produce purchased finished replacement parts are located in the United States.¹³⁸

In some cases, Caterpillar itself produces the replacement parts needed in some of its machines. When Caterpillar manufactures the part, they are referred to as "worked parts," to distinguish them from the "purchased finished replacement parts" manufactured by third party suppliers. Most of Caterpillar's worked parts are manufactured by its plants in the United States. However, the majority of Caterpillar replacement parts are produced by third parties rather than by the company itself.¹³⁹

24-Hour Parts Delivery. Caterpillar also maximizes its parts business by offering to its customers best in class parts replacement services. A 2012 Caterpillar Year in Review Report stated: "A key strength is [the company's] ... ability to manufacture parts [and] ... deliver unmatched parts availability to dealer and customers anywhere in the world."¹⁴⁰ The 2012 report highlighted the company's focus on

¹³⁴ Subcommittee interview of William Springer (11/7/2013).

¹³⁵ See Caterpillar presentation, "Parts Growth & Distribution Network Transformation," by Caterpillar executives Steve Gosselin and Steve Larson, Feb. 2012 Caterpillar Board of Directors Meeting, CAT-001885 – 898, at 888. See also 2/8/2012 minutes from Caterpillar Board of Directors meeting, CAT-001855 - 865, at 857.

¹³⁶ "2012 Year in Review," prepared by Caterpillar and on its website, at 33, <http://s7d2.scene7.com/is/content/Caterpillar/C10005383>.

¹³⁷ Craig T. Bouchard & James V. Koch, *The Caterpillar Way*, at 169 (2014); Subcommittee interview of David Burritt, former Caterpillar CFO (12/4/2013).

¹³⁸ 2/21/2014 Caterpillar Inc. Presentation to the Senate Permanent Subcommittee on Investigations, at PSI-Caterpillar-14-000001 - 010, at 002.

¹³⁹ 12/3/2013 Caterpillar response to Subcommittee Questionnaire, CAT-000270 - 298, at 277.

¹⁴⁰ "2012 Year in Review," prepared by Caterpillar, at 33, <http://s7d2.scene7.com/is/content/Caterpillar/C10005383>. See also 12/11/2002 minutes from

quick delivery of parts by citing an instance in which a Caterpillar dealer delivered a part to a customer only one hour after the customer called in.¹⁴¹

Caterpillar has set a goal of delivering its parts anywhere in the world within 24 hours of a request and views its ability to meet that goal as differentiating it from its competitors.¹⁴² Caterpillar tracks its delivery performance and manages dealer inventory levels to assist with parts delivery.¹⁴³ According to Caterpillar, its dealers are able to fill 85% to 90% of parts orders immediately upon request from parts kept on site, and 95% of the remaining parts are delivered anywhere in the world within 24 hours.¹⁴⁴ Other similar industries, such as automobiles, can take 2-7 days to ship parts that are not held in stock at a dealership.¹⁴⁵ According to Caterpillar's transfer pricing documentation, "Caterpillar's guarantee to deliver parts anywhere in the world on very short notice enables it to sell more machines, since customers know that they will not be idled long by missing parts."¹⁴⁶

Caterpillar has been performing functions critical to the parts side of its business for decades. In the 1990s, for example, U.S. personnel were warehousing parts, setting stocking levels, forecasting parts usage and demand, managing support systems, invoicing, overseeing the parts

Caterpillar Board of Directors meeting, CAT_001855 - 865, at 856 ("product support is vitally important to the company and its dealers").

¹⁴¹ "2012 Year in Review," prepared by Caterpillar, at 15.

<http://s7d2.scene7.com/is/content/Caterpillar/C10005383>.

¹⁴² See, e.g., 9/11/2006 "Caterpillar, Inc. Valuation of Caterpillar's 100% Interest in Shareholder's Equity of Caterpillar of Australia Pty. Limited," Ernst & Young, PwC-PSI-CAT-00015198 - 272, at 218; 4/18/1996 "Caterpillar Inc. Evaluation of Arm's Length Pricing for Intercompany Transactions Year Ended December 31, 1994," PwC_CAT_PSI_00008634 - 880, at 684 ("parts distribution is one of Caterpillar's most important competitive advantages in the marketplace"). See also "Building the World - Caterpillar," article in *Access*, a publication of Federal Express (May 2012), <http://access.van.fedex.com/caterpillar/> (When asked about Caterpillar's commitment to deliver a part anywhere in the world within 24 hours, Stuart Levenick, Group President of Caterpillar's Customer Service and Dealer Support segment, said: "That's a big commitment, and that's worldwide. It means we've got an enormous network of parts distribution. We've got logistics people feeding parts into these depots, dealers carrying inventory. All of this has to work like a clock. ... Logistics is huge for us."). Komatsu, a key Caterpillar competitor, has made an almost identical guarantee. See <http://www.komatsuamerica.com/komatsu-parts>.

¹⁴³ Subcommittee interview of William Springer, Caterpillar (11/7/2013).

¹⁴⁴ Id. See also Subcommittee interview of Thomas Quinn, PWC (10/2/2013) (Caterpillar's success rate in meeting its 24-hour delivery standard is typically in the upper 90th percentile); 11/6/1998 PWC memorandum from John Hatch to Charles Larson and Steven Williams, PWC, "CAT and COSA," PwC_PSI_CAT_00169827 - 838, at 833 ("Dealers now provide 80% of parts orders immediately upon request, and 99% are shipped within a day of being requested").

¹⁴⁵ See 11/6/1998 PWC memorandum from John Hatch to Charles Larson and Steven Williams, PWC, "CAT and COSA," PwC_PSI_CAT_00169827 - 838, at 833 ("contrast this to 2-7 days for car dealers that do not have a part in stock").

¹⁴⁶ 4/18/1996 "Caterpillar Inc. Evaluation of Arm's Length Pricing for Intercompany Transactions Year Ended December 31, 1994," PwC_CAT_PSI_00008634 - 880, at 684-685.

introduction process, and working on parts delivery.¹⁴⁷ According to other Caterpillar documentation during the 1990s:

“Caterpillar’s after sales service, which includes supporting dealers in the servicing of equipment and the timely provision of parts around the world, is one of its major competitive tools. Caterpillar’s role in after-sales service includes developing servicing procedures and standards, technical manuals, technical support and training for dealers, and warranty support. The dealer network and parts distribution are the two keys to after-sales service. The marketing companies have responsibility for the dealer network, while P&SS [Parts & Services Support Division in the United States] performs the primary management activity for the parts distribution network. Cat Inc., as the designer of the system and owner of the Morton parts center, has the greatest strategic role.”¹⁴⁸

According to Caterpillar representatives, CSARL and its subordinate marketing companies continue to play an instrumental role in fulfilling the 24 hour parts delivery promise by helping monitor local parts demand and ensure needed parts are stockpiled at local distribution centers.¹⁴⁹

(2) Role of the United States in Caterpillar’s Parts Business

Former Caterpillar CFO David Burritt told the Subcommittee that the company’s ability to provide high quality parts within 24 hours anywhere in the world depends upon logistic capabilities that were developed by the company over more than 75 years.¹⁵⁰ While Caterpillar’s replacement parts business has operations around the world and is supported by its marketing companies, including CSARL in Switzerland, and by dealer personnel worldwide, the company’s parts leadership and strategic functions remain centered in the United States.¹⁵¹ Altogether, Caterpillar has over 8,300 employees who work

¹⁴⁷ Undated interview notes of Craig Barley – Manager, Peoria, Parts & Services Support Availability & Inventory Management, collected by PwC, PwC_PSI_CAT_00179037 - 038. See also 12/1998, Caterpillar Inc., Global Tax Optimization, Risk Adjusted Benefit Analysis, Working Papers – Draft 1,” PWC-PSI-CAT-00001336 - 671, at 415 (“P&SS [Parts & Services Support division] appears to track parts (forecasting, scheduling, purchasing, shipping, inventory levels) on a global basis with great amounts of detail”); Subcommittee interview of Deborah Kraft, Caterpillar (2/5/2014).

¹⁴⁸ 1/26/1998 “Caterpillar Inc. Evaluation of Arm’s Length Pricing for Intercompany Transactions Year Ended December 31, 1996.” PwC_PSI_CAT_00009105 - 334, at 156. See also 9/15/1998 “Caterpillar, Inc. 1997 Documentation Report Final Report,” PwC_PSI_CAT_00009335 - 612 at 393; 9/15/1999 “Caterpillar 1998 Documentation Report,” PwC_PSI_CAT_00009613 - 928, at 674.

¹⁴⁹ Subcommittee interview of David Picard, Caterpillar (3/4/2014).

¹⁵⁰ Subcommittee interview of David Burritt, former Caterpillar CFO (12/4/2013).

¹⁵¹ See, e.g., 2/8/2012 minutes from Caterpillar Board of Directors meeting, CAT_001855 - 865, at 857 (describing Caterpillar’s parts distribution business as using a “U.S. centric model”);

on parts, about 4,900 of whom are located in the United States, more than any other country, despite the fact that 67% of Caterpillar sales occur offshore.¹⁵² That concentration of U.S. employees is due in part to the fact that nearly 70% of purchased finished Caterpillar replacement parts sold offshore are still manufactured in the United States.¹⁵³ Both before and after the 1999 CSARL transaction, Caterpillar's replacement parts business has been led and managed primarily from the United States.

Key Parts Personnel. A number of organizations within Caterpillar Inc. manage key aspects of its replacement parts business. The Customer and Dealer Support business segment, headed by Stuart Levenick of Illinois, performs a number of the key functions, including parts logistics and distribution, inventory management, and parts pricing.¹⁵⁴ A key division is the Customer Services Support Division, which is charged with "growing Caterpillar's aftermarket parts and services business" and handling "parts distribution," among other tasks.¹⁵⁵ It is headed by Stephen Gosselin, who is based in Illinois. Within his division, Barbara Hodel, also located in Illinois, is the Director of Parts Distribution and oversees the company's warehouses and distribution centers.¹⁵⁶ Two additional key employees are Joseph Van Wassenhove, Parts Pricing Manager, and Timothy Gryl, Service Parts Manager and head of Caterpillar's Inventory Management Group. Both are Illinois residents.

Another key organizational unit is the Caterpillar Enterprise System Group, headed by David Bozeman who reports directly to CEO Douglas Oberhelman. Mr. Bozeman, too, is based in Illinois. This new "order-to-delivery organization" was formed in 2013.¹⁵⁷ A key employee is Frank Crespo, the head of Purchasing, which is responsible for developing and overseeing the company's supplier base which manufactures the purchased finished replacement parts sold abroad. Another key employee is Edward O'Neil, manager of Manufacturing

9/1998 PWC report, "Caterpillar Inc. Global Tax Optimization Case for Action," PwC_PSI_CAT_00004632, at 670 (describing Caterpillar's "U.S. 'centric' role" as a "Negative Tax Rate Driver"); 4/18/1996 "Caterpillar Inc. Evaluation of Arm's Length Pricing for Intercompany Transactions Year Ended December 31, 1994," PwC_CAT_PSI_00008634 - 880, at 686 and 698 (describing Caterpillar Inc. as playing the "greatest strategic role" in after sales service and stating that "Parts & Services Support, a division of Cat Inc. located in Morton, IL is charged with managing the worldwide parts distribution network").

¹⁵² 12/3/2013 Caterpillar response to Subcommittee Questionnaire, CAT-000270 - 298, at 279.

¹⁵³ 3/7/2014 Caterpillar response to Subcommittee Questionnaire, CAT-001866 - 2264, at 866.

¹⁵⁴ See "Stuart L. Levenick," Caterpillar officer profile prepared by Caterpillar, <http://www.caterpillar.com/en/company/governance/officers/stuart-l-levenick.html>.

¹⁵⁵ See "Stephen A. Gosselin," Caterpillar officer profile prepared by Caterpillar, <http://www.caterpillar.com/en/company/governance/officers/stuart-l-levenick/stephen-a-gosselin.html>.

¹⁵⁶ Subcommittee interview of Deborah Kraft, Caterpillar (2/5/2014).

¹⁵⁷ "David P. Bozeman," Caterpillar officer profile prepared by Caterpillar, <http://www.caterpillar.com/en/company/governance/officers/david-p-bozeman.html>; 4/13/2014 Caterpillar Enterprise System Group press release.

Logistics.¹⁵⁸ Both are located in Illinois. Among other responsibilities, the new group is responsible for transporting Caterpillar parts around the world.

A former key member of the company's parts leadership was Steven Larson, who was head of the parts logistics division for the last nine years until he retired in February 2014.¹⁵⁹ Mr. Larson was also based in Illinois. After his retirement, the parts logistic division was dissolved and its functions integrated with the Customer Services Support Division.¹⁶⁰

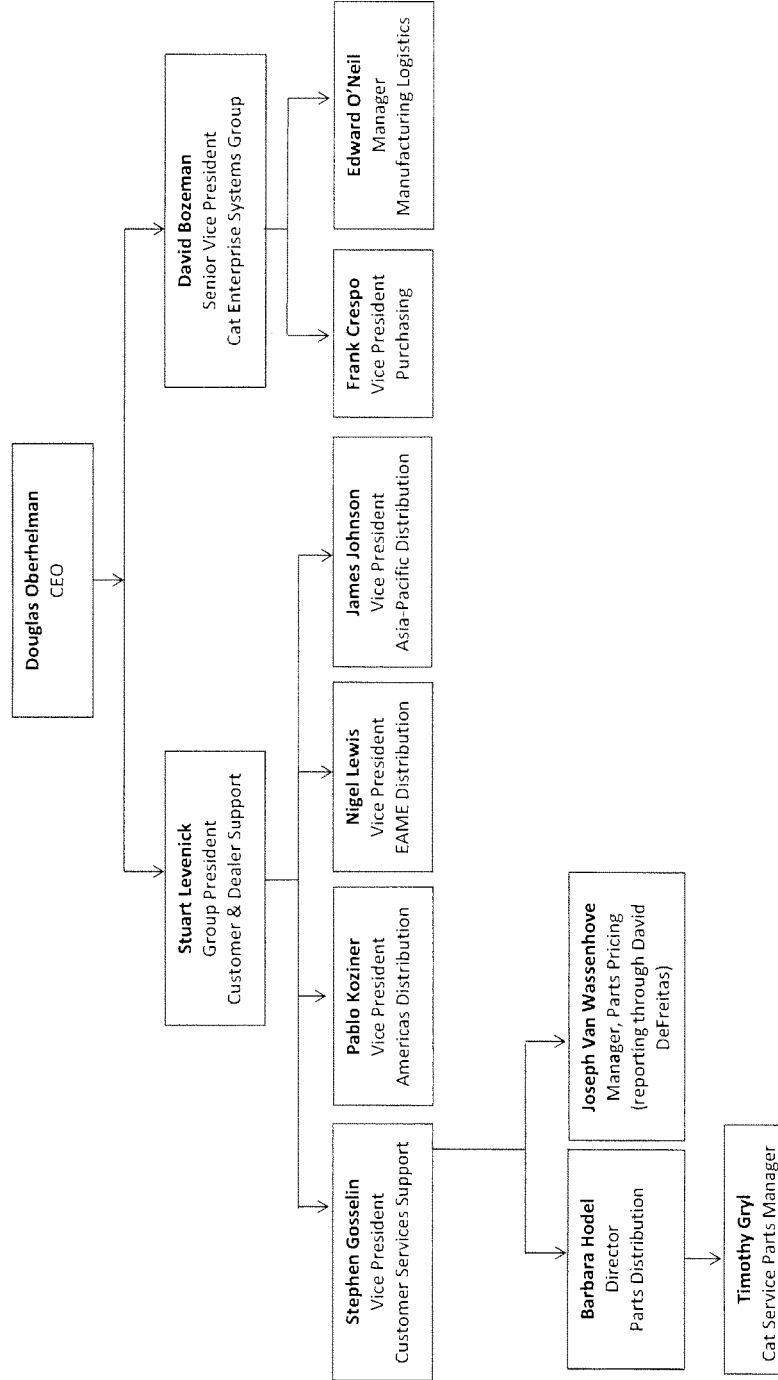
The following chart depicts Caterpillar organizations and executives who lead and manage key business functions supporting its non-U.S. parts sales.

¹⁵⁸ His group is the successor to the Manufacturing Logistics & Transportation Group formerly part of Steven Larsen's parts logistics division. 4/13/2014 Caterpillar Enterprise System Group press release.

¹⁵⁹ See 8/20/2013 "Caterpillar Announces Retirements of Long-Time Officers; Appointments and Changes in Responsibilities for Vice Presidents will Drive Company Strategy," Caterpillar press release, <http://www.caterpillar.com/en/news/corporate-press-releases/h/caterpillar-announces-retirements-of-long-time-officers-appointments-and-changes-in-responsibilities-for-vice-presidents-will-drive-company-strategy.html> (noting Mr. Larson was head of the division for nine years and "played a critical role in the successful divestiture of a majority interest in Caterpillar Logistics Services in 2012, and ... guided the build out, modernization and expansion of the Cat® parts distribution network").

¹⁶⁰ Id. ("Concurrent with the announcement of Steve Larson's retirement, Caterpillar is announcing a strategic realignment of the Parts Distribution & Diversified Products Division and the Customer Services Support Division. As part of this realignment, Caterpillar's Parts Distribution business will be integrated into the Customer Services Support Division, which is led by Vice President Steve Gosselin. The Customer Services Support Division is focused on aggressively growing Caterpillar's parts and product support. The division develops and supports deployment of parts and service products, processes and programs for our dealers, enabling them to deliver unmatched product support. Including Caterpillar Parts Distribution this division will form a single global parts organization that will allow a seamless Caterpillar focus on supporting customer requirements for product support.").

Caterpillar Organizations Performing Key Functions Related to Parts



Storing Parts. Illinois not only hosts the vast majority of Caterpillar's senior parts leadership, but is also the home of the Morton warehouse which is Caterpillar's central hub for stocking replacement parts.¹⁶¹ Morton is twice the size of Caterpillar's next largest warehouse,¹⁶² and is used by Caterpillar distribution centers, dealers, and customers around the world to obtain hard-to-get parts.¹⁶³ About 40% by value of CSARL-owned parts destined for sale abroad are stored in the Morton warehouse.¹⁶⁴ In addition to Morton, as of 2012, Caterpillar had five other warehouses in the United States, as well as smaller distribution centers across the country.¹⁶⁵ Outside of the United States, in 2012, Caterpillar had three warehouses, one each in South America, the Asia Pacific region, and the Europe, Africa, Middle East region, along with other distribution centers around the world.¹⁶⁶ In the last two years, Caterpillar has opened additional warehouse facilities within and outside of the United States. That the United States has continued to play a central role in the company's parts distribution business is reflected in the minutes of a February 2012 Caterpillar Board of Directors meeting in which management advocated converting Caterpillar's parts distribution business from a "U.S. centric" model into one that relied more on regional distribution centers.¹⁶⁷

Managing Parts Inventories. Inventory supply levels at the Morton warehouse as well as Caterpillar's other warehouses and distribution centers around the world are monitored and managed by the Inventory Management Group, which is headquartered in the United States.¹⁶⁸ This group is included within the Customer Services Supports

¹⁶¹ Subcommittee interview of Thomas Quinn, PwC (12/17/2013)

¹⁶² Id. The next two largest parts warehouses are located in Grimbergen, Belgium and Singapore. Smaller distribution sites are located elsewhere in the United States and in other parts of the world.

¹⁶³ "85% of worldwide parts inventory is managed from Morton-moving toward 100%." Undated interview notes of Craig Barley – Manager, Peoria, P&SS Availability & Inventory Management, collected by PwC, PwC_PSI_Cat_000179037 - 038. At one point, the Morton distribution center even controlled 100% of the physical parts inventory kept in Caterpillar's main European warehouse. Id.

¹⁶⁴ 11/26/2013 letter from Caterpillar to Subcommittee, CAT-000267 - 269, at 268.

¹⁶⁵ Caterpillar presentation, "Parts Growth & Distribution Network Transformation," by Caterpillar executives Steve Gosselin and Steve Larson, Feb. 2012 Caterpillar Board of Directors Meeting, CAT-001885 - 898 at 897 ("Cat Parts Distribution Future Footprint," chart); 2008 "Caterpillar Worldwide Locations," prepared by Caterpillar Inc. (listing 14 distribution centers across the United States). http://pdf.cat.com/cda/files/113505/7/2008%20WW%20location_final.pdf.

¹⁶⁶ Caterpillar presentation, "Parts Growth & Distribution Network Transformation," by Caterpillar executives Steve Gosselin and Steve Larson, Feb. 2012 Caterpillar Board of Directors Meeting, CAT-001885 - 898 at 897 ("Cat Parts Distribution Future Footprint," chart). The EAME warehouse is in Grimbergen, Belgium; none of the warehouses or distribution centers have ever been in Switzerland.

¹⁶⁷ 2/8/2012 minutes from Caterpillar Board of Directors meeting, CAT_001855 - 865. See also Caterpillar presentation, "Parts Growth & Distribution Network Transformation," by Caterpillar executives Steve Gosselin and Steve Larson, Feb. 2012 Caterpillar Board of Directors Meeting, CAT-001885 - 898.

¹⁶⁸ Subcommittee interview of Deborah Kraft, Caterpillar (2/5/2014).

Division, headed by Timothy Gryl, and managed out of Illinois.¹⁶⁹ Caterpillar uses this group to monitor and determine the number and types of parts it should order from its suppliers and keep on hand at various locations. Under Caterpillar's obligations in its service agreement with CSARL, this group monitors and manages inventory levels for parts needed on a worldwide basis.¹⁷⁰

The Inventory Management Group operates a global inventory monitoring system that tracks parts inventory levels around the world in Caterpillar's distribution network, forecasts demand for particular parts, and transports parts on an emergency basis.¹⁷¹ Its state-of-the-art inventory management software, which is at the heart of the company's logistics capabilities, was developed in and is administered from Caterpillar operations in Illinois. The group predicts demand for parts by evaluating historical demand patterns using sophisticated algorithms and generates recommended stocking levels for Caterpillar's worldwide distribution facilities.¹⁷² On the issue of predicting future parts demand, Stuart Levinick, Customer and Dealer Support head, explained:

"We're able to understand how many hours a machine is being utilized each month, and we track that – by model, by industry, and by geography – so you can get ahead of how much these machines are being used, how much fuel they're burning, and that correlates back to future parts demand. So it's giving us a leg up to understand with our supply base when to start to dial up capacities, and when to ease back."¹⁷³

The Inventory Management Group also helps customers acquire parts on an expedited basis from manufacturers if the parts are not immediately available in Caterpillar's inventory.

Although the Inventory Management Group is managed from the United States, it is assisted by Caterpillar parts and service representatives located in distribution centers and marketing companies around the world. Those representatives assist dealers in monitoring and managing their parts inventories to facilitate sales. According to Caterpillar, the representatives spend roughly 50% of their time at dealer sites, and occasionally are co-located at a dealership.¹⁷⁴ Parts and service representatives help dealers maximize aftermarket part sales by systematically evaluating and predicting when parts will wear out, when they should be ordered and in what quantities, as well as helping dealers

¹⁶⁹ Id.

¹⁷⁰ 12/3/2013 Caterpillar response to Subcommittee Questionnaire, CAT-000270 - 298, at 296.

¹⁷¹ Subcommittee interview of Deborah Kraft, Caterpillar (2/5/2014).

¹⁷² Subcommittee interview of William Springer, Caterpillar (11/7/2013).

¹⁷³ 5/1/2013 "The Big Interview: Caterpillar's Stuart Levinick," Construction Week Online, Stian Overdahl, <http://www.constructionweekonline.com/article-22168-the-big-interview-caterpillars-stuart-levenick/1/print/>.

¹⁷⁴ Subcommittee interview of William Springer, Caterpillar (11/7/2013).

prevent counterfeit parts from entering their markets.¹⁷⁵ Representatives also assist in training dealer technicians on proper service and maintenance of Caterpillar machines.¹⁷⁶ Service manuals for parts and machines are designed by Caterpillar personnel in the United States and shipped to dealers around the world.¹⁷⁷ In addition, Caterpillar provides marketing consulting services, and creates and supports dealer marketing programs for replacements parts.¹⁷⁸

Customers needing replacement parts typically turn first to their local Caterpillar dealer, which keeps a parts inventory on site and is able to provide the requested part 85-90% of the time.¹⁷⁹ If the part is not available on site, the dealer, or occasionally the customer, can place an order for the replacement part which is sent to the appropriate Caterpillar distribution facility, generally the closest location geographically. Inventory systems at the facility automatically check for availability of the part in the facility's onsite inventory. If the part is available it will be pulled from the facility's inventory and prepared for shipment. If the part is not available at the facility, the order will automatically be sent to the next closest warehouse or distribution center, the largest being the Morton warehouse in Illinois.¹⁸⁰ When the part is located, it is prepared for immediate shipment with the goal of delivering the part to the local dealer or customer within 24 hours of the order.

Caterpillar uses numerous inventory systems to monitor parts supplies in its warehouses. These systems anticipate what parts will be needed when and where to replenish inventories around the world. Its general parts inventory system was designed in and is run from the United States.¹⁸¹ Caterpillar's U.S. software engineers developed the algorithms and other software elements integral to that system, which tracks inventory quantities throughout Caterpillar's worldwide distribution network.¹⁸² Other systems keep track of orders, purchases, sales, and inventory pricing, and also generate parts invoices for dealers. Historically, distribution centers in Grimbergen and Singapore have had personnel to expedite and schedule orders, but all parts forecasting and ordering was done from Morton, Illinois, even for parts sourced in Europe.¹⁸³

Manufacturing Parts. In connection with its parts business, Caterpillar not only has to forecast the types and numbers of replacement parts needed, but also order their manufacture in time to

¹⁷⁵ *Id.*

¹⁷⁶ *Id.*

¹⁷⁷ Subcommittee interview of Deborah Kraft, Caterpillar (2/5/2014).

¹⁷⁸ 12/3/2013 Caterpillar response to Subcommittee Questionnaire, CAT-000270 - 298, at 296.

¹⁷⁹ Subcommittee interview of William Springer, Caterpillar (11/7/2013).

¹⁸⁰ Subcommittee interview of Edward Simpkins, Caterpillar (1/29/2014).

¹⁸¹ *Id.* Backup systems are located in Belgium.

¹⁸² *Id.*

¹⁸³ Undated interview notes of Craig Barley – Manager, Peoria, Parts & Services Support Availability & Inventory Management, collected by PWC, PwC_PSI_CAT_00179037 - 038.

meet customer demand. Caterpillar Inc. has sophisticated proprietary ordering systems, which were developed and are mainly administered out of the United States and function worldwide.¹⁸⁴ While Caterpillar manufactures a portion of the required replacement parts itself, most of its replacement parts must be ordered from its third-party suppliers.¹⁸⁵

The company dedicates significant resources to managing its relationships with its third-party parts suppliers. The company's Purchasing group, led by Frank Crespo of Mossville, Illinois, has been assigned primary responsibility for managing those relationships.¹⁸⁶ The Purchasing group works closely with the suppliers to ensure they build parts that meet Caterpillar's quality standards and price requirements.¹⁸⁷ Its duties include working with suppliers to procure materials and services, forecasting demand for materials and parts, and monitoring the business viability of the supply base, with the overall goal of ensuring parts orders will be filled on time. Purchasing personnel visit suppliers in the United States and abroad to ensure capability and quality control in compliance with Six Sigma management principles.¹⁸⁸ In some cases, Caterpillar personnel are embedded at supplier sites to oversee manufacturing, and suppliers undergo rigorous financial audits by Caterpillar personnel.¹⁸⁹

In addition, under the service agreement signed between Caterpillar Inc. and CSARL referenced earlier, Caterpillar Inc. agreed to manage third-party suppliers within the United States that produce parts sold around the world. Under this agreement, Caterpillar Inc. consults with CSARL on identifying potential U.S. suppliers, visits those suppliers, negotiates terms with them, arranges for the transportation and delivery of specified parts, and inspects those parts for quality.¹⁹⁰

Once parts manufactured in the United States by Caterpillar or a third-party supplier are produced, they may be packaged by a third party contractor. Third-party packaging companies take delivery of the parts and package them under the Caterpillar brand so they are suitable for storage at warehouses and subsequent sale. The relationship with these third-party packaging companies in the United States is also managed by the Purchasing group in the United States. Packaged parts have historically been delivered to the Morton distribution center in Illinois prior to being shipped to the company's regional distribution centers.¹⁹¹

¹⁸⁴ See "Summary of Orders and Invoicing Systems," PwC_PSI_CAT_00018032 - 036.

¹⁸⁵ 12/3/2013 Caterpillar response to Subcommittee Questionnaire, CAT-000270 - 298, at 277.

¹⁸⁶ Subcommittee interview of Deborah Kraft, Caterpillar (2/5/2014). The Global Purchasing Division was also known, at times, as the Product Support Division.

¹⁸⁷ Id.

¹⁸⁸ See Craig T. Bouchard & James V. Koch, *The Caterpillar Way*, at 169 (2014); Subcommittee interview of David Burritt, former Caterpillar CFO (12/4/2013).

¹⁸⁹ Id.

¹⁹⁰ 12/3/2013 Caterpillar response to Subcommittee Questionnaire, CAT-000270 - 298, at 296.

¹⁹¹ Subcommittee interview of Deborah Kraft, Caterpillar (2/5/2014). See also undated interview notes of Craig Barley - Manager, Peoria, Parts & Services Support Availability & Inventory

Today, some parts are also packaged and shipped from points outside of the United States.

Transporting Parts. Caterpillar also typically arranges for the transportation of parts from its third-party suppliers to its regional distribution facilities, a service managed by Caterpillar's Transportation Division, which is headquartered at the Morton distribution center in Illinois.¹⁹² The Transportation Division, which is part of the Caterpillar Enterprise System Group, assists in delivering parts to Caterpillar's 19 global storage and distribution centers, including the warehouses in Grimbergen and Singapore.¹⁹³ As the goods arrive, Caterpillar personnel here and abroad are responsible for conducting quality inspections to ensure the parts meet the company's standards. The distribution centers are also responsible for conducting ongoing oversight over the life of a product, in part to evaluate the performance of the replacement parts.¹⁹⁴ The head of Caterpillar's quality division is also located in the United States and operates out of the Morton distribution center.¹⁹⁵

Thousands of Parts Personnel. In response to questions from the Subcommittee, Caterpillar provided information about how many of its U.S. employees are involved with the "purchase, storage, movement, and sales of replacement parts."¹⁹⁶ Caterpillar indicated that of the 8,300 Caterpillar employees involved in those functions in 2012, about 4,900 worked in the United States. Of those 4,900 U.S. employees, Caterpillar indicated that about 3,600 were involved with "[p]arts [d]istribution ([l]ogistics)," about 1,035 were involved with "[g]lobal [p]urchasing," about 35 were involved with "parts pricing," about 115 were involved with "[p]arts [m]arketing [s]upport," and about 100 worked for the "Distribution Services Division."¹⁹⁷

Caterpillar's replacement parts business is a complex and demanding undertaking that requires expertise in forecasting parts demand, managing inventory supply levels, ordering the manufacture of needed parts, exercising quality control, packaging parts for shipment, and delivering parts as needed. Senior leadership for the Caterpillar parts business has been and continues to be located primarily in the United States. Key inventory management systems and controls, as well as ordering systems, were developed in the United States and continue to be managed from there. The company's largest and most important

Management, collected by PwC, PwC_PSI_CAT_00179037 - 038 ("Most regional distribution centers are served from Morton, not from contract packagers, because of low volume at regional centers.").

¹⁹² Subcommittee interview of Deborah Kraft, Caterpillar (2/5/2014).

¹⁹³ See undated PwC interview notes of Don Puryear, Caterpillar Purchasing Transportation and Technical Support Manager, PwC_PSI_CAT_00179035 - 036.

¹⁹⁴ Subcommittee interview of Deborah Kraft, Caterpillar (2/5/2014).

¹⁹⁵ Id.

¹⁹⁶ 12/3/2013 Caterpillar response to Subcommittee Questionnaire, CAT-000270 - 298, at 279.

¹⁹⁷ Id.

distribution center and parts warehouse operates out of Illinois. The majority of Caterpillar parts manufacturing takes place in the United States. To date, Caterpillar's replacement parts business has been and continues to be led and managed primarily from the United States.

D. Caterpillar in Switzerland

Although its major operations have always been in the United States, Caterpillar has also had a small continuous presence in Switzerland for decades. Today, out of 118,500 employees worldwide, about 400, or less than one half of one percent of its employees, are located in Switzerland.¹⁹⁸

COSA. For forty years, from 1960 to 1999, Caterpillar's leading Swiss affiliate was Caterpillar Overseas, S.A. (COSA), which was based in Geneva.¹⁹⁹ COSA acted as Caterpillar's lead marketing company for the Europe, Africa, and Middle East (EAME) region.²⁰⁰ COSA's responsibilities included purchasing machines and parts from Caterpillar for resale to EAME dealers, developing and maintaining the EAME dealer network, providing logistics support for parts delivery; providing EAME dealers with marketing information and sales training; acting as a liaison between EAME dealers and Caterpillar on product performance and service issues; helping EAME dealers obtain financing from Caterpillar or private banks to purchase inventory and improve their dealerships; and conducting oversight of EAME dealers to ensure their compliance with Caterpillar sales and service agreements. COSA worked with Caterpillar's U.S. employees who were in charge of approving new dealers, designing machines and their replacement parts, developing marketing campaigns and sales training materials for dealers, and providing dealer financing.²⁰¹ COSA had a regional focus, and was one of several offshore marketing companies that Caterpillar sponsored around the world.²⁰²

Aside from COSA's marketing work, Caterpillar had a very limited presence in Switzerland. Of its 125 manufacturing plants, none were or are located there.²⁰³ Of its 19 distribution centers, none were or

¹⁹⁸ 3/7/2014 "In the Matter of Caterpillar Inc.," Caterpillar Expert Witness Report, John P. Steines, Jr., Professor of Law, New York University, PSI-Caterpillar-17-000003 - 023, at 006 (CSARL in Switzerland currently has about 400 employees).

¹⁹⁹ 4/18/1996 "Caterpillar Inc. Evaluation of Arm's Length Pricing for Intercompany Transactions Year Ended December 31, 1994," PwC_CAT_PSI_00008634 - 880, at 673.

²⁰⁰ Id.; 12/19/1996 "Caterpillar Inc. Evaluation of Arm's Length Pricing for Intercompany Transactions Year Ended December 31, 1995," PwC_CAT_PSI_00008881 - 9104, at 916-917.

²⁰¹ 12/19/1996 "Caterpillar Inc. Evaluation of Arm's Length Pricing for Intercompany Transactions Year Ended December 31, 1995," PwC_CAT_PSI_00008881 - 9104, at 930-931.

²⁰² Id. at 917-918.

²⁰³ 2/21/2014 "Caterpillar Inc. Presentation to the Senate Permanent Subcommittee on Investigations," at PSI-Caterpillar-14-000001 - 010 at 002. See also 2008 "Caterpillar Worldwide Locations," prepared by Caterpillar Inc., http://pdf.cat.com/cda/files/113505/7/2008%20WW%20location_final.pdf. In 2004, Caterpillar purchased a local Swiss company that packaged, but did not manufacture, industrial turbines and

are in Switzerland. When EAME dealers needed replacement parts, the parts were generally shipped from Caterpillar's primary warehouse in Morton, Illinois or from other Caterpillar distribution centers, such as its warehouse in Grimbergen, Belgium. Very few replacement parts have ever been shipped from Switzerland to another country. In addition, during COSA's tenure, no worldwide or regional Product Managers were based in Switzerland.²⁰⁴

In addition to its headquarters in Switzerland, COSA also operated a branch office that was first in Hong Kong and later in Singapore, providing marketing support for Caterpillar dealers in Asia and the South Pacific.²⁰⁵ Unlike Switzerland, in addition to the marketing office, Caterpillar maintained a parts distribution center and some manufacturing facilities in Singapore to serve Asian dealers.²⁰⁶

For years, Caterpillar's foreign marketing companies that helped support the sale of parts, including COSA's marketing operations in Switzerland and Singapore, were allocated a share of Caterpillar's non-U.S. parts profits. Although the amount fluctuated over time, the baseline apportionment was 50-50 on a legal entity basis prior to 1992.²⁰⁷ During this time, Caterpillar had little incentive to have a more precise apportionment because all profits on parts were immediately taxable in the United States by operation of Subpart F. In 1992, the marketing companies' share was set at 4% of the profit of the 30% profit margin for non-U.S. parts sold in their region, which translated into roughly 13% of those non-U.S. parts profits.²⁰⁸ That profit allocation for COSA continued until 1999.

CSARL. In 1999, as part of the Swiss tax strategy that is the focus of this Report, COSA and several other Swiss affiliates' assets and business activities were consolidated into a renamed Swiss entity, Caterpillar SARL (CSARL).²⁰⁹ Since then, CSARL has served as Caterpillar's leading Swiss affiliate. It has continued to perform the same marketing functions as COSA, and the EAME regional marketing

related systems. "Caterpillar Inc. Completes Acquisition of Turbomach S.A.," (6/17/2004), *PRNewswire*, <http://www.prnewswire.com/news-releases/caterpillar-inc-completes-acquisition-of-turbomach-sa-75032792.html>.

²⁰⁴ 12/3/2013 Caterpillar response to Subcommittee Questionnaire. CAT-000270 - 298, at 281-294.

²⁰⁵ 4/18/1996 "Caterpillar Inc. Evaluation of Arm's Length Pricing for Intercompany Transactions Year Ended December 31, 1994." PwC_CAT_PSI_00008634 - 880, at 673; 12/19/1996 "Caterpillar Inc. Evaluation of Arm's Length Pricing for Intercompany Transactions Year Ended December 31, 1995," PwC_CAT_PSI_00008881 - 9104, at 916-917; 3/7/2014 "In the Matter of Caterpillar Inc.," Caterpillar Expert Witness Report, John P. Steines, Jr., Professor of Law, New York University, at PSI-Caterpillar-17-000003 - 023, at 006.

²⁰⁶ 3/7/2014 "In the Matter of Caterpillar Inc.," Caterpillar Expert Witness Report, John P. Steines, Jr., Professor of Law, New York University, at PSI-Caterpillar-17-000003 - 023, at 006.

²⁰⁷ Subcommittee interview of Steven Williams, PWC (2/19/2014).

²⁰⁸ 12/19/1996 "Caterpillar Inc. Evaluation of Arm's Length Pricing for Intercompany Transactions Year Ended December 31, 1995." PwC_CAT_PSI_00008881 - 9104, at 959.

²⁰⁹ 2/16/2010 "Caterpillar Inc. CSARL Permanent File Chronological History: 1999-2010," PwC_PSI_CAT_00003406 - 463, at 407.

work is the focus of the vast majority of CSARL employees in Switzerland today.²¹⁰ In 2000, Caterpillar made the head of the EAME Distribution Division a Vice President reporting to the Customer and Dealer Support Group President.²¹¹ That division head has been located in Switzerland at CSARL. The division head's duties were described by Caterpillar as "in charge of marketing of all Caterpillar Products, parts and services in the Europe, Africa, Middle East and Commonwealth of independent States Region."²¹² As part of that marketing work, CSARL has continued to support Caterpillar's non-U.S. dealer network with respect to parts. Its duties have included helping to ensure dealer inventories have the parts they need, supporting Caterpillar's commitment to deliver needed parts within 24 hours, and acting as a liaison between the dealers and Caterpillar parts personnel in the United States.²¹³ CSARL has also maintained the Singapore branch which, today, has about 400 employees.²¹⁴

In addition, as part of the 1999 transaction, CSARL was designated as Caterpillar's "global purchaser" of purchased finished replacement parts (PFRPs), the Caterpillar replacement parts manufactured by third-party suppliers. It took over that role from Caterpillar Inc., the U.S. parent corporation. Acting as the initial purchaser of parts, CSARL either instantaneously resold the PFRPs to Caterpillar in the United States or sold them over time to non-U.S. independent dealers, Caterpillar affiliates, or customers, as explained in more detail below.

Initially, CSARL became the nominal PFRP purchaser for the EAME region. Then, from 1999 to 2003, Caterpillar, the U.S. parent, designated CSARL as the nominal PFRP purchaser for more and more of its geographical regions, executing a series of licensing agreements with its Swiss affiliate.²¹⁵ The licensing agreements generally directed that between 4% and 6% of the sales of licensed products by CSARL be paid to Caterpillar as a royalty.²¹⁶ In addition, CSARL entered into a servicing agreement with Caterpillar Inc. to pay Caterpillar's costs plus a 5% markup, for the U.S. parent to continue to perform a number of core parts functions, including managing the worldwide parts inventory, supervising suppliers, forecasting parts demand, supervising parts logistics, and storing CSARL-owned parts in the United States.²¹⁷

²¹⁰ Subcommittee interview of David Picard, Caterpillar (3/4/2014).

²¹¹ 12/3/2013 Caterpillar response to Subcommittee Questionnaire, CAT-000270 - 298, at 284.

²¹² *Id.*

²¹³ Subcommittee interview of David Picard, Caterpillar (3/4/2014).

²¹⁴ 3/7/2014 "In the Matter of Caterpillar Inc.," Caterpillar Expert Witness Report, John P. Steines, Jr., Professor of Law, New York University, at PSI-Caterpillar-17-000003 - 023, at 006.

²¹⁵ 1/16/2003 Caterpillar's legal counsel memorandum "History of Significant Changes in International Operations (Not Inclusive of Financing Arrangements) 1997 - 2002," PSI-TWLF-02-000423 - 436.

²¹⁶ 3/7/2014 "In the Matter of Caterpillar Inc.," Caterpillar Expert Witness Report, John P. Steines, Jr., Professor of Law, New York University, at PSI-Caterpillar-17-000003 - 023, at 007.

²¹⁷ *Id.*

CSARL was unable then or now to perform those parts functions itself, lacking the necessary personnel, infrastructure, and expertise.

After the CSARL transaction, in 2000, Caterpillar relocated three regional Product Managers who worked on machines and products used in the EAME region, moving them from France and Belgium to Switzerland.²¹⁸ Most of the company's Product Managers, however, have continued to work in the United States. In 2009, after the IRS issued new regulations requiring foreign affiliates of U.S. manufacturers to meet certain requirements to avoid Subpart F taxation, Caterpillar assigned one global Product Manager to CSARL.²¹⁹ In addition, Caterpillar created a new position at CSARL for a "Worldwide Parts Manager" which was filled by Quentin de Warlincourt, who was already working in Switzerland.²²⁰ Mr. de Warlincourt was the first worldwide parts manager stationed in Switzerland. He was charged with establishing an "overall parts strategy" in consultation with Caterpillar Inc.'s Executive Office and acting as a liaison among Caterpillar business units involved with parts management, as explained in more detail below.²²¹ He reported to Stephen Gosselin, head of the Customer Services Support Division, in the United States. Over the next five years, Mr. de Warlincourt assembled a staff of five to twelve persons in Switzerland.²²² Caterpillar witnesses told the Subcommittee that having a more localized worldwide parts manager resulted in operational efficiencies due to greater knowledge and awareness of local supply needs.²²³ He was recently replaced by Thomas Zihlmann, who is located in Switzerland and whose job title has been changed to Worldwide Parts Strategy Manager.²²⁴

At the Subcommittee's request, Caterpillar provided information about the total number of its Swiss employees involved with the "purchase, storage, movement, and sales of replacement parts."²²⁵ Caterpillar indicated that, of the 8,300 Caterpillar employees involved with those functions in 2012, about 66 were located in Switzerland. Caterpillar indicated that, of those 66 Swiss employees, 10 were involved with "parts pricing" and about 56 worked for the EAME Distribution Services Division.²²⁶

²¹⁸ 12/3/2013 Caterpillar response to Subcommittee Questionnaire, CAT-000270 - 298, at 281-282.

²²⁰ 1/2010, "Caterpillar Inc. CSARL 2009 activities Report to Audit Team," 00003830 - 875, at 832, 847.

²²⁰ 12/3/2013 Caterpillar response to Subcommittee Questionnaire, at CAT-000270 - 298, at 286.

²²¹ 3/15/2010, "Caterpillar Inc. Worldwide Parts Management Final Closing Book, Draft Version as of March 15, 2010." PwC_PSI_CAT_00003876 - 4168, at 906-907.

²²² Subcommittee interview of David Picard, Caterpillar (3/4/2014).

²²³ *Id.*

²²⁴ 3/27/2014 Information provided by Caterpillar to the Subcommittee, PSI-Caterpillar-21-000001 - 002.

²²⁵ 12/3/2013 Caterpillar response to Subcommittee Questionnaire, at CAT-000270 - 298, at 279.

²²⁶ *Id.*

IV. EMPLOYING A SWISS TAX STRATEGY TO AVOID U.S. TAXES

Since the company's inception, Caterpillar's replacement parts business has operated as a "U.S. centric" business, led and managed primarily from the United States. Prior to 1999, Caterpillar reported 85% or more of the profits from the sale of its replacement parts to non-U.S. customers as taxable U.S. income, while attributing 15% or less of the profits to its Swiss affiliate and other marketing companies. At that time, even the portion of the profits attributed to its market companies was included on Caterpillar's U.S. tax return as taxable income under Subpart F. Beginning in 1998, however, Caterpillar's tax department paid millions of dollars to PricewaterhouseCoopers (PWC) and McDermott Will & Emery to develop and implement a tax strategy to lower the company's global taxes. PWC designed a Swiss tax strategy to direct the lion's share of Caterpillar's non-U.S. purchased finished replacement parts (PFRP) profits away from the United States to Switzerland, where Caterpillar had negotiated an effective tax rate of 4% to 6%,²²⁷ lower even than the Swiss federal statutory rate of 8.5%.²²⁸

In 1999, Caterpillar implemented the Swiss tax strategy, which it called the Global Value Enhancement or "GloVE" program.²²⁹ As part of that program, it renamed a Swiss subsidiary Caterpillar SARL (CSARL) which became the nominal recipient of the purchased finished parts profits and enabled Caterpillar to direct those profits away from the United States to Switzerland.²³⁰ Like its predecessor, CSARL also served as a marketing company, supporting Caterpillar's independent dealers in Europe. Over time, CSARL was also assigned responsibility for other Caterpillar marketing companies around the globe, and Caterpillar directed their parts revenues to Switzerland as well. By 2008, approximately 45% of Caterpillar's consolidated revenues and 43% of its profits had been shifted to CSARL, an entity with less than one half of one percent of CAT's 118,500 employees.²³¹ As a result, over the next thirteen years, from 2000 to 2012, Caterpillar shifted U.S.

²²⁷ 8/30/2013 Caterpillar response to Subcommittee Questionnaire, CAT-000070; 12/3/2013 Caterpillar response to Subcommittee Questionnaire, CAT-000270 - 274. When asked about the tax rate that Caterpillar paid in Switzerland, the PWC partner who led the tax consulting efforts and was also involved in Caterpillar's transfer pricing issues told the Subcommittee that Caterpillar had received a Swiss Government ruling that allows it to pay the statutory rate on only 20% of its non-Swiss source income, resulting in an effective tax rate of 4%. Subcommittee interview of Thomas Quinn, PWC (10/2/2013).

²²⁸ 12/3/2013 Caterpillar response to Subcommittee Questionnaire, CAT-000270 - 298, at 270.

²²⁹ 10/5/1999 "Caterpillar Inc. Global Value Enhancement Project Draft."

PwC_PSI_CAT_00004483 - 530.

²³⁰ See 8/22/2008 "Delivering Vision 2020 Value Transformation: An After-Tax View,"

PwC_PSI_CAT_00058419 - 472, at 429 and 449.

²³¹ 7/30/2008 PWC Presentation, "Caterpillar Sarl Overview," PwC_PSI_CAT_00065585 - 610, at 589.

taxable income of more than \$8 billion offshore to Switzerland and deferred or avoided paying U.S. taxes totaling about \$2.4 billion.

A. Adopting the Swiss Tax Strategy

PricewaterhouseCoopers is Caterpillar's longtime auditor, having provided auditing services to the company since the 1920s, primarily from its offices in Chicago.²³² In the 1990s, in addition to serving as Caterpillar's independent auditor, PWC provided the company with special tax consulting services designed to reduce its global taxes.

GTOP Review. In the late 1990s, PWC offered clients a program through its tax consulting services group known as the "Global Tax Optimization Program" (GTOP).²³³ As part of that program, PWC offered to review a client's business operations to identify potential tax savings. The goal of GTOP was to conduct a comprehensive assessment of the company's tax practices at the state, national, and international levels, identify tax inefficiencies, and recommend ways to change its operations to lower its overall tax payments.²³⁴ PWC described the program as "a coordinated, tailored approach to achieving [a company's] lowest sustainable tax rate."²³⁵

In 1997, PWC tax consulting services and Caterpillar began discussions regarding a potential GTOP review of Caterpillar's business and tax practices.²³⁶ In 1998, Caterpillar agreed to conduct the GTOP review, but did so by engaging a law firm, McDermott Will & Emery, which in turn engaged PWC on Caterpillar's behalf to conduct the review.²³⁷ Caterpillar relied on McDermott Will & Emery for tax advice. PWC initiated the GTOP review that same year. Internally, Caterpillar called the PWC tax reduction program the Global Value Enhancement (GloVE) program.²³⁸

Five Year Effort. PWC's tax review and tax reduction strategy for Caterpillar took about a year to complete; implementing the tax strategy took several more years, for a total of nearly five years, from 1998 to 2003. Caterpillar's tax department was the driving force behind

²³² Subcommittee interview of Thomas Quinn, PWC (10/2/2013).

²³³ *Id.*

²³⁴ *Id.*

²³⁵ 4/14/1998, PWC presentation to Caterpillar, "Global Tax Optimization," PwC_PSI_CAT_00004892, at 895.

²³⁶ Subcommittee interview of Thomas Quinn, PWC (10/2/2013).

²³⁷ 11/13/2006 PricewaterhouseCoopers National Office memorandum, "Independence Consultation Database," PSI-TWLF-21-000228 - 231, at 229; Subcommittee interview of Thomas Quinn, PWC (10/2/2013).

²³⁸ Subcommittee interviews of Thomas Quinn, PWC (10/2/2013) and James Bowers, PWC (1/23/2014).

the company's decision to adopt PWC's recommended tax strategy.²³⁹ The tax department paid for the tax consulting services provided by PWC and McDermott Will & Emery as well as the business division costs associated with the CSARL structure.²⁴⁰ Caterpillar has estimated the total five-year cost at over \$55 million.²⁴¹

The bulk of PWC's substantive work occurred in the first two phases of the program: the "analyze phase" and the "develop phase."²⁴² The analyze phase involved PWC's examining Caterpillar's tax practices and the business and operational factors driving its value and tax liability and identifying ways to lower its effective tax rate. The develop phase involved PWC's providing a specific set of recommendations as well as an operational feasibility analysis and a cost-benefit analysis of its proposals.²⁴³

According to PWC, during the initial analyze phase in 1998, PWC conducted an extensive set of interviews with Caterpillar's executive office and business unit leaders to assess the views of Caterpillar's corporate officials regarding the direction of the company.²⁴⁴ This process also involved on-site visits to Caterpillar facilities, both inside and outside the United States.

Swiss Tax Strategy Proposed. Sometime in 1998, PWC submitted a report to Caterpillar containing a summary of ideas to reduce Caterpillar's tax liability.²⁴⁵ In the report, PWC presented Caterpillar with a list of 49 potential strategies to lower the company's effective tax rate.²⁴⁶ One of the report's key proposals focused on Caterpillar's replacement parts business, which produced a steady

²³⁹ Deposition of Sally Stiles in *Schlicksup v. Caterpillar*, PSI-TWLF-11-000113 - 114, at 106-107; Subcommittee interview of Robin Beran, Caterpillar, Chief Tax Officer (10/18/2013).

²⁴⁰ Subcommittee interview of Robin Beran, Caterpillar (10/18/2013). See also August 2008 email chain among Robin Beran, Rodney Perkins, and others indicating that the tax department paid business unit costs for implementation, management, and inventory ownership related to CSARL. Mr. Perkins, Caterpillar International Tax Manager, wrote: "[C]harges were primarily implementation, then they became primarily maintenance. We've [tax department] been paying for both since Day 1." 8/21/2008 email chain among Caterpillar tax department personnel, PSI-TWLF-02-001625 - 628. It also appears that the tax group in Geneva paid for the software package to keep track of CSARL's legal entities and financial statements. Deposition of Rodney Perkins in *Schlicksup v. Caterpillar*, PSI-TWLF-10-000004, at 077-078.

²⁴¹ 3/21/2014 email from PWC's legal counsel to Subcommittee, "Response regarding fees." PSI-PWC-22-000001 - 003.

²⁴² Subcommittee interview of Thomas Quinn, PWC (10/2/2013).

²⁴³ *Id.*

²⁴⁴ *Id.*

²⁴⁵ See undated PWC presentation to Caterpillar, "Caterpillar GTOP Summary of Ideas," PwC_PSI_CAT_00004566 - 631. See also 7/14/1998 email from Steven Williams, PWC, to Thomas Quinn, PWC, and others, PwC_PSI_CAT_00204970 - 974 (listing three initial ideas: removing Caterpillar from the parts supply chain, increasing the profit margin on parts, and reducing the profit margin on machines).

²⁴⁶ See undated PWC presentation to Caterpillar, "CATERPILLAR GTOP Summary of Ideas," PwC_PSI_CAT_00004566 - 631.

stream of taxable profits for the company. Under the then existing system, third party manufacturers made the replacement parts and sold them to the U.S. parent company, which then sold the parts to its marketing companies for subsequent resale to Caterpillar's non-U.S. independent dealers. The inclusion of the U.S. parent in the transactions meant that the parts' sales revenues were included on Caterpillar's U.S. tax return and also subject to tax under Subpart F. PWC proposed deferring or avoiding that tax by "remov[ing] Caterpillar Inc. from the chain of title passage for purchased finished parts (from U.S. or foreign sources) sold to foreign marketers," and replacing the U.S. parent with a new Swiss entity as the direct purchaser of the third party manufactured replacement parts.²⁴⁷

PWC explained to the Subcommittee that, by removing the U.S. parent, Caterpillar Inc., from the chain of title for third party manufactured parts sold to non-U.S. customers, Caterpillar would no longer have two related entities transacting business with each other in the supply chain.²⁴⁸ According to PWC, if Caterpillar Inc. were removed and replaced by a non-U.S. entity, such as a Swiss corporation, Subpart F's foreign base company sales rules would no longer apply, and the offshore income would no longer be immediately attributed to Caterpillar Inc. as a sale and therefore taxed in the United States. Instead, the funds could be attributed to Switzerland, and Caterpillar would be able to defer paying any U.S. taxes on that income simply by keeping it offshore, avoiding the Subpart F provision that was intended to capture this kind of income. Moreover, by attributing the income to Switzerland, PWC reasoned that Caterpillar could take advantage of the very low tax rate of 4% that the company had negotiated with that country.²⁴⁹

PWC documents proposing the tax strategy stated that it involved only "relatively simple re-invoicing requirements."²⁵⁰ Caterpillar and PWC told the Subcommittee that the tax strategy required few changes in the company's business operations, because its non-U.S. marketing companies were already selling the third party manufactured replacement parts to its non-U.S. dealers. They characterized the tax strategy as aligning the company's tax structure with sales practices already in place.

²⁴⁷ Id. See also 9/1998 PWC report, "Caterpillar Inc. Global Tax Optimization Case for Action," PwC_PSI_CAT_00004632, at 674 (describing the proposal as PWC's "Solution #1" to reduce Caterpillar's taxes).

²⁴⁸ Subcommittee interview of Thomas Quinn, PWC (10/2/2013).

²⁴⁹ Id. In addition, if the Swiss affiliate were to receive dividends or royalties from lower tier Caterpillar affiliates, it would be able to use the U.S. check-the-box rules to ensure those entities were disregarded for U.S. tax purposes and, again, avoid Subpart F taxes.

²⁵⁰ Undated PWC presentation to Caterpillar, "Caterpillar GTOP Summary of Ideas," PwC_PSI_CAT_00004566 - 631, at 618; 9/1998 PWC report, "Caterpillar Inc. Global Tax Optimization Case for Action," PwC_PSI_CAT_00004632, at 674.

Caterpillar, with the approval of its executive steering committee, which was comprised of business executives including the CFO, adopted PWC's recommended tax strategy.²⁵¹ Caterpillar also decided, at the same time, to realign its European manufacturing operations, moving their headquarters to Geneva. Its decision led to the execution of a series of licensing and servicing agreements between Caterpillar Inc., the U.S. parent, and CSARL, its Swiss affiliate, as described below.

Auditing Its Own Tax Strategy. At the same time PWC was providing Caterpillar with tax consulting services and advocating the Swiss tax strategy, PWC continued to act as Caterpillar's independent auditor. Independent auditors are typically charged with reviewing a corporation's financial statements and expressing an opinion on whether they fairly present the corporation's financial position under generally accepted accounting principles.²⁵² PWC performed that function with respect to Caterpillar's financial statements, which included reviewing Caterpillar's estimates of the company's tax liabilities. As part of that review, PWC auditors were responsible for auditing and approving the company's use of the very tax strategy developed, advocated, and sold to Caterpillar by their PWC colleagues.

PWC's actions occurred prior to enactment of the Sarbanes-Oxley Act of 2002, which targeted various conflicts of interests that arise when a public accounting firm performs auditing and other services for a client, including tax consulting services, for the same corporation at the same time.²⁵³ Prior to its enactment, federal regulations did not place any restriction on accounting firms providing both audit and tax consulting services contemporaneously. After its enactment, a public accounting firm was permitted to perform those services concurrently only if approved in advance by the client corporation's Board of Directors Audit Committee.²⁵⁴ PWC told the Subcommittee that, both

²⁵¹ Id.

²⁵² See, e.g., AU Section 110, Responsibilities and Functions of the Independent Auditor, Public Company Accounting Oversight Board (PCAOB) website, <http://pcaobus.org/Standards/Auditing/Pages/AU110.aspx> "AU" is a reference to "audit" standards.

²⁵³ Sarbanes-Oxley Act of 2002, Pub. L. 107-204, 116 Stat. 745, 107th Cong. (2002).

²⁵⁴ Id. at § 201(a), codified at 15 U.S.C. § 78j-1(h). PCAOB auditing standards relating to independence and advising on tax transactions include the following:

RULE 3520. AUDITOR INDEPENDENCE. A registered public accounting firm and its associated persons must be independent of the firm's audit client throughout the audit and professional engagement period.

RULE 3522. TAX TRANSACTIONS. A registered public accounting firm is not independent of its audit client if the firm, or any affiliate of the firm, during the audit and professional engagement period, provides any non-audit service to the audit client related to marketing, planning, or opining in favor of the tax treatment of, a transaction -

(a) Confidential Transactions – that is a confidential transaction; or

(b) Aggressive Tax Position Transactions – that was initially recommended, directly or indirectly, by the registered public accounting firm and a

before and after enactment of the Sarbanes-Oxley Act, the Caterpillar Audit Committee approved PWC's contemporaneous delivery of auditing and tax consulting services for the company.²⁵⁵

At PWC, the auditing team included a tax partner, James Bowers, who was responsible for assisting the audit team in auditing Caterpillar's financial statements, including Caterpillar's estimates of the company's tax liabilities based in part on its implementation of the Swiss tax strategy. Mr. Bowers told the Subcommittee that he initially introduced PWC's GTOP team to Caterpillar and attended the initial presentation.²⁵⁶ He also indicated that, for a three-year period from 1999 to 2002, while he was assisting with the audit of Caterpillar's financial statements, he also spent up to one-third of his time working on "GloVE implementation," meaning implementation of the Swiss tax strategy.²⁵⁷ He said that his primary role involved explaining the details of Caterpillar's business operations and structure to PWC's tax consultants. Mr. Bowers said that, by 2003 or 2004, his work level on the Swiss tax strategy had "dropped significantly." In addition, he told the Subcommittee that, during the course of his audit work at Caterpillar, he conferred on issues related to the Swiss tax strategy with the same PWC tax consultants who had helped to design and implement it. According to Mr. Bowers, he performed an independent analysis of the Swiss tax strategy and concluded that it complied with the U.S. tax code.²⁵⁸ He also told the Subcommittee that he did not memorialize his analysis of the Swiss tax strategy by putting it in writing.²⁵⁹

significant purpose of which is tax avoidance, unless the proposed tax treatment is at least more likely than not to be allowable under applicable tax laws.

RULE 3524. AUDIT COMMITTEE PRE-APPROVAL OF CERTAIN TAX SERVICES. In connection with seeking audit committee pre-approval to perform for an audit client any permissible tax service, a registered public accounting firm shall –

- (a) describe, in writing, to the audit committee of the issuer –
 - (1) the scope of the service, the fee structure for the engagement, and any side letter or other amendment to the engagement letter, or any other agreement (whether oral, written, or otherwise) between the firm and the audit client, relating to the service; and
 - (2) any compensation arrangement or other agreement, such as a referral agreement, a referral fee or fee-sharing arrangement, between the registered public accounting firm (or an affiliate of the firm) and any person (other than the audit client) with respect to the promoting, marketing, or recommending of a transaction covered by the service;
- (b) discuss with the audit committee of the issuer the potential effects of the services on the independence of the firm; and
- (c) document the substance of its discussion with the audit committee of the issuer.

²⁵⁵ Subcommittee interview of James Bowers, PWC (1/23/2014).

²⁵⁶ *Id.*

²⁵⁷ *Id.*

²⁵⁸ *Id.*

²⁵⁹ *Id.*

\$55 Million Tax Strategy. From 1998 to 2004, Caterpillar paid PWC over \$80 million in tax consulting fees, including over \$55 million related to the development and implementation of the Swiss tax strategy involving CSARL.²⁶⁰ From 2000 to 2012, Caterpillar also paid PWC another \$200 million in auditing fees.²⁶¹

The Swiss tax strategy immediately lowered Caterpillar's effective tax rate. A 2010 "Global Tax & Trade Update" prepared by Caterpillar's Global Finance and Strategic Support Division reported that the company's "Effective Tax Rate ha[d] dropped to lowest in the Dow 30."²⁶² It summarized the effective tax rate "drivers" as "Losses in high-tax countries, Profits in low."²⁶³ According to Caterpillar, to date, the Swiss tax strategy has enabled the company to defer paying U.S. taxes of at least \$2.4 billion.²⁶⁴

B. Shifting Profits from United States to Switzerland

As described earlier, Caterpillar developed its third party manufactured replacement parts business, which included parts design, a reliable third party supplier base, effective parts forecasting and inventory management, a worldwide parts distribution network, and an effective parts delivery system, over the course of decades. PWC's Swiss tax strategy did not attempt to change any of those operational details. Instead, it focused on changing the legal entity that served as the paper owner of Caterpillar's replacement parts and the recipient of the non-U.S. parts profits.

Original Legal Title Chain. Prior to the creation of CSARL in 1999, Caterpillar Inc., the U.S. parent corporation, bought the purchased finished replacement parts (PFRPs) needed for Caterpillar machines directly from the third party suppliers that manufactured the parts for the company.²⁶⁵ Caterpillar often designed replacement parts that fit only Caterpillar machines, retained ownership of and patented the designs, and contracted with third party suppliers to manufacture them.²⁶⁶ Many of the PFRP third party suppliers were located in the United States in close proximity to the Caterpillar manufacturing plants that produced its

²⁶⁰ 3/21/2014 email from PWC's legal counsel to Subcommittee. "Response regarding fees." PSI-PWC-22-000001 - 003.

²⁶¹ Id.

²⁶² 4/13/2010 "Global Tax & Trade Update." PwC_PSI_CAT_00205974 - 990, at 975.

²⁶³ Id. at 979.

²⁶⁴ 12/3/2013 Caterpillar response to Subcommittee Questionnaire. CAT-000270 - 298, at 298.

²⁶⁵ See 3/7/2014 "In the Matter of Caterpillar Inc.," Caterpillar Expert Witness Report by John P. Steines, Jr., Professor of Law, New York University, at PSI-Caterpillar-17-000003 - 023, at 005-006.

²⁶⁶ 12/19/1996 "Caterpillar Inc. Evaluation of Arm's Length Pricing for Intercompany Transactions Year Ended December 31, 1995." PwC_CAT_PSI_00008881 - 9104, at 921.

machines.²⁶⁷ In fact, at the time of the CSARL transaction in 1999, according to a Caterpillar document, it appears that out of \$853 million in parts sales, \$712 million or 83%, were obtained from the United States.²⁶⁸ Although Caterpillar has since taken steps to globalize its supplier base, in 2012, nearly 70% of the finished parts purchased by CSARL for sale to foreign customers still came from the United States.²⁶⁹

Prior to 1999, Caterpillar was the initial buyer of its third party manufactured replacement parts, and if the replacement parts were to be sold in Europe, Africa, or the Middle East (EAME region), Caterpillar typically sold the parts to its affiliated marketing company, Caterpillar Overseas S.A. (COSA), which was incorporated in Switzerland.²⁷⁰ COSA, in turn, sold the parts to Caterpillar's independent foreign dealers in the EAME region.²⁷¹ The non-U.S. PFRP legal title and supply chain was typically as follows:

**Third party supplier → Caterpillar Inc. (US) →
COSA → non-US independent dealer**

Caterpillar's profits from its non-U.S. parts sales were taxable in the United States; COSA's profits were also taxable in the United States as foreign base company sales income under Subpart F.²⁷²

Caterpillar also manufactured some of its own replacement parts, which it referred to as "worked parts" to distinguish them from the purchased finished replacement parts manufactured by unrelated third party suppliers. The legal title and supply chain for the worked parts was as follows:

Caterpillar Inc. (US) → COSA → non-US independent dealer

The supply chain for Caterpillar's worked parts did not change and has continued to function unaltered except for the substitution of CSARL for COSA, including for worked parts sold offshore. Sales income from those Caterpillar parts continues to be included on the company's U.S. tax return.

²⁶⁷ Subcommittee interview of William Springer, Caterpillar (11/7/2013); see also Craig T. Bouchard & James V. Koch, *The Caterpillar Way*, at 200 (2014).

²⁶⁸ 5/28/1999 "Global Value Enhancement Development Phase Status Report," PwC_PSI_CAT_00004349 - 455, at 365. Caterpillar uses the term "sourced" to indicate that an item was procured from that country or region.

²⁶⁹ 3/7/2014 Caterpillar response to Subcommittee Questionnaire, CAT-001866 - 2264, at 866.

²⁷⁰ See 3/7/2014 "In the Matter of Caterpillar Inc.," Caterpillar Expert Witness Report, John P. Steines, Jr., Professor of Law, New York University, at PSI-Caterpillar-17-000003 - 023, at 005-007.

²⁷¹ *Id.*

²⁷² *Id.* at 003 - 004.

Caterpillar's standard practice was to compensate the internal Business Divisions involved with the sales of its non-U.S. parts. Its practice was to assign a routine profit to the divisions that performed routine business services and the residual profits – sometimes called “entrepreneurial” profits – to the divisions that contributed directly to the creation of those residual profits.²⁷³ According to Caterpillar, in its internal management books, Caterpillar treated COSA, the marketing company, as a routine parts distributor and gave it only a routine share of the non-U.S. parts profits.²⁷⁴ Other U.S. divisions were awarded the residual profits. At the same time, almost all of the profits, no matter which division received them, were typically included in Caterpillar's U.S. tax return and taxed.²⁷⁵ The end result was that, from about 1994 to 1999, Caterpillar's internal management books matched Caterpillar's tax books in terms of profit allocations.²⁷⁶

(1) Altering the Legal Title Chain for Finished Parts

Caterpillar's implementation of the Swiss tax strategy required multiple steps over the course of four years between 1999 and 2003.²⁷⁷ They included forming CSARL, designating it as the nominal “global purchaser” of Caterpillar's finished parts in various licensing agreements, changing Caterpillar's invoice systems, and assigning CSARL tolling agreements with two Caterpillar affiliates.

Forming CSARL. CSARL was first formed under another name in 1997.²⁷⁸ When Caterpillar decided to implement the Swiss tax strategy, CSARL was selected as the key Swiss entity and given a new name. According to PWC, CSARL is treated as a limited liability

²⁷³ 10/29/2007 “Caterpillar Inc. Transfer Pricing Discussion Items,” PwC_PSI_CAT_00129637 - 646, at 640. See also Subcommittee interview of Thomas Quinn, PWC (10/2/2013).

²⁷⁴ Id. In comparison, residual non-U.S. parts profits were also assigned to Caterpillar's French and Belgian affiliates, which had manufacturing facilities. See also 10/29/2007 PWC slide presentation “Caterpillar Inc. Transfer Pricing Discussion Items,” PwC_PSI_CAT_00129637 - 646, at 640. According to PWC, prior to Mr. Fites' setting the across-the-board share of accountable profits for Caterpillar marketing companies in 1992, Caterpillar had split the non-U.S. residual parts profits with the marketing companies on a 50/50 legal entity basis. The U.S. share of the sales profits were reported as U.S. taxable income on Caterpillar's U.S. tax return, while the marketing companies' share was also reported on Caterpillar's tax return as Subpart F income. Subcommittee Interview of Steven Williams, a PWC Managing Director (2/19/2014).

²⁷⁵ See 3/7/2014 “In the Matter of Caterpillar Inc.,” Caterpillar Expert Witness Report, John P. Steines, Jr., Professor of Law, New York University, at PSI-Caterpillar-17-000003 - 023, at 003-004.

²⁷⁶ 8/22/2008 “Delivering Vision 2020 Value Transformation: An After-Tax View,” PwC_PSI_CAT_00058419-472.

²⁷⁷ See 2/16/2010 “Caterpillar Inc. CSARL Permanent File Chronological History: 1999-2010,” PwC_PSI_CAT_00003406 - 463, at 407.

²⁷⁸ See 3/7/2014 “In the Matter of Caterpillar Inc.,” Caterpillar Expert Witness Report, John P. Steines, Jr., Professor of Law, New York University, at PSI-Caterpillar-17-000003 - 023, at 003. CSARL acquired its current name in 1999, in connection with the implementation of the PWC tax strategy.

corporation – a Swiss SARL – for Swiss tax purposes, but as a limited liability partnership for U.S. tax purposes.²⁷⁹ In connection with the tax strategy, CSARL was set up with six members or partners, all of which were Caterpillar foreign affiliates.²⁸⁰ The six were COSA, Caterpillar Overseas Credit Corporation SARL, Caterpillar Overseas Investment Holding SARL, Caterpillar Commercial Holding SARL, Caterpillar Asia Pacific LP, and Caterpillar Product Development SARL. In 1999, each of the six partners contributed assets and business activities to CSARL, which emerged as Caterpillar’s leading Swiss affiliate.²⁸¹ Later, Caterpillar added a seventh CSARL member, Caterpillar International Investment SARL.²⁸²

In 2006, Caterpillar reorganized its affiliates and added several new intermediate owners between itself and CSARL. The new owners were generally shell corporations located in tax havens, including Bermuda, Luxembourg, and Switzerland; all were affiliated with and ultimately owned by Caterpillar Inc. in the United States.²⁸³ They included, in addition to COSA, Caterpillar International Ltd. of Bermuda; Caterpillar Holding Ltd. of Bermuda; Caterpillar Luxembourg SARL of Luxembourg; and Caterpillar Commercial Holding SARL.²⁸⁴ The following chart depicts CSARL’s current ownership.

²⁷⁹ 2/16/2010 “Caterpillar Inc. CSARL Permanent File Chronological History: 1999-2010,” PwC_PSI_CAT_00003406 - 463, at 406. “SARL” stands for Société à responsabilité limitée, a type of private limited liability corporate entity that exists in Switzerland, France, and a few other countries. A SARL is a company whose liability is limited to the contributions of its members. It is comparable to a limited liability partnership in the United States. See also 3/7/2014 “In the Matter of Caterpillar Inc.,” Caterpillar Expert Witness Report, John P. Steines, Jr., Professor of Law, New York University, at PSI-Caterpillar-17-000003 - 023.

²⁸⁰ 2/16/2010 “Caterpillar Inc. CSARL Permanent File Chronological History: 1999-2010,” PwC_PSI_CAT_00003406 - 463, at 406 (CSARL is treated as a partnership for U.S. tax purposes and is owned directly or indirectly (through disregarded entities) by controlled foreign corporations that are directly or indirectly owned by Caterpillar). See also 3/7/2014 “In the Matter of Caterpillar Inc.,” Caterpillar Expert Witness Report, John P. Steines, Jr., Professor of Law, New York University, at PSI-Caterpillar-17-000003 - 023.

²⁸¹ See 2/16/2010 “Caterpillar Inc. CSARL Permanent File Chronological History: 1999-2010,” PwC_PSI_CAT_00003406 - 463, at 407 and 411.

²⁸² Id. at 411.

²⁸³ 8/14/2013 Caterpillar response to Subcommittee Questionnaire, CAT-000001 - 065, at 011 - 038.

²⁸⁴ Id.

Caterpillar Ownership of CSARL



Prepared by Permanent Subcommittee on Investigations, based on 8/14/2013 Caterpillar response to Subcommittee Questionnaire, CAT-000001 - 065, at 011 - 038.

Designating CSARL as Global Parts Purchaser. In 1999, in accordance with the tax strategy designed by PWC, Caterpillar designated CSARL as the purchaser of its third party manufactured parts intended for sale outside of the United States. According to PWC, that designation resulted in two key changes.²⁸⁵ First, Caterpillar Inc., the U.S. parent corporation, was removed from the non-U.S. parts supply chain, and replaced with CSARL which became the nominal “global purchaser” of PFRP parts.²⁸⁶ The new parts legal title chain was as follows:

²⁸⁵ See 11/13/2006 PWC national office memorandum from Kevin Mitchell to Sharad Jain, “Caterpillar Inc.,” PSI-TWLF-21-000001 - 265, at 229.

²⁸⁶ Id. See also 3/7/2014 “In the Matter of Caterpillar Inc.,” Caterpillar Expert Witness Report, John P. Steines, Jr., Professor of Law, New York University, at PSI-Caterpillar-17-000003 - 023, at 005-006.

Third party supplier → CSARL → non-US independent dealer

The only operational change required by the new legal title chain was that the third party suppliers had to remove Caterpillar Inc.'s name from the top of their parts invoices and replace it with CSARL. Similarly, Caterpillar had to change its systems to remove its name from the parts purchase orders and replace it with CSARL. Other than those paper and system changes, the physical aspects of the company's activities in purchasing, storing, and shipping Caterpillar's parts did not change.

The tax consequences, however, were significant, according to PWC and Caterpillar. Because Caterpillar Inc. was removed from the legal title chain altogether, and CSARL bought the parts from and sold the parts to unrelated parties, PWC and Caterpillar claimed that the profits from those sales were no longer subject to Subpart F's foreign base company sales rules, were not immediately taxable, and if kept outside of the United States could be protected from U.S. taxation through deferral.²⁸⁷ In the 1999 planning documents for the CSARL transaction, under a benefits analysis, PWC wrote that the CSARL transaction "will migrate profits from CAT Inc. to low-tax marketing companies."²⁸⁸ PWC added that, by doing so: "We are effectively more than doubling the profit on parts."²⁸⁹

Executing Two Tolling Agreements. The second key change, according to PWC, was that CSARL entered into "tolling agreements" with Caterpillar's two main European manufacturing operations in France and Belgium.²⁹⁰ Those tolling agreements required Caterpillar's French and Belgian affiliates to provide manufacturing services to CSARL in exchange for the cost of their operations plus 7%. By limiting their profit margins to 7%, the tolling agreements shifted the residual or entrepreneurial profits for the manufactured goods from the two manufacturing facilities in France and Belgium to CSARL in Switzerland.²⁹¹ In addition, the Product Managers for the machines produced by the French and Belgian facilities moved to CSARL. The

²⁸⁷ See, e.g., See 3/7/2014 "In the Matter of Caterpillar Inc.," Caterpillar Expert Witness Report, John P. Steines, Jr., Professor of Law, New York University, at PSI-Caterpillar-17-000003 - 023, at 006 ("The restructuring simply removed Caterpillar from the outbound PFRP supply chain. As a result, Caterpillar earned no profits (other than royalties and fees paid by CSARL described below) from outbound PFRP sales, and CSARL's profits were no longer taxable under Subpart F because there was no longer a related party (Caterpillar under the old structure) in the supply chain, which Section 954(d) requires as a condition of foreign base company sales income.").

²⁸⁸ 12/1998, Caterpillar Inc., Global Tax Optimization, Risk Adjusted Benefit Analysis, Working Papers -Draft 1," PWC-PSI-CAT-00001336 - 671, at 411.

²⁸⁹ Id. at 412.

²⁹⁰ See 11/13/2006 PWC national office memorandum from Kevin Mitchell to Sharad Jain, "Caterpillar Inc.," PSI-TWLF-21-000001 - 265, at 229. See also 3/7/2014 "In the Matter of Caterpillar Inc.," Caterpillar Expert Witness Report, John P. Steines, Jr., Professor of Law, New York University, at PSI-Caterpillar-17-000003 - 023, at 004.

²⁹¹ 11/30/2000 "European Manufacturing Initiative Caterpillar SARL.," PwC_PSI_CAT_00016468 - 511, at 502.

primary effect of the tolling agreements was to shift French and Belgian profits to Switzerland; they had relatively little effect on Caterpillar's U.S. tax savings.²⁹²

Caterpillar and PWC told the Subcommittee that, as a result of the tolling agreements and CSARL's new role as a "global parts purchaser," and because of the increasing importance of non-U.S. sales and its foreign dealer network, CSARL had become more than a routine distributor of parts entitled to a routine share of the profits. Instead, according to Caterpillar and PWC, CSARL was also entitled to the residual profits associated with the parts it purchased and sold.

In addition, Caterpillar and PWC claimed that CSARL had "newly recognized intangibles" associated with its marketing duties that had been present when COSA performed those duties, but had not been appropriately compensated. As a result, Caterpillar and PWC claimed that, as of 1999, Caterpillar could appropriately allocate 85% or more of the non-U.S. replacement parts profits to CSARL, instead of the 15% or less allocated to its predecessor, COSA. At the same time, as detailed below, Caterpillar decided not to change its internal allocation of profits, which decided employee incentive pay and bonuses; on Caterpillar's internal management books, CSARL continued to receive credit only for the type of routine profits allocated to a parts distributor. For years after the CSARL transaction, as explained further below, Caterpillar's internal profits allocation for business purposes no longer matched its profits allocation for tax purposes.²⁹³

(2) Licensing Intangible Rights In Exchange for Royalties

In order for CSARL to replace Caterpillar Inc. in the parts legal title chain, Caterpillar engaged in a number of complex related party transactions. Beginning in 1999, in addition to the tolling agreements, Caterpillar, the U.S. parent, entered into a series of licensing agreements with its new Swiss affiliate, CSARL. Those agreements gave CSARL the right to manufacture and sell Caterpillar goods outside of the United States in exchange for paying certain royalty fees to its U.S. parent. The licenses generally permitted CSARL to "make, purchase, use, market, offer for sale, sell, and import" Caterpillar products, including replacement parts, in markets outside of the United States.²⁹⁴

²⁹² See 8/22/2008 "Delivering Vision 2020 Value Transformation: An After-Tax View," PwC_PSI_CAT_00058419 - 472, at 429.

²⁹³ In the mid-2000's, CSARL's marketing companies became a cost center and profits became reallocated to the product groups. Subcommittee interview of Jananne Copeland, Caterpillar (10/30/2013).

²⁹⁴ See, e.g., 1/1/2001 Second Amended and Restated License Agreement, CAT-000306 - 699, at 373. See also 9/23/2013 letter from Caterpillar to Subcommittee, PSI-Caterpillar-04-000001 - 009, at 004.

First License Agreement. On September 1, 1999, Caterpillar Inc. and CSARL entered into their first license agreement for PFRPs and worked parts.²⁹⁵ The license gave CSARL certain exclusive and nonexclusive rights to buy PFRPs from third party suppliers and worked parts from Caterpillar, as well as the right to sell those replacement parts to non-U.S. customers in the Europe, Africa, and Middle East (EAME) region.²⁹⁶ In exchange for those rights, CSARL agreed to pay a 15% royalty for PFRPs and a 7% royalty for worked parts to Caterpillar Inc. on net sales in the EAME region.²⁹⁷

As a temporary aside, Caterpillar and CSARL also entered into a year-long purchasing agency agreement in which Caterpillar agreed to act as the purchasing agent for parts purchased from third party suppliers.²⁹⁸ That agreement permitted Caterpillar Inc.'s name to continue to appear on the PFRP purchase orders and invoices by making it clear that Caterpillar Inc. was acting on behalf of CSARL in relation to the third-party suppliers.²⁹⁹ That purchasing agency agreement, which ended after a year, provided Caterpillar with time to make systems changes so that the name on the purchase order and invoices could be changed to CSARL.

Service Agreement. In addition to the licensing agreement, Caterpillar Inc. and CSARL entered into a service agreement under which Caterpillar Inc. agreed to provide certain services for CSARL relating to the management and sales of replacement parts.³⁰⁰ The services specified by the agreement were extensive and included: developing service manuals, performing parts logistics and warehousing services; engaging in strategic parts planning; managing third-party suppliers within the United States (including visiting suppliers, negotiating terms, arranging for transportation, and conducting quality inspections); managing part flows such as inventory management worldwide; performing parts pricing determinations; maintaining accounting, shipping, customs and other records; processing parts returns; providing marketing consulting services for dealers; and covering inland freight charges for materials destined for U.S. contract

²⁹⁵ 1/16/2003 Caterpillar's legal counsel memorandum "History of Significant Changes in International Operations (Not Inclusive of Financing Arrangements) 1997 - 2002," PSI-TWLF-02-000423 - 436, at 423.

²⁹⁶ *Id.*

²⁹⁷ *Id.*

²⁹⁸ *Id.* at 427. See also 9/1/1999 Purchasing Agency Agreement (unexecuted copy), PwC_PSI_CAT_00053632 - 641; "Reallocated Parts Purchasing Agreement, December 1, 1999," CAT-000306 - 699, at 535-542.

²⁹⁹ 1/16/2003 Caterpillar's legal counsel memorandum "History of Significant Changes in International Operations (Not Inclusive of Financing Arrangements) 1997 - 2002," PSI-TWLF-02-000423 - 436, at 427.

³⁰⁰ *Id.* at 423-424. See also, e.g., 9/1/1999 Fifth Amended and Restated Services Agreement, CAT-000653 - 663.

packagers.³⁰¹ In essence, the service agreement required Caterpillar to continue to manage the parts business, since CSARL did not have the personnel, infrastructure or expertise to perform those functions. In exchange for providing those services, CSARL agreed to pay Caterpillar a fee equal to the cost of the services plus 5% of the costs.³⁰²

Bundled License Agreement and Royalty Rate. Following that first licensing agreement for the EAME region, CSARL entered into several similar agreements covering nearly all of Caterpillar's offshore regions including Latin America, Canada, Mexico, India, Asia, Australia, and the South Pacific.³⁰³ The resulting tax planning led to the creation of 37 partnerships between CSARL and other Caterpillar affiliates.³⁰⁴ Ultimately, Caterpillar Inc. cancelled the individual licensing agreements and bundled all of the licenses and royalty payments into a single agreement resulting in a combined royalty rate for replacement parts and its prime products, including Caterpillar machines.³⁰⁵ The bundled royalty payment to Caterpillar Inc. involved a sliding scale that ranged from 4% to 6% of the combined net sales of Caterpillar parts and machines.³⁰⁶ The sliding scale was constructed so that the higher the total net sales, the higher the royalty rate. For the first five years of the bundled royalty agreement, CSARL paid a combined royalty of just under 4%, which then increased to 5% and ultimately to

³⁰¹ 12/3/2013 Caterpillar response to Subcommittee Questionnaire, CAT-000270 - 298, at 295 - 296. A September 1999 services agreement stated the services "shall include, but not be limited to: 1. Creation, translation, and dissemination of services manuals, service literature, and other materials for replacement parts; 2. Inventory availability management; 3. Providing parts customer service to dealers (i.e., dealer order inquiries, dealer order expediting); 4. Providing parts pricing determinations; 5. Processing of dealer parts returns; 6. Human resources assistance; 7. Maintenance and support with respect to information systems; 8. Marketing consulting (i.e., creation and support of dealer marketing programs); 9. Strategic planning; and 10. Accounting services." In addition with respect to CSARL inventory in U.S. warehouses: "11. Manage and monitor inventory levels worldwide and perform expediting services; 12. Arrange for transportation of CAT SARM goods; 13. General warehousing services and facilities for such; and 14. Inventory management services at U.S. warehouses." 9/1/1999 Fifth Amended and Restated Services Agreement, CAT-000653 - 663, at 661. PWC's initial planning document indicated that a payment would be made to Caterpillar Inc. in the United States for parts procurement and for management of the parts system. 12/1998, Caterpillar Inc., Global Tax Optimization, Risk Adjusted Benefit Analysis, Working Papers -Draft 1," PwC-PSI-CAT-00001336 - 671, at 408.

³⁰² See, e.g., 9/1/1999 Fifth Amended and Restated Services Agreement, CAT-000653 - 663, at 663. Subcommittee interview of Thomas Quinn, PWC (10/2/2013).

³⁰³ 1/16/2003 Caterpillar's legal counsel memorandum "History of Significant Changes in International Operations (Not Inclusive of Financing Arrangements) 1997 - 2002," PSI-TWLF-02-000423 - 436.

³⁰⁴ See 11/13/2006 PWC national office memorandum from Kevin Mitchell to Sharad Jain, "Caterpillar Inc.," PSI-TWLF-21-000001 - 265, at 229.

³⁰⁵ See 1/16/2003 Caterpillar's legal counsel memorandum "History of Significant Changes in International Operations (Not Inclusive of Financing Arrangements) 1997 - 2002," PSI-TWLF-02-000423 - 436.

³⁰⁶ See, e.g., 1/1/2011 License Agreement, CAT-000306 - 699. The licensing agreement specified a 4% bundled royalty payment, based upon a "weighted average" of 15% parts royalty and 3% machine royalty. See, e.g., 3/2005 "Caterpillar Inc. Summary Meeting Notes, Revised Draft," from March 7-9, 2005 meeting in Geneva, PwC_PSI_CAT_00150466 - 488, at 470.

6%.³⁰⁷ By entering into this license agreement, Caterpillar U.S. gave up rights to 85% or more of the finished replacement parts profits in exchange for a royalty of less than 15% for finished replacement parts.³⁰⁸

The adequacy of the royalty paid by CSARL to Caterpillar was cited as a concern on several occasions by the Caterpillar tax department and PWC tax advisors. In 2002, a PWC presentation noted that CSARL was experiencing such high profits, it raised questions about the 4% royalty it was paying to Caterpillar: “High profit in Licensed Business puts pressure on 4% bundled royalty.”³⁰⁹ The 4% royalty nevertheless remained in place for another three years. PWC’s transfer pricing subject matter expert told the Subcommittee that every CSARL licensing fee percentage point was worth approximately \$100 million in parts profits that could be kept in Switzerland with U.S. taxes deferred.³¹⁰ Another 2006 PWC email reported:

³⁰⁷ Subcommittee interview of Thomas Quinn, PWC (12/17/2013); 1/16/2003 Caterpillar’s legal counsel memorandum “History of Significant Changes in International Operations (Not Inclusive of Financing Arrangements) 1997 - 2002,” PSI-TWLF-02-000423 - 436, at 423-424; 3/2005 “Caterpillar Inc. Summary Meeting Notes, Revised Draft,” from March 7-9, 2005 meeting in Geneva, PwC_PSI_CAT_00150466 - 488, at 470; See 3/7/2014 “In the Matter of Caterpillar Inc.,” Caterpillar Expert Witness Report, John P. Steines, Jr., Professor of Law, New York University, at PSI-Caterpillar-17-000003 - 023, at 005.

³⁰⁸ These percentages are based on financial figures provided by Caterpillar to the Subcommittee. Typically, CSARL aggregates the profits from non-U.S. sales of Caterpillar parts and machines and provides Caterpillar Inc. with one bundled royalty amount for use of all Caterpillar licensed property. Since the Swiss tax strategy focused solely on Caterpillar’s purchased finished replacement parts (PFRP) business, however, the Subcommittee requested data on just the portion of CSARL’s profits and royalty payments related to non-U.S. PFRP sales. Caterpillar provided the Subcommittee with an estimate of CSARL’s total PFRP profits before tax over an eight-year period. For that eight-year period, according to Caterpillar, CSARL’s non-U.S. PFRP profits before tax totaled \$8,075,907,000. See 12/3/2013 Caterpillar response to Subcommittee questionnaire, CAT-000270 – 298, at 277. Caterpillar also provided the Subcommittee with an estimate of CSARL’s annual royalty payments to Caterpillar Inc. associated with the non-U.S. replacement parts business. For that same period of time, according to Caterpillar, CSARL’s royalty payments to Caterpillar Inc. totaled \$1,098,149,000. See 1/14/2014 Caterpillar response to Subcommittee Questionnaire, CAT-000299 - 303, at 301. That royalty amount includes payments made by CSARL for both PFRP parts manufactured by independent third parties and parts manufactured by Caterpillar. Using the figures provided by Caterpillar, the royalty, or license fee, paid by CSARL to Caterpillar Inc. for profits related to parts averaged 13.6% of CSARL’s PFRP profits over the eight-year time period. Over that same time period, CSARL retained the remaining 86.4% of the PFRP profits. CSARL also paid Caterpillar Inc. service fees during that eight-year time period for services provided by Caterpillar Inc. related to the replacement parts business in an amount equal to Caterpillar’s costs plus 5%. For the 8 year period, using data provided by Caterpillar on the total amount of service fees paid by CSARL to Caterpillar Inc., the Subcommittee estimated that the 5% markup related to those fees totaled about \$75 million, which, if accurate, would alter the 13.6% and 86.4% profit split by only about 1 percentage point.

³⁰⁹ 7/2/2002 “Caterpillar, CSARL Technology Ownership,” PwC_PSI_CAT_00024791 - 808, at 799. Caterpillar explained to the Subcommittee that the transfer pricing method it used yield a range of potentially acceptable royalty rates, and the 4% rate was heading toward the bottom of the acceptable range, hence the “pressure” to increase the rate. Subcommittee interview of Steven Williams, PWC (2/19/2014).

³¹⁰ Subcommittee interview of Steven Williams, PWC (2/19/2014). See also 1/25/2006 email from Christopher Dunn, PWC, to Steven Williams, PWC, “CSARL royalty rate,” PwC_PSI_CAT_00132905 - 909.

“We did a lot of work in Q4 2005, to decide whether the 4% needed to be raised in 2005. We recommended not to change it in 2005, but to raise it to 5% beginning in 2006. We are putting together documentation now to support the sliding scale provision from 2006-2010.”³¹¹

The 5% royalty paid by CSARL in 2006, was later raised to 6%.

In 2008, Rodney Perkins, Caterpillar’s International Tax Manager who worked on CSARL, sent an email to PWC expressing concern about CSARL’s continuing to pay the 6% royalty rate on Caterpillar products with a high profit margin:

“[A]s we place high margin product in CSARL, wouldn’t the bundled royalty rate have to increase as well. I doubt we can defend continued usage of 6% royalty; we already have difficulty with the existing structure to keep CSARL within acceptable profit ranges.”³¹²

When asked about this email, Mr. Perkins told the Subcommittee that he saw a tax risk associated with the adequacy of the royalty rate paid to Caterpillar Inc.³¹³

At the Subcommittee’s request, Caterpillar provided data on the annual parts profits reported by CSARL and the annual royalty payments made to Caterpillar related to parts over an eight year period. The data showed that the parts profits reported by CSARL over that eight-year period totaled about \$8 billion, while the royalty payments paid by CSARL to Caterpillar totaled about \$1 billion.³¹⁴ When the annual royalty payments were compared to the annual parts profits each year during the eight-year period, the data showed that the royalties paid to Caterpillar Inc. ranged from 9% to 16% of the total parts profits, with an overall eight-year average of 14%. The data also showed that

³¹¹ 1/23/2006 email from Steven Williams, PWC, to Mark Dalbey, PWC, “CSARL royalty rate,” PwC_PSI_CAT_00018341.

³¹² 10/27/2008 email from Rodney Perkins, Caterpillar, to Edward Bodnam, PWC, “Alignment VPs and PMs by Subject Facilities,” PwC_PSI_CAT_00059123 - 127, at 125.

³¹³ Subcommittee interview of Rodney Perkins, Caterpillar (1/15/2014). James Bowers, the PWC tax partner who reviewed Caterpillar’s tax issues, including with respect to CSARL, also expressed discomfort about the royalty level, explaining that it was always difficult to evaluate. Subcommittee interview of James Bowers, PWC (1/23/2014). See also other documents raising concerns about the CSARL royalty rate. 1/25/2006 email from Christopher Dunn, PWC, to Steven Williams, PWC, “CSARL royalty rate,” PwC_PSI_CAT_00132905 - 909; 11/14/2005 draft “Caterpillar SARL 2006 - 2010 Royalty Rate: Options and Implications,” PwC_PSI_CAT_00133088 - 115; 12/6/2005 “Caterpillar SARL 2006 - 2010 Royalty Rate: Executive Summary,” PwC_PSI_CAT_00133120 - 126.

³¹⁴ 12/3/2013 Caterpillar response to Subcommittee Questionnaire, CAT-000270 - 298, at 277; 1/14/2014 Caterpillar response to Subcommittee Questionnaire, CAT-000299 - 303, at 301.

CSARL retained 84% to 91% of the parts profits each year, leading to an overall eight-year average of 86%. This data confirmed that, overall, Caterpillar obtained 15% or less of the non-U.S. parts profits, while CSARL obtained 85% or more.

Caterpillar takes the position that, rather than focus on the division of profits related to parts alone, the appropriate focus is on the division of profits resulting from the single bundled royalty rate under the latest licensing agreement, which aggregates both parts and machine profits. Over an eight-year period, that aggregated royalty rate leads to total gross profits of \$11 billion, reflecting both parts and machine sales, and a total royalty payment of \$3 billion. The resulting profit split directs about 31% of the combined profits to Caterpillar Inc. in the United States, and about 69% to CSARL in Switzerland. Aggregating the two types of profits, however, disregards the fact that the planning and motivation for the Swiss tax strategy that produced the licensing agreement focused solely on parts profits and did not mention machines.

Purchaser for Caterpillar Inc. In addition to CSARL's acting as Caterpillar's "global purchaser" for its non-U.S. affiliates, CSARL also became the initial purchaser of PFRPs for its U.S. parent, Caterpillar Inc., even for PFRPs manufactured by third party suppliers located in the United States. Caterpillar's outside tax expert explained: "[B]ecause U.S. suppliers did not want to deal with more than one purchaser, CSARL purchased not only outbound PFRP but also goods destined for U.S. dealers and customers."³¹⁵ CSARL purchased and then automatically and instantaneously resold the PFRPs to Caterpillar Inc. in paper transactions referred to as "flash title" transactions. CSARL performed the flash title transactions at cost, with no markup or profit for the role played by the Swiss affiliate.³¹⁶ While Caterpillar did not permit CSARL to make a profit on the parts sold to it in the United States, Caterpillar continued to allocate 85% or more of the non-U.S. parts profits to CSARL in Switzerland.

While the licensing agreements designated CSARL as the company's "global parts purchaser," they did not lead to CSARL's hiring a significant number of new personnel. CSARL continued to operate with less than one percent of Caterpillar's worldwide employees.

(3) Constructing a Virtual Parts Inventory

In addition to setting up CSARL, altering the third party parts legal title chain, and drafting the licensing, royalty, and service agreements, Caterpillar Inc.'s tax department created an Inventory Tax Accounting

³¹⁵ 3/7/2014 "In the Matter of Caterpillar Inc.," Caterpillar Expert Witness Report, John P. Steines, Jr., Professor of Law, New York University, at PSI-Caterpillar-17-000003 - 023, at 005.

³¹⁶ *Id.*

System (ITAS) to track the Caterpillar parts owned by CSARL in the United States as a result of its new purchasing activities. ITAS created a software-based, virtual parts inventory that served as a second set of inventory books for CSARL parts held in U.S. warehouses and played a key role in carrying out the Swiss tax strategy.³¹⁷

The ITAS software system was created to exist in addition to Caterpillar's general global inventory system, which ITAS drew upon for data. Caterpillar's general global inventory system tracked parts on an individual basis, so that the company knew exactly how many parts it had, what types of parts they were, and where they were located. ITAS did not alter or replace the inventory tracking system Caterpillar used in its day-to-day business operations; instead, for tax purposes only, it tracked "virtual parts bins" consisting of commingled parts owned by Caterpillar Inc. and CSARL.

Before initiation of the Swiss tax strategy in 1999, Caterpillar Inc. owned all of the replacement parts in its U.S. warehouses prior to selling them to its marketing companies.³¹⁸ With the designation of CSARL as the nominal "global purchaser" of the company's third party manufactured replacement parts, however, Caterpillar had to create a system to show CSARL as the owner of the relevant replacement parts in the U.S. warehouses that were expected to be exported to foreign countries, including Canada and Mexico. The ability to show CSARL as the owner of the parts was needed to enable Caterpillar and CSARL to take advantage of the export tax exemption under tax code Section 956(c)(2)(B), which allows foreign affiliates to store goods in a U.S. warehouse without creating a taxable U.S. presence.³¹⁹ At the same time, Caterpillar did not want to incur the expense and inconvenience of formally segregating the CSARL parts from the other parts owned by Caterpillar Inc.³²⁰

According to PWC, Caterpillar tax and accounting personnel conceived of the ITAS approach, and then worked with PWC and McDermott Will & Emery personnel to design the system to track ownership of parts kept in a "physically commingled inventory" while ensuring technical tax compliance.³²¹ ITAS was supposed to show that

³¹⁷ 6/8/2006 email from Robin Beran, Caterpillar, to James Bowers, PWC, "Fw: FYI - 2006 Corporate Tax Audit Committee Presentation." PwC_PSI_CAT_00004799 - 827, at 823; Deposition of Robin Beran in Schlicksup v. Caterpillar, PSI-TWLF-12-000064.

³¹⁸ Subcommittee interview of Thomas Quinn, PWC (12/17/2013).

³¹⁹ See Background chapter, Export Exception.

³²⁰ See Subcommittee interviews of Thomas Quinn, PWC (10/2/2013 and 12/17/2013) (indicating that when a PWC representative suggested segregating the two sets of replacement parts, he was "laughed out of the room").

³²¹ Subcommittee interview of Thomas Quinn, PWC (10/2/2013); 9/8/2009 "Caterpillar Inc. CSARL Briefing." PWC-PSI-CAT-00069730 - 772, at 759 - 61; Deposition of Robin Beran in Schlicksup v. Caterpillar, PSI-TWLF-12-000064 - 065, at 057-058.

CSARL had separate ownership of parts stored in Caterpillar's U.S. warehouses, even though the CSARL parts were completely commingled with the Caterpillar Inc. parts, there were no separate ownership labels, and Caterpillar employees did not and could not distinguish between the two sets of parts in any way.³²²

ITAS attempted to solve the problem by declaring that Caterpillar and CSARL each owned a portion of the parts in a "virtual bin," that the parts could be treated on an interchangeable basis, and that CSARL's ownership of a particular part could be determined at a particular point in time, such as after the part was sold and shipped to a non-U.S. customer.

If either CSARL or Caterpillar ran out of parts in a "virtual bin" as tracked in the ITAS system, ITAS assumed that each party could automatically borrow needed parts from the other and return those borrowed parts when future parts deliveries came in.³²³ The virtual borrowing took place without notice and without either party charging or paying a fee to the other. Caterpillar's tax director explained the ITAS system this way: "[I]t was designed to reflect that the parts are basically common parts and to the extent that CSARL or [Caterpillar] Inc. would have parts in the same bin, they might be shared back and forth and replaced."³²⁴

Caterpillar and PWC personnel advised the Subcommittee that it was not uncommon for each entity to engage in that type of virtual borrowing. According to Caterpillar, over a five-year period between 2008 and 2013, Caterpillar and CSARL borrowed from one another more than three million parts with a collective value of more than \$800 million.³²⁵ Caterpillar also calculated that, on average each year, more than 10% of the parts stored in Caterpillar's U.S. warehouses were borrowed between the two related companies.³²⁶

³²² Subcommittee interview of Thomas Quinn, PWC (10/2/2013); 3/7/2014 "In the Matter of Caterpillar Inc.," Caterpillar Expert Witness Report, John P. Steines, Jr., Professor of Law, New York University, at PSI-Caterpillar-17-000003 - 023, at 005.

³²³ Subcommittee interview of Rodney Perkins, Caterpillar (1/15/2014). PWC's tax consultant and partner, Thomas Quinn, referred to the interchangeable use of each other's parts as an "accommodation," rather than a "borrow." He advised that entities did not borrow back and forth, since that type of borrowing would create a problem. Instead, he described the activity as follows: if one of the parties ran out of its allocation in a bin, it would take parts allocated to the other party, but would replace those parts at later date from future deliveries. Subcommittee interview of Thomas Quinn, PWC (12/17/2013). See also 3/7/2014 "In the Matter of Caterpillar Inc.," Caterpillar Expert Witness Report, John P. Steines, Jr., Professor of Law, New York University, at PSI-Caterpillar-17-000003 - 023, at 005.

³²⁴ Deposition of Robin Beran in *Schlicksup v. Caterpillar*, PSI-TWLF-12-000065, at 058.

³²⁵ 3/13/2014 letter from Caterpillar's legal counsel to Permanent Subcommittee on Investigations, PSI-Caterpillar-18-000001 - 003, at 003.

³²⁶ *Id.*

The end result was that instead of segregating the Caterpillar versus CSARL parts,³²⁷ Caterpillar warehouse personnel stored all of the replacement parts together, pulled parts to fill orders the same way they always had, without regard to CSARL's ownership, and then shipped the parts to the dealers or customers who had ordered them. The ITAS system then retroactively determined, for all parts shipped to non-U.S. customers, that those parts had belonged to CSARL. As Caterpillar's auditor observed:

“[T]he effect of ‘virtual bins’ is that it allows inventory physically located in the US to be viewed in total (for group inventory management purposes), but different parties can own the inventory. Thus, CSARL owns inventory in the US and can use that inventory to fulfil both customer and marketing entity requirements outside the US, any sales transacted in the US continue to be transacted by Cat Inc.”³²⁸

In some ways, the ITAS solution could be compared to how farmers have used grain silos: fungible goods belonging to separate owners are deposited and commingled in the same silo and, when an owner requests a withdrawal, that owner's inventory is recorded as reduced even though no one knows exactly whose grain was provided. In contrast to the ITAS situation, however, the owner of grain stored in the silo cannot draw more than the owner had deposited without purchasing the excess grain at a market rate.

The ITAS system was an artificial inventory system created solely for tax purposes. It existed outside of and in addition to Caterpillar Inc.'s general global inventory system, which provided the data for ITAS. The second inventory book created by the ITAS system did not change how any of Caterpillar's parts were warehoused, tracked, or shipped. The tax consequences of the ITAS system are discussed in more detail below.

(4) Making Paper, Not Operational, Changes

The end result of the CSARL transaction was that changes were made on paper, but not in how the replacement parts business actually functioned. Beginning in 1999, CSARL became the nominal “global purchaser” of all of Caterpillar's finished replacement parts sold to non-U.S. customers in all areas of the world other than the United States. To implement that change, CSARL's name, instead of Caterpillar Inc.'s name, appeared on the parts invoices.

³²⁷ Deposition of Jananne Copeland in *Schlicksup v. Caterpillar*, PSI-TWLF-15-000007, at 052-053.

³²⁸ 6/11/2005 memorandum from PWC Swiss Tax Team, “Morton,” PwC_PSI_CAT_00206146 - 149.

The 1998 and 1999 planning documentation prepared by PWC and Caterpillar indicated that altering the invoices was the primary change needed to implement the Swiss tax strategy, and that no other substantive changes in Caterpillar's parts operations were planned or expected. The original PWC proposal, for example, described the "Benefits/Costs" of the Swiss tax strategy as involving "[r]elatively simple re-invoicing requirements."³²⁹ Another PWC document offered these "Main Implementation Observations":

"There will be no change with respect to sales of parts by COSA. Changes are proposed to the purchase of parts for resale. ... There will be no change in the physical locations of Accounts Payable processing. ... Invoicing from suppliers will be changed from CAT HE and Morton HE to COSA 'HE.' ... There is no change to dealer pricing."³³⁰

A later Caterpillar document referred to the removal of the U.S. parent company from the legal title chain for third party manufactured replacement parts as having "minimal business substance."³³¹

In interviews, Caterpillar and PWC personnel told the Subcommittee that, at the time of the 1999 transaction, no substantive changes were made in how the replacement parts business actually functioned, and no Caterpillar personnel were moved to CSARL with respect to parts.³³² William Springer, former Caterpillar Vice President of Product Support, told the Subcommittee that he was unaware of any changes in business function related to parts as a result of the CSARL transaction.³³³ Sally Stiles, a senior Caterpillar tax manager, provided the same information, telling the Subcommittee that there was no substantive change in Caterpillar's purchased finished replacement parts

³²⁹ Undated PWC report, "Caterpillar CTOP Summary of Ideas," PwC_PSI_CAT_00004566 - 631, at 618. See also 9/1998 PWC report, "Caterpillar Inc. Global Tax Optimization Case for Action," PwC_PSI_CAT_00004632, at 674.

³³⁰ Undated PWC report, "Caterpillar Inc. Operational Feasibility Analysis High Level Target Designs: Migration/Deferral," PwC-PSI-CAT-00004548 - 565, at 551. 7/14/1998 email from Steven Williams, PWC, to Thomas Quinn, PWC, and others, PwC_PSI_CAT_00204970 - 974.

³³¹ Caterpillar presentation, "Product Management Alignment," (1/9/2009), PwC-PSI-CAT-00224682 - 686, at 685.

³³² Subcommittee interviews of Robin Beran, Caterpillar (10/18/2013), Rodney Perkins, Caterpillar (1/15/2014), and Steven Williams, PWC (2/19/2014) (each acknowledging they analyzed the CSARL transaction under a transfer pricing analysis and indicating that it was not necessary to move personnel); James Bowers, PWC (1/23/2014). All documents discussing moving product managers to CSARL related to CSARL's entering into tolling agreements with Caterpillar's manufacturing facilities in Belgium and France; none related to parts. See, e.g., 6/1/1999 minutes of GloVE Steering Committee meeting, PwC_PSI_CAT_00168292 - 296, at 295 (proposal to move product managers to Geneva related to implementation of manufacturing tolling agreements).

³³³ William Springer, Caterpillar (11/7/2013). See also Deposition of William Springer in Schlicksup v. Caterpillar, at PSI-TWLF-18-000003, at 013.

business as a result of the CSARL transaction.³³⁴ A 2006 PWC document explained the lack of operational changes at the time by stating that the CSARL transaction was intended simply to reflect what was already occurring and “better align the taxation of transaction flows with how Caterpillar actually manages those operations.”³³⁵

None of the sworn deposition testimony provided by Caterpillar’s personnel contradicted the information provided to the Subcommittee. When asked about the changes required in Caterpillar’s business operations, for example, Caterpillar’s tax department head, Robin Beran, said under oath:

“Q. What changes in business operations did it require?

A. It changed who actually bought the parts because CSARL became the acquirer of all the parts from the beginning. It changed various customs and logistics issues because of who the importers of record might be. There’s a lot of changes that come into play.

Q. Well, other than paper issues that were caused by the entities that became involved, were there any other changes to the physical flow of purchased finished replacement parts?

A. Physical flow, probably not substantially.”³³⁶

In addition, Edward Rapp, who was located in Switzerland between 1995 and 2004, and from 2000 to 2004, was Vice President of the EAME Marketing Division, testified in a deposition, that while in Geneva, he was familiar with CSARL’s predecessor COSA, but had not even heard of CSARL.³³⁷

Caterpillar’s Chief Accounting Officer also indicated in a Subcommittee interview that the 1999 transaction resulted in no change before tax in the total amount of Caterpillar profits from third party manufactured replacement parts sales.³³⁸ That information matched her earlier deposition testimony in which she said that the operating profit for parts sales was the same both before and after the 1999 transaction.³³⁹

Several Caterpillar representatives explained that, beginning in 1999 and continuing to the present, CSARL paid Caterpillar Inc. a service fee for Caterpillar personnel to continue to perform key business

³³⁴ Subcommittee interview of Sally Stiles, Caterpillar, Director of Global Tax and Trade Operations (9/4/2013).

³³⁵ 11/13/2006 PWC national office memorandum from Kevin Mitchell to Sharad Jain “Caterpillar Inc.,” PSI-TWLF-21-000001 - 265, at 229. See also Subcommittee interview of Robin Beran (10/18/2013).

³³⁶ Deposition of Robin Beran in *Schlicksup v. Caterpillar*, at PSI-TWLF-10-000008, at 178.

³³⁷ Deposition of Edward Rapp in *Schlicksup v. Caterpillar*, at PSI-TWLF-19-000019.

³³⁸ Subcommittee interview of Jananne Copeland, Caterpillar (10/30/2013).

³³⁹ Deposition of Jananne Copeland in *Schlicksup v. Caterpillar*, PSI-TWLF-15-000018, at 039.

functions supporting non-U.S. parts sales, including parts design, parts forecasting, inventory management, supplier oversight, and parts storage and delivery.³⁴⁰ Caterpillar's ongoing role in performing those parts functions was described in a report prepared for the Subcommittee by Caterpillar's outside tax expert as follows:

"CSARL reimburses Caterpillar ... for various engineering and logistical services provided by Caterpillar personnel located in the United States involved in engaging with suppliers and storing and managing inventory in U.S.-situated warehouses. ... [M]uch of the purchasing and logistical functions relating to outbound PFRP continued after the restructuring to be carried out by Caterpillar personnel located in the United States."³⁴¹

The ongoing servicing arrangement is additional evidence that Caterpillar continued to perform the same parts functions it always had – an unsurprising development since CSARL did not have the personnel, infrastructure, or expertise to take on those tasks.

Caterpillar's parts business has been and continues to be led and managed primarily from the United States. Nearly all the senior leadership of the parts business has been and remains in Illinois. Caterpillar's U.S. warehouses continue to operate in the same way as in the past. Caterpillar continues to manage the parts inventory and parts forecasting on a worldwide basis and manage the supplier base in the United States, just as it did before the transaction. CSARL continues to pay Caterpillar to keep doing the same work, which CSARL continues to be unequipped to perform.

(5) Managing the Offshore Cash Buildup

After the Swiss tax strategy was put in place, Caterpillar not only saved on U.S. taxes, it also experienced a "cash buildup in Geneva."³⁴² According to the company, while CSARL collected a "significant portion of profit" for the company, Caterpillar had "[p]rimary cash needs in the U.S.," creating what the company referred to as a "[u]se [d]ilemma."³⁴³ In 2002, Caterpillar wrote that it would "[n]eed to

³⁴⁰ Subcommittee interviews of Robin Beran, Caterpillar (10/18/2013) and Rodney Perkins, Caterpillar (1/15/2014). See also servicing agreements.

³⁴¹ 3/7/2014 "In the Matter of Caterpillar Inc.," Caterpillar Expert Witness Report, John P. Steines, Jr., Professor of Law, New York University, at PSI-Caterpillar-17-000003 - 023, at 007. See also 12/3/2013 Caterpillar response to Subcommittee Questionnaire, CAT-000270 - 298, at 296.

³⁴² 4/13/2010 Caterpillar report Global Tax & Trade Update, PwC_PSI_CAT_00205974 - 990, at 984.

³⁴³ 1/22/2008 Caterpillar presentation for meeting with Edward Rapp, Caterpillar Global Finance & Strategic Support, PSI-TWLF-19-000001 - 215, at 094. The additional tax costs would presumably be due to the growth of Caterpillar's pool of offshore earnings outpacing the amount of previously taxed income the company had on hand and available for repatriation to the United States without additional tax. *Id.*

[r]epatriate [c]ash in the US,” that “CSARL need[ed] to repatriate \$60-\$70m per year” to meet Caterpillar’s U.S. cash requirements, and that “Subpart F after-tax income alone may be insufficient to meet cash repatriation needs.”³⁴⁴

In 2005, Caterpillar’s tax director, Robin Beran, notified the company’s Chief Financial Officer about CSARL’s offshore cash buildup:

“[D]ue to successful planning from prior years, significant low taxed earnings (over \$1.5 billion) have accumulated in CSARL. This cash is now increasing at about \$70 million per month at tax rates of about 10%. This is resulting in offshore cash balances that can no longer be managed through intercompany loans and purchases without triggering significant additional tax costs, and an increase in CAT’s effective tax rate.”³⁴⁵

Mr. Beran asked for authorization to proceed with a restructuring to facilitate repatriation of the offshore cash to the United States, noting that “failure to proceed will result in significant additional tax costs.”³⁴⁶ Mr. Beran also noted in a 2006 memo that “ever-increasing cashflows from non-US sources to service US cash needs continue to place pressure on the indefinite reinvestment status of CSARL earnings. We are working on planning, which is projected to provide between \$1 billion to \$1.5 billion [in] repatriation relief.”³⁴⁷

In 2010, Caterpillar’s finance department identified a “Crossover” cash buildup problem which it defined as “when offshore cash no longer can be accessed in the U.S. without incremental U.S. tax cost,”³⁴⁸ meaning having to pay the U.S. corporate tax rate when the funds were repatriated to the United States. The finance department noted the “[h]igh enterprise tax cost of repatriation – 25% additional tax,” and stated that it was “[d]eveloping tax efficient repatriation strategies” to return \$3 billion to the United States.³⁴⁹ It listed several possible strategies for returning funds to the United States, including making “[l]oans to U.S. with minimal tax impact ... [p]repay[ing] royalties

³⁴⁴ 7/2/2002 PWC presentation, “CSARL Technology Ownership,” PwC_PSI_CAT_00024791 - 808, at 797.

³⁴⁵ 2/28/2005 email from Robin Beran, Caterpillar, to David Burritt, Caterpillar, “Authorization to proceed with planning and ABP [sic] cost adjustment,” PSI-TWLF-12-000008, at 315. The “significant additional tax costs” refers to the company’s having to pay the U.S. corporate tax rate of up to 35% if the funds were to be repatriated to the United States.

³⁴⁶ Id.

³⁴⁷ 7/14/2006 memorandum from Robin Beran, Caterpillar, to David Burritt, Caterpillar, PSI-TWLF-16-000262 - 263.

³⁴⁸ 4/13/2010 Caterpillar Inc. presentation to Audit Committee, “Global Tax & Trade Update,” PwC_PSI_CAT_00205974 - 990, at 984.

³⁴⁹ Id.

...[and] [e]xpand[ing] goods prepayment – CSARL purchases from U.S. affiliates.”³⁵⁰

Caterpillar appears to have executed at least one of these strategies. According to a memorandum prepared by Caterpillar’s auditor, PWC, in 2011, Caterpillar Inc. entered into an agreement with CSARL “whereby CSARL made \$4 billion of advance payments for certain prime product up to 2 years in advance and received a discount for orders placed against this advance payment.”³⁵¹ As of the end of 2013, Caterpillar’s offshore cash assets totaled \$17 billion, giving the company the 33rd largest offshore amount of 1,000 corporations reviewed.³⁵²

C. Identifying the Swiss Tax Strategy as High Risk

Internal Caterpillar and PWC documentation shows that Caterpillar knew, at the highest levels of the company, that critical elements of the Swiss tax strategy it had adopted had high risk aspects. In 2006, Caterpillar’s tax department devised a tax risk rating system to evaluate the risks associated with the company’s tax positions, analyzed two key elements of the Swiss tax strategy, and gave aspects of those elements a high risk rating. Rather than turn away from its aggressive tax position, however, Caterpillar instead sought ways to reduce the risk rating; when that did not happen, the company stopped using the rating system altogether in 2008.

Tax Reserves. One sign of Caterpillar’s recognition that its new Swiss tax strategy was high risk was the action taken by the company at one point to set aside a “tax reserve” equal to 50% of CSARL’s profits in case the IRS challenged the strategy.³⁵³ A tax reserve is a position recorded in a company’s audited financial statements to set aside money in case an uncertain tax position taken by the company on a tax return is successfully challenged by the IRS. The PWC auditor who reviewed Caterpillar’s tax issues, James Bowers, told the Subcommittee that the tax reserve was established due to uncertainties associated with the complex transaction flows, the adequacy of the royalty rates, and accounting issues related to CSARL.³⁵⁴ That reserve was later reduced,

³⁵⁰ Id.

³⁵¹ 12/31/2011 PWC Audit Memo. “Review intercompany transaction including company reorganizations and significant agreements,” PwC-PSI-CAT-00194435 - 436.

³⁵² See March 2014 “Foreign Indefinitely Reinvested Earnings: Balances Held by the Russell 1000: A Six-Year Snapshot,” Audit Analytics, at 4.

³⁵³ Subcommittee interview of James Bowers, PWC (1/23/2014). See also 6/2004 “Presentation to Caterpillar Inc. Audit Committee,” CAT - 001899 - 939, at 912; 4/10/2007 “FIN 48 Adoption and Corporate Tax Update,” at CAT- 002037 and 040; 4/13/2010 Caterpillar Inc. presentation to Audit Committee. “Global Tax & Trade Update,” PwC_PSI_CAT_00205974 - 990, at 982.

³⁵⁴ Subcommittee interview of James Bowers, PWC (1/23/2014).

after adoption of new tax accounting rules, to reflect 5% of the CSARL profits in each tax year.³⁵⁵

Adopting the Tax Risk Guard Rails System. Another sign of Caterpillar’s concerns about the risky nature of its Swiss tax strategy was action taken by an internal council of senior tax and accounting personnel, during the course of developing and implementing a new tax risk management process, to rate aspects of the Swiss tax strategy as “higher” risk.

The Swiss tax strategy was evaluated for risk at Caterpillar in connection with a new tax risk management tool known as the “Tax Risk Guard Rails” (TRGRs) project. The objective of the TRGRs project was to “develop a documented, more objective process” to identify and convey the business risks associated with uncertain tax positions to both company executives and the Audit Committee of the Board of Directors “in a non-technical manner.”³⁵⁶ Current and former Caterpillar employees interviewed by the Subcommittee attempted to downplay the significance of the TRGRs tax risk rating, but the evidence shows it was used to inform senior levels of the company about the risks associated with two critical elements of the Swiss tax strategy. The TRGRs system was developed at the direction of Caterpillar’s former CFO, David Burritt, its ratings were assigned by consensus of company tax and accounting experts, and remained in place for two years.

In 2004, when Mr. Burritt became Caterpillar Inc.’s CFO, he took steps to improve the company’s tax risk management processes.³⁵⁷ Mr. Burritt had previously worked with Daniel Schlicksup in Caterpillar’s Geneva office. When he took over as CFO, Mr. Burritt brought Mr. Schlicksup back to Caterpillar’s tax department in the United States to assist with tax risk management and improve the company’s global tax practices. Upon his return, Caterpillar announced the following concerning Mr. Schlicksup’s new position as its “Tax Strategy Manager”:

“Effective March 1, [2005,] D.J. (Dan) Schlicksup will become Tax Strategy Manager for Corporate Tax Services. In this new role, Dan’s primary function will be to provide leadership to our Global Tax Strategy, including benchmarking our performance and processes versus world-class and developing metrics to measure our progress. In addition, Dan will help provide leadership to Global Tax Communications, Personnel and Succession Planning.

³⁵⁵ 4/10/2007 “FIN 48 Adoption and Corporate Tax Update,” at CAT- 002041. FIN 48 stands for FASB Interpretation No. 48.

³⁵⁶ Caterpillar report, “Caterpillar Inc., Global Finance —Tax Risk Management. World Class Global Finance Operations to Support Vision 2020,” PSI-TWLF-4-000091 - 097, at 093.

³⁵⁷ 8/19/2005 email from David Burritt, Caterpillar, to Daniel Schlicksup, Caterpillar, “Re: Gene Fife – 210 of 250 companies remove CFO when there is material weakness,” PSI-TWLF-04-000131 (“This is exactly why we must step up the rigor on tax processes”).

Dan's educational background and work experience brings additional diversity to the Corporate Tax team. Dan has a very strong educational background with a Law degree and a Masters in Taxation coupled with a CPA. His previous experience working at Price Waterhouse in the tax department and at Cat as a Tax Manager in Peoria, Accounting & Tax Strategy Manager in Gosselies, and Director of European Tax Services in Geneva will serve him well in this new role."³⁵⁸

Early in his new position, Mr. Schlicksup learned about the TRGRs risk management tool from a leading business advisory organization, the Corporate Executive Board.³⁵⁹ Mr. Schlicksup brought the concept to the attention of Mr. Burritt who encouraged him to develop the TRGRs system for Caterpillar.³⁶⁰ The Tax Risk Guard Rails system was designed to evaluate tax positions for the following types of risks: technical, operational, compliance, financial statement, management, and reputational.³⁶¹ The system further broke down those risks into 19 "indicative criteria," requiring ratings on such factors as "industry practice," "magnitude of cash impact," "legal advice," and "impact on financial statements."³⁶² The last criteria required the tax position to be rated on what was referred to as the "WSJ Test," apparently referring to how it might be portrayed by the Wall Street Journal.³⁶³ Each of the criteria was scored using a rating system of 1 to 5, with 5 being the highest risk. A weighting system was also used, making some factors more important than others. Once specific tax position risks were evaluated and scored, they were to be plotted on a graph indicating whether their risk was low, medium, or high.³⁶⁴ Once the risks were identified, they were to be presented to company executives.³⁶⁵

In September 2005, Mr. Burritt shared the TRGRs concept with Douglas Oberhelman who was then Group President of the finance

³⁵⁸ 2/21/2005 email from Deborah Schrader, Caterpillar, to Elaine Atchley, Caterpillar, "General Mailing – Personnel Announcement," PSI-TWLF-04-000004.

³⁵⁹ For more about the Corporate Executive Board, see its website, <http://www.executiveboard.com/exbd/about/index.page?>.

³⁶⁰ Subcommittee interview of David Burritt, Caterpillar, former CFO (12/4/2013). See also 2/10/2006 email from David Burritt, Caterpillar, to Daniel Schlicksup, Caterpillar, "Re: Fw: Meeting re Tax Guardrails," PSI-TWLF-04-000038. See also 9/23/2005 email from David Burritt, Caterpillar, to Douglas Oberhelman, Caterpillar, and others, "FYI Only – Meeting with Gene Fife on Sept 26," PSI-TWLF-04-000039.

³⁶¹ See "Caterpillar Inc., Global Finance-Tax Risk Management, World Class Global Finance Operations to Support Vision 2020, PSI-TWLF-16-000188 - 194, at 190.

³⁶² See 3/21/2006 TRGRs presentation with ratings chart, prepared by Caterpillar, PSI-TWLF-11-000225.

³⁶³ Id.

³⁶⁴ "Caterpillar Inc., Global Finance-Tax Risk Management, World Class Global Finance Operations to Support Vision 2020," at slide 6, PSI-TWLF-16-000188 - 194, at 193.

³⁶⁵ Rodney Perkins Deposition in *Schlicksup v. Caterpillar*, PSI-TWLF-10-000004, at 117.

department, explaining that “[w]e will follow a process based on research done by the Corporate Executive Board that enables us to better analyze and understand our risks.”³⁶⁶ Mr. Burritt also asked Mr. Schlicksup to present the TRGRs concept to Caterpillar’s Audit Committee Chairman, Eugene Fife.³⁶⁷ Mr. Fife responded positively and asked for the TRGRs concept to be included on the agenda for a December Audit Committee meeting.³⁶⁸ In December 2005, Robin Beran, Caterpillar’s tax director, presented the TRGRs concept to the full Audit Committee and identified several deliverables for the February 2006 Audit Committee meeting, including identifying the tax risk categories and defining low, medium, and high risks.³⁶⁹

Assigning Tax Risk Ratings. Caterpillar’s Tax Council began its initial substantive work on the TRGRs project in January 2006 and continued through March.³⁷⁰ The Tax Council was a group of senior personnel from Caterpillar’s tax and accounting departments, formed at the suggestion of Mr. Burritt, to address key tax issues for the company.³⁷¹ According to Caterpillar’s Tax Director and Senior International Tax Manager for CSARL, the Tax Council reviewed, identified, and evaluated a broad range of Caterpillar tax risks, acting by consensus and in “good faith” with deference given to individuals with a higher level of expertise.³⁷²

³⁶⁶ 9/23/2005 email from David Burritt, Caterpillar CFO, to Douglas Oberhelman, Caterpillar Group President for Finance, “Meeting with Gene Fife on Sept 26,” PSI-TWLF-04-000039.

³⁶⁷ 9/26/2005, Presentation re Global Tax Management, PSI-TWLF-04-000040 - 073, at 040 and 066. Subcommittee interview of Daniel Schlicksup (8/29/2013 - 8/30/2013).

³⁶⁸ See 10/28/2005 email from Robin Beran, Caterpillar, to Daniel Schlicksup, “Dec. audit comm mtg,” PSI-TWLF-04-000341 - 344 (“Gene was very excited about this when we met with him, indicated that he wants this [TRGRs] to be part of every audit committee meeting and obviously wanted it on the Dec agenda (Doug [Oberhelman] even mentioned that to us). I would ask, when was the last time Gene acted in this manner about a tax issue?”).

³⁶⁹ 12/13/2005 Presentation re Global Tax Management, slides 1 and 27, PSI-TWLF-16-000167 - 180, at 167 and 180; Subcommittee interview of Daniel Schlicksup (8/29/2013 - 8/30/2013).

³⁷⁰ 1/3/2006 email from Rodney Perkins to Daniel Schlicksup, Jananne Copeland, and others, “Need asap please ... creating Tax Rf[s]k Guard Rails,” PSI-TWLF-04-000345-346; 2/7/2006 email from Daniel Schlicksup to David Burritt, “Tax Risk Guard Rails-audex,” PSI-TWLF-04-000978 (“David, I have a solid draft to the guard rails done I feel comfortable that if Gene [Fife] demanded to see something today and you came and got me, I could present the draft and get the Aud Comm comfortable that we are meeting our commitments.”); 2/9/2006 email from Brad Halverson, CAT controller, to Daniel Schlicksup, “Tax Risk Guardrails, PSI-TWLF-04-000356-357; 2/10/2006 email from David Burrit to Daniel Schlicksup, “Meeting re Tax Guard Rails,” PSI-TWLF-04-000358-359 (“Meeting with Brad Halverson and Robin Beran week of Mar 13 - 2 hours (BradH, RobinB, DanS, Janie Copeland) Meeting week of Feb 20 off-site, all day at Ivy Club (Rod, Sally, Gary, JamesC, Al, Robin, JohnC, DanS JanieC and Terri Pierpont) Meeting week of Feb 27 off-site, all day at Ivy Club (Rod, Sally, Gary, JamesC, Al, Robin, JohnC, DanS, JanieC and Terri Pierpont).” 02/27/2006 email from Daniel Schlicksup to David Burritt, “A/C meeting,” PSI-TWLF-04-000089 (“We had a two offsite last week to finalize the guard rails. We have two more days next week to plot the tax positions on the guard rails.”).

³⁷¹ Subcommittee interview of Rodney Perkins, Caterpillar (1/15/2014) and Robin Beran, Caterpillar (10/18/2013). Mr. Beran told the Subcommittee that CFO David Burritt formed the idea for the Tax Council.

³⁷² See, e.g., Subcommittee interview of Rodney Perkins, Caterpillar (1/15/2014). Mr. Perkins described two meetings on the tax risk guardrails project, each of which was “offsite” and about 1-2 days in length. He told the Subcommittee one additional meeting took place about a year

In March 2006, the Tax Council evaluated two critical elements of the Swiss tax strategy which raised concerns: CSARL's bundled royalty rate and the ITAS virtual inventory system.³⁷³ The Tax Council assigned multiple 5 ratings – meaning the highest risk rating – to several criteria related to the CSARL's bundled royalty rate, including with respect to “industry practice,” “business purpose and substance,” and “magnitude of cash impact.”³⁷⁴ The Tax Council assigned even more 5 ratings to the ITAS virtual inventory system, including a 5 high-risk rating for the legal advice provided in connection with the system and for the reputational risk associated with the “WSJ test.” Overall, when those and other individual ratings were combined, averaged, and weighted, the Tax Council ranked those two elements of the Swiss tax strategy as among the highest risk tax issues it examined.³⁷⁵

Although the Tax Council's TRGRs findings were planned to be presented to the Audit Committee in earlier meetings,³⁷⁶ they were actually included on a meeting agenda in June 2006. On June 13, 2006, it appears that the Audit Committee was not presented with the TRGRs findings, but instead with a description of the TRGRS process including the steps to be taken to identify and define risks categories and the associated criteria, although Caterpillar officials who attended that meeting told the Subcommittee that they could not remember any details about the presentation.³⁷⁷

after the initial meetings. Mr. Perkins said the meetings were very thorough, and everyone weighed in. He indicated that there was a sense in the meetings to move on as quickly as possible, but that the participants put in a good faith effort during the meetings. See also Sally Stiles Deposition in *Schlicksup v. Caterpillar*, PSI-TWLF-11-000008, at 65; Deposition of Rodney Perkins in *Schlicksup v. Caterpillar*, PSI-TWLF-10-000004, at 115; deposition of Robin Beran in *Schlicksup v. Caterpillar*, at PSI-TWLF-12-000008, at 32.

³⁷³ 3/21/2006 Tax Risk Guard Rails presentation, PSI-TWLF-11-000224 - 227.

³⁷⁴ 3/21/2006 TRGRs presentation, prepared by Caterpillar, ratings chart at PSI-TWLF-11-000225.

³⁷⁵ Id. Of the 15 tax positions it reviewed, the Tax Council rated the bundled royalty rate and the virtual inventory system as the third and sixth highest risk tax positions.

³⁷⁶ See, e.g., 1/11/2006 email from David Burritt to Daniel Schlicksup, “the Audit Committee & Tax Risk Guard Rails,” PSI-TWLF-04-000076 (“Please plan to include in Feb advance material”); 2/9/2006 email from David Burritt to Daniel Schlicksup, “Tax Risk Guard Rails,” PSI-TWLF-04-000080 (“We need to move this forward The issue was not raised but I think we missed a due date. Let's make sure this gets included in the April material in ‘final’ form.”); and 5/12/2006 email from David Burritt to Robin Beran “Audit Committee- June,” PSI-TWLF-16-000217 (“I will call Ali but our instruction from Gene [Fife, Audit Committee Chairman] was on [tax risk] guard rails”); 5/12/2006 email from David Burritt to Robin Beran “Audit Committee- June” (responding to a question from Mr. Burritt about whether they were ready to present to the Audit Committee, Mr. Beran wrote: “We were done with them [the TRGRs] about 5 weeks ago.”).

³⁷⁷ 6/13/2006 Audit Committee Presentation, “Income Tax Update,” CAT 001949 - 965; 6/13/2006 “Agenda Audit Committee,” PSI-TWLF-16-000214 (“this presentation will provide an update on World Class Tax initiatives supporting our Global Finance Transformation, including “tax guard rails.”) Robin Beran testified that the “Income Tax Update” presentation noted above looked like part of the presentation given to the Audit Committee in June, but he was unsure whether he gave the presentation. Deposition of Robin Beran in *Schlicksup v. Caterpillar*, PSI-TWLF-12-000008, at 114. The Subcommittee obtained from PWC a similar copy of a 6/13/2006 Audit Committee presentation, which was an attachment to an email

Caterpillar's tax department also shared the TRGRs findings with PWC partner James Bowers who assisted in the audit of the company's financial statements, including Caterpillar's estimates of its tax liabilities. Mr. Bowers advised the Subcommittee that he had received the TRGRs risk ratings and believed that they were later presented to the company's Audit Committee.³⁷⁸ He said that the TRGRs process had identified risks associated with the Swiss tax strategy, but recalled that they were similar to the risks identified when Caterpillar increased its tax reserves.³⁷⁹ He said that he had been unaware that the Tax Council had rated certain CSARL tax elements as "high" risk.³⁸⁰

On August 11, 2006, Mr. Schlicksup wrote CFO Burritt that he was being pressured to lower the TRGR risk ratings for some tax positions. Mr. Schlicksup advised the following about the TRGRs status:

"Tax Council will be meeting in near future to update TRGRs. The pressure I am getting is focused on the risk shown on the guard rails. For example, I am being questioned why the structured finance deals should be considered to have high reputational risk I think he [Robin Beran, the tax director] is very concerned about showing any risk at all.

I need to understand where you want to go with the TRGRs. Are we going to stop where we are at which is just informing the board about the process we went through to create the guard rails, or are we going to show the board the results and have a meaningful discussion explaining our risk profile and to determine the board's comfort with it? I don't want to spend a lot of time on this if it's not going to go anywhere. I recommend the latter as I believe it is a best practice and the whole point for going down this path in the first place."³⁸¹

between Robin Beran, Caterpillar, and James Bowers, PWC tax partner, which included an email that indicated the presentation was sent to Caterpillar senior executives Douglas Oberhelman and David Burritt. 6/8/2006 email from Robin Beran to James Bowers, "Fw: FYI - 2006 Corporate Tax Audit Committee Presentation," PwC_PSI_CAT_00004799 - 827. The attachment to this email set out plotted tax positions identifying risk for various positions including CSARL's Bundled Royalty rate and the Virtual Inventory. *Id.* at 827. It does not appear that these positions were presented to the Audit Committee at the June 2006 meeting. Neither Robin Beran nor the Audit Committee Chairman, Eugene Fife, recalled any details about the TRGRs presentation to the Audit Committee. Subcommittee interviews of Robin Beran, Caterpillar (10/18/2013) and Eugene Fife, Caterpillar (11/13/2013). In fact, Mr. Fife had no recollection of the phrase "Tax Risk Guard Rails." Former CFO David Burritt remembers the concept of TRGRs being discussed with the Audit Committee, but he does not recall whether the actual TRGRs were presented. Subcommittee interview of David Burritt, Caterpillar (12/4/2013).

³⁷⁸ Subcommittee interview of James Bowers, PWC tax partner (1/23/2014). He advised that the ratings were presented to the Audit Committee in April 2008.

³⁷⁹ *Id.*

³⁸⁰ *Id.*

³⁸¹ 8/11/2006 emails between Daniel Schlicksup and David Burritt, "Tax Risk Guard Rails," PSI-TWLF-04-000126 - 128, at 127.

Mr. Burritt responded: “The latter is the way to go, of course. Why would we have started this if we weren’t going to do it right?”³⁸² However, Mr. Burritt also wrote in a later email: “Focus now on Oct A/C [Audit Committee] meeting. Let’s meet after that. But no more emails on this, pls. I get too many already.” Around this time, the Tax Director, Robin Beran, sent an email to Mr. Schlicksup indicating that he understood that it was implicit the tax department would keep the ratings below high risk: “Assuming guidance is to stay below high [risk] in all areas, how do we utilize?”³⁸³

2008 TRGRs Report to Audit Committee. The Tax Risk Guard Rails project remained in place for approximately two years, from 2006 to 2008.³⁸⁴ Its risk ratings were reviewed twice each year by the Tax Council which retained the high risk ratings assigned to the royalty and virtual inventory issues associated with CSARL.³⁸⁵ As late as April 8, 2008, a presentation with a “Global Tax Update” touting implementation of the TRGRs tax risk management tool was prepared for the Audit Committee.³⁸⁶ The presentations noted that the “Tax Risk Guards Rails” risk ratings were part of Caterpillar’s “robust” tax risk management process.³⁸⁷ It also advised the Audit Committee that Caterpillar’s “risks are actively managed.”³⁸⁸

One of the slides in the 2008 presentation identified the “CSARL – Parts Distribution – Management & Reputation” as one of the “Higher Risk Areas.”³⁸⁹ The Audit Committee was also advised in the presentation that the company had developed a plan with outside counsel to mitigate this risk.³⁹⁰ The presenter’s note to this presentation stated, with regard to parts distribution:

“CSARL and CAT Inc. trade parts in a manner that increases the Parts Sales that qualify for favorable tax treatment. The complexity of the activity could be cast in unfavorable light. To

³⁸² Id. at 126.

³⁸³ 7/28/2006 email from Robin Beran to Daniel Schlicksup, PSI-TWLF-04-000368.

³⁸⁴ Subcommittee interview of David Burritt, former Caterpillar CFO (12/4/2013): “Caterpillar Inc. Report to Audit Committee.” PSI-TWLF-16-000114 - 124, at 121. The report was provided as part of Caterpillar’s “World Class Tax Update” that it had “implemented the Tax Risk Guard Rails to reduce Risk and Complexity.”

³⁸⁵ 3/21/2006 Tax Risk Guardrails, PSI-TWLF-04-000382; 10/15/2007 Tax Risk Guardrails, PSI-TWLF-04-000383; 3/18/2008 Tax Risk Guardrails, PSI-TWLF-04-000384 and 2/8/2006, Tax Risk Guardrails Criteria (draft), PSI-TWLF-04-000381.

³⁸⁶ 4/8/2008 Caterpillar “Global Tax Update,” CAT-002087 - 112; 5/13/2008 email from James Bowers, PWC audit partner, to Sharad Jain. “Tax Presentation,” PWC_PSI_CAT_00036773. Mr. Bowers advised the Subcommittee that the attachment to the email was presented to the Audit Committee. Subcommittee interview of James Bowers, PWC (1/23/2014).

³⁸⁷ Id. The presentation showed that Caterpillar’s tax risk management processes were “robust,” 4/8/2008 Caterpillar “Global Tax Update,” CAT-002087 - 112, at 094.

³⁸⁸ 4/8/2008 Caterpillar “Global Tax Update,” CAT-002087 - 112. See also 5/13/2008 email from James Bowers, PWC, to Sharad Jain “Tax Presentation” PwC_PSI_CAT_00036773.

³⁸⁹ Id.

³⁹⁰ Id.

ensure our position is correct, we worked extensively with outside counsel and accountants on the process involved.”³⁹¹

Together, the evidence indicates that the TRGRs risk ratings served to focus attention on the Swiss tax strategy, led to a consensus among participants on Caterpillar’s Tax Council that the strategy had risky elements, and alerted Caterpillar’s Board of Directors, through the Board’s Audit Committee, as well as its senior executives, to the ongoing risks posed by the Swiss tax strategy.

Downplaying the TRGR High Risk Ratings. When asked about the TRGR risk ratings related to the Swiss tax strategy, Caterpillar downplayed their significance. During interviews with the Subcommittee, senior executives from Caterpillar’s tax department, as well as Caterpillar’s CFO at the time they were implemented, told the Subcommittee that the TRGRs risk ratings were of limited value in informing either the Board of Directors or the Audit Committee about Caterpillar’s tax risks, and the risk ratings were therefore abandoned in 2008. During interviews, these executives recalled little detail about the tax risks or ratings identified during TRGRs process or how they were used. The Audit Committee Chairman at the time, Eugene Fife, told the Subcommittee he had no recollection of the phrase “Tax Risk Guard Rails,” despite the fact that he appeared to have played an active role in their adoption.³⁹² The Caterpillar Tax Director, Robin Beran, said that he had been skeptical of the usefulness of the risk ratings from the beginning,³⁹³ and viewed the ratings as flawed because anything involving a large amount of money would lead to a high risk rating.³⁹⁴ He told the Subcommittee that rather than rely on the TRGRs ratings assessed by his senior staff, he relied on expert tax advice from PWC and McDermott Will & Emery. Another senior tax department official, Rodney Perkins, told the Subcommittee that the TRGRs process was not a useful tool and that he didn’t remember the risks associated with CSARL.³⁹⁵ Former CFO David Burritt acknowledged that he was originally in favor of implementing the TRGRs process, but later concluded that the process was too “heavy” and time and resource-intensive. He told the Subcommittee that he did not recall any specific risks that the TRGRs identified.³⁹⁶

³⁹¹ 5/13/2008 email from James Bowers, PWC, to Sharad Jain “Tax Presentation” PwC_PSI_CAT_00036774 - 791, at 785.

³⁹² Subcommittee interview of Eugene Fife, Caterpillar Audit Committee Chair (11/13/2013).

³⁹³ Deposition of Robin Beran in *Schlicksup v. Caterpillar*, PSI-TWLF-12-000008, at 23.

³⁹⁴ Subcommittee interview of Robin Beran, Caterpillar (10/18/2013).

³⁹⁵ Subcommittee interview of Rodney Perkins, Caterpillar (1/15/2014). Mr. Perkins also advised the Subcommittee that he was more concerned with the adequacy of the amount of the licensing fees paid by CSARL, than the lack of a business purpose or economic substance in the CSARL transaction.

³⁹⁶ Subcommittee interview of David Burritt, former Caterpillar CFO (12/4/2013).

D. Swiss Tax Strategy Policy Concerns

The Swiss tax strategy that PWC designed and Caterpillar adopted to lower its U.S. taxes raises multiple policy questions. They include whether the strategy lacked economic substance, whether the agreements between Caterpillar Inc. and CSARL violated arm's-length principles, and whether its use of a virtual inventory system created a taxable U.S. presence for CSARL. Together, these and related problems demonstrate why transfer pricing agreements between a U.S. parent corporation and its foreign affiliate raise multiple policy concerns; the agreements are between related parties with aligned interests and too often function, not to allocate costs or profits fairly between the parties, but simply to shift profits offshore to avoid U.S. taxes, exploiting loopholes and weaknesses in U.S. transfer pricing regulations.

(1) Economic Substance Concerns

The first policy issue raised by Caterpillar's Swiss tax strategy is whether the CSARL transaction lacked economic substance. At least two tax professionals within Caterpillar concluded that the CSARL transaction lacked economic substance and had no business purpose other than tax avoidance, bringing those concerns to the attention of officers at the highest levels of the company through an anonymous letter in 2004, and a series of emails and memoranda by the company's Global Tax Strategy Manager beginning in 2007. Even though company executives knew the CSARL transaction had been tax motivated, the employee concerns were dismissed. While Caterpillar does not dispute that the CSARL transaction was the result of a tax strategy designed to lower the company's taxes, Caterpillar says that fact is irrelevant and its actions should be judged solely on whether it has complied with U.S. transfer pricing laws and regulations, which it contends the company did.

Anonymous Letter. In 2004, an anonymous letter was received by Caterpillar's CEO and the tax department alleging that the CSARL transaction lacked any business purpose other than tax avoidance.³⁹⁷ The letter stated in part:

"I do not believe Caterpillar's transfer pricing practices (past and present) meet the IRS' tests. The Officers and Board of Directors need to examine the transfer pricing issue before Caterpillar ends up in court and in the press [T]he Tax Code does not permit transactions or an organizational structure that have no substantial business purpose other than for tax avoidance purposes. The

³⁹⁷ Robin Beran told the Subcommittee that he shared the anonymous letter with the IRS auditors stationed at the company. Subcommittee interview of Robin Beran, Caterpillar Tax Director (10/18/2013).

CSARL reorganization in my opinion, does not meet this test. When you look through the reorganization, the primary purpose was to avoid taxes.

Over the past few years, Caterpillar's tax rate has dropped significantly due to very questionable transactions and organizational changes. I work in the Tax Department and I strongly disagree with how we have conducted our business over the past few years. I have not spoken out before, because of the fear of retribution. I am speaking out now for the long term good of Caterpillar. An independent investigation (not PWC or our outside tax counsel) is needed. If there is no independent investigation or if there is any retribution, I will go the IRS."³⁹⁸

Caterpillar's Tax Director, Robin Beran, forwarded the anonymous letter to the CEO along with a memorandum disputing its analysis and recommending against further investigation, because he considered the issues raised to be without merit.³⁹⁹ Mr. Beran wrote that the allegations were untrue, and the author was misinformed. With regard to the transfer pricing issue, he stated: "CAT's transfer pricing policy is the result of detailed analysis of the functional activities of the various entities in strict accordance with Treasury Regulations."⁴⁰⁰ He also noted that two independent accounting firms had assisted in Caterpillar's analysis. With regard to the allegations concerning the lack of a business purpose other than tax avoidance, he explained that CSARL was formed to facilitate and coordinate Caterpillar's non-U.S. business activities throughout the world, which had been previously carried out by CSARL's predecessor, COSA. He also noted: "The basic operations of Caterpillar SARL are no different than any other valid and legal partnership operating anywhere in the world."⁴⁰¹

Tax Strategy Manager Concerns. Three years later, in 2007, Daniel Schlicksup, Caterpillar's Global Tax Strategy Manager, began raising similar concerns inside the company. In January 2007, Mr. Schlicksup wrote an email to Caterpillar's Tax Director raising questions about the CSARL transaction and the "economic substance" tax doctrine. He wrote: "To my knowledge there is no one in CSARL managing the parts business or managing the subcontracting of all the activity to [Caterpillar] Inc."⁴⁰² He suggested that a review of the facts and case law would be prudent, sending several recent cases from the

³⁹⁸ 5/6/2004 memorandum from Robin Beran, Caterpillar, to Douglas Oberhelman, Caterpillar, "Tax Concerns Raised by an Unnamed Source," PSI-TWLF-02-0001393 - 396, at 395.

³⁹⁹ Id.

⁴⁰⁰ Id. at 393.

⁴⁰¹ Id. at 394.

⁴⁰² 1/19/2007 email from Daniel Schlicksup, Caterpillar Global Tax Strategy Manager, to Robin Beran, Caterpillar, PSI-TWLF-02-000349 - 352, at 349.

Seventh Circuit.⁴⁰³ From July through September, Mr. Schlicksup repeated his concerns to the company's legal department about the lack of business substance in the CSARL transaction, as well as raising concerns about other aspects of Caterpillar's business.⁴⁰⁴ In September 2007, Mr. Schlicksup sent an email to Caterpillar's ethics officer reiterating his concerns. He wrote:

"There is about approximately \$1b on the balance sheet representing profit after tax generated by the CSARL parts initiative. The number increases by about \$200-250M per year In January 2007, I raised the issue of whether the judicial doctrines of Economic Substance and Business [P]urpose have been adequately addressed.... The essence of the issue is that to my knowledge, the parts business is managed from the US, yet we are running the parts profits through Switzerland as if the business was managed by CSARL."⁴⁰⁵

He also wrote: "I believe an inquiry into this issue is appropriate."

In April 2008, when Mr. Schlicksup was preparing a presentation for the Caterpillar Board of Directors discussing CSARL among other high risk tax strategies, he sent an email to the head of the tax department, Robin Beran, again raising the economic substance issue and urging that it 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 of case law. ... I don't think you can talk about CSARL without addressing this issue and it is not addressed in the charts you have included."⁴⁰⁶

When the formal inquiry and Board discussion that he requested failed to materialize, in May 2008, Mr. Schlicksup sent Caterpillar's Executive Office a memorandum detailing his concerns about improprieties occurring at the company, including his concerns about the

⁴⁰³ Id. Mr. Schlicksup sent another email to Mr. Beran about the lack of economic substance in the CSARL transaction in March 2008. Mr. Beran responded: "I didn't get to mention it you ... but it [is] covered extensively in 4 memos" prepared by outside counsel. 3/24/2008 email from Robin Beran, Caterpillar, to Daniel Schlicksup, Caterpillar. PSI-TWLF-02-000469.

⁴⁰⁴ 7/19/2007 email from Daniel Schlicksup, Caterpillar, to Debra Kuper, Caterpillar Senior Corporate Counsel, "FYI, I assume you want this information as it comes up," PSI-TWLF-02-000368; 8/14/2007 email from Daniel Schlicksup, Caterpillar, to James Buda, Caterpillar, "Tomorrow's Meeting," PSI-TWLF-02-000369 - 379.

⁴⁰⁵ 9/07/2007 email from Daniel Schlicksup, Caterpillar, to Nancy Snowden, Caterpillar Director of Business Resources, "OBP Complaint - Accounting Practices- No. 2," PSI-TWLF-02-000387 - 392, at 387.

⁴⁰⁶ 4/1/2008 email from Daniel Schlicksup, Caterpillar, to Robin Beran, Caterpillar, "Pls review again before we send in AM," PSI-TWLF-07-000022.

lack of business substance in the CSARL transaction.⁴⁰⁷ Mr. Schlicksup's memorandum identified the following problems: the CSARL transaction lacked a business purpose other than tax avoidance; there was no real change in the company's business functions as a result of the CSARL transaction; there was no non-tax related change in Caterpillar's economic position after the CSARL transaction; and the transaction was tax motivated.⁴⁰⁸

Another senior tax manager in Caterpillar's tax department, Rodney Perkins, when asked about the CSARL transaction in a deposition, made statements that raised further questions about the tax strategy's business purpose. Mr. Perkins, Caterpillar's Senior International Tax Manager with direct responsibility for CSARL, was asked in a deposition about whether the CSARL transaction had any "business advantage" other than "the avoidance or deferral" of U.S. tax and said under oath the following:

"Q. What was the benefit to Caterpillar Inc., to have CSARL purchase finished replacement parts instead of having Caterpillar, Inc., buy them and sell them to CSARL?

A. It would alter the character of income from CSARL from includable deemed distribution income to the U.S.

Q. So the advantage to Caterpillar, Inc., would be that it would pay less federal income tax?

A. Yes.

Q. And that would be an advantage to the enterprise as a whole in the sense that the tax was at least deferred?

A. Yes.

Q. Was there any business advantage to Caterpillar, Inc., to have this arrangement put in place other than the avoidance or deferral of income taxation at higher rates?

A. No, there was not.

[Caterpillar Counsel]: Let's take a break."⁴⁰⁹

⁴⁰⁷ 5/1/2008 memorandum from Daniel Schlicksup, Caterpillar, to the Caterpillar Executive Office (Douglas Oberhelman, Group President; and Edward Rapp, Group President). PSI-TWLF-02-001208 - 222.

⁴⁰⁸ Mr. Schlicksup was later demoted from his position in the Caterpillar tax department and filed a lawsuit against his employer charging retaliation under the Sarbanes-Oxley Act. Schlicksup v. Caterpillar, Case No. 09-1208 (C.D. Illinois, Peoria Division 2009). In 2012, the lawsuit was settled for an undisclosed amount and dismissed. One Caterpillar representative expressed the view that Mr. Schlicksup may have decided to file the lawsuit earlier and wrote emails while at the company to help his case.

⁴⁰⁹ Deposition of Rodney Perkins in Schlicksup v. Caterpillar, PSI-TWLF-10-000004, at 111. When the Subcommittee asked Mr. Perkins about his deposition testimony, he claimed that what he meant was that there was no advantage in a lower effective tax rate for the business units.

Other factors also support the view that the CSARL transaction lacked economic substance. They include that the Swiss tax strategy, for which PWC's tax consultants were paid over \$55 million, was explicitly designed as a tax reduction effort; it was driven and paid for by the company's tax department;⁴¹⁰ and was touted as Caterpillar's "primary tax structure" used to lower its U.S. effective tax rate.⁴¹¹ One of the indicators that the IRS has identified as suggesting an economic substance problem is when a transaction is "promoted/developed/administered" by the corporation's tax department or outside tax advisors.⁴¹² In addition, as recounted earlier, the CSARL transaction made changes on paper, but not in the actual functioning of Caterpillar's replacement parts business which continued to be led and managed from the United States.

Moreover, Caterpillar's profit before tax on a consolidated basis remained essentially unchanged compared to before the CSARL transaction. At the same time, only a small portion of those consolidated profits were reported in the United States as taxable income.⁴¹³ In short, the point of the CSARL transaction was not to increase Caterpillar's earnings, but simply to send more of its profits abroad to lower the company's effective tax rate.

Caterpillar contends that the CSARL transaction, while tax motivated, reflected the changing nature of its parts business, which included increasing sales outside of the United States. According to the company's 2013 annual report, for example, about 67% of Caterpillar's total revenues were generated by non-U.S. sales.⁴¹⁴ Caterpillar executives attribute that increased sales activity to its marketing companies, including CSARL, whose job is to re-sell Caterpillar products and parts to its non-U.S. dealer network. Caterpillar asserts that the CSARL transaction was simply a matter of removing the unnecessary presence of the U.S. parent company from the legal title chain for third party manufactured parts sold abroad. However, of the Caterpillar finished replacement parts sold abroad, nearly 70% were manufactured in the United States, and the U.S. parent company continued to manage and lead the company's parts business primarily

This explanation didn't appear credible in the context of the questions and answers given during his deposition cited above.

⁴¹⁰ Deposition of Sally Stiles in *Schlicksup v. Caterpillar*, PSI-TWLF-11-000008, at 106-107; Subcommittee interview of Robin Beran, Caterpillar (10/18/2013).

⁴¹¹ Caterpillar presentation from Robin Beran, Caterpillar, to Edward Rapp, Caterpillar, Global Tax & Trade, PSI-TWLF-19-000090 - 097, at 093.

⁴¹² See 7/15/2011 "Guidance for Examiners and Managers on the Codified Economic Substance Doctrine and Related Penalties," prepared by the IRS. <http://www.irs.gov/Businesses/Guidance-for-Examiners-and-Managers-on-the-Codified-Economic-Substance-Doctrine-and-Related-Penalties>.

⁴¹³ Subcommittee interviews of Rodney Perkins, Caterpillar (1/15/14) and Jananne Copeland, Caterpillar (10/30/2013); Deposition of Jananne Copeland *Schlicksup v. Caterpillar*, PSI-TWLF-15-000007, at 039.

⁴¹⁴ Caterpillar Inc. Annual Report (Form-10K), at 8 (2/19/2013).

from the United States. The ongoing dominant role of Caterpillar's U.S. personnel in the company's parts business raises questions about whether the CSARL transaction, and the resulting allocation of non-U.S. parts profits to Switzerland, accurately reflect the economic reality of Caterpillar's parts business.

2007 Review and Report. In 2007, the same year Mr. Schlicksup raised concerns about the CSARL transaction, a PWC document shows that Caterpillar's tax department initiated a review to determine whether CSARL had sufficient "operational substance" to support Caterpillar's decision to direct most parts profits to Switzerland.⁴¹⁵ A PWC chronology of events related to the CSARL transaction noted that the Caterpillar tax department's review had concluded in a written report that "sufficient substance was maintained by CSARL" so that no "material exposure" existed for the company.⁴¹⁶ When the Subcommittee requested a copy of that report from both Caterpillar and PWC, however, neither provided one. Caterpillar told the Subcommittee that it was unable to identify any responsive document other than documents for which it was asserting attorney-client privilege, and PWC advised it was unable to locate a copy in its files.⁴¹⁷

2009 Review and Actions to Preserve \$300 Million Annual Tax Benefit. In late 2008, the IRS proposed a regulation creating a new test to allow a manufacturer to claim that a controlled foreign corporation (CFC) was exempt from U.S. taxation under a manufacturing exception to Subpart F.⁴¹⁸ To meet the new test and qualify for the tax exemption, a CFC had to show that it made a "substantial contribution" to the manufacturing process.⁴¹⁹ During that 2008 time period, Caterpillar was also conducting an unrelated realignment of its business operations. At that time, PWC and Caterpillar's tax department conducted another review of CSARL to determine whether it met the new IRS requirements, whether CSARL's parts business had adequate substance to preserve its annual parts tax benefit, and whether it would need to increase the royalty paid to Caterpillar.

In November 2008, an email exchange between two PWC transfer pricing experts assigned to Caterpillar discussed the possible problems with CSARL.⁴²⁰ Steven Williams, a PWC Managing Director, wrote:

⁴¹⁵ 2/16/2010 "Caterpillar Inc., CSARL Permanent File, Chronological History: 1999-2010."

PwC_PSI_CAT_00003406 - 463, at 409-410.

⁴¹⁶ *Id.*

⁴¹⁷ 12/3/2013 Caterpillar response to Subcommittee Questionnaire, CAT-000270 - 298, at 297.

⁴¹⁸ For more information about the proposed regulation, see background chapter of this report, Foreign Base Company Sales Income – Manufacturing Exception.

⁴¹⁹ See Treas. Reg. § 1.954-3(a)(4)(iii).

⁴²⁰ 11/4/2008 emails between Steven Williams, PWC Managing Director, Global Transfer Pricing, and Thomas Quinn, PWC International Tax Service Partner. PwC_PSI_CAT_00033157 - 159.

“[J]ust curious—say they [Caterpillar] decide most PMs [Product Managers] stay in U.S. How do we retain CSARL parts profits if those ‘US entrepreneurs’ claim both machine AND parts profit?”

Thomas Quinn, a PWC tax partner who helped design the CSARL transaction, replied:

“PMs in US will put some pressure on the parts profit model. These guys are really bought into the PM is king concept. We are going to have to create a story that will put some distance between them [product managers] and parts (eg. all the parts that are non-current) to retain the benefit. Get ready to do some dancing.”

Mr. Williams responded:

“What the heck. We’ll all be retired when this audit comes up on audit. [Edward] Bodnam and [C]hris Dunn will have to solve it. Baby boomers have their fun, and leave it to the kids to pay for it.”⁴²¹

A few days after this email exchange, Mr. Williams and Mr. Quinn worked with Caterpillar’s Tax Director, Robin Beran, on a presentation for Caterpillar’s Executive Office alerting them to the potential problems involving CSARL.⁴²² Their November 11, 2008 presentation described CSARL’s tax benefits, analyzed its potential problems in meeting the new IRS regulatory requirements, and recommended additional actions to bolster its substantive parts operations. The presentation began by noting that, since 1999, the CSARL transaction had produced \$1.3 billion in cumulative after-tax benefits and forecasted an additional \$250 million tax benefit for 2008.⁴²³ With regard to the related tolling agreements, the presentation noted a total of \$200 million in after-tax benefits to date, while forecasting a loss for 2008. The presentation indicated that, overall, CSARL “today” produced a tax benefit of “250 - 300M” per year, resulting in a lower effective tax rate of 5 - 6 percentage points and \$0.40 - \$0.48 profits per share.⁴²⁴

The presentation then described the new IRS requirements for qualifying a foreign affiliate to claim the manufacturing exception to Subpart F, which required a showing that the affiliate made a “substantial contribution” to the manufactured goods being sold. The presentation expressed doubt that CSARL had the entrepreneurial or substantive manufacturing operations called for by the IRS

⁴²¹ Id.

⁴²² See 11/6/2008 emails between Steven Williams, PWC, and Thomas Quinn, PWC, PwC_PSI_CAT_00033229 - 234.

⁴²³ 11/11/2008 email from Rodney Perkins, Caterpillar, to Thomas Quinn, PWC, “Exec Office Slides - Business Alignment.” PwC_PSI_CAT_00033241: 11/11/2008 presentation, Caterpillar Inc., “2009 Business Alignment Update Briefing,” PwC_PSI_CAT_00033242 - 252.

⁴²⁴ Id. at 245.

requirements. The presentation stated: “IRS insisted on substantial local entrepreneurial decision-making.”⁴²⁵

To meet the IRS requirements and preserve CSARL’s tax benefits, the presentation recommended that four worldwide product managers be moved to Geneva.⁴²⁶ It warned that “[r]egional product managers will not be sufficient under the proposed IRS regulations,” and the “failure to take action weakens current CSARL structure,” which meant its “\$250 million tax benefit would be at risk.”⁴²⁷ Another presentation in January 2009, urged that worldwide product managers and a “Global Parts Management” organization be located in Geneva to address “optics concerns” related to “[t]axation in CSARL with minimal business substance.”⁴²⁸

On December 4, 2008, Rodney Perkins, Caterpillar’s Senior International Tax Manager for CSARL, sent an email copying Caterpillar’s Tax Director and CFO and forwarding a message to PWC expressing concern about the potential impact of the proposed IRS regulations on CSARL and urging that steps be taken to expand CSARL beyond a regional role and give it more “entrepreneurial substance.”⁴²⁹ He wrote in part:

“After realignment, benefits for both machine and parts are at risk unless there’s sufficient entrepreneurial substance in Geneva (worldwide product managers, not regional product managers, achieve this) Regional entrepreneurship doesn’t create worldwide entrepreneurship for parts---PARAMOUNT IMPORTANCE CSARL is not regional Current language in examples of proposed US regulations states: where substantial operational responsibilities and decision making regularly exercised by domestic parent employees [Worldwide Product Mgrs employed by Cat Inc in the US], who are directing the activities of a principal’s employees [regional product managers in CSARL], the principal does not meet the manufacturing exception [immediate US taxation of CSARL profits, including those arising from parts] [D]epending upon final language when regs released, could be PARAMOUNT

⁴²⁵ Id.

⁴²⁶ Id. at 247 and 350. See also 11/6/2008 email from Steven Williams, PWC, to Thomas Quinn, PWC, PwC_PSI_CAT_00033229 (“need five guys outside US to maintain CSARL benefits (250 in parts, 50+ in machines in normal years)”).

⁴²⁷ 11/11/2008 email from Rodney Perkins, PWC, to Thomas Quinn, PWC, “Exec Office Slides - Business Alignment,” PwC_PSI_CAT_00033241; 11/11/2008 presentation, Caterpillar Inc., “2009 Business Alignment Update Briefing,” PwC_PSI_CAT_00033242 - 252.

⁴²⁸ 1/9/2009 email from Michael Murphy, PWC, to Steven Williams, PWC, “CAT Slides,” PwC_PSI_CAT_00224682; 2009 presentation, Caterpillar Inc., “Product Management Alignment,” PwC_PSI_CAT_00224683 - 686, at 685.

⁴²⁹ 12/05/2008 email from Rodney Perkins, PWC, to Thomas Quinn, PWC, “Business Alignment-Product Manager Conference Calls-Global Tax Observations,” PwC_PSI_CAT_00060748 - 749.

IMPORTANCE[.] Absence of any worldwide product manager in Geneva and relocation of some regional managers have significantly weakened existing substance.”⁴³⁰

The IRS’ proposed regulations were finalized in February 2009. Despite the warnings and recommendations of PwC and the company’s Tax Director, however, it appears Caterpillar chose not to move any worldwide Product Managers to CSARL in Switzerland; nor did it transfer additional regional Product Managers there to replace some who had left. Instead, according to an internal PwC document, the company simply worked with PwC “to ensure that the responsibilities of Geneva-based ‘Regional Product Managers’ complied with new Treas Reg. 1.954-3 which required CSARL employees demonstrate [a] ‘substantial contribution’ in the manufacturing process.”⁴³¹

During this same period, Caterpillar also created a new worldwide parts position at CSARL, the first in Switzerland. In November 2009, the company created the position of “Worldwide Parts Manager,” which was filled by a non-U.S. employee, Quentin de Warlincourt, at CSARL.⁴³² According to Caterpillar’s outside legal counsel, the new Worldwide Parts Manager was “in charge of WW [worldwide] parts management” and “[a]ccountable for the aftermarket strategy for all Machine Business Divisions, and Engine Business Divisions.”⁴³³ The presentation also stated: “Runs the WW Parts Roundtable, [d]rives implementation through other groups that impact aftermarket business sales and strategy (Components, Logistics, Distribution Services, Purchasing, etc.).”

⁴³⁰ Id.

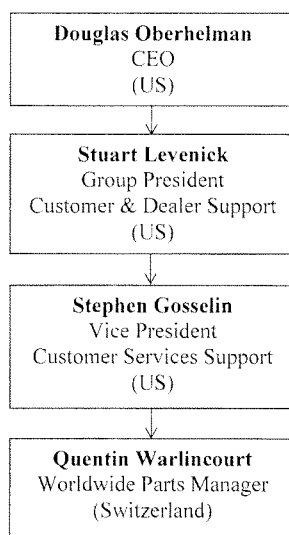
⁴³¹ PwC presentation, “Caterpillar Inc. CSARL 2009 activities Report to Audit Team January 2010,” PwC_PSI_CAT_0003830 - 0003875, at 833 [emphasis in original]. See also 12/3/2013 Caterpillar response to Subcommittee Questionnaire, CAT-000270 - 298, at 281-293.

⁴³² 12/3/2013 Caterpillar response to Subcommittee Questionnaire, CAT-000270 - 298, at 286; PwC presentation, “Caterpillar Inc. CSARL 2009 activities Report to Audit Team January 2010,” PwC_PSI_CAT_0003830 - 875, at 848.

⁴³³ 12/3/2013 Caterpillar response to Subcommittee Questionnaire, CAT-000270 - 298, at 286.

Mr. Warlincourt's position was made part of the Customer Services Support Division, and he reported to the division head, Stephen Gosselin, in the United States.⁴³⁴ The resulting position fit into Caterpillar's organization as follows:

CSARL's Worldwide Parts Manager



In a January 2010 report prepared by PWC's tax consulting services summarizing its 2009 CSARL activities for PWC's Caterpillar auditing team, the PWC tax partners described the creation of the new Worldwide Parts Manager position as enabling CSARL to "have closer management, supervision, and entrepreneurial responsibilities over WW [worldwide] parts."⁴³⁵ The PWC tax consulting services presentation also informed the PWC auditing team: "The WW Parts Management Structure provides further substance to preserve annual parts benefit of \$300m."⁴³⁶

In March 2010, an internal draft PWC report included Caterpillar materials describing additional details about the new CSARL position. It noted that the Worldwide Parts Manager was the "global steward" of a Worldwide Parts Strategy Roundtable, which was comprised of senior personnel representing all of the machine and engine business

⁴³⁴ 5/17/2010 email from Michael Murphy, PWC Manager Autonomy and Technology, to Steven Williams, PWC, "WW Parts Manager," PwC_PSI_CAT_00213059 - 064, at 063.

⁴³⁵ PWC presentation, "Caterpillar Inc. CSARL 2009 Activities Report to Audit Team January 2010," PwC_PSI_CAT_0003830 - 875, at 847.

⁴³⁶ Id. at 848.

divisions.⁴³⁷ At the same time, neither the Worldwide Parts Manager nor the Roundtable appears to have been given any key decision-making authority with regard to parts. For example, the Roundtable was empowered to provide advice, but apparently not to exercise decision-making authority, with respect to parts margin targets, sale targets, cost targets, or pricing.⁴³⁸

Over the following five years, Mr. Warlincourt assembled a small staff of five to twelve persons in Switzerland.⁴³⁹ He continued to report to the Customer Services Support Division head in the United States. He was not joined by other senior parts executives.⁴⁴⁰ Mr. Warlincourt has since been replaced by Thomas Zihlmann, who is located in Switzerland and whose job title has been changed to Worldwide Parts Strategy Manager.⁴⁴¹

Caterpillar's Response to Allegations of Lack of Economic Substance. Caterpillar disagrees with the claim that the CSARL transaction lacked economic substance and had no business purpose other than to reduce the company's taxes. The company provided the Subcommittee with a report prepared by an outside tax expert, New

⁴³⁷ 3/15/2010 "Caterpillar Inc. Worldwide Parts Management Final Closing Book, Draft Version as of March 15, 2010," PwC_PSI_CAT_00003876 - 168, at 882.

⁴³⁸ Id. at 888-891 and 906-912.

⁴³⁹ Subcommittee interview of David Picard, Caterpillar (3/4/2014).

⁴⁴⁰ Caterpillar's legal counsel sent the Subcommittee a letter identifying four key parts personnel who were transferred to CSARL in connection with the restructuring of the Swiss entity, COSA: "[T]here has been substantial movement of personnel with significant responsibilities within, and to, Switzerland including: (i) the promotion of a Vice-President as a new Group President responsible for all of EAME operations, (ii) the movement of several Product Managers to Switzerland, and (iii) the appointment of a Parts Purchasing Manager in Switzerland. Further, the Worldwide Parts Manager was later located in Switzerland together with a newly appointed Vice-President in Singapore." 9/23/2013 Caterpillar letter to the Subcommittee, PSI-Caterpillar-04-000001 - 009, at 004. In a subsequent letter, Caterpillar's legal counsel provided additional detail about the positions shifted to CSARL after its creation, and included a list of more than three dozen positions, many of which had already been located in Switzerland. The list was composed primarily of positions at the manager level. 12/3/2013 Caterpillar response to Subcommittee Questionnaire, CAT-000270 - 298, at 281-293. The listed positions appear to have been primarily regional in focus, often associated with CSARL's tolling agreements with Caterpillar's Belgian and French manufacturing facilities, and seemed to bear little direct connection with or responsibility for the company's global parts business. For example, Gerard Vittecoq, who was a managing director in Caterpillar Belgium S.A., responsible for the Belgium manufacturing facilities, moved to CSARL and became the Vice President of EAME. His new responsibilities included "joint responsibility with the newly created Product Development Division for EAME, excluding Marketing." He also had responsibility for enterprise profitability for manufacturing facilities within EAME. His responsibilities appear to have been limited to the machines manufactured in EAME, and included only a minimal role at best in connection with the global PFRP parts business or third party parts suppliers. Another example offered in the letter was the promotion of Edward Rapp, who became Vice President for EAME Marketing. Mr. Rapp, who served in Geneva between 1995 and 2004, received this promotion without changing his location. Mr. Rapp, who presumably had day-to-day contacts with EAME dealers, testified at a deposition in 2011, that while in Geneva he was familiar with CSARL's predecessor, COSA, but had not heard of CSARL. Deposition of Edward Rapp in Schlicksup v. Caterpillar, PSI-TWLF-19-000001, at 019.

⁴⁴¹ 3/27/2014 Information provided by Caterpillar to the Subcommittee, PSI-Caterpillar-21-000001 - 002.

York University School of Law Professor John Steines, who was hired by Caterpillar to analyze the economic substance issue and who concluded the CSARL transaction did not offend that doctrine:

“Legislative history of the codification of the economic substance doctrine makes clear that the decision to remove Caterpillar from the outbound PFRP supply chain did not violate the economic substance doctrine. And case law interpreting the substance-over-form and economic substance doctrines reveals that they are primarily reserved for highly engineered transactions, frequently unrelated to the taxpayer’s core business and involving tax-indifferent parties with no stake in the outcome other than a fixed return, that Congress would not have countenanced as consistent with the purpose of the statutes it enacted – in other words, transactions that most impartial tax professionals would concede are tax shelters.

“Caterpillar’s restructuring is of an entirely different realm – a sensible business decision to remove a redundant middleman between supplier and customer, fully within the text and spirit of subpart F, notwithstanding that it deferred some U.S. tax. The inventory accommodation and flash title features of Caterpillar’s inventory control system are pragmatic business solutions to normal business problems and do not approach what would raise a problem under the case law digested above.

“In my professional judgment, it is extremely unlikely that a court adjudicating with fidelity to the law presented in this report would find that the restructuring or the countless ensuing outbound PFRP transactions offend the doctrines of substance over form or economic substance.”⁴⁴²

The outside expert’s report did not view CSARL’s six Swiss partners, each assigned a separate profit stream that included a stream for worked parts, PFRPs, and various machines; its licensing agreements with 37 Caterpillar affiliates; its service agreement with Caterpillar to run the non-U.S. parts business; or its use of flash titling or a virtual inventory system, as an example of a “highly engineered transaction.” Instead, the report viewed it as reflecting a “sensible business decision to remove a redundant middleman between supplier and customer ... notwithstanding that it deferred some U.S. tax.” The report failed to explain, however, why the decision to remove Caterpillar Inc. from the supply chain made business sense from a non-tax perspective, in

⁴⁴² 3/7/2014 “In the Matter of Caterpillar Inc.” Caterpillar Expert Witness Report by John P. Steines, Jr., Professor of Law, New York University. PSI-Caterpillar-17-000003 - 023, at 017 - 018.

particular since Caterpillar Inc., the “redundant middleman,” continued to play the central role in the company’s physical supply chain and parts business, from designing parts and forecasting parts demand, to overseeing the company’s third party parts suppliers, to tracking, storing, and delivering the parts, to providing the leadership needed to run such a complex, far-flung business – all functions that CSARL did not have the personnel, infrastructure, or expertise to perform.

Caterpillar’s Tax Director and its Senior International Tax Manager told the Subcommittee that the key analysis was, not whether the CSARL transaction lacked economic substance, but whether the licensing transactions were executed in conformance with U.S. transfer pricing laws and regulations, under the arm’s length standard.⁴⁴³ They assert that the company complied with all U.S. transfer pricing requirements.

(2) Arm’s Length Transaction Concerns

A key policy issue, then, is whether the CSARL licensing agreements complied with the arm’s length principle that is critical to valid transfer pricing agreements between related parties. An arm’s length transaction is a transaction conducted as though the parties were unrelated.⁴⁴⁴ The arm’s length principle requires that Caterpillar have executed the licensing and related agreements with CSARL at a price and in a manner in which it would have transacted those agreements with an unrelated third party.⁴⁴⁵

Prior to the 1999 CSARL transaction, approximately 15% of the company’s parts profits were attributed to Caterpillar’s Swiss affiliate, COSA, an allocation which represented what had previously been a routine share of the profits for the Swiss affiliate’s work in servicing Caterpillar’s foreign dealers.⁴⁴⁶ COSA profits were reported as subpart

⁴⁴³ Subcommittee interviews of Robin Beran, Caterpillar (10/18/2013) and Rodney Perkins, Caterpillar (1/15/2014). Those issues are addressed below.

⁴⁴⁴ See Treas. Reg. § 1.482-1(b).

⁴⁴⁵ See Treas. Reg. § 1.482-1(b) Arm’s length standard (“In determining the true taxable income of a controlled taxpayer, the standard to be applied in every case is that of a taxpayer dealing at arm’s length with an uncontrolled taxpayer. A controlled transaction meets the arm’s length standard if the results of the transaction are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances (arm’s length result). However, because identical transactions can rarely be located, whether a transaction produces an arm’s length result generally will be determined by reference to the results of comparable transactions under comparable circumstances.”).

⁴⁴⁶ Caterpillar’s 1995 transfer pricing documentation described the portion of parts profits allocated to Caterpillar’s Swiss marketing affiliate as 4% of the cumulative 30% return on part sales earned by Caterpillar. 12/19/1996 “Caterpillar Inc. Evaluation of Arm’s Length Pricing for Intercompany Transactions Year Ended December 31, 1995,” PwC_CAT_PSI_00008881 - 9104, at 959. See also 11/14/2005 “Caterpillar SARL 2006-2012 Royalty Rate: Options and Implications,” PwC_PSI_CAT_00133127 -180, at 164; 3/7/2014 “In the Matter of Caterpillar Inc.,” Caterpillar Expert Witness Report by John P. Steines, Jr., Professor of Law, New York

F income and taxed in the United States.⁴⁴⁷ Nearly all of the remaining 85% of the parts profits were attributed to Caterpillar and also taxed in the United States.⁴⁴⁸ After the CSARL transaction, in 2000, however, Caterpillar gave a significant portion of the profits from its non-U.S. finished replacement parts business to CSARL in exchange for a licensing fee.

In its final form, the Caterpillar licensing agreement required CSARL to pay a bundled royalty rate for selling both parts and machines. According to data provided by Caterpillar, the aggregated royalty rate ended up providing Caterpillar Inc. with an amount equal to about 31% of the total combined non-U.S. replacement parts and machine profits, while the other 69% or more of the combined profits went to CSARL.⁴⁴⁹ When just the parts profits are considered, the profit split is even more dramatic: instead of 85% or more of the profits from non-U.S. parts sales going to Caterpillar Inc. in the United States as it had for decades prior to 1999, the licensing agreement directed 15% or less of those profits to Caterpillar in the United States and 85% or more of the parts profits to CSARL in Switzerland. While Caterpillar contends that the aggregated royalty rate is the more appropriate rate to consider, since that is the rate contained in the final license agreement which covers both parts and machines, it is notable that the Swiss tax strategy that led to the licensing agreement targeted only the company's non-U.S. parts profits, without mentioning machines. In any event, both profit splits have resulted in lopsided profits allocations in favor of CSARL over Caterpillar.

At the same time, Caterpillar continued to perform key functions supporting the non-U.S. sales of Caterpillar branded parts, including much of the parts design, parts forecasting, inventory management, parts ordering, supplier oversight, quality control, parts pricing, and parts storage and delivery. It did so for cost plus a 5% markup, which produced only limited income for the U.S. parent. Caterpillar also continued to bear the ultimate economic risk for the parts business, since its consolidated financial statements included CSARL's financial results. Whether profitable or unprofitable, CSARL necessarily affected Caterpillar's overall financial results.

It defies logic that Caterpillar would have entered into a licensing transaction with an unrelated party in which it gave away 69%, 85%, or more of its business profits on an annual basis in exchange for a 31%, 15%, or smaller share of the profits, while continuing to perform core

University, at PSI-Caterpillar-17-000003 - 023, at 007; Subcommittee interview of Thomas Quinn, PWC (12/17/2013).

⁴⁴⁷ See 3/7/2014 "In the Matter of Caterpillar Inc.," Caterpillar Expert Witness Report by John P. Steines, Jr., Professor of Law, New York University, at PSI-Caterpillar-17-000003 - 023, at 006.

⁴⁴⁸ See id. at 003 - 004.

⁴⁴⁹ 12/3/2013 Caterpillar response to Subcommittee Questionnaire, CAT-000270 - 298, at 277.

functions to support those profits and continuing to bear the ultimate economic risk. Caterpillar only engaged in the CSARL transaction, because the profits sent to Switzerland went to CSARL, a related party, and enjoyed a low Swiss tax rate of 4%. In addition, CSARL's profits were included in Caterpillar's consolidated financial statements, so that CSARL's financial success contributed directly to Caterpillar's positive results.

It is also notable that CSARL paid nothing to Caterpillar Inc. to compensate the company for the decades Caterpillar spent developing its parts business before turning it over to CSARL, including developing a third party supplier base, designing a large selection of proprietary parts, and creating a world class logistics system to store and deliver those parts anywhere in the world within 24 hours. Nor did CSARL compensate Caterpillar Inc. for the right to the future profit streams associated with the non-U.S. parts business – billions of dollars in parts “annuities” that would last as long as Caterpillar's durable machines. In fact, CSARL made no “buy-in” or other payment or provided any super royalty to compensate Caterpillar Inc. for the business it had built or for the future profits that would be generated. Instead, CSARL paid Caterpillar Inc. only an annual royalty equal to 15% or less of the profits produced by the non-U.S. parts business each year plus a service fee for performing key parts functions on a cost plus 5% basis.⁴⁵⁰ It is hard to understand how Caterpillar would ever have entered into such an arrangement with an unrelated party.

Caterpillar contends, however, that CSARL fully compensated Caterpillar Inc. for all property and services provided by Caterpillar Inc. related to its parts business, in accordance with the transfer pricing rules.⁴⁵¹ Caterpillar also contends that the CSARL transaction's profit split was an appropriate arm's length result under current transfer pricing regulations and case law, highlighting the aggregated royalty rate that produced a 69/31% profit split. In a letter to the Subcommittee, Caterpillar wrote:

“Caterpillar Inc. has paid an immediate U.S. tax on approximately 35 percent of the total system profit from the licensed business [parts and machines]. This allocation of profit to the licensor exceeds the 25-75 percent ‘rule of thumb’ profit split articulated by the U.S. Tax Court in *Ciba-Geigy Corp. v. Comm’r*, 85 T.C. 172 (1985).”⁴⁵²

⁴⁵⁰ 11/14/2005 “Caterpillar SARL 2006-2012 Royalty Rate: Options and Implications,” PwC_PSI_CAT_00133127 -180; 9/23/2013 Caterpillar Letter to Subcommittee, PSI-Caterpillar-000002 - 009, at 004 (CSARL license permitted it “to make, purchase, use, offer for sale, sell, and/or import” PFRPs in exchange for paying an “arm's length” annual royalty).

⁴⁵¹ 9/23/2013 Caterpillar Letter to the Subcommittee, PSI-Caterpillar 000001 - 009, at 003.

⁴⁵² *Id.* at 007.

In the *Ciba-Geigy Corp.* case cited by Caterpillar, however, the court found that the petitioner had “retained more than 80 percent of the net profits before royalties,” and held, “under the rule of thumb emphasized by respondent, petitioner retained more than a reasonable amount of net profits.”⁴⁵³ That holding raises obvious questions about the reasonableness of the 85/15% profit split favoring CSARL with respect to non-U.S. parts profits. But even if the 69/31% aggregate profit split were considered, other cases evaluating profit splits between related corporate entities have disregarded the 75/25% rule of thumb in favor of more balanced profit allocations that the courts have found to be more equitable.⁴⁵⁴

The arm’s length principle provides the bedrock upon which U.S. transfer pricing regulations are built. In this case study, Caterpillar replaced an 85/15% profit split with a 15/85% profit split of the non-U.S. parts profits, while continuing to perform the core functions of the parts business and retaining the economic risks. It makes little business sense for Caterpillar to take those actions without receiving any compensation for the future revenue stream or the value of the parts business that Caterpillar had built up over decades.⁴⁵⁵ The Caterpillar case study provides, in a manufacturing setting, a transfer pricing agreement between a U.S. parent and foreign subsidiary that seems to be less about constructing an arm’s length transaction to divide economic contributions and risk, and more about shifting billions of dollars in profits to an offshore tax haven in ways designed to lower the U.S. parent’s U.S. taxes.

(3) Assignment of Income Concerns

Another issue raising arm’s length questions involves Caterpillar’s decision to split its parts profits off from its machine sales, and direct those parts profits to CSARL without receiving any compensation for the economic value associated with its past and future machines, under the Assignment of Income Doctrine. The Assignment of Income Doctrine is a judicial doctrine that prohibits an inequitable distribution of profits. Under *Lucas v. Earl*, a taxpayer cannot separate the “fruit,” or income, from the “tree on which it grew.”⁴⁵⁶ Yet in this transaction,

⁴⁵³ *Ciba-Geigy Corp. v. Comm’r.* 85 T.C. 172, 229 (1985).

⁴⁵⁴ See, e.g., *Eli Lilly & Co. v. Commissioner*, 84 T.C. 996 (1985), rev’d in part and aff’d in part, 856 F.2d 855 (7th Cir. 1988) (approving 55/45 profit split); *G.D. Searle & Co. v. Commissioner*, 88 T.C. 252 (1987) (approving 44/66 profit split); *Bausch & Lomb, Inc. v. Commissioner*, 92 T.C. 525, 584 (1989), aff’d, 933 F.2d 1084, 1089 (2d Cir. 1991) (approving 50/50 profit split).

⁴⁵⁵ When Caterpillar’s PWC tax consultants were asked if true unrelated parties would ever give away income in this manner, they deflected the question, responding that the transaction merely needed to be justified under current transfer pricing rules. Subcommittee interviews of Thomas Quinn, PWC (12/17/2013) and Steven Williams, PWC (2/19/2014).

⁴⁵⁶ *Lucas v. Earl*, 281 U.S. 111 (1930). In *Lucas*, a man attempted to lower his tax payments by assigning the legal right to his work income, through contract, to his wife. The court determined that the husband had performed the work accruing the right to the income, with no role played by his wife, and that his income could not be assigned to her. The court wrote:

Caterpillar acted to separate the “fruit,” the sale of its high-profit-margin parts, from the “tree,” the sales of its low-profit-margin machines on which the parts profits depend, and did so without seeking any compensation for producing the machines on which future parts rely to have value.

When Caterpillar sells a machine, it often does so at extremely low profit margins.⁴⁵⁷ At the same time, the replacement parts used to service that Caterpillar machine can bring profit margins that are multiple times larger. The majority of Caterpillar’s overall profits are attributable to its parts profits. The same is true for CSARL. In some years, as much as 80% of CSARL’s profits from its licensed business have come from parts sales, despite only making up 20% of its sales revenues.⁴⁵⁸ CSARL has itself recognized that Caterpillar’s “sale of replacement parts is dependent on the sale of machines.”⁴⁵⁹ In fact, at the time of the 1999 CSARL transaction, Caterpillar’s tax consultants observed that “the field population of CAT prime products, which is created as CSARL markets prime products in its territory, creates the demand for CAT replacement parts.”⁴⁶⁰ However, as a result of the transaction, the profits for Caterpillar’s parts business were split off from the profits of the machine business, without CSARL’s offering any compensation for Caterpillar’s development of the underlying business.

Historically, the majority of Caterpillar’s machines have been built in the United States and then sold around the world. In addition, the majority of all research and development for the machines is conducted in the United States, and nearly all of the intellectual property is retained here as well.⁴⁶¹ In 1997, 75% of Caterpillar’s consolidated machine sales came from machinery and engines manufactured in the United States.⁴⁶² Although Caterpillar has since globalized its manufacturing operations and two-thirds of its sales now come from overseas, the

“There is no doubt that the statute could tax salaries to those who earned them and provide that the tax could not be escaped by anticipatory arrangements and contracts however skillfully devised to prevent the salary when paid from vesting even for a second in the man who earned it. That seems to us the import of the statute before us and we think that no distinction can be taken according to the motives leading to the arrangement by which the fruits are attributed to a different tree from that on which they grew.”

Id. at 114-115.

⁴⁵⁷ See 10/5/1999 “Caterpillar Inc. Global Value Enhancement Project Draft”.

PwC_PSI_CAT_00004483 - 530, at 508.

⁴⁵⁸ 11/14/2005 “Caterpillar SARL 2006-2012 Royalty Rate: Options and Implications.”

PwC_PSI_CAT_00133127 -180, at 148.

⁴⁵⁹ 2/16/2010 “Caterpillar Inc. CSARL Permanent File Chronological History: 1999-2010.”

PwC_PSI_CAT_00003406 - 463, at 406.

⁴⁶⁰ See 10/5/1999 “Caterpillar Inc. Global Value Enhancement Project Draft.”

PwC_PSI_CAT_00004483-530, at 498.

⁴⁶¹ 8/30/2013 Caterpillar response to Subcommittee Questionnaire, CAT-000066 - 108, at 076.

⁴⁶² Caterpillar Inc. Annual Report (Form-10K), at A-17 and A-18 (1997).

majority of Caterpillar machines and replacement parts are still manufactured in the United States.⁴⁶³

Due to the Swiss tax strategy, however, the initial purchaser of all of Caterpillar's purchased finished replacement parts is CSARL in Switzerland. That means, for example, that for a mining truck designed and built in the United States and exported to Canada, the majority of the profits from that machine sale would be allocated to the United States and result in taxable U.S. income. In contrast, for any Caterpillar branded parts manufactured by U.S. third party suppliers to repair that mining truck and shipped to Canada from Caterpillar's U.S. warehouse, the majority of the parts profits would go to Switzerland, thereby splitting the parts profits from the machine profits in a way that does not reflect the business reality that the same company is responsible for both profit streams.

When Caterpillar builds a machine in the United States and exports it, it creates a years-long stream of income that results from the selling of the replacement parts. By executing the CSARL transaction, the company transferred its parts annuity to a foreign affiliate without receiving any compensation for the forfeited income stream or for the development and of the underlying business, thus separating the parts fruit from the machine tree. The Assignment of Income Doctrine may require those parts profits to be reassigned to Caterpillar Inc., which continues to design, manufacture, and sell the original machines.

(4) Virtual Inventory System Concerns

A fourth policy issue relates to the practice of Caterpillar and CSARL sharing parts stored in U.S. warehouses and using a virtual inventory system, separate and apart from the company's general inventory system, to track CSARL ownership of parts for tax purposes. As discussed earlier, the virtual inventory system, which splits ownership of groups of parts between Caterpillar Inc. and CSARL without assigning ownership of any particular part to either company, uses a retroactive after-the-sale method of assigning parts ownership. This inventory system could be viewed as establishing CSARL partnership activity on U.S. soil which would trigger U.S. taxation of its U.S. parts profits.

According to Caterpillar, the third party manufactured replacement parts that are attributed to CSARL are stored in U.S. warehouses and shipped from the United States directly to Caterpillar's foreign dealers or customers, without ever passing through Switzerland. In 2012,

⁴⁶³ In 2012, 54% of Caterpillar machines and nearly 70% of Caterpillar replacement parts sold abroad were manufactured in the United States. None of the machines or replacement parts have ever been manufactured in Switzerland. 1/14/2014 Caterpillar response to Subcommittee Questionnaire, CAT-000299 - 303, at 302.

CSARL held nearly \$525 million worth of purchased finished replacement parts (PFRPs) in Caterpillar's U.S. warehouses, which made up over 35% of all PFRPs located in those U.S. warehouses and 40% by value of CSARL's worldwide parts inventory.⁴⁶⁴

In addition, on paper, CSARL routinely acquires replacement parts from third party suppliers for instantaneous pass-through resale to Caterpillar Inc. in the United States. According to Caterpillar, CSARL sells 40 to 50% of its total PFRP purchases immediately to Caterpillar Inc. using what is referred to as a "flash title." A flash title simply means that CSARL makes the initial purchase of the part and automatically and instantaneously transfers the ownership title to Caterpillar Inc. CSARL's purchases the flash-titled parts using Caterpillar's internal forecasts of the quantities of parts that will be sold to U.S. customers.⁴⁶⁵ When CSARL flash-titles parts to Caterpillar Inc., it does so at cost and without charging any fee,⁴⁶⁶ which suggests the sales are little more than paper transactions between related parties, as opposed to arm's-length transactions.

Caterpillar provided the Subcommittee with dollar figures over a three year period showing the volume of replacement parts CSARL has purchased from third party suppliers, the amounts flashed-titled to Caterpillar Inc., the amounts retained by CSARL after the flash-titling, and the amounts of CSARL-owned parts stored in U.S. warehouses. Caterpillar indicated, for example, that in 2012, CSARL acquired about \$2.3 billion worth of parts from third-party suppliers and immediately flash-titled \$1 billion of those parts to Caterpillar Inc. CSARL then retained apparent ownership of the remaining \$1.3 billion of parts inventory, storing nearly \$525 million of those parts in U.S. warehouses.

As explained earlier, CSARL and Caterpillar Inc. parts are commingled in storage bins in the U.S. warehouses, and U.S. warehouse personnel have no way to differentiate between the parts owned by the two companies. Instead, warehouse employees simply fill orders as they come in, with no regard for paper ownership of particular parts. For instance, if an order came in for a quantity of air filters to service Caterpillar equipment at a mine in Canada, the warehouse would pull the requested filters from the storage bins and ship them to the customer, a nearby dealer, or a nearby Caterpillar distribution center. After the sale, since the order was destined for Canada, ITAS, the virtual inventory system, would retroactively determine that the order was filled using

⁴⁶⁴ 11/26/2013 letter from Caterpillar to Subcommittee, CAT-000267 - 269, at 268. Since Caterpillar has no parts warehouses in Switzerland, CSARL's remaining parts are stored in warehouses and distribution centers located in a variety of other countries around the world.

⁴⁶⁵ See 3/7/2014 "In the Matter of Caterpillar Inc.," Caterpillar Expert Witness Report by John P. Steines, Jr., Professor of Law, New York University, at PSI-Caterpillar-17-000003 - 023, at 007; Subcommittee Interview of Thomas Quinn, PWC (10/2/2013).

⁴⁶⁶ See 3/7/2014 "In the Matter of Caterpillar Inc.," Caterpillar Expert Witness Report by John P. Steines, Jr., Professor of Law, New York University, at PSI-Caterpillar-17-000003 - 023, at 007.

CSARL-owned parts. However, if at the time of the order, all of the air filters in the U.S. warehouse bin were already allocated to and owned by Caterpillar Inc., ITAS would automatically “borrow” the parts from Caterpillar Inc.’s inventory, and credit them to CSARL on the virtual inventory system. When the next supply of air filters was delivered by the third-party manufacturer, the ITAS system would automatically and virtually “replenish” the parts CSARL had borrowed from Caterpillar.

The ITAS virtual inventory system does not operate like a normal inventory system. It places groups of parts in “virtual bins,” determines what percentage of the parts in each bin belongs to CSARL, and then decides whether a particular part shipped from the U.S. warehouse should be viewed as a CSARL-owned part. As explained earlier, while the inventory system arguably functions similar to the way a grain silo mixes fungible grains deposited by various owners and then dispenses the grain without tracking its precise ownership, in those circumstances the grain owners typically pay market rates if they draw grain in excess of the amount they deposited; there is no wholesale borrowing with no notice and no cost. ITAS’ virtual approach to tracking CSARL’s parts in the United States is not only unusual, it operates as a second set of books in addition to Caterpillar’s regular inventory program, which tracks individual parts.

Under the U.S. tax code, while foreign entities like CSARL are allowed to hold goods awaiting export in U.S. warehouses without creating a taxable presence in the United States,⁴⁶⁷ if those goods are commingled, co-owned, or co-managed as a joint enterprise, they may create a taxable U.S. presence for the foreign company.⁴⁶⁸ CSARL’s parts, which are intended for export, have never been physically segregated in the U.S. warehouses from the Caterpillar parts intended for domestic sales. In fact, according to PWC, when its tax consultant suggested establishing that practice at Caterpillar’s U.S. warehouses, he was “laughed out of the room.”⁴⁶⁹

Rather than being physically segregated, CSARL and Caterpillar parts are routinely commingled in the warehouse storage bins. In addition, “ownership” of particular parts can transfer back and forth between CSARL and Caterpillar as needed while stored in the U.S. warehouses, including through flash-titling and automatic borrowing. According to information provided by Caterpillar, hundreds of thousands of parts worth millions of dollars and involving as much as 10% of the parts stored in Caterpillar’s U.S. warehouses are borrowed through the ITAS system each year.⁴⁷⁰

⁴⁶⁷ See IRC § 956(c)(2)(B).

⁴⁶⁸ See, e.g., *Commissioner v. Culbertson*, 337 U.S. 280 (1949).

⁴⁶⁹ See Subcommittee interview of Thomas Quinn, PWC (12/17/2013).

⁴⁷⁰ 3/13/2014 letter from Caterpillar’s legal counsel to Permanent Subcommittee on Investigations, PSI-Caterpillar-18-000001 - 003, at 003.

When a common pool of inventory is jointly managed for the mutual benefit of two entities, the courts have long held that a de facto U.S. partnership may exist.⁴⁷¹ While an argument could be made that the Caterpillar-CSARL arrangement did not create a common pool of inventory in the sense that ownership of particular parts was ultimately assigned, the facts are plain that, on the warehouse floor, the two companies shared commingled parts without regard to which company owned which parts. Another argument is that the inventory practices do not involve joint management in the sense that CSARL pays Caterpillar to manage its parts while stored in U.S. warehouses, but the service agreement between CSARL and Caterpillar says nothing about flash-titling, borrowing parts back and forth, or assigning parts ownership after sales are made, practices that provide evidence of joint management of the parts inventory. At the least, the facts suggest a review is warranted to determine whether Caterpillar Inc. and CSARL, in fact, have a common pool of inventory that is jointly managed for the benefit of both parties.

If a de facto U.S. partnership exists between Caterpillar Inc. and CSARL, it would, in turn, create a taxable U.S. presence for each partner. The inventory profits of each partner, including those attributed to CSARL, would then become subject to U.S. taxation.⁴⁷² Caterpillar's tax consultants were well aware that using the ITAS virtual inventory potentially created that type of tax risk, warning in one 2009 presentation:

"The physical inventory commingled into a single inventory stock, as long as the information systems (ie-ITAS) supporting the financial inventory records can confirm the ownership of that inventory stock belonging to CSARL and CAT Inc. Separate inventory records for Cat Inc. and CSARL must be available at any point in time. ITAS must not inadvertently represent the commingled inventory arrangement as a partnership /joint tenancy between CSARL and CAT Inc., or intercompany transactions as a sale or loan between CSARL and CAT Inc."⁴⁷³

Caterpillar disagrees with the view that its virtual inventory is either invalid or creates a taxable U.S. partnership. Yet CSARL's virtual inventory system, which was designed in consultation with Caterpillar's tax department, is a redundant inventory system that tracks CSARL ownership of parts by applying ownership percentages to commingled bins of parts without bothering to identify which specific

⁴⁷¹ See, e.g., *Commissioner v. Culbertson*, 337 U.S. 280 (1949) (stating that the relevant inquiry is to determine whether the parties in good faith and acting with a business purpose intended to join together in the conduct of a joint enterprise for profit). The Tax Court has also set forth a list of factors that courts have used to evaluate this factual inquiry. See *Luna v. Commissioner*, 42 T.C. 1067 (1964).

⁴⁷² See Article 7 (2) of the Swiss-U.S. Bilateral Income Tax Treaty (1996).

⁴⁷³ 9/8/2009 "CSARL Briefing," prepared by PWC, PWC_PSI_CAT_00093950 - 992, at 981.

parts belong to CSARL until after those parts are sold. It may have been used to mask the fact that the two sets of CSARL and Caterpillar parts are commingled and jointly managed. At the same time, for the virtual inventory system to function at all, it appears to require “virtual bins” containing a common pool of inventory parts, jointly managed. That jointly managed pool of inventory, in turn, could produce an ongoing partnership between Caterpillar Inc. and CSARL on U.S. soil, making each partner subject to U.S. taxation.

(5) Intangible Valuation Concerns

Another key policy issue involves how, as a result of its licensing agreements with CSARL, Caterpillar justified reducing its share of the non-U.S. parts profits from an 85/15% split to a 15/85% split, and sending the larger share of the profits to Switzerland, a low tax jurisdiction.⁴⁷⁴ Caterpillar told the Subcommittee that its Swiss operations had valuable marketing intangibles that had not been previously recognized and which justified allocating the lion’s share of the non-U.S. parts profits to CSARL. That analysis, however, marks a dramatic change from past valuations.

COSA Intangibles. Caterpillar told the Subcommittee that CSARL’s predecessor Swiss entity, COSA, which began operating in Switzerland in 1960, had valuable “marketing intangibles” that were transferred to CSARL, and that those intangibles were previously unrecognized but valuable enough that they warranted the company’s attributing most of the non-U.S. parts profits to Switzerland. For 40 years, until 1999, COSA was the locus of Caterpillar’s operations in Switzerland. It was the shareholder for many of Caterpillar’s foreign marketing companies, acted as a marketing company itself, and supported the Caterpillar dealer network in the Europe, Africa, and Middle East (EAME) region.⁴⁷⁵ A COSA branch office in Singapore provided the same marketing and support services for the Caterpillar dealer network in Asia and the South Pacific.

In the planning documentation supporting the 1999 CSARL transaction, PWC wrote that, for years, COSA had been undercompensated for its marketing intangibles. PWC noted that COSA had been allocated 4% of the cumulative 30% profit margin on non-U.S. parts, meaning it had received only about 13% of the total parts

⁴⁷⁴ See 12/3/2013 Caterpillar response to Subcommittee Questionnaire, CAT-000270 - 298, at 277; 1/14/2014 Caterpillar response to Subcommittee Questionnaire, CAT-000299 - 303, at 301.

⁴⁷⁵ 4/18/1996 “Caterpillar Inc. Evaluation of Arm’s Length Pricing for Intercompany Transactions Year Ended December 31, 1994,” PwC_CAT_PSI_00008634 - 880, at 673.

profits.⁴⁷⁶ PWC depicted that level of compensation as appropriate for a routine parts distributor or marketer, but not for a marketing company that also supported and helped to develop the Caterpillar dealer network.

In 1998, PWC wrote: “[U]p through 1998, we have characterized COSA (and other marketers[]) as routine marketers. ... This will change and our documentation reports will rely on greater discussion of the value of the marketers['] contribution.”⁴⁷⁷ PWC also observed: “We are not transferring an intangible, we are just recognizing an intangible they had already.”⁴⁷⁸ PWC’s Managing Director explained to the Subcommittee that, without the added valuable intangibles, Caterpillar could not have justified shifting so much profit to its Swiss affiliate, which would otherwise have been entitled to only the routine profits of a routine parts distributor.⁴⁷⁹ Instead, after finding that COSA had previously unrecognized “significant marketing intangibles,” PWC concluded that COSA should have been awarded a higher percentage of the parts profits and proposed dramatically increasing the previous allocation of parts profits for COSA’s successor, CSARL.⁴⁸⁰

Intangibles Already Recognized. PWC’s claim that COSA had previously unrecognized, valuable marketing intangibles is contradicted by other documents showing that Caterpillar was well aware of and had long acknowledged the valuable work of its marketing companies. For example, three years earlier, in 1996, PWC had cited the role of Caterpillar’s marketing companies in helping to distribute its prime products and parts to the Caterpillar network of dealers.⁴⁸¹ Its 1996 transfer pricing documentation, which is required to be maintained by law to defend transfer pricing positions, stated:

“Parts distribution is one of Caterpillar’s most important competitive advantages in the marketplace. Caterpillar’s guarantee

⁴⁷⁶ See undated, unattributed handwritten PWC notes, PwC_PSI_CAT_00011180 - 183, at 181; 3/7/2014 “In the Matter of Caterpillar Inc.,” Caterpillar Expert Witness Report by John P. Steines, Jr., Professor of Law, New York University, at PSI-Caterpillar-17-000003 - 023, at 007.

⁴⁷⁷ 12/1998, Caterpillar Inc., Global Tax Optimization, Risk Adjusted Benefit Analysis, Working Papers—Draft 1,” PWC-PSI-CAT-00001336 - 671, at 412.

⁴⁷⁸ Id. Caterpillar’s tax consultant also told the Subcommittee that PWC realized it took a risk in changing the intercompany transfer pricing method and documentation for the company. Subcommittee interview of Thomas Quinn, PWC (12/17/2013). See also 12/1998, Caterpillar Inc., Global Tax Optimization, Risk Adjusted Benefit Analysis, Working Papers—Draft 1,” PWC-PSI-CAT-00001336 - 671, at 411 (identifying as a “Risk” the “change from current intercompany pricing method and documentation”).

⁴⁷⁹ Subcommittee interview of Steven Williams, PWC (2/19/2014).

⁴⁸⁰ Subcommittee interview of Thomas Quinn, PWC (10/2/2013; 12/17/2013); 9/1998 PWC report, “Caterpillar Inc. Global Tax Optimization Case for Action,” PwC_PSI_CAT_00004632, at 675-676; 12/1998 Caterpillar Inc., Global Tax Optimization Risk Adjusted Benefit Analysis, Working Papers—Draft 1” prepared by PWC, PwC_PSI_CAT_00001411, at 412.

⁴⁸¹ 12/19/1996 Caterpillar Inc. Evaluation of Arm’s Length Pricing for Intercompany Transactions, Year Ended December 31, 1995, Prepared by Price Waterhouse LLP, Final Report, PwC_CAT_PSI_00008881 - 971, at 930-971.

to deliver parts anywhere in the world on very short notice enables it to sell more machines, since customers know that they will not be idled by long missing parts. The parts distribution function at Caterpillar is very closely associated with the marketing functions because of its strategic importance in sales and aftermarket services.”⁴⁸²

The 1996 transfer pricing documentation continued:

“Caterpillar’s after sales service, which includes supporting dealers in the servicing of equipment and the timely provision of parts around the world, is one of its major competitive tools The dealer network and parts distribution are the two keys to after-sales service. Since the marketing companies are responsible for both, they have responsibility for this important entrepreneurial activity.”⁴⁸³

In 2000, after it created CSARL, PWC described the role of Caterpillar’s marketing companies in a nearly identical fashion in its transfer pricing documentation, suggesting that nothing had changed with respect to their duties or their intangible value.⁴⁸⁴ Caterpillar also noted at that time that the average length of a dealer relationship with CSARL’s predecessor in the EAME territory, COSA, was more than 45 years with little dealer turnover, showing that Caterpillar had long understood the importance of its marketing companies in supporting its dealer network.⁴⁸⁵

Justifying the Higher Value. Other documents suggest that PWC realized it needed to change Caterpillar’s transfer pricing documentation to justify attributing greater value to CSARL’s “marketing intangibles.” One PWC analyst framed the issue this way:

“To recap, the primary issue is trying to attribute some of the high profits earned by CAT to COSA. To do so, we want to identify COSA’s establishment and maintenance of the dealer network as a source of intangible values.”⁴⁸⁶

⁴⁸² Id. at 929.

⁴⁸³ Id. at 931.

⁴⁸⁴ 9/17/2001 “Caterpillar Fiscal Year 2000 Transfer Pricing Documentation Report,” PwC_CAT_PSI_00004975 - 5162, at 029 - 030. This same language was repeated in Caterpillar’s report the following year. 9/16/2002 Caterpillar U.S. Transfer Pricing Documentation Report Year Ended December 31, 2001. PwC_CAT_PSI_00005163 - 305, at 212-213.

⁴⁸⁵ 9/17/2001 “Caterpillar Fiscal Year 2000 Transfer Pricing Documentation Report,” PwC_CAT_PSI_00004975 - 5162, at 032.

⁴⁸⁶ 11/6/1998 PWC memorandum from John Hatch to Charles Larson and Steven Williams. “Subject: CAT and COSA.” PwC_PSI_CAT_00169827 - 838, at 827.

The PWC analyst then provided a detailed analysis of the company's "intangibles" and offered ways to support the claim that the marketing companies' relationship with the dealers was a valuable asset. The analyst noted first that valuing the intangibles was a "purely" qualitative exercise.⁴⁸⁷ He wrote that he was unable to identify any studies that supported a quantitative valuation and was himself unable to quantify their dollar value.⁴⁸⁸ He wrote: "To sum up, we can provide very convincing stories for the argument that COSA should retain some share of the high profits, but actually quantifying their share may be difficult to do with any precision."⁴⁸⁹

The analyst then identified several of the intangibles that had supposedly escaped previous recognition as valuable. One was the marketing companies' potential contribution to cost efficiencies through the company's worldwide network of dealers. The analyst explained: "[B]y having a worldwide network already established, CAT can increase its cost advantages due to the economies of scale over competitors who lack such an extensive network." He also noted that the Caterpillar distribution network was already capable of replacing almost any part within 24 hours for a machine anywhere in the world, which was a valuable asset that marketing companies could help support.⁴⁹⁰ He also theorized that "the dealer network may contribute to the design of better products through customer feedback that is essential to the design process."⁴⁹¹ He concluded that Caterpillar's dealer relationships set it apart from its competitors, and that its marketing companies contributed to the well-being of that network.⁴⁹²

It is difficult to see how this analysis identified new marketing intangibles that had previously escaped recognition. In addition, while the analysis described how marketing companies contributed to Caterpillar's success, what the analysis left out was how Caterpillar itself had significantly contributed to the development and maintenance of its worldwide dealer network and to the design, management, and delivery of its parts. That Caterpillar, as U.S. parent of the global company, had itself made a major contribution to its worldwide dealer network had long been recognized. For example, in 1994 transfer pricing documentation, written prior to the CSARL transaction, PWC wrote:

⁴⁸⁷ Id. at 832.

⁴⁸⁸ Id. at 828. "The analysis should make clear the difficulties faced in trying to quantify a share of profits from parts sales attributed to the field population." Id. at 830.

⁴⁸⁹ Id. at 828.

⁴⁹⁰ Id. at 836.

⁴⁹¹ Id. at 834.

⁴⁹² Id. at 836.

“CAT has the largest role with market and development, since 1) it has the largest single market, 2) it was the originator of the basic marketing systems and concepts, and 3) it continues to be involved with the development and oversight of worldwide marketing and approaches. The marketing companies also have major responsibility for market development; in fact, this is their primary responsibility.”⁴⁹³

Given the outsized role of Caterpillar in establishing its worldwide dealer network – which was in place long before the CSARL transaction – and in leading and managing its parts business – a role which has remained largely unchanged after CSARL’s creation – the decision to increase the allocation of the non-U.S. parts profits to Switzerland from 13% in 1999, to 85% in 2013, has not been justified.⁴⁹⁴

Inconsistent Valuation. Still another set of documents that contradict the claims about the value of the marketing intangibles held by CSARL date from 2001, when CSARL acquired a related U.S. marketing company responsible for Caterpillar’s marketing efforts in Latin America, the Caribbean, and Canada, and treated its intangible assets as having little economic value.

In 2001, Caterpillar expanded CSARL’s reach to include parts sold in the Americas region, outside of the United States. Later that year, CSARL entered into a complicated, restructuring transaction with a related entity known as Caterpillar Americas (CACO), a U.S. company wholly owned by Caterpillar and located in Miami, Florida.⁴⁹⁵ CACO had served as Caterpillar’s marketing company for Latin America, the Caribbean, and Canada for the prior forty years.⁴⁹⁶ Like CSARL and its predecessor COSA, CACO had purchased machines and parts from Caterpillar Inc. and its affiliates for resale to dealers in Latin America, the Caribbean, and Canada, and helped develop and support the dealer network in its assigned region.⁴⁹⁷

CACO’s activities appear to have been nearly identical to those performed by COSA for the EAME region. Its responsibilities included:

“(i) the negotiation and signing of contracts with dealers in the CACo assigned region; (ii) the purchase of products and parts from Cat Inc. and other Caterpillar affiliates for resale to dealers; (iii)

⁴⁹³ 4/18/1996 “Caterpillar Inc. Evaluation of Arm’s Length Pricing for Intercompany Transactions Year Ended December 31, 1994.” PwC_CAT_PSI_00008634 - 880, at 685.

⁴⁹⁴ See, e.g., 12/3/2013 Caterpillar response to Subcommittee Questionnaire, CAT-000270 - 298, at 295.

⁴⁹⁵ 11/26/2001 Caterpillar Inc., “Economic Analysis of Intangible Assets Transferred by Caterpillar Americas Co. to Caterpillar Americas Sarl Prepared by Price Waterhouse Coopers.” PwC_PSI_CAT_00142353 - 367, at 357.

⁴⁹⁶ Id.

⁴⁹⁷ Id.

taking title to products purchased from Cat Inc. (and other Caterpillar affiliates) destined for dealers; (iv) arranging logistics support for prime product and part shipments; (v) maintaining minor inventory levels of prime product for quick delivery to dealer customers; (vi) assisting dealers in identifying product performance issues and conveying technical data about such problems to Cat Inc.; (vii) providing dealers with marketing information and sales training programs; (viii) assisting dealers in arranging financing; and (ix) conducting monitoring and oversight activities to insure compliance by dealers with the terms of dealer sales and service agreements.”⁴⁹⁸

On December 1, 2001, CACO transferred its responsibilities and certain tangible and intangibles assets to another Caterpillar Swiss affiliate known as Caterpillar Americas SARL (CAmSARL). As part of that transaction, CAmSARL shares were transferred to CSARL.⁴⁹⁹ Subsequently, PWC prepared a formal report with an economic analysis of the intangible assets transferred by CACO to CAmSARL and, ultimately, to CSARL.⁵⁰⁰

PWC listed and described CACO’s marketing intangibles, which included its dealer relationships and contracts, marketing brochures and website, procedures and manuals, good will, and a going-concern value. PWC then concluded that CACO’s intangibles were “routine in nature and easily reproducible by another comparable marketing and distribution company.”⁵⁰¹ PWC further noted that “the value of the Intangible Asset Transferred had only limited legal protection and economic life.”⁵⁰² PWC found nothing particularly valuable in the intangibles transferred to CSARL.

Subsequent PWC and Caterpillar documentation took note of that analysis. For example, in 2007, when a PWC managing director was considering how to value CSARL’s marketing intangibles, he noted: “CSARL (or its predecessor COSA, or CFEL, or CACO) has spent decades building up the dealer network around the world. And has spent decades building brand name through advertising.” But, he wrote: “Caveat is that in 2001, we said in another transaction [CACO] that there is no significant marketing intangibles.”⁵⁰³ An internal Caterpillar document from 2005, analyzing CSARL’s profit split, put it even more bluntly: “Should we expand profit split analysis – additional income to

⁴⁹⁸ Id.

⁴⁹⁹ 11/26/2001 Caterpillar Inc., “Economic Analysis of Intangible Assets Transferred by Caterpillar Americas Co. to Caterpillar Americas Sarl Prepared by Price Waterhouse Coopers,” PwC_PSI_CAT_00142353 - 367, at 357.

⁵⁰⁰ Id. at 367.

⁵⁰¹ Id. at 356.

⁵⁰² Id.

⁵⁰³ 7/9/2007 email from Steven Williams, PWC, to Christopher Dunn, PWC, PwC_PSI_CAT_00122483 - 484.

CSARL for part[s] responsibility, dealers/marketing intangibles (but consider agreements in LAD [Latin America Division] restructuring stating that dealer IP is not very valuable)?”⁵⁰⁴

The bottom line is that when CSARL acquired marketing intangibles from CACO in 2001, it assigned almost no value to them. Yet when CSARL was created, Caterpillar claimed it had found “newly recognized” marketing intangibles that were so valuable they justified dramatically increasing the portion of non-U.S. parts profits sent to Switzerland. Those two positions are irreconcilable. The larger policy issue is that valuing intangibles held by foreign affiliates is an inherently subjective exercise undertaken by transfer pricing parties like Caterpillar that are less interested in getting the valuation right than in figuring out a way to send profits offshore to a low-tax jurisdiction to defer and avoid U.S. taxes.

(6) Conflicting Profit Allocation Concerns

Still another policy issue focuses on how Caterpillar has allocated its non-U.S. parts profits one way for tax purposes and a different way internally for business purposes such as assigning incentive pay.

For tax purposes, beginning in 1999, Caterpillar claimed that the majority of its non-U.S. parts profits should go to its Swiss affiliate, CSARL, because of CSARL’s valuable marketing intangibles, and accordingly sent billions of dollars over the years to Switzerland. Internally, however, Caterpillar’s business divisions kept track of their individual operating profits, which were known across the company as “accountable profits.” The accountable profits were tracked and used to calculate incentive pay awarded to individual business divisions and their employees.⁵⁰⁵ In contrast to the profits recorded for tax purposes, since at least 1992, the company’s accountable profits allocated the majority share of the parts profits to business divisions in the United States, and only a routine distributor’s share to CSARL in Switzerland, which was the same share that its predecessor COSA as well as Caterpillar’s other marketing companies had traditionally received.

For years prior to the CSARL transaction, Caterpillar’s internal and external profits reports did not diverge. From 1992 to 1999, CSARL’s predecessor COSA, as well as all of Caterpillar’s other foreign marketing companies, were awarded the same amount of accountable profits. Their share was set at 4% of the profit of the total 30% profit margin for non-U.S. parts, which translated into roughly 13% of the

⁵⁰⁴ 3/2005 “Caterpillar Inc. Summary Meeting Notes, Revised Draft,” from March 7-9, 2005 meeting in Geneva, PwC_PSI_CAT_00150466 - 488, at 469.

⁵⁰⁵ Subcommittee interview of David Burritt, former Caterpillar CFO (12/4/2013).

overall non-U.S. parts profits.⁵⁰⁶ The remainder of the parts profits went to Caterpillar's commercial entities or product groups (16%), its manufacturing plants (3%), component profit centers (4%), and the U.S. Parts Division (3%).⁵⁰⁷ Any residual or entrepreneurial profits were typically awarded to the product groups responsible for the parts or underlying machines. According to Caterpillar, the 4% share of accountable profits attributed to the foreign marketing companies was set by former CEO Donald Fites in 1992, to avoid disputes over the accountable profits. The percentage apparently reflected Mr. Fite's view of the marketing companies as routine parts distributors and marketers. In addition, historically, Caterpillar's internal accountable profits matched the profits reported by its legal entities for tax purposes.⁵⁰⁸

In 1999, when the CSARL transaction was being designed, the PWC tax consultants were told that the business lines did not want any changes to how accountable profits were calculated.⁵⁰⁹ The end result was that the company changed how the profits were split for tax purposes, but not how they were reported for internal business purposes, such as assigning bonuses. PWC observed before the CSARL transaction would eliminate the company's ability to show that its external and internal profit allocations matched. In 1998, PWC wrote:

"Issue of changing transfer pricing and resulting differences of US documentation reports: up through 1998, we have characterized COSA (and other marketers[]) as routine marketers. We have also relied on conformity of management and legal books as one of our [transfer pricing] defenses. This will change and our documentation reports will rely on greater discussion of the value of the marketer[]'s contribution (support[ed] by additional external research)."⁵¹⁰

⁵⁰⁶ See 3/7/2014 "In the Matter of Caterpillar Inc.," Caterpillar Expert Witness Report by John P. Steines, Jr., Professor of Law, New York University, at PSI-Caterpillar-17-000003 - 023, at 007 (describing the 4% share as "a relatively small gross profit").

⁵⁰⁷ 12/19/1996 "Caterpillar Inc. Evaluation of Arm's Length Pricing for Intercompany Transactions Year Ended December 31, 1995." PwC_CAT_PSI_00008881 - 9104, at 959.

⁵⁰⁸ 8/22/2008 "Delivering Vision 2020 Value Transformation: An After-Tax View," PwC_PSI_CAT_00058419 - 472, at 446-447. According to PWC, prior to Mr. Fites' setting the across-the-board share of accountable profits for Caterpillar marketing companies in 1992, Caterpillar had split the non-U.S. residual parts profits with the marketing companies on a 50/50 legal entity basis. The U.S. share of the sales profits were reported as U.S. taxable income on Caterpillar's U.S. tax return, while the marketing companies' share was also reported on Caterpillar's tax return as Subpart F income. Subcommittee interview of Steven Williams, PWC (2/19/2014).

⁵⁰⁹ See undated, unattributed handwritten PWC notes. PwC_PSI_CAT_00011180 - 183, at 181 ("don't want to change accountabilities. People won't like"); "Caterpillar Inc. Operational Feasibility Analysis High Level Target Designs: Migration/Deferral," prepared by PWC, PwC_PSI_CAT_00004548 - 565, at 552 ("Preliminary Operational Issues: . . . (3) Reconciliation of divergence between legal entity and accountable profit.").

⁵¹⁰ See also 12/1998, Caterpillar Inc., Global Tax Optimization, Risk Adjusted Benefit Analysis, Working Papers -Draft 1," PWC-PSI-CAT-00001336 - 671, at 415, at 411-413 [emphasis omitted from original].

PWC also noted: “Operational Issues: 1. will create different transfer prices for legal [entities] vs. management books.”⁵¹¹

As PWC predicted, after the CSARL transaction, the accountable profits no longer matched the legal entity profits, and the difference at CSARL continued to grow with each additional parts license it signed. CSARL’s accountable profits remained at the 4% level,⁵¹² while its legal entity profits increased dramatically to reflect all of the third party manufactured non-U.S. parts income it was receiving, including residual and entrepreneurial profits (but minus the royalty fee and cost plus 5% service fee paid to Caterpillar Inc.). Despite the increase in CSARL’s profit allocation for tax purposes, CSARL’s accountable profits within Caterpillar remained the same. For years, its employees’ incentive pay continued to be calculated with reference to the 4% accountable profits assigned to marketing companies. In other words, Caterpillar did not change its internal view of which business functions created value and profit for the company, but maintained that same view until the accountable profits system ended in the mid-2000’s.⁵¹³

(7) Transfer Pricing Concerns

In response to policy concerns related to economic substance, arm’s length principles, the virtual inventory system, the intangible valuations, and profit allocations, Caterpillar took the position that what the Subcommittee should really focus on is whether the company had complied with U.S. transfer pricing laws and regulations. It asserts that it has.

In correspondence with the Subcommittee, Caterpillar explained that the CSARL transaction was simply a restructuring of the company’s supply chain resulting in Caterpillar having a more closely aligned business and legal structure.⁵¹⁴ Caterpillar wrote:

“[T]he fact that a company may have structured its transaction flows one way for some period of time does not prevent the

⁵¹¹ Id. at 413. See also 9/2006 “Caterpillar European Business Model Review, PwC_PSI_CAT_00028030 - 095, at 085 (“Accountable (vs legal entity) concepts are often referred to. However the key personnel who would be involved in a tax audit are well educated regarding legal entity. The risk of people in the business without an understanding of the differences between the two should be closely managed.”).

⁵¹² Subcommittee interview of Jananne Copeland, Caterpillar (10/30/2013). Ms. Copeland told the Subcommittee that it was understood that CSARL and its related transaction would impact the legal entity reported profits, but the CSARL changes were required to have a “zero impact” on the accountable for the business units. See also 1/16/2003 CNAMSARL Accounting Guidebook, PSI-TWLF-10-000173.

⁵¹³ Subcommittee interview of Jananne Copeland, Caterpillar (10/30/2013). Ms. Copeland told the Subcommittee that in the mid-2000s, the accountable profits system changed. The marketing groups no longer were allocated accountable profits, but instead were to be treated as cost centers; any profits were instead reallocated to the product groups.

⁵¹⁴ See 9/23/2013 letter from Caterpillar to the Subcommittee, PSI-Caterpillar-04-000001 - 009.

company from structuring its transactions flows in a different way later. Of course there must be compensation for any property transferred and services performed in connection with a restructuring, as there was in Caterpillar's case, but changing a supply chain structure is not, in and of itself, a taxable event."⁵¹⁵

Caterpillar also wrote that there "was no taxable transfer of intangible property as a result of the mere fact that Caterpillar used to purchase from a particular set of manufacturers, and now Caterpillar SARL does."⁵¹⁶ In fact, according to Caterpillar's PWC tax consultant, no taxable transfer of intellectual property occurred as a result of the CSARL transaction.⁵¹⁷

Caterpillar also told the Subcommittee that it was not a necessary participant in the parts legal title chain for non-U.S. customers, and the company had every right to arrange its affairs to minimize its taxes, including by forming CSARL and designating it as the company's global purchaser of parts.

Caterpillar's assertions that it is allowed to arrange its affairs to minimize its taxes and is free to change its operations over time are, of course, true. But those permissible activities do not provide license for the company to engage in a transaction which has no economic substance other than tax avoidance or which violates arm's length principles.

Caterpillar's focus on its compliance with U.S. transfer pricing regulations, rather on the substance of its offshore transfers, also lays bare the contradiction at the center of the transfer pricing system. General tax principles – including the principle that U.S. multinational corporations are supposed to pay tax on their worldwide income – too often get lost in an analysis of whether a transfer pricing agreement was properly priced and can be justified under existing regulations and case law. Missing from that analysis is the overarching fact that related parties do not operate as if they were unrelated and so rarely engage in a true arm's length transaction. Instead, corporate affiliates often act in concert, using dubious transfer pricing agreements, to shift profits offshore and defer and avoid paying U.S. taxes on those profits.

Caterpillar has been and remains an American success story. Its headquarters, corporate leadership, and manufacturing facilities, as well as its profitable parts business, are still based primarily in the United States, but it now sends 85% or more of its non-U.S. parts profits to Switzerland. While Caterpillar claims it is sending the profits there because its Swiss affiliate has valuable marketing intangibles, the facts

⁵¹⁵ Id. at 004.

⁵¹⁶ Id.

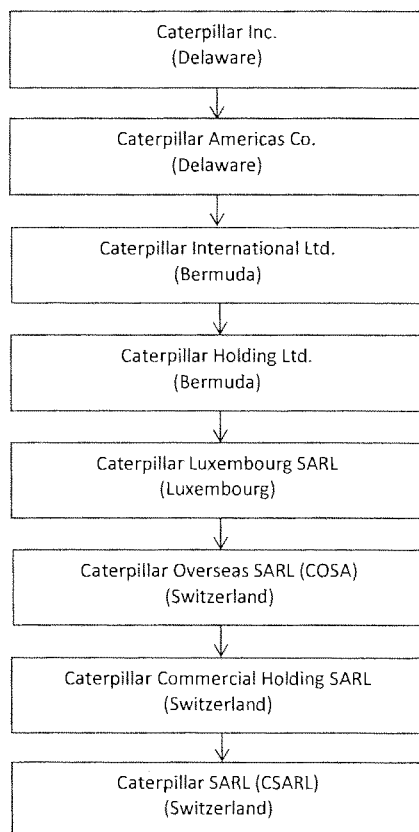
⁵¹⁷ Subcommittee interview of Thomas Quinn, PWC (12/17/2013).

show that the real reason is a Swiss tax strategy – bought and paid for by the company’s tax department – to take advantage of a 4-6% Swiss corporate effective tax rate while deferring and avoiding U.S. taxes. That Swiss tax strategy has so far enabled Caterpillar to defer paying U.S. taxes totaling \$2.4 billion.

The facts also raise questions about whether the CSARL transaction could meet a true arm’s length standard. Caterpillar shifted billions of dollars in parts profits to a related party offshore without being compensated for developing its parts business over decades or for surrendering its right to future parts profits. It appears to have done so for tax reasons, while making use of gimmicks like virtual inventories, Swiss intangibles, and internal corporate profit allocations for tax purposes that bore no relationship to profit allocations made for business purposes, such as awarding pay. The Caterpillar case study shows that offshore profit shifting is not reserved for high tech companies transferring intellectual property to tax havens, but is also the province of traditional manufacturers using financially engineered transactions to transfer billions of dollars of profits offshore to a tax haven affiliate.

#

Caterpillar Ownership of CSARL

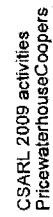


Source: 8/14/2013 letter from McDermott Will & Emery LLP, CAT_000011-038
Prepared by Permanent Subcommittee on Investigations, April 2014

Permanent Subcommittee on Investigations

EXHIBIT #1a

Permanent Subcommittee on Investigations
EXHIBIT #1b



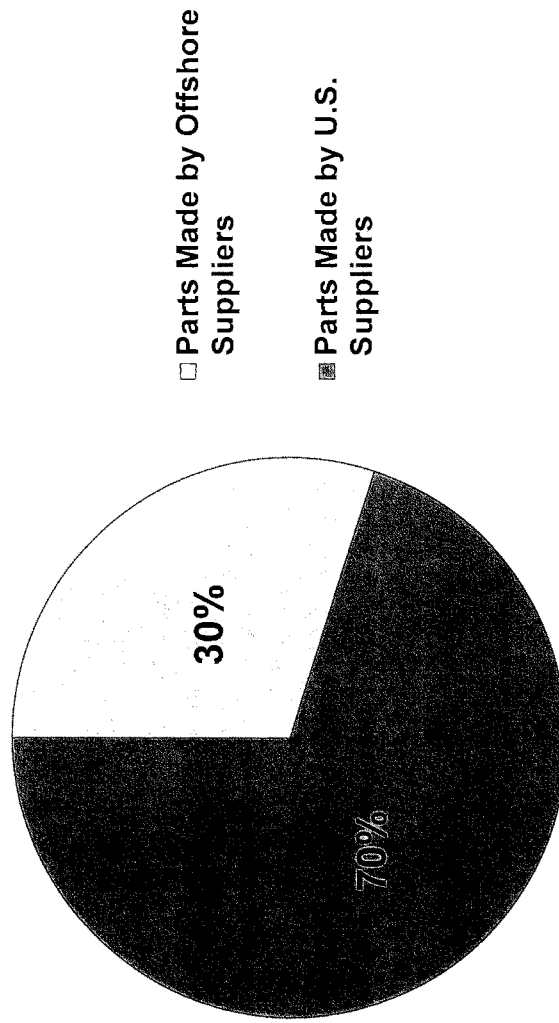
Source: PricewaterhouseCoopers submission to Subcommittee, PwC_PSI_CAT_00003411
Prepared by the U.S. Permanent Subcommittee on Investigations, April 2014.

**Redacted by the
Permanent Subcommittee on Investigations**

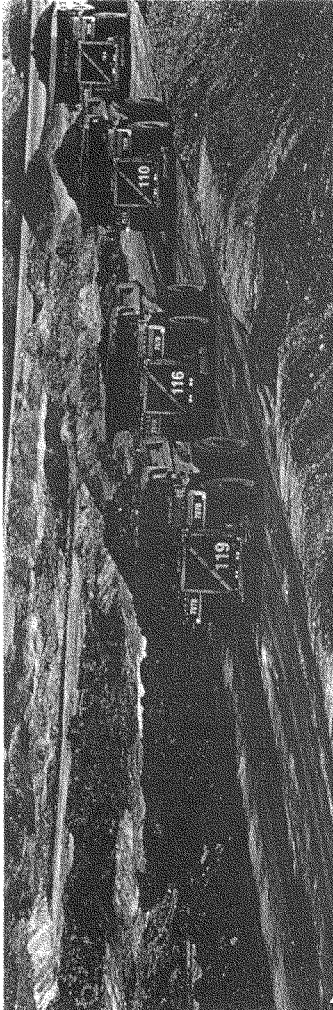
	CSARL Finished Parts Profit Before Tax	Parts Royalty Fee Paid to Caterpillar Inc.	Royalty Fee as a % of Profit
Total	\$ 8,075,907,000	\$ 1,098,149,000	13.6%

Prepared by Permanent Subcommittee on Investigations, April 2014.
Source: Caterpillar Response to Subcommittee Questionnaire, CAT-000277, 301.

CSARL Offshore Replacement Parts Sales



Permanent Subcommittee on Investigations
EXHIBIT #1d



Permanent Subcommittee on Investigations
EXHIBIT #1e

The Caterpillar 797

Made in America

Engine	Indiana
Axles	North Carolina
Tires	South Carolina
Driver's Cab	Illinois

For Global Replacement Parts Made in America 85% of Parts Profit go to Switzerland

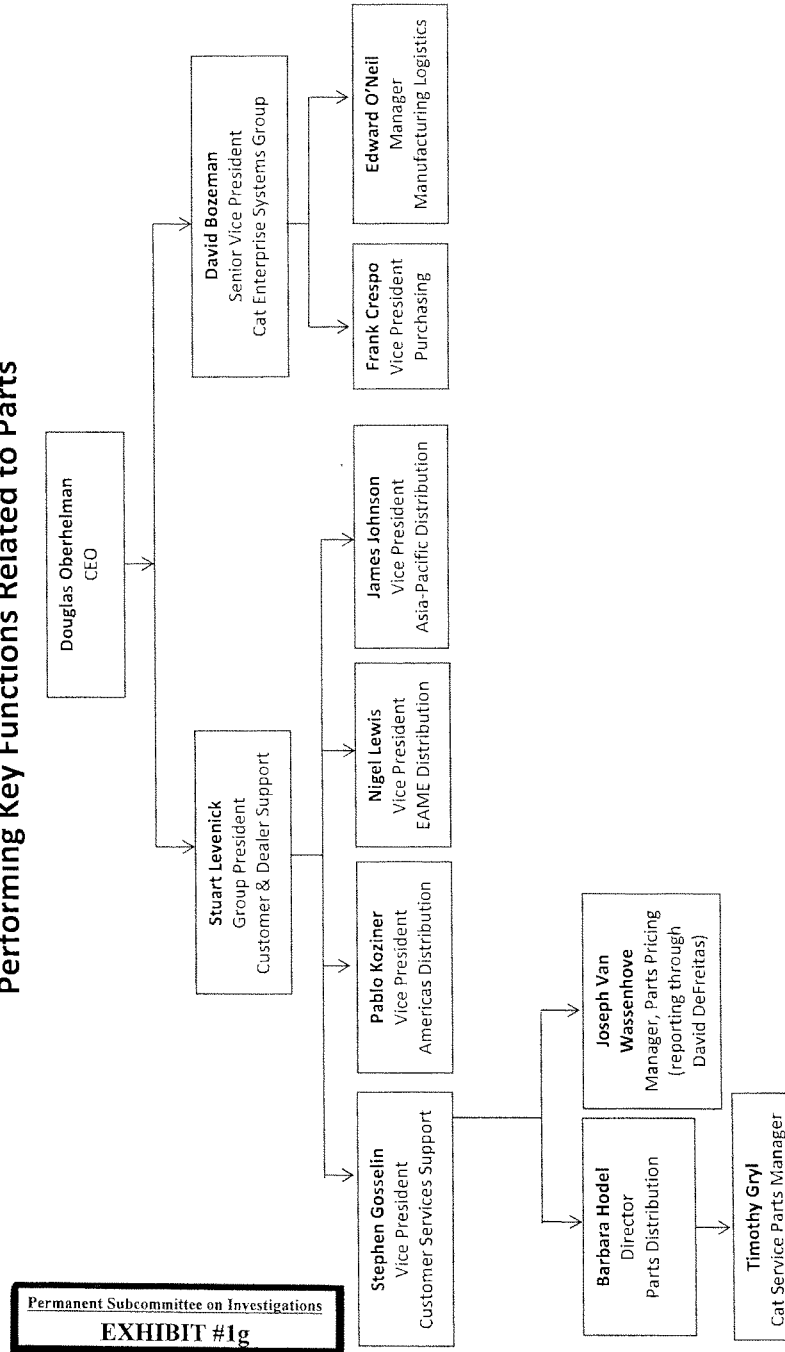
Source: National Geographic "Ultimate Factories"
Prepared by the U.S. Permanent Subcommittee on Investigations, April 2014.

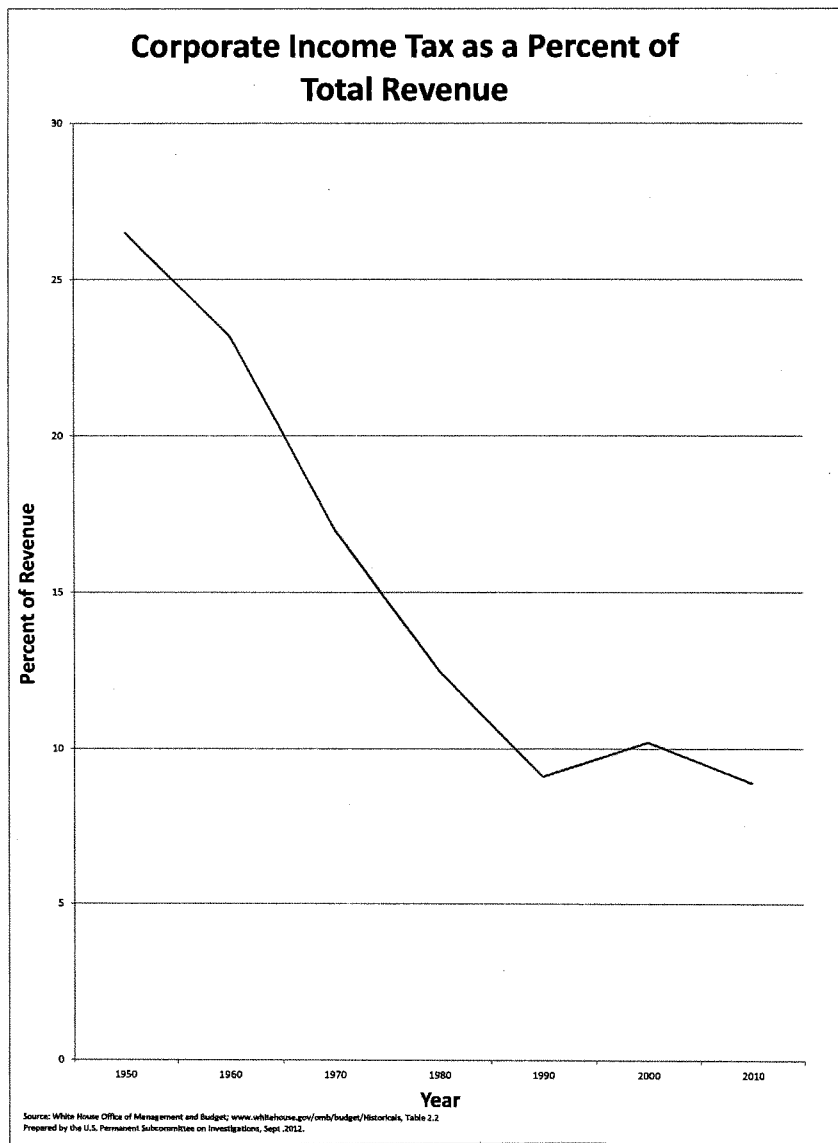
Caterpillar Replacement Parts

United States	Switzerland (4% effective tax rate)
<ul style="list-style-type: none"> - Caterpillar Inc. - 4,900 parts employees - 54 manufacturing facilities - 70% of global finished parts manufacturing - 10 warehouses - Stores and ships 1.5 billion parts - Stores no parts in foreign countries 	<ul style="list-style-type: none"> - CSARL - 65 parts employees - 0 manufacturing facilities - 0 parts manufacturing - 0 warehouses - Stores 40% of its parts in the U.S. - Remaining 60% of parts in Caterpillar owned warehouses in other countries

Permanent Subcommittee on Investigations
EXHIBIT #1f

Caterpillar Organizations Performing Key Functions Related to Parts





Permanent Subcommittee on Investigations

EXHIBIT #1h

From: Hill, Eleanor [mailto:EHill@KSLAW.com]
Sent: Friday, March 21, 2014 9:44 AM
To: Katz, David (HSGAC)
Subject: Response regarding fees

David,

I am enclosing, on behalf of our client PricewaterhouseCoopers LLP ("PwC"), information responsive to your request for fees paid to PwC for tax consulting and audit services relating to Caterpillar from the years 1998 to the present.

Given the number of years covered by your request, we have identified responsive and available information from two different sources, as provided in Attachment A and Attachment B. Please note that data provided in Attachment A relates to a different Fiscal Year than data provided in Attachment B. There are also differences in the scope of the data included in the different attachments, as explained below.

Attachment A sets forth the annual tax and audit fees between FYE 12/31/2000 and FYE 12/31/2012, according to Caterpillar's annual meeting proxy statements. Fees paid to PwC for tax and audit services, if any, would be included in these proxy disclosures.

Attachment B, a document entitled "CATERPILLAR – GLOVE/VISION PROJECT BILLINGS", sets forth what appears to be the annual amounts billed by PwC for GLOVE/VISION services between FYE 6/30/1999 and FYE 6/30/2004. PwC produced an earlier version (PwC_PSI_CAT_00195723) of this document to the Subcommittee on February 14, 2014. Note that, unlike the broader data included in the proxy disclosures, the data in Attachment B only includes billings related to the GLOVE/VISION Project. Based on our review to date, we have no reason to believe that the information in Attachment B is not accurate.

In an effort to be timely, I am transmitting this by email today. We will, however, also include this information in the supplemental production we are planning for next week. As we have discussed, this response is the product of a good faith effort to identify, in a timely manner, the most responsive and accurate available information with respect to your request. As always, if you have questions or a discussion would be helpful, please give me a call.

Regards,
Eleanor

Eleanor Hill
King & Spalding LLP
1700 Pennsylvania Ave, N.W.
Washington D.C. 20006-3737
Tel: 202-626-2955
Fax: 202-626-3737

Permanent Subcommittee on Investigations

EXHIBIT #2

PSI-PWC-22-000001

ATTACHMENT A

<u>Year</u>	<u>Tax Planning and Consulting Fees¹</u>	<u>Audit Fees²</u>	<u>Audit Related Fees³</u>	<u>Tax Compliance Fees⁴</u>
2000	\$ 12,800,000	\$ 6,700,000	-	-
2001	\$ 17,000,000	\$ 7,600,000	-	-
2002	\$ 11,800,000	\$ 8,500,000	\$ 3,900,000	\$ 2,300,000
2003	\$ 10,500,000	\$ 10,200,000	\$ 3,500,000	\$ 2,500,000
2004	\$ 7,800,000	\$ 18,700,000	\$ 2,600,000	\$ 3,400,000
2005	\$ 6,400,000	\$ 15,700,000	\$ 3,000,000	\$ 2,300,000
2006	\$ 2,600,000	\$ 20,200,000	\$ 3,000,000	\$ 2,200,000
2007	\$ 2,700,000	\$ 21,400,000	\$ 4,700,000	\$ 2,200,000
2008	\$ 2,300,000	\$ 22,200,000	\$ 5,500,000	\$ 2,800,000
2009	\$ 1,900,000	\$ 21,800,000	\$ 2,100,000	\$ 1,900,000
2010	\$ 1,700,000	\$ 23,200,000	\$ 5,000,000	\$ 2,200,000
2011	\$ 3,900,000	\$ 31,600,000	\$ 1,600,000	\$ 1,800,000
2012	\$ 1,500,000	\$ 31,900,000	\$ 2,800,000	\$ 1,700,000

¹ **Tax Planning and Consulting Fees:** The table sets forth the annual fees for tax planning and consulting services between FYE 12/31/2000 and FYE 12/31/2012, according to Caterpillar's annual meeting proxy statements beginning in 2001. Fees paid to PwC for tax planning and consulting services in connection with Caterpillar SARL, if any, would be included in these proxy disclosures. Please note that the fees listed for FYE 2000 and FYE 2001 include other services provided to Caterpillar, as noted in the proxy statements.

² **Audit Fees:** The table sets forth the audit services fees (including out-of-pocket expenses) between FYE 12/31/2000 and FYE 12/31/2012, according to Caterpillar's annual proxy meeting statements beginning in 2001. Fees paid to PwC for audit services relating to Caterpillar SARL, if any, would be included in these proxy disclosures.

³ **Audit Related Fees:** The table sets forth the "audit-related" fees (including out-of-pocket expenses) between FYE 12/31/2002 and FYE 12/31/2012, according to Caterpillar's annual meeting proxy statements beginning in 2004. Fees paid to PwC for such services relating to Caterpillar SARL, if any, would be included in these proxy disclosures. The 2002 and 2003 audit related fees are included in the 2004 annual proxy meeting statement.

⁴ **Tax Compliance Fees:** The table sets forth the tax compliance fees (including out-of-pocket expenses) between FYE 12/31/2002 and FYE 12/31/2012, according to Caterpillar's annual meeting proxy statements beginning in 2003. Fees paid to PwC for such services relating to Caterpillar SARL, if any, would be included in these proxy disclosures. The 2002 and 2003 tax compliance fees are included in the 2004 annual meeting proxy statement.

CATERPILLAR INC. - GLOVE / VISION PROJECT BILLINGS

Invoice Date	Amount	Expense	Total Invoice	Cumulative Total Billed	(Cumul Amts Only)	(Cumul Exps Only)
7/31/1998	100,000	41,187	141,187.00	141,187.00	100,000.00	41,187.00
10/19/1998	100,000	54,891	154,891.00	296,078.00	200,000.00	96,078.00
10/19/1998	500,000	0	500,000.00	796,078.00	700,000.00	96,078.00
11/11/1998	500,000	0	500,000.00	1,296,078.00	1,200,000.00	96,078.00
12/15/1998	500,000	39,616	539,616.00	1,835,694.00	1,700,000.00	135,694.00
1/18/1999	500,000	45,174	545,174.00	2,380,868.00	2,200,000.00	180,868.00
2/16/1999	625,000	26,343	651,343.00	3,032,211.00	2,825,000.00	207,211.00
3/12/1999	625,000	70,768	695,768.00	3,727,979.00	3,450,000.00	277,979.00
4/15/1999	625,000	54,267	679,267.00	4,407,246.00	4,075,000.00	332,246.00
5/13/1999	625,000	72,135	697,135.00	5,104,381.00	4,700,000.00	404,381.00
6/10/1999	625,000	67,607	692,607.00	5,796,988.00	5,325,000.00	471,988.00
7/12/1999	625,000	91,232	716,232.00	6,513,220.00	5,950,000.00	563,220.00
8/13/1999	625,000	83,799	708,799.00	7,222,019.00	6,575,000.00	647,019.00
9/16/1999	625,000	103,013	728,013.00	7,950,032.00	7,200,000.00	750,032.00
10/11/1999	625,000	92,681	717,681.00	8,667,713.00	7,825,000.00	842,713.00
11/18/1999	625,000	75,177.86	700,177.86	9,367,890.86	8,450,000.00	917,890.86
12/15/1999	625,000	94,989.82	719,989.82	10,087,880.68	9,075,000.00	1,012,880.68
1/18/2000	625,000	83,696	708,696.00	10,796,576.68	9,700,000.00	1,096,576.68
2/16/2000	625,000	66,174	691,174.00	11,487,750.68	10,325,000.00	1,162,750.68
3/18/2000	625,000	88,317	713,317.00	12,201,067.68	10,950,000.00	1,251,067.68
4/13/2000	625,000	59,606	684,606.00	12,885,673.68	11,575,000.00	1,308,673.68
5/15/2000	625,000	70,633	695,633.00	13,577,306.68	12,200,000.00	1,377,306.68
6/13/2000	625,000	42,206	667,206.00	14,244,512.68	12,825,000.00	1,419,512.68
7/13/2000	625,000	53,093	678,093.00	14,922,605.68	13,450,000.00	1,472,605.68
8/17/2000	625,000	63,485	688,485.00	15,611,090.68	14,075,000.00	1,538,090.68
9/15/2000	625,000	57,847	682,847.00	16,293,937.68	14,700,000.00	1,593,937.68
12/11/2000	900,000	210,118	1,110,118.00	17,404,055.68	15,600,000.00	1,804,055.68
1/17/2001	900,000	70,424	970,424.00	18,374,479.68	16,500,000.00	1,874,479.68
2/23/2001	900,000	43,556	943,556.00	19,318,035.68	17,400,000.00	1,918,035.68
3/26/2001	900,000	116,102	1,016,102.00	20,334,137.68	18,300,000.00	2,034,137.68
4/19/2001	825,000	120,506	945,506.00	21,279,643.68	19,125,000.00	2,154,643.68
5/15/2001	650,000	43,841	693,841.00	21,973,484.68	19,775,000.00	2,198,484.68
6/14/2001	341,383	58,617	400,000.00	22,373,484.68	20,116,383.00	2,257,101.68
7/18/2001	325,388	74,611	400,000.00	22,773,484.68	20,441,772.00	2,331,712.68
8/20/2001	312,044	87,956	400,000.00	23,173,484.68	20,753,816.00	2,419,668.68
9/26/2001	339,361	60,539	400,000.00	23,573,484.68	21,093,177.00	2,480,307.68
12/20/2001	4,129,621	296,705	4,426,326.00	27,999,810.68	25,222,798.00	2,777,012.68
1/16/2002	925,000	18,142	943,142.00	28,942,952.68	26,147,798.00	2,795,154.68
3/15/2002	2,005,000	123,892	2,128,892.00	31,071,844.68	28,152,798.00	2,919,046.68
7/1/2002	3,750,000	304,190	4,054,190.00	35,126,034.68	31,902,798.00	3,223,236.68
8/20/2002	475,000	47,483	522,483.00	35,648,517.68	32,377,798.00	3,270,719.68
9/17/2002	370,000	21,541	391,541.00	36,040,058.68	32,747,798.00	3,292,260.68
10/7/2002	322,000	13,674	335,674.00	36,375,732.68	33,069,798.00	3,306,934.68
10/7/2002	4,190,000	201,233	4,391,233.00	40,766,965.68	37,259,798.00	3,507,167.68
11/7/2002	231,000	15,557	246,557.00	41,013,522.68	37,490,798.00	3,522,724.68
12/11/2002	500,000	5,630	505,630.00	41,519,152.68	37,990,798.00	3,528,354.68
1/9/2003	605,000	13,740	618,740.00	42,137,892.68	38,595,798.00	3,542,094.68
1/20/2003	1,500,000	117,441	1,617,441.00	43,755,333.68	40,095,798.00	3,659,535.68
2/14/2003	497,000	7,817	504,817.00	44,260,150.68	40,592,798.00	3,667,352.68
4/18/2003	1,500,000	160,043	1,660,043.00	45,920,193.68	42,092,798.00	3,827,395.68
5/28/2003	175,000	37,796	212,796.00	46,132,989.68	42,267,798.00	3,865,191.68
7/15/2003	2,900,000	133,095	3,033,095.00	49,166,084.68	45,167,798.00	3,998,286.68
7/15/2003	175,000	33,385	208,385.00	49,374,469.68	45,342,798.00	4,031,671.68
9/26/2003	2,900,000	38,793	2,938,793.00	52,313,262.68	48,242,798.00	4,070,464.68
12/12/2003	2,103,000	53,335	2,156,335.00	54,469,597.68	50,345,798.00	4,123,799.68
3/23/2004	2,100,000	0	2,100,000.00	56,569,597.68	52,445,798.00	4,123,799.68
7/16/2004	2,000,000	0	2,000,000.00	58,569,597.68	54,445,798.00	4,123,799.68
Grand Totals	54,445,798	4,123,799	58,569,598			

3,125,442 = Total APD Bills
3,000,000 = Total Time billed to APD

	Amts. Billed FYTD	Exps. Billed FYTD	Total Billed FYTD
FYE 6/30/99	5,325,000	471,988	5,796,988
FYE 6/30/00	7,500,000	947,525	8,447,525
FYE 6/30/01	7,291,383	837,589	8,128,972
FYE 6/30/02	8,036,415	581,945	8,698,360
FYE 6/30/03	17,190,000	1,112,825	18,302,825
FYE 6/30/04	9,103,000	92,128	9,195,128

Note: 5/26/03 bill was for Caterpillar (FE work)
Note: the smaller 7/15/03 bill was for Cat Brazil

Bills Rendered to date

PSI-PWC-22-000003
8/30/2004

1:09-cv-01208-MMM -BGC # 120-45 Page 1 of 15		E-FILED Friday, 23 September, 2011 01:21:03 PM Clerk, U.S. District Court, ILCD
History of Significant Changes in International Operations (Not Inclusive of Financing Arrangements) 1997-2002		
A general definition for each Class Interest is attached as Exhibit A.		
Relevant Transaction	What	CSARL Class Interest
	Effective 7/14/97, COSA ¹ and CCH ² organized Caterpillar S.A.R.L. ("CSARL" or "CAT SARL") (named "Caterpillar Commercial S.A.R.L." until 7/6/99, at which point it was renamed Caterpillar S.A.R.L.)	
	Effective 8/1/97, COSA and CCH Entered into a Joint Venture Agreement (the "Original JV Agreement") memorializing certain of their understandings and agreements with respect to CSARL, including the: <ul style="list-style-type: none"> funding of the development and commercialization of the 1997 Technologies;³ manufacturing and marketing of products and parts resulting from the development and commercialization of the 1997 Technologies (the "1997 Technologies Activity"); and sharing of the distributions, profits and losses from the 1997 Technologies Activity. 	COSA – Preferred partnership interest CCH – Common partnership interest
	Effective as of 1/1/98, COSA and CCH entered into a First Amendment to Joint Venture Agreement (the "First Amendment") memorializing their additional understandings and agreements regarding extension of the provisions of the Original JV Agreement to cover the: <ul style="list-style-type: none"> funding of the development and commercialization of the 1998 Technologies;⁴ manufacturing and marketing products and parts resulting from the development and commercialization of the 1998 Technologies (the "1998 Technologies Activities"); and the sharing of the distributions, profits and losses from the 1998 Technologies Activities. <p>The First Amendment generally extended the provisions of the Original JV Agreement to the 1998 Technologies Activities without modification.</p>	COSA – Preferred partnership interest CCH – Common partnership interest
Transaction	On 7/1/99, CAT and COSA organized Caterpillar Holding (Suisse) S.A.R.L., a	

¹ Caterpillar Overseas S.A., a société anonyme organized under the laws of Switzerland on 11/30/60 and wholly-owned by Caterpillar Inc. ("CAT").

² Caterpillar Commercial Holding S.A. ("CCH") (formerly named "Caterpillar Building Construction Products AG,") a société anonyme organized under the laws of Switzerland on 8/4/95 and was wholly-owned by CAT.

³ The 1997 Technologies was generally understood to include both the Forest Products Technology and the P2000 Technology (which is also referred to as the "Compact Construction Equipment Business.")

⁴ The 1998 Technologies was generally understood to include the "Articulated Trucks," "Drag Line Buckets," and "G340-16 Engines" (otherwise referred to as the Developed MAK M32 Technology).

CH099 4024965-7 039437.0010 **DRAFT 1-16-03** 1
PSI-TWL-F-02-000422

Permanent Subcommittee on Investigations
EXHIBIT #3

<i>1999 Swiss Restructuring</i>	société à responsabilité limitée organized under the laws of Switzerland ("CHS"). CAT contributed cash in the amount of CHF 99,000 to CHS as Registered Capital. In exchange, CAT received 1 common share of CHS which had a par value of CHF 99,000. COSA contributed cash in the amount of CHF 1,000 to CHS as Registered Capital. In exchange COSA received 1 common share of CHS with a par value of CHF 1,000. CHS was registered on 7/6/99.	
Transaction <i>1999 Swiss Restructuring</i>	Effective 8/18/99 , CAT transferred its single share of CHS and all 35,021 shares of its wholly-owned subsidiary, CCH, to COSA in exchange for 351,200 of the common shares of COSA with a par value of CHF 100.	
Transaction <i>1999 Swiss Restructuring</i>	Effective as of 9/1/99 , COSA, CCH and CHS entered into a First Amended and Restated Joint Venture Agreement to reflect: <ul style="list-style-type: none"> contributions to CSARL by COSA of a U.S.\$75,402,629 Subordinated Loan in favor of COSA, and the assets and liabilities described in Articles 1 and 2 of a Contribution In Kind Agreement between COSA and CSARL dated 9/1/99; contributions to CSARL by CHS of CHF 16,000; the admission of CHS as a Partner of CSARL; and the revised understandings and agreements among the partners with respect to the sharing of the profits and losses of, and distributions by, CSARL and certain other matters. 	CHS-Class A COSA-Class B COSA- <ul style="list-style-type: none"> Preferred C-1 Preferred C-2 CCH- <ul style="list-style-type: none"> Common C-1 Common C-2
Transaction <i>1999 Swiss Restructuring</i>	Effective as of 9/1/99 , CAT and CSARL entered into a Purchased Finished Replacement Parts License Agreement ("PFR Parts License") and a Worked Parts License Agreement , which gave CSARL certain exclusive and nonexclusive rights with respect to having made and purchasing "PFR Parts" and "Worked Parts" in exchange for respective royalty amounts of 15% and 7% of Net Sales in the CAT SARL Territory. The term, "CAT SARL Territory" was essentially defined as the former territory associated with COSA. ⁵	

⁵ Pursuant to the PFR Parts License CSARL was granted the following rights:

- an exclusive right and license to have made and/or purchase PFR Parts (and to perform or have performed processes associated therewith) for sale by CAT SARL to Third Parties in the CAT SARL Territory;
- a nonexclusive right similar to that above with respect to PFR Parts for sale by CAT SARL to CAT pursuant to and in accordance with the terms of the Purchasing Agency Agreement;
- a nonexclusive right and license to use identified intellectual property for having PFR Parts made by Third Parties in accordance with the rights granted above;
- a nonexclusive right and license to purchase PFR Parts from CAT's network of Third Party suppliers; and
- all other rights and licenses reasonably necessary for CAT SARL to exploit the rights and licenses specifically identified above.

Pursuant to the Worked Parts License Agreement CSARL was granted the following rights:

- an exclusive right and license to have "Worked Parts" made (and to perform or have performed processes associated therewith) by CAT Affiliates, outside the United States, for sale by CAT SARL in the CAT SARL Territory;
- a nonexclusive right and license to have Worked Parts made (and to perform or have performed processes associated therewith) by CAT Affiliates, outside the United States, for sale by CAT SARL to CAT for resale by CAT and/or other CAT Affiliates outside the CAT SARL Territory;
- an exclusive right and license to use identified intellectual property for having Worked Parts made by CAT Affiliates in accordance with the rights granted above; and
- all other rights and licenses reasonably necessary for CAT SARL to exploit the rights and licenses specifically identified above.

Transaction <i>1999 Swiss Restructuring</i>	Effective as of 9/1/99 , CAT and CSARL entered into a Purchasing Agency Agreement , ⁶ pursuant to which CSARL appointed CAT as its non-exclusive purchasing agent with respect to certain of its purchases from third party suppliers, and a Services Agreement , ⁷ pursuant to which CAT provides certain services with respect to CSARL's management and sales of replacement parts.	
Transaction <i>1999 Swiss Restructuring extended to the Singapore Branch</i>	CAT and CSARL entered into a First Amended and Restated Purchased Finished Replacement Parts License Agreement and a First Amended and Restated Worked Parts License Agreement , which principally expanded the definition of the CAT SARL Territory effective as of 12/1/99 , to include the following territories associated with CAT SARL's Singapore Branch: India, Bangladesh, Korea, Lao PDR, Cambodia, Thailand, Philippines, Myanmar, Indonesia, Bhutan, Nepal, Malaysia, Singapore, Sri Lanka, Vietnam, and Mongolia.	
Transaction <i>1999 Swiss Restructuring</i>	Effective 12/1/99 , CAT and CSARL entered into (1) a Reallocated Parts License Agreement ; (2) the Second Amended and Restated Services Agreement ; and (3) a Reallocated Parts Purchasing Agency Agreement .	
Transaction <i>COFA 2000</i>	On 5/9/00 , COSA formed Caterpillar Overseas Investment Holding S.A. ("COHSA") under the laws of Switzerland with CHF 100,000. In exchange, COSA received 1,000 shares of COHSA with a par value of CHF 100.	
Transaction <i>COFA 2000</i>	On 5/31/00 , CAT formed Caterpillar Holdings Australia Limited, a company registered under the Corporations Law of Victoria (" <i>CAT Holdings Australia</i> ") with A\$2 of capital and in exchange received 2 ordinary shares of Caterpillar Holdings Australia. A Form 8832 was filed making an initial entity classification election to treat CAT Holdings Australia as a disregarded entity of CAT effective 5/31/00.	
Transaction <i>COFA 2000</i>	On 5/31/00 , Caterpillar of Australia Ltd. (" <i>COFA</i> ") formed a wholly-owned subsidiary, Caterpillar Commercial Australia Limited, under the laws of Australia as a public company limited by shares.	
Transaction <i>COFA 2000</i>	On 6/1/00 , CAT formed Caterpillar (Bermuda) Ltd. and received 12,000 shares. A Form 8832 was filed making an initial entity classification election to treat Caterpillar (Bermuda) Ltd. as a disregarded entity of CAT effective 6/1/00.	
Transaction <i>COFA 2000</i>	On 6/6/00 , the following entities each transferred the one share of COFA that they held as nominee for CAT, to CAT: Caterpillar of Delaware, Inc., COSA,	

The Worked Parts License Agreement was generally understood to be relevant with respect to those parts manufactured by Caterpillar Belgium S.A. and Caterpillar France S.A.

⁶ The Purchasing Agency Agreement was amended and restated from time to time with the principal purpose of modifying the definition of "CAT SARL Territory", consistent with the transactions described below.

Pursuant to the terms of the Purchasing Agency Agreement, CAT agreed to purchase from CSARL all Goods not destined for the "CAT SARL Territory," (such goods being defined as "Transferred Goods") with the sale being deemed to occur immediately after CAT initially purchased such Transferred Goods on behalf of CSARL – even though the Transferred Goods were not specifically identified until they arrived at the contract packagers. The sale was to take place according to the same price and payment terms as those applicable when CSARL purchased the same Transferred Goods from the third party supplier.

⁷ Except as otherwise noted below, the Services Agreement was amended and restated from time to time with the principal purpose of modifying the definition of "Territory", consistent with the transactions described below.

	Caterpillar of Canada Limited and Caterpillar UK Limited.	
Transaction <i>COFA 2000</i>	On 6/14/00 , CAT and Caterpillar (Bermuda) Ltd. entered into an Assignment, Acceptance and Bill of Sale agreement pursuant to which CAT contributed to Caterpillar (Bermuda) Ltd. its rights, title and interest in and to a Participation Agreement with Société Générale.	
Transaction <i>COFA 2000</i>	On 6/19/00 , CAT transferred all of the issued and outstanding 1,023,750 shares of COFA to Caterpillar Holdings Australia in exchange for (a) the increase of the aggregate value of Caterpillar Holdings Australia's shares by an amount equal to the fair market value of the COFA shares and (b) A\$2 nominal consideration.	
Transaction <i>COFA 2000</i>	On 6/20/00 , CAT contributed the following to COSA in exchange for 84,080 registered shares of a nominal value of CHF 100 each of COSA: (a) the 2 issued and outstanding shares of CAT Holdings Australia; (b) all 12,000 of the issued and outstanding shares of Caterpillar (Bermuda) Limited, and (c) all 500 of the issued and outstanding shares in Caterpillar Overseas Credit Corporation S.A. ("COCCSA").	
Transaction <i>COFA 2000</i>	On 6/27/00 , COSA transferred the following shares to its wholly-owned subsidiary, COCCSA in exchange for 85,580 shares of a nominal value of CHF 100 each of COCCSA: (a) the 2 issued and outstanding shares of CAT Holdings Australia; (b) all 12,000 issued and outstanding shares of Caterpillar (Bermuda) Limited; (c) the single issued and outstanding share of CHS with a par value of CHF 100,000, (d) all 1,000 registered shares of a nominal value of CHF 100 of COHSA.	
Transaction <i>COFA 2000</i>	On 6/30/00 , COFA assigned its rights and interests to a Facility Agreement entered into with Caterpillar Financial Australia Limited to Caterpillar Commercial Australia Limited.	
Transaction <i>SCM</i>	Effective at the end of the day 6/30/00 , CAT sold its shares in Mitsubishi Heavy Industries Ltd., with which it had entered into a 50/50 joint venture, Shin Caterpillar Mitsubishi Ltd.	
Transaction <i>COFA 2000</i>	Effective 7/3/00 , COCCSA contributed to CSARL in exchange for an interest in CSARL: (a) 2 shares of CAT Holdings Australia and (b) 12,000 shares of Caterpillar (Bermuda) Limited.	
Transactions <i>COFA 2000, SCM, and Class C (C-3) Technologies</i>	<p>On 7/3/00, COSA, CCH, CHS, COCCSA and COHSA Entered into a Second Amended and Restated Joint Venture Agreement to:</p> <ul style="list-style-type: none"> • effective 9/1/99, amend their understandings and agreements as memorialized in the First Amended And Restated Joint Venture Agreement and make clarifications of, and corrections to, the First Amended And Restated Joint Venture Agreement; • reflect the 4/18/00 contribution by CCH of U.K. £5,600,000 used by CSARL to purchase certain small telescopic materials handler technology from Claas Holdings Limited; • effective 7/3/00, reflect the expansion of the activities of Company to include the Class D Company Activity and the Class E Company Activity; • effective 7/3/00, reflect the contribution by CCH of CHF 32,000 for use ½ in 	<p>CHS-Class A</p> <p>COSA-</p> <ul style="list-style-type: none"> • Class B • Preferred C-1 • Preferred C-2 <p>CCH-</p> <ul style="list-style-type: none"> • Common C-1 • Common C-2 <p>COCCSA-Class D</p>

	<p>the Class C-1 Company Activity and ½ in the Class C-2 Company Activity;</p> <ul style="list-style-type: none"> • effective 7/3/00, reflect the contribution by CHS of CHF 32,000 for use in the Class A Company Activity; • effective 7/3/00, reflect the contribution by COIHSa of CHF 48,000 for use in the Class E Company Activity and its admission as a Partner of CSARL; • effective 7/3/00, reflect the contribution by COCCSA of the 2 existing and outstanding shares of CAT Holdings Australia (which held COFA) and its admission as a Partner of CSARL; and • effective 7/3/00, reflect the revised understandings and agreements of COSA, CCH and CHS and the understandings and agreements of COCCSA and COIHSa with respect to the sharing of the profits and losses of, and distributions by, CSARL and certain other matters. 	COIHSa-Class E
Transaction <i>COFA 2000</i>	CAT and CSARL entered into a Second Amended and Restated Purchased Finished Replacement Parts License Agreement and a Second Amended and Restated Worked Parts License Agreement which in principal part expanded the definition of CAT SARL Territory effective 7/3/00 to include the following territories associated with Caterpillar of Australia Ltd. Australia, Fiji Islands; New Caledonia; New Zealand; Papua New Guinea; Samoa, America; Solomon Islands; Tahiti and Tonga.	
Transaction <i>Class C (Original Loan & Guaranty Agreement)</i>	Caterpillar Belgium S.A., a company incorporated under the laws of Belgium, as lender, and CSARL, as borrower, entered into a Variable Amount Loan Agreement dated 11/30/00 (the " Original Loan Agreement "), and COSA and Caterpillar Belgium S.A. entered into a Guaranty dated 11/30/00 under which COSA guaranteed Borrower's obligations under such loan agreement (the " Original Guaranty ").	
Transactions <i>Class C</i> <i>(Combination of C-1 and C-2 class into C-1 and specifies related to the C-3 class)</i>	<p>On 11/30/00, COSA, CCH, CHS COCCSA and COIHSa entered into a Third Amended and Restated Joint Venture Agreement to amend and restate the Second Amended And Restated Joint Venture Agreement in order to memorialize:</p> <ul style="list-style-type: none"> • effective 9/1/99, clarifications of, and corrections to, the Second Amended And Restated JV Agreement; • effective 12/1/99, the combination of the Original Class C-1 Company Activity and the Original Class C-2 Company Activity into the Class C-1 Company Activity and their understandings and agreements with respect to the Class C-1 Company Activity; • effective 4/18/00, their understandings and agreements with respect to the Class C-3 Company Activity;⁸ and • effective 7/3/00, clarifications related to the Class D Company Activity and Class E Company Activity. 	<p>CHS-Class A</p> <p>COSA-</p> <ul style="list-style-type: none"> • Class B • Preferred C-1 <i>(C-1 consists of a combination of the C-1 and C-2 Interests)</i> • Preferred C-3 <p>CCH-</p> <ul style="list-style-type: none"> • Common C-1 • Common C-3 <p>COCCSA-Class D</p> <p>COIHSa-Class E</p>
Transaction <i>1999 Swiss Restructuring</i>	Effective 9/1/00 , the Purchasing Agency relationship between CAT and CSARL was terminated and CSARL began to issue purchase orders and receive invoices from third party suppliers in its own name. Accordingly, effective 9/1/00 , CAT and CSARL entered into a Termination Agreement terminating the Purchasing Agency Agreement, as amended and restated from time to time and entered into a Termination Agreement canceling the Reallocated Parts Purchasing Agency Agreement and a Reallocated Parts License Agreement.	

⁸ The Class C-3 interest was generally understood to encompass the small telescopic materials handler technology.

	Effective 9/1/00 , CAT and CSARL also entered into a Purchasing Services Agreement , pursuant to which CAT provides certain purchasing services to CSARL with respect to certain of CSARL's purchases from third party suppliers. ⁹	
Transactions <i>EAME</i> <i>COFA 2001</i>	During November 2001, COSA, CCH, COCCSA acting on its own behalf and as successor to CHS, and COIHSARL acting on its own behalf and as successor to COIHS ¹⁰ entered into a Fourth Amended and Restated Joint Venture Agreement amend and restate the Third Amended And Restated Joint Venture Agreement in order to: <ul style="list-style-type: none"> • effective on dates as specified in the Third Amended And Restated JV Agreement, reflect clarifications of, and corrections to, the Third Amended And Restated JV Agreement; • effective 1/1/01, memorialize their understandings and agreements regarding the expansion of the activities of CSARL to include the Class F Company Activity; • effective 8/14/01, reflect the merger of CHS into COCCSA and the conversion of COIHS to COIHSARL; and • effective 8/21/01, reflect the distribution by CSARL to COCCSA of the shares of CAT Holdings Australia and Caterpillar (Bermuda) Ltd. 	COCCSA- <ul style="list-style-type: none"> • Class A • Class D COSA- <ul style="list-style-type: none"> • Class B • Preferred C-1 • Preferred C-3 CCH- <ul style="list-style-type: none"> • Common C-1 • Common C-3 • Class F COIHSARL- <ul style="list-style-type: none"> • Class E
Transaction <i>EAME</i>	Effective as of 1/1/01 , CAT and CSARL entered into a License Agreement ("Bundled License Agreement") which effectively replaced the Second Amended and Restated PFR Parts License Agreement and the Second Amended and Restated Worked Parts License Agreement, but limited the definition of CSARL Territory to exclude the territories associated with COFA, identified above and expanded CSARL's rights to include those connected with the Class F activities, described above with respect to the Fourth Amended and Restated Joint Venture Agreement. In exchange for the rights granted under the License Agreement CSARL agreed to pay CAT a royalty of 4% of Net Sales (i) to Third Parties within the CSARL Territory, (ii) to CAT Affiliates located outside of the CSARL Territory, or (iii) to Caterpillar Special Services Belgium, Sprl., adjusted for certain items. The Bundled License Agreement provides that Caterpillar France S.A. ("CFS") and Caterpillar Belgium S.A. ("CBSA") (and, where appropriate, other	

⁹ The Purchasing Services Agreement has been amended and restated from time to time with the principal purpose of modifying the definition of "CAT SARL Territory", consistent with the transactions described below.

Similar to the agreement by the parties as contained within the former Purchasing Agency Agreement, CAT agreed to purchase from CSARL all Goods not destined for the "CAT SARL Territory," (such goods being defined as "Transferred Goods"). Unlike the Purchasing Agency Agreement, however, the sale was to occur once the Transferred Goods were specifically identified at the contract packager locations (as opposed to relating back to the time at which CSARL obtained title to the Transferred Goods). Consistent with the past, however, the sale was to take place according to the same price and payment terms as those applicable when CSARL purchased the same Transferred Goods from the third party supplier.

¹⁰ See the transactions involving CHS and COIHSARL effective 8/14/01 and 8/18/01, as described below.

	CAT Affiliates) will provide research and development and related engineering services for CAT pursuant to engineering services agreements with CAT and that intellectual property arising as a result of such services is considered licensed by CAT to CSARL under the Bundled License Agreement. ¹¹ Upon request by CAT, CSARL as licensee agrees to provide supervision and oversight for CAT of the performance of such services. ¹²	
Transaction <i>EAME</i>	Effective as of 1/1/01 , CSARL and CBSA and CSARL and CFSA entered into Manufacturing Services Agreements ("MSAs") pursuant to which CBSA and CFSA agreed to provide CSARL with toll manufacturing services in exchange for a recovery of their cost of operations and a 7% return of capital employed fee. ¹³	
Transaction <i>EAME</i>	Effective as of 1/1/01 , CSARL and CBSA and CSARL and CFSA exchanged a Letter Agreement pursuant to which they memorialized their agreements as of 1/1/01 regarding implementation and interpretation of the MSA during the Systems Modification Period (which was defined as the period beginning 1/1/01 and ending when the information and accounting systems were modified to reflect the legal relationship contemplated by the MSA, which date was 7/30/01).	
Transaction <i>EAME</i>	Effective as of 1/1/01 , CAT, CSARL and CBSA entered into a Caterpillar Products Tripartite Agreement pursuant to which a license agreement effective as of 2 October 1967, as amended from time to time, by and between CAT and CBSA was cancelled.	
Transaction <i>EAME</i>	Effective as of 1/1/01 , CAT, CSARL and CFSA entered into a Caterpillar Products Tripartite Agreement pursuant to which a license agreement effective as of 30 March 1961, as amended from time to time, by and between CAT and CFSA was cancelled.	
Transaction <i>COFA 2001</i>	On 8/14/01 , CHS was merged into COCCSA and COIHSARL was converted to COIHSARL.	
Transaction <i>COFA 2001</i>	Effective 8/18/01 , a Form 8832 was filed to treat COIHSARL as a disregarded entity, and as a result, COIHSARL was liquidated into COCCSA for United States tax purposes effective 8/17/01.	
Transaction <i>COFA 2001</i>	On 8/21/01 , CSARL distributed the shares CAT Holdings Australia and Caterpillar (Bermuda) Ltd. to COCCSA.	
Transaction <i>CACO</i>	On 8/22/01 , Caterpillar Americas Co. (" <i>CACO</i> ") formed Caterpillar Americas S.A.R.L. (" <i>CAmSARL</i> ") under the laws of Switzerland as a société à responsabilité limitée. ¹⁴	

¹¹ **Effective as of 1/1/01**, CAT and CBSA; and CAT and CFSA entered into **Engineering Services Agreements**, pursuant to which CBSA and CFSA agreed to provide certain engineering related services to CAT.

¹² **Effective as of 1/1/01**, CSARL and CBSA and CSARL and CFSA entered into **Engineering Maintenance Services Agreements** pursuant to which CBSA and CFSA agreed to provide CSARL engineering services for alterations of products manufactured by CSARL and processes relating thereto.

¹³ There were a number of other agreements executed in connection with the EAME transaction. An index to these agreements is attached as Exhibit B.

¹⁴ A Form 8832 was filed to treat CAmSARL as a disregarded entity for federal income tax purposes as of the date of its formation.

Transaction <i>COFA 2001</i>	Effective 8/27/01 , CAT Holdings Australia converted into a proprietary company and officially became known as Caterpillar Holdings Australia Pty. Ltd.	
Transaction <i>COFA 2001</i>	Effective 9/1/01 , a check-the-box election was made to treat CAT Holdings Australia as a disregarded entity, and as a result, CAT Holdings Australia was liquidated for United States tax purposes on 8/31/01.	
Transaction <i>COFA 2001</i>	Effective 9/7/01 , COFA and its wholly-owned subsidiary, Caterpillar Commercial Australia, an Australian company treated as a corporation for U.S. federal tax purposes, converted into a proprietary companies.	
Transaction <i>CACO</i>	On 9/19/01 , CAmSARL (99%) and CSARL (1%) formed Caterpillar Latin America Services SRL as a sociedad de responsabilidad limitada organized under the laws of Costa Rica (" <i>CLASS</i> "). ¹⁵	
Transaction <i>COFA 2001</i>	Effective 10/01/01 , a Form 8832 was filed to treat COFA as a disregarded entity of COCCSA and as a result, COFA was liquidated into COCCSA for United States tax purposes on 9/30/01.	
Transaction <i>CACO</i>	On 10/10/01 , CAmSARL (99.967%) and CSARL (.033%) formed Caterpillar Americas Mexico, S. de R.L. de C.V. as a limited liability partnership with variable capital organized under the laws of Mexico (" <i>CAMX</i> "). ¹⁶	
Transaction <i>CACO</i>	On 11/1/01 , CAmSARL (99.99%) and CSARL (.01%) formed Caterpillar Brasil Services S-C Ltda as a sociedade civil por quotas de responsabilidade limitada organized under the laws of Brazil (" <i>CBSL</i> "). ¹⁷	
Transaction <i>CACO</i>	On 11/12/01 , CLASS (99.967%) and CAmSARL (.033%) formed Caterpillar Latin America Services de Mexico, S. de R.L. de C.V. as a limited liability partnership with variable capital organized under the laws of Mexico (" <i>CLASM</i> "). ¹⁸	
Transaction <i>CACO</i>	On 11/21/01 , CLASS (99.9%) and CAmSARL (.1%) formed Caterpillar Latin America Servicios de Chile Ltda. as a sociedad de responsabilidad limitada organized under the laws of Chile (" <i>CLASC</i> "). ¹⁹	
Transaction <i>CACO</i>	Pursuant to a Share Transfer Agreement and Stock Power , dated as of 11/21/01 and effective as of 11/30/01, Caterpillar transferred all of the 1,460,788 issued and shares in COSA to CACO. ²⁰ For tax purposes it was determined that the transfer of these shares was effective 11/21/01 .	

¹⁵ A Form 8832 was filed to treat CLASS as a disregarded entity for federal income tax purposes effective at the time when CSARL owned 100% of CAmSARL, thus making CLASS a disregarded entity.

¹⁶ A Form 8832 was filed to treat CAMX as a disregarded entity for federal income tax purposes. The election was made effective at the time when CSARL owned 100% of CAmSARL, thus making CAMX a disregarded entity.

¹⁷ A Form 8832 was filed to treat CBSL as a disregarded entity for federal income tax purposes. The election was made effective at the time when CSARL owned 100% of CAmSARL, thus making CBSL a disregarded entity.

¹⁸ A Form 8832 was filed to treat CLASM as a disregarded entity for federal income tax purposes.

¹⁹ A Form 8832 was filed to treat CLASC as a disregarded entity for federal income tax purposes.

²⁰ Caterpillar owned 100% of CACO both before and after the transfer of the COSA stock.

Transaction <i>CACO</i>	On 11/29/01, CLASS and CLASM formed Caterpillar Latin America Services de Puerto Rico, S. en C. as a limited co-partnership organized under the laws of Puerto Rico ("CLASP"). ²¹	
Transaction <i>CACO</i>	Effective 11/30/01, and pursuant to a Contribution in Kind Agreement dated November 26, 2001 and an Assignment Agreement dated November 30, 2001 and in consideration for a CHF 780,000 increase in the nominal value of the share of CACO in CAMSARL's capital, CACO transferred tangible and intangible assets (including Dealer Contracts and Purchase Orders) related to its business of selling Caterpillar products in the Caribbean, Central America, Mexico and South America to CAMSARL. Additionally, CACO transferred to CAMSARL its interest in Forchester de Brasil Ltda., Forchester International, S.A. and Forchester del Peru S.R.L.	
Transaction <i>CACO</i>	Effective 11/30/01, CACO transferred its shares in CAMSARL to CSARL in exchange for an interest in CSARL.	
Transaction <i>CACO</i>	Effective 11/30/01, CACO transferred the interest in CSARL to COSA in exchange for 49,485 common shares of COSA.	
Transaction <i>CACO</i>	CAT and CSARL entered into a First Amended and Restated License Agreement ("First Amended and Restated Bundled License Agreement") which effective 12/1/01, expanded the definition of CSARL Territory to include the following territories associated with Caterpillar Americas S.A.R.L.: Caribbean, Central America, Mexico and South America.	
Transaction <i>CACO</i>	Effective 12/1/01, CSARL, Caterpillar and CAMSARL entered into The Interim Parts Agreement which memorialized the understanding among the parties that Caterpillar will hold certain inventory in its U.S. warehouses as CSARL's consignee.	
Transaction <i>CACO</i>	Effective 12/4/01, COSA transferred certain interests in CSARL that it received from CACO in the 11/30/01 transaction, described above as a contribution in kind, to CCH (which received the Common C interest in exchange for 20 shares of CHF 1,000 par value) and to COCCSA (which received the A, D, and E Class Interests in exchange for 400 shares of CHF 100 par value). Effective 12/4/01 and after the transfer described immediately above, COCCSA transferred the Class E Interest that it received from COSA to COIHSARL in exchange for an increase in the nominal share value of its single share from CHF 100,000 to CHF 120,000..	
Transaction <i>Class Cs (Refinancing Loan Agreement Due to EAME)</i>	During November 2002, CSARL ("Borrower") and Caterpillar Group Services S.A., ²² ("CGS or Lender") entered into an Intercompany Loan Agreement as of 1/1/02 (the "Refinancing Loan Agreement") under which Borrower obtained a loan from Lender (the "Refinancing Loan") that was used to repay the loan made to Borrower under the Original Loan Agreement.	

²¹ A Form 8832 was filed to treat CLASP as a disregarded entity for federal income tax purposes.

²² CGS is a company organized under the laws of Belgium with a registered office at Avenue Des Etats Unis 1, B-6041; Gosseles, Belgium.

Transaction <i>CACO – Canada</i>	On 7/16/02 , CACO formed Caterpillar North America S.A.R.L. ("CNAmS") under the laws of Switzerland as a société à responsabilité limitée. ²³	
Transaction <i>CACO – Canada</i>	On 7/22/02 , Caterpillar transferred 100% of the shares of Caterpillar Commercial Services Ltd. ("CCSL") and Caterpillar of Canada Ltd. ("CCA Ltd.") to CACO.	
Transaction <i>CACO – Canada</i>	On 7/23/02 , CACO transferred 100% of the shares of CCSL and CCA Ltd. to COSA in exchange for ____.	
Transaction <i>CACO – Canada</i>	On 8/1/02 , Caterpillar of Canada Corporation ("CCAC") was formed as a subsidiary of COSA through an amalgamation of CCSL, CCA Ltd. and an unnamed Nova Scotia Unlimited Liability Company ²⁴ under Canadian law.	
Transaction <i>CACO – Canada</i>	<p>Effective 8/30/02, and prior to the transfers described below, CACO transferred to CNAmS transferred tangible and intangible assets (including Dealer Contracts and Purchase Orders) necessary to conduct business with Canadian dealers.²⁵ In exchange for this contribution in kind, CNAmS shall increase the nominal value of the share of CACO in its share capital by CHF 150'000.- from CHF 20'000.- up to an amount of CHF 170'000.</p> <p>Effective 8/30/02, CACO transferred its share in CNAmS to CSARL in exchange for an interest in CSARL.</p> <p>Effective 8/30/02, COSA transferred 6,650,000 shares of CCAC to CSARL in exchange for an interest in CSARL.</p> <p>Effective 8/30/02, CACO transferred its interest in CSARL to COSA in exchange for 5'412 new registered shares of COSA each with a nominal value of CHF 100.- and fully paid up;</p> <p>Effective 8/30/02, COSA transferred portions of the interest in CSARL it received in the above transaction to CCH (which received the Common C Class Interest in exchange for 20 new registered shares of CCH each with a nominal value of CHF 1'000) and to COCCSA (which received the Class A, D and E Class Interests in exchange for in exchange for 400 new registered shares of COCCSA each with a nominal value of CHF 100).</p> <p>Effective 8/30/02, COCCSA transferred the Class E Interest it received above to COIHSARL. In consideration for this contribution in kind COCCSA had the nominal value of its registered share of COIHSARL increased from CHF 120'000.- to CHF 140'000.</p>	

²³ A Form 8832 was filed to treat CNAmS as a disregarded entity for U.S. federal income tax purposes, effective as of the date of formation.

²⁴ The unnamed Nova Scotia Unlimited Liability Company was formed by CCA Ltd. on July 9, 2002, and remained wholly owned by CCA. Ltd. as of the date of the amalgamation.

²⁵ CNAmS was responsible for the sale of Caterpillar products in Canada. CCAC provided marketing services on behalf of CNAmS pursuant to a marketing service agreement between the parties.

	Effective 8/30/02 , CSARL transferred its 6,650,000 shares of CCAC to CNAmS in exchange for an increase in its registered share in CNAmS.	
Transactions <i>Class C</i> <i>(Combination of Class C-1 and Class C-3)</i> <i>CACO; and</i> <i>CACO-Canada</i>	During November 2002, COSA, CCH, COCCSA and COIHSARL, entered into a Caterpillar SARL Restated Joint Venture Agreement to amend and restate the Fourth Amended And Restated Joint Venture Agreement in order to: <ul style="list-style-type: none"> • effective on dates as specified in the Fourth Amended And Restated JV Agreement, to reflect clarifications of, and corrections to, the Fourth Amended And Restated JV Agreement; • effective 12/1/01, memorialize their understandings and agreements regarding the combination of the Class C-1 Company Activity and the Class C-3 Company Activity; and • effective 12/1/01, memorialize their understandings and agreements regarding the expansion of the CSARL Territory to include the Caribbean, Central America, Mexico and South America; and effective 8/30/02, Canada. 	COCCSA- <ul style="list-style-type: none"> • Class A • Class D COSA- <ul style="list-style-type: none"> • Class B • Combined Class C Preferred: <i>(Combined Class C is a combination of the C-1 and C-3 interests)</i> CCH- <ul style="list-style-type: none"> • Combined Class C Common • Class F- COIHSARL- <ul style="list-style-type: none"> • Class E
Transaction <i>CACO-Canada</i>	CAT and CSARL entered into a Second Amended and Restated License Agreement , which effective 8/30/02 expanded the definition of CSARL Territory to include Canada.	
Transaction <i>Class C</i> <i>(Increased Loan Amounts))</i>	CSARL and CGS entered into an Amended Intercompany Loan Agreement dated 11/29/02 (such amended loan agreement and any and all amendments, schedules and exhibits thereto, and any and all renewals, extensions and/or refinancings thereof, are collectively referred to as the " Loan Agreement ") providing for loans to Borrower (each a " Loan ") up to an increased total amount and amending and restating the Refinancing Loan Agreement. COSA agreed to guarantee CSARL's obligations under the Loan Agreement, on substantially the same terms and conditions as the Original Guaranty by entering into a Guaranty Agreement in favor of the Lender on 29 November 2002 (" COSA Guaranty ").	
Transaction <i>Singapore Branch/ Bermuda Partnership planning</i>	On 12/13/02 , COCCSA and COIHSARL organized Caterpillar Asia Pacific L.P. (" CAPLP's ") as a limited partnership under the laws of Bermuda. A Form 8832 will be filed making an initial entity classification election to treat CAPLP as a corporation for U.S. federal tax purposes will be made effective 12/13/02 . On 12/18/02 , COCCSA, as general partner contributed \$27,000 and COIHSARL, as limited partner, contributed \$1,000 to the capital of CAPLP.	
Transaction <i>Class C -</i> <i>(Preparatory for COSA's Contribution of its CSARL Interest to CCH)</i>	On CCH organized Caterpillar Product Development S.A.R.L. , (" CPDSARL "), a société à responsabilité limitée under the laws of Switzerland; and effective 12/19/02 (the " CPDSARL Contribution Date "), CCH transferred to CPDSARL, as a capital contribution, all of CCH's interest in the Class F Company Activity.	
Transaction <i>Class C -</i>	COCCSA, COSA, CCH COIHSARL, and CPDSARL entered into a First Amendment to Caterpillar SARL Restated Joint Venture Agreement to	COCCSA- <ul style="list-style-type: none"> • Class A

<i>(Prepatory for COSA's Contribution of its CSARL Interest to CCH)</i>	<p>amend the CSARL Restated Joint Venture Agreement to:</p> <ul style="list-style-type: none"> • effective 12/19/02, reflect the admission of CPDSARL as a Partner of CSARL; and • effective 12/19/02, effectuate the transfer and contribution of the Class F Company Activity from CCH to CPDSARL. 	<ul style="list-style-type: none"> • Class D <p>COSA-</p> <ul style="list-style-type: none"> • Class B • Combined Class C Preferred <p>CCH-</p> <ul style="list-style-type: none"> • Combined Class C Common <p>COIHSARL</p> <ul style="list-style-type: none"> • Class E <p>CPDSARL-Class F</p>
Transaction <i>Class C – (COSA's Contribution of its CSARL Interest to CCH)</i>	On 12/23/02 (the " <i>CCH Contribution Date</i> "), COSA transferred to CCH as a capital contribution all of its interests in CSARL and therefore, ceased to be a member/partner of CSARL.	
Transaction <i>Class C – (Replacement of COSA as Guarantor of CSARL's debt to CGS by CCH)</i>	On 12/23/02 , CGS agreed to the substitution of CCH's guaranty for COSA's guaranty under the COSA Guaranty and to the termination of COSA's obligations under the COSA Guaranty effective contemporaneously with the transfer by COSA of its interest in CSARL to CCH.	
Transaction <i>Class C – (COSA's Contribution of its CSARL Interest to CCH and Combination of the Combined Class C Common and Preferred Interests into a single Class C Interest)</i>	COCCSA, CCH, COIHSARL and CPDSARL entered into a Second Amendment to Caterpillar SARL Restated Joint Venture Agreement to amend and restate the Caterpillar SARL Restated Joint Venture Agreement (the " <i>Agreement</i> ") as amended, to: <ul style="list-style-type: none"> • amend and restate the Agreement to reflect clarifications of, and corrections to the Agreement, as so amended; • effective 12/23/02 reflect that COSA ceased to be a member/Partner of CSARL; • effective 12/23/02, effectuate the transfer of all of COSA's interests in CSARL to CCH; and • effective 12/23/02, simplify the agreement as it pertains to the Class C Company Activity so that the terms as they relate to such are the same as those applicable to each other Company Activity. 	<p>COCCSA-</p> <ul style="list-style-type: none"> • Class A • Class D <p>CCH-</p> <ul style="list-style-type: none"> • Class B • Class C (Both the Preferred and Common interests) <p>COIHSARL-</p> <ul style="list-style-type: none"> • Class E <p>CPDSARL-Class F</p>
Transaction <i>Singapore Branch/ Bermuda Partnership Planning</i>	As of 1/1/03 and effective after the APD Contribution (defined below), (i) COCCSA, as general partner of CAPLP, transferred to CAPLP as a contribution in kind and as paid in surplus all the Class G Company Activity (defined below), and (ii) COIHSARL, as a limited partner of CAPLP, transferred to CAPLP as a contribution in kind and as paid in surplus a 1/136 (i.e., .7353%) interest in the Class E Company Activity.	
Transactions <i>Asia Pacific and;</i>	COCCSA, CCH, COIHSARL, CPDSARL and CAPLP entered into a Third Amendment to Caterpillar SARL Restated Joint Venture Agreement to amend and restate the Second Amendment to Caterpillar SARL Restated Joint Venture Agreement to: <ul style="list-style-type: none"> • effective as of 1/1/03, reflect the contribution by COCCSA as paid in surplus to the Singapore branch of CSARL certain sales and distribution assets 	<p>COCCSA-</p> <ul style="list-style-type: none"> • Class A • Class D <p>CCH-</p> <ul style="list-style-type: none"> • Class B • Class C

Singapore Branch/ Bermuda Partnership Planning	<p>activities and liabilities related to the Chinese, Taiwanese and Australian markets ("APD Contribution") and effectuate the establishment of the Class G Company Activity;</p> <ul style="list-style-type: none"> • effective 1/1/03, effectuate transfers of the Class G Company Activity and a 1/136 interest in the Class E Company Activity to CAPLP's Contributed Surplus Account (as defined in the Contribution In Kind Agreement among COCCSA, COIHSARL and CAPLP dated 12/27/02); and • effective 1/1/03 and after the APD Contribution, the admission of CAPLP as a Partner of CSARL. 	<p>COIHSARL-</p> <ul style="list-style-type: none"> • Class E 135/136 <p>CPDSARL-</p> <ul style="list-style-type: none"> • Class F <p>CAPLP-</p> <ul style="list-style-type: none"> • Class G • Class E 1/136
	<p>CAT and CSARL entered into a Third Amended and Restated License Agreement ("<i>Third Amended and Restated Bundled License Agreement</i>") which effective 1/1/03 expanded the definition of CSARL Territory to include: the People's Republic of China; Hong Kong; the Republic of China (Taiwan); Australia, Fiji Islands; New Caledonia; New Zealand; Papua New Guinea; Samoa, American; Solomon Islands; Tahiti and Tonga.</p>	

Exhibit A**CLASS INTERESTS**

“A” CSARL’s income from sales of all PFR Parts (which are generally defined as finished replacement parts purchased directly by CSARL from third party suppliers and effective 7/1/00 includes those from SCM).

“B” CSARL’s income from sales to Dealers within the territory formerly associated with COSA, of replacement parts, machines, components, engines, work tools and other products manufactured by CAT and/or other CAT Affiliates. Also, compensation and commissions received by CSARL that relate to the use of CSARL’s marketing territory; the Geneva office building, and the results of Treasury Functions that are not conducted on behalf of the other Class Interests.

“C-1” The income of CSARL and its Singapore Branch from sales of products related to the 1997 Technologies manufactured by CAT and/or other CAT Affiliates

“C-2” The income of CSARL and its Singapore Branch from sales of products related to the 1998 Technologies manufactured by CAT and/or other CAT Affiliates.

“C-3” The income of CSARL and its Singapore Branch from sales of products related to certain small telescopic materials handles technology acquired from Claas Holdings Limited, manufactured by CAT and/or other CAT Affiliates.

“D” CSARL’s income from sales of everything but PFR Parts and SCM sourced Machines to COFA and to the Singapore Branch and the Singapore Branch’s income from the sale of the same. Also, compensation and commissions received related to use of the Class D Company Activity Territory; the manufacturing assembly assets and activities of CSARL and Disregarded Entity Subsidiaries located in and conducted within the Class D Company Activity Territory; real estate located in Singapore; and the Class D Treasury functions.

“E” CSARL’s income from sales of SCM sourced Machines that are sold to Third Parties, the COFA branch of COCCSA/CHS/COIHSA and the Singapore Branch and the Singapore Branch’s income from the sale of SCM sourced Machines to Third Parties.

“F” CSARL’s income from the sales of replacement parts, machines, components, engines, work tools and other products manufactured by CSARL under the Manufacturing Services Agreements with CAT Belgium and CAT France (“Tolling Product”) and the Singapore Branch’s income from the sale of the same to Third Parties.

“G” The income of CSARL and its Singapore Branch in connection with the acquisition, promotion and sale in the APD Company Activity Territory of PFR Parts.

301

1:09-cv-01208-MMM -BGC # 120-45 Page 15 of 15

Exhibit B

EAME Transaction Documents


CATERPILLAR INC.

EVALUATION OF ARM'S LENGTH PRICING
FOR INTERCOMPANY TRANSACTIONS

Year Ended December 31, 1994

Prepared by Price Waterhouse LLP

FINAL REPORT
April 18, 1996

Price Waterhouse LLP 

Permanent Subcommittee on Investigations

EXHIBIT #4a

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00008634

"Caterpillar, Inc., headquartered in Peoria, Illinois, is the world's largest manufacturer of earthmoving, construction, and materials handling equipment, and a major manufacturer of diesel and natural gas engines and gas turbines.

The [company's] products have a wide variety of uses, including highway, dam, pipeline, and other construction; petroleum, agricultural, industrial, and other applications; and electric power generation systems."

Caterpillar products are sold and serviced principally through a worldwide network of more than 200 independently owned dealers and one company-owned dealership.

This report focuses on intercompany transactions for earthmoving and construction equipment, machines, engines, and production components and replacement parts for these segments. The industrial turbine power systems designed, manufactured, and marketed by Caterpillar's Solar Turbines Inc. subsidiary are not part of this report.

a. Structure

Caterpillar was formed in 1925 by two companies which produced wheel and crawler tractors principally for agricultural uses. Until 1950, all manufacturing was performed in the United States, although there had been overseas sales by the predecessor companies since 1909. Exports represented about 20% of sales by the late 1940's. In the 1950's and 1960's, Caterpillar established manufacturing operations in the United Kingdom, Brazil, Australia, Canada, France, Mexico, and Belgium. The original purpose of these international operations was to overcome barriers such as foreign exchange shortages, tariffs, import controls, and other difficulties in supplying replacement parts to customers. Later, the manufacturing plants were established to enable Caterpillar to provide prime products to users in all parts of the world.

In addition to these manufacturing operations, marketing subsidiaries were established to market product and to provide product support outside the United States Caterpillar Americas Company

(CACO) was established in 1957 to serve the Western Hemisphere;¹⁵ Caterpillar Overseas, S.A. (COSA) was first established in 1957 as Caterpillar Overseas C.A. in Venezuela and was organized and relocated in Switzerland in 1960 to serve the rest of the world outside the U.S. In 1967, Caterpillar Far East, Ltd (CFEL) was formed by COSA to serve Asian markets. In 1994, CFEL became a separate branch of COSA.

Caterpillar has established a number of subsidiary companies generally organized according to their principal function as either marketing and manufacturing companies and, within these, by geographic area of responsibility. For example, Caterpillar Overseas S.A. is the marketing company for Europe, the Middle East, and Africa and is a subsidiary of Caterpillar, Inc. By contrast, Caterpillar France S.A. (Cat France) is a manufacturing subsidiary supplying a range of products across a number of markets.

No corporate entity is "pure" in terms of functions, however. Because of local needs, almost all Caterpillar manufacturing companies perform some marketing, and vice versa. For example, Cat France sells its own manufactured product directly to dealers in France, although COSA performs all of the other marketing functions that enhance Cat France's ability to make these sales. On the other side, the Australian company (Caterpillar of Australia, Ltd -- COFA), predominantly a marketing company, also has a minor manufacturing function, assembling motor graders for its own market.

COSA is the shareholder for many of Caterpillar's foreign manufacturing companies (including Caterpillar's share of overseas joint venture companies) and marketing companies. The remaining companies are generally subsidiaries of Caterpillar, Inc. For the purposes of this transfer price review, the ownership structure of the entities is not as important as the business relationships among them. Our description and analysis focuses on intercompany transactions and the economic

¹⁵ CACO is consolidated with Caterpillar Inc. in the U.S. tax return and hence, is not discussed in detail in the remainder of this report.

functions exercised by each company. The legal structure is not discussed further in this report, except as needed.

b. Product Flow

Generally, Caterpillar product flows from a manufacturing company to a related marketing company, to independent dealers, and finally to end-users. Departure from this flow occurs only when and where conditions require a departure. The following is a brief description of the normal flow of prime products, parts, and components among related Caterpillar companies.

i. Manufacturing

Prime Product. Prime product refers to the completed machines or engines sold by Caterpillar entities to their dealer network. Prime product is manufactured at Caterpillar owned plants or (in a few instances) by a third party manufacturer.

Sourcing for products is generally based on geography, so that the nearest plant that manufactures an item is typically the source of that product for the local marketing company. Because sales volumes for some large machines do not justify multiple manufacturing sites, these machines are usually sourced at a single plant and sold to each of the marketing companies.

Replacement Parts. Caterpillar maintains three primary parts distribution centers serving parts depots worldwide. Morton, IL is headquarters of the Parts & Service Support (P&SS) business unit and the primary parts distribution center for North America; Grimbergen, Belgium is a branch of COSA (and owns the inventory therein); and Singapore sells to dealers in the CFEL region. Thus, P&SS sells the requisite replacement parts to the marketing company, which then sells to dealers, who in turn sell to the customer. In addition, other Caterpillar companies maintain parts depots or facilities in Australia, Brazil, Canada, Mexico, and South Africa.

products or components; production delays for lack of supplies; and missed sales from failures to supply dealers.

The manufacturing companies (Cat Inc., Cat Belgium and Cat France) generally bear the inventory risk for finished product. Cat Inc., COSA and CFEL also have inventory risk for their parts inventories.

5. Purchasing. Purchased materials represent about 60 percent of the manufacturing cost of Caterpillar product, so purchasing is clearly an important activity for Caterpillar manufacturing operations. At the same time, Caterpillar's purchases primarily consist of commodities and components manufactured to Caterpillar specifications. Purchasing per se at Caterpillar is a relatively routine activity, subject to relatively little risk, and is principally the responsibility of manufacturing companies, including the manufacturing operations of Cat Inc, Cat Belgium and Cat France.

6. Manufacturing operations. With more than 20 plants around the world and virtually all of its revenues derived from the sale of manufactured goods, manufacturing operations are a keystone activity. At the same time, given the responsibility within "commercial entities" for overall strategy, technology, manufacturing process design, and cost control, manufacturing operations themselves are best viewed as essential functions that, nevertheless, would command a "normal" manufacturing return if carried out by an unrelated contractor.

7. Quality control. Quality control, too, is important, but the entrepreneurial aspects of quality control at Caterpillar are found in product design and manufacturing process design. Quality control operations are a "routine" manufacturing function. Daily responsibility for quality control rests with the commercial entities and manufacturing companies.

8. Parts distribution. Parts distribution is one of Caterpillar's most important competitive advantages in the marketplace. Caterpillar's guarantee to deliver parts anywhere in the world on very short

notice enables it sell more machines, since customers know that they will not be idled long by missing parts. The parts distribution function at Caterpillar, is very closely associated with the marketing functions because of its strategic importance in sales and aftermarket services.

Caterpillar operates a network of parts distribution centers, parts depots, and other parts facilities around the world. Parts distribution, and ownership of parts facilities rests principally with the marketing companies. The major parts distribution center is located at Morton, Illinois, which is part of Cat Inc. The two other major parts distribution centers belong to COSA and CFEL. COFA maintains a large parts depot.

c. Marketing Functions

Caterpillar does not market and sell directly to end users, but is rather like automotive companies that sell to unrelated dealers, who in turn sell to the customer. Thus, Caterpillar's marketing operations, as distinct from marketing strategies, are mainly focused on ways of developing and supporting its dealer network so that dealers can sell more.

1. Market development. Market development functions are aimed at the establishment, maintenance, and nurturing of Caterpillar's dealer network. Introduction of product improvements, new products, or expansion to new market areas or classes of end customers are also market development functions, in conjunction with dealers.

Cat Inc. has the largest role with regard to market and dealer development, since 1) it has the largest single market, 2) it was the originator of the basic marketing systems and concepts, and 3) it continues to be involved with the development and oversight of worldwide marketing programs and approaches. The marketing companies also have major responsibility for market development; in fact, this is their primary responsibility.

2. Pricing. Pricing has both strategic and tactical components. The strategic economic choice of trading off margins for sales volumes is one that Caterpillar has faced often in recent years, especially in certain product lines and geographical markets. On a micro level, adjustments to pricing may be required to meet local or temporary market conditions, to establish prices for product improvements, or to help dealers in competitive situations.

The "commercial entities" are responsible for worldwide pricing policy for their respective product lines, in conjunction with local market knowledge contributed by the marketing companies. Cat Inc, Cat Belgium, Cat France therefore have predominant roles in establishing pricing policies.

3. After sales service. Caterpillar's after sales service, which includes supporting dealers in the servicing of equipment and the timely provision of parts around the world, is one of its major competitive tools. Caterpillar's role in after-sales service includes developing servicing procedures and standards, technical manuals, technical support and training for dealers, and warranty support.

The dealer network and parts distribution are the two keys to after-sales service. Since the marketing companies are responsible for both, they have responsibility for this important entrepreneurial activity. Cat Inc., as the designer of the system and owner of the Morton parts center, has the greatest strategic role. COSA, CFEL, and COFA undertake substantial activities in this area.

4. Marketing Operations. Caterpillar performs a variety of marketing programs, both at a general corporate level and in cooperation with its dealers. For example, Caterpillar marketing companies advertise directly (and join with dealers in cooperative advertising) develop marketing programs, and conduct marketing education for its dealers. The marketing companies (including Cat Inc.'s NACD) all have complete day-to-day responsibility for marketing.

5. Sales. With the exception of certain kinds of sales such as those to some government financing programs, Caterpillar does not generally sell directly to end users. However, Caterpillar sales

representatives will make joint sales calls with dealers when needed and when the size or importance of the prospective sale warrants.

Actual sales to dealers, as well as the occasional sales to end users, are of course arranged predominantly by the marketing companies, including NACD in Cat Inc. In addition, the manufacturing companies make sales to dealers in their own countries. When manufacturing companies sell directly to dealers, whether in their own country or another, they pay a 5 percent fee to the relevant marketing company as compensation for the services that the marketing company provides.

6. Dealer administration. Maintaining Caterpillar's dealer network requires significant day-to-day effort including visits to dealers by Caterpillar field staff. Providing support to dealers in the area of financial management and financing, for example, are important activities in the overall marketing scheme.

All companies with marketing responsibilities are actively involved in dealer administration. These include Cat Inc. and the three principal marketing companies.

has the incentive to reduce its manufacturing costs, including purchases from other Cat suppliers and third parties, and to design products specific to customers' needs.¹⁸

2. Sale of Parts

Parts & Service Support ("P&SS"), a division of Cat Inc. located in Morton, IL, is charged with managing the worldwide parts distribution network. Intercompany pricing of parts consists of four major components: (1) Sale of Parts to Marketing Companies, (2) Purchase of Parts from Manufacturing Facilities, (3) Compensation to P&SS for its Functions, and (4) Distribution of Residual Parts Profit to Commercial Entities.¹⁹

- **Sale of Parts to Marketing Companies:** Marketing companies purchase parts from P&SS at an **11% discount off Area D/N**. For non-US marketing companies, local D/N is converted to a factor to yield the equivalent discount off US D/N.²⁰ The 11% discount from Area D/N is applied to all marketing companies, and is intended to cover the local marketing company's sales variance, operating expenses²¹ and a 4% return on sales.
- **Purchase of Parts from Manufacturing Facilities:** P&SS purchases parts from manufacturing facilities, or from third party vendors. Parts acquired from manufacturing facilities are purchased at different prices depending on the type of parts:

¹⁸See section 3 below for discussions of the intercompany pricing of production components.

¹⁹For details, see Exhibit III-2.

²⁰The parts inventory and invoicing system is not set up to handle different Area D/Ns, so all intercompany prices are set as a percentage of US D/N.

²¹Estimated as 4% for sales variances and 3% for marketing expenses.

- If the part is a "worked part" (manufactured in a Cat facility), P&SS purchases the part at the established intercompany price for that part when sold as a "production component". As described in more detail below, production components are sold inter-plant at market-based prices, based on quotes from independent suppliers. Therefore, if a replacement part purchased by P&SS is identical to a part used as a production component, the market-based production component price is used as the P&SS acquisition price.
- If the part is a "purchased finished" part (acquired by a Cat manufacturing facility directly from a supplier, and then shipped to a replacement parts warehouse), P&SS purchases the part from the manufacturing facility at the factory's acquisition cost, without a markup. P&SS then pays a procurement fee to the manufacturing facility for its procurement services.²²
- **Compensation to P&SS for its functions:** P&SS incurs expenses in managing the replacement parts system, including principally the operating costs of the warehouses and the P&SS headquarters in Morton (including a world-wide computer system for managing the inventory). Out of the gross margin earned from buying the parts from the facilities, and selling the parts to the marketing entities, P&SS earns a fee calculated as its direct operating costs plus 10% of the "enterprise profit" earned on the sale of the parts.²³ As P&SS is a division of Cat Inc, a US entity, this share remains part of the taxable income of Cat Inc.
- **Distribution of Parts Residual Profit to Commercial Entities:** After paying the P&SS fee, the residual profit is allocated to the commercial entities responsible for

²²This procedure happened in the COSA division in 1994. In future years, Cat Inc. (P&SS) will purchase finished parts directly from the vendor for resale to the marketing companies.

²³See Exhibit III-2 for details.

**CATERPILLAR INC.
EVALUATION OF ARM'S LENGTH
PRICING FOR INTERCOMPANY
TRANSACTIONS**

Year Ended December 31, 1995

Prepared by Price Waterhouse LLP

**FINAL REPORT
December 19, 1996**

**Permanent Subcommittee on Investigations
EXHIBIT #4b**

Price Waterhouse LLP 

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00008881

**1995 Documentation
FINAL REPORT**

6. Manufacturing operations. With more than 20 plants around the world and virtually all of its revenues derived from the sale of manufactured goods, manufacturing operations are a critical activity. At the same time, given the responsibility within "commercial entities" for overall strategy, technology, manufacturing process design, and cost control, manufacturing operations themselves are best viewed as essential functions that, nevertheless, would command a "normal" manufacturing return if carried out by an unrelated contractor.

7. Quality control. Quality control, too, is important, but the entrepreneurial aspects of quality control at Caterpillar are found in product design and manufacturing process design. Quality control operations are a "routine" manufacturing function. Daily responsibility for quality control rests with the commercial entities and manufacturing companies.

8. Parts distribution. Parts distribution is one of Caterpillar's most important competitive advantages in the marketplace. Caterpillar's guarantee to deliver parts anywhere in the world on very short notice enables it sell more machines, since customers know that they will not be idled long by missing parts. The parts distribution function at Caterpillar is very closely associated with the marketing functions because of its strategic importance in sales and aftermarket services.

Caterpillar operates a network of parts distribution centers, parts depots, and other parts facilities around the world. Parts distribution, and ownership of parts facilities rests principally with the marketing companies. The major parts distribution center is located at Morton, Illinois, which is part of Cat Inc. The two other major parts distribution centers belong to COSA and COSA-Sing. COFA maintains a large parts depot.

c. Marketing Functions

Caterpillar does not market and sell directly to end users, but is rather like automotive companies that sell to unrelated dealers, who in turn sell to the customer. Thus, Caterpillar's marketing

operations, as distinct from marketing strategies, are mainly focused on ways of developing and supporting its dealer network so that dealers can sell more.

1. Market development. Market development functions are aimed at the establishment, maintenance, and nurturing of Caterpillar's dealer network. Introduction of product improvements, new products, or expansion to new market areas or classes of end customers are also market development functions, in conjunction with dealers.

Cat Inc. has the largest role with regard to market and dealer development, since 1) it has the largest single market, 2) it was the originator of the basic marketing systems and concepts, and 3) it continues to be involved with the development and oversight of worldwide marketing programs and approaches. The marketing companies also have major responsibility for market development; in fact, this is their primary responsibility.

2. Pricing. Pricing has both strategic and tactical components. The strategic economic choice of trading off margins for sales volumes is one that Caterpillar has faced often in recent years, especially in certain product lines and geographical markets. On a micro level, adjustments to pricing may be required to meet local or temporary market conditions, to establish prices for product improvements, or to help dealers in competitive situations.

The "commercial entities" are responsible for worldwide pricing policy for their respective product lines, in conjunction with local market knowledge contributed by the marketing companies. Cat Inc, Cat Belgium, Cat France therefore have predominant roles in establishing pricing policies.

3. After sales service. Caterpillar's after sales service, which includes supporting dealers in the servicing of equipment and the timely provision of parts around the world, is one of its major competitive tools. Caterpillar's role in after-sales service includes developing servicing procedures and standards, technical manuals, technical support and training for dealers, and warranty support.

**1995 Documentation
FINAL REPORT**

The dealer network and parts distribution are the two keys to after-sales service. Since the marketing companies are responsible for both, they have responsibility for this important entrepreneurial activity. Cat Inc., as the designer of the system and owner of the Morton parts center, has the greatest strategic role. COSA, COSA-Sing, and COFA undertake substantial activities in this area.

4. Marketing Operations. Caterpillar performs a variety of marketing programs, both at a general corporate level and in cooperation with its dealers. For example, Caterpillar marketing companies advertise directly (and join with dealers in cooperative advertising) develop marketing programs, and conduct marketing education for its dealers. The marketing companies (including Cat Inc.'s NACD) all have complete day-to-day responsibility for marketing.

5. Sales. With the exception of certain kinds of sales such as those to some government financing programs, Caterpillar does not generally sell directly to end users. However, Caterpillar sales representatives will make joint sales calls with dealers when needed and when the size or importance of the prospective sale warrants.


Actual sales to dealers, as well as the occasional sales to end users, are of course arranged predominantly by the marketing companies, including NACD in Cat Inc. In addition, the manufacturing companies make sales to dealers in their own countries. When manufacturing companies sell directly to dealers, whether in their own country or another, they pay a 5 percent fee to the relevant marketing company as compensation for the services that the marketing company provides.

6. Dealer administration. Maintaining Caterpillar's dealer network requires significant day-to-day effort including visits to dealers by Caterpillar field staff. Providing support to dealers in the area of financial management and financing, for example, are important activities in the overall marketing scheme.

**1995 Documentation
FINAL REPORT**

All companies with marketing responsibilities are actively involved in dealer administration. These include Cat Inc. and the three principal marketing companies.

PARTS PROFIT DISTRIBUTION CONCEPTS		
PROFIT CENTER	PARTS PROFIT DISTRIBUTION OBJECTIVES	METHODOLOGY
MARKETING ORGS	Motivate to maximize parts POPS & price realization	Distribute a % of parts sales
PRIME PRODUCT PROFIT CENTERS	Motivate to create machine populations with high degree of proprietary components which have high parts margins & high POPS	Distribute a portion of residual profit
COMPONENT PROFIT CENTERS	Motivate to develop differentiated & proprietary components for prime products which are profitable for profit centers & the enterprise	Mfg parts: market-based transfer prices Pur parts: distribute a portion of residual profit
MANUFACTURING PLANTS	Motivate to lower plant costs	Market-based transfer prices
P&SS	Motivate to: 1) Drive overall parts profit 2) Achieve acceptable ROA (on \$1.5B in assets) 3) Keep owning & operating costs of CAT equipment best value in the industry	Distribute a % of enterprise profit



Price Waterhouse LLP

PARTS PROFIT DISTRIBUTION

PARTS PROFIT RECIPIENTS

	PORTION OF TOTAL
MARKETING:	4 %
CACO CFEL COSA	
CBSA COFA NACD	
ENGINE DIVISION CPI	
MANUFACTURING PLANTS:	3 %
ALL US MFG PLANTS	
ALL SUB MFG PLANTS	
COMPONENT PROFIT CENTERS:	4 %
CHEM PRODUCTS TRANSMISSIONS	
HYDRAULICS UNDERCARRIAGE	
ENGINE DIV (for captive engines)	
COMMERCIAL ENTITIES:	16 %
44 PRODUCT GROUPS	
P&SS	3 %
TOTAL	30 %

PARTS PROFIT DISTRIBUTION

RULES FOR SHARING RESIDUAL PROFIT BETWEEN
COMPONENT PROFIT CENTERS AND COMMERCIAL ENTITIES

TYPE OF PART	PURCHASED PART		WORKED PART	
	COMPONENT		COMPONENT	
	PROFIT CENTER	COMMERCIAL ENTITY	PROFIT CENTER	COMMERCIAL ENTITY
CHEMICAL PRODUCT	60 % a)	40 %	0 % b)	100 %
HYDRAULIC	60 % a)	40 %	0 % b)	100 %
TRANSMISSION	60 % a)	40 %	0 % b)	100 %
UNDERCARRIAGE	20 % a)	80 %	0 % b)	100 %
ENGINE				
– CAPTIVE	80 %	20 %	80 %	20 %
– COMMERCIAL	0 %	100 %	0 %	100 %
ALL OTHER	0 %	100 %	0 %	100 %

Comments:

- a) Identification of purchased part for which component profit center receives a % of residual profit is done by design control.
- b) Component profit center obtains its profit in the transfer price to P&SS

320

CATERPILLAR INC.
EVALUATION OF ARM'S LENGTH PRICING FOR
INTERCOMPANY TRANSACTIONS

Year Ended December 31, 1996

FINAL DRAFT REPORT

Prepared by Price Waterhouse LLP

January 26, 1998

Permanent Subcommittee on Investigations
EXHIBIT #4c

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00009105

1996 Documentation
FINAL DRAFT

P&SS, a division of Cat Inc. The major parts distribution center is located at Morton, Illinois, which is part of Cat Inc. The two other major parts distribution centers are part of COSA (located in Grimbergen, Belgium) and COSA-Sing (located in Singapore). COFA maintains a large parts depot. In these non-US parts facilities, the inventory is controlled by P&SS, although it is owned for legal purposes by the marketing companies. The intercompany price for the sale of spare parts from P&SS to the marketing companies includes a component for the interest costs of the marketing companies' ownership of the parts.

c. Marketing Functions

Caterpillar does not market and sell directly to end users, but is rather like automotive companies that sell to unrelated dealers, who in turn sell to the customer. Thus, Caterpillar's marketing operations, as distinct from marketing strategies, are mainly focused on ways of developing and supporting its dealer network so that dealers can sell more.

1. Market Development. Market development functions are aimed at the establishment, maintenance, and nurturing of Caterpillar's dealer network. Introduction of product improvements, new products, or expansion to new market areas or classes of end customers are also market development functions, in conjunction with dealers.

Cat Inc. has the largest role with regard to market and dealer development, since 1) it has the largest single market, 2) it was the originator of the basic marketing systems and concepts, and 3) it continues to be involved with the development and oversight of worldwide marketing programs and approaches. The marketing companies also have major responsibility for market development; in fact, this is their primary responsibility.

2. Pricing. Pricing has both strategic and tactical components. The strategic economic choice of trading off margins for sales volumes is one that Caterpillar has faced often in recent years, especially in certain product lines and geographical markets. On a micro level,

II-23

adjustments to pricing may be required to meet local or temporary market conditions, to establish prices for product improvements, or to help dealers in competitive situations.

The "commercial entities" are responsible for worldwide pricing policy for their respective product lines, in conjunction with local market knowledge contributed by the marketing companies. Cat Inc., Cat Belgium, Cat France therefore have predominant roles in establishing pricing policies.

3. After Sales Service. Caterpillar's after sales service, which includes supporting dealers in the servicing of equipment and the timely provision of parts around the world, is one of its major competitive tools. Caterpillar's role in after-sales service includes developing servicing procedures and standards, technical manuals, technical support and training for dealers, and warranty support.

The dealer network and parts distribution are the two keys to after-sales service. The marketing companies have responsibility for the dealer network, while P&SS performs the primary management activity for the parts distribution network. Cat Inc., as the designer of the system and owner of the Morton parts center, has the greatest strategic role. COSA, COSA-Sing, and COFA undertake substantial activities in this area.

4. Marketing Operations. Caterpillar performs a variety of marketing programs, both at a general corporate level and in cooperation with its dealers. For example, Caterpillar marketing companies advertise directly (and join with dealers in cooperative advertising) develop marketing programs, and conduct marketing education for its dealers. The marketing companies (including Cat Inc.'s NACD) all have complete day-to-day responsibility for marketing.

Caterpillar, Inc.

1997 Documentation Report

Final Report

September 15, 1998

Prepared by:
PricewaterhouseCoopers LLP

Permanent Subcommittee on Investigations
EXHIBIT #4d

PRICEWATERHOUSECOOPERS

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00009339

it is owned for legal purposes by the marketing companies. The intercompany price for the sale of spare parts from P&SS to the marketing companies includes a component for the interest costs of the marketing companies' ownership of the parts.

c. Marketing Functions

Caterpillar does not market and sell directly to end users, but is rather like automotive companies that sell to unrelated dealers, who in turn sell to the customer. Thus, Caterpillar's marketing operations, as distinct from marketing strategies, are mainly focused on ways of developing and supporting its dealer network so that dealers can sell more.


1. Market Development. Market development functions are aimed at the establishment, maintenance, and nurturing of Caterpillar's dealer network. Introduction of product improvements, new products, or expansion to new market areas or classes of end customers are also market development functions, in conjunction with dealers.

Cat Inc. has the largest role with regard to market and dealer development, since 1) it has the largest single market; 2) it was the originator of the basic marketing systems and concepts; and 3) it continues to be involved with the development and oversight of worldwide marketing programs and approaches. The marketing companies also have major responsibility for market development; in fact, this is their primary responsibility.

2. Pricing. Pricing has both strategic and tactical components. The strategic economic choice of trading off margins for sales volumes is one that Caterpillar has faced often in recent years, especially in certain product lines and geographical markets. On a micro level, adjustments to pricing may be required to meet local or temporary market conditions, to establish prices for product improvements, or to help dealers in competitive situations.

The "commercial entities" are responsible for worldwide pricing policy for their respective

II-24

PRICEWATERHOUSECOOPERS 

**1997 Documentation
Final Report**

product lines, in conjunction with local market knowledge contributed by the marketing companies. Therefore, Cat Inc., Cat Belgium, and Cat France have predominant roles in establishing pricing policies.

3. After Sales Service. Caterpillar's after sales service, which includes supporting dealers in the servicing of equipment and the timely provision of parts around the world, is one of its major competitive tools. Caterpillar's role in after sales service includes developing servicing procedures and standards, technical manuals, technical support, training for dealers, and warranty support.


The dealer network and parts distribution are the two keys to after sales service. The marketing companies have responsibility for the dealer network, while P&SS performs the primary management activity for the parts distribution network. Cat Inc., as the designer of the system and owner of the Morton parts center, has the greatest strategic role. COSA, COSA-Sing, and COFA undertake substantial activities in this area.

4. Marketing Operations. Caterpillar performs a variety of marketing programs, both at a general corporate level and in cooperation with its dealers. For example, Caterpillar marketing companies advertise directly (and join with dealers in cooperative advertising), develop marketing programs, and conduct marketing education for its dealers. The marketing companies (including Cat Inc.'s NACD) all have complete day-to-day responsibility for marketing.

5. Sales. With the exception of certain kinds of sales such as those to some government financing programs, Caterpillar does not generally sell directly to end users. However, Caterpillar sales representatives will make joint sales calls with dealers when needed and when the size or importance of the prospective sale warrants.

Actual sales to dealers, as well as the occasional sales to end users, are of course arranged predominantly by the marketing companies, including NACD in Cat Inc. In addition, the

11-25

PRICEWATERHOUSECOOPERS 

**1997 Documentation
Final Report**

manufacturing companies may in some instances make sales to dealers in their own countries. When manufacturing companies sell directly to dealers, whether in their own country or another, they pay a 5 percent fee to the relevant marketing company as compensation for the services that the marketing company provides.

6. Dealer Administration. Maintaining Caterpillar's dealer network requires significant day-to-day effort including visits to dealers by Caterpillar field staff. Providing support to dealers in the area of financial management and financing, for example, are important activities in the overall marketing scheme.

All companies with marketing responsibilities are actively involved in dealer administration. These include Cat Inc. and the three principal marketing companies.

Final Report

Caterpillar

Fiscal Year 2000 U.S. Transfer Pricing Documentation Report

September 17, 2001

PRICEWATERHOUSECOOPERS

Permanent Subcommittee on Investigations
EXHIBIT #5

**2000 Documentation
Final Report**

The original purpose of these international operations was to overcome barriers such as foreign exchange shortages, tariffs, import controls, and other difficulties in supplying replacement parts to customers. Later, manufacturing plants were established to enable Caterpillar to provide prime products to users in all parts of the world.

In addition to these manufacturing operations, marketing subsidiaries were also established to market product and to provide product support outside the United States. Cat marketing companies distribute Cat products – both prime product and replacement parts – through a network of independent dealers. As a general rule, there is one dealer per country, and each dealer has an exclusive territory.

Cat's dealers have been associated with Caterpillar products for an average of approximately 50 years. This longevity of the commercial relationship is considered by Cat to be a very important business advantage. Cat believes that critical aspects of its dealers – aspects that give Cat marketing companies a competitive advantage over their competitors – include the dealers' financial strength and size; their physical presence (e.g., the German dealer has over 40 branch locations in Germany); the capabilities of their sales force, technicians, and engineers; their loyalty to Caterpillar; and their stability, as reflected in the longevity of the dealerships.

Caterpillar dealers earn revenue from three interrelated activities: prime product sales, replacement parts sales, and service sales.

The remainder of this chapter describes in greater detail: the types of entities that have evolved within Cat, the entities tested in this report, and the transactions under review.

B. Summary of Entities1. Principal Types of Entities

Caterpillar operations are organized into various entities. Each entity can normally be characterized as containing entrepreneurial activities, marketing activities, or supplier factory activities, or any combination thereof. Below is a description of each primary type of entity.

a. Entrepreneurial

Entrepreneurs either own the intangibles used to manufacture product or they license the intangibles employed from another Cat entity.⁹ Entrepreneurial entities have primary responsibility for developing and implementing product strategy for their designated product lines. This responsibility includes: design of the product to meet market demands, responsibility for manufacturing product, and (jointly with the relevant marketing company) developing a marketing strategy including the establishment of prices in each of the primary markets around the world. Entrepreneurial entities are responsible for the manufacture of their products, either directly in their own manufacturing facilities or through supplier relationships with other Caterpillar facilities.

Entrepreneurial entities are charged with designing and manufacturing products at the lowest cost, and positioning sales in the market at the highest price and volume, in order to maximize profits of the entrepreneurial entity.

b. Marketing Companies

Caterpillar marketing entities maintain dealer relationships, purchase product from

⁹ All research and development expenses are borne by the technology owner.

The entrepreneurial entities have primary responsibility for setting Caterpillar's market strategy for their products. Cat Inc. has the primary responsibility for market strategy for products manufactured in Cat Inc. factories. Similarly, Cat SARL has a major role in setting market strategy for products manufactured by Cat Belgium and Cat France. Cat SARL also is engaged in establishing market strategy for its product lines. The marketing companies, too, play a role in setting market strategy for their territories, especially with regard to advertising, marketing, and dealer relationships.

For example, Cat SARL is responsible for determining market strategy in its region. Cat SARL evaluates competitors and competitor offerings in each of the countries in its territory and uses this information to set local area prices, dealer promotions, advertising goals, and product positioning. Cat SARL also evaluates dealer operations, including equipment sales, part sales, and after-sales service. Cat SARL assists dealers in determining which parts of their businesses to emphasize and market to customers.

Market Development. Market development functions are aimed at the establishment, maintenance, and nurturing of Caterpillar's dealer network. Expansion to new market areas or new classes of end customers are also market development functions, in conjunction with dealers.

The marketing companies (including Cat Inc. for the US market) have the primary responsibility with regard to market and dealer development. Cat SARL, for example, has both local area representatives, who are responsible for maintaining local dealer relationships, and product groups, which contain experts on products and competitors. The local area representatives directly assist dealers with dealer-specific issues such as assistance on sales calls, delivery or service issues, and communication of Caterpillar objectives. The product groups provide expertise on specific product issues such as highlighting technical differences between Caterpillar and competitor products or providing detailed advice on which products are most appropriate for specific

**2000 Documentation
Final Report**

applications. Cat SARL also supports a sales and demonstration facility in Malaga, Spain where dealers may bring their customers to observe Caterpillar equipment in action. Approximately 150-200 customers per day visit the Malaga facility.

Pricing. Pricing has both strategic and tactical components. The strategic economic choice of trading off margins for sales volumes is one that Caterpillar has faced often in recent years, especially in certain product lines and geographical markets. On a micro level, adjustments to pricing may be required to meet local or temporary market conditions, to establish prices for product improvements, or to help dealers in competitive situations.

The entrepreneurial entities are responsible for worldwide pricing policy for their respective product lines, in conjunction with local market knowledge contributed by the marketing companies. Therefore, Cat Inc. and Cat SARL have predominant roles in establishing pricing policies.

The marketing companies also have input into their local area dealer net prices. Cat SARL, for example, can recommend a change to base prices in certain countries with significant competitive price pressures or unusual market conditions. Any base price changes, however, have to be approved by the entrepreneurial entity responsible for the product. Alternatively, Cat SARL may decide to offer promotional pricing or merchandising programs; these discounts are reflected as Cat SARL's sales variance.

Marketing and Sales Operations. Caterpillar performs a variety of marketing programs, both at a general corporate level and in cooperation with its dealers. For example, Caterpillar marketing companies advertise directly (and join with dealers in cooperative advertising), develop marketing programs, and conduct marketing education for its dealers. The marketing companies all have significant day-to-day responsibility for marketing.

**2000 Documentation
Final Report**

With the exception of certain kinds of sales such as those to some government financing programs and some direct engine sales to large manufacturers, Caterpillar does not generally sell directly to end users. However, Caterpillar sales representatives will make joint sales calls with dealers when needed and when the size or importance of the prospective sale warrants.

Actual sales to dealers, as well as the occasional sales to end users, are of course arranged predominantly by the marketing companies. In addition, the manufacturing companies may in some instances make sales to dealers in their own countries. When manufacturing companies sell directly to dealers, whether in their own country or another, they pay a commission to the relevant marketing company as compensation for the services that the marketing company provides.

Dealer Administration and After-Sales Service. Maintaining Caterpillar's dealer network requires significant day-to-day effort including visits to dealers by Caterpillar field staff. Providing support to dealers in the area of financial management and financing, for example, are important activities in the overall marketing scheme.

All companies with marketing responsibilities are actively involved in dealer administration. These include Cat Inc. and the three principal marketing companies. Caterpillar's after sales service, which includes supporting dealers in the servicing of equipment and the timely provision of parts around the world, is one of its major competitive tools. Caterpillar's role in after sales service includes developing servicing procedures and standards, technical manuals, technical support, training for dealers, and warranty support.

The dealer network and parts distribution capabilities are the two keys to after sales service. The marketing companies have responsibility for the dealer network and manage the replacement parts distribution warehousing and activities in their regions. Cat SARL, Cat SARL-Sing, and CofA also employ parts marketing specialists for their regions.

Specific dealer development activities undertaken by Cat SARM, for example, include installation and training on dealer information systems; dealer process improvement assistance (consulting and best practices advice on sales, parts, service, tools, etc.); and dealer business and financial assistance (reviewing dealer business plans and financial results, benchmarking dealer results against established standards, making recommendations to improve dealer efficiency and profitability, sharing new business opportunities, etc.).

Parts Distribution. Parts distribution is one of Caterpillar's most important competitive advantages in the marketplace. Caterpillar's guarantee to deliver parts anywhere in the world on very short notice enables it to sell more machines, since customers know that they will not be idled by missing parts. The parts distribution function at Caterpillar is very closely associated with the marketing functions because of its strategic importance in sales and aftermarket services.

Caterpillar operates a network of parts distribution centers, and other parts facilities around the world. The major parts distribution center is located in Morton, Illinois, which is part of Cat Inc. Other major parts distribution centers are part of Cat SARM (located in Grimbergen, Belgium) and Cat SARM-Sing (located in Singapore). CofA also maintains a distribution center. In these non-US parts facilities, the inventory is typically owned by the marketing companies.

Marketing companies acquire replacement parts from two sources, Cat Inc. and Cat SARM. Parts manufactured in Caterpillar factories ("worked parts") in the U.S. and in non-European factories (e.g., Cat Mexico and Cat Brasil) are sourced by Cat Inc. Parts acquired for third party vendors ("purchased finished parts") are sourced by Cat SARM. Worked parts destined for sale in the EAME region are sourced by Cat SARM. This latter category includes worked parts produced by Caterpillar's European facilities (Cat Belgium, Cat France, and others).

Cat SARL pays a license fee and various service fees to Cat Inc. related to the purchased finished and European worked replacement parts business.

b. Marketing Risks

Inventory Risk. Inventory risk for finished product remains for a limited period of time with the marketing companies, who hold title only for the time in transit from the factory to the dealer. The factories have minimal inventory risk for finished product since assembly for most product is usually based on dealer orders. Inventory risk for replacement parts rests entirely with the marketing entities, who own the finished parts inventory for their territories.

Foreign Exchange Risk (See 1.2.4 above.) The foreign exchange risk for the marketing operations rests with the marketing companies. Marketing companies hedge their exchange rate exposure on an annual basis against changes in local currencies vs. the US dollar. Most marketing companies purchase in US dollars from related entrepreneurial companies.

c. Marketing Assets

Name. Caterpillar's name and reputation have worldwide recognition. Caterpillar has promoted its name and related trademarks, logos, etc. and defended them as necessary. Development and maintenance of the Caterpillar name, and related trademarks, are performed, or paid for, by Cat Inc. and Cat Inc. owns all rights thereof.

Established Dealer Network The foreign marketing companies hold the dealer contracts. Caterpillar has a network of worldwide dealers that provide sales and service support to customers.

**2000 Documentation
Final Report**

Cat Inc., with assistance from the foreign marketing companies, spends significant resources in supporting and improving the dealer network, through sales and service training, dealer administration support, financial advice, and other programs.

The marketing companies are primarily responsible for maintaining the dealer relationships that form the basis of the dealer network. As detailed above, the marketing companies provide dealer services that range from market strategy and market development to specific business and financial assistance to dealers. Furthermore, the marketing companies receive dealer feedback and work in cooperation with the dealers in order to obtain current market, product, and customer information. In the EAME territory, for example, Cat SARL has dedicated significant resources to dealer development and relationship building. As a result, the average length of a dealer relationship in the EAME territory is more than 45 years and dealer turnover is rare.

E. Conclusion and Characterization of Entities

Based on the information gathered during our functional analysis, we have characterized each entity. Below is a description of our characterization. In addition, we specify which entities have been selected as tested parties.

1. Entities with Combined Manufacturing and Marketing Functions

a. Cat Inc.

Cat Inc. is the parent company and is the most complex entity. Cat Inc. operates as an entrepreneur, a marketer and an intangible owner. Cat Inc. is the parent company of the global enterprise. Since Cat Inc. is the most complex Cat entity it was not selected as a tested party in this report.

b. Cat SARL

Cat SARL is also a complex entity. Cat SARL operates as an entrepreneurial entity, a marketer and a supplier factory. Although Cat SARL is a complex entity, it is a simpler entity than Cat Inc. As a result, we have selected Cat SARL as the tested party for transactions between Cat Inc. and Cat SARL. In Chapter III we will test Cat SARL's results against the results of a set of independent European manufacturers.

2. Marketers*a. Cat SARL-Singapore*

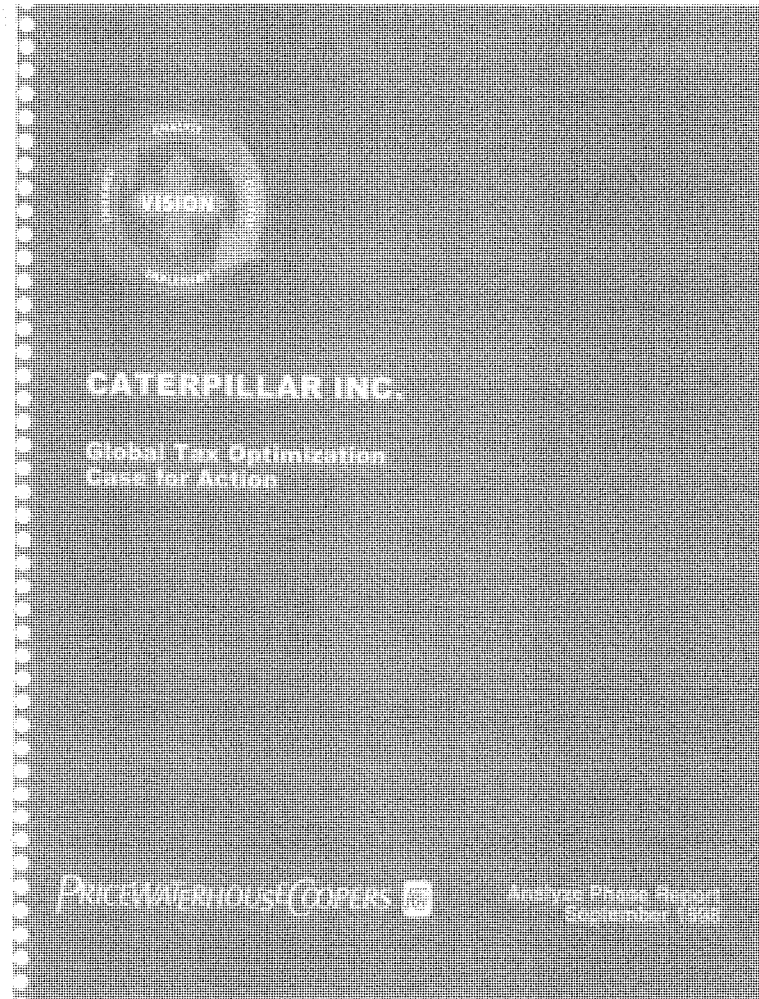
Cat SARL-Singapore is a marketer and will be tested in Chapter IV against a set of independent Asian distributors.

b. CofA

CofA is also a marketer and will be tested in Chapter V against a set of independent Australian distributors.

3. Manufacturers*a. Cat (UK) Ltd.*

Cat (UK) Ltd. is a supplier manufacturer for both Cat Inc. and Cat SARL. Cat (UK) Ltd's compensation from Cat SARL and Cat Inc. is based on the same formula. Accordingly, in Chapter VI we have tested Cat (UK) Ltd.'s results in total against the results of a set of independent European manufacturers.



CONFIDENTIAL

Permanent Indemnification on Reconciliation

PwC-CAT-00000002

EXHIBIT #6

Confidential Treatment Requested by PwC

PwC_PS_CAT_00000002



Table of Contents

	Page
Executive Summary	3
I. Caterpillar Today	
Existing Tax Profile	4
Benchmarking	5
Primary Tax Rate Drivers	6
II. Vision for Caterpillar	
NPV of Cash Savings	8
Improved Financial Measures	9
Best In Class	11
III. Strategy for Caterpillar	
Overview	12
Global Income Migration Strategy	13
Financial Structuring Solutions	17
Jurisdictional Solutions	18
Other Significant Subsidiaries	19
Ideas for Special or Further Consideration	21
IV. Next Steps	
Develop Phase	23
Proposed Timeline	24
Appendices	
Appendix A: Tax Rate Benchmarking	25
Appendix B: Tax and Cash Savings	36
Appendix C: Tax Solutions	37

The Caterpillar income forecasts and related tax assumptions form an integral part of this report

Private & Confidential
Subject to Attorney Client
and/or Work Product Privilege

PRICEWATERHOUSECOOPERS

CONFIDENTIAL

PwC-CAT-00003876

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00004636



Caterpillar Today

Primary Tax Rate Drivers

Substantially all of Caterpillar's income is currently subject to tax in the U.S. or jurisdictions having comparable tax rates (i.e., 35% or higher). As a major exporter, the company benefits from a U.S. tax rate reduction (3.2 percentage points in 1997) on export sales. This benefit is largely offset, however, by state and local income taxes and other adjustments. Thus, the company's Structural Tax Rate (STR) can be viewed as approximately 35%. As noted earlier, operating losses and other one time planning measures have often reduced the company's ETR to below 35% in prior years.

Caterpillar's foreign taxes are not a major STR component as a result of both effective jurisdictional planning and the company's ability to fully utilize foreign tax credits against its U.S. tax. However, based on Caterpillar's current tax operating structure, it will be difficult to sustain a worldwide tax rate much below the U.S. statutory rate of 35%. The single most significant opportunity to reduce Caterpillar's STR is to take advantage of the Company's substantial presence in Switzerland where income is taxed well below 35%.

There are several factors which currently drive Caterpillar's tax rate and/or which will impact the company's opportunity to optimize its tax position.



Positive Tax Rate Drivers

- Swiss substance and low tax rate
- Significant exporter
- Foreign tax credit position
- Illinois-based manufacturing
- Jurisdictional planning (e.g., Australia, U.K., Germany)
- Unrelated dealer network
- Mobility of CAT financial income



Negative Tax Rate Drivers

- U.S. 'centric' profile
- Limited deferral of low-tax earnings
- Manufacturing in high-tax locations (e.g., Italy, Belgium, etc.)
- U.S. ownership of intangibles
- Pre-tax performance metrics
- Market creation fee
- Conformity of tax and management books
- Losses in Asia
- Mexican and other foreign tax planning offset by U.S. tax cost
- Movement of states (other than Illinois) to single sales apportionment factor

Private & Confidential
Subject to Attorney Client
and/or Work Product Privilege

Page 8

PRICEWATERHOUSECOOPERS

CONFIDENTIAL

PwC-CAT-00003680

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00004640



Strategy for Caterpillar

III. Strategy for Caterpillar

Overview

We have developed a strategy that we believe will achieve tax optimization for Caterpillar. This strategy can be summarized as follows:

- ✓ Migrate income from the U.S. to lower-tax jurisdictions
- ✓ Obtain/maintain U.S. tax deferral
- ✓ Maximize export benefits
- ✓ Employ tax effective Treasury strategies
- ✓ Isolate state income in Illinois
- ✓ Utilize intra-jurisdictional opportunities

Implementation of the strategy is achieved through the execution of three main initiatives:

- ✓ Global Income Migration
- ✓ Financial Structuring, and
- ✓ Jurisdictional Planning

These initiatives and the specific ideas to achieve the Vision are summarized on the following pages. The purpose of the Analyze phase is to identify opportunities, quantify the approximate net benefits to the Company and achieve high-level buy-in for further development leading to a comprehensive implementation plan. As a result, any one of the following ideas may require substantial modification, result in benefits different than those estimated, or lead to even more significant opportunities. Taken as a whole, however, we believe these ideas will result in substantial further optimization of Caterpillar's tax position.

Private & Confidential
Subject to Attorney Client
and/or Work Product Privilege

Page 12

PRICEWATERHOUSECOOPERS

CONFIDENTIAL

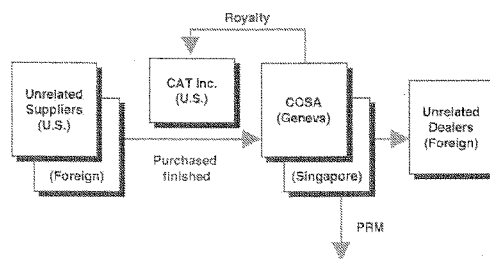
PwC-CAT-00003685

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00004646



CAT Inc. Out of Chain Solution #1



Description of Idea

- Remove Caterpillar Inc. from the chain of title passage for purchased finished parts (from U.S. or foreign sources) sold to foreign marketers. The foreign marketers would then buy from and sell to unrelated parties.

Benefits/Costs

- Eliminates Subpart F character of foreign marketers profits on purchased finished parts sales.
- Relatively simple re-invoicing requirements.

Issues

- LIFO cost of transferring in-transit inventory from CAT Inc. to COSA
- Clearing the 30% full inclusion hurdle
- Reduction of FSC benefit
- Reduction of foreign source income

Private & Confidential
Subject to Attorney-Client
and/or Work Product Privilege

Page 38

PRICEWATERHOUSECOOPERS

CONFIDENTIAL

PwC-CAT-00003714

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00004674



Recognize Profit Associated with Marketing Solution #2

Parts Profit Split	Current Margin Split (% of Sales)	Vision Margin Split (% of Sales)
Marketing		
Routine Functions	4	4
Dealer Network		5
Field Population		3
Intangible Trademark		2
Parts and Service Support		
Routine Functions	3	3
Logistics		3
Manufacturing Plants		
Routine Functions	3	3
Market Creation Fee		
Component Profit Center	4	
Commercial Entities	16	
Design		4
Field Population		3
Total	<u>30</u>	<u>30</u>

Description of Idea

- Evaluate and reallocate parts profitability to reflect
 - Recognition of valuable marketing intangibles
 - Compensation of designers, and
 - Creation of parts base of installed equipment

Rationale

- All residual profit is currently identified with commercial entity. No recognition given to valuable marketing intangibles (e.g. dealer network).
- All value of installed base/field population is attributed to commercial entity. Field population results from collective design, manufacturing and marketing efforts (razor/razor blades).
- Profit from logistics - CUP exists from CLS business with higher margins.
- "Design fee" should be compared to a royalty.

Benefits/Costs

- Migrates profits from CAT Inc. to low-tax marketing companies
- An additional 11 percentage points (from 4% to 15%) of margin attributable to QDSA (Dealer Network, Field Population, and Logistics).

Issues

- Overcoming resistance to changing current method of profit accounting
- Employee measurement and benefit plans
- Increasing manufacturers' margins on machines
- Buy-in from current system through a declining royalty

Private & Confidential
Subject to Attorney Client
and/or Work Product Privilege

Page 22

PRICEWATERHOUSECOOPERS

CONFIDENTIAL

PwC-CAT-00003715

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00004675



CATERPILLAR GTOP

Summary of Ideas

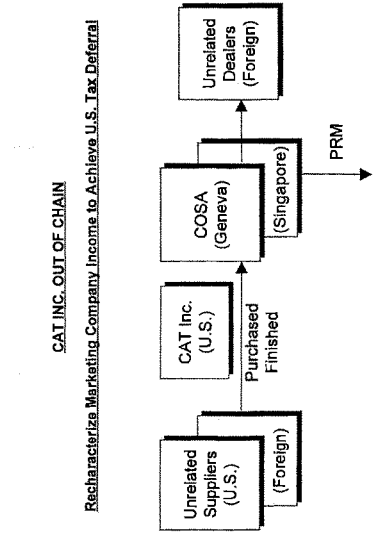


CONFIDENTIAL

PwC-CAT-00003606

Permanent Subcommittee on Investigations

EXHIBIT #7



Description of Idea:

- Remove Caterpillar Inc. from the chain of title passage for purchased finished parts (from U.S. or foreign sources) sold to foreign marketers. The foreign marketers would then buy from and sell to unrelated parties.

Benefits/Costs:

- Eliminates subpart F character of foreign marketers profits on purchased finished parts sales.
- Relatively simple re-invoicing requirements

Issues:

- LIFO cost of transferring in-transit inventory from CAT Inc. to COSA
- Clearing the 50% full inclusion hurdle
- Reduction of FSC benefit
- Reduction of foreign source income

INCREASE PROFIT ASSOCIATED WITH MARKETING

U.S. Tax Deferral

Parts Profit Split	Current Margin Split (% of Sales)	Value Margin Split (% of Sales)
Marketing		
Routine Functions	4	4
Dealer Network		5
Field Population		3
Parts and Service Support		
Routine Functions	3	3
Logistics		3
Manufacturing Plants		
Routine Functions	3	3
Manufacturing		
Component Profit Center	4	
Commercial Entities	15	6
Design		3
Field Population		
Total	30	30

Description of Idea:

- Evaluate and reallocate parts profitability to recognize appropriateness
 - Recognition of valuable marketing intangibles
 - Compensation of designers, and
 - Creation of parts base of installed equipment

Rationale:

- All residual profit is currently identified with commercial entity. No recognition given to valuable marketing intangibles e.g. dealer network
- All value of installed base/field population is attributed to commercial entity. Field population results from collective design, manufacturing and marketing efforts (razor/razor blades).
- Profit from logistics - CUP exists from CLS business with higher margins.
- "Design fee" should be compared to a royalty.

Benefits/Costs:

- Migrates profits from CAT Inc. to low-tax marketing companies

Issues:

- Overcoming resistance to changing current method of profit accounting
- Increasing manufacturer's margins on machines
- Buy-in from current system

Caterpillar Inc.

Operational Feasibility Analysis
High Level Target Designs:
Migration/Deferral



For Discussion Purposes Only
Company Confidential: Do Not Copy

Version 1.1 (2/16)

PRICEWATERHOUSECOOPERS

CONFIDENTIAL

Permanent Subcommittee on Investigations
EXHIBIT #8

PwC-CAT-00003586

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00004548



B1. COSA as Entrepreneur: European Sold Parts High-Level Target Design

A. Solution: General Description

CAT Inc. will be removed from the chain of title passage for purchased finished parts sourced from the U.S. or from overseas and sold to foreign marketers (COSA, CACO, COFA etc). COSA will therefore acquire the purchased finished parts directly from unrelated suppliers for resale to the dealers. COSA will also acquire worked parts in the same way. This will cause the accumulation of parts profit in COSA that was previously accumulated in CAT Inc./CAT HE. COSA will pay fees to P&SS for logistics and other parts order functions. COSA will pay a royalty (MCF transfer) to CAT Inc. reflecting design intangibles and recognizing the participation of CAT Inc. in the creation of the base of installed equipment. In addition, the parts profit retained in COSA will be enhanced to better reflect the contributions of the functions, risks and dealer network intangibles controlled by COSA.

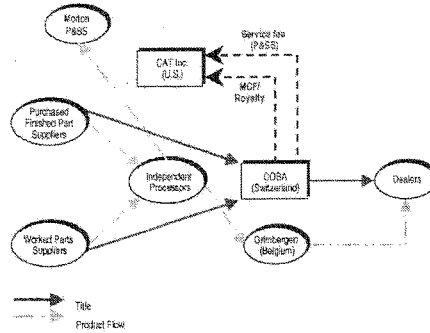
Relative financial effects of the solution are as follows:

US Millions	1997	Return on Sales
COSA net sales	2,988	
Current COSA profit	82	2.7%
Profit from Cat Inc to COSA		
Cat Inc parts profit	154	
Royalty and service fees	(83)	71
Revised COSA profit	153	5.1%
Parts profit deferred from US taxation	67	
Annual earnings & cash flow benefit provided by difference between US and Swiss tax rates	15	



B1. COSA as Entrepreneur: European Sold Parts High-Level Target Design

Diagram



B. Main Implementation Observations

1. There will be no change with respect to sales of parts by COSA. Changes are proposed to the purchase of parts for resale.
2. There will be no change in the physical locations of Accounts Payable processing. Opportunities are created for shared service efficiencies.
3. COSA will create new "HE" to capture and record all transactions relating to parts purchased for sale in COSA territory. Use of the existing CAT HE facility code will be discontinued.
4. Invoicing from suppliers will be changed from CAT HE and Motion HE to COSA "HE." Supply contracts will be changed to COSA.
5. There will be enhanced marketing profit and therefore a reduced pool of Market Creation Fee for redistribution to entities with design rights. The enhancement arises from realignment of inter-company profit. There is no change to dealer pricing. A reconcilable difference is created between legal and accountable profit.
6. Royalty/Service fee arrangements to be developed.

Page 2

Subject to Attorney Client and/or Work Product Privilege

PRICEWATERHOUSECOOPERS

Version 3.2 (2/95)

CONFIDENTIAL

PwC-CAT-00003591

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00004551



B1. COSA as Entrepreneur: European Sold Parts High-Level Target Design

C. Preliminary Operational Issues

1. Supplier receives multiple purchase orders. Supplier issues multiple invoices (to each marketing company). Implementation timeline is dependent on ability to communicate this to suppliers.
2. Coordination with payables processing.
3. Reconciliation of divergence between legal entity and accountable profit.
4. Treasury Management. Change in cash accumulation and repatriation approaches.
5. Exceptions for:
 - emergency shipments
 - redeployments
 - remanufactured products.

D. Tax Issues

1. Characterization of MCF/Royalty payment and therefore coordination of treatment by other marketing entity jurisdictions (i.e. Singapore).
2. LIFO Recapture.
3. Customs and VAT
4. Review of agreements with tax authorities
 - a) Belgium
 - b) Switzerland

E. Agreements

1. Service agreement/P&SS.
2. Distribution license/CAT Inc.
3. Intangibles license/CAT Inc.
4. Supplier agreements
5. PTE Service agreement

Page 3

Subject to Attorney Client and/or Work Product Privilege

PRICEWATERHOUSECOOPERS

Version 1.0 (2005)

CONFIDENTIAL

PwC-CAT-00003592

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00004552



CATERPILLAR INC.

**Global Tax Optimization
Risk Adjusted Benefit Analysis**

Working Papers - Draft 1

**Develop Phase Report - Part 1
December 1998**

PRICEWATERHOUSECOOPERS

CONFIDENTIAL

Permanent Subcommittee on Investigations
EXHIBIT #9

PwC-CAT-00002904

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00001336



Table of Contents

I. RABA: Executive Summary

II. RABA: Solution Slides

III. RABA: Numerical Analysis

Comparison to Develop
Risk adjustments and Year 1 versus 1998/99 Analysis

IV. Migration and Deferral

Solution 1: CAT Inc out of chain
Solution 2: Recognize profits associated with marketing
Solution 3: Marketers share design costs
Solutions 4A,B and C

V. Cost of Capital

Solution 8: Subpart F reducer/German hybrid instrument
Solution 9: Modify tax accounting for interest subsidy payments
Solution 12: Factoring to reduce CGS Subpart F income
Solution 14: Brazilian interest on equity
Solution 16: Finance company for State tax benefit

VI. Jurisdictional

Solution 17: Deductible dividends
Solution 19: Recognize COSA as a related supplier of Commissionaire FSC
Solution 21: Supercharge FTCs/Reduce Subpart F income with Foreign Deficits
Solution 27: Increase utilization of CICL warranty reserves
Solution 29: Reduce P/L expenses through use of stock options
Solution 33: Abnormal retirement of York Plant

VII. Dealer Strategies

Solution 26: Utilization of CICL for dealer extended warranty
Solution 28: Management of like-kind exchange program for dealers

VIII. Other Solutions Developed

Solutions 13,15,18,22,24,25,30,31 and 32

NB There are no templates for solutions 5 (SCM), 10 (Irish Bank), 11 (Capital Allowances), 23 (CAT offshore);
Solution 20 (Cat China) has been combined with Solution 21 (Supercharge FTCs); Of these it is likely that one
will be produced only for solution 5.

*Private & Confidential
Subject to Attorney Client and/or
Work Product Privilege*

PRICEWATERHOUSECOOPERS

CONFIDENTIAL

PwC-CAT-00002906

Confidential Treatment Requested by PwC

PwC PSI CAT 00001338



Agenda

- Introductions
- Project Overview and Current Status
- Caterpillar's Tax Vision
- Caterpillar's Tax Optimization Strategy
 - Risk Adjusted Benefits
 - Specific Optimization Strategies
 - Migration and Deferral
 - Cost of Capital
 - Jurisdictional
 - Dealer Focused
- Next Steps

Page 2
PWC-CAT-0002909

Subject to Attorney Client and/or Work Product Privilege

PRICEWATERHOUSECOOPERS

CONFIDENTIAL

PwC-CAT-0002909


PwC_PSI_CAT_0002909

Confidential Treatment Requested by PwC



Project Overview - Current Status

- **Purpose:** Increase shareholder value through tax optimization
- **6-month review:** Caterpillar, McDermott, Will & Emery and PricewaterhouseCoopers
- Risk Adjusted Benefit Analysis now complete:
 - Technical Tax Analysis
 - Available Facts and Assumptions Clarified
 - Benefits Quantified : Committed, Probable and Bold
- Next Steps
 - Operational Feasibility Analysis ("OFA")
 - Detailed Design ("Blueprint")
 - Implementation



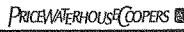
Caterpillar's Tax Vision

The Company's Vision for Tax Optimization is to achieve significant **cash savings** and a long term, sustainable **structural** tax rate approaching 30% - comparable to Best in Class Dow 30 Companies.

Page 3

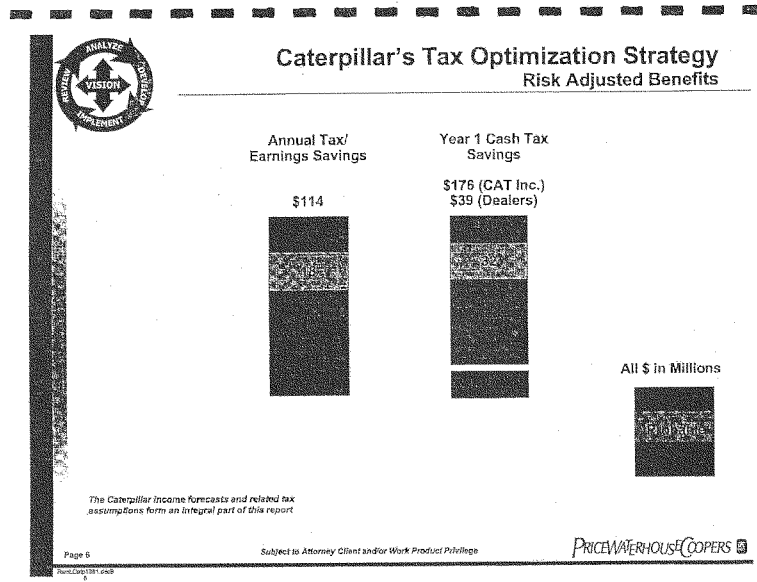
RevCat301.doc

Subject to Attorney Client and/or Work Product Privilege



PwC_PSL_CAT_00001344

Confidential Treatment Requested by PwC

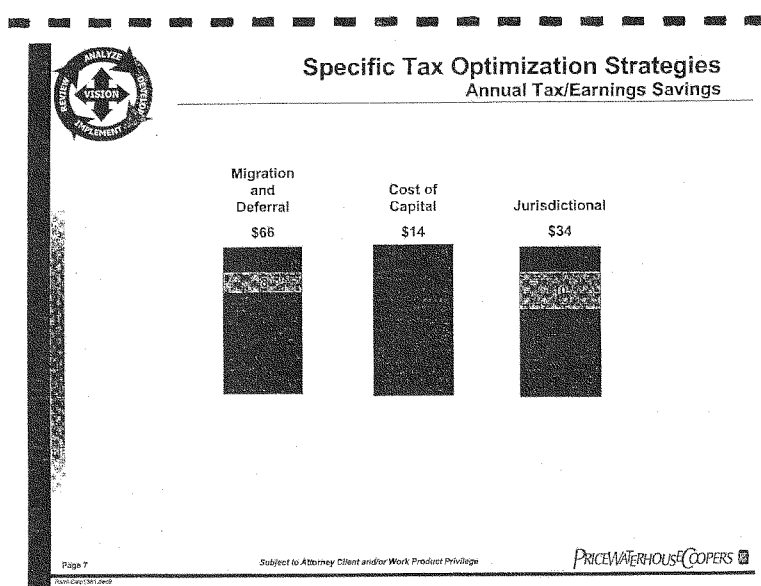


PwC_PSL_CAT_00001345

Confidential Treatment Requested by PwC

CONFIDENTIAL

PwC-CAT-00002813



CONFIDENTIAL

PwC-CAT-00002914

PwC_PSI_CAT_00001346

Confidential Treatment Requested by PwC



Migration and Deferral

- Recharacterize and increase parts profits earned by COSA
- Treat COSA as entrepreneur for European contract manufacturing
- Marketing companies share design costs
- CACO parts profits migrated from U.S.
- Treat COSA as entrepreneur for Mexican contract manufacturing
- Recharacterize profit on SCM products

Earnings \$66	Cash \$66
25.5%	25.5%

Page 9

Particulars (in millions)

Subject to Attorney-Client and/or Work Product Privilege

PRICEWATERHOUSECOOPERS

CONFIDENTIAL

PwC-CAT-00002916

PwC_PSI_CAT_00001348

Confidential Treatment Requested by PwC



Migration and Deferral

Recharacterize and Increase Parts Profits Earned by COSA

Changes Proposed

- COSA and COSA-Singapore purchase replacement parts directly from third-party vendors and from CAT facilities.
- COSA and COSA-Singapore pay fees (P&SS) and royalties (MCF) to CAT Inc.
- Increase profit to Marketers to recognize valuable dealer contributions.
- Convert COSA-Singapore to corporation for Singapore tax purposes.

Risk Adjustments

- Change from historical transfer pricing methodology.
- Minimal U.S. PE exposure.
- No taxable outbound transfer.
- Full inclusion avoided by increasing marketing profit.
- LIFO recapture tax and increased cost of any future LIFO liquidations.
- Coordinate with Swiss Technology Company planning.

Year 1 Benefits

- COSA and COSA-Singapore's purchased finished parts income is increased and recharacterized as non-Subpart F income.



- COSA benefit: \$15 million.
- COSA-Singapore benefit: \$10 million.
- FSC benefits for suppliers identified.

Operational Issues

- Supplier receives multiple purchase orders.
- Supplier issues invoices to each marketing company.
- Service agreement and license agreement needed between COSA, COSA-Singapore and CAT Inc. for P&SS and payment of MCF.
- True-up transactions: Intercompany sales transaction is required to reallocate incoming parts upon delivery.
- Belgium and France must replace lost MCF to retain profitability (see page 12).
- Develop systems to determine and pay fees/ royalties to CAT Inc.

Page 11

Subject to Attorney Client and/or Work Product Privilege

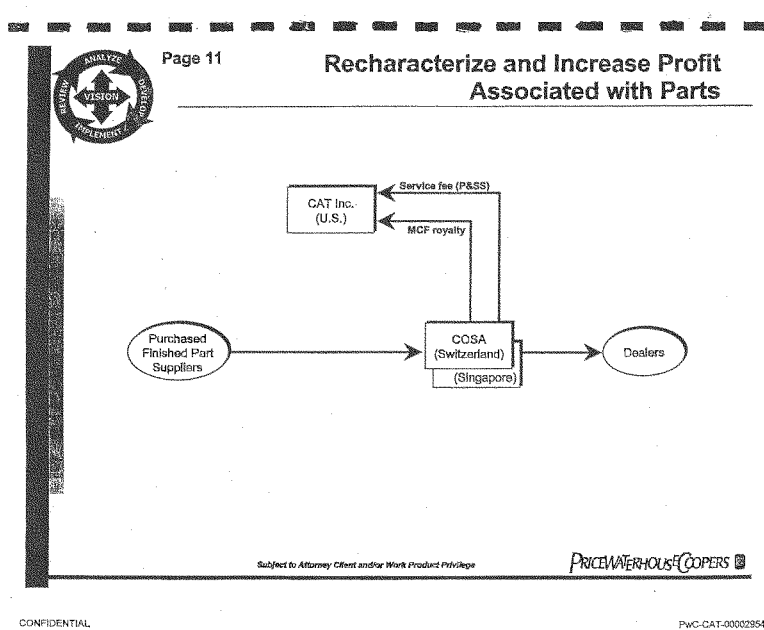
PRICEWATERHOUSECOOPERS

CONFIDENTIAL

PwC-CAT-00002930

PwC_PSI_CAT_00001562

Confidential Treatment Requested by PwC



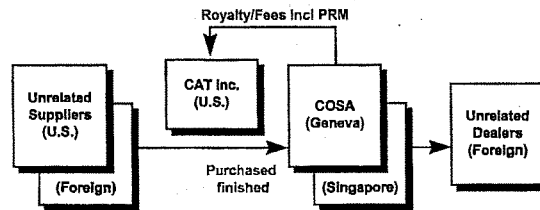
SOLUTION 1: CAT INC OUT OF CHAIN
REPORT TEMPLATE
 Page 2 of 4

CURRENT DRAFT as of 21-Dec-88 10:32 AM

E. Structure Diagrams

Before

After



F. Key Facts and Assumptions

1. Purchasing agents at Morton can issue a purchase order to a supplier on behalf of Cat Inc and (up to three other) purchasers
2. Vendors will receive up to four purchase orders (Inc, COSA, COSA-Sing, and eventually CACO). Shipment may be to Morton for all four shipments. Morton consolidates and ships to Grimbergen and Singapore.
3. COSA and COSA-Sing pay fee to Cat Inc (P&SS) for parts procurement, and for management of parts system. Fee calculated as 18% of parts sales (less any local expenses at Grimbergen and Singapore)
4. COSA and COSA-Sing pay Market Creation Fee to Cat Inc. Cat Inc then pays out a portion to Cat Belgium and Cat France (and any other non-US commercial entities); and retains the balance in Cat Inc. Fee estimated at approx 20% of sales.
5. Coordinate with parts structure contemplated for Swiss Technology Company

G. Technical Tax Issues (from 11/23 mtg in Rosemont)

1. Commingling (954, 956, LIFO)
 - 1.1. Greg Palmer: write-up needed for ruling on LIFO
 - 1.2. Wayne Jenner: write up needed on risk memo (954)
 - 1.3. Operational changes (Quinn)
 - 1.3.1. defer title until specific identification is possible and LIFO issue
 - 1.3.2. system changes, eg 2 purchase orders
2. State Issues: nexus because of inventory for export: White
3. Character of Payments back to Cat

CONFIDENTIAL

PwC-CAT-00002976

Confidential Treatment Requested by PwC

PwC_PSI_CAT_0000140

**SOLUTION 1 : CAT INC OUT OF CHAIN
REPORT TEMPLATE**

CURRENT DRAFT as of 21-Dec-08 10:32 AM

Page 3 of 4

- 3.1. Deductible in Swiss? Withholding in Swiss? McDonald/Quinn
4. Swiss Rate: McDonald/Quinn
5. 70/30: Brent Esplin/McGill
6. US Permanent Establishment
 - 6.1. purchasing/packaging/painting: Sandra McGill
7. LIFO (\$123m OK?) see Palmer
8. Defer title passage from suppliers [mitigates LIFO issue?]
9. 367 transfer? Valuable supply contracts transferred (no, since under Solution 1 we pay all income back above a routine income)

H. Benefits Quantification / Risk analysis

1. See attached 4-page model (COSA Current + Vision, COSA-Singapore Current + Vision)
2. Tax rate savings for COSA:
 - COSA from US: 9.6% vs 29% current. Benefit = 19.4%
 - COSA from other: 9.6% vs 35% current. Benefit = 25.4%
 - Combined COSA rate benefit: 19.9%
 - Query: should we be including a US state tax rate to reflect state taxation of subpart F?
3. Tax rate savings for COSA-Singapore (to be confirmed)
 - COSA-Sing from US: 14% vs 29% current. Benefit = 15%
 - COSA-Sing from other: 14% vs 35% current. Benefit = 21%
 - Combined COSA-Sing rate benefit: 16.1%
 - Query: should we be including a US state tax rate to reflect state taxation of subpart F?

	COSA	COSA-SING
1. US source (Cat Inc)	\$21.9m	\$11.0m
2. Europe source (Cat HE)	\$1.3m	n/a
3. SCM Source	\$0.9m	\$2.4m
Total Migration	\$24.1m	\$13.4m
Tax Rate Differential	19.9%	16.1%
Total Savings	\$4.8m	\$2.2m

I. Detailed Impact on Tax Filing

J. Operational issues

1. Determine commingled inventory vs. P&SS as purchasing agent for COSA + others
2. Reallocate incoming parts on arrival @ Morton (i.e. anticipated allocation at time of purchase may not reflect needs at time of arrival)
3. Need license agreement for COSA to pay out PRM as license fee

K. Timeline to Implementation

CONFIDENTIAL

PwC-CAT-00002977

Confidential Treatment Requested by PwC

PwC PSI CAT 00001409

**SOLUTION 2: RECOGNIZE PROFIT ASSOCIATED WITH MARKETING
REPORT TEMPLATE**
Page 1 of 3

CURRENT DRAFT as of 21-Dec-98 10:33 AM

A. Team Responsible:

GPA team

B. Countries Potentially Impacted:

United States
Switzerland
Singapore

C. Solution Description:

1. Recognize that the current profit allocation for the marketers undercompensates them for their valuable contributions to the overall profit of the business.
2. Increase parts profit allocation to marketers to reflect:
 - valuable marketing intangibles: dealer network created by marketing companies, service support by dealers & marketing company
 - creation of parts base of installed equipment.

D. Solution Benefits and Costs

1. Migrate profits from Cat Inc to low-tax marketing companies
2. Increase in Profits: \$70 million in COSA, \$53 million to COSA-Singapore
3. Tax savings, attributable to increase in profits on non-Subpart F parts: \$6.6 million (COSA), \$4.1 million COSA-Singapore.
4. Risk: change from current intercompany pricing method and documentation. For best results, combine with Solution 3 and charge product managers (at least partially) to COSA and COSA-Sing.

E. Structure Diagrams

Before

After

F. Key Facts and Assumptions

1. The marketing companies have created a significant intangible: ownership of the dealer network, and the value therefrom.
2. Customers (end-users) who buy Cat machines instead of competitors', do so because of the service they receive from dealers: quick turnaround of service and spare parts, dealer service to customer. This quick turnaround is a function of COSA getting parts to the dealer within 24 hours, and COSA's training of the dealer in servicing Cat machines. It is the marketing company (e.g. COSA), which has trained the dealer.

CONFIDENTIAL

PwC-CAT-00002979

Confidential Treatment Requested by PwC

PwC PSI CAT 00001411

**SOLUTION 2 : RECOGNIZE PROFIT ASSOCIATED WITH MARKETING
REPORT TEMPLATE** **CURRENT DRAFT as of 21-Dec-98 10:33 AM**
Page 2 of 3

3. The field population of existing machines leads to replacement parts sales. The marketing companies are responsible jointly with the product manufacturers for having created the installed base.
4. Assumption: There is arm's length evidence of Original Equipment Manufacturers allowing third parties to take over the replacement parts business.

G. Technical Tax Issues

1. Is there a 367(d) outbound transfer of intangibles? Arguably not, at least in solution 2, because we are just recognizing that the current interco price undercompensates COSA and other marketers. We're not transferring an intangible, we are just recognizing an intangible they had already. In addition, our method of calculating the amount of increased profit to COSA is allowing COSA to earn up to the top of the arm's length range on sales and distribution, thus masking the specific calculation of the marketing intangibles at COSA. 1.1. If no 367(d) transfer of intangibles, then there is no buy-in necessary.
2. Issue of changing transfer pricing, and resulting difference of US documentation reports: up through 1998, we have characterized COSA (and other marketers) as routine marketers. We have also relied on *conformity of management and legal books* as one of our defenses. This will change, and our documentation reports will rely on greater discussion of the value of the marketers' contribution (supported by additional external research)

H. Benefits Quantification / Risk analysis

1. We are effectively more than doubling the profit on parts. Now we would have to test COSA and COSA-Sing on a combined basis (do not segregate machines vs. parts). Our profit schedules of COSA and COSA-Sing in the documentation reports should combine machines and parts.
2. The Comparable Profit Method of testing the profit on the foreign marketers allows us some "room" to increase profit at the marketers. For example, COSA earned 2.7% overall in 1997 for parts and machines (3-yr average: 3.3%). The top of the interquartile range is 5.1%. COSA could earn up to 5.1% on a combined basis and still be within the arm's length range. Increasing the parts profit alone in 1997 to allow COSA to earn the 5.1% profit would increase parts profit by \$70.7 million, \$33 million of which relates to purchased-finished parts. The parts operating profit margin would increase from 7.1% to 18.3%.
3. Similarly, the COSA-Singapore parts operating profit margin would increase from 8.1% to 24.7%. (The Asian comparables range was significantly higher than the European comparables.) COSA-Singapore's overall operating profit was 4.2% in 1997 (3-yr average of 5.7%), while the top of the interquartile range was 9.0%. Therefore, we can increase COSA-Singapore's profit by \$53 million, of which \$26 million would be attributable to purchased-finished
4. Tax Rate Savings: \$10.7 million for COSA and COSA-Singapore.
5. See Detailed Calculation Next Page.

CONFIDENTIAL

PwC-CAT-00002980

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00001412

Error! Not a valid link.

I. Detailed Impact on Tax Filing

J. Operational Issues

1. Will create different transfer prices for legal vs. management books.

2. Are we taking too much profit from manufacturers, especially from Belgium?

Shifting \$70 million in income to COSA will come out of the manufacturers' Parts Residual Margin (Market Creation Fee). Risk that we are taking so much profit from Belgium and France that their profit will fall too low. Some portion of this reduction will come from PRM earned by Belgium and France, with the balance from Cat Inc. Need to quantify reduction in PRM earned by Belgium and France, vs. reduction in PRM suffered by Inc. Belgium earned \$49m in PRM (84% of its total profit), mostly from sales in COSA territory. (France earned \$13m (35% of its total profit), from COSA and other territories (probably 1/3 COSA))

3. If we are reducing Belgium and France's profit too much, then we need to consider making Belgium and France as contract manufacturers for COSA. (and also for Cat Inc as well, on sales from Belgium and France back to Cat Inc.) Without PRM/MCF, Belgium and France would need to increase their prime product price to the marketing companies. In that case, the product management team at Belgium and France should then be charged on a service-fee basis to COSA and Cat Inc., and COSA would pay a royalty back to Cat Inc. *(this is a major modelling exercise that we have not started yet!)*

K. Timeline to Implementation

CONFIDENTIAL

PwC-CAT-00002981

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00001413

SOLUTION 3 : MARKETERS SHARE DESIGN COSTS
REPORT TEMPLATE **CURRENT DRAFT as of 21-Dec-98 10:33 AM**
 (Chuck Larson's draft of 11/23/98, put into Template format)
 Page 1 of 3

A. Team Responsible:
 GPA team

B. Countries Potentially Impacted:
 United States
 Switzerland

C. Solution Description:

1. COSA enters into a cost sharing arrangement (CSA) with Cat Inc. for the R&D associated with intangibles that relate to certain replacement parts. By sharing R&D costs (and paying any required buy-ins), COSA is entitled to exploit its interests in the intangibles assigned to it under the arrangement. There would be no need for COSA to pay other intangibles fees (i.e., market creation fee payments or license fees) to Cat Inc.
2. Currently, COSA purchases replacement parts from Cat Inc. at transfer prices that are intended to leave COSA with a "routine" profit for its marketing and distribution functions. All product intangibles are owned by Cat Inc., and the profit attributable to these intangibles accrues to Cat Inc.
3. *For this solution to work, do we have to combine Belgium and France into Contract Manufacturing? Should the product managers also work for COSA and COSA-Sing? In this case, COSA becomes the "entrepreneurial manufacturer" for Europe, and would pay a royalty to Cat Inc.*

D. Solution Benefits and Costs

1. By sharing R&D costs, COSA is entitled to exploit its interests in the intangibles assigned to it under the arrangement. Costs for COSA include a timing disadvantage. COSA must contribute funds under the CSA, and most likely make buy-in payments to Cat Inc., before its benefits (arising from exploiting its interests in the intangibles) are forthcoming. This timing disadvantage can be overcome through sufficiently profitable sales of the parts.

E. Structure Diagrams

Before

After

F. Key Facts and Assumptions

CONFIDENTIAL

PwC-CAT-00002982

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00001414

SOLUTION 3 : MARKETERS SHARE DESIGN COSTS
REPORT TEMPLATE **CURRENT DRAFT as of 21-Dec-98 10:33 AM**
 (Chuck Larson's draft of 11/23/98, put into Template format)
 Page 2 of 3

1. P&SS appears to track parts (forecasting, scheduling, purchasing, shipping, inventory levels) on a global basis with great amounts of detail. Thus, information should be available to track COSA's sales of relevant parts.
2. COSA can be an "eligible participant" in a parts CSA. This should be the case given that the cost sharing regulations do not contain an "active conduct rule".
3. That parts only -- and not the original equipment to which the parts relate, which were developed simultaneously -- can be in the CSA. This appears feasible, given the factors that the regulations focus on, namely 1) that the cost be shared in proportion to the reasonably anticipated benefits from exploiting the intangibles developed under the CSA, and 2) that there is an appropriate "buy-in" for intangibles that exist as of the inception of the CSA and are shared through the CSA.

But consider issue above—if PRM shifted to COSA reduces Belgium and France profit too low, then we have to increase Belgium and France's profit, either through (1) increasing transfer price for prime product, or (2) converting Belgium and France into contract manufacturers. In this latter case, then COSA becomes the licensee for prime product as well as parts.

G. Technical Tax Issues

H. Benefits Quantification / Risk analysis

Quantifying benefits requires information/assumptions on several issues including those listed below:

1. Which parts are under the CSA ("covered parts") (all models of prime product? Worked parts and purchased finished parts? Current and non-current parts?)
 - 1.1. For purchased finished parts, one idea here is that COSA's rights for a particular part would take effect at the time the purchased finished part becomes non-current. Then, COSA would fund any P&SS engineering pertaining to that part.
2. The rate at which (timing and volume), after the inception of the CSA, COSA begins to sell covered parts (P&SS and/or the business units should be able to forecast the trajectory of future parts sales that is expected in relation to a new prime product that is developed today)
3. The relevant amount of intangible development costs (probably not all Cat R&D, but a certain subset)
4. COSA's share of the intangibles development costs (under the regulations this is to be determined based on the CSA members' reasonably expected operating profits through their exploitation of the developed intangibles)
5. Projections of COSA's reasonably anticipated benefits from exploiting its interests in the intangibles assigned to it under the CSA

CONFIDENTIAL


PwC-CAT-00002983

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00001415

Confidential Treatment Requested by PwC

PwC_PSI_CAT_0000443

<p>CATERPILLAR INC.</p>	
<p>Global Value Enhancement Project</p>	
<p>Economic Analysis of SARL Intercompany Transactions with Cat Inc. in the COSA Territory</p>	
<p>DRAFT October 5, 1999</p>	
<p><i>Sealed</i></p>	
 <p>GloVE</p>	
<p>CONFIDENTIAL RED <i>Subject to Attorney Client and/or Work Product Privilege</i></p>	

CONFIDENTIAL

PwC-CAT-00003499

Permanent Subcommittee on Investigations

EXHIBIT #10

Economic Analysis of Royalty Rates and Transfer Prices

DRAFT International Competitiveness

- For prime product transfer pricing, the transfer pricing policy utilized in recent years will be carried-over. Although the policy calls for the marketing company to earn a ROS equal to 2%, actual ROS results have been less than 2%, as shown in the table below.

— This generates a prime product-segment ROS for SARL of 0.8%.

SARL Prime Product Segment - COSA Territory		
	U.S. \$ millions	
Sales	2,494	100%
COGS	<u>2,363</u>	95%
Gross Profit	131	5.3%
Operating Expenses	<u>110</u>	4.4%
Operating Profit	<u>21</u>	0.8%

Actual 1998 results

Draft, October 5, 1999

CONFIDENTIAL RED



CONFIDENTIAL

PwC-CAT-00003524

Economic Analysis of Royalty Rates and Transfer Prices

DRAFT International Competitiveness

- For replacement parts, applying the proximate net profitability differential ratio to the target prime product ROS of 2% provides a basis for an appropriate replacement parts ROS.

SARL's Replacement Parts Segment - COSA Territory		
	U.S. \$ millions	
Sales	712	100%
COGS	<u>358</u>	50%
Gross Profit	354	50%
Operating Expenses (incl. roy.)	<u>229</u>	32%
Operating Profit	<u>125</u>	18%

Based on 1999 Plan data

Draft, October 5, 1999

CONFIDENTIAL RED



CONFIDENTIAL

PwC CAT 000469

Confidential Treatment Requested by PwC

PwC_PS_CAT_0000349

CATERPILLAR INC.



Private & Confidential

CONFIDENTIAL

PwC-CAT-00003365

Permanent Subcommittee on Investigations
EXHIBIT #11

Part C: COSA Global Benefit Analysis

		Net Pre-tax Margin %					Swiss Net	Tax Rate	Benefit	% of
		Sales	Total	U.S.	Local	Swiss	Margin	Differential		Sales
COSA	Europe source	106	35	15	0	20	21	25	5	5
	U.S. source	329	36	15	0	21	69	20	14	4
Singapore	Local source	16	9	9	0	0	0	25	0	0
	U.S. source	104	39	15	3	21	22	20	4	4
CACo.	U.S. source	149	35	15	3	17	25	20	5	3
COFA	Local source	19	12	12	0	0	0	25	0	0
	U.S. source	130	36	15	3	20	26	20	5	4
		<u>853</u>					<u>163</u>		<u>33</u>	<u>4</u>
Post Cost Sharing							<u>246</u>		<u>51</u>	<u>6</u>

Notes:

Based on 1999 Plan with actual proportions of purchased finished and worked parts sales.

Page 13

Global Value
Enhancement
Subject to Attorney Client and Work Product Privilege

CONFIDENTIAL

PwC-CAT-00003381

From: CN=Jim Matthews/OU=US/OU=TLS/O=PwC
 To: CN=Steven R. Williams/OU=US/OU=TLS/O=PwC@Americas-US
 Sent: 07/09/2007 08:15:26 AM EST
 CC: CN=Christopher E Dunn/OU=US/OU=TLS/O=PwC@Americas-US
 Subject: Re: Caterpillar: value of marketing intangibles

Steve, I can certainly work on this. Is this urgent...as in we need this in a day or two? or is it something like the end of the week?

Thanks,
 Jim

Jim Matthews | PricewaterhouseCoopers LLP | Transfer Pricing Group | Email:
 jim.matthews@us.pwc.com
 Two Commerce Square, Suite 1700 | 2001 Market Street | Philadelphia, PA
 19103-7042 | Phone: (267) 330-3101 | Fax: (813) 281-1519

Steven R. Williams/US/TLS/PwC
 07/07/2007 10:06 AM

"Reply to All" is Disabled

To
 Jim Matthews/US/TLS/PwC@Americas-US
 cc
 Christopher E Dunn/US/TLS/PwC
 Subject
 Caterpillar: value of marketing intangibles

Jim-- our Chicago team is on vacation this week. Can you do some research on the "trademark legal entitlement" approach to marketing intangibles. I think that was used a lot in [redacted] Anjali may have a source for previous work done on that.

The concept is that right now, we split Caterpillar's non-US residual profit just by R&D expenditures. We don't do anything as sophisticated even as creating a stock of R&D. And we don't give CSARL any credit for the dealer network, or any other marketing intangibles.

What is this "legal entitlement" approach to marketing intangibles? I haven't used it, but I've heard about it. Apparently, under that concept, CSARL pays Cat Inc for the "legal entitlement" but CSARL has rights to "further develop" that intangible on its own.

The point is that CSARL (or its predecessor COSA, or CFEL, or CACO) has spent decades building up the dealer network around the world. And has spent decades

Permanent Subcommittee on Investigations EXHIBIT #12

Confidential Treatment Requested by PwC

PwC PSI CAT 00122483

building the brand name through advertising.

Caveat is that in 2001, we said in another transaction that there is no significant marketing intangibles other than workforce in place. ie we made the assertion that dealer want access "yellow iron" and want the "Cat-designed yellow iron that works well"-- they don't really care whether it's purchased from Cat Americas Co (a US company), or Caterpillar Americas SARL (a Swiss co). Accordingly, we only valued CACo's "business" that CAmSARL had to "pay for" as the value of the assembled work force.

Of course, the reason I want to improve the profit split analysis is that CSARL is "pushing the edge of the IQ range".


I'd like a 2-3 page memo explaining the issue and what data we would need.

Thanks.

CATERPILLAR INC.

ECONOMIC ANALYSIS
OF INTANGIBLE ASSETS TRANSFERRED
BY CATERPILLAR AMERICAS CO. TO
CATERPILLAR AMERICAS SARL

Prepared By:

PRICEWATERHOUSECOOPERS 

Privileged and Confidential

Permanent Subcommittee on Investigations
EXHIBIT #13

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00142353

Caterpillar Inc.
Economic Analysis of Intangible Assets Transferred
By Caterpillar Americas Co. to Caterpillar Americas SARL

TABLE OF CONTENTS

I. EXECUTIVE SUMMARY.....	1
A. Scope and Purpose of Analysis.....	1
B. Overview.....	1
C. Conclusion.....	2
II. FUNCTIONAL ANALYSIS	3
A. Responsibilities Transferred to CAmSARL.....	3
B. Intangibles Assets Transferred to CAmSARL.....	4
C. Functional Analysis Conclusions	6
III. ECONOMIC ANALYSIS OF INTANGIBLE ASSETS TRANSFERRED TO CAmSARL.....	7
A. Intangible Assets Definition	7
B. Selection of a Method	7
C. Application of the CPM	9
D. The Value of the Intangible Assets Transferred	11
IV. CONCLUSION	14
 APPENDIX A: CONTRIBUTION IN KIND AGREEMENT	 15
APPENDIX B: CAmSARL PRO FORMA FINANCIAL STATEMENTS	24
APPENDIX C-1: APPLICATION OF THE CPM	25
APPENDIX C-2: BUSINESS DESCRIPTIONS OF COMPARABLE DISTRIBUTORS	31
APPENDIX D: STATISTICAL ANALYSIS.....	33

I. EXECUTIVE SUMMARY

A. Scope and Purpose of Analysis

PricewaterhouseCoopers LLP ("PwC") has been engaged by McDermott, Will & Emery to assist Caterpillar Inc. ("Cat Inc." or the "Company") in the evaluation of certain intangible assets that were transferred by Caterpillar Americas Company ("CACo") to Caterpillar Americas SARL ("CAMSARL") as of November 26, 2001. More specifically, this engagement entailed testing the arm's length value of the following assets:

- (1) Dealer Contracts;
- (2) Training Programs (Pro2000 and Masters programs);
- (3) Order Tracking Software;
- (4) Procedures and Manuals;
- (5) Marketing Brochures/Product Catalogues;
- (6) Website;
- (7) Any Other Marketing-Related Intangibles (such as Customer Lists or Dealer Network) Associated with the Caribbean, Central America, Mexico and South America; and
- (8) Goodwill and Going-Concern Value Located In the Caribbean, Central America, Mexico and South America.

Hereinafter, the above listed intangible assets will be collectively referred to as the "Intangible Assets Transferred".

For purposes of this analysis, we applied the arm's length standard as defined in the U.S. Treasury Regulations issued under § 482 of the Internal Revenue Code¹. The arm's length standard under the Treasury Regulations that the prices paid in intercompany transaction be similar to the prices that would have been charged between unrelated parties operating under the same or similar circumstances.²

This report is based upon information provided by employees at Caterpillar and publicly available information. PwC has not independently verified or audited the information considered in the preparation of this report.

B. Overview

Following this Executive Summary, Section II provides (i) an overview of the organization structure of Caterpillar in Latin America and an overview of the responsibilities transferred by CACo to CAMSARL; and (ii) a description of the Intangible Assets Transferred by CACo to CAMSARL. Section III of the study provides (i) an overview of the intangible assets definition; (ii) an overview and selection of the alternative transfer pricing methods; (iii) the application of

¹ The arm's length standard is the internationally accepted norm for testing the appropriateness of intercompany transfer prices.

² Reg. §1.482-1(b)(1).

the CPM method; and (v) application of an unspecified method to derive the most reliable measure of the arm's length consideration of the Intangible Assets Transferred. Finally, Section IV summarizes the findings of this study.

C. Conclusion

On December 1, 2001, CACo's distribution responsibilities and certain tangible assets (e.g. inventories) were transferred to CAmSARL. In connection with this re-structuring, CACo also transferred certain intangible assets to CAmSARL. This report analyzes the value of the Intangible Assets Transferred from CACo to CAmSARL.

Our analysis of the Intangible Assets Transferred indicates that they are routine in nature and easily reproducible by another comparable marketing and distribution company. Moreover, the Intangible Assets Transferred had only limited legal protection and economic life. The value of the Intangible Assets Transferred by CACo to CAmSARL consists mainly of the value of the workforce in place.

To test the arm's length value of the Intangible Assets Transferred, the Comparable Profit Method ("CPM") and an unspecified method were employed. The CPM and the unspecified method provide the most reliable method to evaluate the amount to be charged by CACo to CAmSARL. The CPM supports the conclusion that the Intangible Assets Transferred are routine in nature.

Therefore, our analysis indicates that the value of the Intangible Assets Transferred is to allow CAmSARL to avoid start-up costs and risks associated with the formation of a new company such as hiring, training and/or relocation of employees. Thus, to determine the value associated with the Intangible Assets Transferred we used an unspecified method. The unspecified method relies on empirical analysis to provide an estimate of the foregone profits that CAmSARL would have realized without the Intangible Assets Transferred under the same or similar circumstances. The empirical observations indicate the reduced sales associated with exceptional employee turnover and the resulting foregone operating income. Specifically, our economic analysis indicates that during this year, sales could be reduced by 12.8 percent. Based on this estimated reduction in sales, we estimate that the value of the Intangible Assets Transferred as defined in the U.S. Treasury Regulations issued under § 482 of the Internal Revenue Code to be approximately between \$2.8 to \$3.1 million.

II. FUNCTIONAL ANALYSIS

A. Responsibilities Transferred to CAmSARL

CACo, a U.S. company based in Miami and wholly-owned by Cat Inc., served as Caterpillar's marketing company for Latin America and other regions until November 30, 2001. Until that time, CACo functioned as a buy-sell distributor for approximately forty years, purchasing parts and prime product from Cat Inc. and its affiliates for resale to dealers in Latin America, the Caribbean, and Canada.

CACo's responsibilities with respect to product dealers included: (i) the negotiation and signing of contracts with dealers in the CACo assigned region; (ii) the purchase of products and parts from Cat Inc. and other Caterpillar affiliates for resale to dealers; (iii) taking title to products purchased from Cat Inc. (and other Caterpillar affiliates) destined for dealers; (iv) arranging logistics support for prime product and part shipments; (v) maintaining minor inventory levels of prime product for quick delivery to dealer customers; (vi) assisting dealers in identifying product performance issues and conveying technical data about such problems to Cat Inc.; (vii) providing dealers with marketing information and sales training programs; (viii) assisting dealers in arranging financing; and (ix) conducting monitoring and oversight activities to insure compliance by dealers with the terms of dealer sales and service agreements. The economic activities associated with purchase and resale of Caterpillar products to dealers in the CACo's sales region occurred both within the U.S. and offshore.

As of December 1, 2001, Cat Inc. has established CAmSARL as the non-exclusive distributor of parts and prime product in Latin America and the Caribbean.³ Pursuant to this distribution arrangement, Cat Inc. and related entities sell parts and prime product to CAmSARL at arm's-length intercompany prices. CAmSARL then resells the products to the dealers in Latin America and the Caribbean on the same terms as CACo, incurring the similar selling, general, and administrative expenses as CACo.⁴

³ CACo is a U.S. company that is wholly owned by Cat Inc. and included in Cat's U.S. consolidated group. CAmSARL is a Swiss limited liability company that was organized by CACo, initially wholly owned by CACo, and classified as a disregarded entity for federal income tax purposes. Following CACo's transfer of intangible assets to CAmSARL, CACo contributed the shares of CAmSARL to CSARL in exchange for a partnership interest in CSARL. CSARL is a Swiss limited liability company that is classified as a partnership for U.S. federal income tax purposes. Since CAmSARL is a disregarded entity, the transfer of shares of CAmSARL to CSARL is treated for federal income tax purposes as a transfer by CACo to CSARL of the assets that CACo had previously transferred to CAmSARL. For federal income tax purposes, the partners of CSARL are COSA, a Swiss company, and CCH and COCCSA, two wholly owned Swiss subsidiaries of COSA. COSA, CCH and COCCSA are classified as corporations for federal income tax purposes. COSA is wholly owned by CACo. Following its receipt of its partnership interest in CSARL, CACo transferred to COSA its interest in CSARL, and COSA then transferred portions of such partnership interest to COCCSA and CCH. CACo's transfer of its CSARL partnership interest to COSA is treated for purposes of Section 367 of the Internal Revenue Code as a transfer by CACo to COSA of its share, as a partner of CSARL, of the assets of CSARL determined in accordance with the CSARL joint venture agreement. It is the latter transfer that is within the ambit of Section 367 of the Code.

⁴ The restructuring will include segregation of the Canadian territory. CAmSARL is now responsible only for the Latin America and Caribbean territories.

CACo's Miami-based employees became employees of Caterpillar Americas Services Company ("CASCo") and are compensated on a cost-plus service fee by CAMSARL for all the technical support, administrative and back office functions. CACo employees based outside of the U.S. became employees of non-U.S. service companies and are also compensated on a cost-plus service fee by CAMSARL for the provision of marketing and administrative services.

Cat Inc. transferred CACo's responsibilities to CAMSARL as part of an effort by Caterpillar to consolidate certain marketing, sales and distribution functions into an entity focused on the needs of non-U.S. customers. The transfer of CACo responsibilities to CAMSARL coincides with the relocation of additional service personnel to offshore entities dedicated to serving non-U.S. customers more effectively and efficiently than may be accomplished from the U.S. By consolidating such services and functions in an offshore entity, Cat seeks to increase sales of prime products and parts to non-U.S. customers.

B. Intangibles Assets Transferred to CAMSARL

Pursuant to the Contribution in Kind Agreements signed on November 26, 2001 by CACo and CAMSARL, CACo transferred to CAMSARL certain assets⁵. CAMSARL employs these assets in the performance of its new distribution functions in Latin America. Per Exhibit A to the Contribution in Kind Agreement, the whole list of assets that were transferred includes certain short-term investments, inventory, intangible assets, investments in subsidiaries, contracts and purchase orders.⁶

As listed on Exhibit C of the Contribution in Kind Agreement, the Intangible Assets Transferred from CACo to CAMSARL consist of:

1. Dealer Contracts;
2. Training Programs (Pro2000 and Masters programs);
3. Order Tracking Software;
4. Procedures and Manuals;
5. Marketing Brochures/Product Catalogues;
6. Website;
7. Any Other Marketing-Related Intangibles (such as Customer Lists or Dealer Network) Associated with the Caribbean, Central America, Mexico and South America; and
8. Goodwill and Going-Concern Value Located In the Caribbean, Central America, Mexico and South America.

⁵ The Contribution in Kind Agreement can be found in Appendix A of this report.

⁶ This report only analyzes the value of the Intangible Assets Transferred as listed on Appendix C.

Below we analyze the nature of each of the above listed Intangible Assets Transferred:

- The Dealer Contracts generally are terminable at will within 90 days by either party.⁷ The agreements do not provide for scheduled price increases or minimum purchase requirements by dealers. The agreements therefore have a short economic life, and provide no basis for assuming economic value beyond the 90-day termination period. Moreover, the Sales and Service agreements have little or no economic value without the corresponding right to purchase and resell Caterpillar products, or the right to use the Caterpillar trademark.
- The Pro2000 and Masters training programs developed by CACo have proved successful in promoting sales among dealers in Latin America. Although proprietary, the training programs nevertheless simply assist CACo to maintain its market share relative to other heavy equipment suppliers in Latin America, and thereby protect its routine distribution income from erosion. The training programs are therefore routine operating intangible assets that functionally could be reproduced over time by another start-up company with sufficient investment of time and resources.
- The Order Tracking Software is a customer service program that allows CAT and CACo employees to check the status of a customer order. The Order Tracking Software was developed by Cat Inc. and only minor improvements were made by CACo. The Order Tracking improvements made by CACo consist mostly of customization to its environment. Therefore, the customization of the Order Tracking Software would have very limited value outside of CACo.
- Procedures and manuals provide documentation of the CACo work procedures, which have evolved over time. Most procedures and manual have been developed by Cat Inc. but may be further developed for the Latin American markets. The benefit of such procedures and manuals is to ensure the smooth operation of the CACo business during employee rotation or the unexpected loss of key personnel. Procedures and manuals are standard business practice, are likely to be short lived.
- Marketing brochures, catalogues and company websites were mostly developed by Cat Inc. Marketing brochures and catalogues are sometimes customized by CACo to the Latin American market through routine language translations, the use of local photographs, and enhanced sensitivity of the publications to local customs and business practices. The marketing brochures, product catalogues, and website are the result of standard business practices and could be easily reproduced over time by start-up company.

⁷ The Dealer Contracts consist of the Dealer Sales and Service Agreement, Distribution Agreement for Engines, Parts and Service, Power Systems Distribution Agreement, Dealer Representative Consent, Distribution Agreement for Medium Speed Engine Sales and Service, and any other similar agreements between CACo and third party dealers selling Caterpillar branded products in the Latin American region.

- Information relating to equipment dealers in Latin America is publicly available. Typically, there is one Caterpillar dealer per country (the territories of Brazil and Mexico are served by multiple dealers each). Hence, there is no trade secret value associated with the assembly of the names of CACo customers. The only value in the customer lists is the likelihood that the dealers will purchase Caterpillar products from CAMSARL again in the future as they have done in the past. However, dealers and customers value the “Caterpillar” brand name and products, not the CACo name. The CACo name thus has no separate trade name or brand value. Therefore, the dealer network effectively belongs to Cat Inc., not CACo, evidenced by the fact that dealers would not stop buying Caterpillar products if CACo were to be replaced by a new sales and marketing company.
- Any going concern or goodwill intangible value attributable to CACo would be derived from and consist primarily (if not exclusively) of the value of the trained and assembled workforce-in-place. Although CAMSARL will inherit many experienced personnel, CACo’s employees are routinely rotated to new positions every three to five years within CACo or other Caterpillar entities. Hence, any value associated with a trained workforce in place is limited to the short period required to train new employees to perform routine marketing and distribution functions on behalf of CAMSARL.

C. Functional Analysis Conclusions

Based on our analysis of the Intangible Assets Transferred we conclude that they are routine and common to most distribution and marketing companies. These assets have only limited economic life, and could be effectively reproduced by a new start-up company with sufficient investment of time and resources. Moreover, the Intangible Assets Transferred would have limited value outside of CACo. These assets have no legal protection (i.e. patent or registration) and would have little or no value on a stand-alone basis.

The Intangible Assets Transferred have been developed over time through the accumulated business experience of a going-concern providing routine marketing and distribution services. When combined, an organized assembled workforce would enable a new start-up company to step into the shoes more quickly than if it were to start afresh. Therefore, we conclude that the Intangible Assets Transferred have very limited economic value and this value is mostly related to its assembled workforce in place.

III. ECONOMIC ANALYSIS OF INTANGIBLE ASSETS TRANSFERRED TO CAmSARL

A. Intangible Assets Definition

Treasury Regulations issued under § 482 of the Internal Revenue Code define intangible property as “any commercially transferable interest in any item included in the following six classes of intangibles, that has substantial value independent of the services of any individual.”⁸ Specifically, Treasury Regulations issued under § 482 of the Internal Revenue Code provide the following list of potential intangible assets:

- (1) Patents, inventions, formulae, processes, designs, patterns, or know-how;
- (2) Copyrights and literary, musical, or artistic compositions;
- (3) Trademarks, trade names, or brand names;
- (4) Franchises, licenses, or contracts;
- (5) Methods, programs, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists, or technical data; and
- (6) Other similar items.

With respect to *other similar items*, an item is considered similar if it “derives its value not from its physical attributes but from its intellectual content or other intangible properties.”⁹

B. Selection of a Method

The standard applied under Treasury Regulations issued under § 482 of the Internal Revenue Code to analyze the value of transferred intangible property is the arm's length standard. Under this standard, a controlled transaction meets the arm's length standard if the results of the transaction are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in a comparable transaction under comparable circumstances.¹⁰ The Treasury Regulations issued under § 482 of the Internal Revenue Code regulations provide that the arm's length character of the transfer of an item of intangible property must be determined by applying one of the methods specified in the regulations under a “best method” analysis. The specified methods include: (i) the Comparable Uncontrolled Transaction (“CUT”) Method; (ii) the Comparable Profits Method (“CPM”); (iii) the Profit Split Method (“PSM”); and (iv) Unspecified Methods.¹¹

The CUT method evaluates whether the amount charged for a controlled transfer of intangible property was appropriate by reference to the amount charged in a comparable uncontrolled transaction. The CUT method is generally the most direct and reliable measure of an arm's

⁸ Reg. § 1.482-4(b).

⁹ Reg. § 1.482-4(b)(6).

¹⁰ Reg. § 1.482-1(b).

¹¹ Reg. § 1.482-4(a).

length result for the transfer of an intangible if the uncontrolled transaction involves the transfer of the same intangible under substantially the same circumstances as the controlled transaction.

When the CUT method cannot be applied because adequate valid comparable transactions cannot be identified, the regulations provide that the CPM may be used to test the arm's length character of a royalty rate or value of intangible property.¹² Under the CPM approach, royalty payments are deemed to be at arm's length if the post-royalty operating profits reported by the licensee fall within the arm's length profitability range derived from uncontrolled taxpayers that are functionally similar to the taxpayer being analyzed but do not own or use valuable non-routine intangibles.¹³

The Profit Split Method, as it applies to the transfer of intangible property, is based on the allocation of the overall profits attributable to an intercompany transaction. The relative contribution of a party to a controlled transaction should be an indication of the relative profits that should be attributed to that party.¹⁴

The use of unspecified methods to value intangible property transactions between related parties is permissible as long as the method provides the most reliable measure of an arm's length result.¹⁵ The regulations provide that such unspecified method should take into account the general principle that uncontrolled taxpayers evaluate the terms of the transaction by considering the realistic alternatives to that transaction, and only enter into that transaction if none of the alternatives is preferable. In establishing whether a controlled transaction achieved an arm's length result, an unspecified method should provide information on prices or profits that the controlled taxpayer could have realized by choosing a realistic alternative to the controlled transaction.¹⁶

Because comparable and reliable CUTs could not be identified, and the profit split method appears inapplicable in these circumstances, a combination of the CPM and unspecified methods provided by the Treasury Regulations issued under § 482 of the Internal Revenue Code regulations was chosen to value the Intangible Assets Transferred.¹⁷ The CPM is applicable here because the method provides an approach to test for the presence overall of high-value intangibles or residual goodwill by assessing whether such assets have contributed to non-routine profits earned by CACo above those consistent with the normal profits earned by comparable marketing and distribution companies. The use of an unspecified method – in this case, the measurement of intangible property value by determination of the foregone profits that CAMSARL would have realized without the Intangible Assets Transferred – provides the most

¹² Reg. § 1.482-4(c).

¹³ Reg. § 1.482-5.

¹⁴ Reg. § 1.482-6.

¹⁵ Reg. § 1.482-4(d).

¹⁶ *Id.*

¹⁷ The fact that comparable and reliable CUTs are not available to value most of the Intangible Assets Transferred is consistent with their classification as "operating intangibles" under the regulations of Section 367(d). Operating intangibles are defined in the regulations as property of a type not ordinarily licensed or transferred between unrelated parties for consideration contingent upon the transferee's use of the property. Reg. § 1.367(a)-1T(d)(5)(ii).

reliable measure of the arm's length result because it takes account of the profits that the controlled taxpayer could have realized by choosing a realistic alternative to the controlled transfer.

C. Application of the CPM

Application of the CPM required a search for comparable marketing and distribution companies. The description of the search performed can be found in Appendix C of this report.¹⁸ This search resulted in a set of five comparable companies that produced an arm's length range as measured by their operating margin of 2.3 percent to 5.1 percent.¹⁹ The median level of operating profit earned by the comparable marketing and distribution companies is 4.2 percent.

The results of the CPM were then compared to those of CACo. Table 1 below presents the financial performance of CACo over the 1997 through 2001 period. From Table 1, based on CACo's financial data, the highest operating profit earned by CACo during the 1997 through 2001 period was 3.6 percent.

Table 1
CACo Financial Statements (including Canada)
(USD millions)

	1997	1998	1999	2000	2001*	Average 97-01
Net Sales	\$2,197.1	\$2,268.1	\$1,754.3	\$1,859.2	\$1,897.2	\$1,995.2
Gross Margin	151.7	128.8	84.5	79.0	106.7	110.2
Operating Expenses	85.0	112.4	106.8	159.3 **	100.6	112.8
Operating Income	66.7	16.4	(22.3)	(80.3)	6.1	(2.7)
Other Exp/(Inc)	(11.3)	(7.3)	(11.0)	(1.2)	(0.4)	(6.2)
Profit Before Tax	\$78.0	\$23.7	(\$11.3)	(\$79.0)	\$6.5	\$3.6
Operating Margin	3.0%	0.7%	-1.3%	-4.3%	0.3%	-0.1%
Profit Margin Before Tax	3.6%	1.0%	-0.6%	-4.3%	0.3%	0.2%

*June year to date annualized data.

**Includes approximately \$60 million one time only payment of Foreign Sales Corp. commission (1992 through 1997 adjustment).

¹⁸ Appendices C1 and C2 provide a discussion of the search for comparable companies and an analysis of the financial results for the comparable companies, including detailed search strategy and business descriptions for comparable distributors.

¹⁹ Note that this arm's length range, 2.3 percent to 5.1 percent, is unadjusted for balance sheet differences between CACo/CaMSARL and the comparables. CaMSARL will have significantly lower assets, as a percentage of sales, than comparables. (CaMSARL's inventory is limited to in-transit inventory, and CaMSARL factors all of its receivables.) It is reasonable to expect, therefore, that a correctly-applied balance sheet adjustment would lower the interquartile range by up to one percentage point.

Table 2 provides CAMSARL's Pro Forma financial results in 2000. These Pro Forma CAMSARL financial results have been created in an effort to determine the expected profit-and-loss statement for CAMSARL. The lower level of sales - \$795 million as compared to \$1,897 million - are due to the two categories of sales to Latin American dealers that will not be handled by CAMSARL. The two categories of sales that will not be handled by CAMSARL are: (i) sales to Canadian dealers; and (ii) sales to Latin America dealers occurring within the US (US title passage). As shown in Table 2, the 2000 Pro Forma financial results were derived from adjusting CACo's financial statements for the lines of business that will not be transferred.²⁰ On a Pro Forma basis CAMSARL would have earned an operating profit margin of 2.4 percent in 2000.

Table 2
CAMSARL Pro Forma Financial Statements
(USD Millions)

	2000
Net Sales	\$795.48
Gross Margin	\$85.90
Operating Expense	<u>(\$67.15)</u>
Operating Income	<u>\$18.75</u>
Operating Income %	2.36%
Pro Forma CAMSARL = CACO Financial Statements Less Canada Less US Title Passage Plus Mexico Parts	

The historic financial results obtained by CACo and reflected on Table 1 and the Pro Forma financial statements for CAMSARL on Table 2 are two measures of the profitability of the distribution function in Latin America. These two measures demonstrate that the distribution function in Latin America earns operating profit margins that are within the arm's length range of comparable distribution companies of 2.3 percent to 5.1 percent.

²⁰ Detailed derivation of the Pro Forma financial results of CAMSARL is provided in Appendix B.

The fact that both CACo and CAMSARL Pro Forma earn or would have earned a level of profitability that is not greater than the financial results of comparable distributors of industrial products performing similar marketing and distribution activities supports the analysis that these companies do not own significant non-routine intangible assets. This is consistent with the corporate worldwide transfer pricing policy by which CACo earned a routine return for the routine risks incurred, routine functions performed and routine operating assets developed and employed.²¹ Therefore, the CPM indicates that CACo does not possess non-routine operating assets.

D. The Value of the Intangible Assets Transferred

As discussed in the Functional Analysis, although the Intangible Assets Transferred are routine in nature, they have value to CAMSARL since they would enable it to avoid start-up costs during its initial period. In effect, the transfer of CACo's intangibles allows CAMSARL to "step into the shoes" of CACo immediately, thus allowing CAMSARL to earn a normal distributor profit much sooner than if it were it to reproduce the assets through investment over time. Moreover, an unrelated party would be willing to pay in order to avoid initial start-up costs. Therefore, the amount of foregone profits and additional risk avoided by CAMSARL provides the best measure of the arm's length value of the Intangible Assets Transferred.

To measure the profits likely to be foregone by CAMSARL during the start-up period without access to the Intangible Assets Transferred, Caterpillar and PwC examined empirical information related to the substantial loss in employees in the San Francisco district office in 2000 due to voluntary separation as well as the normal employee rotation. Caterpillar determined that sales of equipment, engines and parts dropped considerably in the San Francisco district in 2000 due to the loss of several key sales representatives and sales managers.

A statistical analysis²² prepared by Caterpillar and PwC suggests that the percentage decline in Caterpillar's Percentage of Industry Sales ("PINS") attributable to the higher than expected employee turnover in the San Francisco district was 12.8 percent. Caterpillar further estimates that the reduction in sales attributable to the staff turnover lasted for approximately one year after which the district office again achieved normal personnel operating levels and productivity, and sales. The experience of Caterpillar in San Francisco provides a unique experience from which to gauge the value of a trained workforce in place and other related Intangible Assets Transferred.

Based on the estimated decline in sales of 12.8 percent, we estimated the foregone profits for CAMSARL if CAMSARL were to begin operations without the benefit of the Intangible Assets Transferred, particularly the trained workforce in place. The observed sales decline of 12.8 percent was used to calculate CAMSARL's sales level under an initial or "Start-Up Scenario"

²¹ Because Cat Inc., which owns, develops and maintains patents, brands, and other intangible property incorporated in Caterpillar products it receives compensation for its intangible assets primarily through the price of product sold to CACo and CAMSARL and through receipt of royalties on licensed product sold by CAMSARL.

²² See Appendix D for a summary of the statistical analysis.

which assumes the absence of a trained workforce in place. Our analysis estimates that the reduction in sale would not be coupled with a reduction in Selling, General & Administrative expenses ("SG&A") of the same magnitude. Although the new company would have reduced employee costs it would incur additional training and recruiting costs. Thus, we estimate that the reduction in SG&A would only be 95 percent of the reduction in sales (i.e. 12.2 percent). The analysis further assumes that the reduction in sales attributable to the hypothetical absence of the sales staff, as well as the loss of the other intangible assets, would last for one year.

Based on the above assumptions, PwC conducted a sensitivity analysis of the foregone profit by applying two alternative sales growth rate projections: no growth and 5 percent annual sales growth. The results of this analysis are shown in Table 3.

Table 3
Sensitivity Analysis
(\$ Millions)

	Sales Growth Rate	
	0%	5%
Foregone Operating Income	\$2.8	\$3.1

Table 4 represents one of the scenarios described in Table 3. Specifically in Table 4 we compare the projected performance under the "Steady State" (i.e., CAmSARL has access to CACo's operating intangible assets) to a "Start-Up" (i.e., CAmSARL does not benefit from CACo's operating intangible assets) assuming no sales growth and a 12.8 percent decline in sales attributable to staff turnover.

Table 4
Example Economic Analysis Assuming No Growth in Sales

	<u>2002</u>
Net Sales CAmSARL "Steady State"	\$795.48 *
Operating Income CAmSARL "Steady State"	\$18.75
Net Sales CAmSARL "Start Up" (12.8% Reduction in Sales and 12.2% Reduction in SG&A)	\$694.03
Operating Income CAmSARL "Start Up"	\$15.93
Difference in Operating Income - Foregone Profits	(\$2.82)

* CAmSARL's 2002 sales are based on the \$795.5 million Pro Forma net sales for 2000. (see Table 2) which assumes no sales growth through 2002, its first year of operation.

Therefore, the application of this foregone profits start-up analysis to CAmSARL – an unspecified method under Treasury Regulations §1.482 – indicates that the total value of the Intangible Assets Transferred is between \$2.8 million to \$3.1 million. In other words, if CAmSARL were to develop the Intangible Assets Transferred over a year and were to recruit and train the workforce, the amount that it would have foregone in profits would be between \$2.8 to \$3.1 million.

*Caterpillar Inc.
Summary Meeting Notes
Geneva, March 7-9, 2005*

REVISED DRAFT

CSARL Profitability and Royalty
March 7, 2005

Participants: Nathalie Laks, Mary Miller, Crystal Carter, John Caviness, Giles Parsons, Nigel Burroughs, Pierre de Pena, Gary Abellard, Tom Quinn, Steve Williams (presenter), Ian Dykes, Yvonne Coysh, Natalia Pryhoda

Issues:

- CSARL profitability increasing
- Current "bundled royalty" agreement with Cat Inc. @ 4% royalty expires on 1/1/06 (6th amendment)
- Need to justify Cat Inc.'s I/C pricing (primarily royalty) with CSARL for TP documentation purposes

Discussion Points:

[See PowerPoint presentation "Caterpillar Inc.- Caterpillar SARL Transfer Pricing Analysis", March 7, 2005]

Current Transfer Pricing Tests

1. CPM analysis – licensed business may be above arm's length range for 2005; aggregated – OK
2. Profit split – indicates a 5% royalty based on 2001-2004 profitability; preliminary 78/22 residual profit split is a conservative approach for US; profit split analysis is based on CSARL related R&D expenditure; excludes dealer/marketing and TM intangibles
3. CUTs – while inexact – indicate royalty range 2%-5%

Revisions to Testing Methodology

4. Should we expand profit split analysis – additional income to CSARL for parts responsibility, dealers/marketing intangible (but consider agreements in LAD restructuring stating that dealer IP is not very valuable)?
5. Is CPM/TNMM still the best method?
6. Reconsider current comparables set (e.g., remove JLG, etc., use Amadeus companies)? (SW/ID)
7. Use range other than IQ range? (per US regs, IQ range ordinarily provides an acceptable measure of range of returns, however other statistical methods may be used if are more reliable)

Volume Observations

8. CSARL's profitability is driven by volume growth – historical sales increased faster than costs
9. Third-party agreements – as volume increases – royalty rate may decrease to motivate sales growth (mature business); royalty rate may also increase if original royalties were set up for startup operations
10. While CSARL is a mature business (volume increase should bring lower royalty rate), CSARL actually added new, more profitable territories – so volume increase could require a higher royalty rate
11. Is it possible to argue that CSARL profits increased due to higher volume of products sold to 3rd party customers from CSARL's efforts, while operating expenses remained low – so royalty change is not relevant? (GA)
12. However, volume growth may be related to adding new businesses, not specific product line sales growth

Hedging Gains

13. CSARL high profitability in 2004 also driven by est. \$80M hedging gain (\$650M total operating profit) – MTH contracts terminated in 2004 – so no hedging effect in 2005
14. If hedging related to balance sheet restatement – excluded from analysis
15. MTH contracts terminated in 2004 – these contracts are related to operations in future periods (will be no hedge for spot FX sales) – consider excluding from analysis? (TQ)

19

Permanent Subcommittee on Investigations
EXHIBIT #14

Confidential Treatment Requested by PwC

PwC PSI CAT_00150469

**Presentation to Caterpillar Inc.
Audit Committee**

June 2004

**Corporate Tax
Robin D. Beran**



**Permanent Subcommittee on Investigations
EXHIBIT #15**

**Purchased Finished Parts Distribution
— Prior to Establishing CSARL**

**Effective Tax Burdens
Associated with Operating
Income:**

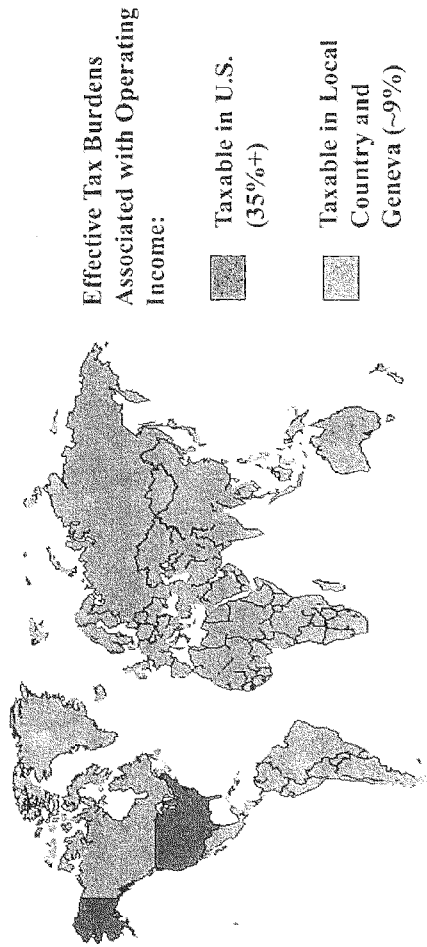
 Taxable in U.S.
(35%+)

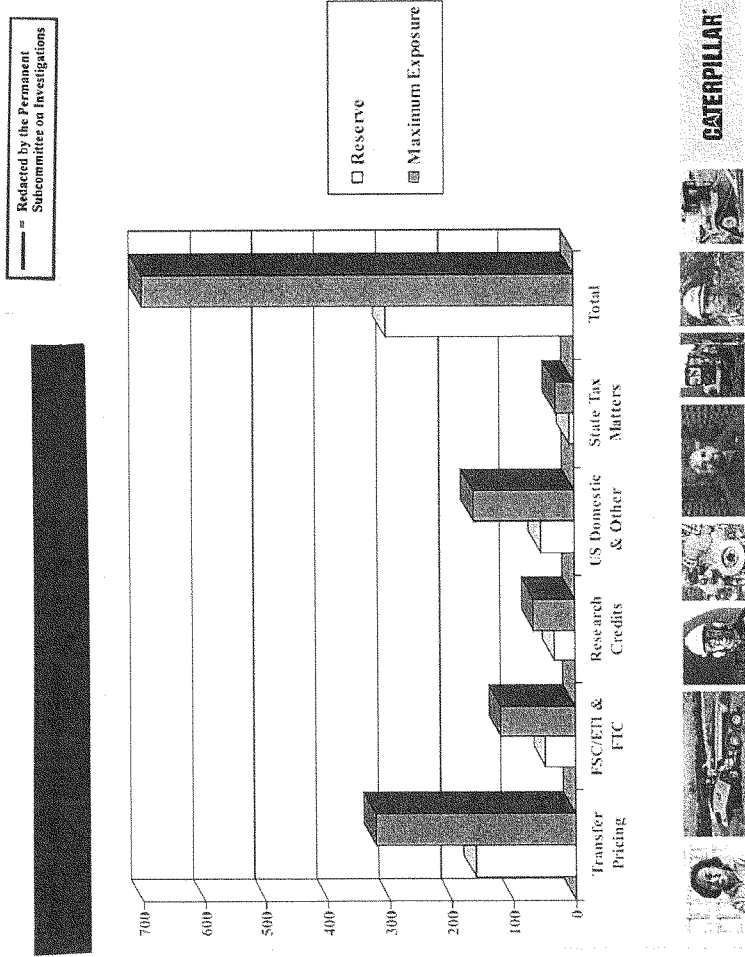
 Taxable in Local
Country (25%-
35%+)

 Taxable in U.S.
and Local Country
(35%+)



Purchased Finished Parts Distribution — Post CSARL

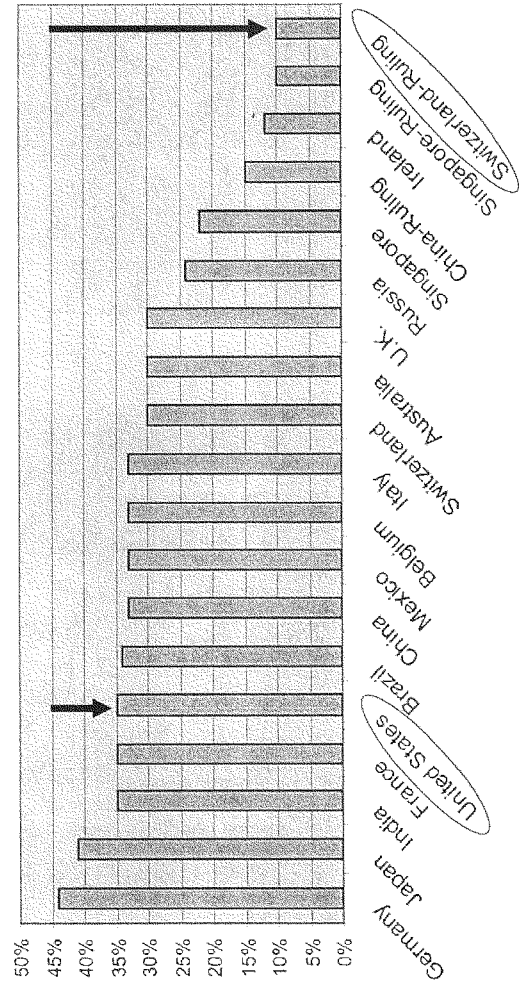




ETR- Causes of "Low-Taxed" Non-U.S. Earnings

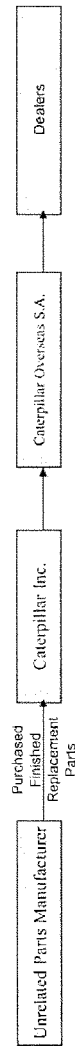
Switzerland provides favorable tax rulings that many U.S. companies utilize.

Tax Rates



Background - Pre-2001 (Before Caterpillar S.A.R.L.)

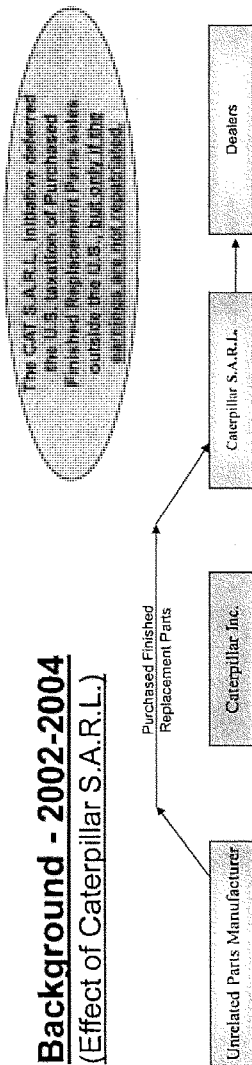
Pre-2001, the Swiss earnings were taxed in the U.S. and, therefore, the funds were available for U.S. funding needs.



Profit from operations	50	50
Swiss profit taxable in US	<u>50</u>	
Total US taxable profit	100	
Tax @ 35%	<u>(35)</u>	
Cash available for US funding	<u>65</u>	

Includes the Swiss earnings because they have been fully subjected to U.S. tax.

Background - 2002-2004 (Effect of Caterpillar S.A.R.L.)



Profit from operations	50	50
"No" Swiss profit taxable in US	0	—
Taxable profit	50	50
Tax @ 35% US / 10% Swiss	(18)	(5)
Cash available for funding in U.S.	32	
Cash available for funding in Switz.		45

8/22/2008 2:15 PM

Delivering Vision 2020

Value Transformation: An After-tax View

Prepared jointly by Corporate Tax and Corporate Accounting Services

Mary Miller
Terri Pierpont
Rod Perkins
Matt Dobberfuhr

Permanent Subcommittee on Investigations

EXHIBIT #16

Confidential Treatment Requested by PwC

PwC PSI CAT 00058419

Confidential - RED

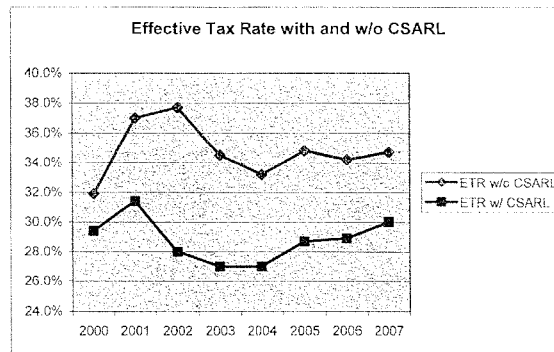
manufacturing). See Section IV for a complete discussion on the CSARL operations. Table I-6 reflects the financial statement benefits the CSARL structure provides:

Table I-6

CSARL Benefits (in millions of \$)			
	Parts	Tolling	Benefits
2000	39	-	39
2001	46	21	67
2002	80	29	109
2003	108	3	111
2004	133	33	166
2005	196	37	233
2006	214	41	255
2007	222	11	233
TOTAL	1,038	175	1,213

Table I-7 shows the actual Caterpillar effective tax rate (bottom line) and what the tax rate would have been without the CSARL structure in place (top line).

Table I-7



Confidential - RED

IV. Maintaining Prior Gains

The single largest factor driving Caterpillar's effective tax rate below the U.S. statutory rate is the ability to maintain deferral of earnings outside the U.S. Most of these deferred earnings are located within the Caterpillar S.A.R.L. ("CSARL") organization. The two primary operational drivers of the CSARL deferral are (1) purchases of replacement parts from suppliers directly by CSARL for marketing regions outside the US and (2) product management benefits for assemblies at the Grenoble and Gosselies facilities (i.e., toll manufacturing).

In conjunction with a reorganization of European Operations in 2001, CSARL became the manufacturing entrepreneur for activities at the Grenoble and Gosselies facilities. Caterpillar France SAS ("CFSAS") and Caterpillar Belgium SA ("CBSA") provide manufacturing services to CSARL, receiving a service fee consistent with their limited functions and risks. CBSA and CFSAS are not in the buy-sell flow of transactions. Consistent with the management structure, all inventories are owned by CSARL, and corresponding technology licenses are between CAT Inc. and CSARL. As noted in Section III, it is extremely important that the key functions such as product management, product development and inventory risk, remain within CSARL, rather than at CBSA and CFSAS.

U.S. tax rules penalize the sale of purchased goods to a non-U.S. customer where the product was purchased from a related Caterpillar entity. However, if these same goods were purchased directly from an unrelated entity and re-sold to a non-U.S. customer, the income would not be immediately taxed in the U.S. Caterpillar purchases significant quantities of replacement parts from unrelated suppliers to service field populations of CAT produced products. CSARL is the entity with territorial marketing rights to non-U.S. regions. In 1999, CSARL began purchasing replacement parts directly from suppliers for sale into non-U.S. markets. By removing CAT Inc. from the supply chain in connection with the reorganization of certain European operations and payment of a royalty to Caterpillar Inc. (formerly: 3rd party supplier → CAT Inc. → CSARL → non-U.S. Customer), CSARL is both buying from and selling to unrelated parties (current supply chain: 3rd party supplier → CSARL → non-U.S. Customer).

Confidential - RED

This allows the profits on these sales to be deferred from U.S. taxation. To maintain this tax benefit, supplier agreements and service agreements must be respected and maintained. The cost of logistics or administrative service activities related to purchased finished replacement parts must be borne by CSARL. CSARL can perform such activities itself or engages others to perform this work on CSARL's behalf. In addition, CSARL must incur the carrying costs of inventory ownership, as well as risk of obsolescence.

See charts I-6 and I-7 for the historical view of the CSARL impact to profit and the effective tax rate. In addition to maintaining the alignment of functions and risks within CSARL, past and future CSARL benefits depend on the management of the non-U.S. cash position. As noted in Section I. "Caterpillar's Effective Tax Rate: Past and Present," indefinite reinvestment of CSARL deferred earnings outside the U.S. is required, or U.S. GAAP will mandate these earnings be recorded at the 35% U.S. tax rate. This increased tax cost can occur by repatriating CSARL low-tax earnings to the U.S. or lacking a reasonable plan to indefinitely reinvest those earnings outside the U.S. In other words, even if no cash is repatriated to the U.S., the U.S. GAAP rules will require a tax provision on current earnings at the 35% U.S. rate, unless a definite plan exists to maintain the earnings outside the U.S. Prior earnings of CSARL back to its formation are also at risk of uplift to the US tax rate if a reinvestment plan does not exist.

For every \$100 million of low-tax CSARL earnings repatriated, the financial statement impact would be additional tax expense of 30 percentage points. The impact on the earnings per share would be a reduction of 5 cents per share per \$100M of repatriation. Without a reinvestment plan, future benefits also would be in jeopardy, and the ongoing effective tax rate would be similar to Table I-7 "ETR w/o CSARL" line.

V. Caterpillar's Cash Obstacle

As noted, the most significant impediment to reducing Caterpillar's effective tax rate below the U.S. statutory rate is the ability to maintain deferral of earnings outside the U.S. This ability depends upon the management of the non-U.S. cash position. Indefinite reinvestment of low-tax

Confidential - RED

earnings outside the U.S. is required, or U.S. GAAP will mandate these earnings be recorded at the 35% U.S. tax rate.

Caterpillar has stated its earnings and cash objectives as:

- a. Continue growing the business through both organic and acquisitive means
- b. Funding pension plans
- c. Increasing dividends to our shareholders
- d. Repurchasing Caterpillar stock

Caterpillar has seen record growth and profitability over the past few years. As a global operating company, a significant amount of cash is generated outside the U.S. in jurisdictions with low-tax rates. However, as a US-based company, the final three of Caterpillar's above listed cash objectives must be funded with U.S. cash.

The primary objective, funding the growth of the company, includes both organic and acquisitive growth. Organic growth includes investments in capital projects (replacing, building or improving property, plants and equipment) and research activities. Organic growth demands lie both inside the U.S. and outside the U.S. However, research activities are currently funded primarily inside the U.S. As Caterpillar expanded its global reach, it was anticipated expansion via acquisitions would occur predominantly outside the U.S.

Redacted by the
Permanent Subcommittee on Investigations



The cash crossover position is continuously monitored by a stellar Global Finance and Strategic Support team from Treasury and Tax. Crossover is the point where non-U.S. cash utilized in the U.S. exceeds tax capacity. Tax capacity is the ability to apply cash to US operations and uses without incurring significant, additional enterprise tax expense. This includes repatriation of non-U.S. earnings previously taxed in the U.S., advance payments for US-sourced goods and services, or one-time planning opportunities (such as the 2005 U.S. tax legislation allowing repatriation of non-U.S. earnings at a low US rate, often referred to as the Homeland Investment Act). Based on existing and past treasury practices, crossover is expected to occur in late 2008 or early 2009. Chart V-I shows the history and projections of crossover.

Global Finance and Strategic Support



Global Tax & Trade Update

Audit Committee, April 13, 2010

CATERPILLAR®

Confidential Treatment Requested by P&G.

Confidential Treatment Requested by P&G.

P&G_2010_Full_Report

Permanent Subcommittee on Investigations
EXHIBIT #17

Summary – Key Messages

- We have Global Tax & Trade resources—
 - Retirements absorbed, focus on development and retention of bench
- Effective Tax Rate has dropped to lowest in the Dow 30
 - 2009 ETR dramatically impacted by decline and mix of income, plus \$133 million in discrete benefits
- Tax Reserves of \$761 million are adequate
- Cash Management – Build-up of foreign earnings and cash are being aggressively managed to improve returns while protecting assets.
- Legislation and Regulation—
 - Political attacks on Big Business continue
 - Caterpillar is leading lobbying activities in Washington
 - Coordinated approach has been successful and is continuing



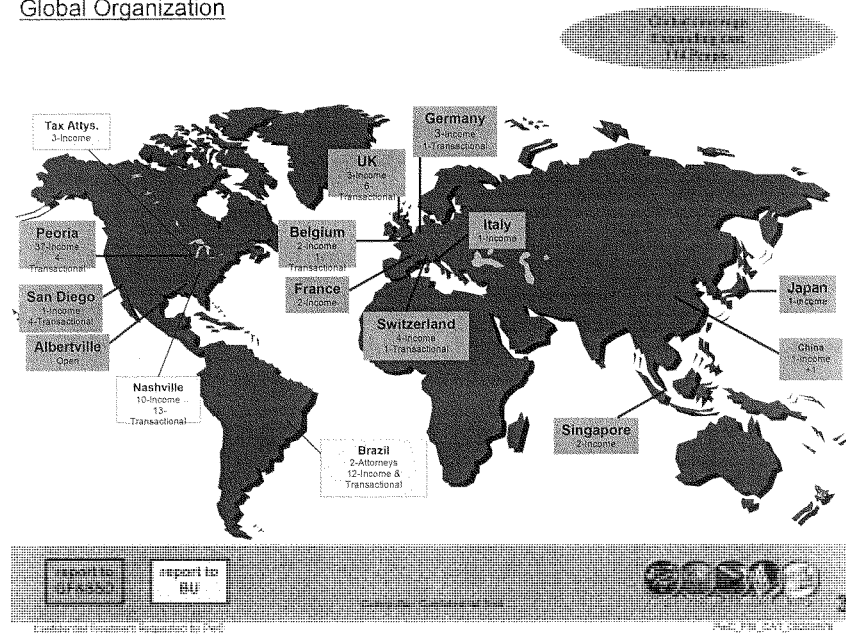
Caterpillar: Confidential Red

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00205976

2

Global Organization



Effective Tax Rate – Dow 30

Effective Tax Rate – Dow 30
 Rank 1 to 30 by Effective Tax Rate
 ETR

Dow 30	2009 ETR	2008 ETR	Rank	Competitors	ETR
Caterpillar Inc.	-47.5%	21.2%	1	Fiat (CNH)	-131.1%
Bank of America	-44.0%	9.5%	2		
General Electric Co.	-10.5%	5.3%	3	Volvo	-28.6%
Verizon Communications, Inc.	10.5%	20.9%	4		
Merck & Co. Inc.	14.8%	20.1%	5		
Hewlett-Packard Co.	18.6%	20.5%	6		
DuPont (E.I.) de Nemours	19.0%	15.9%	7		
Cisco System	20.3%	21.5%	8		
Pfizer Inc.	20.3%	17.0%	9		
Johnson & Johnson	22.1%	23.5%	10		
Coca-Cola Co.	22.6%	21.7%	11	Terex	22.7%
Boeing Co.	22.9%	33.6%	12		
Travelers	23.0%	21.0%	13		
Intel Corp.	23.4%	31.1%	14		
American Express Co.	24.8%	19.8%	15	Cummins	24.4%
International Bus. Mach.	26.0%	26.0%	16		
Procter & Gamble Co.	26.3%	24.5%	17		
Microsoft Corp.	26.5%	25.8%	18		
United Technologies Corp.	27.4%	27.1%	19		
J.P. Morgan Chase & Co.	27.5%	-33.4%	20		
KRAFT FOODS INC. CL A	29.4%	29.0%	21		
McDonalds Corp.	29.8%	30.0%	22		
3M Company	30.0%	31.1%	23		
AT&T Inc.	32.4%	34.9%	24	Komatsu	32.8%
Wal-Mart Stores, Inc.	34.2%	34.2%	25	Deere & Co.	34.3%
Home Depot, Inc.	35.2%	35.6%	26		
Walt Disney Co.	36.2%	36.1%	27		
Alcoa Inc.	38.3%	43.2%	28		
Chevron Texaco Corp.	43.0%	44.2%	29		
Exxon Mobil Corp.	47.0%	46.0%	30		

Caterpillar Confidential Real



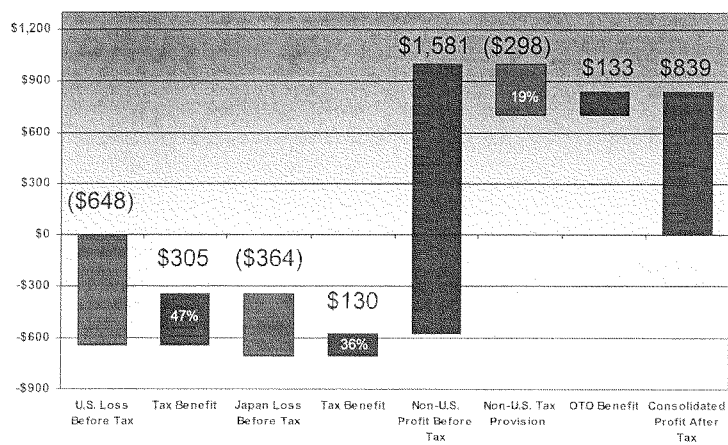
5

Confidential Treatment Requested by PwC

PwC_PSI_CAT_0025378

2009 Effective Tax Rate – Drivers
(\$ Millions)

Losses in high-tax rate countries,
Profits in low



Caterpillar: Confidential Red



6

Confidential Treatment Requested by PwC

PwC_PSL_CAT_002058/9

Cash Management**“Crossover” cash buildup in Geneva**

Actively working to utilize
Geneva cash

Caterpillar Definition: Crossover occurs when offshore cash no longer can be accessed in the U.S. without incremental U.S. tax cost

Impact and Risk:

- High enterprise tax cost of repatriation – 25% additional tax
- Low return on bank deposits of excess Geneva cash

Balance December 2009	\$1.5 billion
2010 Growth	<u>\$2.9 billion</u>
ATS Dec. 2010	\$4.4 billion
Geneva Cash Feb. 2010	\$1.6 billion

Plans:

- Geneva cash position monitored monthly
- Aggressively manage Geneva cash buildup
- Develop tax efficient repatriation strategies



Cash Management

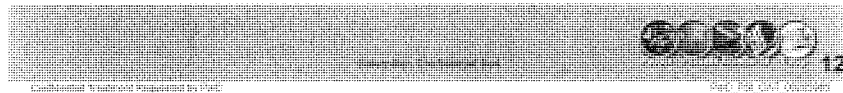
Improve utilization and
returns vs. bank deposits

Action Plans – What are we doing?**Developing tax efficient repatriation strategies – \$3 billion**

- 2010 Planning Actions – Repatriate \$1 billion
 - Loans to U.S. with minimal tax impact
 - Tax efficient dividends – high-tax pools
- 2010 Planning Opportunities – \$2 billion
 - Prepay royalties
 - Expand goods prepayment – CSARL purchases from U.S. affiliates
 - Other options under consideration

Aggressively managing Geneva cash utilization – \$1 billion

- Fund reduction of external debt for Cat Japan
- Fund part of Cat Financial's non-U.S. funding needs
- Supplier pre-pay programs – steel, tires

Plans identified to cover cash flow through 2010

Caterpillar Board of Directors
Minutes Excerpts

08/11/99
P.5

Global Value Enhancement (GloVE) project

Mr. Owens discussed the Global Value Enhancement (GloVE) project involving numerous initiatives under the guidance of the Corporate Tax Department reporting to a steering committee chaired by the Chief Financial Officer. The projects were said to range from simple process changes to subsidiary capital restructuring. Approval of two initiatives coming out of this effort was being requested. These were explained and, after discussion, on motion duly made, seconded and unanimously carried, the following resolutions were adopted:

RESOLVED, that the recapitalization of \$25,000,000 of existing loans from Caterpillar Inc. to Caterpillar Commercial Holding S.A.

Redacted by the
Permanent Subcommittee on Investigations

12/11/02
Page 5

Mr. Owens then updated the Board on Critical Success Factor #4 – Product Support Parts Sales Growth. He described the parts business value chain and the product support core processes, and explained that the company has recently focused on parts sales and increased investment in parts products development, parts and service systems, and emphasized increasing parts sales and service people in the field. In addition, he said

Proprietary and Confidential

Permanent Subcommittee on Investigations

EXHIBIT #18

CAT-001855

Caterpillar Board of Directors
Minutes Excerpts

12/11/02
Page 6

that in 2003 the company will change the accountable system to align internal business units' goals and objectives in order to drive more accountability for parts sales and profit.

He described the expected future parts growth and the factors that influence the growth including product mix and product design. He detailed the metrics to be utilized for Critical Success Factor #4 including parts order growth and parts margin improvement.

He concluded by saying the product support business is vitally important to the company and its dealers; has been a traditional source of competitive advantage and the company is working to strengthen that position; initiatives currently in place have served to sustain sales in a recessionary market; plans are in place to accelerate growth; and the company has long-term metrics in place to achieve its goals on this critical success factor.

**Redacted by the
Permanent Subcommittee on Investigations**

December 9, 2009
Page 11

Mr. Levenick reviewed positive feedback from customers and dealers, the improvement in the clarity of roles and responsibilities and the increase in teamwork that has resulted from the Enterprise Alignment. He also noted that there are numerous areas for continued focus, which include business table effectiveness, clarifying decision rights, focus on distribution manager portfolio responsibility and the organization of the parts business. He noted that customer feedback would be the best measure of the effectiveness of the Enterprise Alignment. He also reviewed the 2012 Quarry and Special Industries Division targets to demonstrate the increased alignment under the new structure. In response to questions from the Board, Mr. Levenick described the organization of the Company's parts business and how the business table operates.

Proprietary and Confidential

CAT-001856

Caterpillar Board of Directors
Minutes Excerpts

Redacted by the
Permanent Subcommittee on Investigations

February 8, 2012
Page 8

Parts Growth and Distribution Facility Footprint Expansion

Mr. Levenick invited Messrs. Gosselin and Larson to discuss the Company's parts business. Mr. Gosselin began by explaining that the "seed, grow, harvest" business model ingrained in the organization was a catalyst to aftermarket parts sales and services, creating an annuity continuing long after original equipment sales and generating customer loyalty, PINS and profits. He then identified six strategic actions being undertaken to maximize the aftermarket opportunity. Mr. Gosselin then tracked current parts performance against financial and operations goals established in 2010, noting that the Company had made significant improvements and was on track to meet the 2015 targets. He then explained the Company was making similar progress on POPS.

Mr. Larson next described the efforts underway to transform the parts distribution business from a United States centric model into regional distribution centers located throughout the world. He noted that the 2011 parts distribution and delivery business had met or exceeded the internal objectives or competitive benchmarks. Mr. Larson then described the distribution network transformation that was underway. This, he observed, involved moving from world-wide suppliers and

Proprietary and Confidential

CAT-001857

Caterpillar Board of Directors
Minutes Excerpts

February 8, 2012

Page 9

packaging to regional suppliers and packaging, with the goal of reducing the number and distance of shipments. Under the reconfigured global footprint, he explained, receiving points would be closer to suppliers and shipping points closer to dealers and customers. Mr. Larson then previewed a map showing the planned location of distribution facilities and contrasted the Company's strategy with that of Komatsu.


During their presentations Messrs. Gosselin and Larson responded to questions from the Board concerning Bucyrus, remanufacturing, automation, facility and workforce size, the Company's ability to identify the most profitable parts and those that are rarely ordered, barriers to on-time delivery, the optimal number of distribution facilities and on-line ordering in secondary markets.

August 8, 2012

Page 5

Parts and Distribution

Mr. Levenick explained that the parts business was meeting its inventory availability and turnover targets, but levels were elevated as a result of the initial stocking of three new parts distribution centers. He noted that the business was focused on opportunities to eliminate inventory for low volume parts and increase direct shipments from parts suppliers to dealers.



— = Redacted by the Permanent
Subcommittee on Investigations

Proprietary and Confidential

CAT-001858

Caterpillar Audit Committee
Minutes Excerpts

**Redacted by the
Permanent Subcommittee on Investigations**

12/09/2003
Audit Committee
Page 4

Business unit risk management update (Product Support Division)

Mr. Springer then made a presentation regarding the implementation of the company's Business Risk Management ("BRM") process in the Product Support Division ("PSD"). He began with an overview of the company's various roles in the product support process and interaction with the dealers. He discussed the company's parts business, its importance to the enterprise and the implementation of the company's product support excellence on Critical Success Factor. He described the company's goals for the Product Support Division and the applicable metrics to be achieved in a very difficult competitive environment. He said that this combination of factors required a very thorough analysis of PSD's strategy and risks.

Proprietary and Confidential

CAT-001860

Caterpillar Audit Committee
Minutes Excerpts

04/08/2008
Audit Committee
Page 5

Global Finance and Strategic Support Transformation Update

Income Tax Matters

Mr. Beran provided a presentation on, and led a discussion of, the Company's income tax matters and specifically noted that the Company now has global tax resources in place to manage tax issues, its effective tax rate ("ETR") which is approximately at the median of the Dow 30 companies, its tax reserves which are adequate and the tax department's risk management processes which are robust.



Redacted by the
Permanent Subcommittee on Investigations

Redacted by the
Permanent Subcommittee on Investigations

Proprietary and Confidential

CAT-001863

Caterpillar Audit Committee
Minutes Excerpts

04/07/2009
Audit Committee
Page 5

Mr. Larson then noted that the key points regarding the Logistics Division are that it is driving transformational change in the Transportation, Manufacturing Logistics and the Cat parts business that will deliver significant value and address key areas of risk. He noted that the Logistics Division has set a goal of reducing parts inventory during 2009 by US\$350-500 million while maintaining 95% parts availability. He also informed the Committee that the external client business delivered 15% return on assets in 2008 and US\$71 million in positive cash flow.

12/08/2009
Audit Committee
Page 2

Project "Stay Strong" / Financial Markets update



Redacted by the
Permanent Subcommittee on Investigations

Proprietary and Confidential

CAT-001864

From: CN=Steven R. Williams/OU=US/OU=TLS/O=PwC
 To: CN=Clifford A. Mangano/OU=US/OU=TLS/O=PwC@Americas-US
 Sent: 08/29/2007 11:26:25 AM EST
 CC: CN=Thomas F. Quinn/OU=US/OU=TLS/O=PwC;CN=Charles Larson/OU=US/OU=TLS/O=PwC@Americas-US
 Subject: Fw: Caterpillar parts history

Chuck Larson has an even better memory than me. Here's a file of the parts data at Caterpillar. This showed that more than 50% of parts sales were for parts originally placed in service more than 10 years prior. And to capture 80% of parts sales, you had to go back 20 years. (ie, in a given year, Cat still sold 20% of replacement parts that were first placed in service more than 20 years prior....)

Hence the very long tail for cost sharing buy-in.

----- Forwarded by Steven R. Williams/US/TLS/PwC on 08/29/2007 12:18 PM -----

Charles Larson/US/TLS/PwC
 08/29/2007 12:05 PM
 Office: (312) 298-3105; Mobile: (708) 205-7997
 Chicago
 US
 "Reply to All" is Disabled

To: Steven R. Williams/US/TLS/PwC@Americas-US
 cc:
 Subject: Re: Caterpillar parts history

Steve, here is what I could find off-hand:

I hope this helps.

-Chuck

Steven R. Williams/US/TLS/PwC
 08/29/2007 10:39 AM

"Reply to All" is Disabled

To: Charles Larson/US/TLS/PwC@Americas-US
 cc:
 Subject: Re: Caterpillar parts history

yes if you can find the excel model. I gave Cat some presentations in both 02 and 03, regarding the tradeoff between higher CS+ royalty now, vs lower overall CS later, but they always balked at the 10 year transition period. (easy enough to model)

the parts life cycle analysis-- showing parts consumption per machine over the machine life-- from Cat, is the "evidence" I'm looking for that supports the "parts life cycle" So if you have that, it would be great.

thanks a lot!

Charles Larson/US/TLS/PwC
 08/29/2007 11:33 AM
 Office: (312) 298-3105; Mobile: (708) 205-7997
 Chicago
 US
 "Reply to All" is Disabled

To: Steven R. Williams/US/TLS/PwC@Americas-US
 cc:
 Subject: Re: Caterpillar parts history

I remember it. We met in DC with Steve Hannas from some law firm to discuss the potential cost sharing model. I probably have some old excel models etc. if you'd like to have them.

Permanent Subcommittee on Investigations

EXHIBIT #19

Confidential Treatment Requested by PwC

PwC PSI CAT 00024439

Steven R. Williams/US/TLS/PwC
08/29/2007 10:30 AM

"Reply to All" is Disabled

To
Charles Larson/US/TLS/PwC@Americas-US
cc

Subject
Caterpillar parts history

Hey Chuck--

I recall an interesting analysis we did for Cat at least 5 years ago, and wonder if you were involved with me at the time. We were considering if Cat Sari could cost share instead of paying a royalty (ie a declining royalty for old technology, plus cost sharing for new technology).

the rate of decline of course had to do with the product life cycle.

then we got some analysis from Cat that showed that machines still consume (profitable) replacement parts for 10, 20 years, so the declining royalty became too long to make it worthwhile, ie the product life cycle was 10+ years when you considered replacement parts.

But do you recall that parts analysis? of age of machines and consumption of parts? It was surprising how long machines stayed in service and still consumed parts... We are considering a similar analysis for another client.

Thanks

Steve



CATERPILLAR®

Parts Growth & Distribution Network Transformation

Steve Gosselin / Steve Larson

February 2012 Board of Directors Meeting

CONFIDENTIAL F&D. DO NOT COPY OR DISTRIBUTE

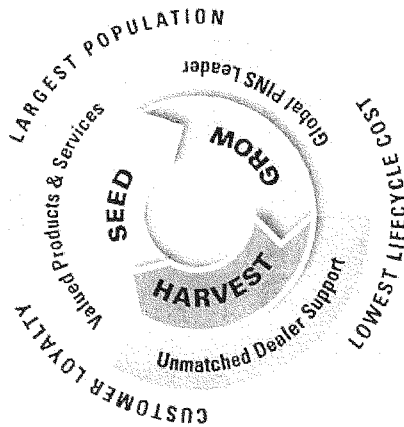
Confidential & Proprietary

ermanent Subcommittee on Investigations
EXHIBIT #20

CAT-001885

The Caterpillar Business Model

Our Fundamental, Competitive Advantage—Executed in Close Partnership with our Dealers



Maximizing our parts & service opportunity given our large field population is critical to our ability to increase customer loyalty, PINS and profitability.

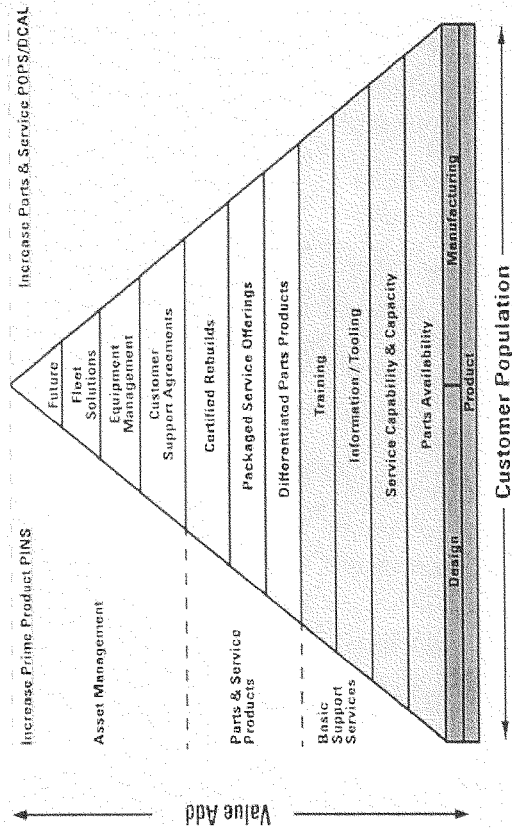
2011-2015
ENTERPRISE STRATEGY &
OUR VALUES IN ACTION

CUSTOMERS. PEOPLE. STOCKHOLDERS. CATERPILLAR*

CONFIDENTIAL. REG. DO NOT COPY OR DISTRIBUTE

Enterprise Product Support Strategy

A Strong Product Support Foundation Enables More Effective Parts Marketing



2011-2015
ENTERPRISE STRATEGY &
OUR VALUES IN ACTION

CUSTOMERS. PEOPLE. STOCKHOLDERS.

CATERPILLAR®

CONFIDENTIAL, REL. DO NOT COPY OR DISTRIBUTE

3

Enterprise Parts Strategy Strategic Actions

Aggressive Strategic Actions
Aligned Across the
Enterprise

- ✓ Increase Parts Distribution Capacity and Operational Efficiency
- ✓ Increase Parts Manufacturing Capacity
- ✓ Improve Customer Ease of Doing Business with Caterpillar
- ✓ Enhance Dealer Capability & Market Competitiveness
- ✓ Expand Parts & Service Offerings
- ✓ Simplify & Attack Our Cost Structure

423

2011-2015
ENTERPRISE STRATEGY &
OUR VALUES IN ACTION

CUSTOMERS. PEOPLE. STOCKHOLDERS.

CATERPILLAR®

CONFIDENTIAL - FD. DO NOT COPY OR DISTRIBUTE

4

Cat Parts Desired State

The Parts Strategy Targeted
Significant Improvements....
We Are On Target to Deliver

Fall 2010 Current Desired State

Manufacture / Distribution Capacity

Distribution Capacity Utilization

Supply Chain Delivery Performance

Parts Availability

Parts Past Due

Price Premiums
Undercarriage

Engine Parts

93% 96.3% 95%

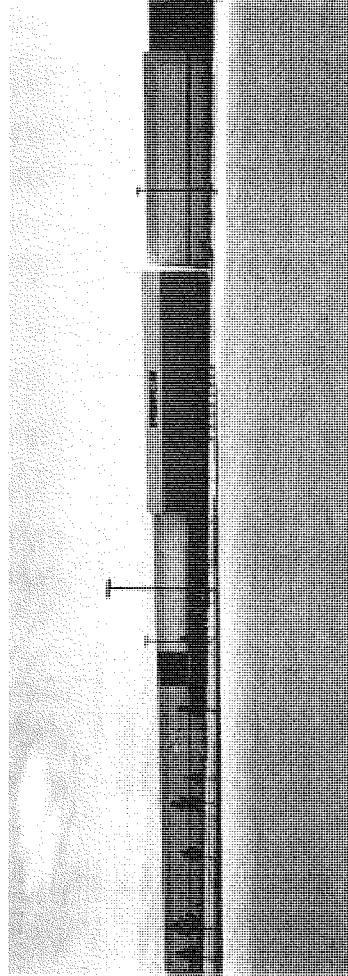
2011-2015
ENTERPRISE STRATEGY &
OUR VALUES IN ACTION

CUSTOMERS. PEOPLE. STOCKHOLDERS. **CATERPILLAR®**

— = Reduced by the Permanent
Subcommittee on Investigations

CONFIDENTIAL REQ. DO NOT COPY OR DISTRIBUTE

5



425

Clayton, Ohio / Distribution Center and Inbound Processing Center

Parts Distribution & Logistics Division Transforming Caterpillar's Parts Distribution Network

Steve Larson

2011 Parts Distribution & Logistics Scorecard

— = Redacted by the Permanent Subcommittee on Investigations

	ABP Target	Actual
Net Sales		
Safety		
On-time Delivery - external		
On-time Delivery - internal		
Parts Availability	94.8%	96.3%
Inventory Turns		

- Demand at Record Levels
- Safety performance significantly better than competitors
- Improving Supply Chain
- Record Parts Availability
- Turns Above Target

Strong Performance in 2011

Parts shipping errors have been reduced by 18% from 2010, by 44% from 2008. Quality project won Group President Annual Quality Improvement award.

2011-2015
ENTERPRISE STRATEGY &
OUR VALUES IN ACTION

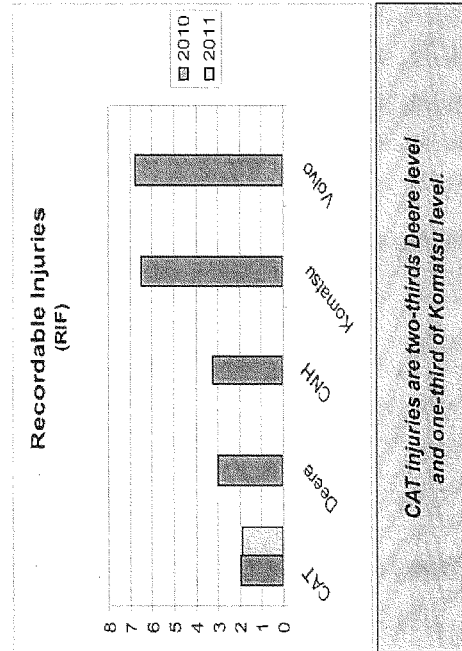
CUSTOMERS. PEOPLE. STOCKHOLDERS.

CATERPILLAR*

CONFIDENTIAL. RTO. DO NOT COPY OR DISTRIBUTE

8

Parts Distribution Competitive Benchmarks – North America



2011-2015
ENTERPRISE STRATEGY &
OUR VALUES IN ACTION

CUSTOMERS. PEOPLE. STOCKHOLDERS. **CATERPILLAR®**

CONFIDENTIAL (RIF) DO NOT COPY OR CIRCULATE

Source: Carlisle North America Service Parts Conference

Parts Distribution Competitive Benchmarks – North America

Confidential & Proprietary

Redacted by the
Permanent Subcommittee on Investigations

428

2011-2015
ENTERPRISE STRATEGY &
OUR VALUES IN ACTION

CUSTOMERS. PEOPLE. STOCKHOLDERS. **CATERPILLAR***

CONFIDENTIAL, PTD, DO NOT COPY OR DISTRIBUTE

Source: Carlisle North America Service Parts Conference

18

CAT-001894

Parts Distribution Competitive Benchmarks – North America

Confidential & Proprietary

Redacted by the
Permanent Subcommittee on Investigations

429

2011-2015
ENTERPRISE STRATEGY &
OUR VALUES IN ACTION

CUSTOMERS. PEOPLE. STOCKHOLDERS. **CATERPILLAR**

CONFIDENTIAL REQ. DO NOT COPY OR DISSEMINATE

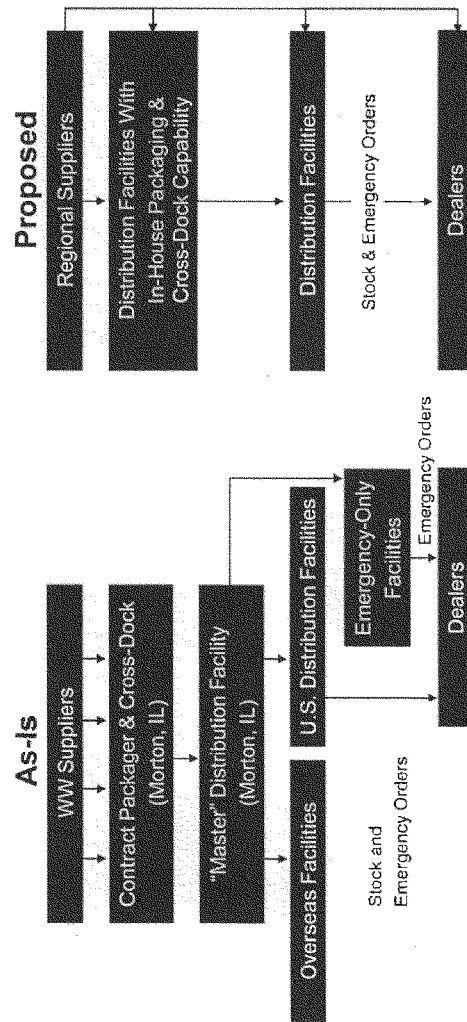
Source: Carlisle North America Service Parts Conference

11

CAT-001895

Solution: Network Transformation

Processes And Systems
Are Foundational

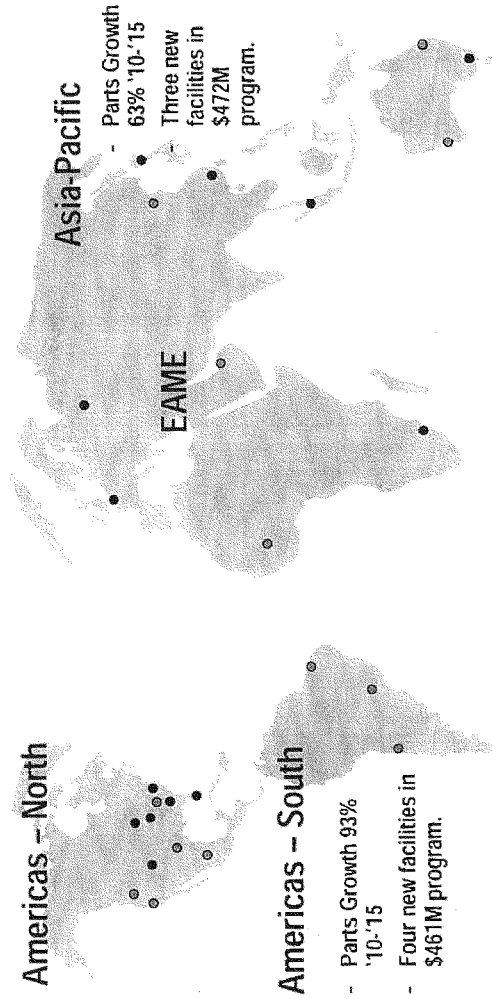


- Receiving points closer to suppliers
- Shipping points closer to dealers and customers

CONFIDENTIAL REQ. DO NOT COPY OR DISTRIBUTE

12

Cat Parts Distribution Future Footprint



- 8 Existing
EAME - 1, AN - 5, AS - 1, AP - 1
- 13 New
AP - 3, EAME - 2, AN - 4, AS - 4
- 5 Expansion
EAME - 2, AP - 3

Excluding Bucyrus

West Africa location for illustration purposes only actual location TBD

CONFIDENTIAL, REG. DO NOT COPY OR DISTRIBUTE

Cat Parts Distribution - Summary

- Strong foundation for transformation work – record parts availability, inventory turns exceeding target, and shipping quality significantly improved
- Excellent progress on facility additions / expansions to date
 - Utilizing lean capital deployment principles
 - Work beginning on Asia Pacific and Americas South programs
- Strong organizational alignment on capacity plans
- Future focus on getting more capacity from existing / planned investments
 - Low volume parts strategy
 - Direct ship initiative
 - Service life policy

Caterpillar dealer push may drive some out, Levenick says

BY JAMES B. KELLEHER

LAS VEGAS Thu Mar 6, 2014 1:33am EST

<http://www.reuters.com/article/2014/03/06/us-caterpillar-dealers-idUSBREA250AZ20140306>



Stuart Levenick, group president of Caterpillar, speaks at the Reuters Manufacturing and Transportation Summit in New York, December 12, 2011 file photo.

CREDIT: REUTERS/DRENNAN MCDERMID

(Reuters) - Caterpillar Inc's (CAT.N) bid to lift the financial performance of its dealer network isn't designed to thin the ranks of the 178 independent distributors that sell and service its earth-moving products around the globe, a company executive said.

But Stuart Levenick, who is charged with overseeing the financial turnaround, said an unknown number of dealers including some family-run businesses, could be casualties of the push unveiled last month.

"This is not a plan to cull our dealers or drive consolidation - although you can expect that some of that will occur," Levenick told Reuters in an interview on Wednesday.

"But we do expect results. If you are not aligned, if you're not progressing towards those results, then you can expect us to move judiciously to make changes ... They all get that."

Caterpillar used to organize its global business - including dealer relations - regionally rather than by product category or customer type. So dealers were, in Levenick's words, "measured against the guy down the street".

That changed when the company reorganized a few years ago. The far-flung dealer network was put under one executive in Peoria, Illinois, who began comparing the performance of dealers across the globe.

The disparities, Levenick says, were jaw-dropping. So, too, were the money-making possibilities - if the laggards sold machines, parts and services as efficiently as dealers in the top half of the dealer performance rankings.

Permanent Subcommittee on Investigations

EXHIBIT #21

That, in a nutshell, is what the company has said it now wants them to do. Caterpillar has said the plan could increase sales and service revenue at the dealer level by \$9 billion to \$18 billion by 2018 - and that much of that increased revenue would flow to Caterpillar itself.

Under the plan, underperforming dealers have until the end of 2014 to come up with a plan for raising key metrics. Once the plan is approved by Caterpillar, they have three years to meet the targets.

The push is not without risk. Caterpillar has long touted its independent dealers, whose 162,000 workers more than double its global headcount, as a key competitive advantage, especially in recent years as lower-priced Asian rivals with thinner dealer support networks rose up to challenge it.

Tweaking that magic formula could create some ugly chemistry and sour the special relationship that Caterpillar says has been key to its success in remaining the world's top maker of construction and mining equipment.

The company has tried to increase distributor enthusiasm for the plan by tapping 20 of its top-performing dealers to help design the program's carrots and sticks.

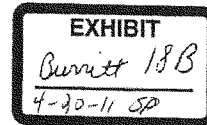
So far, Levenick says, "there's not a lot of pushback." But the plan is still in its infancy and resistance could grow as dealers are forced to change long-standing practices and raise their game.

Analysts say a number of factors are driving Caterpillar's focus on dealer performance, including a tougher-than-expected sales environment, especially of high-margin products to the mining sector.

After peaking at \$66 billion in 2012, Caterpillar's sales tumbled 16 percent to \$55.6 billion in 2013 and the company has said 2014 revenue growth will be flat and could even fall as much another 5 percent.

But customer expectations are playing a big role, too, Levenick says. Many of Caterpillar's customers now do business around the globe and work with multiple dealers whose service levels - and prices - are not always consistent. "They want to have a common experience wherever they go," he said.

(Editing by Jeremy Laurence)



Global Tax Management

Purpose of Meeting

- To Inform you why and how we are strengthening Tax Risk Management

Key Message Points

- We are taking Tax Risk Management to a new level
- Qualified people are the key to World-Class Tax Risk Management

December 13, 2005

Agenda

What we'll
cover today

- What is Tax Management ?
- State of the Tax Business at Caterpillar
- State of the Tax Business Current Headlines, Research & Data Points
- Path to World-Class Tax Risk Management
- People Risk = Tax Risk

Income Taxes
2
December 13, 2005

Agenda

What we'll
cover today

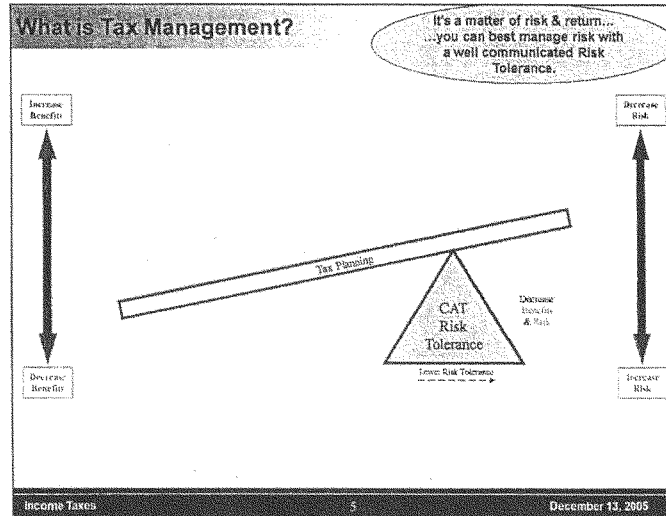
- What is Tax Management ?
- State of the Tax Business at Caterpillar
- State of the Tax Business . . . Current Headlines, Research & Data Points
- Path to World-Class Tax Risk Management
- People Risk = Tax Risk

Income Taxes
3
December 13, 2005

What is Tax Management?

Tax Management can
appear complex, but the
basic concepts are
simple.

Income Taxes
4
December 13, 2005



Agenda

What we'll cover today

- What is Tax Management ?
- State of the Tax Business at Caterpillar
- State of the Tax Business ... U.S. overight, Impact of a Bankruptcy
- Path to World-Class Tax Risk Management
- People Risk = Tax Risk

Income Taxes 6 December 13, 2005

State of Tax Business at Caterpillar

Cash benefits exceeding [REDACTED]

Cash Impact Since 1990
(excluding carry-forwards & benefits from use of cash)

**Redacted by the
Permanent Subcommittee on Investigations**

Income Taxes 7 December 13, 2005

State of Tax Business at Caterpillar

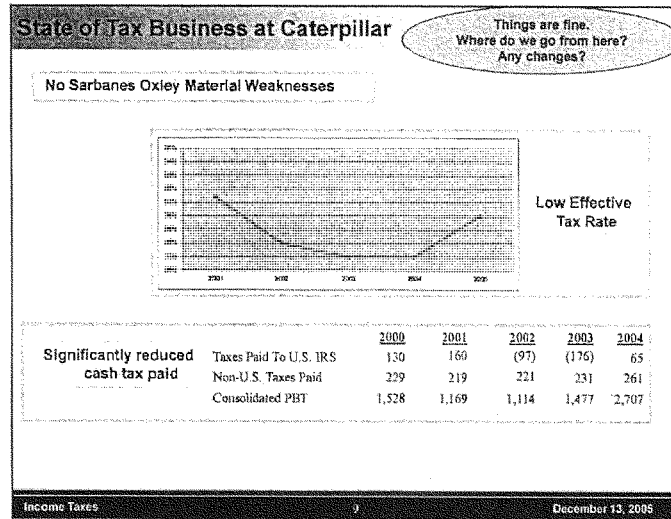
Significant risk, but managed well.

Risk Management

- ▶ [REDACTED] LIFO Reserve..... [REDACTED]
- ▶ Double Taxation of Income (70+% Effective Tax Rate) [REDACTED]
- ▶ Tax Reserves..... [REDACTED]
- ▶ Deferred Tax Assets..... [REDACTED]

**Redacted by the Permanent
Subcommittee on Investigations**

Income Taxes 8 December 13, 2005



Agenda

What we'll cover today

- What is Tax Management ?
- State of the Tax Business at Caterpillar
- State of the Tax Business.... Current Headlines, Research & Data Points
- Path to World-Class Tax Risk Management
- People Risk = Tax Risk

Income Taxes 10 December 13, 2005

State of Tax Business – In General

Increasing Audit Committee responsibility for Risk Management, & Increasing outside scrutiny

SOX

Section 404, as part of 2002 Sarbanes-Oxley Management Assessment of Financial Controls

The Commission staff has been actively requiring both annual and interim disclosures on internal control systems

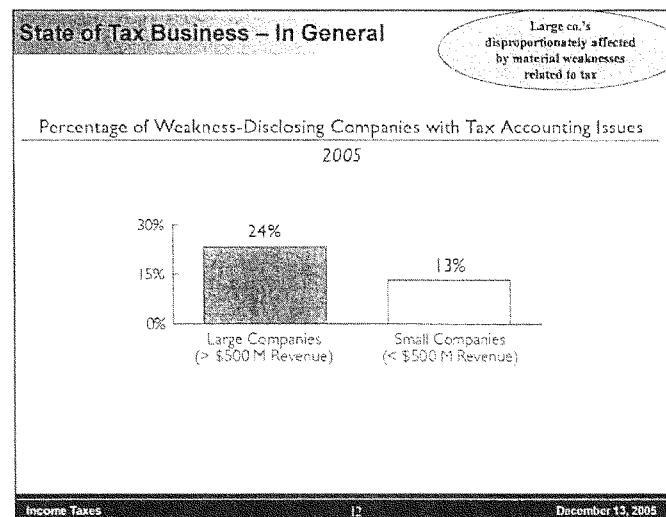
NYSE

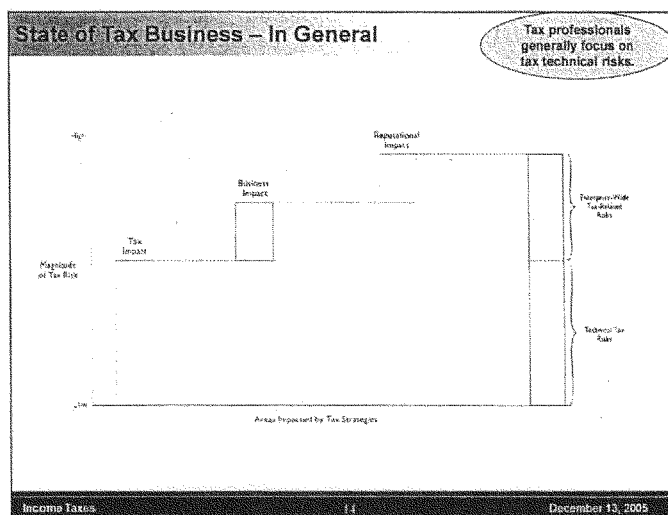
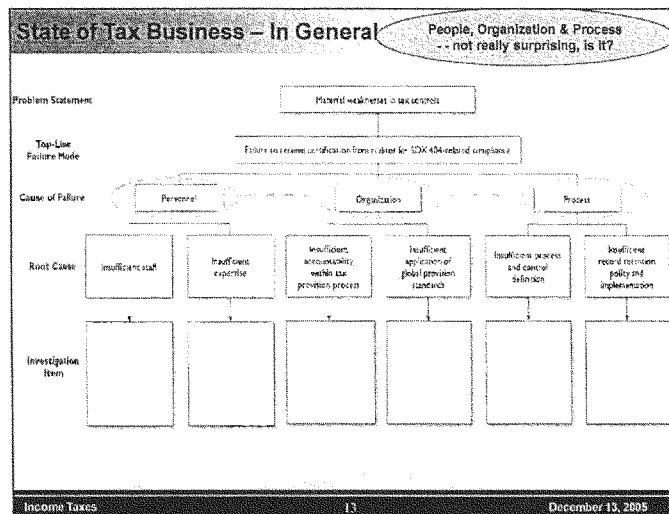
The listing standards require companies to disclose material weaknesses in internal control systems

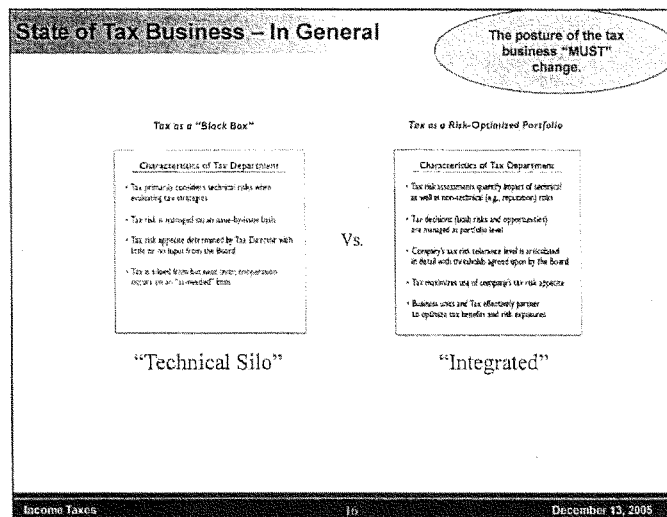
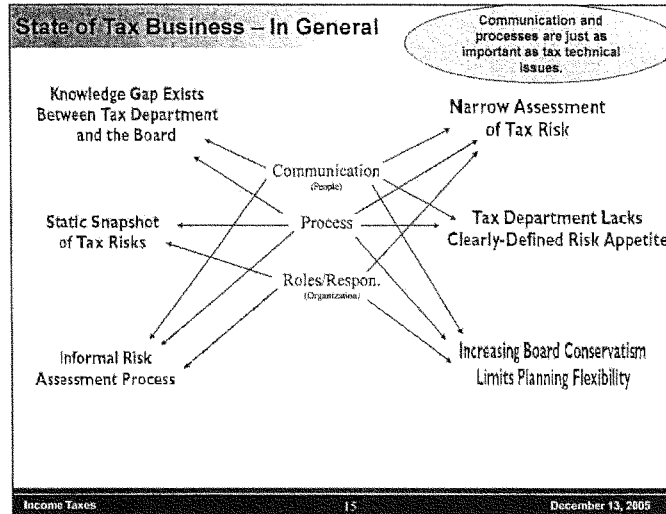
SEC

Section 303a of the Securities Exchange Act of 1934 requires companies to disclose material weaknesses in internal control systems

Income Taxes 11 December 13, 2005







Agenda

What we'll cover today

- ◆ What is Tax Management ?
- ◆ State of the Tax Business at Caterpillar
- ◆ State of the Tax Business ... Current Initiatives, Personnel & Case Points
- ◆ Path to World-Class Tax Risk Management
- ◆ People Risk = Tax Risk

Income Taxes
17
December 13, 2005

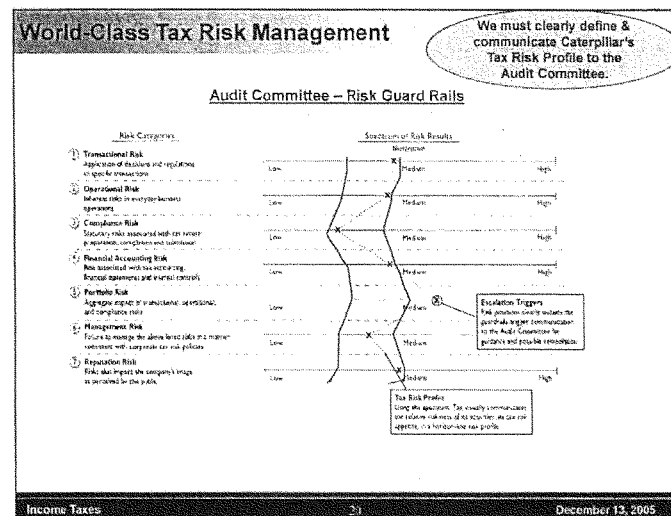
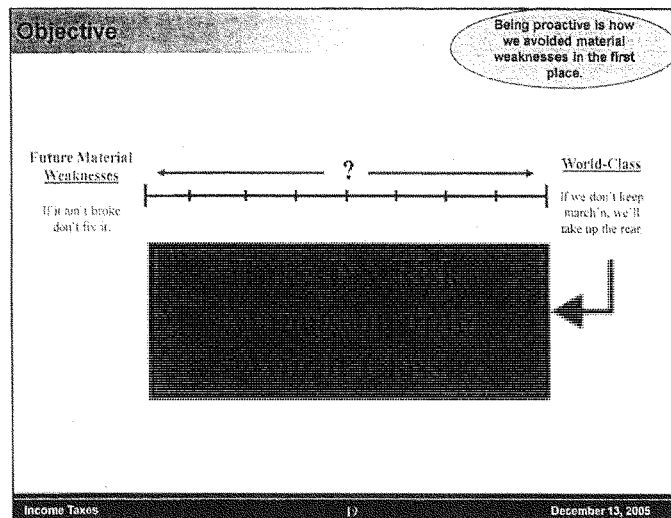
Objective

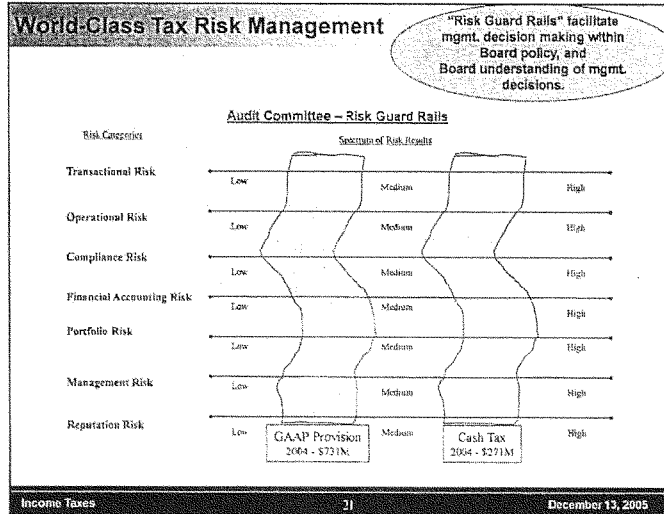
Where do we go from here?
Any changes?

The Evolution of the Typical Tax Department's Risk Appetite

Illustrative

Income Taxes
18
December 13, 2005



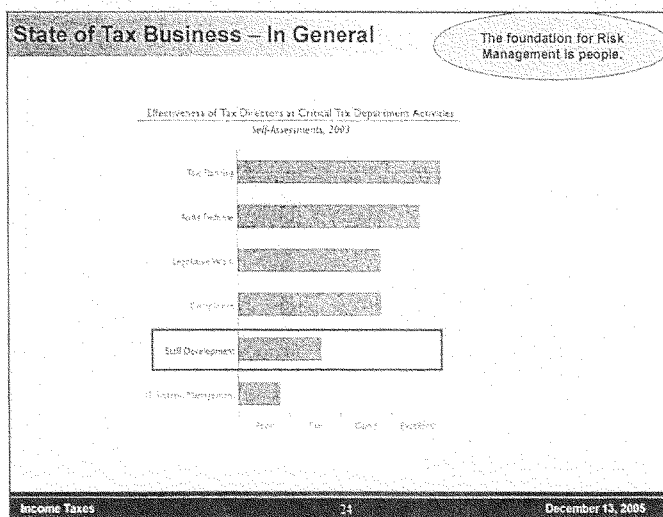
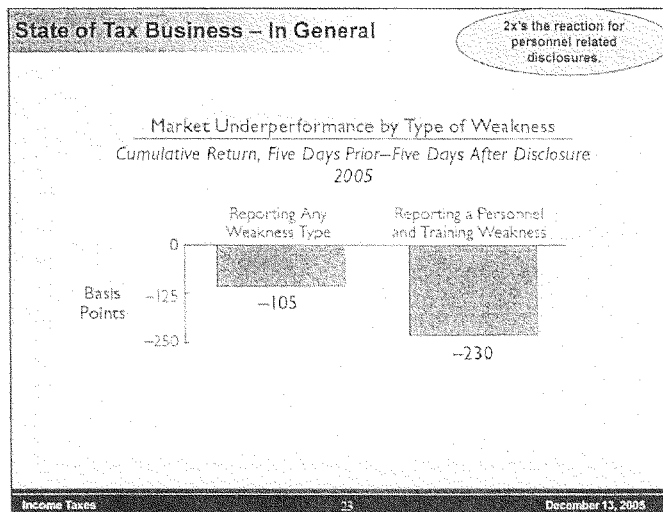


Agenda

What we'll cover today

- What is Tax Management ?
- State of the Tax Business at Caterpillar
- State of the Tax Business.....
- Path to World-Class Tax Risk Management
- People Risk = Tax Risk

Income Taxes 22 December 13, 2005



State of Tax Business – In General

Change requires new skills.

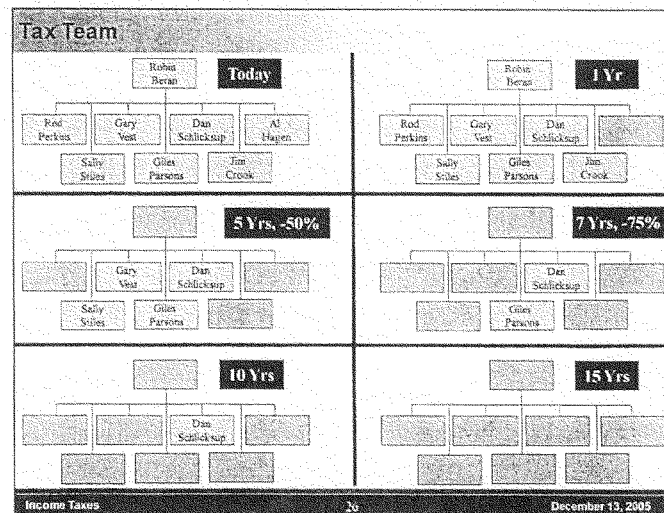
New Roles in Tax
Examples from Leading Companies

Project Manager
Individual with project management experience is tasked with activities such as SOX documentation and ensures projects are completed in a timely fashion. No prior tax expertise is required but individual is familiar with Microsoft Project, Visio and other project management tools.

Information Technology Specialist
Individual is tasked with data collection, systems implementation, data queries and data management. Prior tax expertise is not required, but may be beneficial. Individual is familiar with ERP packages and manipulating Microsoft Excel for cross-varying "short cuts."

Continuous Process Improvement Expert
Individual is tasked with identifying opportunities for efficiency across Planning, Audit and Compliance activities. Prior tax expertise is required, as it is often desired to help map process inefficiencies.

Income Taxes 25 December 13, 2005



Deliverables: for Feb. Audit Comm. Mtg.

Focus on Risk Management

- Present Tax Risk Guard Rails
 - Identify Tax Risk Categories
 - Define degrees of risk for Low/Med/High
 - Define GAAP & Cash-Tax Guard Rails for each risk category
 - Mutual agreement on Tax Risk Guard Rails
 - Plot current tax positions on Guard Rails (April Mtg.)
- Present Risk Management Policy
 - Define roles and responsibilities of Tax Director, Controller, CFO & Audit Committee

Income Taxes 27 December 13, 2005

END

Income Taxes 28 December 13, 2005

**Tax Risk Guardrails - audex**

Daniel Schlicksup to: Dave B. Burritt

02/07/2006 08:52 AM

From: Daniel Schlicksup/0E/Caterpillar

To: Dave B. Burritt/0G/Caterpillar@Caterpillar

Caterpillar: Confidential Green

Dave, I have a solid draft of the guard rails done. I have not polished it into a presentation because it was not included on the agenda. I feel comfortable that if Gene demanded to see something today and you came and got me, I could present the draft and get the Aud Comm comfortable that we are meeting our commitments. I will send you a couple of the charts shortly that represent the overall excel file.

On your other audex, I did not want to embarrass Sharad or Jim in the meeting, and it would have been very uncomfortable for them if I had asked to stay behind. I believe it's important for you to have the facts & data so that you don't get caught in the middle or blind sided. Then you can much better decide the facts and course of action, if any -- that's clearly your call.

Good luck in the meetings & please call if you have any questions.

Permanent Subcommittee on Investigations**EXHIBIT #23**

PSI-TWLF-04-000078



A/C meeting
Daniel Schlicksup to: Dave B. Burritt

02/27/2006 04:34 PM

From: Daniel Schlicksup/OE/Caterpillar
To: Dave B. Burritt/OG/Caterpillar@Caterpillar

Caterpillar: Confidential Green

FYI,

Robin indicated that the tax presentations were moved from April a/c meeting to June. We had a two day offsite last week to finalize the guardrails. We have two more days next week to plot the tax positions on the guardrails. This will be done in April if the agenda changes.

Permanent Subcommittee on Investigations

EXHIBIT #24

PSI-TWLF-04-000089

Permanent Subcommittee on Investigations
EXHIBIT #25a

Permanent Subcommittee on Investigations
EXHIBIT #25b

Categories	WT	Indicative Criteria	Weighted Points
Transitional	10	Tax Law	3 30 348
	5	Tax Personnel Community	5 25
	1	Industry Practice	5 5
	10	Business Purpose & Substance	5 50
	5	Consistency	5 25
	5	Financial Statement Cash Impact	5 25
	7	Documentation	1 7
Operational	10	Operational Change	3 30 369
Compliance	5	Compliance Requirements	1 5 156
	10	Availability of Data	1 10
Financial		Accounting	1 10 225
	10	Reinvestment	1 3
	3	Valuation Allowances and Deferred Tax Assets	3 15
	5	Documentation	3 15
	5	Process	5 50
	10	Magnitude of Impact on Financial Statement	3 30 369
Management	5	Process	3 15 273
	7	BU versus Legal Entity	5 35
	10	Operational Change without Tax Advice	1 10
Reputational	10	WSJ Test	3 30 369
			12.07
			18.12
			13.52
			18.57
			17.53
			17.08
			10.10
			12.36
			14.66
			12.21
			16.17
			25.34
			20.77
			20.08
			18.12

Redacted By
Permanent Subcommittee
on Investigations

Permanent Subcommittee on Investigations
EXHIBIT #25c

Category	Definition	Indicator	Law	Medium	Risk
Operational	Level of risk structure or transaction creates negative impact on everyday business operations.				
	Change				
	There was operational change required by the business unit to implement the structure or transaction.				
	4. The business unit would agree that the required operational change was not a significant change or disruption to the business.				
	5. The business unit would agree that the required operational change was not a significant change or disruption to the business.				
	There was operational change required by the business unit to implement the structure or transaction.				
	4. The business unit resisted the required change and was reluctant to implement the change.				
	5. The business unit has facts and data to support the proposed risk associated with the change.				
Compliance	Level of risk structure or transaction creates associated with tax return preparation, completion and submission.				
	Compliance Requirement				
	There are no compliance requirements associated with this structure or transaction.				
	4. The compliance requirements are well established to the point that there is no interpretation of the regulations required to comply.				
	5. The compliance requirements are the same or similar to requirements we have complied with before.				
	There are compliance requirements associated with this structure or transaction.				
	4. The compliance requirements are not well established to the point that there is no interpretation of the regulations.				
	5. No have not had to comply with these requirements before.				
Financial	Level of risk structure or transaction creates associated with tax accounting, financial statements or financial controls.				
	Reserves				
	The accounting department has determined that the structure or transaction requires no reserve.				
	4. The accounting department has determined that the structure or transaction does require a reserve and 100% of the tax benefit has been reserved.				
	5. The accounting department has determined that the structure or transaction does require a reserve and less than 100% of the tax benefit has been reserved.				
Management	Probability above risks can be managed consistent with corporate tax risk policies.				
	Corporate Tax Risk Policy				
	There is a written Corporate Tax Risk Policy.				
	4. The CFO, Controller, Tax Accountants, Tax Director and direct reports to the Tax Director are familiar with the content of the policy and its application.				
	5. There is a well established practice of managing Transactional, Operational, and Compliance risk in accordance with the policy.				
	There is a written Corporate Tax Risk Policy.				
	4. The CFO, Controller, Tax Accountants, Tax Director and direct reports to the Tax Director are not familiar with the content of the policy and its application.				
	5. There is not a well established past practice of managing Transactional, Operational, and Compliance risk in accordance with the policy.				
Reputation	Probability structure or transaction will generate negative impact on the Company's image as perceived by the public.				
	WSJ Test				
	The Executive Office would not publicly disclose this structure or transaction for a WSJ article.				
	The Executive Office would not want to have to answer questions from the press about this topic.				
	Executive Knowledge				
	4 or fewer members of the Executive Office understand the structure or transaction.				
	3 or fewer members of the Executive Office understand the structure or transaction.				

Income Tax Update

June 13, 2006

*Building momentum on the journey
to Global Finance & Strategic Support Transformation...*

VALERIAN

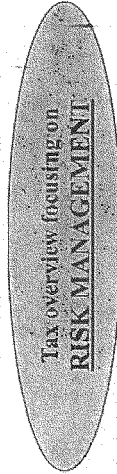
CONFIDENTIAL

Confidential & Proprietary

Permanent Examination of Investigation
EXHIBIT #26

CAT-001949

Tax Agenda

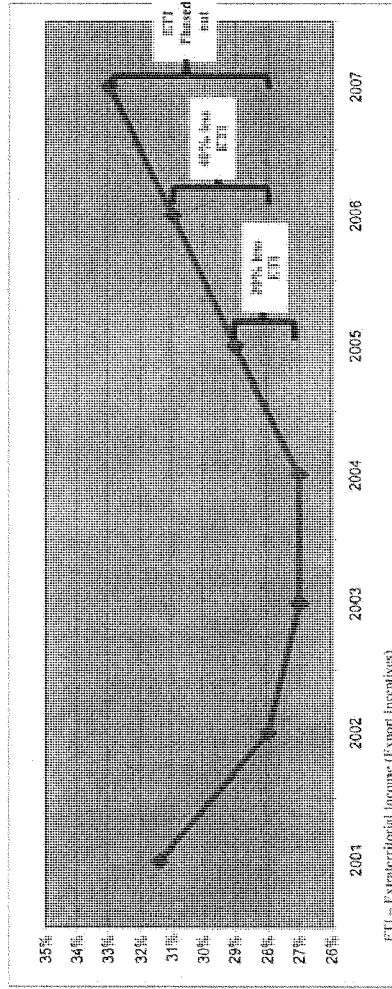


• Key Messages

- Effective Tax Rate trending up
- Difficult IRS exams
- Adequate reserves
- Complex risk environment, but well managed
- Complex reporting environment, but integrated with Global Finance & Strategic Support Transformation

Effective Tax Rate

Export incentive phase-out increases ETR in 2005, 2006 and 2007.



U.S. Rate	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%
Export Incentives	[4.9%]	[4.4%]	[4.9%]	[4.9%]	[2.7%]	[2.0%]
Foreign Earnings	[0.1%]	[3.4%]	[4.0%]	[3.7%]	[3.2%]	[2.4%]
Misc.	1.4%	0.8%	0.9%	0.5%	10.4%	0.4%
ETR	31.4%	28.0%	27.0%	27.0%	28.7%	31.0%
						(Estimate)

Effective Tax rate

2005 rank primarily due to earnings in low-tax jurisdictions.

Dow 30	2005 ETR	2004 ETR	Rank	Competitors	ETR
Boeing Co.	9.1%	7.1%	1		
AT&T - Formerly SBC Communications Inc.	16.3%	30.5%	2	Ingersoll Rand Co. Ltd.	16.3%
General Electric Co.	17.4%	17.6%	3		
Alcoa Inc.	22.8%	25.1%	4		
Johnson & Johnson	23.8%	33.7%	5		
American Express Co.	24.2%	29.8%	6		
Microsoft Corp.	26.3%	33.0%	7		
United Technologies Corp.	26.8%	26.2%	8		
Coca-Cola Co.	27.2%	22.1%	9	Volvo	27.0%
American International Group	28.0%	29.7%	10		
Caterpillar Inc.	28.7%	27.0%	11	Caterpillar Inc.	28.7%
Pfizer Inc.	29.7%	19.0%	12		
McDonalds Corp.	29.7%	28.9%	13		
Allria Group, Inc.	29.9%	32.4%	14		
Verizon Communications, Inc.	30.3%	28.2%	15	Cummins	30.0%
Procter & Gamble Co.	30.5%	30.7%	16		
J.P. Morgan Chase & Co.	30.6%	27.9%	17		
Citigroup Inc.	30.8%	28.4%	18		
Walt Disney Co.	31.1%	32.0%	19		
Intel Corp.	31.3%	27.8%	20		
Honeywell Int'l. Inc.	31.9%	23.8%	21		
Hewlett-Packard Co.	32.3%	16.7%	22		
General Motors	33.5%	33.0%	23	Deere & Co.	33.1%
3M Company	34.0%	33.0%	24		
International Bus. Mach.	34.6%	29.7%	25		
Wal-Mart Stores, Inc.	34.7%	36.1%	26		
Merck & Co. Inc.	37.1%	27.1%	27		
Home Depot, Inc.	37.1%	36.8%	28	Komatsu	36.5%
DuPont (E.I.) de Nemours	41.3%	-22.8%	29		
Exxon Mobil Corp.	41.4%	40.3%	30		

Caterpillar Confidential Red

Tax Reserves

Ending 2005 Tax Reserves

Caterpillar reserves
are adequate.

Redacted by the
Permanent Subcommittee on Investigations

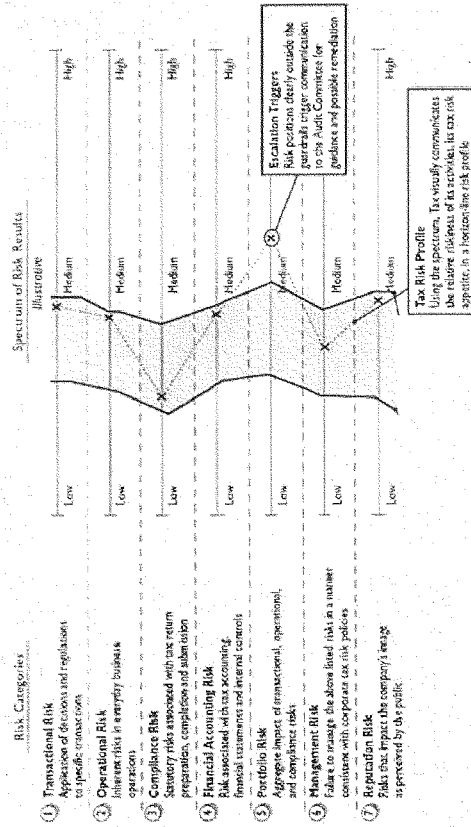
Transfer Pricing
Export Incentives
Research Credit
TIN Capitalization
US Federal (incl Interest)
US State
Total



December 2005 Meeting

We must define, understand
& communicate Caterpillar's
Tax Risk Profile.

Audit Committee – Risk Guard Rails



From the Corporate Executive Board

Tax Risk Guard Rails - Process

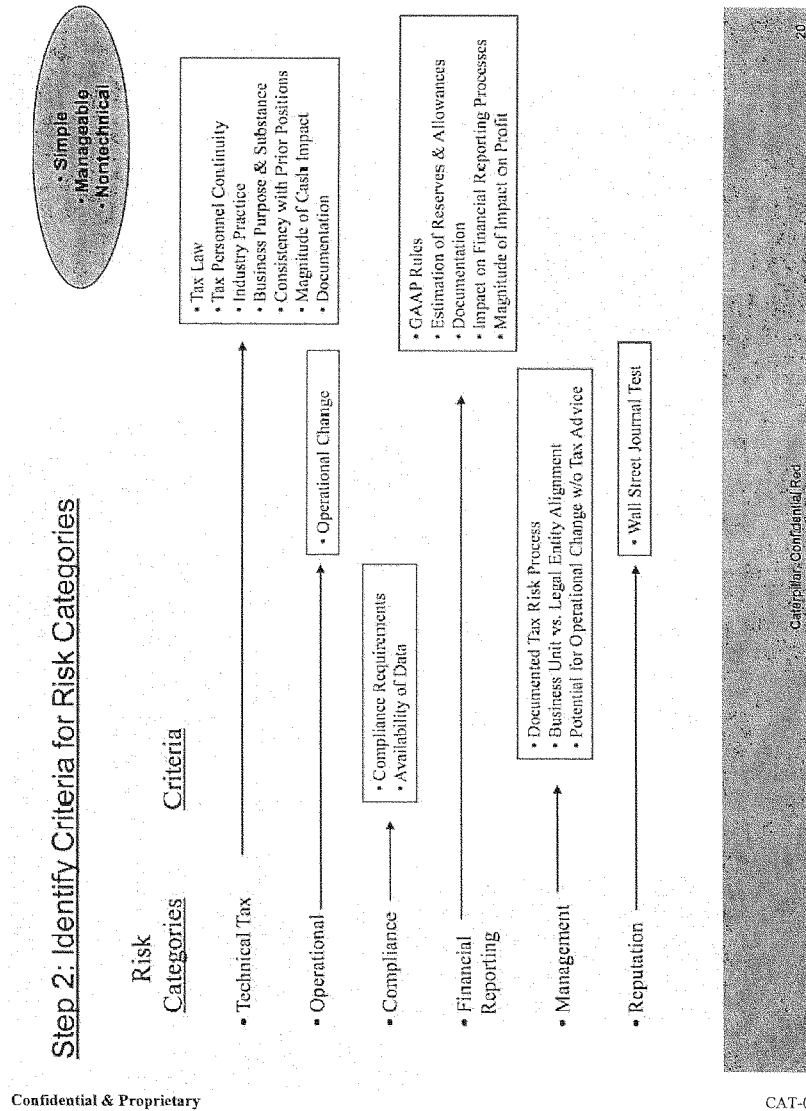


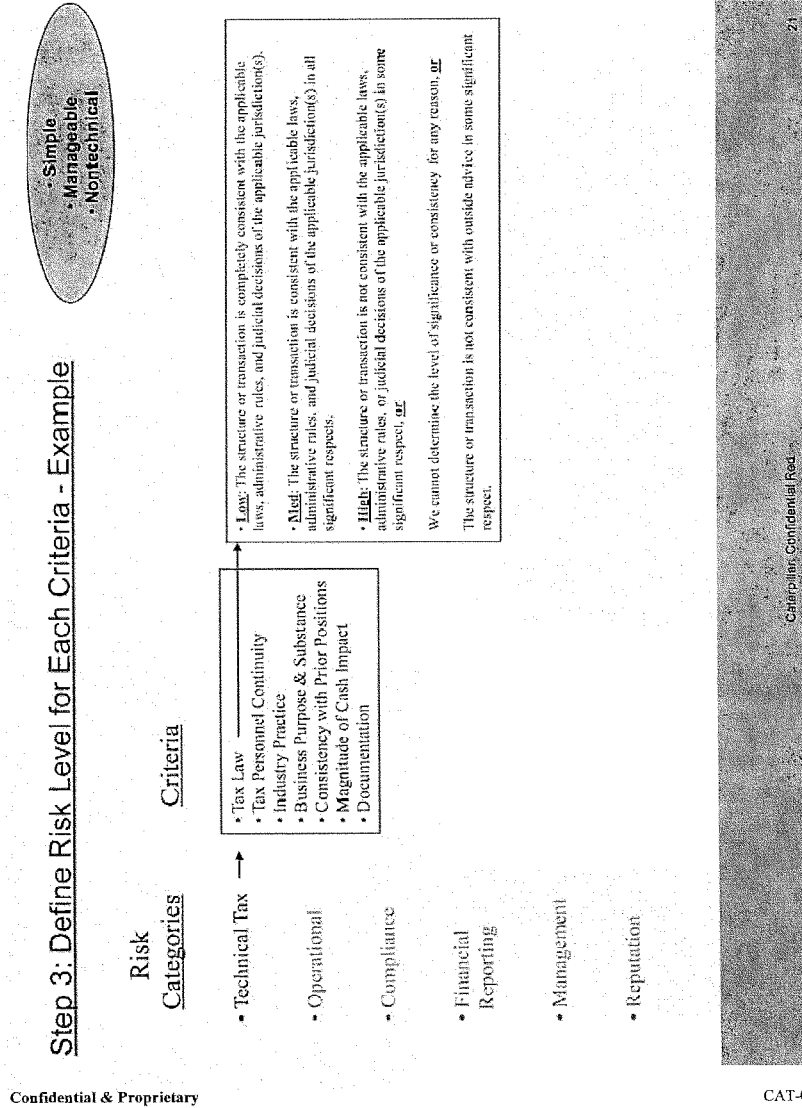
- Step 1 – Identify & Define Risk Categories
- Step 2 – Identify Criteria for Risk Categories
- Step 3 – Define Risk Level for each Criteria

Step 1: Identify & Define Risk Categories

These are the potential "business risks" that can be created by tax positions.

<u>Risk Categories</u>	<u>Definition</u>
• Technical Tax	• Level of risk the structure or transaction creates with full compliance with the law, regulations and court decisions.
• Operational	• Level of risk the structure or transaction creates for everyday business operations.
• Compliance	• Level of risk the structure or transaction creates for tax return preparation, completion and submission.
• Financial Reporting	• Level of risk structure or transaction creates associated with tax accounting, financial reporting or internal controls.
• Management	• Probability above risks can be managed consistent with corporate tax risk policies.
• Reputation	• Probability the structure or transaction will generate negative impact on the Company's image.

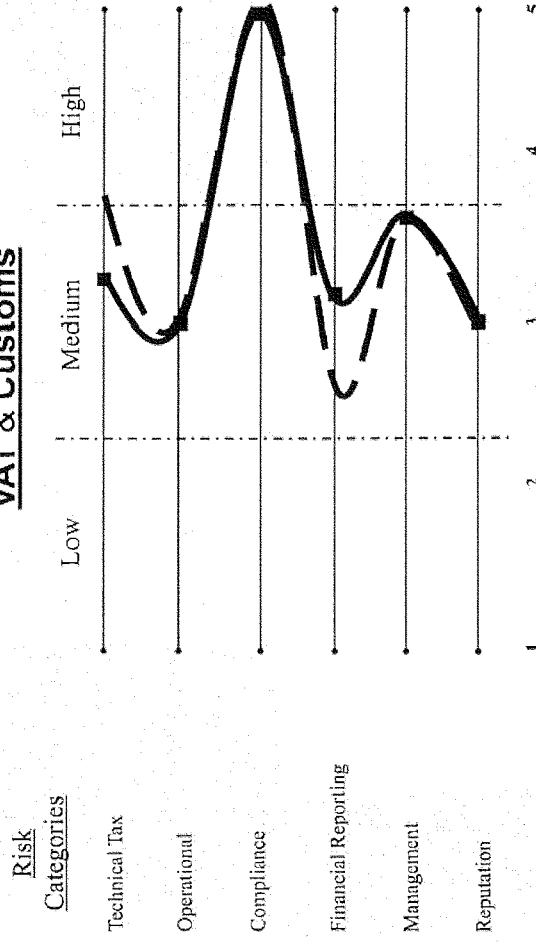




Tax Risk Guard Rails - Examples

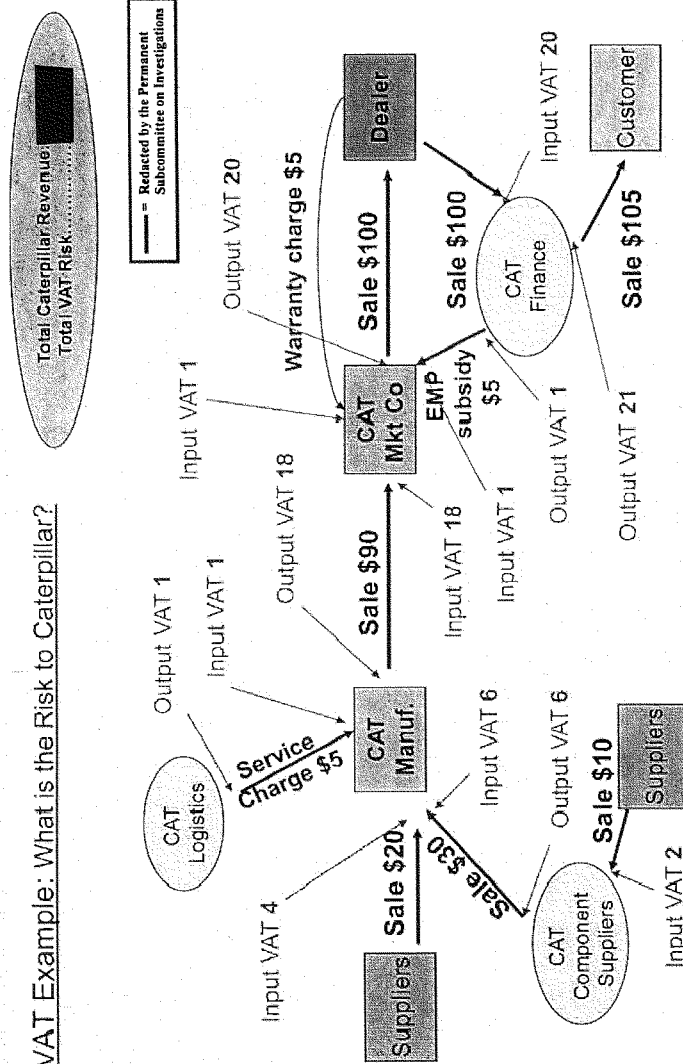
Other tax positions followed the same process.

VAT & Customs



VAT Example: What is the Risk to Caterpillar?

Confidential & Proprietary



Caterpillar Confidential Risk

CAT-001962

Global Finance & Strategic Support Transformation

WW Consolidated Financial Statements

Tax Detail
 25M+ sales transactions
 50M+ I/C transactions
 Etc.
 Etc.
 Etc.

Tax Savings are in the details, not the financial statements. Tax sensitized processes are a must.

FACT
 60% of tax effort is spent on data
 • Compiling
 • Completion
 • Correcting

CAUSE
 Unintegrated, tax insensitive, legacy systems

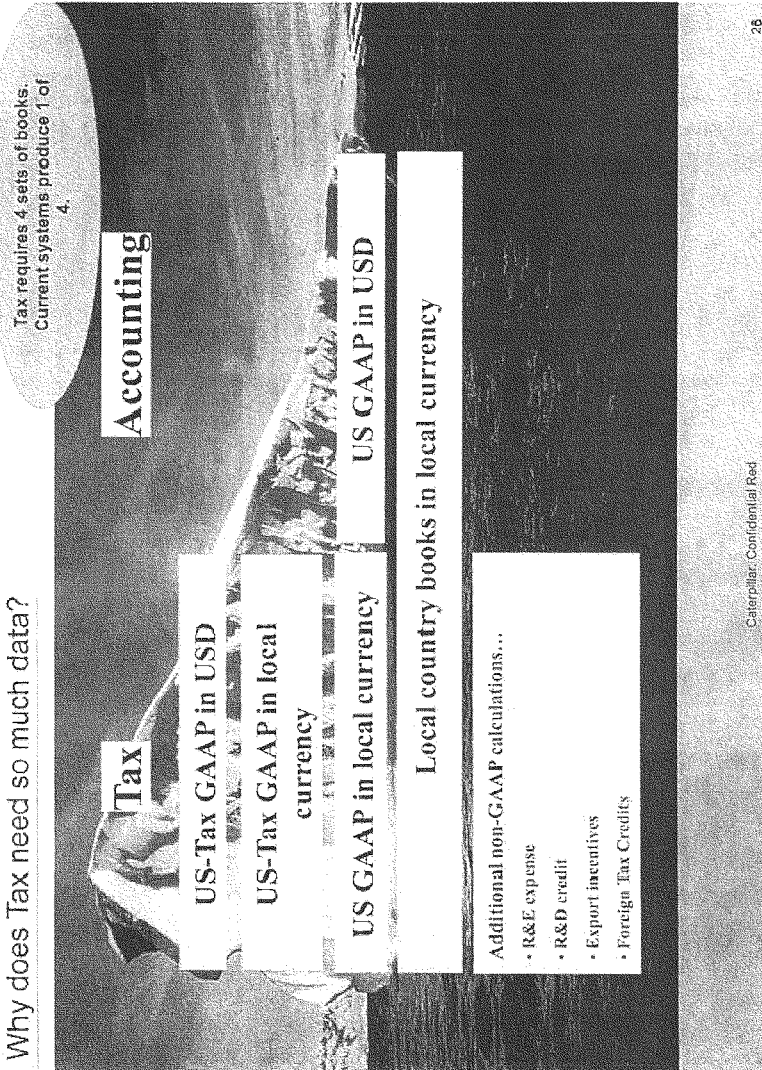
Confidential & Proprietary

CATERPILLAR CONFIDENTIAL RED

24

CAT-001963

Why does Tax need so much data?



In Summary

It's a challenging environment, rapidly changing, and we're adapting.

• Key Messages

- Effective Tax Rate trending up
- Difficult IRS exams
- Adequate reserves
- Complex risk environment, but well managed
- Complex reporting environment, but integrated with Global Finance & Strategic Support Transformation



Re: fyi only -- Update to Legal 6S team on regulatory compliance

Robin D Beran to: Daniel Schlicksup, Dave B. Burritt

07/28/2006 08:28 AM

From: Robin D Beran/OS/Caterpillar

To: Daniel Schlicksup/OE/Caterpillar@Caterpillar, Dave B. Burritt/OG/Caterpillar

Caterpillar: Confidential Green

Good work, Dan. We need to schedule a meeting to update the final review/charts. I believe we've noted some new info on one, and I think we have metrics problem re complexity for the VAT & Customs chart. Can discuss further, but current chart puts one area at high. Assuming guidance is to stay below high in all areas, how could we utilize?

Robin

Beranrd@cat.com 309.675.4478

Daniel Schlicksup

From: Daniel Schlicksup

Sent: 07/28/2006 08:19 AM

To: Dave Burritt

Subject: fyi only -- Update to Legal 6S team on regulatory compliance

Provided overview of Tax Risk Guard Rails yesterday to a 6S team from legal working specifically on a deep dive into regulatory compliance risks for the company for which penalties can be stiff due to new regulations. They were impressed with what Tax has done and said it fits perfectly in with what they are trying to do. They encouraged us to continue with the process and explain our current tax risk profile to the audit committee to get their approval.

Permanent Subcommittee on Investigations

EXHIBIT #27

PSI-TWLF-04-000368



Tax Risk Guard Rails
Daniel Schlicksup to: Dave B. Burritt

08/11/2006 05:02 PM

From: Daniel Schlicksup/OE/Caterpillar
To: Dave B. Burritt/OG/Caterpillar@Caterpillar

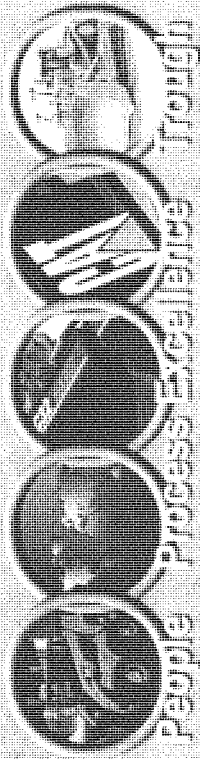
Caterpillar: Confidential Green

FYI, Tax Council will be meeting in near future to update TRGRs. The pressure/question I am getting is focused on reducing the risk shown on the guard rails. For example, I am being questioned why the structured finance deals should be considered to have high reputational risk. How would we explain to someone why we sold our factories and leased them back and got a lot of cash in the form of favorable financing rates when nothing really happened? I think he is very concerned about showing any risk at all. Also, he seems to forget the financial statement issues surrounding structured finance with PwC.

I need to understand where you want to go with the TRGRs. Are we going to stop where we are at which is just informing the board about the process we went through to create the guard rails, or are we going to show the board the results and have a meaningful discussion explaining our risk profile and to determine the board's comfort with it? I don't want to spend a lot more time on this if it is not going to go anywhere. I recommend the latter as I believe it is a best practice and the whole point for going down this path in the first place.

Please give me some feedback.

Global Finance and Strategic Support



People Process Excellence Trough

Global Tax Update

Purpose: Annual Update on Tax Management

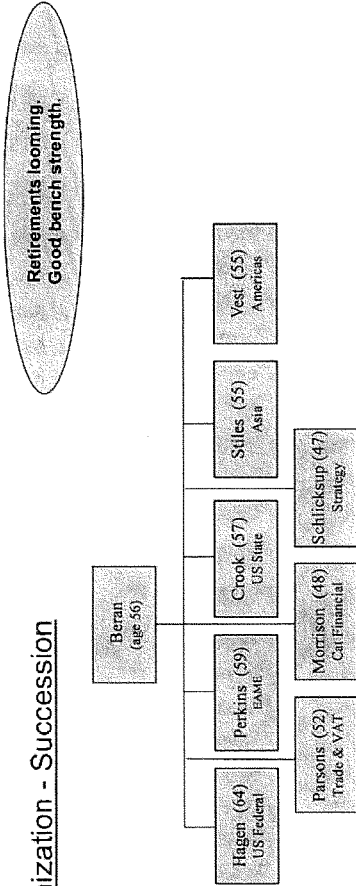
Key Messages:

- We have "Global" Tax and Trade resources
- Effective Tax Rate is increasing, near mid of Dow 30 range
- Tax Reserves are Adequate
- Tax Risk Management processes are robust

April 8, 2008

CALCIPILLAY

Global Organization - Succession

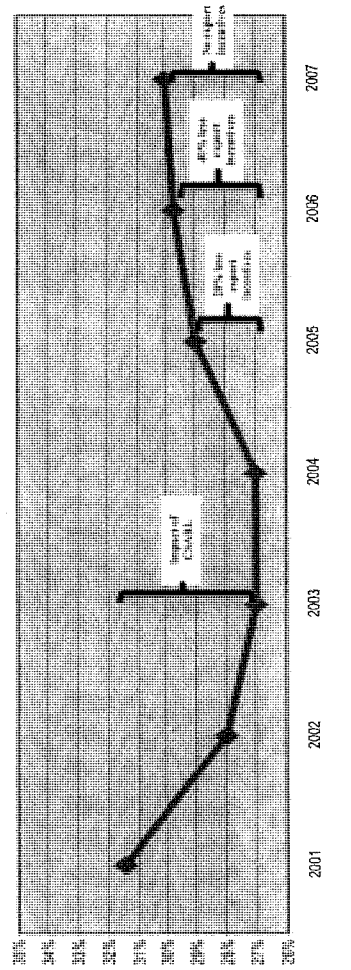


Next level: Abellard-41, Bakanowski-48, De Pena-37, Gates-49, Grierson-53, Laks-45, McWhorter-47, Miller-45, Poling-42, Rae-53, Zinneman-39

2nd level: Cachbach-31, Carter-44, Dobberfuhl-30, Duley-32, Estebanez-33, Gao-36, Grace-38, Mitchell-44, Murphy-41, Stranz-29, Wright-49

Effective Tax Rate - Trend

Expect 2008 ETR of 31.5%
Increase primarily due to
expiration of U.S. R&D Credit.



U.S. Rate	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%
Export Incentives	[4.9%]	[4.4%]	[4.9%]	[4.9%]	[2.7%]	[2.1%]	[0.0%]
Foreign Earnings	[0.1%]	[3.4%]	[4.0%]	[3.7%]	[3.2%]	[3.5%]	[4.7%]
Misc.	1.4%	0.8%	0.9%	0.6%	[0.4%]	0.4%	[0.3%]
ETR	31.4%	28.0%	27.0%	27.0%	28.7%	29.8%	30.0%

Effective Tax Rate - Trend

Confidential & Proprietary

ETR is average for the Dow 30.

Dow 30	2007 ETR	2006 ETR	Rank	Competitors	ETR
General Motors	-595.0%	56.0%	1		
Citigroup Inc.	-129.4%	27.3%	2		
Merck & Co. Inc.	2.8%	28.7%	3		
Pfizer Inc.	11.0%	15.3%	4		
General Electric Co.	15.5%	16.1%	5		
American International Group	16.3%	30.1%	6		
DuPont (E.I.) de Nemours	20.0%	5.9%	7		
Johnson & Johnson	20.4%	24.2%	8		
Hewlett-Packard Co.	20.8%	13.8%	9	Fiat (CNH)	21.3%
Intel Corp.	23.9%	28.6%	10	Volvo	23.7%
Coca-Cola Co.	24.0%	22.8%	11		
American Express Co.	27.3%	30.0%	12		
International Bus. Mach.	28.0%	29.0%	13	Komatsu	27.8%
Bank of America	28.4%	33.9%	14		
United Technologies Corp.	28.8%	27.2%	15		
Procter & Gamble Co.	29.7%	30.0%	16		
Caterpillar Inc.	30.0%	28.9%	17	Caterpillar Inc.	30.0%
Microsoft Corp.	30.0%	31.0%	18		
3M Company	32.1%	30.6%	19		
J.P. Morgan Chase & Co.	32.6%	31.4%	20	Cummins	32.6%
Wal-Mart Stores, Inc.	33.6%	33.1%	21	Deere & Co.	33.0%
Boeing Co.	33.7%	30.9%	22	Terex	33.2%
AT&T Inc.	34.4%	32.4%	23		
Alcoa Inc.	34.6%	24.3%	24		
McDonalds Corp.	34.6%	31.0%	25		
Walt Disney Co.	37.2%	34.7%	26		
Home Depot Inc.	38.1%	38.0%	27		
Chevron Texaco Corp.	41.9%	48.4%	28		
Verizon Communications, Inc.	42.0%	32.8%	29		
Exxon Mobil Corp.	44.0%	43.0%	30		

Caterpillar: Confidential Red

CAT-002092

Issues - Tax Reserves

Caterpillar reserves
are adequate.

476

Redacted by the
Permanent Subcommittee on Investigations

Caterpillar SARL
Transfer pricing
Export benefits
U.S. - Federal
U.S. - International
Non-U.S.
State

Caterpillar: Confidential Red

Issues – Risk Management

Processes are robust.

- **Sarbanes Oxley**

- Robust quarterly identification and evaluation process for tax uncertainties
 - Global team of tax professionals reviews operating activities and material tax positions with local accounting managers

- **Tax Risk Guard Rails**

- Global Central Committee review of uncertain tax positions
 - Representatives from Accounting and Tax who consider risk factors: Transactional, Operational, Compliance, Financial Reporting, Management and Reputation.

Issues – Risk Management

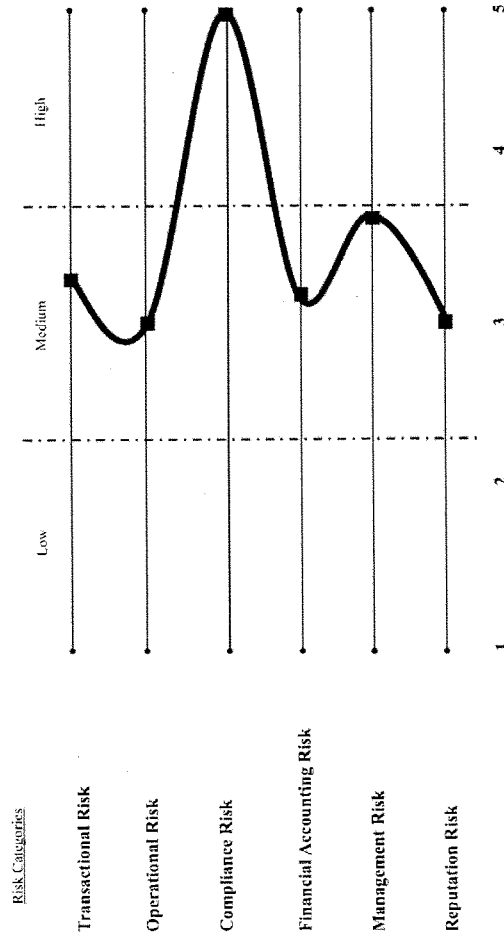
These are the
"business risks"
created by tax positions.

<u>Risk Categories</u>	<u>Definition</u>
• Transactional	• Compliance with the law, regulations and court decisions.
• Operational	• Impact on business operations.
• Compliance	• Tax return preparation, completion and submission.
• Financial Reporting	• Tax accounting, financial statements or internal controls.
• Management	• Consistency with corporate tax risk policies.
• Reputation	• Impact on the Company's image.

Issues – Risk Management Example

Complex definitions tied to individual transactions.

VAT



Issues – Risk Management

High risk areas are actively managed.

Higher Risk Areas

- VAT - Compliance
- Customs - Compliance

Mitigation

- Established Global Process Owner
- Established Global Procedures and Training
- Moving toward better, global control

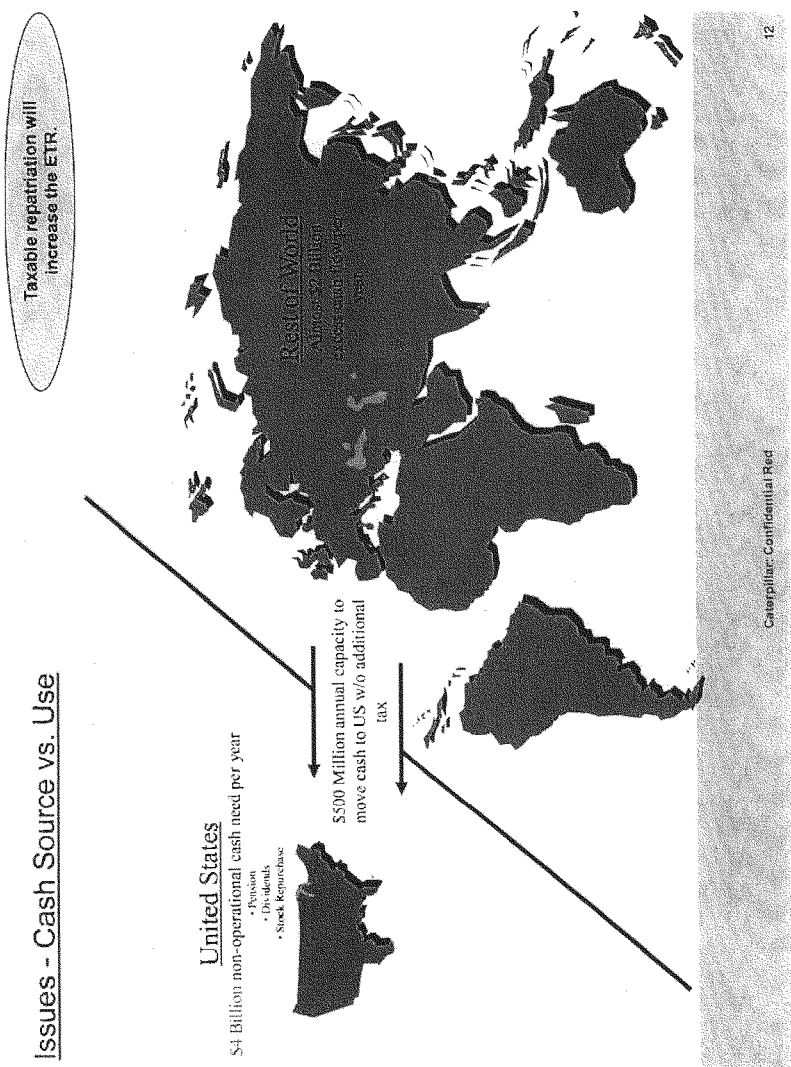
480

- CSARL – Product Management - Operational

- Annual review of activities.
- New Regulations issued by IRS

- CSARL – Parts Distribution - Management & Reputation

- Developed plan with outside counsel and accountants



In Summary – Key Messages

- We have “Global” Tax and Trade resources
- Effective Tax Rate is increasing, near mid of Dow 30 range
- Tax Reserves are Adequate
- Tax Risk Management processes are robust

P&SS AVAILABILITY & INVENTORY MANAGEMENT

Craig Barley-Manager, Peoria

General Facts

Worldwide field population: 1.2 mil engines, .8 mil machines

200 dealers worldwide

500,000 part numbers serviced by P&SS

-170,000 made as ordered-slow moving

-330,000 stocked in a P&SS facility

-50,000 stocked at a dealer

80% of P&SS total assets is parts inventory. 50-60% of value of inventory is fast moving (10 or more orders per month) parts, 40-50% is slow moving

P&SS holds 6.5 months of total stock worldwide-just under two turns per year. Low number because of many part numbers. 10% parts numbers produce 80% of volume, but 90% parts numbers are held in inventory. P&SS holds 3 months of fast moving inventory.

Worked vs PF does not really matter for inventory management, what matters is fast or slow moving

Morton and US

85% of worldwide parts inventory is managed from Morton-moving toward 100%

-determine parts to service

-set stocking levels

-forecast usage

-plan material from sources

-determine disposition of surplus

-manage supporting systems

-maintain transaction audit trail

-resolve record discrepancies

-improve record accuracy

300 people in Craig Barley's availability and inventory organization-all but 4 in Morton

Regional stock facilities are "facing centers"-first point of filling dealer order

Orders not able to be filled by regional facility are filled by searching the system

Emergency orders are orders which customers pay premium to receive faster

Most regional distribution centers are served from Morton, not from contract packagers

because of low volume at regional centers

Morton holds worldwide safety stock

Systems

Antares is the dealer interface computer system-records dealer sales and orders. Antares feeds into the inventory management system that runs min/max calcs and calculates parts forecasts

Central America and North America have the new Antares system

Europe still has Antares predecessor, but is now converting

Permanent Subcommittee on Investigations

EXHIBIT #30

Grimbergen order processing system is linked back to Morton by daily batch transmission

Morton knows if Grimbergen sold a part, received part, scrapped a part-information goes into Morton global parts forecast calc

Inventory management system calculates recommended requirements and transfers to corporate "Lognet" system.

Orders on Lognet are based on current expected demand at time of order

Total expected demand is made up of facility demands

CAT manufacturers and purchased finished suppliers obtain orders from "Lognet."

95% of parts go through a contract packager who will ship to Morton, Grimbergen, York, Singapore, and other large facilities

Morton directs contract packagers how to deploy based on current expected demand at time of receipt-distribute to give all stock centers fair share based on stock levels

P&SS Outside US

Grimbergen and Singapore have a person to expedite and schedule orders, but all calculation and ordering is done from Morton, even for Europe source parts

Singapore and SCM control own inventory

Grimbergen receives European worked and PF through a contract packager and Morton then tells Grimbergen where to send parts-Singapore, Morton, etc

In Europe, Grimbergen manages warehousing (main function), contract packagers, freight and transportation, government documentation (duty etc), customer service on orders, information systems center, business services (accounting), availability and inventory (12 expeditors working with Euro PF suppliers and plants).

Europe marketing is in Geneva and purchasing is in Grimbergen

100% of Grimbergen inventory is controlled by Morton

PURCHASING TRANSPORTATION AND TECHNICAL SUPPORT

Don Puryear-Manager, Peoria

General Facts**Purchasing**

- P&SS purchases 40% of purchased finished; remainder contracted to other purchasing groups
 - Mossville (engines)
 - Purchasing & Transportation Europe-PT Europe (Grenoble, Gosselies)
 - Central Purchasing (Peoria)
 - Leicester
 - Cat Services Ltd. (Tokyo)
- Contract purchasing groups have authority to accept price increases; P&SS Morton monitors contract groups overall price performance.
- PT Europe and US purchaser both place orders on Europe suppliers
- Cat supplier relationships
 - Balance desire for long-term relationship and price and quality
 - Cat doesn't guarantee volumes or duration of agreement, all agreements have termination clause based on price or quality
 - JV supplier agreements exist-Donaldson (filters), Mexico JV (castings)
 - Cat offers input/training to suppliers but supplier controls own business
- Purchasing involves
 - selection of supplier
 - negotiation of price and availability
- Can have a JIT production line but not a JIT service (parts) business

Scheduling

- P&SS Morton expedites PF coming to Morton
- Expeditor goes to supplier to get non current part made if not in P&SS inventory
- Emergency order is when part is not in parts system

Technical Support (Engineering)

- Ensure non current parts have proper cost reduction focus-may redesign to use steel available in smaller lots
- Have design control of service kits-bearing kits, overhaul kits
- Eliminate duplicate parts in system

Transportation

- Operational traffic, daily material movements-expediting and tracing
- Import/export-customs, forwarders, NAFTA documentation
- Do not negotiate rates or select carriers-corporate traffic does this
- Decides rail, air, sea, or truck and then uses carrier selected by corporate

Other

- 46-48% of gross revenue is from non-current parts
- P&SS takes interest in design but not real design control when a part becomes non current
- Cat may buy from a supplier who also sells non-Cat product, but the Cat-product is made to Cat tolerances therefore is still distinguished-oil, bolts, bearings

Permanent Subcommittee on Investigations

EXHIBIT #31

- What sells Cat parts
 - liberal warranty process
 - best availability
 - part designed specific to Cat machines
 - trend of customer going more to dealer for service (machine complexity)

Who purchases what?

- Central purchasing groups-buy all current and non current
 - P&SS for batteries, filters, ground engaging tools
 - Corporate purchasing for bearings, heat transfer, etc
 - Business units for areas of expertise-cabs, pistons, electrical
- Non central purchasing groups
 - P&SS buys non current
 - Plants buy current-machined, welded, stamped items

P&SS has developed (over 12 years) network of suppliers for non current that is independent of current production suppliers (foundry, machine shop etc-specialize in low volume, quick turn around)

A separate non current supply network is not as evolved in Europe

PT Europe is the central buyer for the European requirement-Cat US central purchasers developed the sources for central-type parts, PT Europe set up own sources for non-central type parts

Purchasing principle-centralized purchasing, decentralized scheduling

Remanufactured parts may be worked by manufacturer or unrelated party

P&SS provides purchasing service to remanufactured parts group for fee

IN THE UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF ILLINOIS

DANIEL J. SCHLICKSUP,)	
)	
Plaintiff,)	
)	
VS.)	No. 09-1208
)	
CATERPILLAR, INC., DAVID B.)	
BURRITT, ALICE BARBOUR, ROBIN))	
D. BERAN, JAMES B. BUDA,)	
DOUGLAS R. OBERHELMAN, and)	
EDWARD J. RAPP,)	
)	
Defendants.)	

The deposition of SALLY A. STILES, called for examination pursuant to the provisions of the Federal Rules of Civil Procedure of the United States District Courts as they apply to the taking of depositions, taken before Paula A. Morsch, C.S.R. License No. 84-002965, a Certified Shorthand Reporter in the State of Illinois, on the 24th day of February, 2011, commencing at the hour of 12:00 p.m. and ending at 6:00 p.m., at 415 Hamilton Boulevard, in the City of Peoria, County of Peoria, State of Illinois.

ADVANTAGE REPORTING SERVICE

Permanent Subcommittee on Investigations

EXHIBIT #32

PSI-TWLF-11-000008

1 product support?

2 A First off I wouldn't call product support
3 the parts areas. There is not a parts area of the
4 company, especially during this period. There was
5 not a group that would say I manage the parts
6 business. Product support, I don't know if they
7 were involved or not.

8 Q So you recall somebody from Logistics as
9 being involved, but do you also recall anybody from
10 the other areas that dealt with parts? You say
11 there was no one part area but there were a bunch of
12 areas that dealt with parts. Any other areas
13 besides Logistics?

14 A Not that I recall.

15 Q And was Barb Church the only one you
16 recall as being involved?

17 A That's the only name I can come up with.
18 I recall there were more people involved. I just
19 don't know their names.

20 Q Have you seen Barb Church lately?

21 A No.

22 Q Is it fair to say that the driving force
23 behind Glove or CSARL was the tax department and not

1 any business unit?

2 A Yes.

3 Q How did you first hear about Glove?

4 A At the opening meeting with the
5 consultants.

6 Q With Price Waterhouse?

7 A Yes.

8 Q Did you work with McDermott, Will & Emery
9 on Glove?

10 A Yes.

11 Q Who did you work with there?

12 A Lowell Yoder.

13 Q Anyone else?

14 A David Ryder.

15 Q Anyone else?

16 A Sherry Everson.

17 Q Anyone else?

18 A There were others, yes. I just can't
19 remember all the names.

20 Q Have you ever seen any kind of a
21 memorandum from Price Waterhouse analyzing the issue
22 of business or economic substance when it came to
23 CSARL?

IN THE UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF ILLINOIS

DANIEL J. SCHLICKSUP,)	
)	
Plaintiff,)	
)	
VS.)	No. 09-CV-1206
)	
CATERPILLAR, INC., et al,)	
)	
Defendants.)	

The deposition of ROBIN BERAN, called for examination pursuant to the provisions of the Federal Rules of Civil Procedure of the United States District Courts as they apply to the taking of depositions, taken before Paula A. Morsch, C.S.R. License No. 81-002565, a Certified Shorthand Reporter in the State of Illinois, on the 15th day of March 2011, at the hour of 9:00 a.m., at 415 , in the City of Peoria, County of Peoria, State of Illinois.

AD
(309)

Permanent Subcommittee on Investigations

EXHIBIT #33

24

PSI-TWLF-12-000008

1 A Was that specifically the product
2 managers?

3 Q I believe that the second from last
4 question I asked you was specific to the product
5 managers. I think my last question just asked if
6 there's anyone, but let me have it read back.

7 (Record read as requested.)

8 MR. TURNER: I object, form.

9 A I don't really recall having a discussion
10 with the product managers.

11 Q Did anybody at Caterpillar ever ask you
12 what the effect would be in the field on the product
13 managers if the expansion that you were proposing
14 was implemented?

15 MR. TURNER: Object, form and
16 foundation.

17 A I'm sure I had conversations with people
18 about the flow of parts. The management structure
19 related to decisions tied to parts distribution, the
20 fact was when we established the changes, we were
21 reflecting the way the company was already doing
22 business back in '99 and prior years.

23 Q Did you believe that the expansion of the

1 distribution of purchased finished replacement parts
2 by CSARL into the entire world except for the United
3 States would require any changes in business
4 operations?

5 A No, it required some changes.

6 Q What changes in business operations did it
7 require?

8 A It changed who actually bought the parts
9 because CSARL became the acquirer of all the parts
10 from the beginning. It changed various customs and
11 logistics issues because of who the importers of
12 record might be. There's a lot of changes that come
13 into play.

14 Q Well, other than paper issues that were
15 caused by the entities that became involved, were
16 there any other changes to the physical flow of
17 purchased finished replacement parts?

18 A Physical flow, probably not substantially.

19 ~~Q From the period of 2000 to 2003, was it~~
20 necessary as a result of the CSARL implementation
21 for the product managers to incur any expenses on
22 their budgets?

23 ~~A Any?~~

IN THE UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF ILLINOIS
PEORIA DIVISION

DANIEL J. SCHLICKSUP,)
)
 Plaintiff,)
)
 vs.) No. 09-1208
)
CATERPILLAR, INC.,)
DAVID B. BURRITT, ALICE)
BARBOUR, ROBIN D.)
BERAN, JAMES B. BUDA,)
DOUGLAS R. OBERHELMAN,)
and EDWARD J. RAPP,)
)
 Defendants.)

THE DEPOSITION of RODNEY PERKINS, called
for examination pursuant to notice, and
pursuant to the provisions of the Code of Civil
Procedure, and the Rules of the Supreme Court
thereof pertaining to the taking of
depositions, taken before me, Donna F. Banks,
CSR, a Notary Public in and for the County of
Peoria and State of Illinois, at 415 Hamilton
Boulevard, in the City of Peoria, County of
Peoria and State of Illinois, on March 10,
2011, at 9:00 a.m.

ADV
(309)

Permanent Subcommittee on Investigations
EXHIBIT #34

24

PSI-TWLF-10-000004

1 exhibit 9?

2 A Yes.

3 Q And in this instance, the amount of selling
4 general and administrative expenses was 4.248
5 billion dollars, is that correct?

6 A Yes.

7 Q And the higher that -- it's sort of like a
8 teeter-totter, the higher that number goes, the
9 lower the number for consolidated profit before
10 taxes, is that correct?

11 A Yes.

12 Q And so the more that's incurred by Caterpillar,
13 Inc., for general expenses, including legal and
14 accounting, the lower the number is going to be
15 for consolidated profit before taxes, is that
16 correct?

17 A That's correct.

18 Q So the expenses relating to the CSARL structure
19 for accounting and legal services, those were
20 paid by Caterpillar, Inc., and not by CSARL, is
21 that correct?

22 A Yes.

23 Q And CSARL was never asked to reimburse any of

1 those expenses, is that correct?

2 A I don't believe they were.

3 Q What was the benefit to Caterpillar, Inc., to
4 have CSARL purchase finished replacement parts
5 instead of having Caterpillar, Inc., buy them
6 and sell them to CSARL?

7 A It would alter the character of the income from
8 CSARL from includable deemed distribution
9 income to the U.S.

10 Q So the advantage to Caterpillar, Inc., would be
11 that it would pay less Federal income tax?

12 A Yes.

13 Q And that would be an advantage to the
14 enterprise as a whole in the sense that the tax
15 was at least deferred?

16 A Yes.

17 Q Was there any business advantage to
18 Caterpillar, Inc., to have this arrangement put
19 in place other than the avoidance or deferral
20 of income taxation at higher rates?

21 A No, there was not.

22 MR. TURNER: Let's take a break.

23

1 (Whereupon a short recess was
2 taken and proceedings resumed as
3 follows.)
4 (Deposition Exhibit Number 12 was
5 identified for the purpose of
6 the record.)

7 Q Have you seen exhibit 12 before?

8 A Yes.

9 Q Do you think you saw exhibit 12 shortly after
10 it was created, at least in draft form?

11 A Yes.

12 Q When is the last time you saw exhibit 12 before
13 today?

14 A In its draft form?

15 Q Yes.

16 A Seven years ago.

17 Q Have you seen exhibit 12 in its final form
18 since you left Caterpillar?

19 A No.

20 Q Was the draft that we've marked as exhibit 12
21 prepared by McDermott, Will and Emery?

22 A Yes.

23 Q Was it prepared by a lawyer who is now

1 IN THE UNITED STATES DISTRICT COURT
2 FOR THE CENTRAL DISTRICT OF ILLINOIS

3 DANIEL J. SCHLICKSUP,)
4 Plaintiff,)
5 VS.) No. 09-1208
6 CATERPILLAR, INC., DAVID B.)
7 BURRITT, ALICE BARBOUR, ROBIN))
8 D. BERAN, JAMES B. BUDA,)
9 DOUGLAS R. OBERHELMAN, and)
 EDWARD J. RAPP,)
 Defendants.)

 ORIGINAL

11 The deposition of JANIE COPELAND, called
12 for examination pursuant to the provisions of the
13 Federal Rules of Civil Procedure of the United
14 States District Courts as they apply to the taking
15 of depositions, taken before Paula A. Morsch, C.S.R.
16 License No. 84-002965, a Certified Shorthand
17 Reporter in the State of Illinois, on the 5th day of
18 May, 2011, at the hour of 9:00 a.m., at 415 Hamilton
19 Boulevard, in the City of Peoria, County of Peoria,
20 State of Illinois.

ADVANTAGE

Permanent Subcommittee on Investigations
EXHIBIT #35

PSL-TWLF-15-000007
673-1881

<p>35</p> <p>1 accounting that's done for CSARL?</p> <p>2 A I don't personally, no. I have a group</p> <p>3 that works under me in Geneva that is involved, but I</p> <p>4 am, at a very high level, familiar with what they</p> <p>5 do.</p> <p>6 Q Do you know if they perform the entries</p> <p>7 for that accounting system?</p> <p>8 A I believe they do, yes.</p> <p>9 Q Is the accounting system for CSARL used</p> <p>10 solely for tax purposes?</p> <p>11 A I don't know. I'm not familiar with the</p> <p>12 processes.</p> <p>13 Q For processes that are actually used to</p> <p>14 state earnings on the company's publicly disclosed</p> <p>15 statements, are you the controller for those</p> <p>16 processes?</p> <p>17 A Yes.</p> <p>18 Q And do you think that the processes for</p> <p>19 CSARL's accounting are not the same as the processes</p> <p>20 you oversee for purposes of the publicly disclosed</p> <p>21 statements?</p> <p>22 MR. TURNER: Object, foundation.</p> <p>23 Object, form.</p> <p>PAULA A. MORSCH, C.S.R. ADVANTAGE REPORTING SERVICE, 309-673-1881</p>	<p>37</p> <p>1 statement of Caterpillar, Inc.?</p> <p>2 A That's right, yes.</p> <p>3 Q How are the numbers calculated for CSARL</p> <p>4 that are used for financial statement purposes?</p> <p>5 A They're calculated according to U.S. GAAP</p> <p>6 rules.</p> <p>7 Q Using your regular accounting system, is</p> <p>8 that right?</p> <p>9 A That's right.</p> <p>10 Q So are there two sets of books for CSARL,</p> <p>11 one that does the partnership accounting and another</p> <p>12 that does the accounting in the context of the</p> <p>13 consolidated results?</p> <p>14 A Like I said, I'm not familiar with how</p> <p>15 they do the partnership accounting.</p> <p>16 Q Do you know if when earnings are</p> <p>17 consolidated, is it done in the same way for CSARL</p> <p>18 as for COS?</p> <p>19 A I guess I don't know what you mean in the</p> <p>20 same way. Yes, people report in their U.S. GAAP</p> <p>21 financial statements and we consolidate them.</p> <p>22 Q Do you know how partnership results are</p> <p>23 then used on a consolidated basis for the corporate</p> <p>PAULA A. MORSCH, C.S.R. ADVANTAGE REPORTING SERVICE, 309-673-1881</p>
<p>36</p> <p>1 A Can you repeat the question?</p> <p>2 Q Yes. Well, let me ask you this. Do you</p> <p>3 know what system is used to do the accounting work</p> <p>4 for CSARL?</p> <p>5 A No.</p> <p>6 Q Is partnership accounting done anywhere</p> <p>7 besides CSARL at Caterpillar?</p> <p>8 A I'm not aware that it is, no.</p> <p>9 Q And do you know if CSARL or the tax</p> <p>10 department had to go out and buy a system that would</p> <p>11 do partnership accounting?</p> <p>12 A I don't know.</p> <p>13 Q Are the books and records that you control</p> <p>14 set up for a corporation in corporate accounting?</p> <p>15 A That's correct.</p> <p>16 Q Is CSARL treated as a partnership on the</p> <p>17 SEC disclosures?</p> <p>18 A No.</p> <p>19 Q Is it treated as a corporation?</p> <p>20 A SEC disclosures are consolidated results</p> <p>21 at Caterpillar.</p> <p>22 Q So is somehow the information that's</p> <p>23 associated with CSARL consolidated into the overall</p> <p>PAULA A. MORSCH, C.S.R. ADVANTAGE REPORTING SERVICE, 309-673-1881</p>	<p>38</p> <p>1 results?</p> <p>2 MR. TURNER: Object, form.</p> <p>3 Q Let me ask it this way. Do you know how</p> <p>4 many partners there are?</p> <p>5 A No.</p> <p>6 Q In CSARL?</p> <p>7 A No, I don't.</p> <p>8 Q Do you know what happens to different</p> <p>9 income and expense streams at CSARL?</p> <p>10 A At a very high level. I'm not involved in</p> <p>11 the details.</p> <p>12 Q Okay. At a high level what happens with</p> <p>13 the different partnership income and expense streams</p> <p>14 at CSARL?</p> <p>15 A Depending on the nature of the income,</p> <p>16 they can be taxed at different rates.</p> <p>17 Q Okay. Are there -- do you know who the</p> <p>18 partners in CSARL are?</p> <p>19 A Not really, no. Like I said, I have very</p> <p>20 high level knowledge.</p> <p>21 Q Are some of the partners corporations?</p> <p>22 A I don't know.</p> <p>23 Q Do you know if the accounting for purposes</p> <p>PAULA A. MORSCH, C.S.R. ADVANTAGE REPORTING SERVICE, 309-673-1881 PSI-TWLF-15-000017</p>

<p>39</p> <p>1 of the consolidated books and records of</p> <p>2 Caterpillar, Inc., is done the same way with respect</p> <p>3 to Swiss operations now as it was before CSARL?</p> <p>4 A It's the same.</p> <p>5 Q So the results that are reported on a</p> <p>6 consolidated basis would be the same now as they</p> <p>7 would be if there was no CSARL, is that right?</p> <p>8 A Can you explain what you mean by same?</p> <p>9 Q The same numbers reported.</p> <p>10 A I imagine tax expenses is different</p> <p>11 because CSARL is a different company than what we</p> <p>12 had before.</p> <p>13 Q Before you get to the tax line of the</p> <p>14 return, would the results be the same?</p> <p>15 A Yes.</p> <p>16 Q So would operating profit still be the</p> <p>17 same?</p> <p>18 A Yes.</p> <p>19 Q But earnings after taxes would be</p> <p>20 differently?</p> <p>21 A Right.</p> <p>22 Q Do you have someone who works with the tax</p> <p>23 department concerning CSARL?</p> <p>PAULA A. MORECH, C.S.R. ADVANTAGE REPORTING SERVICE, 309-673-1881</p>	<p>41</p> <p>1 Q Did you only have a role with respect to</p> <p>2 CSARL after you came back from Indiana?</p> <p>3 A I had a brief role. I was on family leave</p> <p>4 and then I came back to a special assignment prior</p> <p>5 to going to Indiana where I reviewed the accounting</p> <p>6 on a consolidated basis for CSARL, a special</p> <p>7 project.</p> <p>8 Q Do you know approximately when that was?</p> <p>9 A October of 2000.</p> <p>10 Q Were you on family leave to have a baby?</p> <p>11 A Yeah.</p> <p>12 Q So you had just come back from the family</p> <p>13 leave and you were on the special assignment?</p> <p>14 A Right, uh-huh.</p> <p>15 Q That's probably pretty easy to pinpoint</p> <p>16 when that occurred?</p> <p>17 A That's why I can get to the month, yeah.</p> <p>18 Q Do you know how long you stayed in that</p> <p>19 special assignment?</p> <p>20 A Until I moved in January.</p> <p>21 Q So how many months is that?</p> <p>22 A It's essentially three months.</p> <p>23 Q Who assigned you to that?</p> <p>PAULA A. MORECH, C.S.R. ADVANTAGE REPORTING SERVICE, 309-673-1881</p>
<p>40</p> <p>1 A Terri Pierpont.</p> <p>2 Q Is there anyone else that you have who</p> <p>3 does something with respect to CSARL?</p> <p>4 A Terri has two staff. They may be involved</p> <p>5 as well.</p> <p>6 Q Anyone else?</p> <p>7 A No.</p> <p>8 Q Were you at the company when CSARL was</p> <p>9 started?</p> <p>10 A Yes.</p> <p>11 Q What was your position?</p> <p>12 Let me ask you this way. Before 2001 were</p> <p>13 you in the Administration Building before you went</p> <p>14 to Indiana?</p> <p>15 A Yes, I was in capital assets.</p> <p>16 Q When did you leave North Carolina?</p> <p>17 A Early 1998.</p> <p>18 Q So from early '98 until 2001 you were --</p> <p>19 A I was fixed asset manager, fixed asset</p> <p>20 accounting manager in corporate accounting</p> <p>21 Q In that role did you have anything to do</p> <p>22 with CSARL?</p> <p>23 A No.</p> <p>PAULA A. MORECH, C.S.R. ADVANTAGE REPORTING SERVICE, 309-673-1881</p>	<p>42</p> <p>1 A Steve Goose.</p> <p>2 Q What was his position?</p> <p>3 A Corporate -- I don't know his title. He</p> <p>4 was in corporate accounting and consolidating. He</p> <p>5 was a manager.</p> <p>6 Q What was the nature of the need for that</p> <p>7 special project?</p> <p>8 A Because CSARL was new, there was new</p> <p>9 transactions, we wanted to make sure consolidated</p> <p>10 operating profit wasn't affected and we had made all</p> <p>11 the appropriate intercompany eliminations for</p> <p>12 unrealized profit in inventory, and we concluded</p> <p>13 that we were.</p> <p>14 Q So is it fair to say that you wanted to</p> <p>15 make sure that on a consolidated basis the numbers</p> <p>16 turned out the same as before?</p> <p>17 A That's right.</p> <p>18 Q That would be the numbers before you got</p> <p>19 to the tax line, right?</p> <p>20 A That's right.</p> <p>21 Q In arriving at operating profit?</p> <p>22 A That's right, uh-huh.</p> <p>23 Q Did you learn at that time that there was</p> <p>PSI-TWLF-15-000018</p>

500



Rodney J.
Perkins/OS/Caterpillar
06/06/2005 01:32 PM

To: Daniel Schicksup/SE/Caterpillar@Caterpillar

cc:

bcc:

Subject: Fw: Authorization to proceed with planning and ABP cost adjustment

Caterpillar: Confidential Green

Here's the timing of the initial approvals by DBB and DRO. As I recall this memo is the one DBB then forwarded to DRO, who then "penned" his approval with instructions "let's go." or something along those lines....

Rod Perkins
Intl Tax Manager (Europe Africa & Middle East)
Corporate Tax, Caterpillar Inc.
100 NE Adams, Peoria Illinois 61629-4230
E-mail: rjperkins@cat.com
Telephone: (309) 675-4499
Fax: (309) 494-4543

----- Forwarded by Rodney J Perkins/OS/Caterpillar on 06/06/2005 01:29 PM -----



Robin D Beran/OS/Caterpillar
02/28/2005 09:24 AM

To: Rodney J Perkins, Giles A. Parsons, John P. Caviness

Subject: Fw: Authorization to proceed with planning and ABP cost adjustment

Caterpillar: Confidential Green

Retention Category: L21 - Contracts/Agreements
- Compliance and Support Records

This was it.

Robin
309.675.4478 - beranrd@CAT.com

----- Forwarded by Robin D Beran/OS/Caterpillar on 02/28/2005 09:22 AM -----



Robin D Beran/OS/Caterpillar
02/28/2005 03:23 PM

To: Dave B. Burritt

Subject: Authorization to proceed with planning and ABP cost adjustment

Caterpillar: Confidential Green

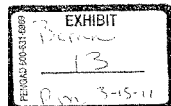
Retain Until: 03/27/2005

Retention Category: G90 - General
Matters/Administration

Dave, as we discussed,

Due to the successful planning from prior years, significant low taxed earnings (over \$1.5 billion) have accumulated in CS&I. This cash is now increasing at about \$70 million per month at tax rates of about 10%. This is resulting in offshore cash balances that can no longer be managed through intercompany loans and purchases without triggering significant additional tax costs, and an increase in CAT's effective tax rate. Corporate Tax needs authorization to move forward on planning related to legal restructurings and cash movements to the US from non US subsidiaries of approximately \$2.5 to \$3.5 billion, including approximately \$1.0 billion under the repatriation incentive in the recently enacted Tax Act. We are also solving debt/equity problems that exist in our UK and German tax groups, and creating a more tax efficient offshore structure for future non US investments.

Working with counsel at McDermott, Will & Emery, we met with E&Y, KPMG and PwC to solicit ideas. We have melded these ideas into an overall plan, but now need to move to the next steps. This entails



PSI-TWLF-12-000315

501

engaging firms to assist in developing final plans and implementation steps, including cost estimates. The work will be broken down amongst the 3 accounting firms, based on best ideas presented, and will proceed in increments to control costs and meet timelines.

This work is required now because:

- o The Tax Act requires the \$1.0 billion of qualifying dividends to be paid before end of year.
- o The other planning must be coordinated with the qualifying dividend planning.
- o The debt:equity problems are causing lost interest deductions, thereby hurting our overall effective tax rate.
- o This planning will allow us to optimize utilization of existing cash, and cover earnings for approximately the next 3 years.

Rough estimates of external costs approach \$5 million, spread across the 3 accounting firms and MWE. This will be in addition to our approved ABP amounts. As detailed plans are developed we will lock in costs, and keep you informed of the progress. Failure to proceed will result in significant additional tax costs, approximately 15 to 25% of any cash moved to the US, or the need to stop sweeping all cash to the US, which may require borrowing in the US while holding cash offshore. Repatriation without planning would cost over \$200 million for 2005, and would move the ETR over 1/2 point.

Robin
309.675.4478 - beranrd@CAT.com

Confidential Treatment Requested by PwC

PwC_PSI_CAT_0005565

Caterpillar Sàrl

Overview

July 30, 2008

R ♦

Permanent Subcommittee on Investigations

EXHIBIT #37

Caterpillar Sarl – Pop Quiz

Question #1 - How much of Caterpillar Inc.'s consolidated revenue and profit, respectively does Csarl generate?

- a) 30% of revenue and 20% of profit
- b) 40% of revenue and 33% of profit
- c) 45% of revenue and 43% of profit
- d) 50% of revenue and 45% of profit
- e) who cares it's all intercompany, right?

Answer: c) Csarl's consolidated revenues and profits in 2007 were \$20 billion and \$1.5 billion



E-FILED

Friday, 16 September, 2011 01:51:27 PM

Interoffice Memorandum U.S. District Court, ILCD

Facility

Date May 6, 2004

Plant/Office

Department

Attention J. W. Owens

copy: F. L. McPheeters
J. B. Buda
R. K. Kanuru
T. C. Gwillim

Plant/Office	Department	Attention

RE: Tax Concerns Raised by an Unnamed Source

On May 6, 2004, Jim Owens and Raj Kanuru (Caterpillar Tax Counsel) received copies of an undated and unsigned letter (the "Letter", *see attached*) from an individual claiming to be a current Caterpillar Tax Department employee.

The Letter makes the following allegations:

1. Caterpillar's transfer pricing practices (past and present) do not satisfy IRS guidelines;
2. The Caterpillar S.A.R.L. re-organization does not have a substantial business purpose and was transacted primarily for tax avoidance purposes; and
3. Recent reductions in the global effective tax rate are due to questionable transactions and organizational changes.

Additionally, the letter makes reference to a recent U.S. income tax deficiency levied by the Internal Revenue Service on a U.S. branch of the U.K. pharmaceutical company, GlaxoSmithKline, plc. The \$2.7 billion tax (and estimated \$2.5 billion in interest and penalties) assessment was a result of the breakdown of ten years of negotiations between Glaxo and the IRS regarding Glaxo's transfer pricing policies during the 1980's and 1990's.

The author of the letter has called for an independent investigation of the foregoing allegations by a party other than either PwC or McDermott Will & Emery. If no investigation is conducted, the anonymous author states he/she will report these allegations to the IRS.

In response, I do not feel an investigation is warranted since the allegations set forth in the Letter are simply untrue and the author is unfortunately very misinformed as to the facts and established practices of Corporate Tax, as well as the IRS audit process.

Specifically, with respect to the first allegation, Caterpillar's transfer pricing policy is the result of detailed analysis of the functional activities of the various entities in strict accordance with required Treasury Regulations. Two independent accounting firms provide reports on different parts of our operations. Comparables of prices based on external data are analyzed and Caterpillar's prices are established within the middle two quartiles of the range of comparables. This analysis is completed

annually and all determinations have been documented and provided to the IRS as part of the IRS's routine audit procedures.

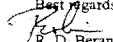
The second allegation in the Letter questions the business purpose of Caterpillar SARL's reorganization in Switzerland. Caterpillar SARL was formed to facilitate and coordinate Caterpillar's non-U.S. business activities throughout the world. It initially consisted of activities previously carried out by Caterpillar Overseas SA, with additional non-U.S. marketing and ancillary activities contributed after 1999. The Caterpillar SARL partnership is owned by non-U.S. Caterpillar subsidiaries, which contributed assets to the partnership and, in turn, received profit allocations based on their contributions. Some of these assets, mainly non-U.S. marketing related assets, had been held by U.S. subsidiaries of Caterpillar and were transferred down through multiple subsidiaries.

The basic operations of Caterpillar SARL are no different than any other valid and legal partnership operating anywhere in the world. Great care has been taken to ensure Caterpillar's operations are consistent with Switzerland's laws and any applicable U.S. and international tax laws. Information related to asset transfers and sales/charges to Caterpillar SARL and all other Caterpillar entities has been filed as part of Caterpillar's annual U.S. income tax return. U.S. activity of all Caterpillar SARL partners has also been provided to the IRS as part of routine audit procedures. Over 6% of almost 2,500 pages of the 2000, 2001 and 2002 Federal Income Tax Returns, exclusive of an additional 7,000 pages of foreign subsidiaries' financial information, relates to disclosures of the organization and re-organization of the various entities.

The third allegation refers to the writer's general disagreement with how the Tax Department has conducted business over the past few years. It is impossible to fully address this concern due to its vagueness. However, Caterpillar has been, and continues to be, very cooperative with the IRS in all tax audits and inquiries. The efforts of internal Tax Counsel and assistance from external counsel enable Corporate Tax to ensure Caterpillar is compliant with all relevant laws and regulations related to the tax function. We feel strongly that Corporate Tax has taken conservative, well-supported and documented tax positions on all issues and promotes a transparent atmosphere that encourages candid discussion, openness, and integrity.

As the IRS is currently engaged with Caterpillar in a tax audit of the years 1995 to 1999, has already completed tax audits for previous years and is planning the tax audit for more recent years, we already do, and will continue to, provide information to the IRS related to all the above issues.

Please let me know if you have any further questions concerning this matter.

Best regards,

 R. D. Beran
 Director of Taxation

The Internal Revenue Service is pursuing Multinationals who are evading taxes. The IRS wants the UK pharmaceutical company, Glaxo Smith Kline to pay \$5 billion in taxes, penalties, and interest for the years 1989 to 1996. This case involves transfer pricing. I do not believe Caterpillar's transfer pricing practices (past and present) meet the IRS' tests. The Officers and Board of Directors need to examine the transfer pricing issue before Caterpillar ends up in court and in the press. Similarly, the Tax Code does not permit transactions or an organizational structure that have no substantial business purpose other than for tax avoidance purposes. The CSARL reorganization in my opinion, does not meet this test. When you look through the reorganization, the primary purpose was to avoid taxes.

Over the past few years, Caterpillar's tax rate has dropped significantly due to very questionable transactions and organizational changes. I work in the Tax Department and I strongly disagree with how we have conducted our business over the past few years. I have not spoken out before, because of the fear of retribution. I'm speaking out now for the long term good of Caterpillar. An independent investigation (not PWC or our outside Tax counsel) is needed. If there is no independent investigation or if there is any retribution, I will go to the Internal Revenue Service.

4295
 M. Raj Kanyar
 CATAPOLU
 N. E. DODAN
 PERMANENT
 6/16/29

1:09-cv-01208-MMM -BGC # 120-31 Page 1 of 2

E-FILED
 Friday, 23 September, 2011 01:21:03 PM
 Clerk, U.S. District Court, ILCD



Robin D Beran/05/Caterpillar
 01/19/2007 11:07 AM

To: Daniel Schicksup/0E/Caterpillar/0Caterpillar
 C: John P. Caviness/0A/Caterpillar/0Caterpillar
 Re:

Subject: Re: C (01/19/2007) Attorney Client Privilege Re: 7th Cir Cases[]

Caterpillar Confidential/0E/

Dan, I think this is really a non-issue, under the heading of clear application of the existing law, and that it changes the various facts and circumstances. I described something like this to the JCT and SFC staff in our mtg yesterday, and they didn't suggest at all that it was inappropriate. We got a pretty clear indication that individual legal entities would be respected, unless there was something truly artificial in the structure.

Now we need to keep working on getting language in the history to make sure field examiners don't go off the deep end.

Robin
 309.675.4478 - berand@CA1.com

Every transaction has far consequences
 Daniel Schicksup/0E/Caterpillar



Daniel Schicksup/0E/Caterpillar
 01/19/2007 11:44 AM

To: John P. Caviness/0A/Caterpillar/0Caterpillar
 Subject: CONFIDENTIAL Attorney Client Privilege Re: 7th Cir Cases[]

Caterpillar Confidential/0E/

Re: 7th Cir 12/18/2007

Retention Category: 100% General
 Matters/Adm. Sub. 0.0%

John: Here are the additional cases. Levin is particularly interesting. Please review it and let's discuss. [attachment "Levin v. Commr. 832 F.2d 403 (7th Cir. 1988).doc" deleted by Daniel Schicksup/0E/Caterpillar] [attachment "Levin v. Commr. TC 43 405 (1985).doc" deleted by Daniel Schicksup/0E/Caterpillar] [attachment "Forsyth v. Commr. 845 F.2d 746 (7th Cir. 1988).doc" deleted by Daniel Schicksup/0E/Caterpillar] [attachment "Saviano v. Commr. 765 F.2d 643 (7th Cir. 1985).doc" deleted by Daniel Schicksup/0E/Caterpillar]

Robin, as part of the coalition on the codification of economic substance and business purpose, John and I have begun reading relevant caselaw from the 7th Circuit. An article describes the 7th Circuit as applying the conjunctive test requiring both business purpose and economic substance for transactions to be upheld. "No matter how you describe or apply this test or tests, the 7th Circuit seems to have a history of holding against the taxpayer where they find no economic substance." For example, the Court has referred to the "magic words" approach where taxpayers believe that if they have legal documents with all the right words in them, then all is well, but the Court ignores the legal documents where there was no real intent for one party to actually get into and operate the business stated in the documents or there is no activity to support the legal arrangement. This is true even when the "letter of the Code" is followed. The Court clearly states that tax motivated transactions are ok and taxpayers have the right to minimize taxes, but not if the transaction is one without any economics behind it, but for tax savings. This is why we went to so much trouble to be sure the business changed and adheres to the change in the contract manufacturing arrangement in Europe. However, whenever the topic of CSARL parts initiative is discussed from a risk point of view, the discussion seems to be limited to the risk that the IRS will challenge and adjust the royalty rate. I think the bigger risk is that the Service will attack it as lacking economic substance which would not adjust the benefit, but deny it in total. To my knowledge there is no one in CSARL managing the parts business or managing the sub-contracting of all the activity to Inc. Given the case law above, I think it would be prudent to review the situation from this angle, particularly in light of the FIN48 requirement that one assume the IRS knows all the facts when assessing risk. John.


Permanent Subcommittee on Investigations

EXHIBIT #39

PSI-TWLF-02-000349

and I could talk about options for addressing this

John P. Caviness/OA/Caterpillar

 John P. Caviness/OA/Caterpillar 01/17/2007 08:34 AM	To: Daniel Schlicksup Subject: 7th Cir. Cases	Retention Category: G50 - General Matters Administration
Caterpillar Confidential Green	Retain until: 02/16/2037	

Hi, Dan. Would you mind e-mailing the two 7th Cir. cases you mentioned yesterday?

Thanks very much

Best regards
John

John P. Caviness
 Corporate Counsel - Tax
 Caterpillar Inc. / Legal Services Division
 100 NE Adams St., Peoria, IL 61629-4295
 e-mail: jpcavins@caterpillar.com
 ph: 1 (309) 675-1579
 fax: 1 (309) 675-1753
 tel: 7-725-1579

 THIS E-MAIL IS INTENDED ONLY FOR THE USE OF THE INDIVIDUAL OR ENTITY TO WHICH IT IS
 ADDRESSED AND MAY CONTAIN INFORMATION THAT IS PRIVILEGED AND/OR CONFIDENTIAL. IF
 YOU ARE NOT THE INTENDED RECIPIENT OF THIS E-MAIL, PLEASE DELETE IT AND ANY
 ATTACHMENTS, WITHOUT OPENING THEM, IMMEDIATELY.

1:09-cv-01208-MMM -BGC # 120-32 Page 1 of 1

E-FILED
 Friday, 23 September, 2011 01:21:03 PM
 Clerk, U.S. District Court, ILCD



Daniel
 Schlicksup/0E/Caterpillar
 01/22/2007 08:25 AM

To: Robin D Beran/0S/Caterpillar; John P
 Cavness/0A/Caterpillar/0A/Caterpillar
 Cc:

Re:

Subject: Re: CONFIDENTIAL Attorney-Client Privilege Re: Tm Co
 Cases [X]

Caterpillar: Confidential Green

Hey Robin and John, a couple of things to take into account in this analysis

First, I think this has less to do with respecting legal entities than whether there is substance underlying the transactions in which they engage. The Courts have applied econ subst and/or bus purpose test(s) for decades. The cases stand for the proposition that merely following the letter of the law will not suffice if there is no underlying economics to the transaction. The current bill in congress is intended to codify what the courts have said in the past, not overrule or modify it. I am not sure what "clear application" means, but am certain based on what we have heard from DC that the Congress does not intend for it to mean that current case law will not apply. My only point is that I think it would be prudent to have John review the MWE memos to determine if this case law has been taken into account. A substance review seems prudent given the indications that the bill will almost certainly be enacted into law. We do this for the euro contract manufacturing and luxco (I think).

Second, we might want to think about how to use the econ subst and/or bus purpose test(s) to help us in the upcoming license fee litigation. In this case, the IRS is trying to say that we should ignore the economic substance of what was going on (subs paying for technology for which they cannot make profit in their markets).

Thanks Dan

Robin D Beran/0S/Caterpillar



Robin D Beran/0S/Caterpillar
 01/19/2007 11:03 AM

To: Daniel Schlicksup/0E; John P Cavness
 Subject: Re: CONFIDENTIAL Attorney-Client Privilege Re: Tm Co
 Cases [X]

Caterpillar: Confidential Green

Retain Until: 07/19/2018

Retention Category: G6 - General
 Matters Administration

Dan, I think this is really a non issue, under the heading of clear application of the existing law, and that it changes the various subs facts and circumstances. I described something like this to the JCT and SFC staff in our mtg yesterday, and they didn't suggest at all that it was inappropriate. We got a pretty clear indication that individual legal entities would be respected, unless there was something truly artificial in the structure.

Now we need to keep working on getting language in the history to make sure field examiners don't go off the deep end.

Robin
 309 675 4478 - beranrd@CAT.com

Every transaction has tax consequences
 Daniel Schlicksup/0E/Caterpillar

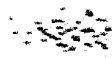


Daniel

To: John P Cavness; Robin D Beran

1:09-cv-01208-MMM -BGC # 120-33 Page 1 of 1

E-FILED
 Friday, 23 September, 2011 01:21:03 PM
 Clerk, U.S. District Court, ILCD



John P.
 Caviness/OA/Caterpillar
 01/22/2007 08:35 AM

To: Daniel Schlicksup@E-Caterpillar@Caterpillar; Robin D.
 Beran US-Caterpillar@Caterpillar

cc:

bcc:

Subject: Re: CONFIDENTIAL Attorney-Client Privilege Re: 7th Cir.
 Cases

Caterpillar: Confidential Green

I'd much rather discuss this in person than continue a long e-mail chain.

Best regards,
 John

John Caviness
 Corporate Counsel - Tax
 Caterpillar Inc.'s Legal Services Division
 100 NE Adams Street, Peoria, IL 61629-4295
 e-mail: cavjnp@caterpillar.com
 phone: (309) 675-1579
 fax: (309) 675-1753
 cell: 7-725-1579

 This e-mail is intended only for the use of the individual or
 entity to which it is addressed and may contain information
 that is PRIVILEGED and/or CONFIDENTIAL. If you are not
 the intended recipient of this e-mail, please delete it and any
 attachments, without opening them, immediately.

Daniel Schlicksup:

From: Daniel Schlicksup [mailto:dschlicksup@e-caterpillar.com]
 Sent: Friday, September 23, 2011 1:15 PM
 To: John P. Caviness [mailto:cavjnp@caterpillar.com];
 Subject: RE: CONFIDENTIAL Attorney-Client Privilege Re: 7th Cir.
 Cases

Hey Robin and John, a couple of things to take into account in this analysis:

First, I think this has less to do with respecting legal entities than whether there is substance underlying the transactions in which they engage. The Courts have applied econ subst and/or bus purpose test(s) for decades. The cases stand for the proposition that merely following the letter of the law will not suffice if there is no underlying economics to the transaction. The current bill in congress is intended to codify what the courts have said in the past, not overrule or modify it. I am not sure what "clear application" means, but am certain based on what we have heard from DC that the Congress does not intend for it to mean that current caselaw will not apply. My only point is that I think it would be prudent to have John review the MWE memos to determine if this caselaw has been taken into account. A substance review seems prudent given the indications that the bill will almost certainly be enacted into law. We do this for the euro contract manufacturing and Luxco (I think).

Second, we might want to think about how to use the econ subst and/or bus purpose test(s) to help us in the upcoming license fee litigation. In this case, the IRS is trying to say that we should ignore the economic substance of what was going on (subs paying for technology for which they cannot make profit in their markets).

1:09-cv-01208-MMM -BGC # 120-57 Page 1 of 1

E-FILEDFriday, 23 September, 2011 01:21:04 PM
Clerk, U.S. District Court, ILCDDaniel
Schlicksup/GE/Caterpillar
6/4/01/2006 05:28 PM

To: Robin D Beran (US-Caterpillar)

cc:

b6:

Subject: Pls review again before we send in AM

Caterpillar - Confidential Email

Retain Date: 04/01/2011



04/01/06 Apr 2006 Audit Comm File - 4 x 2 pgs

Look at the guard rail charts - I changed product management to tolling with goss and gren - more descriptive, your call? I changed CSARL Parts Distribution including Virtual Parts Inventory to CSARL - Virtual Parts Inventory. This is only risk associated to the virtual parts inventory, not anything else. Using the word "including" implies there is something else.

On page 12 I don't think there are new regs related to or annual reviews of the Parts Distribution Operations - are there? Shouldn't this be limited to the Tolling/Contract Manufacturing?

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 of case law. I have been told John has them and maybe he has them, and now we are worried about me reading them - even PwC memos. If we had these memos and they properly addressed these issues then I feel I would have seen them a long time ago. I don't think you can talk about CSARL without addressing this issue and it is not addressed in the charts you have included. I don't think this presentation can be considered "a full, transparent discussion of CSARL with the Board". I think discussing CSARL in this manner is misleading. Again, and with all due respect, if I am wrong then someone please tell me why based on the facts and the law.

Thanks Dan

Permanent Subcommittee on Investigations

EXHIBIT #40

PSI-TWLF-07-000022

Confidential Treatment Requested by PAC

Product Management Alignment
RecommendationRecommend
Preserve & Build**1) Implement Global Parts Management organization in Geneva**

- Executes entrepreneurial responsibilities
- Must support all MBDs
- Staff likely drawn from Industry and Solutions & Product Support orgs

2) Locate Regional Product Managers in Geneva

- Substantial contribution to MWL, MTTT/L, HEX and MG manufacturing
- Global Product Managers provide oversight role

3) Support organizations provide added entrepreneurial substance

- Global Purchasing
- Industry Groups
- Solutions & Product Support

PAC, Pro, CAT, 0003338

CATERPILLAR
TODAY'S WORLD. TOMORROW'S WORLD.

Confidential Treatment Requested by PwC

Product Management Alignment

CSARL Benefits – Based on 2008 Results

Recommend
Preserve & Brasil

			Benefits			
	Products	Presence	Preserve	Preserve & Brasil	Preserve & Enhance	Preserve & Optimize
Parts	All MBDs	Global Parts Manager(s)	\$ 300	\$ 300	\$ 300	\$ 300
Machines	MWL	Bouteille	(50)	(50)	(50)	(50)
	MTT	Bouteille				
	HEX	Kauk				
	WHEX	Abbott				
	MG	Bouteille	15 - 25	15 - 25	15 - 25	15 - 25
	AT	Lancot				
	LTTT	Ransley				50 - 75
	LWL	Srinath				10 - 25
			<u>\$ 250</u>	<u>\$265 - \$275</u>	<u>\$280 - \$325</u>	<u>\$340 - \$425</u>

Note: Benefits are based on 2008 results.

CATERPILLAR
TODAY'S WORK. TOMORROW'S WORLD.

PwC, PwC, CAI, 0000000000

Product Management Alignment

Enhance & Optimize

Defer decision to
enhance &
optimize

- 1) **Requires relocation of WW Product Managers**
 - PMs that have sole manufacturing source in U.S.
 - Entrepreneur must not be located at manufacturing source
- 2) **Inefficient, ineffective product management**
 - Distance to manufacturing, product development, business partners, customers
 - Requirement of eleven days in Geneva too restrictive
- 3) **While technically appropriate, creates optics concerns**
 - Taxation in CSARL with minimal business substance
- 4) **Election not required in 2009**
 - Election may be deferred
 - Revisit in conjunction with GPNP execution

Confidential Treatment Requested by PwC

Product Management Alignment

CSARL Benefits – Based on 2009 ATS

Including Brasil
enhances benefit
by \$26m

			Benefits			
	Products	Presence	Preserve	Preserve & Brasil	Preserve & Enhance	Preserve & Optimize
Parts	All MBDs	Global Parts Manager(s)	\$ 300	\$ 300	\$ 300	\$ 300
Machines	MWL	Bouteille	(40)	(21)	(21)	(50)
	MTTT	Bouteille				
	HEX	Kauk				
	WHEX	Abbott				
	MG	Bouteille		7	7	(6)
	AT	Lancot			(9)	(9)
	LTTT	Ransley				28
	LWL	Srinath				7
			<u>\$ 260</u>	<u>\$ 286</u>	<u>\$ 277</u>	<u>\$ 271</u>

* - Preserve & Optimize represents RPM responsibilities for EMEA, Americas and Asia Pac

PwC, PwC, CAI, 000000001

CATERPILLAR
TODAY'S WORK. TOMORROW'S WORLD.

From: Rod J Perkins <Perkins_Rodney_J@cat.com>
To: srwde1@aol.com; Thomas F. Quinn/US/TLS/PwC@Americas-US
Sent: 11/11/2008 10:28:11 AM
Subject: Exec Office Slides - Business Alignment

Steve and Tom,

Attached are the slides that will be used today during the meeting with the
Exec Office.

Rod Perkins
International Tax Manager (Europe Africa & Middle East)
Global Tax & Trade, Caterpillar Inc.
100 NE Adams, Peoria Illinois 61629-4230
E-mail: rjperkins@cat.com
Telephone: (309) 675-4499
Mobile: (309) 361-8594
Fax: (309) 675-6573

- 2009 Business Alignment EO Update 11-11-2008_ppt.zip

Permanent Subcommittee on Investigations

EXHIBIT #42

Confidential Treatment Requested by PwC

PwC PSI CAT 00033241

Confidential Treatment Requested by PAC

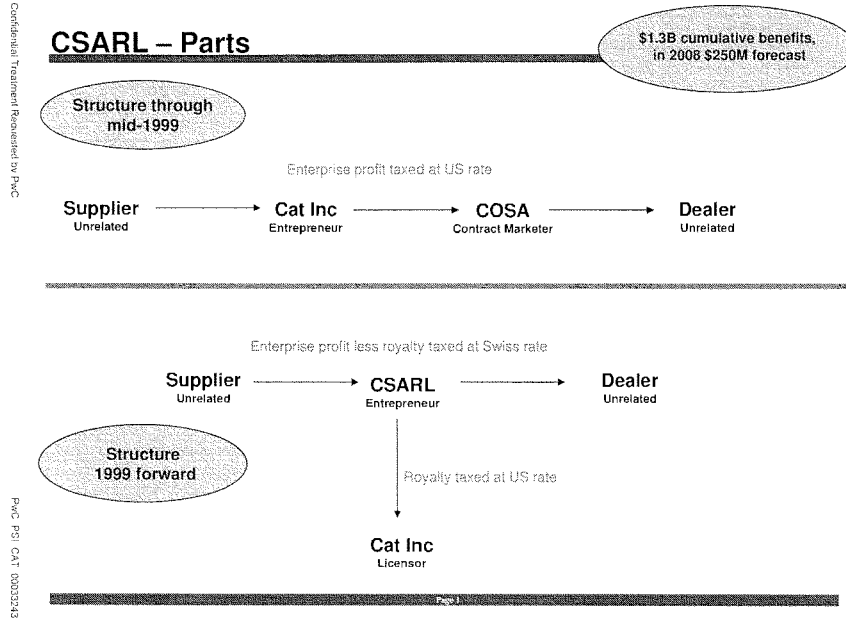
Caterpillar Inc.

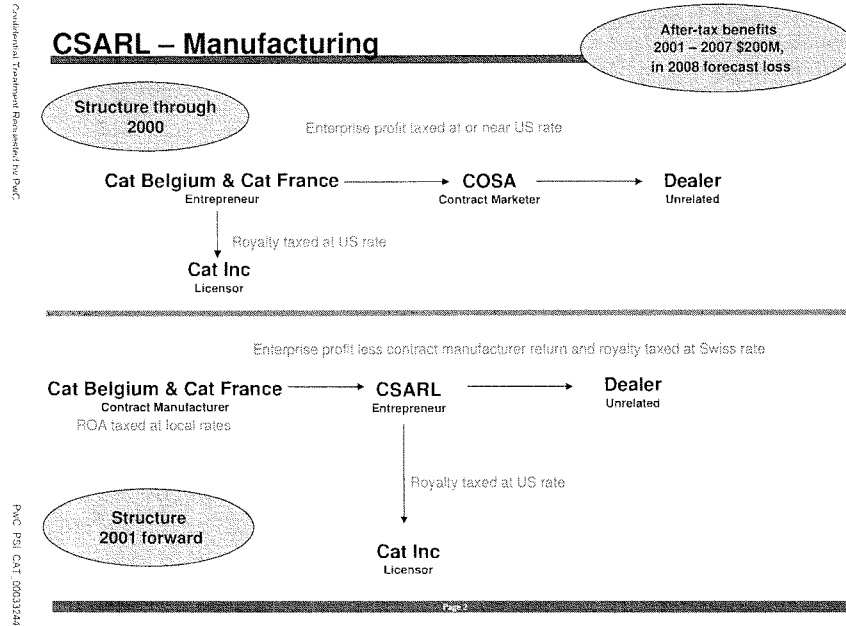
**Machine Business Alignment:
Update Briefing**

November 11, 2008
Due Date November 17

**Purpose: Leverage business realignment to preserve
and enhance CSARL benefits**

PAC PS CA 1003342





CSARL

Must ensure benefits
are maintained or
grown

**Parts &
Manufacturing
structures result in
significant benefits**

Today

- \$250 - \$300M
- PPS = \$0.40 - \$0.48
- ETR Impact 5 - 6 pts

Current Presence

- ✓ Group President
- ✓ Marketing VP & BU
- ✓ EAME Operations Management
- ✓ Product Mgrs -
 - MTTT (Oval) & TTL – Patrick Durieux
 - MWL (Regional) – Quentin DeWarlincourt
 - HEX (Regional) – Zack Kauk
 - WEX – Brian Abbott (CSarl employee, primarily located in Wackersdorf)

What's Changing

- New IRS Regulations: Regional Product Managers not enough ... need more presence
 - While CAT provided significant input, IRS insisted on substantial local entrepreneurial decision-making
- Global Product Manager for Oval MTTT & TTL moved from Geneva ... reducing presence
- Enterprise Alignment creates opportunity to redefine presence ...
 - Other products
 - Brazil production

Business Realignment - Protect the Existing CSARL Benefits (2008 \$250M)

> CSARL Thru 2008

- > Mary Bell BCP
 - > Small Hex (WW) Ken Gray Akashi
- > Gary Stampanato IPDD
 - > Medium Hex (Regional) Zack Kauk Geneva
 - > Large Hex (Regional) Zack Kauk Geneva
 - > MWL (Regional) Quentin DeWarlincourt Geneva
 - > Wheeled Hex Brian Abbott Wackersdorf
- > Mark Pflederer HCMD
 - > MTTT (Regional) P Duriex Geneva
 - > TTL (WW) P Duriex Geneva

RED Not Supportive of CSARL as entrepreneur
 GREEN Beneficial

> CSARL 2009 Fwd (Business Realignment)

- > Tom Bluth Earthmoving
 - > MWL Karl Weiss Beijing
 - > MTTT/TTL Scott Johnson Peoria
- > Gary Stampanato Excavation
 - > Medium Hex Tom Frake Peoria
 - > Large Hex Ken Gray Akashi
 - > Wheel Ex Brian Abbott Wackersdorf
- > Chris Curfman Mining
- > Bill Springer Quarry & Waste

Business Realignment - Preserve And/Or Grow the Existing CSARL Benefits (2008 \$250M)

		Preserve & Preserve & Preserve			
		Preserve	Enhance	Optimize	& Brasil
> Tom Bluth Earthmoving					
MWL Karl Weiss			X		
MTTT/TTL Scott Johnson					X
MG Pat O'Connell Decatur	\$15M-\$25M			X	X
Select					
> Gary Stampanato Excavation					
Small Hex Dan Harms					
Medium Hex Tom Frake					X
Large Hex Ken Gray		any			X
Wheeled Hex Brian Abbott			X		
AT Steve Lanctot	\$15M-\$50M		X	X	
> Chris Curfman Mining					
LTTT Andrew Ransley	\$50M-\$75M		X	X	
LMT Ed McCord		four			
> Bill Springer Quarry & Waste					
WTS Larry Tate					
LWL Sri Srinath	\$10M-\$25M			X	
Preserve		\$250M	\$250M	\$250M	\$250M
Incremental		----	\$65M-\$125M	\$90M-\$175M	\$15M-\$25M

Relocate 4 PMs to Geneva
Need final decision
before year-end

Other Requirements:

- Retain GP in Geneva
- Retain regional distribution services
- Retain EAME OPS Mgt in Geneva
- No regional product managers in Belgium or France

Singapore would be an option for one of the PMs

Executive Summary

Enhance the CSARL benefits

Outcomes:

- Preserves existing benefits
- Offers incremental benefits, accretive in year one, depending on timing of relocations
- Sustainable growth in benefits
- Low risk of implementation

Issues:

- Regional product managers will not be sufficient under proposed IRS regulations
- Requires managing two pools of cash, one in US, the other offshore
- System modifications

Risks & Challenges:

- Failure to take action weakens current CSARL structure
- Changes in responsibilities, subsequent pressures to relocate key personnel
- Continued downturn in economic conditions (e.g., ROS < 9% reduces tax savings)
- Exposures in currency movement can negatively impact margins
- Possible adverse US tax legislation under the Obama administration

Confidential Treatment Requested by PwC

Back-up Slides

PwC_PoD_Cat_00000249

Business Realignment - Protect & Grow the Existing CSARL Benefits (2008 \$250M)**> Proposed CSARL PM Structure**

- > Tom Bluth Earthmoving
 - > **MWL** Karl Weiss Beijing
 - > **MTTT/TTL** Scott Johnson Peoria
 - > **MG** Pat O'Connell ~~Duranton~~ Geneva \$15M-\$25M

People identified in green
preserve and enhance; pick
any four to preserve only

- > Gary Stampanato Excavation
 - > **Medium Hex** Tom Frake Peoria
 - > **Large Hex** Ken Gray Akashi
 - > **Wheel Ex** Brian Abbott Wackersdorf
 - > **AT** Steve Lancot ~~Peterlee~~ Geneva \$15M-\$50M

Other Requirements:

- Retain GP in Geneva
- Retain regional distribution services
- Retain EAME OPS Mgt in Geneva
- No regional product managers in Belgium or France

- > Chris Curfman Mining
 - > **LTTT** Andrew Flansley ~~Peoria~~ Geneva \$50M-\$75M

- > Bill Springer Quarry & Waste
 - > **LWL** Sri Srinath ~~Aurora~~ Geneva \$10M-\$25M

Enhanced benefit is
\$90M - \$175M

Singapore would be an option for one of the PMs

Business Realignment - Global Tax & Trade Recommendation

Only higher margin
products deliver
benefits (>9%)

Recommendation:

- Location of either the following groupings outside the US, preferably in Geneva, but Singapore may also work
 - Maintain existing CSARL benefits---
 - PMs: MTTT, MWL, LHEX, MHEX, MWEX
 - OR
 - MBD VPs: Mining, Quarry, Earthmoving, & Excavation
 - Approaching \$300M annually & growing, primarily parts distribution
 - Substance through 2008 supported by WW and/or regional PMs, managing machines, supporting parts and field population growth, together with regional marketing operations
- Increase benefits by product---
 - Add benefit for Brazil Production
 - MG \$10M - \$25M
 - MTTT, LHEX, MHEX \$25M - \$50M
 - Other high-margin machines with benefit
 - AT \$15M - \$50M
 - LTTT \$50M - \$75M
 - LWL \$10M - \$25M

Selective PM relocation adds
\$100-\$200M/year;
MBD VP relocation is
significantly lower due to
portfolio effect


Executive Summary – What's Changed

Two key changes:
Underlying law
Business Realignment

- **Prior law based on case law**
 - Established ability to *attribute* "manufacturer" status through contractual risk shifting
 - Could establish "manufacturer" status through either product control or process control
 - Amount of benefit required ability to show entrepreneurial control over the product
 - Required actual ownership of inventory to achieve benefit
- **Current proposed law**
 - Cat influenced the definition of the regulations, focusing on nine criteria
 - Buy/sell ownership of finished goods is sufficient
 - Proposed law focuses on employees of CSARL making a "substantial contribution" to the manufacturing of product including:
 - *"management of risk of loss & manufacturing profits"*
 - *"quality control, direction of intellectual property development"*
 - Amount of benefit required ability to show entrepreneurial control over the product
 - Concern is worldwide product managers outside Geneva/Singapore will control most of the substantial contribution factors, and no one in Geneva/Singapore will have enough control to be considered "substantial"
- **Critical entrepreneurial PM role, which provides current support, impacted by two new forces**
 - MBD reorganization
 - IRS regulations, focused on manufacturing control
- **Above forces place existing \$250M/year benefit at risk**
 - However, if managed correctly, it should enable incremental financial benefits

Caterpillar Inc
CSARL 2009 activities
Report to Audit team
January 2010

Tom Quinn, Tax ITS
Steve Williams, Tax Transfer Pricing
Ed Bodnam, Tax ITS

PRICEWATERHOUSECOOPERS 

CONFIDENTIAL

PwC-CAT-00002431

Permanent Subcommittee on Investigations
EXHIBIT #43

CSARL: 2009 Activities

October 2008: "Enterprise Alignment" announced by Exec Office:

During 2009: PwC Tax assisted Corporate Tax to align CSARL activities with the new "Enterprise Alignment". Four workstreams:

Workstream	Benefit
"RPMs in Geneva" with defined responsibility for production in CBSA (Gosselies), CFSA (France), and, new from 2009, with responsibility for CBL (Brazil).	\$44.3m (Brazil only)
"Brazil Parts": CBL legal entity focus on manufacturing, new entity CBCL to sell parts, sourced from CSARL, to Brazilian customers	\$10.4m ("Brazil")
"Worldwide Parts Manager": establish group in CSARL Geneva with worldwide parts responsibilities	\$300m ("Preserve")
"Legal Reorganization of CSARL": Legal reorganization of CSARL to utilize Class F tolling losses	\$50m

CSARL: 2009 Activities

Original recommendation to EO from Corporate Tax – January 2009

Product Management Alignment Recommendation

1) Implement Global Parts Management organization in Geneva

- Executes entrepreneurial responsibilities
- Must support all MBDs
- Staff likely drawn from Industry and Solutions & Product Support orgs

2) Locate Regional Product Managers in Geneva

- Substantial contribution to MVL, M11 PL, HEX and MG manufacturing
- Global Product Managers provide oversight role

3) Support organizations provide added entrepreneurial substance

- Global Purchasing
- Industry Groups
- Solutions & Product Support

CATERPILLAR

* Original slides located in Appendices

CONFIDENTIAL

PwC-CAT-00002433

3. Worldwide Parts Management Group in CSARL

The Enterprise Alignment allowed for Caterpillar to strengthen the substance surrounding CSARL's parts sales.

- From 1999 through 2009, Caterpillar has relied on "unrelated-to-unrelated" transactions, through disregarded entities, to support that CSARL's parts sales were not FBCSI (Class A, Class G)
- Enterprise Alignment allowed for the creation of a WW Parts Management Group, in Geneva, to have closer management, supervision, and entrepreneurial responsibilities over WW Parts. This group consists of representatives of MBDs/EBDs, and M&PS COE ("parts steward")
- Thus, the WW Parts Management Group provides additional substance to the "unrelated-to-unrelated" basis for non-FBCSI treatment.

CSARL 2009 activities
PricewaterhouseCoopers

January 2010
Slide 18

CONFIDENTIAL

PwC-CAT-00002448

3. WW Parts Management in Geneva, p 2

Supporting Evidence:

- Target Design (excerpts attached)
- Revised Parts White Paper with description of WW Parts Mgmt group
- Roles and Responsibilities checklists
- Personnel Announcements, Decision Rights, etc.

- Led by Quentin de Warlincourt, as of Nov 2009.

III. Worldwide Parts Management	
Contents of Closing Book	Status/Notes
1. Final Target Design	WW Parts Business Table Agenda Slides
2. Implementation Checklist	Project workplan
3. Legal Agreements	
4. Other	RACI charts included in WW Parts Business Table Agenda Slides, as finalized by WW Parts Management group (WW Parts Mgmt Announcement)

The WW Parts Management Structure provides further substance to preserve annual parts benefit of \$300m

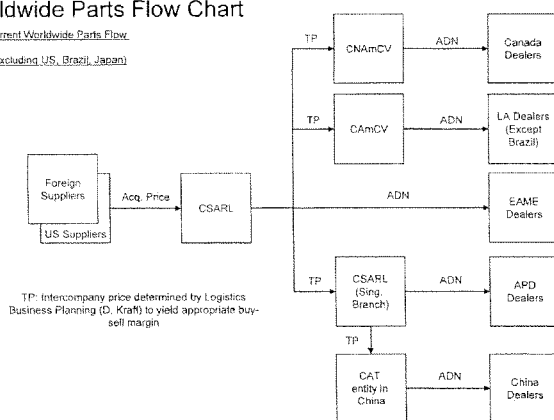
Summary and Next Steps

Summary of Benefits:

Workstream		Benefit per year \$
Brazilian RPM	(new benefit)	\$44.3m
Brazilian Parts	(new benefit)	\$10.4m
Worldwide Parts Management	(preserve)	\$300m
Convert Class F	(reduce detriment)	\$50m
Total Benefit		\$404.7m

Worldwide Parts Flow Chart

Current Worldwide Parts Flow
(Excluding US, Brazil, Japan)



CSARL 2009 activities
PricewaterhouseCoopers

January 2010
Slide 42

From: CN=Michael T. Murphy/OU=US/OU=TLS/O=PwC
To: CN=Steven R. Williams/OU=US/OU=TLS/O=PwC@Americas-US
Sent: 05/17/2010 11:33:49 AM EST
Subject: Re: Fw: WW Parts Manager

Ok will do, I'll start on that right now try to get you something by COB today

Michael T. Murphy | PricewaterhouseCoopers | Telephone: +1 202 312 7586 |
Facsimile: +1 813 496 2721 | michael.t.murphy@us.pwc.com

From: Steven R. Williams/US/TLS/PwC
To: Michael T. Murphy/US/TLS/PwC@Americas-US
Date: 05/17/2010 12:32 PM
Subject: Re: Fw: WW Parts Manager

yep, see subsequent email from TFG. 2pg memo to Quentin (and really to Gosselin), on what the role of the WW Pts Mgr is and why Tax needs it...

Steve Williams | Managing Director | Global Transfer Pricing |
PricewaterhouseCoopers | Telephone: +1 703 918 3339 | Mobile: +1 202 492 6666 |
steven.r.williams@us.pwc.com

Michael T. Murphy/US/TLS/PwC
05/17/2010 12:25 PM

To
Steven R. Williams/US/TLS/PwC@Americas-US
cc

Subject
Re: Fw: WW Parts Manager

Yea I can help out with this.

Do we want the memo or do we want to just give Caviness the closing book? (Memo seems to make more sense)

When do you want me to get started?

"Custodian" --> Ouch. I like to think of myself as the plantation owner of the closing books haha

Permanent Subcommittee on Investigations
EXHIBIT #44

Michael T Murphy | PricewaterhouseCoopers | Telephone: +1 202 312 7586 |
Facsimile: +1 813 496 2721 | michael.t.murphy@us.pwc.com

From: Steven R. Williams/US/TLS/PwC
To: Michael T Murphy/US/TLS/PwC@Americas-US
Date: 05/17/2010 11:51 AM
Subject: Fw: WW Parts Manager

in case we need to help John Caviness reply to this, have you got time to assist?

see Org Announcement from Cat last week for background...

Steve Williams | Managing Director | Global Transfer Pricing |
PricewaterhouseCoopers | Telephone: +1 703 918 3339 | Mobile: +1 202 492 6666 |
steven.r.williams@us.pwc.com

----- Forwarded by Steven R. Williams/US/TLS/PwC on 05/17/2010 11:49 AM -----

Steven R. Williams/US/TLS/PwC
05/17/2010 11:30 AM
Local: 703-918-3339
Int: cell 202 492 6666
"Reply to All" is Disabled

To
thomas f. quinn
cc
Ed Bodnam/US/TLS/PwC
Subject
Fw: WW Parts Manager

actually, if Ed and I are backed up and you need quick turnaround, I can get Mike Murphy to draft something then I can edit and send to you. The request was for

"a short memo or in a conference call summarizing in a structured way our tax guidance for the position, covering items such as:

- background for the initial tax recommendation and key tax requirements
- acceptable range of SG for the WW Parts Manager (ie why we need a senior position, Steve specifically asked this question) - importance of support staff in Geneva or other locations."

Mike can pull that together from the "closing book" and other documents that he is the custodian for.....
Ask John Caviness if he wants us to create something for him.

Steve Williams | Managing Director | Global Transfer Pricing |
PricewaterhouseCoopers | Telephone: +1 703 918 3339 | Mobile: +1 202 492 6666 |
steven.r.williams@us.pwc.com

----- Forwarded by Steven R. Williams/US/TLS/PwC on 05/17/2010 11:28 AM -----

Steven R. Williams/US/TLS/PwC
05/17/2010 10:57 AM
Local: 703-918-3339
Intl: cell 202 492 6666

To
Thomas F. Quinn/US/TLS/PwC
cc
Ed Bodnam/US/TLS/PwC@Americas-US
Subject
Re: Fw: WW Parts Manager

do you need our help in this? if you and Caviness are in Piracicaba?

or since Pierre asked Caviness/Stiles/Vest/Parsons, who of them is supposed to
reply to Quentin/Gosselin?

Ed and I can draft something for you and Caviness to review. Seems like a
short fuse-- I can get to it later this afternoon.

Steve Williams | Managing Director | Global Transfer Pricing |
PricewaterhouseCoopers | Telephone: +1 703 918 3339 | Mobile: +1 202 492 6666 |
steven.r.williams@us.pwc.com

Thomas F. Quinn/US/TLS/PwC
05/17/2010 08:48 AM
Local: 312-298-2733
Intl: mobile: 1-847-867-2401
One North Wacker Drive Chicago IL 60606
US
"Reply to All" is Disabled

To
Steven R. Williams/US/TLS/PwC, Ed Bodnam/US/TLS/PwC
cc
Subject
Fw: WW Parts Manager

Back to the drawing board...

- Tom

Thomas F. Quinn | Int'l Tax Services | PricewaterhouseCoopers | Telephone: +1
312 298 2733 | Mobile: +1 847 867 2401 | thomas.f.quinn@us.pwc.com
----- Forwarded by Thomas F. Quinn/US/TLS/PwC on 05/17/2010 07:48 AM -----

"John P. Caviness" <Caviness_John_P@cat.com>
05/17/2010 06:58 AM

"Reply to All" is Disabled

To
Beran_Robin_D@cat.com
cc
Thomas F. Quinn/US/TLS/PwC@Americas-US
Subject
Fw: WW Parts Manager

FYI

Best regards,
John

John P. Caviness
Tax Counsel
Caterpillar Inc. / Legal Services Division
100 NE Adams St., Peoria, IL 61629-4295
e-mail: cavinjp@cat.com
ph: 1 (309) 675-1579
fx: 1 (309) 675-1753
lt: 7-725-1579

* * * * *

THIS E-MAIL IS INTENDED ONLY FOR THE USE OF THE INDIVIDUAL OR ENTITY TO WHICH
IT IS ADDRESSED AND MAY CONTAIN INFORMATION THAT IS PRIVILEGED AND/OR
CONFIDENTIAL. IF YOU ARE NOT THE INTENDED RECIPIENT OF THIS E-MAIL, PLEASE
DELETE IT AND ANY ATTACHMENTS, WITHOUT OPENING THEM, IMMEDIATELY. -----
Forwarded by John P. Caviness/0A/Caterpillar on 05/17/2010 08:58 AM -----
Pierre De Pena/0E/Caterpillar
05/17/2010 06:25 AM

To
John P. Caviness/0A/Caterpillar@Caterpillar, Sally A
Stiles/0S/Caterpillar@Caterpillar, Gary L. Vest/0S/Caterpillar@Caterpillar,
Giles A. Parsons/1B/Caterpillar@Caterpillar
cc

Fergal Murphy/0E/Caterpillar@Caterpillar, David S.
 Poling/0S/Caterpillar@Caterpillar
 Subject
 WW Parts Manager

Caterpillar: Confidential Green Retain Until: 06/16/2010

Good morning,

As part of the recent organization changes, Quentin de Warlincourt is now reporting to Steve Gosselin. Quentin and Steve had some discussions on the role of the WW Parts Manager and how this would fit in Steve's future organization. As part of this exercise, Quentin would be interested in a short memo or in a conference call summarizing in a structured way our tax guidance for the position, covering items such as:

- background for the initial tax recommendation and key tax requirements
- acceptable range of SG for the WW Parts Manager (ie why we need a senior position, Steve specifically asked this question) - importance of support staff in Geneva or other locations.

Quentin's understanding is that Steve does not have a final opinion yet on the position. He would recommend to move fast, however, as this needs to be cleared before the first wave of announcements.

Best regards,

Pierre

Pierre de Pena
 Inter-company Pricing Manager
 EAME Tax & Trade
 Caterpillar SARL
 Tel +41 (0) 22 849 42 27
 Mob +41 (0) 78 833 42 27

This document was not intended or written to be used, and it cannot be used, for the purpose of avoiding U.S. federal, state or local tax penalties.

This document was not intended or written to be used, and it cannot be used, for the purpose of avoiding U.S. federal, state or local tax penalties.

This document was not intended or written to be used, and it cannot be used, for the purpose of avoiding U.S. federal, state or local tax penalties.

This document was not intended or written to be used, and it cannot be used, for the purpose of avoiding U.S. federal, state or local tax penalties.

This document was not intended or written to be used, and it cannot be used, for the purpose of avoiding U.S. federal, state or local tax penalties.

This document was not intended or written to be used, and it cannot be used, for the purpose of avoiding U.S. federal, state or local tax penalties.

Caterpillar Inc.

Worldwide Parts
Management
Final Closing Book

Draft Version as of March 15, 2010

CONFIDENTIAL

Permanent Subcommittee on Investigations
EXHIBIT #45

PwC-CAT-00002477

Confidential Treatment Requested by PwC

PwC PSI CAT 00003876

**Worldwide Parts Management Group
Key Responsibilities**

1. Parts Business Strategy: Establish the overall parts strategy. This includes establishing the Vision/Mission statement for the parts business and critical success factors to achieve the Vision & Mission. Targets, action plans and performance metrics will be established for each critical success factor. This strategy will be reviewed with the Executive Office (as part of M&PS's EOR) and all MBDs/EBDs to ensure alignment with the strategy. Some of the areas covered by the strategy include the 'go-to-market' strategy for parts' and strategies for the '4 Ps' of marketing (Product, Promotion, Place, Price). As part of this role, the WW Parts Management Group will be included on the approval sign line for all Business Proposals related to the aftermarket parts business (i.e. capital expenditures for new/expanded parts distribution facilities, investments in new parts systems/software, etc.)
2. Margin Targets: Develop Caterpillar enterprise margin targets at the parts product level (i.e. Undercarriage, GET, engine parts, drivetrain, etc.) and by industry in the future when industry-specific parts data becomes available. Identify the products / industries where there are gaps between target and actual margins, and work with parts business table participants to develop action plans for cost reduction, resourcing, design changes, price realization, etc. to improve margins. Review margins and the status of improvement actions at quarterly parts business table meetings. In addition, dealer gross margins (i.e. difference between Suggested Consumer Price and Dealer Net Price) would also be established. The main business table participants the WW Parts Management Group would interface with are: Purchasing, Component Groups, and Parts Pricing.
3. Sales/Share Targets: Develop targets for sales growth / POPS-C at the parts product level and by industry in the future when industry-specific parts data becomes available. Identify products / industries where there are gaps between target and actual sales/POPS-C and work with parts business table participants to develop action plans to improve (i.e. new customer offerings, parts marketing programs, improved parts availability, price/sales variance actions, etc.). Participate in the parts S&OP process to track progress toward meeting sales/POPS-C targets, and establish corrective actions when the sales/POPS-C forecasted in the S&OP falls short of target. The main business table participants the WW Parts Management Group would interface with are: M&PS COE, DSDs, Parts Pricing, S&OP Group in Logistics Div.
4. Cost Targets: Develop cost targets at the parts product level, which are a function of competitively-based price levels and margin targets and/or an understanding of the level needed to achieve Low Cost Producer status. Identify parts products needing cost reduction to ensure healthy margins and work with parts business table participants to develop action plans for material cost reduction,

Caterpillar Confidential: Yellow

I

6/23/09

Closing Book page 30 of 39

CONFIDENTIAL

PwC-CAT-00002507

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00003906

manufacturing cost reduction, resourcing, design changes, etc. to reduce cost. On an annual basis, work with Purchasing to establish the ATS material cost plan (for example "hold cost increases to half of inflation"). The main business table participants the WW Parts Management Group would interface with are: Purchasing, Component Groups, and MBD Product Groups.

5. NPI: Actively engage with the MBD Product Groups and Component groups during the NPI process. Provide input on parts and service related elements of machine & engine NPI programs. Work with NPI teams to evaluate design alternatives to ensure an appropriate balance is achieved between initial machine cost and downstream parts profit. Provide analysis and recommendations to machine product groups and component groups regarding component design, the use of proprietary vs. off-the-shelf components, CAT branding of purchased components, etc. The main business table participants the WW Parts Management Group would interface with are: MBD Product Groups, Component Groups, and M&PS COE.
6. Distribution Services Attributes: Work with DSDs to understand how CAT can help dealers deliver product support excellence. Provide solutions to dealers in critical areas, such as availability, capacity, capability, parts merchandising programs, etc. The main business table participants the WW Parts Management Group would interface with are: DSDs & M&PS COE.
7. Customer Offerings: See NPI. In addition, define customer centric solutions, such as Repair Options, Customer Service Agreements, etc. The main business table participant the WW Parts Management Group would interface with are M&PS COE & DSDs.
8. Parts Pricing/Sales Variance: Develop the annual parts price plan based on EO price realization targets, analysis from the Parts Pricing group (actual vs. target price premiums, actual vs. target margins, competitive price action, currency impacts, etc.), and input from MBD industry groups. The proposed price plan will optimize price realization and support sales and POPS-C goals. Key business table participants the WW Parts Management Group would interface with are: M&PS COE, Parts Pricing, and MBD Industry & Product Groups.
9. Availability: Develop targets for parts availability and monitor actual performance vs. target. When actual performance doesn't meet target, work with CAT Logistics to identify the reasons for the shortfall, establish corrective actions, and work with business table participants to execute those actions. Key business table members the WW Parts Management Group will work with are: Purchasing and CAT component groups (to ensure on-time parts delivery goals are met); CAT Logistics (to ensure proper management of parts supply within the logistics organization); and Distribution Services Divisions (to ensure dealer capability to meet customer parts demand and manage dealer parts inventories).

From: CN=Steven R. Williams/OU=US/OU=TLS/O=PwC
 To: CN=Thomas F. Quinn/OU=US/OU=TLS/O=PwC@Americas-US
 Sent: 11/04/2008 07:54:37 PM EST
 CC: CN=Ed Bodnam/OU=US/OU=TLS/O=PwC@Americas-US
 Subject: Re: is tomorrow really the only shot with DBB?

"3. PMs in US will put some pressure on the parts profit model. These guys are really bought into the PM is king concept. We are going to have to create a story that will put some distance between them and parts (eg. all the parts that are noncurrent) to retain the benefit. Get ready to do some dancing."

What the heck. We'll all be retired when this comes up on audit.

Bodnam and chris Dunn will have to solve it.

Baby boomers have their fun, and leave it to the kids to pay for it.

This document was not intended or written to be used, and it cannot be used, for the purpose of avoiding U.S. federal, state or local tax penalties.

----- Original Message -----

From: Thomas F. Quinn
 Sent: 11/04/2008 06:15 PM CST
 To: Steven Williams
 Cc: Ed Bodnam
 Subject: Re: is tomorrow really the only shot with DBB?

Steve,

1. The meeting with DB is pretty key. See note below. Timing is critical. At most we will have one more day. I am sure Dave will want to send a deck to Rapp in advance of their meeting on the 7th.

2. Include a slide that shows the items for further work. Not sure we will be able to do them now - but lets keep track.

3. PMs in US will put some pressure on the parts profit model. These guys are really bought into the PM is king concept. We are going to have to create a story that will put some distance between them and parts (eg. all the parts that are noncurrent) to retain the benefit. Get ready to do some dancing.

- Tom

Robin D Beran/OS/Caterpillar
 10/30/2008 10:26 AM

To
 Sherie Hittinger/OC/Caterpillar@Caterpillar
 cc
 Dave B. Burritt/OG/Caterpillar@Caterpillar, Rodney J Perkins/OS/Caterpillar
 Subject
 Re: Ready?Link

Caterpillar: Confidential Green Retain Until: 11/29/2008
 Retention Category: G90 - Information and Reports

Confidential

Permanent Subcommittee on Investigations

EXHIBIT #46

PwC_PSI_CAT_00033157

We will be ready for 5th. Will be ready for 7th if we're on same page as Dave and major differences don't arise. Will get materials to Dave yet this week so he can review before the 5th.

Robin D. Beran
Director, Global Tax & Trade
08 - AB4295
Phone: (309) 675-4478, tie line: 7-725-4478
Fax: (309) 675-1753, e-mail: beranrd@cat.com

This e-mail, including attachments, may include confidential and/or proprietary information, and may be used only by the person or entity to which it is addressed. If the reader of this e-mail is not the intended recipient or his or her authorized agent, the reader is hereby notified that any dissemination, distribution, or copying of this e-mail is prohibited. If you have received this e-mail in error, please notify the sender by replying to this message and delete this e-mail immediately. Thank you.

Sherie Hittinger/OC/Caterpillar
10/30/2008 10:14 AM

To
Robin D Beran/OS/Caterpillar@Caterpillar
cc
Dave B. Burritt/OG/Caterpillar@Caterpillar
Subject
Ready?

Caterpillar: Confidential Green Retain Until: 11/29/2008

Robin -- I set up two meetings regarding the Tax Project w/ Business Realignment. 1) Nov 5 - Attendees: DBB/BMH/RDB/RJP; 2) Nov 7 - DBB & EJ.R.

The question is ... will you be ready to meet with Dave on the 5th and will he then be ready for his meeting with EJ.R on the 7th?

Rgds, Sh

Thomas F. Quinn | Int'l Tax Services | PricewaterhouseCoopers | Telephone: +1 312 298 2733 | Mobile: +1 847 867 2401 | thomas.f.quinn@us.pwc.com

Steven R. Williams/US/TLS/PwC
11/04/2008 04:11 PM
Local: 703-918-3339
Int'l: cell 202 492 6666
"Reply to All" is Disabled

To
Thomas F. Quinn/US/TLS/PwC, Ed Bodnam/US/TLS/PwC
cc

Subject
is tomorrow really the only shot with DBB?

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00033158

Seems like we have a lot of open items that we could really spend time on .
-- big picture (global company vs US entrepreneurship vs US tax footprint),
-- snapshot vs longer term view
-- modeling benefits under alternative scenarios.

.. that we ought to spend more time fixing this before the Big Decision-- is
that like next week when DBB meets with Raap?

Also, just curious-- say they decide most PMs stay in US. How do we retain
CSARL parts profit if those "US entrepreneurs" claim both machine AND parts
profit?

Steve

Steve Williams | Managing Director | Global Transfer Pricing |
PricewaterhouseCoopers | Telephone: +1 703 918 3339 | Mobile: +1 202 492 6666 |
steven.r.williams@us.pwc.com

This document was not intended or written to be used, and it cannot be used,
for the purpose of avoiding U.S. federal, state or local tax penalties.



100 NE Adams Street
Peoria, Illinois 61629-6490

CONFIDENTIAL—CONTAINS PROPRIETARY INFORMATION

Summary of Caterpillar Operations and Restructuring of Caterpillar Sarl

Further to our recent discussions and correspondence concerning your inquiry into Caterpillar's international tax practices, we thought that it might be helpful to provide you additional information on Caterpillar and, in particular, on the foreign operations and restructurings of Caterpillar Sarl. We ask that you consider this additional context as you review what you have learned thus far in your inquiry.

Executive Summary

Caterpillar has a high effective tax rate, maintains a very large U.S. manufacturing footprint, claims no U.S. tax deferral on sales in the United States or on export sales, and has not accumulated substantial offshore cash that has not already been subjected to U.S. tax. With respect to its foreign operations, Caterpillar uses standard lawful international tax planning that any responsible multinational enterprise would use. This planning is both appropriately conservative under applicable law and of relatively limited effect in terms of reducing Caterpillar's U.S. tax bill (hence the high effective tax rate, absence of significant offshore cash, etc.). We respectfully submit that Caterpillar is not an example of a multinational engaged in aggressive international tax planning, and that expanding the Subcommittee's inquiry further will not serve to illuminate any particularly important international tax policy issues.

We understand that you are interested in the fact that Caterpillar Inc. was removed from the supply chain of U.S.-sourced parts manufactured by unrelated parties for Caterpillar Sarl to sell into foreign markets. We hope that this paper will clarify the relevant facts and will explain how Caterpillar has complied with both the letter and spirit of relevant U.S. law in carrying out this restructuring and in operating the supply chain on an ongoing basis. Removing Caterpillar Inc. as an unnecessary purchaser in the supply chain resulted in additional deferral of U.S. tax relative to the prior structure, but this reflects flaws in the prior structure rather than anything inappropriate or aggressive about the resulting structure. Moreover, Caterpillar Sarl has fully compensated Caterpillar Inc. for all property and services provided by Caterpillar Inc. in connection with the restructuring and ongoing operation of the supply chain. The economic substance doctrine—which prevents taxpayers from engaging in unnecessarily complicated transactions in order to accomplish tax results not foreseeable by tax policy makers—is simply not relevant to the elimination of Caterpillar Inc. from this supply chain. The tax consequences of business decisions of this nature are governed by specific legal regimes (such as subpart F and the transfer pricing rules) that explicitly address the measurement and deferral of income in these situations. It is well established that these

Permanent Subcommittee on Investigations

EXHIBIT #47

PSI-Caterpillar-04-000002

CONFIDENTIAL & PROPRIETARY
September 23, 2013

basic structuring decisions are not subject to second-guessing under the economic substance doctrine.

Caterpillar's Business, Organization and Reporting

Caterpillar is the world's leading manufacturer of construction and mining equipment, diesel and natural gas engines, industrial gas turbines, and diesel-electric locomotives. Caterpillar is a leading exporter of products to global customers, providing more than 300 products available to customers in approximately 180 countries around the world. In fact, from 2008 through 2012, Caterpillar exported more than \$82 billion of products from the United States, supporting thousands of Caterpillar jobs in the United States as well as thousands of additional jobs at U.S. suppliers who provide components to Caterpillar for those exported products. The marketing, distribution and other support functions of Caterpillar Sarl, and its foreign affiliates, play a vital role in the support of these U.S. exports. About 70 percent of Caterpillar's sales and revenues are from outside of the United States, and over the decades, Caterpillar has grown its international operations to include facilities on six continents to support the provision of products to these global customers.

The Executive Office of Caterpillar is comprised of five Group Presidents, a Senior Vice President and a CEO. The Group Presidents are accountable for a related set of end-to-end businesses that they manage included within a segment. Caterpillar has four reportable segments in which separate profitability is determined. The reportable segments include Construction Industries, Resource Industries, Power Systems and Financial Products. With the exception of Financial Products, each reportable segment manages a product portfolio that supports a particular customer base and is responsible for strategy, design, management, development, marketing, sales and product support related to the product falling within the businesses managed by that segment. That is, each aspect related to the product included in that segment, from design, to manufacture, to sale, and to provision of replacement parts and servicing is determined by the Group President through appointed Vice Presidents and managers assigned to the businesses in that segment.

Reportable segment profitability is determined based on revenue and costs managed by each segment. This includes external sales and internal transfers to other segments less the related cost of goods sold, selling, general and administrative expenses and research and development expenses. Replacement parts are managed as an integral part of each segment. Profitability of replacement parts for products falling within a segment is not separately determined or reported, either internally or externally.

Caterpillar Sarl's Operations Comply With U.S. Tax Law

1. Historical Background of Caterpillar Sarl

Since the 1960s, Caterpillar Sarl (including, for purposes of this discussion, its predecessor entity) has built, grown, and maintained marketing and sales relationships with dealers and customers in foreign markets. Caterpillar Sarl and its foreign affiliates

CONFIDENTIAL & PROPRIETARY
September 23, 2013

have been the principal sellers of replacement parts, machines and engines to foreign dealers in Europe, Africa, Middle East and Asia for over 50 years. These activities are run from Caterpillar Sarl's offices in Switzerland and in Singapore and are a critical component of Caterpillar's business model. This was true both before and after the restructurings that occurred in 1999 and in the early 2000s.

2. Restructuring of Caterpillar Sarl Operations

In 1999 and in the early 2000s, Caterpillar Sarl engaged in a restructuring involving a series of steps that included a change to the supply chain of parts, engines and machines. Aspects of this restructuring included Caterpillar Sarl not only becoming responsible for the global foreign parts purchasing function in which purchased finished parts were purchased directly from third-party suppliers (rather than through Caterpillar Inc.) but also becoming the principal in certain contract (toll) manufacturing arrangements for producing engines and machines in Europe. The U.S. tax impact of this restructuring has been decidedly mixed, as Caterpillar Sarl has generated losses in its role as principal in the contract manufacturing arrangements. But in further establishing Caterpillar Sarl as the entrepreneur for various foreign markets, no attempt was made to "cherry pick" in the sense of leaving loss-making roles in the United States and trying to protect Caterpillar Sarl from such losses.

In connection with this restructuring initiative, and the related assumption of additional functions and risks by Caterpillar Sarl, Caterpillar Sarl licensed intangible property of Caterpillar Inc. to make, purchase, use, market, offer for sale, sell and/or import Caterpillar products in exchange for an arm's length annual royalty payment. In connection with the restructuring, there has been substantial movement of personnel with significant responsibilities within, and to, Switzerland including: (i) the promotion of a Vice-President as a new Group President responsible for all of EAME operations, (ii) the movement of several Product Managers to Switzerland, and (iii) the appointment of a Parts Purchasing Manager in Switzerland. Further, the Worldwide Parts Manager was later located in Switzerland together with a newly appointed Vice-President in Singapore.

It is important to keep the context of the overall restructuring initiative in mind in evaluating the restructuring of the supply chain for purchased finished replacement parts. Looking at purchased finished replacement parts in isolation may yield a distorted view of both the tax benefits of this restructuring activity and the non-tax business changes that it involved. This is particularly the case since profitability is determined on a segment level, and replacement parts are managed as part of each segment. Profitability of replacement parts for products falling within a segment is not separately determined or reported, either internally or externally.

3. An Unnecessary Purchaser in the Supply Chain of Purchased Finished Replacement Parts Was Eliminated

Prior to 1999, purchased finished replacement parts acquired by Caterpillar Sarl's predecessor from U.S.-based suppliers were acquired through Caterpillar Inc. In 1999,

CONFIDENTIAL & PROPRIETARY
September 23, 2013

Caterpillar Sarl began purchasing finished replacement parts directly from unrelated U.S.-based suppliers, with Caterpillar Sarl ordering the parts directly.

Standard prudent international tax planning calls for, and U.S. tax law allows, Caterpillar Sarl to purchase these parts from the unrelated manufacturers directly and then sell the parts to Caterpillar Sarl's unrelated dealers and customers, because "unrelated to unrelated" purchases and sales clearly do not give rise to subpart F income. Having Caterpillar Inc. serve as an intermediary between the unrelated manufacturers and Caterpillar Sarl ran contrary to standard prudent tax planning, by inserting an unnecessary related-party into the transaction and creating unnecessary subpart F income.

The elimination of the related-party purchase and sale transaction from the supply chain as part of the restructuring prevented Caterpillar Sarl from generating subpart F income in connection with the sales of these products to its foreign dealers and customers. In addition, as a function of the increased risks and responsibilities assumed by Caterpillar Sarl under the new arrangement, Caterpillar Sarl earns more profit under the arm's length standard than was the case when Caterpillar Inc. bore these risks and responsibilities.

The Elimination of the Unnecessary Purchaser of Parts Supplied to Caterpillar Sarl Complies With U.S. Tax Law

1. Caterpillar is Free to Structure Transaction Flows in Such a Way as to Permit a Foreign Entity to Purchase Products that the Foreign Entity Markets and Sells

The fact that a company may have structured its transaction flows one way for some period of time does not prevent the company from structuring its transaction flows in a different way later. Of course there must be compensation for any property transferred and services performed in connection with any restructuring, as there was in Caterpillar's case, but changing a supply chain structure is not, in and of itself, a taxable event. A multinational group's decision to have a foreign subsidiary pursue a business opportunity requires no "exit fee" in the form of compensation to the U.S. parent company—rather, it is the transfer of property rights and performance of services that may require such compensation. *See, e.g., HCA v. Comm'r*, 81 T.C. 520 (1983). As described below, Caterpillar Sarl has fully compensated and continues to fully compensate Caterpillar Inc. for all relevant property rights and services that Caterpillar Inc. has licensed and provided to Caterpillar Sarl. No separate compensation was required for the business opportunity as such.

2. A "Transfer" of a Network of Supplier Relationships Is Not a Taxable Transfer of Property

There was no taxable transfer of intangible property as a result of the mere fact that Caterpillar Inc. used to purchase from a particular set of unrelated manufacturers, and now Caterpillar Sarl does so. While legislative proposals have been introduced to

CONFIDENTIAL & PROPRIETARY
September 23, 2013

broaden the relevant definition of intangible property in order to create taxable events with respect to supposed transfers of various amorphous, non-legally-protected intangible qualities (e.g., assembled workforce), current law does not define intangible property so broadly. See, e.g., *Veritas Software Corp. v. Comm'r*, 133 T.C. 297 (2009).

3. **Caterpillar Sarl Has Fully Compensated Caterpillar Inc. for All Property and Services Provided by Caterpillar Inc.**

Caterpillar Sarl fully compensated (and continues to fully compensate) Caterpillar Inc. under the arm's length standard for all intangible property and services provided by Caterpillar Inc. in connection with the transition to (and ongoing operation of) this restructured supply chain. Caterpillar Sarl pays Caterpillar Inc. an ongoing annual royalty of 4-6 percent of Caterpillar Sarl's gross revenue (less returns, discounts, and sales, use, or turnover taxes) associated with the licensed business. Under this arrangement, Caterpillar Inc. has paid an immediate U.S. tax on approximately 35 percent of the total system profit from the licensed business. This allocation of profit to the licensor exceeds the 25-75 percent "rule of thumb" profit split articulated by the U.S. Tax Court in *Ciba-Geigy Corp. v. Comm'r*, 85 T.C. 172 (1985). In fact, in 2012, both Caterpillar Sarl and Caterpillar Inc. had the same return on sales of approximately 9 percent demonstrating that Caterpillar Sarl does not have an unreasonably high return on its business.

Caterpillar Sarl also pays Caterpillar Inc. a service fee of cost plus 5 percent for services rendered by Caterpillar Inc. in connection with the purchasing and logistics functions. Caterpillar Inc. thus has substantial U.S. taxable earnings on all work that it has carried out for Caterpillar Sarl in connection with the restructuring and ongoing operation of the supply chain, as required under the arm's length standard.

4. **The Economic Substance Doctrine is Not Relevant to the Caterpillar Supply-Chain Restructuring**

The economic substance doctrine prevents taxpayers from engaging in unnecessarily complicated transactions in order to accomplish tax results that could not be specifically foreseen by tax policy makers due to the unpredictable interactions between various tax rules as applied to a particular highly engineered set of transactions. When relevant, the doctrine requires some demonstration of a meaningful change in economic position due to the various steps of a transaction and/or a non-tax business purpose for the various steps. The doctrine is not relevant to supply-chain restructurings that actually simplify the relevant transaction flows and produce no tax savings other than those specifically contemplated and controlled by detailed tax rules. Instead, the transfer pricing and subpart F rules govern the allocation and deferral of income resulting from these basic supply-chain arrangements.

The Congress explicitly confirmed this point when it codified the economic substance doctrine. See Joint Committee on Taxation, *Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in Combination*

CONFIDENTIAL & PROPRIETARY
September 23, 2013

with the “Patient Protection and Affordable Care Act,” JCX-18-10 (Mar. 21, 2010), at 152-53 (noting that, “under longstanding judicial and administrative practice,” certain basic business decisions are respected “even if largely or entirely based on comparative tax advantages,” including “a U.S. person’s choice between utilizing a foreign corporation or a domestic corporation to make a foreign investment” and “the choice to utilize a related-party entity in a transaction, provided that the arm’s length standard of section 482 and other applicable concepts are satisfied”); *see also* Internal Revenue Service, LB&I Directive for Industry Directors, *et al.* regarding Guidance for Examiners on the Codified Economic Substance Doctrine and Related Penalties (LB&I-4-0711-015), July 15, 2011 (confirming same). In other words, decisions of this nature are not subject to second-guessing under the economic substance doctrine, because they are already policed by other highly developed legal regimes (i.e., the subpart F and transfer pricing rules).

5. **Caterpillar Sarl is Not Required to Maintain Inventory Outside the United States**

Caterpillar Sarl maintains parts inventory in the United States or in transit through the United States and sells this inventory to foreign dealers and customers without taking physical possession of it in Switzerland or Singapore, as the case may be. The fact that the parts are generally not physically shipped to Caterpillar Sarl in Switzerland or Singapore does not render the arrangement a sham. Entities (and people, for that matter) can own property and incur related risks in places other than where they happen to be located. In fact, the export property exception under section 956(c)(2)(B) specifically envisions that CFCs may own property physically situated in the United States, for export to “foreign countries” (i.e., not just the one where they happen to be located). There has never been a general requirement that property be physically shipped to a particular income-earning location in order to satisfy subpart F or transfer pricing rules.

Caterpillar Bears a High Effective Tax Rate Because its Overall Business Operations and Transaction Structures Tilt Heavily in Favor of U.S. Manufacturing, U.S. Exports, and Transactions Subject to Immediate U.S. Tax

1. **High Effective Tax Rate**

Compared with other large multinational enterprises, Caterpillar has a high effective tax rate (30.5 percent in 2012). This high effective tax rate reflects Caterpillar’s large business presence in the United States and in other high-tax countries around the world.

2. **No Deferral of U.S. Tax on Sales in the United States or on Export Sales**

Caterpillar does not attempt to benefit from low foreign tax rates or deferral of U.S. tax with respect to sales into the U.S. market. Caterpillar also does not benefit from low foreign tax rates or deferral of U.S. tax with respect to a considerable portion of the

CONFIDENTIAL & PROPRIETARY
September 23, 2013

group's sales into foreign markets, as many of these sales are either U.S. export sales or give rise to income taxable on a current basis under subpart F (or both).

In fact, for the years 2010 to 2012, approximately 38 to 65 percent of the U.S. taxable income of Caterpillar Inc. was attributable to Caterpillar Sarl items—either as royalties or service fees received from Caterpillar Sarl or as subpart F income (and gross-up) resulting from Caterpillar Sarl's activities. Further, for this period, Caterpillar Inc. included approximately 25 to 36 percent of the income of Caterpillar Sarl as subpart F income.

3. **Maintains No Substantial Offshore Cash**

Caterpillar's foreign subsidiaries do not hold substantial cash beyond their own working capital needs, and what cash they do currently hold could be repatriated if needed without incurring further U.S. tax cost, because so much of their income has already been subject to current U.S. taxation under subpart F.

4. **Uses Standard Prudent International Tax Planning Consistent with Letter and Spirit of Applicable Rules**

Caterpillar needs to have substantial foreign operations to facilitate its exports and serve its customers around the world. With respect to these operations, Caterpillar engages in standard prudent and lawful international tax planning to obtain the benefit of lower foreign tax rates as well as deferral of U.S. taxes on foreign earnings to the extent permitted under U.S. and foreign law. Caterpillar Sarl, a low-tax foreign subsidiary, sells into many foreign markets, having developed these markets for over 50 years through its substantial operations in Switzerland and Singapore, where the global parts manager and several product managers are located. Some benefit of lower foreign rates and deferral of U.S. taxes result from this structure. However, this is an unremarkable tax result in view of the substantial business presence maintained in Switzerland and Singapore and the fact that Caterpillar Sarl buys in relevant part from unrelated suppliers and sells to unrelated foreign dealers and customers. In addition, a significant portion of the system profit even on these transactions is subject to immediate U.S. tax due to large royalties and service fees paid by Caterpillar Sarl to Caterpillar Inc., as discussed above.

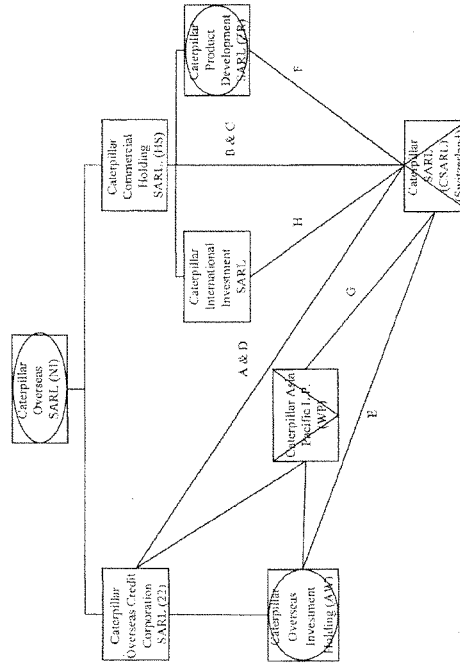
Conclusion

In sum, the arrangements governing Caterpillar Sarl's purchases and sales of finished replacement parts from unrelated suppliers comply with all applicable tax rules and indeed reflect entirely unexceptional prudent tax planning. Any U.S.-based multinational with a need to source products from unrelated manufacturers for sales into foreign markets would be well-advised to structure the relevant transaction flows in this manner. Caterpillar respectfully, but unequivocally, submits that these arrangements do not represent any abuse of the international tax rules. Caterpillar also respectfully submits that its high effective tax rate, large U.S. manufacturing footprint, very large exports and other U.S. taxable sales flows and lack of significant foreign cash

CONFIDENTIAL & PROPRIETARY
September 23, 2013

accumulation make it unattractive as an example for your Subcommittee of a multinational engaged in inappropriate tax planning.

CSARL Legal Structuring



CSARL 2009 activities
PricewaterhouseCoopers

January 2010
Slide 37

CONFIDENTIAL

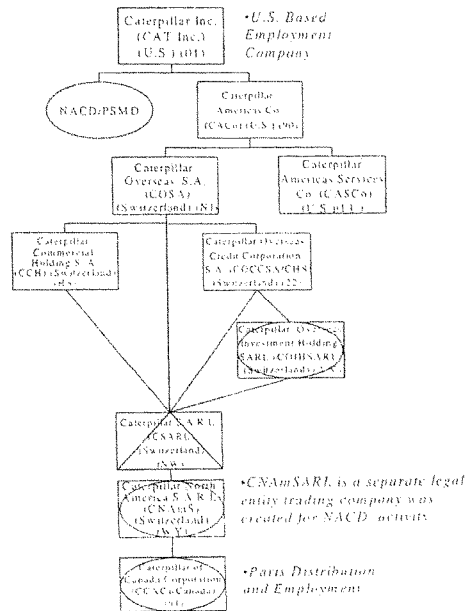
PWC-CAT-00001581

Introduction to Caterpillar North America S.A.R.L.

Legal Structure

Caterpillar North America S.A.R.L. (CNAmSARL) is a Swiss limited liability company created in August of 2002. It is a direct subsidiary of Caterpillar S.A.R.L. (CSARL) and has one subsidiary of its own: Caterpillar of Canada Corporation.

Figure 1: Corporate structure relating to CNAmSARL



Acronym: CNAmSARL
 Facility Code: WY
 Customer Code: Y50W
 Formation Date: 2002
 Function: Trading Company Sales: Yes
 Accounting Services Provided by: Caterpillar Inc. (CAT Inc.)
 Employees: None
 Shareholder(s): Caterpillar S. A. R. L. (CSARL)
 Address: 76 Route de Frontenex
 P. O. Box 6000
 CH-1211 Geneva 6, Switzerland

Functions

CNAmsARL is the legal entity marketing company for Canadian dealers and certain sales to US dealers. In this role, CNAmsARL buys goods from Caterpillar's manufacturing subsidiaries and sells those goods to dealers.

Sales - Canada

CNAmsARL's role in Canada is its most significant. Effective September 1, 2002 it acquired the rights to the Canadian territory and the responsibility for sales of all Caterpillar machines, parts and engines to Canadian Dealers. CNAmsARL will not, however, make sales to any Canadian Original Equipment Manufacturer (OEM).

Sales - US

CNAmsARL's US dealer sales are limited to machines produced in Gosselies, Belgium or Grenoble, France and shipped from those factories on or after May 1, 2003. CNAmsARL, however, will not be a party to any sale made through the North American Storage Program (or other loan machine account) or to the following dealers that are partially or wholly owned by Caterpillar: Carrier Machinery (D100) or Pioneer Machinery (D050).

Other Functions

CNAmsARL has no employees. As a result it must pay other Caterpillar entities to perform the following functions in support of its sales: accounting, administration and marketing support. These relationships and associated fees are discussed in more detail later.

Purpose

CNAmsARL was created and assigned its roles as part of a broader corporate initiative that brings most of Caterpillar's sales outside the United States under the umbrella of CSARL in Geneva, Switzerland.

Accountable Impact

CNAmsARL was created and implemented with the understanding that there be no impact on Caterpillar's accountable profit center reporting systems. While significant changes were made to our legal entity reporting systems, the objective of zero accountable impact was met.

Changes

CNAmsARL was created and implemented through the 6 Sigma process and significant effort was made to ensure that all Canadian, Swiss, and US regulatory requirements were met and controls were in place to maintain compliance over time. Because this structure is sensitive to three different regulatory environments any proposal to change processes or accounting procedures relating to CNAmsARL should be carefully evaluated and include input from the contacts listed below.

Contacts

Canada

Gary Vest, Caterpillar International Tax Manager, Western Hemisphere
(309) 675-4482

US

Rod Perkins, International Tax Manager, Europe Africa and Middle East
(309) 675-4499

CNAmsARL Accounting

Paul Thompson, Corporate Accounting Services, Accounting Supervisor
(309) 675-5003

CSARL Accounting

Fred Rydell, CSARL Corporate Accounting, Supervisor
+41 22 849 4638

CNAMSARL Sales and Sales Variance

Sales:

Canada

All sales of product to *Canadian* dealers are recorded on legal entity WY books with the exception of OEM sales. Legal entity N4 records Canadian OEM sales because these sales are actually made to US parent companies and drop shipped to Canadian manufacturing subsidiaries.

US

Sales of Gosselies (legal entity 25) or Grenoble (legal entity 37) sourced machine prime product to U.S. territory dealers are also recorded on legal entity WY books (exceptions: North American Storage Sales and other loan account sales, Carter Machinery D100 and Pioneer Machinery D050 all of which are booked to 01). All other sales of product to *U.S.* dealers are recorded on legal entity 01 books (machines and parts) or legal entity N4 books (engines and parts).

Accountable Profit Center

All sales to U.S. and Canadian dealers are reported as NACD (machines and parts) or EPD (engines and parts) sales from a business unit perspective.

Sales Variances: All sales variances related to sales to *Canadian* dealers are recorded on legal entity WY books and all sales variances related to sales to *U.S.* dealers are recorded on legal entity 01 (machines and parts) and legal entity N4 (engines and parts) books, with the following exception:

- For Gosselies (legal entity 25) or Grenoble (legal entity 37) sourced machine prime product sold to *U.S.* dealers (recorded as sales on legal entity WY books with the exceptions noted above):
 - Legal entity WY records cash discount.
 - Legal entity WY records invoice discounts, if any.
 - Legal entity 01 (machines only) records post sale credits and merchandising accrual.

All sales variances for *U.S.* and *Canadian* dealers are recorded in the appropriate sales variance category on legal entity 01, N4 or WY books

All sales variances for *U.S.* and *Canadian* dealers are reported as sales variances on NACD (machines and parts) or EPD (engines and parts) business unit results.

Adjusting entries are recorded by legal entity 01 (Sales/Cost of Sales Supervisor) to appropriately move and reflect post sale credit and commercial goodwill items as SG&A expense from a consolidated legal entity basis. The detail supporting this adjusting entry can be found in the Fees section of this document under "Product Promotion and Support Services Fee".

Please refer to the Receivables section for further information on recording of receivables originally booked on legal entity WY books at time of sale, but subsequently sold to legal entity 90 or 01books.

November 26, 2013

*** ~~CONFIDENTIAL~~---CONTAINS PROPRIETARY INFORMATION*****Response of Caterpillar Inc. to Inquiry Relating to Treatment and Use of Offshore Funds**

This document sets forth a supplemental response to Caterpillar Inc.'s ("Caterpillar" or the "Company") November 6, 2013 partial response to Question 6 contained in the Subcommittee's questionnaire dated October 15, 2013.

Caterpillar requests confidential treatment of this response, as it contains Company confidential and proprietary information, the release of which would damage Caterpillar and potentially assist its competitors, particularly its non-U.S. competitors such as Komatsu, Hitachi, Sany, and Volvo.

6. **Please provide the dollar amount of your company's profit before tax that was attributable to the PFRP business for CSARL for each year from 1999 through 2012, earned from inventory stored and shipped from a U.S. warehouse.**

On November 6, 2013, Caterpillar provided to the Subcommittee the amounts of total CSARL purchases of PFRPs (at standard cost) and the amounts of PFRPs that CSARL held in a U.S. warehouse for the years 2011 and 2012. As a supplement to that response, set forth below are the data for the years 2003 through 2012.

With respect to the November 6, 2013 partial response, we would like to clarify that the amount of CSARL purchases of PFRP reflected in that chart included inventory that CSARL did not acquire beneficial ownership of for U.S. tax purposes. In many situations, third party suppliers desire to sell parts to only one legal entity in the Caterpillar group. As an accommodation to the supplier, CSARL serves as the sole contracting party vis-a-vis the supplier in these cases. Thus, CSARL not only purchases inventory on its own behalf for non-U.S. markets, but also acquires title ownership of inventory for the U.S. market and then immediately transfers title to this inventory on to Caterpillar ("Flash-Titled Inventory"). The Flash-Titled Inventory is immediately "resold" by CSARL to Caterpillar at the same price that CSARL purchased the Flash-Titled Inventory from the third-party U.S. supplier, and therefore all profit from the subsequent sale of the Flash-Titled Inventory is reported by Caterpillar in the United States. Caterpillar assumes all freight costs, contract packager costs and all other out-of-pocket costs or expenses associated with the Flash-Titled Inventory, which include insurance charges associated with the Flash-Titled Inventory, from the date of CSARL's acquisition of the Flash-Titled Inventory from the third-party U.S. supplier.

The table below reflects the CSARL inventory purchases (both including and excluding Flash-Titled Inventory), as well the CSARL inventory held in a U.S. warehouse for each of the years 2002 through 2012. The column of Flash-Titled Inventory includes some small stock record inventory adjustments.

CONFIDENTIAL & PROPRIETARY
November 26, 2013

	CSARL Total Purchases @ standard cost	Amount included in prior column that was immediately flash-titled to Caterpillar	CSARL Total Purchases @standard cost excluding the amount immediately flash-titled to Caterpillar	CSARL Purchases @ standard cost stored at a US warehouse
2012	\$			
2011	\$			
2010	\$			
2009	\$			
2008	\$			
2007	\$			
2006	\$			
2005	\$			
2004	\$			
2003	\$			

**Redacted by the
Permanent Subcommittee on Investigations**

As indicated in Caterpillar's prior response, the amounts set forth above include only the purchases by the CSARL entity and do not include purchases made by subsidiaries of CSARL that are disregarded for U.S. Federal income tax purposes. It should also be noted, however, that the purchases by CSARL's disregarded subsidiaries are all made from non-U.S. suppliers. This means that if those amounts were included, the percentage of CSARL's total purchases that are held in a U.S. warehouse would further decrease.

As a follow-up to Caterpillar's November 6, 2013 submission, the Subcommittee requested that Caterpillar provide the percentage of CSARL's total PFRP inventory that was resold to Caterpillar Inc. The Subcommittee also asked whether all purchases not held in a U.S. warehouse were held in a non-U.S. warehouse.

Set forth below is the percentage of CSARL's total PFRP inventory that was sold to Caterpillar for the years 2003 through 2012. This percentage is calculated as the total PFRP inventory sold by CSARL to Caterpillar (excluding Flash-Titled Inventory) bears to the total PFRP inventory purchased by CSARL for the respective year (excluding Flash-Titled Inventory).

CONFIDENTIAL & PROPRIETARY
November 26, 2013

	Percentage of CSARL PFRP Inventory Purchases that was sold to Caterpillar (excluding Flash Titled Inventory)
2012	
2011	
2010	
2009	
2008	
2007	
2006	
2005	
2004	
2003	

We are working to prepare this information for years 1999 through 2002. Finally, please note that inventory that is not reflected on the first schedule above as held in a U.S. warehouse would either be held in a non-U.S. warehouse by CSARL or in transit.

CONFIDENTIAL & PROPRIETARY
December 3, 2013

— = Redacted by the Permanent
Subcommittee on Investigations

5. Please provide the portion of COSA or CSARL's profit before tax attributed to the (a) replacement part and (b) purchased finished replacement part (PFRP) business for each of the years [REDACTED]. Also, please indicate the portion of profit before tax attributable to sales in Switzerland.

Caterpillar's reporting and compliance processes do not determine profit before tax on CSARL's replacement parts sales. There are no existing files or reports that provide the requested profit before tax data. In years where available data content and format permit, we executed a supplemental process to make a good faith estimate of CSARL's profit on replacement parts sales. This process included the following steps and limitations:

- Identify replacement parts sales transactions using source data files created for transfer pricing compliance purposes. These files also include sales data for machines, engines (power systems) and components.
 - [REDACTED]
- Quantify net sales, cost of sales and gross margin. This step relies on general ledger account coding conventions.
- Subtract operating cost estimates to arrive at an estimated operating margin. This requires many broad allocations across machine sales, engine sales, parts sales, component sales and freight. Allocated items include:
 - Sales General & Admin Costs;
 - LIFO inventory adjustment;
 - Commissions and services; and
 - Hedging gains and losses
- License fees were estimated by extending net sales by the primary rate in effect for CSARL's fiscal period. As CSARL's fiscal year ends November 30 and royalty rates are determined on a calendar-year basis, there is imprecision in the expense measurement when rates change between calendar years.
- An estimate of non-operating items (miscellaneous expense) is allocated to CSARL's parts transactions to arrive at a net profit estimate.
- Interest expense and currency gains and losses are excluded from the estimate.
- This estimate is limited to profits from parts sales and does not take into account the significant manufacturing losses of CSARL.

The chart below provides this estimate of CSARL's profit before tax on its commercial sales of replacement parts for the [REDACTED]. The allocation of the profit to the portion of profit before tax attributable to sales in Switzerland is not available.

CONFIDENTIAL & PROPRIETARY
December 3, 2013

— = Redacted by the Permanent
Subcommittee on Investigations

Measure:	Estimated Cat SARL Profit before Tax	Currency:	US Dollars	Rounding:	amounts in thousands
Type of Product Sold	Year				
Replacement Parts					
Purchased Finished Replacement Parts					

Note: "Replacement Parts" amounts reflect all Cat SARL parts sales. "Purchased Finished Replacement Parts" is a sub-set of "Replacement Parts".

Redacted by the
Permanent Subcommittee on Investigations

CONFIDENTIAL & PROPRIETARY
December 3, 2013

10. With regard to the replacement parts business, for each year from 1999 through 2012, please provide the following information:

- The percentage of your company's worldwide headcount and payroll assigned to the PFRP business and located in the U.S.
- The percentage of your company's worldwide headcount and payroll assigned to the PFRP business and located in Switzerland.

Caterpillar does not have employees assigned to a replacement parts business, however there are organizations throughout the enterprise that support purchase, storage, movement, and sales of replacement parts. In the chart below, we have identified divisions participating in these activities and provided U.S. based and non-U.S. based headcount statistics for the years 2006 through 2012. We do not have data for years prior to 2006.

	2006	2007	2008	2009	2010	2011	2012
Parts Distribution (Logistics):							
US Headcount Hourly	1266	1377	1528	1549	1663	1773	2167
US Headcount Management	1134	1158	1273	1142	1242	1448	1452
Total US Headcount	2400	2535	2801	2691	2905	3221	3619
Non-US Headcount Hourly	588	647	779	742	893	972	1063
Non-US Headcount Management	643	723	844	697	763	1055	964
Total non-US Headcount	1231	1370	1623	1439	1656	2027	2027
Global Purchasing:							
US Headcount Management	699	702	625	617	574	885	1036
Non US Headcount Management	599	697	716	706	650	830	1080
Parts Pricing:							
US Headcount Management	38	43	42	29	25	28	37
Parts Pricing Non-US:							
Parts Pricing Corporate (Geneva)					4	4	4
Europe/Africa/Middle East (Geneva)	6	6	6	4	5	6	6
Americas South (Brazil)	6	6	6	5	5	5	5
Asia Pacific	6	6	6	6	6	6	7
Parts Marketing Support US	57	73	59	61	59	93	114
Distribution Services Division:							
Americas US Headcount				99	102	102	104
Non-US Headcount:							
Americas Non-US Headcount				45	47	47	47
Asia Pacific -Singapore				15	15	15	15
Asia Pacific -outside Singapore				91	91	89	88
Europe/Africa/Middle East - outside Geneva				49	51	56	74
Europe/Africa/Middle East (Geneva)				70	62	59	56

• Parts Distribution (Logistics) – Parts Storage, Shipment and Delivery

• Parts Marketing Support – Parts & Services Marketing Administration, Parts Product Training Materials, Maintenance Marketing, Product Support Administration

• Distribution Services Division – Caterpillar's interface with the dealers. Provides assistance to the dealers with regard to dealer financial health, marketing, parts on-hand inventory, parts service shop training, etc. These personnel are Caterpillar's face to the dealers with respect to parts sales.

CONFIDENTIAL & PROPRIETARY

December 3, 2013

11. Please describe CSARL's effective tax rate in Switzerland including in this description any agreements that your company entered into with Swiss tax authorities, whether national or cantonal.

Under Swiss law, CSARL is taxed on its worldwide income, excluding income attributed to foreign branches and establishments.

A. For Federal income tax (IFD), CSARL is taxed at the ordinary 8.5% rate.

B. For Cantonal and Communal income Tax (ICC), CSARL is taxed under the regime of article 23 of the Geneva Corporate Income tax Law (LIPM) taken in application of article 28.4 of the Federal Tax law on the Harmonization of Cantonal Income Taxes (LHID). That regime is available to all companies having a commercial activity focusing predominantly on commercial transactions outside of Switzerland ("Auxiliary Status").

This regime primarily allows to tax revenue from foreign sources at a reduced tax rate and is subject to change every five years. Effective with the 2007 ruling, CSARL is taxed on revenues from foreign sources in accordance with the following reducing scale:

- Turnover Up to CHF 20 million 20%
- From CHF 20 Million to CHF 30 million 15%
On condition that the profit before tax reaches CHF 25 millions
- From CHF 30 Million to CHF 50 million 10%
On condition that the profit before tax reaches CHF 40 millions
- From CHF 50 Million to CHF 100 million 8%
On condition that the profit before tax reaches CHF 75 millions
- From CHF 100 million 7%
On condition that the profit before tax reaches CHF 125 millions

Revenues not attributable to foreign sources are fully taxed at the ordinary rate.

According to the above, the CSARL Swiss effective tax rate varies primarily based on the mix between revenues attributable to foreign sources and to Swiss sources.

CONFIDENTIAL & PROPRIETARY
December 3, 2013

Redacted by the
Permanent Subcommittee on Investigations

15. Please describe any service or management function provided in the United States on behalf of CSARL replacement parts business for the years 1999 through 2012, and the total amount of compensation received from CSARL each year.

Caterpillar Inc. provides various services in the United States for the benefit of the replacement parts portion of CSARL's integrated business. The service activities provided in the 1999 – 2012 periods include those described below.

- a. Contract Packaging - Handling/packaging labor and packaging material costs applicable for material processed at contract packaging locations and processing of returns, as well as manages third party contract packagers.
- b. Logistics/Warehousing Fees – General warehousing services and facilities.

CONFIDENTIAL & PROPRIETARY

December 3, 2013

- c. Purchase Service Fees - Fee for managing third party suppliers within the U.S. Activities performed on behalf of CSARL include:
 - ▶ Consult with CSARL on potential suppliers (sourcing);
 - ▶ Visiting suppliers as requested by CSARL;
 - ▶ Negotiate terms;
 - ▶ Arrange transportation and delivery of goods;
 - ▶ Quality inspection of goods;
 - ▶ Assist in complying with applicable customs laws, rules, or regulations.
- d. Managing Parts Flow – Activities performed include:
 - ▶ Creation, translation, and dissemination of service manuals, service literature, and other materials for replacement parts;
 - ▶ Inventory availability management;
 - ▶ Parts customer service to dealers (order inquiries, order expediting);
 - ▶ Parts pricing analysis and maintenance of price lists;
 - ▶ Maintenance and support of information systems;
 - ▶ Marketing consulting (creating and support of dealer marketing programs);
 - ▶ Manage and monitor inventory levels worldwide and perform expediting services;
 - ▶ Hold any refunds, reimbursements, or other proceeds and to transfer such funds to CSARL; and
 - ▶ Maintain detailed accounting, shipping, customs, and other records.
- e. Inland Freight - Inland freight charges for material destined to U.S. contract packagers.

CONFIDENTIAL & PROPRIETARY
December 3, 2013

Redacted by the
Permanent Subcommittee on Investigations

18. If exhibit 2 was created by CAT, please complete the chart and provide the same information for each of the years from [REDACTED] identifying the CSARL benefits (in millions of dollars) for Parts, Tolling, Reserve, and Benefits. Please also explain the meaning of the CSARL benefits represented by each column in the chart.

Set forth below is the "CSARL Benefits" file updated through [REDACTED]. In order to provide full visibility of the U.S. tax effects to Caterpillar, the chart also sets forth:

- The U.S. Federal income tax on Subpart F Income from the CSARL Partners
- The U.S. Federal income tax to Caterpillar Inc. from the receipt of royalty income from CSARL

Redacted by the Permanent
Subcommittee on Investigations

CONFIDENTIAL & PROPRIETARY

December 3, 2013

- The U.S. Federal income tax to Caterpillar Inc. from the receipt of services income from CSARL

Year	Parts	Contract Mfg.	Reserve	Deferral Benefit	US Tax on SubF Income	US Tax on Royalty Income	US Tax on Services
<div style="border: 1px solid black; padding: 10px; width: fit-content; margin: 0 auto;"> Redacted by the Permanent Subcommittee on Investigations </div>							
TOTAL	2,465	111	(172)	2,404	(1,078)	(1,380)	(33)

Parts = Estimated U.S. Federal income tax deferral on purchased finished parts sales.

Contract Manufacturing = Estimated U.S. Federal income tax deferral on contract manufacturing.

"Benefit" has been renamed "Deferral Benefit" for better representation and understanding.

CONFIDENTIAL & PROPRIETARY
January 14, 2014

Redacted by the
Permanent Subcommittee on Investigations

— = Redacted by the Permanent
Subcommittee on Investigations

4. Please provide the itemized amount of CSARL's royalty and service fee expenses paid to Caterpillar Inc. for each of the years [REDACTED]

The royalties that CSARL pays to Caterpillar Inc. can be itemized into two categories, original equipment and replacement parts. Royalties paid with respect to original equipment includes royalties paid on CSARL's sales of licensed machines and power systems. Royalties paid with respect to replacement parts includes royalties paid on CSARL's sales of licensed replacement parts. This data is

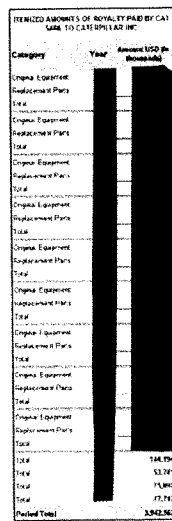
2

Permanent Subcommittee on Investigations

EXHIBIT #50c

CAT-000300

The table set forth below contains the itemized amounts of CSARL's royalty payments to Caterpillar Inc.



— = Redacted by the Permanent Subcommittee on Investigations

Caterpillar Inc. provides various types of services to CSARL. Itemized data for all service activity types is not readily available. Itemized service fee information will be separately provided after the data is gathered.

6. Your 1997 10-K report, on pages A-17 and A-18 (see attached), contains financial information regarding manufacturing activities of CAT's "Machinery" and "Engines" business segments, broken down by geographic segment. Please provide the same information for the years 2009 through 2012.

U.S. GAAP accounting rules for business segments have changed since 1997 and our financial reporting processes no longer support preparation of the requested information. However, we have developed the following table (in \$ millions) from our existing records that we believe approximates for 2009 through 2012 the geographic sales information included on page A-18 of our 1997 Form 10-K. The operating profit information from 1997, however, was arrived at through a substantial number of allocations that we are not able to re-create from our existing records.

CONFIDENTIAL & PROPRIETARY
January 14, 2014

Sales by Manufacturing Country	2009	2010	2011	2012
US Manufactured Sales				
Europe Manufactured Sales				
All Other				
Consolidated Sales	26,540	39,867	57,390	63,069
Revenues by Country	2009	2010	2011	2012
US Revenues	1,358	1,196	1,344	1,158
All Other	1,498	1,536	1,802	1,649
Total Revenues	2,856	2,732	3,146	2,807
Consolidated Sales & Revenues	2009	2010	2011	2012
Total	31,996	42,588	60,536	65,876
Sales of US Manufactured Product (Exports)	2009	2010	2011	2012
Canada				
Latin America				
Europe				
Africa / Middle East / CIS				
Asia / Pacific				
Total	10,389	13,420	19,742	22,811
Sales of Non-US Manufactured Product	2009	2010	2011	2012
Canada				
Latin America				
Europe				
Africa / Middle East / CIS				
Asia / Pacific				
Total	9,053	13,968	20,790	25,130
Total Sales Outside of the US	2009	2010	2011	2012
Canada				
Latin America				
Europe				
Africa / Middle East / CIS				
Asia / Pacific				
Total	20,338	27,388	40,532	47,941

Redacted by the Permanent Subcommittee on Investigations

Redacted by the
Permanent Subcommittee on Investigations

March 7, 2014

*** CONFIDENTIAL—CONTAINS PROPRIETARY INFORMATION *****Response of Caterpillar Inc. to Inquiry Relating to Treatment and Use of Offshore Funds**

This document sets forth Caterpillar Inc.'s ("Caterpillar" or the "Company") response to the first question (first and third bullets) contained in the questionnaire dated February 4, 2014. The response for the second bullet will be provided as soon as this information is available.

Caterpillar requests confidential treatment of this response, as it contains Company confidential and proprietary information, the release of which would damage Caterpillar and potentially assist its competitors, particularly its non-U.S. competitors such as Komatsu, Hitachi, Sany, and Volvo.

Caterpillar's Responses to First Question (first and third bullets)

In its November 26, 2013 response, Caterpillar provided the worldwide total amount of CSARL purchases at standard costs for the years 2003-12.

- What is the dollar amount of those purchases made from third-party suppliers located inside the United States for each of the years 2003-2012?

The dollar amount of CSARL purchases from third-party suppliers located inside the United States, excluding the amount of flash title purchases sold to Caterpillar Inc., is set forth in the chart below for years 2007 – 2012. Detailed supplier data for years prior to 2007 is not available.

	CSARL External Purchases - US Suppliers excluding Flash Title Sales	
2012	\$	[REDACTED]
2011	\$	[REDACTED]
2010	\$	[REDACTED]
2009	\$	[REDACTED]
2008	\$	[REDACTED]
2007	\$	[REDACTED]

March 13, 2014

*** CONFIDENTIAL—CONTAINS PROPRIETARY INFORMATION***

Response of Caterpillar Inc. to Inquiry Relating to Treatment and Use of Offshore Funds

This document sets forth Caterpillar Inc.'s ("Caterpillar" or the "Company") response to a question from the Subcommittee related to inventory accommodations received via email on February 26, 2014. Caterpillar requests confidential treatment of this response, as it contains Company confidential and proprietary information, the release of which would damage Caterpillar and potentially assist its competitors, particularly its non-U.S. competitors such as Komatsu, Hitachi, Sany, and Volvo.

Caterpillar's Response to Accommodations Question

4. Provide a summary of the number and value of accommodations that occur between CSARL and Cat Inc. in the U.S. warehouses. To start, please provide this information for each year from 2008 to present from each entities' perspective; i.e. how much Caterpillar borrowed from CSARL and how much CSARL borrowed from Caterpillar.

- (a) Produce a summary total for each year.
 (b) Describe how these figures relate, if at all, to the information submitted to the Subcommittee on 2/11/14 in response to item 7.

- (a) The quantity and dollar value of accommodations between Cat Inc. and CSARL for years 2008-2013 are set forth in the table below.

	Caterpillar		CSARL	
	Cat Inc. obtained from CSARL	Unit Accommodations	CSARL obtained from Caterpillar	Unit Accommodations
2012	\$	277,765	\$	67,113
2011	\$	325,160	\$	95,636
2010	\$	254,665	\$	128,925
2009	\$	255,536	\$	146,167
2008	\$	238,768	\$	133,466
2007	\$	196,895	\$	118,222

— = Redacted by the Permanent Subcommittee on Investigations

- (b) For accommodations that are not cleared by a subsequent receipt from Cat Inc. within a defined period, CSARL creates a sale or credit to Cat Inc. at cost. The accommodation sales were included in the item 7(d) response submitted to the Subcommittee on 2/11/14. For reference, the table is set forth below.

	CSARL Sales to Cat Inc. of Inventory Seized in U.S. Warehouse held @ Cat SARL standard cost
2012	\$
2011	\$
2010	\$
2009	\$
2008	\$
2007	\$
2006	\$
2005	\$
2004	\$
2003	\$

— = Redacted by the Permanent Subcommittee on Investigations

CAT-0002265

Permanent Subcommittee on Investigations
EXHIBIT #50e

PSI-Caterpillar-18-000003

LICENSE AGREEMENT

This LICENSE AGREEMENT ("Agreement") is made as of **January 1, 2011** (the "**Effective Date**"), by and between CATERPILLAR INC., a Delaware, U.S.A., corporation with its principal executive office at 100 N.E. Adams Street, Peoria, Illinois 61629, U.S.A. ("**CAT**"), and CATERPILLAR SARL, a société à responsabilité limitée organized under the laws of Switzerland, with its principal executive office at 76 Route de Frontenex, Geneva CH-1208, Switzerland ("**CSARL**").

N O W, T H E R E F O R E, for good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, CAT and CSARL (individually sometimes referred to as "**Party**" and collectively referred to as the "**Parties**") hereby agree as follows:

1. Definitions. The following are definitions of terms used herein:

1.1 "**CAT Affiliate**" means any Company that is controlled, directly or indirectly through one or more intermediate Companies, by CAT. For purposes of this definition, "**control**" of a Company means direct or indirect ownership of more than fifty percent (50%) of the voting interests of such Company.

1.2 "**CBL**" means Caterpillar Brasil Ltda., a Brazilian limited company and CAT Affiliate.

1.3 "**CAT France**" means Caterpillar France S.A.S., a French société par actions simplifiée and CAT Affiliate.

1.4 "**CAT Belgium**" means Caterpillar Belgium S.A., a Belgium société anonyme and CAT Affiliate.

1.5 "**CSARL Technology Products**" means those products for which CSARL owns the underlying intellectual property listed in Exhibit A of this Agreement.

1.6 "**CSARL Territory**" means everywhere in the world, not including the United States (excepted as provided in paragraph (a) of this Section 1.6) and Japan.

(a) with respect to sales of products sourced from entities which are operating under a manufacturing services arrangement with CSARL, the United States of America.

1.7 "**CSARL Limited Risk Distributors**" means Caterpillar SARL Singapore Branch, Caterpillar Americas C.V., and Caterpillar North America C.V.

1.8 "**Company**" means any corporation, company, partnership or other business entity.

1.9 "**Discount Rate**" means, the spot rate for the one- (1-) year LIBOR, plus twenty-five basis points (25 bp), on the date of prepayment of royalties under Section 4.3.

Permanent Subcommittee on Investigations

EXHIBIT #51

CAT-000306

1.10 [Reserved]

1.11 **"Intellectual Property"** means (i) all intellectual property which is now or hereafter owned or licensable by CAT that relates to, and/or is necessary, useful or usable on or in connection with, the acquisition of, the inventory management of, the making, having made, purchasing, using, marketing, offering for sale, selling and/or importing of, Licensed Products and (ii) the portions of all intellectual property which are now or hereafter owned or licensable by CAT that are necessary, useful or usable as background technology or Trademarks relating to, or in connection with, the acquisition of, the inventory management of, the making, having made, purchasing, using, marketing, offering for sale, selling and/or importing of, CSARL Technology Products. Intellectual Property includes, but is not limited to, know-how, processes, designs, specifications, engineering standards, trade secrets, inventions, patent applications, patents, copyrights, Trademarks, however embodied (including tangible embodiments of such property, to be provided consistent with past practices of CAT), the Caterpillar Production System (CPS), customer lists, supplier lists, systems and software that relate to, and/or are necessary, useful or usable on or in connection with, the acquisition of, the inventory management of, the making, having made, purchasing, using, marketing, offering for sale, selling and/or importing of, Licensed Products and the portions thereof that are necessary, useful or usable as background technology or Trademarks relating to, or in connection with, the acquisition of, the inventory management of, the making, having made, purchasing, using, marketing, offering for sale, selling and/or importing of, CSARL Technology Products.

1.12 **"Licensed Products"** means products of the character of those in which CAT now or at any time hereafter does business, but excludes (i) CSARL Technology Products, (ii) any products for which CAT does not own or have rights to use the underlying intellectual property and (iii) components sold directly or indirectly to CAT.

1.13 **"Multilateral Netting Process"** means the monthly process whereby amounts owed among CAT and CAT Affiliates are netted to determine the amounts of receivable/payable and/or cash settlements, which are then cleared through CAT.

1.14 **"Net Sales"** means the total gross revenue recorded on sales by:

- (a) CSARL to
 - (i) Third Parties within the CSARL Territory, and
 - (ii) CAT Affiliates located outside of the CSARL Territory,
- (b) CBL on sales of prime product to Third Parties and/or CAT;

provided, however, that the following sales shall be excluded:

- (i) any Licensed Product and/or CSARL Technology Product that CSARL acquires from CAT or any other CAT Affiliate at a price that reflects that CSARL is acting solely as a distributor with respect to such Product; and
- (ii) any Licensed Product and/or CSARL Technology Product that CSARL acquires and resells under an arrangement that reflects that CSARL is acting solely as a purchasing agent with respect to such Product; and

provided, that adjustments shall be made to take into account the following items in total gross revenue:

- (i) trade, area and quantity discounts (including cash discounts); and
- (ii) credits for returned items; and
- (iii) excluding crating, packing, shipping, freight, insurance and the like; and
- (c) CSARL Limited Risk Distributors to Third Parties within the CSARL Territory.

1.15 Consistently applied CAT accounting practices shall define the time at which a sale shall be recorded. "Prepayment Amount" means, with respect to any prepayment of royalties under Section 4.3, an amount equal to the product of (x) Projected Monthly Net Sales, multiplied by (y) the number of months being prepaid, and multiplied by (z) the applicable royalty percentage under Section 4.1.

1.16 "Prepayment Discount" means, with respect to any prepayment of royalties under Section 4.3, an amount equal to the product of (x) the number of months being prepaid, multiplied by (y) the Prepayment Amount, multiplied by (z) the quotient of (i) the Discount Rate divided by (ii) twelve (12).

1.17 "Projected Monthly Net Sales" means a rolling average of Net Sales for the immediately preceding twelve (12) month period (excluding the current month) divided by twelve (12). For example, Projected Monthly Net Sales for a prepayment to be made in July would be an amount equal to aggregate Net Sales for the preceding July through June, divided by twelve (12).

1.18 "Third Party" means any person or Company other than CAT or a CAT Affiliate.

1.19 "Trademarks" means trademarks, service marks and trade names "CAT", "CATERPILLAR", "ACERT" and "Olympian", their respective design marks, and the power edge trade dress.

1.20 "**True-Up Amount**" means, for any calendar year, an amount representing the difference between (x) aggregate royalties for such calendar year calculated in accordance with Section 4.1, and (y) the sum of (i) the aggregate Prepayment Amount(s) for such calendar year actually remitted to CAT and (ii) the aggregate Prepayment Discount(s) for such calendar year with respect to such Prepayment Amount(s).

2. Licenses

2.1 Subject to the conditions and limitations now or hereafter imposed on CAT's right to make the grants contained herein, CAT hereby grants to CSARL nonexclusive rights and licenses to use the Intellectual Property to make, have made, purchase, use, market, offer for sale, sell and/or import (and to perform processes associated therewith) Licensed Products, and nonexclusive rights and licenses to use the portions of the Intellectual Property that are necessary, useful or usable as background technology or Trademarks to make, have made, purchase, use, market, offer for sale, sell and/or import (and to perform processes associated therewith) CSARL Technology Products, provided that the sale of such Licensed Products and CSARL Technology Products is limited to sales by (i) CSARL to CAT or to Third Parties and CAT Affiliates within the CSARL Territory, (ii) CSARL to CAT or any other CAT Affiliate for resale outside of the CSARL Territory, (iii) CSARL to any other CAT Affiliate for resale in the CSARL Territory, and (iv) CSARL to any CAT Affiliate for resale to CAT or any other CAT Affiliate for resale outside of the CSARL Territory.

2.2 Subject to the conditions and limitations now or hereafter imposed on CAT's right to make the grants contained herein, CAT hereby grants to CSARL nonexclusive rights and licenses to:

- (a) use "CAT" or "CATERPILLAR" as part of its company name,
- (b) copy, reproduce, publish (subject to Section 3.3), prepare derivative works, and use any and all works of authorship subject to any copyrights now or hereafter owned, acquired or licensable by CAT, and
- (c) use all other rights and licenses reasonably necessary for CSARL to exploit the rights and licenses specifically granted herein.

2.3 The licenses herein granted to CSARL shall not be construed to mean that CSARL has the sole or exclusive right to use any of the Intellectual Property, and CAT reserves to itself, other CAT Affiliates and its licensees the right to use any and all Intellectual Property throughout the world.

2.4 CSARL acknowledges the validity of the Trademarks licensed under this Agreement and further agrees that it will not at any time do anything or use any such Trademarks in any way that may infringe CAT's rights therein or that may be detrimental to the goodwill associated with the Trademarks or CAT.

2.5 CSARL shall not have any right to acquire the Intellectual Property after any stipulated period and shall not have and shall not represent in any way that it has any right, title or interest in or to any of the Intellectual Property or any of the registrations thereof other than as

provided for in this Agreement. All goodwill that may arise from CSARL's use of the Trademarks shall inure solely to the benefit of CAT, and neither during nor after termination of this Agreement shall CSARL or any sublicensee assert any claim to such goodwill.

3. Sublicensing, Use, Assignment and Supervision of Research Services

3.1 Except as specifically provided herein, CSARL shall not sublicense, convey, pledge, encumber or otherwise dispose of this Agreement or of any right or interest hereunder without the written consent of CAT referencing this Agreement. Any such prohibited act shall be invalid and void and, at Caterpillar's option, shall invalidate and immediately terminate this Agreement. Any assignment or transfer of this Agreement or any right or interest hereunder by operation of law shall immediately terminate and invalidate said Agreement and all rights granted hereby.

3.2 Subject to CAT's written approval and sole discretion, CSARL shall have the right to grant written sublicense(s) to CAT Affiliates, acting as a distributor, contract manufacturer, or otherwise, but without the right of such sublicensees to grant any further sublicense(s). Unless otherwise agreed to by the parties in writing, CSARL will, in the event a sublicense(s) is granted hereunder:

(a) cause the terms and conditions in this Agreement to be substantially included in each sublicense agreement, as well as in any distribution agreement or manufacturing services agreement, as may be appropriate in such case to protect CAT's rights in the Intellectual Property, subject to CAT or its designee retaining its right to (i) set quality standards, specifications and requirements with regard to quality, material standards and workmanship, (ii) inspect, (iii) test, and (iv) approve or disapprove Licensed Product(s) or other use of Intellectual Property; and

(b) provide a copy of any sublicenses or other agreements to CAT.

3.3 CSARL will maintain the Intellectual Property in confidence and use it only in accordance with the licenses granted herein. CSARL shall have no confidentiality obligation with respect to any information that, in the disclosed combination(s), is or becomes known to the public without fault of CSARL. CSARL may disclose Intellectual Property and provide technical assistance to another for the purpose of exploiting the licenses granted to CSARL hereunder; provided that CSARL or any authorized agent of CSARL shall obtain agreement in writing and ensure that such other person (i) uses the Intellectual Property and technical assistance only in accordance with the licenses granted herein, (ii) does not disclose such Intellectual Property or technical assistance to others, and (iii) secures the return of such Intellectual Property and related documents and items upon termination of this Agreement.

3.4 Subject to a right of reimbursement for costs, and except as otherwise agreed to by the parties in writing, CSARL shall assign to CAT any and all rights of CSARL to inventions and improvements developed by CSARL (by itself or jointly with others) during the life of this Agreement with respect to Intellectual Property related to Licensed Products or to any machine, equipment, method or process for manufacturing the Licensed Products. CSARL shall supply CAT with a written description of each such invention or improvement promptly after

developing or acquiring each thereof. CSARL shall also sign or have signed all papers that may be required by CAT for the filing of applications for patents for such inventions and improvements and to vest title in such inventions, improvements, patents and applications in CAT, provided that all such papers, applications and assignments shall be prepared, filed and recorded at the expense of CAT. In the event that during the life of this Agreement CSARL has the opportunity to acquire inventions and/or improvements with respect to Intellectual Property, Licensed Products or to any machine, equipment, method or process for manufacturing the Licensed Products, CSARL hereby grants CAT a right of first refusal to directly acquire such inventions and/or improvements, provided that CAT agrees that it shall exercise such right within fifteen (15) days of notice by CSARL.

3.5 Quality and Inspection

(a) CSARL shall conform strictly with the instructions and specifications supplied by CAT with respect to the use, form and manner in which Trademarks are used on or in connection with all products that use such Trademarks. CSARL shall use such Trademarks only on those products that have the qualities and characteristics that comply with such standards and requirements as may be fixed or approved by CAT.

(b) CAT, through such representatives as it may designate, shall have the right at all reasonable times to inspect and test all products that use the Trademarks before they are offered for sale and to inspect CSARL's places of business, the premises of CSARL's manufacturing service providers, and all records of products pertaining to this Agreement to verify CSARL's compliance with the requirements of this Agreement.

3.6 Trademarks used on or in connection with goods sold by CSARL shall be indicated to be registered trademarks of CAT used by the permission of CAT. All signs, circulars and other advertising published or used by CSARL displaying any such Trademark shall include wording specifying that such Trademark is registered and owned by CAT where appropriate.

3.7 CSARL shall comply with and observe all local laws and regulations with respect to marking or labeling trademarked items for all use made by it of the Trademarks licensed under this Agreement.

3.8 CSARL shall not take any steps or institute any action regarding actual or alleged infringement of any Intellectual Property without first obtaining CAT's written authorization.

3.9 Upon request from CAT and at CAT's expense, CSARL shall provide assistance to CAT in support of CAT's registration, maintenance, renewal and enforcement of the Intellectual Property. In furtherance of the registration, maintenance, renewal and enforcement of the Intellectual Property, CSARL may be required to furnish samples or evidence of use of the products that use Intellectual Property or provide testimony or affidavits concerning the use of such products or execute such other documents as may be necessary to ensure that all right, title and interest in the Intellectual Property reside in CAT.

3.10 At no time may CSARL adapt or use, without CAT's prior written consent, any variation of the Trademarks or any work or trademark or service mark likely to be similar to or confusingly similar to the Trademarks.

3.11 CAT France, CAT Belgium and/or CBL (and, where appropriate, other CAT Affiliates) will provide research and development and related engineering services for CAT pursuant to engineering services agreements with CAT. Intellectual Property arising as a result of such research and development and engineering services is licensed by CAT to CSARL under Section 2. Upon request by CAT, CSARL, as licensee of such Intellectual Property, agrees to provide supervision and oversight for CAT of the performance of such services by CAT France, CAT Belgium and/or CBL (and, where appropriate, other CAT Affiliates) under such engineering services agreements.

4. Consideration

4.1 Royalties. In consideration of the rights and licenses granted in Sections 2 and 3, CSARL hereby agrees to pay to CAT a royalty equal to the applicable percentage of Net Sales set forth below. With respect to any calendar year hereunder, where Net Sales are:

- (a) less than or equal to US\$6,500,000,000, the applicable percentage for such calendar year shall be four percent (4%);
- (b) greater than US\$6,500,000,000, but not greater than US\$9,000,000,000, the applicable percentage for such calendar year shall be five percent (5%); and
- (c) greater than US\$9,000,000,000, the applicable percentage for such calendar year shall be six percent (6%).

4.2 Credit for Ownership of CSARL Technology Products. The royalty amount calculated under Section 4.1 shall be reduced by a credit equal to two percent (2%) of Net Sales during such period of CSARL Technology Products.

4.3 Prepayment of Royalties. So long as CSARL is not in breach of this Agreement, it shall have the option, but not the obligation, to prepay, at any time and from time to time, all or any portion of future royalties due hereunder. In such event, CSARL shall remit to CAT: (i) a notice of prepayment detailing the calendar month(s) to which such prepayment applies; (ii) the Prepayment Amount less the Prepayment Discount; and (iii) supporting calculations made by CSARL in good faith. Notwithstanding the foregoing, prepayment of royalties shall not be allowed on a fractional month basis.

4.4 Annual Payment of True-Up Amount. Within thirty (30) days after the end of each fiscal year of CSARL (or any earlier termination of this Agreement), CSARL shall remit to CAT the True-Up Amount for such calendar year, along with supporting calculations made by CSARL in good faith. If the True-Up Amount for any calendar year is negative, CAT shall promptly remit to CSARL the True-Up Amount (as a positive number) for such calendar year. The obligations of the parties with respect to remittance of any True-Up Amount shall survive any termination of this Agreement.

5. Reports and Payments

5.1 CSARL shall (i) keep regular books of account and make such books available for inspection by an authorized representative of CAT at any time reasonably requested by CAT, (ii) upon the request of CAT, render reports to CAT or another as may be requested, and/or (iii) perform any other task related to reporting with respect to the manufacture, purchase and sale of products under the licenses granted to CSARL in Section 2 as may be reasonably requested by CAT from time to time.

5.2 On a monthly basis, CSARL shall in good faith calculate the royalty due to CAT as specified in Section 4.1. CSARL, or its sublicensee, as provided for in Section 3.2, shall remit payments in full for the royalties specified in Section 4.1 on either a monthly or a quarterly basis, as agreed to by the parties, through the Multilateral Netting Process.

5.3 CSARL shall be responsible for all sales, use and other taxes or governmental fees that may be levied or assessed on any payments or other cash consideration to CAT under this Agreement, excluding only taxes based on CAT's net income. All payments required to be made to CAT under this Agreement shall be without deduction or withholding for or on account of any taxes or similar governmental charges, which taxes and governmental charges are referred to hereinafter collectively, and individually without distinction, as "Withholding Taxes" and are the sole responsibility of CSARL. To the extent any Withholding Taxes may be withheld from any payments or other cash consideration to CAT under this Agreement contrary to this subsection, CSARL shall promptly deliver to CAT official tax receipts or other certificates evidencing payment of such Withholding Taxes.

5.4 Payments shall be made in U.S. dollars unless otherwise agreed by the Parties.

6. Term, Termination and Nonrenewal

6.1 This Agreement shall continue in effect until January 1, 2016. Neither Party may terminate this Agreement without cause during the remaining term of this Agreement.

6.2 If at any time either Party breaches this Agreement, the non-breaching Party may, at its sole option, give notice of termination of this Agreement, which notice shall specify the Agreement provisions which are not being complied with and the failure on which such notice is based, and this Agreement shall then terminate on the expiration of one (1) month ("Cure Period") after such notice is given unless the Party in breach shall furnish evidence, prior to the end of the Cure Period, that the failure specified in such notice has been corrected and no longer exists.

6.3 Upon any termination of this Agreement for any reason:

(a) all sublicenses granted hereunder shall immediately terminate;

(b) CSARL (and its sublicensees) shall immediately cease all use of the rights licensed hereunder; provided, however, CSARL (and its sublicensees) shall be permitted to sell during the six- (6-) month period immediately following the expiration, provided that CSARL (and its sublicensees) comply(ies) with the relevant provisions of this

Agreement, its (or their) remaining inventory of products covered by this Agreement, if any, existing as of the date of expiration. CSARL (and its sublicensees) shall not produce or acquire an excessive number of such products in anticipation of expiration and selling the same during such six- (6-) month period. All of such sales shall be subject to all of the terms of this Agreement;

(c) CSARL shall as directed by CAT, promptly destroy or return to CAT all drawings, prints, designs, specifications, instructions and other documents comprising or relating to the Intellectual Property, together with all copies, summaries or abstracts thereof, and any other information or documentation furnished or delivered to CSARL under this Agreement. The obligation of CSARL shall not extend to information that is or becomes publicly available through no fault of CSARL, is in the possession of CSARL pursuant to another agreement between the Parties, or is obtained by CSARL from a Third Party who has the legal right to convey such information to CSARL; and

(d) CSARL shall promptly follow any direction of CAT concerning storage, shipment, disposal or return of raw material inventory.

7. Indemnification. CSARL shall indemnify, defend and hold harmless CAT, its subsidiaries and affiliates, its and their directors, officers and employees, from and against any and all claims, damages, costs and expenses of any nature with respect to: (i) any use of Intellectual Property; (ii) any loss or damage to property; and/or (iii) any injury to or death of any person, arising out of or attributable to the manufacture or sale of products pursuant to the licenses granted under this Agreement. Such indemnification shall not extend to any claim, damages, costs and/or expenses of any nature with respect to any loss or damage to property, and/or any injury to or death of any person, arising out of or attributable to warranty claims or other obligations resulting from design defects directly attributable to Intellectual Property, but not to the extent resulting from modifications of Intellectual Property by CSARL or its transferees.

8. Disclaimers, Warranties, Protection of Intellectual Property and Limitation of Liability

8.1 Except as disclosed to CSARL, CAT has not received any notice or claim by a Third Party that materially affects CSARL's ability to exercise its rights under this Agreement.

8.2 Nothing in this Agreement shall be construed as a warranty or representation by CAT that anything made, used, offered for sale, sold, imported or otherwise disposed of pursuant to this Agreement is or will be free from infringement of the intellectual property rights of any Third Party.

8.3 CAT is not granting by implication, estoppel or otherwise any license or right under intellectual property or other intangible rights of CAT other than is required to market, make, have made, use, offer for sale, sell or import products as contemplated under this Agreement.

8.4 CSARL shall mark, and shall ensure that all products made by or for it pursuant to this Agreement are marked by manufacturers and suppliers with such legal notice of all Trademarks and copyrights which are subject to this Agreement as may be required, provided

for, or permitted by applicable laws and regulations. CSARL shall undertake any registrations of this Agreement, as required or appropriate, with the cooperation of CAT.

8.5 Upon written request by CAT furnished with reasonable advance notice, CSARL shall discontinue the manufacture of Licensed Products as CAT may designate as being obsolete or superseded, as soon as practicable following receipt of such written request or at such date in the future that CAT shall provide.

8.6 CAT is under no obligation to obtain any intellectual property right (such as by application or registration) or to maintain any such right in force.

8.7 CAT is under no obligation to bring or prosecute actions or suits against third parties for infringement.

8.8 Neither Party will be liable for any special, incidental, indirect, special or consequential damages (including, without limitation, lost profits or revenue), even if informed of the possibility thereof in advance.

8.9 In no event shall CAT be liable to CSARL or any sublicensee for any loss or damage in excess of the amount paid by CSARL or such sublicensee to CAT under this Agreement.

9. **Notices.** Notices hereunder shall be in writing and shall be: (i) delivered in person to the following addresses, as the case may be; (ii) sent by registered or certified mail, postage prepaid, return receipt requested addressed to the following, as the case may be; (iii) sent by facsimile to the following, as the case may be, and confirmed by the sender by mail as provided above; or (iv) sent by guaranteed overnight courier to the following, as the case may be.

To CAT:

Caterpillar Inc.
100 N. E. Adams St.
Peoria, IL 61629-7310
Attn: General Counsel
Phone: (309) 675-4428
Facsimile: (309) 675-6886

To CSARL:

Caterpillar SARL
75 Route de Frontenex
P.O. Box 6000
CH-1211 Geneva 6, Switzerland
Attn: Vice President
Phone: (41) 22849-4203
Facsimile: (41) 22849-4982

With copy to:

Caterpillar Inc.
100 N.E. Adams Street
Peoria, Illinois 61629-9510
Attn: General IP Counsel
Phone: (309) 675-5081
Facsimile: (309) 675-1236

With copy to:

Caterpillar S.A.R.L.
76 Route de Frontenex
P.O. Box 6000
CH-1211 Geneva 6, Switzerland
Attn: General Counsel
Phone: (41) 22849-4204
Facsimile: (41) 22849-4982

Such notices shall be effective, as appropriate, when: personally delivered; deposited with either the U.S. Postal Service or Swiss Postal Service; sent by facsimile; or sent by courier service. Each Party may change any of its addresses specified herein by providing notice thereof in accordance with this Agreement.

10. Provisions Surviving Termination of this Agreement. No termination of this Agreement shall relieve CSARL of any liability or obligation accrued or arising from facts or events occurring under this Agreement prior to such termination and, without limiting the generality of the foregoing, Sections 3, 4, 5, 7 and 8, and all others which by their own terms survive termination, shall survive such termination and continue in full force and effect with respect to such liability or obligation.

11. No Waiver. Any failure of either Party to enforce at any time any of the provisions of this Agreement or any rights or remedies with respect thereto or to exercise any election herein provided shall not constitute a waiver of any such provision, right, remedy or election or in any way affect the validity thereof or of this Agreement. The exercise by either Party of any of its rights, remedies or elections under the terms of this Agreement shall not preclude or prejudice such Party's rights to exercise at any other time the same or other right, remedy or election it may have under this Agreement. The rights of termination provided herein are in addition to any other right, remedy or election either Party may have hereunder, including the right to sue for breach without terminating.

12. No Agency. Nothing contained herein nor anything done by either Party performing under this Agreement shall be deemed to constitute either Party the agent of the other in any sense.

13. Export Control Regulations. CSARL agrees that it will not, contrary to U.S. export control regulations, re-export, directly or indirectly, any technical data furnished to it pursuant to this Agreement, or export, directly or indirectly, any direct product or any such technical data. As used herein, the phrase "technical data" means professional, scientific or technical information, written or oral, including any model, design, photograph, photographic film, document or other article or material, containing a plan, specification, or descriptive or technical information of any kind which can be used or adapted for use in connection with any process, synthesis, or operation in the production, manufacture, utilization, or reconstruction of articles or materials. As used herein, the phrase "direct product" means the immediate product (including processes and services) produced directly by use of the technical data.

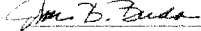
14. Entire Agreement. This Agreement constitutes the entire agreement and understanding between the parties hereto pertaining to the licenses granted herein, and no term or provision of this Agreement shall be varied or modified by any prior or subsequent statement, conduct or act of either of the parties, except that hereafter the parties may amend this Agreement by written instrument specifically referring to this Agreement and executed by an authorized representative of each Party.

15. Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State of Illinois, U.S.A., without regard to the principles of conflicts of law.

16. Counterparts. This Agreement may be executed in any number of counterparts, each of which shall be an original with the same effect as if the signatures thereto and hereto were upon the same instrument.

IN WITNESS WHEREOF, the parties hereto have signed this Agreement on the date(s) herein noted below and shall be effective as of the Effective Date first set forth above.

CAT
CATERPILLAR INC.

By: 

Name: James B. Buda

Title: Sr. VP and Chief Legal Officer

CSARL
CATERPILLAR SARE

By: 

Name: Thomas Zühlmann

Title: Gérant (Managing Director)



EXHIBIT A

LIST OF CSARL TECHNOLOGY PRODUCTS

- 1) Skid Steer Loaders
- 2) Compact Wheel Loaders
- 3) Hydraulic Excavators (including mini-hydraulic excavators)
- 4) Articulated Trucks
- 5) Reciprocating Natural Gas G340-16 Model Engines
- 6) WECO Drag-Line Buckets

A-1

CB

FIFTH AMENDED AND RESTATED SERVICES AGREEMENT

This FIFTH AMENDED AND RESTATED SERVICES AGREEMENT (the "Agreement"), except as otherwise provided herein, is effective as of September 1, 1999 (the "Effective Date"), and amends and restates the Services Agreement originally effective as of September 1, 1999, by and between Caterpillar Inc., a corporation established and existing under the laws of the State of Delaware (U.S.A.) ("CATERPILLAR"), and Caterpillar S.A.R.L., a société à responsabilité limitée organized under the laws of Switzerland ("CAT SARL"), as amended and restated from time to time by the parties.

WHEREAS, CAT SARL makes or has made, markets and sells heavy, earth moving machinery and other equipment outside of the United States and sells a variety of replacement parts for such equipment outside of the United States;

WHEREAS, CAT SARL desires to engage CATERPILLAR to provide the Services described in Section 1 and Schedule 1 to this Agreement on behalf of CAT SARL (or its Subsidiaries, when applicable); and

WHEREAS, CATERPILLAR can provide, directly or through agreements with other companies, the Services described in Section 1 and Schedule 1 to this Agreement.

NOW, THEREFORE, in consideration of the promises, covenants and agreements hereinafter contained and other valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties hereto, intending to be legally bound, hereby agree as follows:

1. Services to be Provided. During the term of this Agreement, CATERPILLAR will provide, or will cause to be provided, to CAT SARL (or its Subsidiaries, when applicable) those services that are set forth on Schedule 1 to this Agreement, which may be amended by the parties from time to time (the "Services").
2. Definitions.
 - 2.1. Multilateral Netting Process. Multilateral Netting Process means the monthly process whereby all amounts owed among CATERPILLAR and its subsidiaries are netted to determine the amounts of receivable/payable and/or cash settlements which are then cleared through CATERPILLAR.

C:\H99 4034959-1 0392\7 0094

Permanent Subcommittee on Investigations

EXHIBIT #52

CAT-000653

2.2. Subsidiary. Subsidiary means any separately organized legal entity that is directly or indirectly wholly-owned by CAT S.A.R.L. and is disregarded as an entity separate from its sole owner, CAT S.A.R.L., for U.S. federal income tax purposes and effective as of July 3, 2000 shall include Caterpillar of Australia Pty. Ltd., a company organized under the laws of the State of Victoria, Australia, having a place of business at 1 Caterpillar Drive, Tullamarine, Victoria 3043, Australia, regardless of whether Caterpillar of Australia Pty. Ltd. is directly or indirectly owned by CAT S.A.R.L.

3. Duties and Responsibilities.

3.1. Territory. The parties agree that CATERPILLAR shall provide the Services to CAT S.A.R.L. (or its Subsidiaries, when applicable) with respect to the territory set forth on Schedule 2 to this Agreement, which may be amended by the parties from time to time (the "Territory").

3.2. Quality Standards. CATERPILLAR shall provide the Services with reasonable care and agrees that it shall provide the Services so as to preserve the goodwill and good reputation associated with the products of CAT S.A.R.L. and its subsidiaries. CATERPILLAR agrees to comply with all applicable laws and regulations, and to obtain all necessary or appropriate regulatory approvals, related to providing the Services in accordance with this Agreement.

3.3. Compliance With Laws. CAT S.A.R.L. shall at all times cooperate with CATERPILLAR's compliance with all applicable laws and regulations, and with its obtaining all necessary or appropriate regulatory approvals, related to providing the Services in accordance with this Agreement.

4. Consideration. CAT S.A.R.L. shall pay to CATERPILLAR a service fee (the "Service Fee") calculated in accordance with the rate set forth on Schedule 3 to this Agreement for Services performed by CATERPILLAR pursuant to this Agreement.

5. Relationship of the Parties. In all matters governed by this Agreement, each party hereto shall be solely responsible for the acts of its employees, and the employees of one party shall not be considered employees of the other party. Except as otherwise provided herein, no party shall have any right, power, or authority to create any obligation, express or implied, on behalf of any other party with respect to the matters governed by this Agreement. It is the intent of the parties hereto that CATERPILLAR shall act as an independent contractor in providing the Services pursuant to this Agreement. Nothing in this Agreement is intended to create or constitute a joint venture, partnership, or agency relationship between the parties hereto or the persons referred to herein, and CATERPILLAR shall have no power to obligate or bind CAT S.A.R.L. in any manner whatsoever with respect to the matters governed by this Agreement.

6. Reports and Payments.

6.1. Reports. CAT S.A.R.L. shall keep regular books of account, make such books

available for inspection by an authorized representative of CATERPILLAR at any time requested by CATERPILLAR, provide CATERPILLAR with the necessary information to calculate the Service Fee, render reports to CATERPILLAR or another as may be requested, and/or perform any other task related to reporting with respect to the Services.

6.2. Payments. On a monthly basis, CATERPILLAR shall, in good faith, calculate the Service Fees due from CAT SARL as specified in Schedule 3 hereof from information provided by CAT SARL. CAT SARL shall remit payments in full for the Service Fees due hereof on a monthly or quarterly basis, as agreed to by the parties, through the Multilateral Netting Process or as otherwise directed by CATERPILLAR.

7. Indemnification. CAT SARL agrees to defend, indemnify, and hold CATERPILLAR harmless against any claims, demands, causes of action and judgments (individually and together a "Loss") arising out of CAT SARL's (or its Subsidiaries') actions or failures to act with respect to the sale, distribution, advertising, or promotion of products or with respect to providing Services under this Agreement, except to the extent such Loss arises as a result of CATERPILLAR's breach of its duties under the Section hereof entitled "Duties and Responsibilities."

8. Term and Termination.

8.1. Term. The initial term of this Agreement shall be three (3) years from September 1, 1999. Unless notice is provided at least ninety (90) days from the end of the initial term, this Agreement shall automatically renew for successive terms of one year thereafter. Following the initial term, either party may terminate this Agreement upon ninety (90) days notice, which shall be given and shall be effective on the date provided in the Section hereof entitled "Notices."

8.2. Termination. If, at any time, either party breaches this Agreement, the other party may, at its sole option, give notice of termination of this Agreement, which notice shall specify the Agreement provision(s) which is/are not being complied with and the failure on which such notice is based. This Agreement shall then terminate on the expiration of one (1) month ("Cure Period") after such notice is given unless the party in breach shall furnish evidence satisfactory to the other party, prior to the end of the Cure Period, that the failure specified in such notice has been corrected and no longer exists.

9. Provisions Surviving Termination of this Agreement. Termination of this Agreement shall not relieve CAT SARL of any liability or obligation accrued under this Agreement prior to such termination and, without limiting the generality of the foregoing, the Sections entitled "Indemnification" and "Provisions Surviving Termination of this Agreement" and the obligation to maintain Intellectual Property in confidence shall survive such termination and continue in full force and effect.

10. Confidentiality. From time to time prior to and during the term of this Agreement, either party ("X") has disclosed or may disclose confidential and proprietary information to the other party ("Y"). This information shall be kept strictly confidential by Y during the term of this Agreement and at all times thereafter, and shall be used solely for its own benefit in connection with providing the Services. Y shall not disclose any confidential information to any person or entity, except to its employees, agents, attorneys, accountants and other advisors who need to know such information to perform the Services or satisfy the duties and obligations hereunder.
11. Assignment. CAT SARRL shall not convey, pledge, encumber or otherwise dispose of this Agreement or of any right or interest hereunder without the prior written consent of CATERPILLAR referencing this Agreement. Any such prohibited act shall be invalid and void and, at CATERPILLAR's option, shall invalidate and immediately terminate this Agreement. Any assignment or transfer of this Agreement or any right or interest hereunder by operation of law shall immediately terminate and invalidate this Agreement and all rights granted hereby.
12. Applicable Law. This Agreement shall be governed by and construed in accordance with the laws of the State of Illinois, U.S.A., without reference to the choice of law principles thereof.
13. Information. CAT SARRL shall provide, upon the request of CATERPILLAR, any information requested by CATERPILLAR that will enable CATERPILLAR to determine or verify the amount of any payment due hereunder by CAT SARRL.
14. Waiver and Modification. Any failure of either party to enforce at any time any of the provisions of this Agreement, or any rights or remedies with respect thereto, or to exercise any election herein provided shall not constitute a waiver of any such provision, right, remedy or election or in any way affect the validity thereof or of this Agreement. The exercise by either party of any of its rights, remedies or elections under the terms of this Agreement shall not preclude or prejudice such party's rights to exercise at any other time the same or other right, remedy or election it may have under this Agreement. The rights of termination provided herein are in addition to any other right, remedy or election that either party may have hereunder, including the right to sue for breach without termination.
15. Severability. In the event that any term or provision of this Agreement shall for any reason be held to be invalid, illegal or unenforceable in any respect, such invalidity, illegality or unenforceability shall not affect any other term or provision, and this Agreement shall be interpreted and construed as if such term or provision, to the extent the same shall have been held invalid, illegal or unenforceable, had never been contained herein.
16. Integration.
 - 16.1. This Agreement constitutes the entire agreement and understanding between the parties hereto pertaining to the Services provided hereunder and no term or provision

of this Agreement shall be varied or modified by any prior or subsequent statement, conduct or act of either of the parties, except that, hereafter the parties may amend this Agreement by written instrument specifically referring to this Agreement and executed by an authorized representative of each party. Corrections, referred to below, reflect the intent of the parties from the inception of the Services Agreement which was effective September 1, 1999.

16.2. The First Amended And Restated Services Agreement: expanded the definition of "Territory" to include that associated with CAT SARL's Singapore branch.

16.3. The Second Amended And Restated Services Agreement:

16.3.1. corrected the language of the Agreement to clearly reflect the parties' intent (a) to true the monthly Service Fee up to actual costs plus 5%; (b) that the Services Agreement was first effective September 1, 1999 and was not amended by the Second Amendment of Agreements executed by and between the parties effective as of September 29, 1999; and (c) that the Service Agreement applies to all finished replacement parts transferred and/or sold by CATERPILLAR to CAT SARL at acquisition cost plus uplifts;

16.3.2. expanded the definition of "Territory" to include that associated with Caterpillar of Australia Ltd. effective as of July 3, 2000; and

16.3.3. expanded the Agreement to include references to sales by Disregarded Entity Subsidiaries effective as of July 3, 2000.

16.4. The Amendment to the Second Amended And Restated Services Agreement:

16.4.1. removed from the definition of "Applicable Goods" purchased finished replacement parts that are purchased by CAT SARL from CATERPILLAR when such are acquired at CATERPILLAR's acquisition cost plus uplifts and corrected the definition of "Applicable Goods" with reference to the suppliers managed under the European Centralized Inventory Control system, whether related or unrelated; and

16.4.2. in connection with 16.4.1 removed from the definition of "Costs" the language "exclusive of CATERPILLAR's costs of performing Services associated with goods sold to CAT SARL by CATERPILLAR or a Related Party at an intercompany (arm's length) price" as (a) an adjustment in that the Agreement no longer applies to services associated with purchased finished replacement parts that are purchased by CAT SARL from CATERPILLAR and (b) as a correction in that the cost basis includes services associated with purchased finished replacement parts acquired from suppliers managed under the European Centralized Inventory Control system, whether related or unrelated.

16.5. The Third Amended And Restated Services Agreement:

- 16.5.1. corrected the references to Disregarded Entity Subsidiaries;
- 16.5.2. expanded the definition of Territory to include the Caribbean, Central America, Mexico and South America effective as of December 1, 2001;
- 16.5.3. expanded the Services to be provided as set forth in Schedule 1; and
- 16.5.4. amended the definition of "Applicable Goods" as set forth in Schedule 3.
- 16.6. The Fourth Amended and Restated Services Agreement expanded the definition of the Territory to include Canada, effective as of August 30, 2002.
- 16.7. This Fifth Amended and Restated Services Agreement:
 - 16.7.1. clarifies the definition of Subsidiary as it relates to Caterpillar of Australia Pty. Ltd.; and
 - 16.7.2. expands the definition of the Territory to include: the People's Republic of China, Hong Kong; and the Republic of China (Taiwan).
- 17. Notices. All notices, requests, demands and other communications hereunder shall be in writing and shall be sent by facsimile or by registered or certified mail, postage prepaid, to CAT SARM and CATERPILLAR at the addresses specified below:

<p><u>If to CAT SARM:</u></p> <p><u>If to CATERPILLAR:</u></p>	<p>Caterpillar S.A.R.L. 76, Route de Frontenex 1211, Geneva, Switzerland Attn: Legal Department Phone: (41 22) 849-4203 Facsimile: (41 22) 849-4982</p> <p>Caterpillar Inc. 100 N.E. Adams Street Peoria, Illinois 61629-9600 United States of America Attn: General Counsel Phone: (309) 675-4452 Facsimile: (309) 675-6886.</p>
----------------------------------------------------------------	-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------
- 18. Headings. The section headings contained in this Agreement are for reference purposes only and shall not effect in any way the meaning or interpretation of this Agreement.
- 19. Authority to Enter into Agreement. Each party warrants and represents that it has the full power and authority to undertake the obligations set forth in this Agreement.

20. Counterparts. This Agreement may be executed in multiple counterparts, each of which will be deemed an original, but all of which constitute one instrument.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement to be effective as of the Effective Date except as otherwise provided herein.

CATERPILLAR INC.

By: _____

Title: _____

CATERPILLAR S.A.R.L.

By: Ch. BGS

Title: Assistant Secretary

20. Counterparts. This Agreement may be executed in multiple counterparts, each of which will be deemed an original, but all of which constitute one instrument.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement to be effective as of the Effective Date except as otherwise provided herein.

CATERPILLAR INC.

By: [Signature]

Title: ATTORNEY

CATERPILLAR S.A.R.L.

By: _____

Title: _____

FIFTH AMENDED AND RESTATED SERVICES AGREEMENTSchedule of Services to be Provided by CATERPILLAR

For purposes of this schedule references to CATERPILLAR shall include CATERPILLAR and any of its Subsidiaries. The Services provided by CATERPILLAR shall include, but not be limited to:

1. Creation, translation, and dissemination of service manuals, service literature, and other materials for replacement parts;
2. Inventory availability management;
3. Providing parts customer service to dealers (i.e., dealer order inquiries, dealer order expediting);
4. Providing parts pricing determinations;
5. Processing of dealer parts returns;
6. Human resources assistance;
7. Maintenance and support with respect to information systems;
8. Marketing consulting (i.e., creation and support of dealer marketing programs);
9. Strategic planning; and
10. Accounting services.

And, effective December 1, 2001, shall also include the following Services pertaining to CAT S&RL inventory in U.S. warehouses:

11. Manage and monitor inventory levels worldwide and perform expediting services;
12. Arrange for transportation of CAT S&RL goods;
13. General warehousing services and facilities for such; and
14. Inventory management services at U.S. warehouses.

FIFTH AMENDED AND RESTATED SERVICES AGREEMENTTerritory

For the purposes of this Agreement, "Territory" means Western Europe, Eastern Europe, Africa, the Middle East, the Commonwealth of Independent States, the Nordic Countries, Russia and Near Asia; and effective as of December 1, 1999 includes the following territories that are associated with CAT S.A.R.L.'s Singapore branch: India, Bangladesh, Korea, Lao PDR, Cambodia, Thailand, Philippines, Myanmar, Indonesia, Bhutan, Nepal, Malaysia, Singapore, Sri Lanka, Vietnam, and Mongolia; and effective as of July 3, 2000 includes, the following territories: Australia; Fiji Islands; New Caledonia; New Zealand; Papua New Guinea; Samoa, American; Solomon Islands; Tahiti and Tonga; and effective as of December 1, 2001 the following territories that are associated with Caterpillar Americas S.A.R.L.: the Caribbean, Central America, Mexico and South America; and effective August 30, 2002 includes Canada, and effective January 1, 2003, includes: the People's Republic of China, Hong Kong, and the Republic of China (Taiwan).

FIFTH AMENDED AND RESTATED SERVICES AGREEMENTService Fee

Beginning September 1, 2000 and for the remaining term of this Agreement unless otherwise agreed by the parties, CATERPILLAR shall charge CAT S.A.R.L. for Services rendered a Service Fee as a percentage of Net Sales (as defined below) of the Applicable Goods (defined below) sold by CAT S.A.R.L. (or any of its Subsidiaries, when applicable) in the Territory as set forth in Schedule 2 and established by the parties from time to time.

"Applicable Goods" are those purchased finished replacement parts that are purchased by CAT S.A.R.L. (or its Subsidiaries, when applicable) from (1) Third Party U.S. suppliers; (2) suppliers managed under the European Centralized Inventory Control system, whether related or unrelated; (3) effective January 1, 2001, Shin Caterpillar Mitsubishi Ltd.; and (4) effective June 11, 2001, Third Party suppliers located outside of the U.S. when such directly ship to locations within the Territory; and that are sold by CAT S.A.R.L. (or its Subsidiaries, when applicable) to Third Parties.

"Third Parties" shall mean anyone other than CATERPILLAR or any company that is controlled, directly or indirectly through one or more intermediate Companies, by CATERPILLAR. For purposes of this definition, "control" of a company means the power, direct or indirect, to direct or cause the direction of the management and policies of such company whether by contract or otherwise; and, in any event, ownership of more than 50% of the voting interests of another company shall be deemed control of that company.

"Net Sales" shall mean the total gross sales of CAT S.A.R.L. (or any of its Subsidiaries, when applicable) of Applicable Goods made in the Territory, less, to the extent that they are included in the gross sales, any returns.

At the end of each year, CATERPILLAR shall determine the total of CATERPILLAR's fully burdened (i.e., including overhead) costs incurred by CATERPILLAR with respect to the Services provided by CATERPILLAR under this Agreement. If the total of the costs plus 3% for the calendar year is greater or less than the amounts charged for such year under the first sentence of this Schedule 3, the Service Fee shall be adjusted and, if greater, CAT S.A.R.L. shall pay CATERPILLAR the difference and, if less, CATERPILLAR shall refund CAT S.A.R.L. the difference. This adjustment shall be made during the Multilateral Netting Process as soon as possible thereafter and payable in the subsequent year.

Chuck

I. What intangible property will be transferred from Cat Inc. to COSARL under the replacement parts license?

Cat Inc. ("Cat") will grant a license to COSARL to make, use and sell Cat replacement parts to COSA's dealers. The license will include the right to sell the products under Cat trademarks.

Reg. section 1.482-4(b) (Definition of Intangible) describes an intangible as an asset that has substantial value independent of the services of any individual and that comprises any item in a specified list (Reg. section 1.482-4(b)(1)-(6)). Scanning the list, it appears that the following items are relevant to the replacement parts license: Patents, designs, trademarks, contracts, systems, procedures, know-how, methods, forecasts, estimates, and technical data.

- Patents and designs: Many of the parts incorporate patented or otherwise proprietary features or designs. Cat will make available to COSARL all such information as needed by COSARL to make, or have made for it, the licensed parts.
- Trademark: The licensed parts will be sold under the Cat trademark. Many parts have the trademark stamped on them, and the packaging will be labeled with the trademark.
- Contracts: COSARL will have the right to buy direct from suppliers that Cat has already qualified and negotiated prices and other terms with, and who are up and running as Cat parts suppliers.
- Systems and procedures: COSARL will have access to the Cat-proprietary LogNet information system for ordering parts from purchased-finished suppliers. COSARL also uses the Cat-proprietary Distribution Requirements Planning (DRP) software for materials control planning at Grimbergen.
- Know-how, methods, forecasts, estimates and technical data: Cat will make available to COSARL. [Does Cat license this technology to COSARL? Or, does Cat use this technology in the context of it rendering services to COSARL?]

part of
part of service?
intang.?

preference for
license

II. Best method selection for determining an arm's length royalty for the replacement parts license

The specified methods for transfers of intangibles are:

- CUT
- CPM
- Profit Split

Primary criteria for choosing the best method are:

- Degree of comparability between tested party or transaction and available comparable uncontrolled companies or transactions, and
- Quality of the data and assumptions used in the analysis.

With respect to activities performed in connection with the replacement parts license, the following is an abbreviated list of factors that could affect comparability of Cat, COSARL or the license with uncontrolled companies or transactions.

1. Functions:

A listing of functions performed should include consideration of resources employed by the company in performing a particular function, such as working capital, fixed assets or intangible assets.

The following table is where we need to end up. Either COSARL performs the functions directly, or COSARL hires Cat to perform the services for it. Either way, COSARL is attributed with performing the services (as long as the service fee is arm's length and, in particular, compensates Cat for Cat's use of any valuable intangibles, such as systems or data bases, in connection with rendering the services to COSARL).

Function	Cat	COSARL	Other
R&D	X		
Product Design/Engineering	X		
Manufacturing engineering	X		X
Product fabrication	X(worked)		X(P/F)
Purchasing		X	
Materials management		X	
Marketing & Distribution:			
Inventory management		X	
Warranty administration		X	
Advertising		X	
Dealer Management		X	
Transportation and warehousing		X	
Legal		X	
Credit and collection		X	
Accounting & Finance		X	
HR		X	

In performing its marketing and distribution function (for original equipment as well as for parts), COSARL brings significant intangible resources to bear, namely the "dealer network".

2. Risks:

This table shows where we should end up. We need to bear in mind the provisions in Reg. section 1.482-1(d)(3)(iii)(B) on the identification of the party that bears a particular risk. There are three criteria: conduct consistent with purported risk bearing; financial capacity to fund losses that could result from bearing the risk; and having managerial control over the business activities that pertain to the risk factor.

	Cat	COSARL	Other
Market Risks (fluctuations in costs, pricing, inventory levels)		X	
R&D Risk (i.e., risk that R&D spending will be wasted)	X		
Financial Risk (FX)		X	
Credit Risk		X	
Product Liability Risk		X	
General business risk		X	

We need to take a position on the “aggregation of transactions” provisions of Reg. section 1.482-1(f)(2)(i). That is, do we test the replacement parts royalty and the tangible property transfer prices jointly, or separately? An important consideration in this regard is the degree to which the two categories of transactions are interrelated. If they are highly interrelated, then the most reliable methodology could be to test the transactions in an aggregated format. See Example 4 of this regulation.

If we use a CPM and an aggregated test format, then the comparables should be a blended sample of distributors (for COSARL’s resale business) and manufacturers (for COSARL’s licensed replacement parts business).

If we separately test the parts royalty and COSARL’s resale business, then we could use a CPM on the latter and (1) CPM or (2) CUT or (3) profit split on the former.

Under an aggregated format, an alternative to the CPM is profit split. Here, we would argue that COSARL’s intangibles differentiate it from CPM comparables to such an extent that CPM is not best method. We need to order and read the Annual Reports for the European distributor comparables -- especially the “high intangible / dealer network” ones -- and learn as much as we can about their distribution channels to see if COSARL really is that different. Another way of exploring this would be to compute a measure of SG&A intensity, as a proxy for COSARL’s investment in its dealers. Then, compare COSA to the comparables. Maybe SG&A as ratio of gross profit (?)

Under the (residual) profit split approach, we would need:

- Indicators of Cat and COSARL’s respective contributions to the combined operating profit of equipment and parts sales in COSA territory. In particular, measures of each

party's relative contribution of intangible property to the relevant business activity are needed, such as market data on fair market value, or indirect measures such as the capitalized cost of developing the intangibles (less an appropriate amount of amortization based on the useful life of each intangible).

To do this, we'll need intangible development costs for Cat ((R&D? and something for the trademark(?)) and COSARL (dealer development costs).

Recommendation:

- CPM under aggregation of transactions format to determine royalty rate
- Supplement by a residual profit split analysis, again under an aggregation of transactions format
- Use one royalty rate for all licensed replacement parts
- Supplemental test / test of reasonableness of royalty through CUT and Sundstrand.

"To Do" List

- Amadeus, industry reports, web sites, other databases*
1. Review Annual Report of each European comparable distributor for detailed description of its distribution network; compare and contrast this with COSARL's
 2. Compile refined sample of European distributors comparables
 3. Compile refined sample of European "licensee" (i.e., manufacturer) comparables
 4. Get COSA balance sheets for last 3 years in order to make asset adjustments to the PLIs
 5. Define and get COSA "dealer development costs" for past 3 years (for residual profit split).
 6. Define and get Cat "intangible development costs" for past 3 years (for residual profit split).
 7. Conduct more P&SS interviews to ascertain 1) if DBS, Antares, DRP and LogNet are really "transferred" to COSARL, or just used by Cat as it performs services to COSARL, and 2) catalog all the services that Cat will be performing for COSARL in connection with COSARL's replacement parts business, and find out how P&SS accountants allocate such costs to COSARL
 8. Determine and compute a measure of "SG&A intensity" for COSA and the distributor comparables to see if there is quantifiable evidence that COSA spends more on distribution channel management than the comparable distributors.
 9. Refine Gene's CUT sample into the best group (i.e., eliminate commission agents and obvious non-parts agreements, etc.)
 10. Summarize Sundstrand into a one-page piece that discussed the relevance of that case to the COSARL licensed replacement parts situation.
 11. Think about other mktg co's
Cat Africa excluded

6/24/99

per Tom: license would not include U.S. worked
P&SS - for worked parts, transfer at std cost to COSARL

- ex. Honda supply*
CUTs from
Fitch, etc. from
12. check warranty - i/c provisions v. 3rd party; licenses, suppliers
liability for design flaws at Cat Inc.? Cat std supply agreement
 13. identifying "parts system" development costs at P&SS
 14. expanding model to whole world

Steven Williams' Response to Supplemental Questions for the Record

From
Chairman Carl Levin

Permanent Subcommittee on Investigations
Hearing On
"Caterpillar's Offshore Tax Strategy"

April 1, 2014

1. During the hearing and in prior interviews with the Subcommittee, you were asked about what has been marked as Hearing Exhibit 13, "Economic Analysis of Intangible Assets Transferred by Caterpillar Americas Co. to Caterpillar Americas SARL," an analysis performed by PricewaterhouseCoopers in 2001. During your Subcommittee interview on February 18, 2014, you stated the 2001 exhibit could be read as inconsistent with the valuation approach taken by PricewaterhouseCoopers in 1999, regarding the marketing intangibles recognized by Caterpillar SARL (CSARL). You also stated that, under a Section 367(d) analysis, goodwill created by Caterpillar Americas Co. (CACO) outside of the United States would not have been subject to a transaction charge when transferred to CSARL in 2001. During the Subcommittee hearing, you testified that the analysis in Exhibit 13 was "looking at the intangibles that were inside the United States," and "[i]t did not include the intangibles outside the United States."
- a. According to Exhibit 13, "the engagement entailed testing the arm's length value of the following assets ... (7) Any Other Marketing-Related Intangibles (such as Customer Lists or Dealer Network) Associated with the Caribbean, Central America, Mexico, and South America; and (8) Good Will and Going-Concern Value Located in the Caribbean, Central America, Mexico and South America." Given that language, was your statement accurate that the 2001 valuation analysis "did not include the intangibles outside the United States"?

Response:

My statement in the hearing, that the 2001 analysis¹ "did not include the intangibles outside the United States" was incorrect, since it is clear in the CACo Report that assets both inside and outside the United States were considered. That statement was an honest and unintentional mistake on my part. It reflected my misplaced recollection of an analysis, considered as the report was prepared many years ago, that, under Internal Revenue Code ("IRC") § 367(d), certain assets outside the United States are not subject to a U.S. transaction charge.

¹ "Economic Analysis of Intangible Assets Transferred from Caterpillar Americas Co. to Caterpillar Americas SARL", referred to as "CACo Report" for the purposes of this response.

The CACo Report, consistent with the requirements under Treas. Reg. § 1.482-4(b), valued the Intangible Assets Transferred, separate from the value of any services, since the services are performed outside of the United States and there was no need to transfer the value attributed to these services. The CACo Report describes certain intangible assets of CACo, and as described in that report, some of those assets are associated with, or located, in non-U.S. territories. The CACo Report does not evaluate assets “inside” or “outside” the United States differently.

The CACo Report considers the intangible assets, separate from any services. The Treasury Regulations under IRC § 482 do not make a distinction between the location of where intangible assets are owned or created. Other provisions of the IRC are relevant in determining the tax consequences of the transfer of assets that are considered to be “foreign” assets.

The phrase I used in the hearing, that the CACo Report “did not include the intangibles outside the United States” refers to a conclusion that could be reached under an analysis under Sec. 367(d), i.e., that assets which are considered part of foreign goodwill and going concern are not subject to a U.S. transaction charge in certain transfers. While not the subject matter of the final CACo report, previous consideration of this IRC § 367 analysis did influence my statement that the intangibles developed outside of the United States were not relevant to the analysis. At the time that the CACo report was being prepared, it was debated whether to prepare the report instead under an IRC § 367 analysis. It was, however, ultimately determined that IRC § 482 and the Treasury Regulations thereunder would be the methodology to be used for the analysis in the report. The conclusion regarding the value of the intangibles, independent of the services, would have been the same under either analysis. The Sec. 1.482 conclusion of no value independent of the value of the services eliminated the need for a separate IRC § 367 analysis.

In the case of CACo, the practical conclusion is similar in both analyses. Using the definition of intangibles under Treas. Reg. § 1.482-4(b), in which intangibles are valued independent of the services of any individual, the value of the intangible assets transferred to CAMSARL have little value outside the value of the services. Under an analysis under IRC § 367(d), in which intangibles that are considered to be part of foreign goodwill or going concern are not subject to a U.S. transaction charge in certain transactions, the remaining U.S. assets transferred are valued separately.

The assets considered in the CACo Report, including Customer List and Dealer Network were found, under IRC § 482 and the Treasury Regulations thereunder, to have limited value without the associated services. The construction that I mistakenly used in the hearing, “outside the United States” reflects, in effect, the practical conclusion that the foreign assets did not have value without the associated services.

- b. If any intangibles were created by CACO outside the United States, please describe them in detail, including the years in which they were created, the types of intangibles created, the functions of the employees that created them, and the location of such employees.**

Response:

Since the 1960s, CACo had employees working alongside of the dealers outside of the United States. By 2001, in the Latin American territories, there were approximately 100 personnel performing dealer activities from offices outside the United States. These individuals assisted the dealers and end users in various areas: product selection, dealership management, sales and service activities, finance and parts guidance and support. There were several "sub-regions" which contained offices for these field personnel including offices in the Caribbean, Mexico, Central America, Northern South America, Brazil and Southern South America.

For example, in 2001, the employees working in offices outside the United States consisted of individuals in ten Latin American countries/territories² providing significant guidance, strategy, and support to dealers in the area of Machine Sales, Parts Sales, Dealer Service, Financing, Power Systems (Electric Power Sales, Marine Petroleum Sales, OEM Truck Engines), and Global Mining (Sales and Product Support). The breadth and expertise of these individuals created marketing intangibles such as "brand awareness" of Caterpillar in the region, through their efforts with Dealers and end users, attendance and marketing at trade shows, regional advertising and other activities. Their daily or weekly assistance provided to the independent dealers enhanced the performance of the Dealer Network. These services are essential in building the Dealer Network, since without these services, the Dealer Contracts by themselves have little value.

- c. Do you view the 2001 valuation analysis conducted of CACO intangibles to be inconsistent with the 1999 valuation analysis conducted of CSARL intangibles, as you indicated during your Subcommittee interview? If not, please explain what changed your view.**

Response:

I believe I indicated in the Subcommittee interview that the two analyses "could be read as inconsistent". In the hearing, I stated that there was "an apparent inconsistency" in the two transactions and that remains my view. In response to Chairman Levin's hearing question as to whether there was an inconsistency, I stated that, "I was recognizing that in two different transactions under different circumstances and different approaches, different assets being valued, that there was a different conclusion." Earlier in the hearing, I also explained the inconsistency by stating, "The reason for that is these were different analyses under different times and actually looking at different assets and different values."

To understand the context of the issues raised by your question, is essential to distinguish the

² Countries/territories included Costa Rica, Mexico, Panama, Puerto Rico, Brazil, Chile, Venezuela, Ecuador, Peru, Colombia and Guatemala.

value of the underlying intangible from the value of the intangible as enhanced by any services required to enhance and support the intangible. A closer examination, therefore, shows that the two analyses were examining different fact patterns:

- **The 1999 analysis considered the COSA/Caterpillar SARL intangibles, as part of the bundle of assets owned, risks borne, and functions performed by Caterpillar SARL, and measured the income earned by Caterpillar SARL in its role. The 1999 analysis reviewed the income resulting from the entirety of Caterpillar SARL's activity.**

The 1999 analysis did not specifically place a value on any particular asset or component of an asset; instead the 1999 analysis evaluated the arm's-length income to be earned by Caterpillar SARL for its combination of functions, assets, and risk.

The 1999 analysis recognized the "dealer network" as one of the value drivers managed by COSA (predecessor to Caterpillar SARL). The term "dealer network" is not a defined term in the tax regulations. At Caterpillar, the term "dealer network" is understood to be comprised of Dealer Contracts between COSA (or other marketing companies) and the individual dealers, as well as the performance of services necessary to fully realize the value of the network. These services included the activities of COSA's marketing personnel and especially the field-based representatives to the dealers that provide: dealer, machine sales, parts, service, and finance guidance, strategy and support, as well as the associated programs, procedures, manuals, and brochures which are utilized by the field personnel. These services were performed by employees of COSA, COSA's branches, and entities that were compensated by COSA.

- **The 2001 analysis considered the value of Dealer Contracts and other intangible assets, separate from the services of individuals, as required by Treas. Reg. § 1.482. The 2001 analysis reviewed only the enumerated assets owned by CACo.**

The 2001 transfer from CACo to CAMSARL (effective 30 November 2001), by contrast, evaluated only the transfer of certain assets of CACo, separate from any services. The CACo Report performed an analysis of the value of the assets under Treas. Reg. § 1.482-4(b), in which intangible property is defined as "any commercially transferable interest in any item included in the following six classes of intangibles, that has substantial value independent of the services of any individual."³ The six classes of intangibles are specified as:

- (1) Patents, inventions, formulae, processes, designs, patterns, or know-how;
- (2) Copyrights and literary, musical, or artistic compositions,
- (3) Trademarks, trade names, or brand names;
- (4) Franchises, licenses, or contracts;
- (5) Methods, programs, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists, or technical data; .
- (6) Other similar items.

The CACo Report valued the specific assets as identified in the Contribution in Kind

³ See CACo Report, at PwC_PSI_CAT_00142361.

Agreement, specified in Appendix A as:⁴

List and Description of Transferred Contracts (listed in Exhibit B to the Agreement)

List of Intangible Assets (listed in Exhibit C to the Agreement)

Marketing Brochures & Product Categories

Website

Any Other Marketing Related Intangible Property Rights Associated With the Caribbean, Central America, Mexico and South America

Order Tracking Software

"Pro2000" and "Masters" Training Programs

Product Technical Data Library

Procedures and Manuals

Goodwill Located in the Caribbean, Central America, Mexico and South America

Going Concern Value Located in the Caribbean, Central America, Mexico and South America

PwC viewed the Dealer Network as part of the category "Any Other Marketing Related Intangible Property Rights", but as mentioned above, the "Dealer Network" is a combination of the actual contracts entered into between the Dealers and the marketing entities such as CACo, and the services provided by the field-based service representatives who maintain daily or weekly contact with the in-country dealers.

- d. Were the intangibles owned by CACO in 2001 considered by PricewaterhouseCoopers to be "intangible property" under the definition of Section 936(h)(3)(B)? Why or why not?

Response:

Yes, however the value of the intangibles transferred by CACo in 2001 must, under the Treas. Reg. § 1.482 analysis used in the report, be determined independent of the value of the services which enable them.

- e. Were the intangibles recognized in CSARL in 1999 considered by PricewaterhouseCoopers to be "intangible property" under the definition of Section 936(h)(3)(B)? Why or why not?

Response:

Yes, however the amount of income attributable to the intangibles employed by Caterpillar SARL in 1999 included the value of the services which enable them and the risks to which they were subject.

In both the 1999 Caterpillar SARL analysis and the 2001 CACo analysis, PwC considered the intangible assets using the Treas. Reg. § 1.482 definition, which is very

⁴ See CACo Report, at PwC_PSI_CAT_00142369 – 00142377.

similar to the IRC § 936(h)(3)(B) definition. In particular, *see* page 1 and page 7 of the CACo report, where the CACo Intangibles were valued using Treas. Reg. § 1.482.

- f. Were the CSARL intangibles recognized in 1999 equivalent to the ones evaluated at CACo in 2001? Why or why not?**

Response:

The intangibles are similar but involve different regions. However, the statutorily required valuation approach in each instance was different. The Caterpillar SARL intangibles evaluated in 1999 considered the income earned by Caterpillar SARL from its combined attributes of its functions performed, its risks borne, and its assets owned. The CACo intangibles evaluated in 2001 considered only the intangible assets transferred by the Asset Transfer Agreement, independent of the associated services and business risks.

- g. Please identify any additional language from Exhibit 13 that supports treating and valuing the 2001 CACo intangibles differently from the 1999 CSARL intangibles.**

Response:

Please refer to page 7 of the CACo Report (PwC_PSI_CAT_00142361) that describes the Treas. Reg. § 1.482-4(b) definition of intangibles as commercially transferable interests in certain items having "substantial value independent of the services of any individual."

- h. Please identify and provide copies of any contemporaneous documents, from in or around 2001, that support treating and valuing the 2001 CACo intangibles differently from the 1999 CSARL intangibles.**

Response:

To date, I have not identified any documents, from in or around 2001 that address treating and valuing the 2001 CACo intangibles differently from the 1999 Caterpillar SARL intangibles.

James Bowers' Response to Supplemental Questions for the Record

**From
Chairman Carl Levin**

**Permanent Subcommittee on Investigations
Hearing On
"Caterpillar's Offshore Tax Strategy"**

April 1, 2014

1. In your interview with the Subcommittee on January 23, 2014, when asked whether you had heard of an inventory system like Caterpillar's "ITAS" inventory, you said: "First time." In addition, when asked whether there were any risks associated from an audit view concerning ITAS, you said: "We had lots of discussions, but ultimately got comfortable with it and what it did."

During the Subcommittee's hearing on April 1, 2014, you had the following exchange with Senator Levin:

Q: Mr. Bowers, one of our experts today said he had never heard of a company keeping two sets of inventory books using a virtual inventory system separate and apart from the company's general inventory system. One to track the parts for the business enterprise, the other to keep track of inventory for tax purposes. Prior to Caterpillar's use of the inventory system, had you ever heard of a virtual inventory system?

A: Senator, different management books from legal books are very common.

Q: Mr. Bowers, I'm not talking about that. I'm asking about inventory systems. Had you ever heard of a virtual inventory system prior to Caterpillar's use of an inventory system? Had you ever heard of it?

A: Senator, different management books from legal books are very common.

A: That particular term I had not heard of.

Q: No. Put aside that. Had you ever heard of a virtual inventory system?

A: An inventory system similar to what has been referred to as virtual I have seen before.

Q: You have?

A: Mhmm.

Q: You've seen it, but you just never heard it described as a virtual one?

A: Ya, it's difficult to understand, you know, an inventory bin is a very physical thing--

Q: Is that what you told our staff by the way? When we asked you specifically have you ever heard of a virtual inventory system or similar system you said no before you saw this system. Did you not tell our staff you had never heard of it?

A: It depends upon how the question gets asked, sir.

Q: The way I just asked it.

A: A virtual inventory system I have not heard of. But when you think about what that sentence says, an inventory bin is a very real thing.

Please clarify for the record what appear to be inconsistent statements in your Subcommittee interview versus your testimony concerning the ITAS virtual inventory system. Please identify the other companies which you saw using a virtual inventory system similar to the system used by Caterpillar.

Response:

In my interview with Subcommittee staff on January 23, 2014, Subcommittee Counsel asked whether I had heard of an inventory system like Caterpillar's inventory tracking and accounting system ("ITAS"). There was also some discussion, at the time, of the use of the term "virtual" to describe ITAS. I indicated during that interview, and again in my testimony at the Subcommittee's April 1, 2014 hearing, that I had not heard of a "virtual" inventory system prior to hearing the term in connection with ITAS.

At the hearing, I was asked additional questions about my knowledge of "a virtual inventory system" or a "similar system." Let me note at the outset that "virtual" inventory system is not a term I regularly use, and "virtual" is not the way I normally view inventory systems. As I said in my testimony, "it's difficult to understand," at least to me, the use of the term "virtual" to describe any inventory system, since inventory is a concrete and physical thing. When I indicated, in response to the questions that I had seen an inventory system similar to ITAS, I was focusing on inventory systems that shared some characteristics of ITAS. For example, I am generally aware that some inventory systems used in certain sectors of the agriculture and energy industries account for inventory stored in one place that belongs to multiple owners, as is true with ITAS. ITAS remains the only case that I am aware of where a company used a system referred to as a "virtual" inventory system.

In my interview with Subcommittee staff, I was also asked whether there were any risks associated with ITAS. As noted in Question #1, I responded that we had lots of discussion and ultimately got comfortable with the inventory system. At the hearing, I made clear that I had "conversations about tax risks" concerning ITAS.

The discussions and conversations we had about “tax risks” centered around whether Caterpillar could develop a system that would meet the applicable technical tax requirements, and whether the system that was needed could be implemented within the necessary timeframe. Based on those discussions, and the fact that the system was actually built and implemented within the necessary time frame, I did get comfortable with Caterpillar’s implementation of ITAS.

May 2, 2014

*** ~~CONFIDENTIAL~~—CONTAINS PROPRIETARY INFORMATION*****Response of Caterpillar Inc. to Inquiry Relating to Treatment and Use of Offshore Funds**

This document sets forth Caterpillar Inc.'s ("Caterpillar" or the "Company") response to the Supplemental Questions for the Record contained in the Subcommittee's letter dated April 11, 2014. Caterpillar requests confidential treatment of this response, as it contains Company confidential and proprietary information, the release of which would damage Caterpillar and potentially assist its competitors, particularly its non-U.S. competitors such as Komatsu, Hitachi, Sany, and Volvo.

Caterpillar's Responses to Supplemental Questions for the Record from Senator Carl Levin

1. During her testimony before the Subcommittee, Julie Lagacy, Vice President of Caterpillar Inc.'s Finance Services Division, stated that "at the time of this realignment, we had approximately 500 employees in our Geneva office, but perhaps more importantly, thousands of employees outside the United States doing the work to help sell parts on machines." Ms. Lagacy testified later: "CSARL had thousands of employees. We had 500 employees at that time in Geneva, Switzerland." According to a letter provided by Caterpillar Inc. to the Subcommittee on August 30, 2013, Caterpillar SARL (CSARL) had between 643 and 682 employees between the years 2010 and 2012. In addition, according to a letter provided by Caterpillar Inc. to the Subcommittee on December 3, 2013, Caterpillar had 1,848 non-U.S. employees supporting the "purchase, storage, movement, and sales of replacement parts" in the year 2006, rising to 3,409 non-U.S. employees by 2012. Of those employees, the December letter identified 66 who were based in Geneva in 2012.
 - a. Is Ms. Lagacy's statement, that "CSARL had thousands of employees," accurate? If so, please indicate each year since its formation in which CSARL has had thousands of employees and provide the total number of employees in each such year. If the statement is not accurate, please confirm whether the August letter provided the correct number of CSARL employees.
 - b. Of the total number of employees at CSARL in Switzerland in 2012, how many supported the purchase, storage, movement, and sales of replacement parts?

During these years, thousands of employees outside the United States supported the "purchase, storage, movement, and sales of replacement parts" by CSARL. These personnel were not employees of Caterpillar Inc., but instead were employees of CSARL, a non-U.S. subsidiary of CSARL, or a non-U.S. affiliate of CSARL. The Caterpillar multinational group contains approximately 450 non-U.S. subsidiaries, one being CSARL, which are each separate legal entities from Caterpillar Inc. Set forth below are tables reflecting the legal entities that employed the personnel outside the United States included in the table in the December 3, 2013 letter. These were the thousands of employees that did work supporting parts as referred to by Ms. Lagacy.

Permanent Subcommittee on Investigations EXHIBIT #55

CAT-002269

CONFIDENTIAL & PROPRIETARY
May 2, 2014

Parts Distribution Non-US Headcount	
Non-US Headcount Hourly	2012
Employing Legal Entity	37
Redacted By Permanent Subcommittee on Investigations	140
	50
	109
	32
	422
	33
	93
	151
	1063
Total Non-US Headcount Hourly	
Non-US Headcount Management	2012
Employing Legal Entity	30
Redacted By Permanent Subcommittee on Investigations	48
	3
	24
	9
	40
	53
	210
	22
	36
	6
	3
	1
	35
	444
Total Non-US Headcount Management	
Total Parts Distribution Non-US Headcount	
2027	

Global Purchasing Non-US Headcount	
Non-US Headcount Management	2012
Employing Legal Entity	11
Redacted By Permanent Subcommittee on Investigations	16
	69
	6
	141
	75
	12
	3
	9
	24
	1
	16
	15
	4
	62
	17
	1
	97
	3
	1
	5
	8
	9
	38
	36
	3
	10
	9
	2
	2
	22
	5
	29
	20
	50
	7
	7
	2
	3
	7
	101
	19
	8
	5
	11
	89
Total Non-US Headcount Management	
1080	

Caterpillar SARL	2
Redacted By Permanent Subcommittee on Investigations	2
	22
	5
	29
	20
	50
	7
	7
	2
	3
	7
	101
	19
	8
	5
	11
	89
Total Non-US Headcount Management	
1080	

The August 30, 2013 letter is correct in stating that, in 2012, there were 66 employees of CSARL (as a separate legal entity) that were located in Switzerland who directly supported the purchase, storage, movement, and sales of replacement parts.

CONFIDENTIAL & PROPRIETARY
May 2, 2014

2. During his testimony, Robin Beran, Caterpillar Inc.'s Chief Tax Officer, stated that all of Caterpillar's offshore warehouses were owned by CSARL or one of its subsidiaries. Please identify the owner of each of Caterpillar's warehouses, whether the warehouse is located within or outside of the United States. If the warehouse is owned by a subsidiary of CSARL, please identify that subsidiary and describe CSARL's ownership interest in that subsidiary.

The table below sets forth the legal entities that own warehouses located outside the United States, and reflects the relationship of these entities to CSARL.

Warehouses located outside of the United States:			
City	Country	Warehouse Owner	Relationship of Warehouse Owner to CSARL
Grimbergen	Belgium	Caterpillar Distribution Services Europe BVBA	Caterpillar SARL Affiliate
Dubai	Arab Emirates	Caterpillar Distribution Services Europe BVBA - Dubai branch	Caterpillar SARL Affiliate
Piracicaba (Non Bonded)	Brazil	Caterpillar Brasil Ltda.	Caterpillar SARL Affiliate
Piracicaba (Bonded)	Brazil	Caterpillar Brasil Ltda.	Caterpillar SARL Affiliate
Monterrey	Mexico	Caterpillar Americas Mexico S. de R.L. de C.V.	Caterpillar SARL Subsidiary (100%)
San Luis Potosi	Mexico	Caterpillar Americas Mexico S. de R.L. de C.V.	Caterpillar SARL Subsidiary (100%)
Melbourne	Australia	Caterpillar of Australia Pty. Ltd.	Caterpillar SARL Affiliate
Johannesburg	South Africa	Caterpillar (Africa) (Proprietary) Limited	Caterpillar SARL Subsidiary (100%)
Singapore	Singapore	Caterpillar SARL - Singapore branch	Caterpillar SARL - Singapore branch
Moscow	Russia	Leased from 3rd party by Caterpillar Distribution International LLC	Owned by 3rd party
Shanghai (Bonded)	China	Caterpillar Logistics (Shanghai) Co. Ltd.	Caterpillar SARL Affiliate
Shanghai (Non Bonded)	China	Caterpillar Logistics (Shanghai) Co. Ltd.	Caterpillar SARL Affiliate
Toronto	Canada	Caterpillar of Canada Corporation	Caterpillar SARL Subsidiary (100%)
Yatala (Queensland)	Australia	Caterpillar of Australia Pty. Ltd.	Caterpillar SARL Affiliate

Note that the Toronto, Canada warehouse closed in 2010 and the Yatala (Queensland), Australia warehouse is new and does not yet hold inventory. The table below lists the warehouses located within the United States, all of which are owned or leased by Caterpillar Inc.

Warehouses located within the United States:		
City	State	Warehouse Owner
Morton	Illinois	Caterpillar Inc.
Clayton	Ohio	Caterpillar Inc.
Atlanta	Georgia	Leased from 3rd Party by Caterpillar Inc.
Denver	Colorado	Caterpillar Inc.
Miami	Florida	Caterpillar Inc.
Spokane	Washington	Caterpillar Inc.
Arvin	California	Caterpillar Inc.
York	Pennsylvania	Caterpillar Inc.
St. Paul	Minnesota	Caterpillar Inc.
Waco	Texas	Caterpillar Inc.

CONFIDENTIAL & PROPRIETARY

May 2, 2014

Caterpillar's Responses to Supplemental Questions for the Record from Senator John McCain

Q. Please submit for the record the years for which the IRS has already completed its audit of Caterpillar. For any years in which the IRS proposed adjustments, please note the year and provide an explanation for any adjustments that were made by Caterpillar.

Caterpillar is audited by the Large Business and International (LB&I) Division of the IRS, which examines corporations with assets in excess of \$10 million. Like other large multinationals, Caterpillar is a "Coordinated Industry Case" taxpayer, and as such is subject to examination on a continuing basis by a team of IRS revenue agents. During these examinations, which are typically conducted in multi-year cycles, the IRS revenue agents examine Caterpillar's tax returns along with the returns of its affiliated entities. The IRS revenue agents gather information about particular subject matters in which they are interested by issuing "Information Document Requests," or "IDRs." IDRs typically request financial data, other company records, or written explanations of particular tax positions taken by the taxpayer.

Since the CSARL restructuring in 1999, the IRS has completed three separate audit cycles, as set forth in the table below. For each cycle, this table includes the number of IDRs issued by the IRS and a description of the major substantive areas covered by these IDRs.

Tax Years	Status of Audit Cycle	Number of IDRs Issued	Primary Substantive Issues
1995-1999	Closed	593	FSC export incentive, R&E credits/deductions, foreign tax credits, transfer pricing, like-kind exchanges, fringe benefits, insurance
2000-2004	Closed	508	CSARL restructuring and operations, ETI export incentive, R&E credits/deductions, depreciation deductions, real estate taxes, foreign tax credits, transfer pricing
2005-2006	Closed by the IRS; 2005 "reopened" by Caterpillar to the extent of the carryback of a net operating loss	353	CSARL restructuring and operations, section 199 domestic production incentive, R&E credits/deductions, foreign tax credits, transfer pricing, section 965 repatriation incentive

The changes to CSARL's operations, which were the focus of the discussion in the hearing, were prominently reflected in detailed tax return disclosures, transfer pricing documentation, and responses to IDRs in these audit cycles. The audit of the restructuring of CSARL and its operations has occurred repeatedly since the initial realignment. The first audit began in 2004 with respect to the 2000-2004 audit cycle. During this cycle, the IRS issued 50 CSARL-related IDRs ranging from copies of financial statements, documents related to the formation of CSARL, and agreements involving CSARL. The IRS participated in an on-site, two-day interview regarding CSARL's supply chain, specifically examining products bought and sold by CSARL. After extensive resources were expended by both the IRS and Caterpillar, no adjustments were proposed or made by the IRS for the 2000-2004 audit cycle with respect to the CSARL restructuring or its ongoing operations.

The audit of these matters continued with respect to the 2005-2006 audit cycle beginning in 2008. The IRS issued additional related IDRs and received the Schlicksup lawsuit filings in June 2009. In September 2009, Caterpillar was informed by the IRS examination team that an IRS international

CONFIDENTIAL & PROPRIETARY
May 2, 2014

examiner was specifically investigating the tax claims made in the lawsuit and that the 2005-2006 audit would be extended for additional months.

Subsequently, nine additional related IDRs were issued. After further extensive IRS and taxpayer resources were expended for the 2005-2006 audit cycle on this matter, no adjustments were proposed or made by the IRS regarding the CSARL restructuring or its operations.

For these same audit cycles for the years 1999 through 2006, the following table summarizes the material proposed adjustments that were initiated by the IRS and the ultimate disposition of such proposed adjustments. Note that this table does not include the adjustments that were initiated by Caterpillar on its own volition to correct errors identified by Caterpillar, which generally comprise the vast majority of the total proposed adjustments. The company itself flags these items for the IRS examination team even when the result is for Caterpillar to pay more taxes. Also note that the dollar amounts in the table below are amounts of income, not tax.

IRS Initiated Proposed Adjustments	1999		2000		2001	
	Proposed Adjustment	Final Adjustment	Proposed Adjustment	Final Adjustment	Proposed Adjustment	Final Adjustment
Reduction of Foreign Sales Corporation Commission Expense	\$248,652,398	\$0				
Treatment of Extraterritorial Income as Subpart F Income					\$27,215,902	\$9,525,566

IRS Initiated Proposed Adjustments	2002		2003		2004	
	Proposed Adjustment	Final Adjustment	Proposed Adjustment	Final Adjustment	Proposed Adjustment	Final Adjustment
Treatment of Extraterritorial Income as Subpart F Income	\$64,891,916	\$5,476,326	\$85,163,040	\$14,028,357	\$182,586,197	\$30,153,521
Reduction in Foreign Tax Credit for Singapore Withholding Taxes			\$3,311,951	0	\$2,805,416	0

CONFIDENTIAL & PROPRIETARY
May 2, 2014

IRS Initiated Proposed Adjustments	2005		2006	
	Proposed Adjustment	Final Adjustment	Proposed Adjustment	Final Adjustment

**Redacted By The
Permanent Subcommittee
on Investigations**

Treatment of Extraterritorial Income as Subpart F Income	\$185,357,779	\$50,951,273	\$177,486,841	\$168,937,216
----------------------------------------------------------------------	---------------	--------------	---------------	---------------

As Mr. Beran noted during the hearing, in the closed audit cycles, the IRS proposed no adjustments relating to CSARL transfer pricing issues or any other CSARL-related matters of the kind discussed in the hearing. As Mr. Beran also noted, the years 2007 forward are still open and remain subject to examination by the IRS. The IRS examination team is currently working on an audit cycle consisting of the years 2007 through 2009, including 2005 to the extent of the net operating loss carryback.

While the IRS examination team has not yet completed its examination for the 2007 – 2009 cycle, including 2005 to the extent of the net operating loss carryback, the team has provided Caterpillar with Notices of Proposed Adjustment (“NOPAs”) for these years in two areas. A NOPA is used by the IRS to communicate a potential adjustment, but it is not a final tax assessment. Legal theories and calculations provided by the IRS in support of a NOPA are not always fully developed or supported by the relevant facts and law, and these legal theories and calculations do not necessarily reflect final conclusions on the part of the examination team, much less on the part of the IRS as a whole.

In the first area, the IRS examination team has proposed to tax on a current basis profits related to CSARL purchased finished replacement parts transactions, based on “substance-over-form” and/or “economic substance” theories similar to those discussed in the April 1, 2014 hearing. As explained in our hearing testimony, Caterpillar remains confident that the relevant transactions complied with all applicable provisions of the Internal Revenue Code and the regulations promulgated thereunder, and did not violate any applicable judicial doctrines, including the substance-over-form and economic substance doctrines as they have been developed under the relevant case law. In the event that adjustments are asserted upon completion of the field examination relating to these matters, Caterpillar would vigorously contest the adjustments and would expect to prevail in any adjudication of the issue on the merits.

CONFIDENTIAL & PROPRIETARY
May 2, 2014

In the second area, the IRS issued an incomplete, unsigned NOPA proposing to disallow foreign tax credits that arose as a result of certain financings unrelated to CSARL. The IRS has not provided a technical explanation of their legal rationale for disallowing the foreign tax credits. If this NOPA is finalized, Caterpillar will contest the proposed adjustment on the basis that the company fully complied with all relevant tax law during the years the transactions giving rise to the foreign tax credits at issue were in place, and again we would expect to prevail in any adjudication of the issue on the merits.

Subject: FW: Caterpillar's Response to May 30th Questions
Date: Friday, June 13, 2014 4:32:37 PM

From: Erickson, Elizabeth [mailto:EErickson@mwe.com]
Sent: Friday, June 13, 2014 03:43 PM Eastern Standard Time
To: Katz, David (HSGAC); Goshorn, Daniel (HSGAC)
Cc: Ryan, Stephen <SRyan@mwe.com>
Subject: Caterpillar's Response to May 30th Questions

Dear Mr. Katz and Mr. Goshorn,

Caterpillar submitted its responses to the Subcommittee's questions for the record on May 2nd ("QFR Response"). On May 30th, you called with a couple of follow-up questions regarding the information submitted. Please find below Caterpillar's response to these follow-up questions. Caterpillar requests confidential treatment of this response, as it contains Company confidential and proprietary information, the release of which would damage Caterpillar and potentially assist its competitors, particularly its non-U.S. competitors such as Komatsu, Hitachi, Sany, and Volvo.

As always, please call me with any questions.

1. With respect to Question 1 of the QFR Response, the Subcommittee staff requested clarification as to which entity employed the employees doing work to support parts outside the United States.

As indicated in Question 1 of the QFR Response, thousands of employees outside the United States supported the "purchase, storage, movement and sales of replacement parts" by CSARL. These were the thousands of employees that did work supporting parts as referred to by Ms. Lagacy. These employees were not employed by Caterpillar Inc. Rather, they were employees of CSARL, a non-U.S. subsidiary of CSARL, or a non-U.S. affiliate of CSARL. For this purpose, a "non-U.S. subsidiary" of CSARL would include a non-U.S. entity owned, directly or indirectly (through a chain of ownership), by CSARL (i.e., a "parent-subsidiary" relationship to CSARL), and a "non-U.S. affiliate" of CSARL would include those non-U.S. entities owned, directly or indirectly, by Caterpillar Inc. but in which CSARL does not own a direct or indirect ownership interest (i.e., a "brother-sister" relationship to CSARL, and a "parent-subsidiary" relationship to Caterpillar Inc.). That is, Caterpillar Inc. has approximately 450 non-U.S. subsidiaries, one being CSARL. The non-U.S. subsidiaries of Caterpillar Inc. that are owned, directly or indirectly, by CSARL are non-U.S. subsidiaries of CSARL, and the non-U.S. subsidiaries of Caterpillar Inc. that are not owned, directly or indirectly, by CSARL are non-U.S. affiliates of CSARL. The thousands of employees outside the United States that supported the "purchase, storage, movement and sales of replacement parts" were employees of CSARL, these non-U.S. subsidiaries of CSARL, or these non-U.S. affiliates of CSARL, and were not employees of Caterpillar Inc.

2. With respect to Question 2 of the QFR Response, the Subcommittee staff requested clarification as to the meaning of "Caterpillar SARL Affiliate" in the table.

For purposes of the table, the term "Caterpillar SARL Affiliate" means a non-U.S. affiliate of CSARL as defined above.

Regards,

Elizabeth A. Erickson
Partner

**McDermott
Will & Emery**

McDermott Will & Emery LLP The McDermott Building 500 North Capitol Street, N.W.
Washington, DC 20001
Tel +1 202 756 8097 Mobile +1 301 802 2583 Fax +1 202 756 8087

[Biography](#) | [Website](#) | [vCard](#) | [E-mail](#) | [Twitter](#) | [LinkedIn](#) | [Blog](#)

IRS Circular 230 Disclosure: To comply with requirements imposed by the IRS, we inform you that any U.S. federal tax advice contained herein (including any attachments), unless specifically stated otherwise, is not intended or written to be used, and cannot be used, for the purposes of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter herein.

This message is a PRIVILEGED AND CONFIDENTIAL communication. This message and all attachments are a private communication sent by a law firm and may be confidential or protected by privilege. If you are not the intended recipient, you are hereby notified that any disclosure, copying, distribution or use of the information contained in or attached to this message is strictly prohibited. Please notify the sender of the delivery error by replying to this message, and then delete it from your system. Thank you.

Please visit <http://www.mwe.com/> for more information about our Firm.

July 22, 2014

*** CONFIDENTIAL—CONTAINS PROPRIETARY INFORMATION*****Response of Caterpillar Inc. to Inquiry Relating to Treatment and Use of Offshore Funds**

This document sets forth Caterpillar Inc.'s ("Caterpillar" or the "Company") response to the Followup Supplemental Questions for the Record contained in the letter from Senator Carl Levin dated June 27, 2014. Caterpillar requests confidential treatment of this response, as it contains Company confidential and proprietary information, the release of which would damage Caterpillar and potentially assist its competitors, particularly its non-U.S. competitors such as Komatsu, Hitachi, Sany, and Volvo.

Caterpillar's Responses to Followup Supplemental Questions for the Record from Senator Carl Levin

1. During the Subcommittee's April 1, 2014 hearing "Caterpillar's Offshore Tax Strategy," Ms. Julie Lagacy stated that at the time of the CSARL realignment "we had approximately 500 employees in our Geneva office, but perhaps more importantly, thousands of employees outside the United States doing the work to help sell parts on machines." Sen. Levin asked Ms. Lagacy to clarify how many employees worked for CSARL, rather than Caterpillar's other subsidiaries, asking specifically "How many employees did CSARL have?" to which Ms. Lagacy responded "CSARL had thousands of employees. We had 500 employees at that time in Geneva, Switzerland."

On April 11, 2014, the Subcommittee sent Caterpillar questions for the record seeking clarification on remarks made by Ms. Lagacy. The first question asked, in part, if Ms. Lagacy's statement during the hearing that "CSARL had thousands of employees" was accurate.

On May 2, 2014, Caterpillar responded that thousands of employees outside the United States supported the "purchase, storage, movement, and sales of replacement parts" by CSARL. Caterpillar also stated that "these personnel were not employees of Caterpillar Inc., but instead were employees of CSARL, a non-U.S. subsidiary of CSARL, or a non-U.S. affiliate of CSARL." Caterpillar also provided tables reflecting the legal entities that employed the personnel outside the United States that supported parts work.

On May 30, 2014, the Subcommittee asked for clarification as to what Caterpillar meant by "non-U.S. affiliate of CSARL" and whether those entities and their employees had any legal relationship to CSARL.

On June 13, 2014, Caterpillar clarified to the Subcommittee that "a 'non-U.S. affiliate' would include those non-U.S. entities owned, directly or indirectly, by Caterpillar Inc. but in which CSARL does not own a direct or indirect ownership interest."

- a. Please identify how many of the "thousands of employees outside the United States support[ing] the "purchase, storage, movement, and sales of replacement parts" by CSARL were employees of CSARL.

CONFIDENTIAL & PROPRIETARY
July 22, 2014

In 2012, there was an estimated total of 255 employees of CSARL (as a separate legal entity) which directly supported the purchase, storage, movement, and sales of replacement parts (81 employees of CSARL predominately located in Switzerland and 174 employees assigned to the Singapore branch of CSARL, referred to as Caterpillar SARL - Singapore Branch). As you will see below, personnel of other non-U.S. entities engaged in the same activities need to be aggregated to provide a true picture of the economic activity related to supporting parts outside the United States for CSARL, which the Caterpillar witnesses accurately described at the hearing.

- b. Please identify how many of the “thousands of employees outside the United States support[ing] the “purchase, storage, movement, and sales of replacement parts” by CSARL were employees of a non-U.S. subsidiary of CSARL. Please identify each such non-U.S. subsidiary by name, the country where it is incorporated, the city and country where its principal place of business is located, the total number of its employees, and the total number of its employees who are engaged in supporting the purchase, storage, movement, and sales of replacement parts.**

Set forth below is a table reflecting the non-U.S. entities that employed the personnel outside the United States in 2012 that were included in a prior table in the December 3, 2013 letter to the Subcommittee. These were the thousands of employees that did work supporting parts as referred to by Ms. Lagacy. Note that the table below does not include the employees of non-U.S. entities that were engaged in parts pricing and distribution services in the Distribution Services Division which are reflected in the prior table in the December 3, 2013 letter to the Subcommittee. Because these parts pricing and Distribution Services Division employees supported parts for CSARL, they should be included with the number of employees that are reflected in the table below to get an accurate sense of the number of non-U.S. employees that were engaged in supporting the purchase, storage, movement, and sales of replacement parts.

The non-U.S. entities that are subsidiaries of CSARL are highlighted in yellow. CSARL and its Singapore branch, referred to as CSARL – Singapore Branch, are highlighted in blue. The non-U.S. entities that are subsidiaries of Caterpillar Overseas SARL (“COSA”), the predecessor of CSARL, not including CSARL, CSARL – Singapore Branch or otherwise reflected as subsidiaries of CSARL, are highlighted in pink. The table reflects the name of the non-U.S. subsidiary, the country where it is incorporated, the city and country where its principal place of business is located, the total number of its employees, the total number of its employees who were engaged in supporting the purchase of replacement parts and the total number of its employees who were engaged in supporting the distribution of replacement parts. Note that the highlighted entities (i.e. those that were subsidiaries of COSA, the predecessor of CSARL) employed over 1,450 employees in 2012 that were engaged in supporting parts for CSARL.

CONFIDENTIAL & PROPRIETARY
July 22, 2014

Employing Legal Entity	Country of Incorporation	City and Country of Principal Place of Business	Total Number of Full-time Employees 2012	Non-US Headcount Supporting Purchasing 2012	Non-US Headcount Supporting Parts Distrib. 2012
			233	11	
			555	18	
			719	69	
			726	75	
			1,487	12	
			119	3	
			478	2	
			1,241	24	
			11	1	
			1,866	15	
			789	15	
			132	62	
			562	1	
			253	97	
Caterpillar Hungary Component Manufacturing Company Ltd.	Hungary	Nagygy. Hungary	309	2	
			12	5	
			263	9	
			1,036	36	
			146	10	
Caterpillar Prodotto Stradali S.r.l.	Italy	Minerbio, Italy	245	9	
Caterpillar SARL	Switzerland	Geneva, Switzerland	482	2	
Caterpillar Servizi Italia Srl	Italy	Minerbio, Italy	55	2	
			1,156	22	
			38	5	
			280	29	
			108	20	
			1,901	50	
			144	2	
			767	2	
			86	3	
Mec-Track S.r.l.	Italy	Ravenna Bologna, Italy	311	7	
			3,185	101	
			260	19	
			281	8	
			1,522	1	
			252	11	
			4,886	89	
Caterpillar (Africa) (Pty) Limited	South Africa	Isando, South Africa	72	3	67
Caterpillar of Australia Pty. Ltd.	Australia	Tullahoma, Australia	569	3	188
Caterpillar of Canada Corporation	Canada	Woodbridge, Canada	158		3
Caterpillar Latin America Servicios de Panama, S. de R.L.	Republic of Panama	Ciudad de Panama, Republic of Panama	3,101	38	74
Caterpillar Asia Pte. Ltd. - Employees Assigned to CSARL - Singapore Branch	Singapore	Singapore, Singapore	628	4	149
			98	2	85
Caterpillar Distribution Services Europe BVBA	Belgium	Grimbergen, Belgium	765	17	632
Caterpillar Distribution International LLC	Russia	Chernaya Gora, Russian Federation	53		33
Caterpillar Distribution Services Europe BVBA - Dubai branch	Belgium	Dubai, United Arab Emirates	130		127
			833	8	6
			81	6	3
Caterpillar France S.A.S.	France	Grenoble, France	1,491		1
Caterpillar Brasil Comercio de Maquinas e Peças Ltda	Brazil	Piracicaba, Brazil	301		186
			1,659	141	444
TOTAL number of Full-time Employees			39,065	1,079	1,027

— = Redacted by the Permanent Subcommittee on Investigations

CONFIDENTIAL & PROPRIETARY
July 22, 2014

- c. Please identify how many of the “thousands of employees outside the United States support[ing] the “purchase, storage, movement, and sales of replacement parts” by CSARL were employees of a non-U.S. affiliate of CSARL, which is defined as being “owned, directly or indirectly, by Caterpillar Inc.” and in which “CSARL does not own a direct or indirect ownership interest.” Please identify each such non-U.S. affiliate of CSARL by name, the country where it is incorporated, the city and country where its principal place of business is located, the total number of its employees, and the total number of its employees who are engaged in supporting the purchase, storage, movement, and sales of replacement parts.

Set forth above in the response to Question 1.b. is a table reflecting the non-U.S. legal entities that employed the personnel outside the United States that were included in a prior table in the December 3, 2013 letter to the Subcommittee. These were the thousands of employees that did work supporting parts as referred to by Ms. Lagacy. Note that the table above does not include the employees of non-U.S. entities that were engaged in parts pricing and distribution services in the Distribution Services Division which are reflected in the prior table in the December 3, 2013 letter to the Subcommittee. Because these parts pricing and Distribution Services Division employees supported parts for CSARL, they should be included with the number of employees that are reflected in the table above to get an accurate sense of the number of non-U.S. employees that were engaged in supporting the purchase, storage, movement, and sales of replacement parts.

The non-U.S. entities that are affiliates of CSARL, that are not subsidiaries of COSA, the predecessor of CSARL, are not highlighted. The table reflects the name of the non-U.S. affiliate, the country where it is incorporated, the city and country where its principal place of business is located, the total number of its employees, and the total number of its employees who were engaged in supporting the purchase of replacement parts and the total number of its employees who were engaged in supporting the distribution of replacement parts. These personnel of non-U.S. entities that are affiliates of CSARL are engaged in the same activities and thus need to be aggregated with the personnel of the highlighted entities to provide a true picture of the economic activity related to supporting parts outside the United States for CSARL.

- d. Please clarify whether Ms. Lagacy’s statement that “CSARL had thousands of employees” was accurate.

The statement in question was a broad reference to the number of employees involved in supporting parts for CSARL outside the United States. After further questioning by Chairman Levin about the exact number of personnel employed by CSARL as a separate legal entity, Ms. Lagacy stated to Chairman Levin that she did not have the exact number or even an approximate number of CSARL employees, and asked that she be allowed to provide follow-up information after the hearing.

Consistent with that exchange, and as requested by the Subcommittee, we have provided detailed follow-up information to this request (in this response as well as our response dated May 2, 2014). As Ms. Lagacy correctly noted during the April 1st hearing, thousands of employees outside the United States supported the purchase, storage, movement, and sales of replacement parts by CSARL. These were the thousands of employees who did work supporting parts as referred to by Ms. Lagacy. These personnel were not employees of Caterpillar Inc., but instead were employees of CSARL, a non-U.S. subsidiary of CSARL, or a non-U.S. affiliate of CSARL.

CONFIDENTIAL & PROPRIETARY
July 22, 2014

2. During the Subcommittee's April 1, 2014 hearing "Caterpillar's Offshore Tax Strategy," Mr. Robin Beran, Caterpillar Inc.'s Chief Tax Officer, stated that all of Caterpillar's offshore parts warehouses were "owned by CSARL or one of its subsidiaries."

On April 11, 2014, the Subcommittee sent Caterpillar questions for the record seeking clarification on remarks made by Mr. Beran. The Subcommittee asked Caterpillar to identify the legal owner of each of Caterpillar's warehouses and to identify CSARL's legal relationship to that entity.

On May 2, 2014, Caterpillar responded, in part, that 8 of Caterpillar's 14 offshore warehouses, including Caterpillar's principal offshore warehouse in Grimbergen, Belgium, were owned by "Caterpillar SARL affiliates." Caterpillar noted that its warehouse in Moscow was owned by a third party.

On May 30, 2014, the Subcommittee asked for clarification as to what Caterpillar meant by "Caterpillar SARL affiliate" and whether those entities had any legal relationship to CSARL.

On June 13, 2014, Caterpillar clarified to the Subcommittee that the term "Caterpillar SARL affiliate" would include those non-U.S. entities owned, directly or indirectly, by Caterpillar Inc. but in which CSARL does not own a direct or indirect ownership interest.

- a. Given that 8 of Caterpillar's offshore warehouses are owned by "Caterpillar SARL affiliates" in which CSARL has no direct or indirect ownership interest, and an additional warehouse is owned by a third party, was Mr. Beran's statement that all of Caterpillar's parts warehouses are "owned by CSARL or one of its subsidiaries" accurate?

In the hearing, immediately preceding your quote, Mr. Beran only referred to warehouses located in Belgium and Singapore. As previously indicated in our letter dated May 2, 2014, the Belgium warehouse is owned by Caterpillar Distribution Services Europe BVBA, an affiliate of CSARL and a wholly-owned subsidiary of COSA, the predecessor of CSARL, and the Singapore warehouse is owned by the Singapore branch of CSARL, Caterpillar SARL – Singapore Branch. The table provided in our letter dated May 2, 2014 sets forth the identity of the entity that is the owner for each of the warehouses.

**SUBCOMMITTEE MAJORITY STAFF
MEMORANDUM TO FILE**

DATE: August 28, 2014

RE: Ownership of Caterpillar's Non-U.S. Parts Warehouses

On April 1, 2014, during the Subcommittee hearing on "Caterpillar's Offshore Tax Strategy," the Chief Tax Officer of Caterpillar Inc., Robin Beran, provided sworn testimony that did not correspond with information previously provided to the Subcommittee by Caterpillar related to the ownership of Caterpillar's parts warehouses located outside of the United States. Mr. Beran's testimony gave the impression that all of those non-U.S. parts warehouses, or at least the two largest warehouses in Belgium and Singapore, were owned by Caterpillar's Swiss subsidiary, Caterpillar SARL (CSARL), or a subsidiary of CSARL. Information previously provided to the Subcommittee by Caterpillar had indicated that all of the non-U.S. warehouses were owned by subsidiaries of Caterpillar Inc., the parent company in the United States, and none were owned CSARL or a CSARL subsidiary. After the hearing, the Subcommittee sought clarification of the facts. The purpose of this memorandum is to set forth the Subcommittee's current understanding of the ownership of Caterpillar's non-U.S. parts warehouses.

Summary of Warehouse Ownership. According to all of the information provided by Caterpillar to the Subcommittee to date, at the time of the hearing, Caterpillar owned 14 parts warehouses outside of the United States. Eight of those 14 non-U.S. warehouses, including Caterpillar's principal non-U.S. warehouse in Belgium, were owned by subsidiaries of Caterpillar Inc., the U.S. parent, with no direct or indirect ownership interest held by CSARL or a CSARL subsidiary. Five of Caterpillar's non-U.S. parts warehouses, including the warehouse in Singapore, were owned by entities related to CSARL. One parts warehouse in Moscow was owned by an unrelated third party.

Hearing Testimony

During the Subcommittee's April 1, 2014 hearing, "Caterpillar's Offshore Tax Strategy," in response to questions by the Subcommittee Chairman concerning Caterpillar's parts warehouses, Mr. Beran provided the following testimony.

Senator Levin. Now, what percentage of the--how many warehouses are there in Switzerland, Caterpillar warehouses or CSARL warehouses? Do you know?

Mr. Beran. None, to my knowledge.

Senator Levin. Do you know how many warehouses there are in the United States, Caterpillar warehouses?

Mr. Beran. I think we discussed earlier there are around ten, but I do not know the exact number.

Permanent Subcommittee on Investigations

EXHIBIT #56a

Senator Levin. Is it true, Mr. Beran, that Caterpillar has its largest parts warehouse and manages its global parts inventory in Morton, Illinois? The largest parts warehouse of Caterpillar in Morton, Illinois. That is my question.

Mr. Beran. Morton has a very sizable facility. I think it is the largest.

Senator Levin. Thank you.

Mr. Beran. But we have large ones in Belgium, in Singapore, in--

Senator Levin. None in Switzerland.

Mr. Beran. None in Switzerland. All of them are owned by CSARL or one of its subsidiaries.

Senator Levin. I understand. You say "owned"? CSARL owns those?

Mr. Beran. Owns--

Senator Levin. Who owns CSARL?

Mr. Beran. CSARL owns all of the--excuse me?

Senator Levin. Who owns CSARL?

Mr. Beran. Ultimately it is owned by Caterpillar Inc., but every government in the world expects us to report by legal entity.

Senator Levin. Right. So CSARL is owned by Caterpillar.

Mr. Beran. That is correct.

Senator Levin. You say CSARL owns those warehouses?

Mr. Beran. CSARL either owns the warehouses or owns the entity that owns them.

Senator Levin. Right, and who owns the entity that owns CSARL?

Mr. Beran. Again, Caterpillar--ultimately Caterpillar Inc.

In his testimony, Mr. Beran stated that "[a]ll" of the warehouses were "owned by CSARL or one of its subsidiaries," but it was unclear whether he was referring to just the warehouses in Belgium and Singapore, or to a larger number of the company's non-U.S. warehouses. He also testified that "CSARL either owns the warehouses or owns the entity that owns them," but it was again unclear to which warehouses he was referring. The Subcommittee accordingly sought to clarify the facts.

Posthearing Information

On April 11, 2014, the Subcommittee sent Caterpillar questions for the record seeking clarification of Mr. Beran's testimony regarding ownership of Caterpillar's non-U.S. warehouses. The Subcommittee asked Caterpillar to identify the legal owner of each of Caterpillar's warehouses and CSARL's legal relationship to each such entity.

On May 2, 2014, Caterpillar responded, in part, that eight of Caterpillar's 14 non-U.S. warehouses, including Caterpillar's principal warehouse in Belgium, were owned by "Caterpillar SARL affiliates." Caterpillar indicated that its Singapore parts warehouse was owned by the Singapore branch of CSARL. Caterpillar also indicated that four additional parts warehouses were owned by entities that were subsidiaries of CSARL, and that its parts warehouse in Moscow was owned by an unrelated third party.

On May 30, 2014, the Subcommittee asked for clarification as to what Caterpillar meant by "Caterpillar SARL affiliates," and whether CSARL had any direct or indirect ownership interest in those entities.

On June 13, 2014, Caterpillar wrote to the Subcommittee that the term "Caterpillar SARL affiliates" meant non-U.S. entities which were owned, directly or indirectly, by Caterpillar Inc., the U.S. parent corporation, and in which CSARL had no direct or indirect ownership interest.

On June 27, 2014, the Subcommittee sent Caterpillar additional questions for the record, which asked, in part, whether Mr. Beran's statement that "all" of Caterpillar's parts warehouses were "owned by CSARL or one of its subsidiaries" was accurate, given that eight of Caterpillar's non-U.S. warehouses were owned by Caterpillar entities in which CSARL had no direct or indirect ownership interest, and one additional warehouse was owned by a third party.

On July 22, 2014, Caterpillar responded that, in his testimony, Mr. Beran had been referring only to the warehouses located in Belgium and Singapore. Caterpillar also wrote that the "Belgium warehouse is owned by Caterpillar Distribution Services Europe BVBA, an affiliate of CSARL and a wholly-owned subsidiary of Caterpillar Overseas SARL (COSA), the predecessor of CSARL, and the Singapore warehouse is owned by the Singapore branch of CSARL, Caterpillar SARL – Singapore Branch."

While Caterpillar characterized Caterpillar Distribution Services Europe BVBA, the direct owner of the Belgium warehouse, as "an affiliate of CSARL," Caterpillar's earlier responses indicated that CSARL held no direct or indirect ownership interest in that entity or in the Belgium warehouse. Similarly, while Caterpillar characterized COSA as "the predecessor of CSARL," COSA is a separate Swiss entity which Caterpillar's earlier responses indicated was not directly or indirectly owned by CSARL. CSARL's lack of any ownership interest in the two entities and the Belgium warehouse indicates that even if Mr. Beran had been referring in his testimony to only the Belgium and Singapore warehouses, he was incorrect when he said that "CSARL either owns the warehouses or owns the entity that owns them." According to the information provided by Caterpillar, CSARL did not hold any ownership interest in the Belgium warehouse.

**SUBCOMMITTEE MAJORITY STAFF
MEMORANDUM TO FILE**

DATE: August 28, 2014

RE: Testimony Related to CSARL's Non-U.S. Parts Employees

On April 1, 2014, during the Subcommittee hearing on "Caterpillar's Offshore Tax Strategy," Julie Lagacy, Vice President of the Financial Services Division of Caterpillar Inc., the U.S. parent corporation, provided sworn testimony that did not correspond with information previously provided to the Subcommittee by Caterpillar related to the number of non-U.S. employees at its Swiss subsidiary, Caterpillar SARL (CSARL), who supported the purchase, storage, movement, and sales of replacement parts. Her testimony suggested that, rather than hundreds of employees, CSARL employed thousands of non-U.S. persons who supported the company's replacement parts business. After the hearing, the Subcommittee sought clarification of the facts. The purpose of this memorandum is to set forth the Subcommittee's current understanding of Caterpillar's non-U.S. employees who handle replacement parts.

Based on all of the information provided to the Subcommittee by Caterpillar to date, it appears that its Swiss subsidiary, CSARL, has 255 employees who directly support the purchase, storage, movement, and sales of replacement parts, 81 of whom reside in Switzerland. An additional 265 employees at CSARL subsidiaries also perform work supporting the company's replacement parts business, for a grand total of 520 CSARL and CSARL subsidiary employees. In addition, about 5,000 non-U.S. employees at other Caterpillar entities – entities not directly or indirectly owned by CSARL – perform work supporting the company's replacement parts and logistics business, producing a total nearly ten times larger than the total number of parts employees associated with CSARL.

Hearing Testimony

During the April 1 hearing, Ms. Lagacy testified that, at the time of the CSARL business realignment in 2000, "we had approximately 500 employees in our Geneva office, but perhaps more importantly, thousands of employees outside the United States doing the work to help sell parts on machines." Because it was unclear whether Ms. Lagacy meant that CSARL or Caterpillar as a whole had thousands of non-U.S. employees working on the parts business, Sen. Levin asked Ms. Lagacy to clarify how many parts employees worked for CSARL, rather than Caterpillar's other subsidiaries, asking specifically: "How many employees did CSARL have?" Ms. Lagacy responded: "CSARL had thousands of employees. We had 500 employees at that time in Geneva, Switzerland." According to a letter provided by Caterpillar Inc. to the Subcommittee dated August 30, 2013, however, in the years 2010 through 2012, CSARL had a total of only between 643 and 682 global employees, many of whom did work unrelated to supporting the replacement parts business. A larger number of parts employees worked for other Caterpillar entities. According to a Caterpillar letter provided to the Subcommittee on December 3, 2013, worldwide in 2006, Caterpillar had a total of 1,848 non-U.S. employees supporting the "purchase, storage, movement, and sales of replacement parts;" in 2012, that total rose to 3,409 non-U.S. employees. When Ms. Lagacy stated that "CSARL had thousands of employees," her

testimony may have left the mistaken impression that thousands, rather than hundreds, of CSARL employees worked on the company's parts business.

Posthearing Information

On April 11, 2014, the Subcommittee sent Caterpillar questions for the record seeking to clarify Ms. Legacy's testimony that "CSARL had thousands of employees," and requesting the actual number of CSARL non-U.S. employees that supported the purchase, storage, movement, and sales of replacement parts.

On May 2, 2014, Caterpillar responded that thousands of employees outside the United States supported the "purchase, storage, movement, and sales of replacement parts" by CSARL. Caterpillar also stated that "these personnel were not employees of Caterpillar Inc., but instead were employees of CSARL, a non-U.S. subsidiary of CSARL, or a non-U.S. affiliate of CSARL." Caterpillar also provided tables reflecting the legal entities that employed the personnel outside the United States that supported the company's parts work.

On May 30, 2014, the Subcommittee asked for clarification as to what Caterpillar meant by a "non-U.S. affiliate of CSARL," and whether those entities and their employees had any legal relationship to CSARL.

On June 13, 2014, Caterpillar responded: "[A] 'non-U.S. affiliate' would include those non-U.S. entities owned, directly or indirectly, by Caterpillar Inc. but in which CSARL does not own a direct or indirect ownership interest."

On June 27, 2014, the Subcommittee again sent Caterpillar questions for the record, this time seeking clarification on the number of employees supporting the purchase, storage, movement, and sales of replacement parts at CSARL, a CSARL affiliate, or a Caterpillar entity in which CSARL held no direct or indirect ownership interest. The Subcommittee again sought clarification as to whether "CSARL had thousands of employees," rather than hundreds.

On July 22, 2014, Caterpillar provided additional information. Caterpillar stated that in 2012, an estimated total of 255 employees of CSARL (as a separate legal entity) directly supported the purchase, storage, movement, and sales of replacement parts, including 81 employees of CSARL in Switzerland and 174 employees assigned to the Singapore branch of CSARL. Caterpillar also provided a chart showing an additional 265 employees of CSARL subsidiaries supporting the company's replacement parts business. Next, Caterpillar identified nearly 3,000 additional employees supporting the parts business who were employed by entities in which CSARL had no direct or indirect ownership interest, including at another Swiss Caterpillar entity known as COSA. Finally, Caterpillar referenced an additional 2,000 non-U.S. employees supporting the parts business from the company's "logistics division," without identifying the precise entity or entities for which those employees worked.

In response to the Subcommittee's question about whether the statement that "CSARL had thousands of employees" was accurate, Caterpillar responded that "the statement in question was a broad reference to the number of employees involved in supporting parts for CSARL outside the United States."

**SUBCOMMITTEE MAJORITY STAFF
MEMORANDUM TO FILE**

DATE: September 11, 2014

RE: False Testimony Related to IRS' Position on Caterpillar's Tax Liability

Prior to and during the Subcommittee's April 1, 2014 hearing on "Caterpillar's Offshore Tax Strategy," Caterpillar represented that the IRS had not objected to the offshore tax strategy at issue in the hearing. After the hearing, however, the Subcommittee learned that, in fact, three months earlier, on December 23, 2013, the Internal Revenue Service (IRS) had sent Caterpillar a notice strongly objecting to its offshore tax strategy, proposing a substantial tax adjustment, and indicating that the agency planned to impose substantial penalties on the company for using an "abusive corporate tax shelter."

On September 10, 2014, Subcommittee staff reviewed a copy of the IRS Notice of Proposed Adjustment (NOPA) sent to Caterpillar by the IRS three months prior to the hearing. In it, the IRS stated that Caterpillar had "implemented an abusive corporate tax shelter," and determined that, using a tax shelter involving its Swiss subsidiary, Caterpillar SARL (CSARL), Caterpillar had understated its U.S. income by over \$3 billion. In addition to unpaid taxes, the IRS proposed tax penalties for using the abusive tax shelter totaling at least \$70 million. The IRS supported its position with over 70 pages of legal and factual analysis, referencing numerous additional exhibits and court documents.

The existence of this NOPA is contrary to sworn testimony provided by a Caterpillar representative to the Subcommittee. While under oath at the Subcommittee's hearing, Caterpillar's Chief Tax Officer, Robin Beran, provided the following testimony regarding the IRS' position when asked about it by the Subcommittee's Ranking Member Senator McCain:

Senator McCain. Mr. Beran, when and how often since 1999 has the IRS audited Caterpillar?

Mr. Beran. Senator, we are under continuous examination. The IRS literally sits right outside my office. In that time frame, we have closed 1999, 2000, 2001, 2002, 2003, 2004, 2005, 2006—

Senator McCain. What haven't you closed? What year?

Mr. Beran. 2007 and later years are still under exam.

Senator McCain. They are still under examination. So you are under constant auditing from the IRS?

Mr. Beran. Yes, we are.

Senator McCain. And they have not claimed you are in violation of IRS regulations?

Permanent Subcommittee on Investigations

EXHIBIT #56c

Mr. Beran. Each year's return provides substantial information, including transfer pricing information related to our international businesses. They proposed no adjustments.

Later, when asked by Subcommittee Member Senator Ron Johnson about whether the IRS had "given their blessing" to Caterpillar's actions, Mr. Beran again concealed the IRS notice filed three months earlier:

Senator Johnson. In the closed-out audits, you said they looked to transfer pricing. I mean, that encompasses this entire relationship with CSARL and, again, because they [the IRS] have proposed no adjustments, they have basically given their blessing to what you have done here from the standpoint of compliance with tax law, correct?

Mr. Beran. That is the way I have taken it. There is extensive documentation that is provided every year, and we know they ask questions about it.

The statement that the IRS "proposed no adjustments" as well as the assertion that the IRS had "given their blessing" to the offshore tax strategy examined at the hearing are contrary to the facts. At the time of the hearing, the IRS was, in fact, seeking additional taxes and penalties from the company related to its offshore tax strategy for the years 2005, 2007, 2008, and 2009. As the company's Chief Tax Officer, Mr. Beran knew or should have known about the IRS notice, the agency's objection to the company's offshore tax strategy, and the proposed multi-billion-dollar tax adjustment and penalties.

Caterpillar continued to conceal the IRS' opposition to the company's offshore tax strategy from the Subcommittee until a month after the April 1 hearing. On May 2, 2014, in a written response to Subcommittee questions for the record, Caterpillar disclosed the following:

"As Mr. Beran noted during the hearing, in the closed audit cycles, the IRS proposed no adjustments relating to CSARL transfer pricing issues or any other CSARL-related matters of the kind discussed in the hearing. As Mr. Beran also noted, the years 2007 forward are still open and remain subject to examination by the IRS. The IRS examination team is currently working on an audit cycle consisting of the years 2007 through 2009, including 2005 to the extent of the net operating carry back.

While the IRS examination team has not yet completed its examination for the 2007 – 2009 cycle, including 2005 to the extent of the net operating loss carryback, the team has provided Caterpillar with [NOPAs] for these years in two areas. ...

In the first area, the IRS examination team has proposed to tax on a current basis profits related to CSARL purchased finished replacement parts transactions, based on "substance-over-form" and/or "economic substance" theories similar to those discussed in the April 1, 2014 hearing."

In addition, on April 15, 2014, the U.S. Securities and Exchange Commission (SEC) sent a letter to Caterpillar inquiring about a reference in its Form 10-K for the fiscal year ended December 31, 2013 regarding "Notices of Proposed Adjustment from the IRS relating to the

taxation of certain non-U.S. operations.”¹ In a letter responding to the SEC on May 30, 2014, Caterpillar wrote the following:

“Caterpillar is currently under audit in the United States for the years 2007 to 2009, including the impact of a net operating loss carryback to 2005. We disagree with Notices of Proposed Adjustment (“NOPAs”) that we received in December 2013 as disclosed in our 10-K for the year ended December 31, 2013 and our Form 10-Q for the quarter ended March 31, 2014.

... [T]he IRS has raised a substance-over-form argument and proposed to currently tax in the United States profits related to certain parts transactions involving our non-U.S. subsidiary, CSARL. Similar questions related to CSARL’s operations were discussed in a hearing held by the U.S. Senate’s Permanent Subcommittee on Investigations on April 1, 2014.”²

Caterpillar’s May 2014 letters to the Subcommittee and to the SEC disclose that, in December 2013, the company received a “notice of proposed adjustment” from the IRS related to profits from certain “parts transactions” involving CSARL, and that the tax issues were “similar” to those discussed during the Subcommittee hearing. Those statements directly contradict the April 2014 testimony of Caterpillar’s Chief Tax Officer that the IRS had proposed “no adjustments” to the company’s tax liability and “given their blessing” to the company’s offshore tax strategy.

¹ 4/15/2014 letter from SEC to Caterpillar Inc., (Attached), <http://www.sec.gov/Archives/edgar/data/18230/000000000014019060/filename1.pdf>.

² 5/30/2014 letter from Caterpillar Inc. to SEC, (Attached), <https://www.sec.gov/Archives/edgar/data/18230/000000000014019060/filename1.pdf>.



UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

April 15, 2014

Via E-mail

Jananne A. Copeland
Chief Accounting Officer
Caterpillar Inc.
100 NE Adams Street
Peoria, IL 61629

**Re: Caterpillar, Inc.
Form 10-K for the fiscal year ended December 31, 2013
Filed February 18, 2014
File No. 001-00768**

Dear Ms. Copeland:

We have reviewed your filing and have the following comments. We have limited our review of your filing to those issues we have addressed in our comments. In our comments, we may ask you to provide us with information so we may better understand your disclosure.

Please respond to this letter within ten business days by providing the requested information, or by advising us when you will provide the requested response. If you do not believe our comments apply to your facts and circumstances, please tell us why in your response.

After reviewing the information you provide in response to these comments, we may have additional comments.

Form 10-K for the fiscal year ended December 31, 2013

Risk Factors, page 9

Our global operations are subject to extensive trade and anti-corruption laws and regulations, page 16

1. In your letter to us dated May 10, 2011, you discussed contacts with Syria and Sudan. We note that your 2013 Annual Meeting Proxy Statement included shareholder proposals that stated that you do business in Syria and Sudan, and third-party distributors in Syria and Sudan state that they sell your products on their websites. Your Form 10-K does not include disclosure about contacts with Syria or Sudan. As you are aware, Syria and Sudan are designated by the State

Jananne A. Copeland
 Caterpillar Inc.
 April 15, 2014
 Page 2

Department as state sponsors of terrorism, and are subject to U.S. economic sanctions and export controls. Please describe to us the nature and extent of any past, current, and anticipated contacts with Syria and Sudan since your 2011 letter, whether through subsidiaries, affiliates, distributors, resellers or other direct or indirect arrangements.

We also are aware of a 2012 news article reporting that a Ukrainian tractor plant had launched delivery of products to Cuba under an agreement for production of Caterpillar tractors. Cuba is designated by the State Department as a state sponsor of terrorism, and is subject to U.S. asset and export controls. Please provide the same types of information requested above for any contacts with Cuba. Your response should describe any products, equipment, components, technology or services you have provided to Syria, Sudan or Cuba, directly or indirectly, and any agreements, commercial arrangements, or other contacts with the governments of those countries or entities controlled by those governments.

2. Please discuss the materiality of any contacts with Syria, Sudan and Cuba described in response to the foregoing comment, and whether those contacts constitute a material investment risk for your security holders. You should address materiality in quantitative terms, including the approximate dollar amounts of any associated revenues, assets, and liabilities for the last three fiscal years and the subsequent interim period. Also, address materiality in terms of qualitative factors that a reasonable investor would deem important in making an investment decision, including the potential impact of corporate activities upon a company's reputation and share value. As you know, various state and municipal governments, universities, and other investors have proposed or adopted divestment or similar initiatives regarding investment in companies that do business with U.S.-designated state sponsors of terrorism. Your materiality analysis should address the potential impact of the investor sentiment evidenced by such actions directed toward companies that have operations associated with Syria, Sudan and Cuba. In this regard, we refer you again to the shareholder proposals described in the foregoing comment.

Consolidated Financial Statements

Note 5. Income Taxes, page A-28

3. We reference the disclosures on page A-31 related to unrecognized tax benefits and the Notices of Proposed Adjustment from the IRS relating to U.S. taxation of certain non-U.S. operations and foreign tax credits. Please tell us the nature and amount of the proposed IRS adjustments. Please also clarify for us your basis for contesting the adjustments in appeals and tell us how these adjustments were considered in the presentation of unrecognized tax benefits in the table on page A-31.

Jananne A. Copeland
Caterpillar Inc.
April 15, 2014
Page 3

We urge all persons who are responsible for the accuracy and adequacy of the disclosure in the filing to be certain that the filing includes the information the Securities Exchange Act of 1934 and all applicable Exchange Act rules require. Since the company and its management are in possession of all facts relating to a company's disclosure, they are responsible for the accuracy and adequacy of the disclosures they have made.

In responding to our comments, please provide a written statement from the company acknowledging that:

- the company is responsible for the adequacy and accuracy of the disclosure in the filing;
- staff comments or changes to disclosure in response to staff comments do not foreclose the Commission from taking any action with respect to the filing; and
- the company may not assert staff comments as a defense in any proceeding initiated by the Commission or any person under the federal securities laws of the United States.

You may contact Kristin Lochhead, Staff Accountant, at (202) 551-3664 or me at (202) 551-3676 if you have questions regarding comments on the financial statements and related matters. Please contact Martin James, Senior Assistant Chief Accountant, at (202) 551-3671 with any other questions.

Sincerely,

/s/ Brian Cascio

Brian Cascio
Accounting Branch Chief

CORRESP 1 filename1.htm



Caterpillar Inc.
100 NE Adams Street
Peoria, IL 61629-6490

May 30, 2014

VIA EDGAR SUBMISSION

U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549
Attention: Brian Cascio, Accounting Branch Chief

Re: **Caterpillar Inc.**
Form 10-K for the Fiscal Year Ended December 31, 2013
Filed February 18, 2014
File No. 001-768

Ladies and Gentlemen:

Caterpillar Inc. ("Caterpillar") hereby responds to the comments of the staff of the U.S. Securities and Exchange Commission (the "Staff") contained in your letter dated April 15, 2014 (the "Comment Letter") regarding Caterpillar's Annual Report on Form 10-K for the fiscal year ended December 31, 2013 (the "2013 Form 10-K"). For the convenience of the Staff, we have set forth below the comments contained in the Comment Letter followed by Caterpillar's response to each comment.

Form 10-K for the fiscal year ended December 31, 2013

Risk Factors, page 9

Our global operations are subject to extensive trade and anti-corruption laws and regulations, page 16

COMMENT:

1. *In your letter to us dated May 10, 2011, you discussed contacts with Syria and Sudan. We note that your 2013 Annual Meeting Proxy Statement included shareholder proposals that stated that you do business in Syria and Sudan, and third-party distributors in Syria*

U.S. Securities and Exchange Commission
 May 30, 2014
 Page 2

and Sudan state that they sell your products on their websites. Your Form 10-K does not include disclosure about contacts with Syria or Sudan. As you are aware, Syria and Sudan are designated by the State Department as state sponsors of terrorism, and are subject to U.S. economic sanctions and export controls. Please describe to us the nature and extent of any past, current, and anticipated contacts with Syria and Sudan since your 2011 letter, whether through subsidiaries, affiliates, distributors, resellers or other direct or indirect arrangements.

We also are aware of a 2012 news article reporting that a Ukrainian tractor plant had launched delivery of products to Cuba under an agreement for production of Caterpillar tractors. Cuba is designated by the State Department as a state sponsor of terrorism, and is subject to U.S. asset and export controls. Please provide the same types of information requested above for any contacts with Cuba. Your response should describe any products, equipment, components, technology or services you have provided to Syria, Sudan or Cuba, directly or indirectly, and any agreements, commercial arrangements, or other contacts with the governments of those countries or entities controlled by those governments.

CATERPILLAR RESPONSE:

As described in our May 10, 2011 letter (the “2011 Letter”), Caterpillar and its subsidiaries do not have any offices, assets, employees or operations in the Syrian Arab Republic (“Syria”) or the Republic of the Sudan (“Sudan”). Caterpillar and its U.S. subsidiaries do not sell products or services to Syria or Sudan. In addition, Caterpillar has no knowledge of sales by its non-U.S. subsidiaries directly to the governments of Syria or Sudan or entities controlled by those governments.

As outlined in the 2011 Letter, several of Caterpillar's non-U.S. subsidiaries historically have sold products to Syria and Sudan as permitted under U.S. economic sanctions and export controls. Sales made by these non-U.S. subsidiaries — Perkins Engines Co. Ltd. (“Perkins”), Caterpillar (NI) Limited, formerly F.G. Wilson Engineering Ltd. (“Caterpillar NI”) and Caterpillar SARL (“CSARL”) — were made principally to independently-owned and -operated dealers or distributors, who in turn sold or leased products to their own customers.

Syria

Beginning on April 13, 2012, Perkins stopped accepting orders from its Syrian distributor, although its distributor agreement has not been terminated. Beginning on May 21, 2012, Caterpillar NI stopped accepting orders from its Syrian distributor, and does not have an agreement with this distributor. CSARL has not made any sales to its dealer for Syria since the 2011 Letter, although the dealership agreement for Syria remains in place.

U.S. Securities and Exchange Commission
 May 30, 2014
 Page 3

Sudan

On November 7, 2013, Perkins issued a letter of termination to its Sudanese distributor that was effective as of May 6, 2014. On October 23, 2013, Caterpillar NI issued a letter of termination to its Sudanese distributor as amended on December 18, 2013 (together, the "Caterpillar NI Letter of Termination"). Pursuant to the Caterpillar NI Letter of Termination, the last shipment date for generator sets is May 31, 2014; the last shipment date for service parts is June 23, 2014; and the distribution agreement will terminate as of June 23, 2014. Caterpillar NI's termination of its Sudanese distributor permits valid warranty support until April 23, 2016 (provided such warranty support complies with applicable economic sanctions and export controls), after which time Caterpillar NI will no longer provide warranty support for products in Sudan. Although its dealership agreement for Sudan remains in place, CSARL stopped accepting orders from its dealer for Sudan for Caterpillar machines, engines and generator sets as of July 1, 2010 and for service parts as of September 30, 2013. As you know, the Republic of South Sudan became an independent nation on July 9, 2011, and prior to this time in 2011, CSARL sold approximately \$25.4 million of Caterpillar products and service parts to its dealer for the specified areas of Sudan that were exempt from U.S. economic sanctions ("exempt areas").

In the future, Caterpillar or its non-U.S. subsidiaries may accept orders from time to time for products destined for Syria or Sudan consistent with applicable economic sanctions and export controls, primarily for humanitarian purposes and for warranty support as described previously.

In our discussions with the Staff, you stated that the following third-party websites referenced Caterpillar products: "Jalladgroup.com" and "PalestinianTractor.com." M. Ezzat Jallad & Fils S.A. ("Jallad") is CSARL's dealer for Syria, Lebanon, Jordan and the Palestinian Territories. Although Jallad's dealership agreement for Syria remains in place, CSARL has not made sales to Jallad for its Syrian business as stated above. We note that Jallad's website references its historical business in Syria, but we did not locate any information indicating that it has any current or on-going sales. Moreover, the website did not mention Sudan. (See <http://www.jalladgroup.com/en/aboutus/sy.php>) Palestinian Tractor and Equipment Co. Ltd. ("Palestinian Tractor") is an authorized dealer representative for Jallad, and its website references Jallad as Caterpillar's dealer for Syria. (See http://www.palestinian-tractor.ps/ptec/about_comm.asp) However, we did not locate any information on the website relating to sales to Syria or any references to Sudan. In either case, we are not aware of any sales of Caterpillar products to Jallad or Palestinian Tractor for Syria or Sudan that would violate applicable economic sanctions or export controls.

Cuba

With respect to Cuba, Caterpillar and its subsidiaries do not have any offices, assets, employees, operations, dealers or distributors in Cuba. Caterpillar and its subsidiaries do not sell products or services to Cuba. Based on discussions with the Staff, we understand that the referenced news article was from 2013 and related to the Kharkov Tractor Plant. Neither Caterpillar nor its subsidiaries have

any agreements with this facility. Moreover, we do not engage in any direct or indirect tractor manufacturing operations in Ukraine. Based on our review of the article from the

U.S. Securities and Exchange Commission
May 30, 2014
Page 4

original internet site as well as a similar article in Russian, it is our understanding that the term “caterpillar” was not a reference to our company, but rather was intended to differentiate “tracked” or “crawler” style tractors from “wheeled” machines, which were also mentioned in the article.

COMMENT:

2. *Please discuss the materiality of any contacts with Syria, Sudan and Cuba described in response to the foregoing comment, and whether those contacts constitute a material investment risk for your security holders. You should address materiality in quantitative terms, including the approximate dollar amounts of any associated revenues, assets, and liabilities for the last three fiscal years and the subsequent interim period. Also, address materiality in terms of qualitative factors that a reasonable investor would deem important in making an investment decision, including the potential impact of corporate activities upon a company's reputation and share value. As you know, various state and municipal governments, universities, and other investors have proposed or adopted divestment or similar initiatives regarding investment in companies that do business with U.S.-designated state sponsors of terrorism. Your materiality analysis should address the potential impact of the investor sentiment evidenced by such actions directed toward companies that have operations associated with Syria, Sudan and Cuba. In this regard, we refer you again to the shareholder proposals described in the foregoing comment.*

CATERPILLAR RESPONSE:

The activities of Caterpillar's non-U.S. subsidiaries with respect to Sudan, Syria and Cuba are not material and do not constitute a material investment risk for Caterpillar security holders.

In quantitative terms, sales to these countries were and are not material to Caterpillar's operations or results. In 2011, 2012, 2013 and 2014 Q1, Caterpillar had total net sales and revenues of \$60.1 billion, \$65.9 billion, \$55.7 billion and \$13.2 billion, respectively. Sales to Sudan (excluding CSARL sales in 2011 to the exempt areas as described above), Syria and Cuba by Caterpillar's non-U.S. subsidiaries during these same periods, and as a percent of Caterpillar's total net sales and revenues, were estimated to be approximately as follows:

U.S. Securities and Exchange Commission
 May 30, 2014
 Page 5

Net Sales to Sudan, Syria and Cuba
 (USD millions)

	2011	2012	2013	2014 Q1
Sudan	\$25.0	\$16.8	\$12.2	\$1.7
Syria	2.1	0.4	0.3	0.0
Cuba	0.0	0.0	0.0	0.0

Percent of Total Net Sales and Revenues

	2011	2012	2013	2014 Q1
Sudan	0.04%	0.03%	0.02%	0.01%
Syria	0.00%	0.00%	0.00%	0.00%
Cuba	0.00%	0.00%	0.00%	0.00%

From a qualitative perspective, several of Caterpillar's non-U.S. subsidiaries historically have sold products to Syria and Sudan as permitted under U.S. economic sanctions and export controls. However, given the insignificant amounts of products sold, we do not believe a reasonable investor would deem such sales into Sudan or Syria to be qualitatively important in making an investment decision or perceive any reasonable risk to our reputation or share value. To our knowledge, these sales were not made to the governments of Sudan or Syria, and neither Caterpillar nor its subsidiaries have any commercial arrangements with the governments of those countries. Furthermore, based on the types of products which were generally sold by our non-U.S. subsidiaries into Syria or Sudan, the typical applications for those products would be in light industry, agriculture, telecommunications, back-up power or replacement parts rather than the activities addressed by many divestment statutes. As described previously, these non-U.S. subsidiaries have stopped accepting, or in the near future will stop accepting, new orders from their distributors and dealers in Syria and Sudan, and in several cases have terminated, or are in the process of terminating, agreements with their distributors. There were no orders from, or sales to, Cuba.

Caterpillar has considered the various divestment initiatives regarding companies that do business in countries designated as state-sponsors of terrorism. In light of the foregoing, we do not believe that divestment from state governments, universities or other investors is appropriate, or that divestment initiatives would have a material negative impact on investor sentiment.

U.S. Securities and Exchange Commission
 May 30, 2014
 Page 6

Consolidated Financial Statements

Note 5. Income Taxes, page A-28

COMMENT:

3. *We reference the disclosures on page A-31 related to unrecognized tax benefits and the Notices of Proposed Adjustment from the IRS relating to U.S. taxation of certain non-U.S. operations and foreign tax credits. Please tell us the nature and amount of the proposed IRS adjustments. Please also clarify for us your basis for contesting the adjustments in appeals and tell us how these adjustments were considered in the presentation of unrecognized tax benefits in the table on page A-31.*

CATERPILLAR RESPONSE:

Caterpillar is currently under audit in the United States for the years 2007 to 2009, including the impact of a net operating loss carryback to 2005. We disagree with Notices of Proposed Adjustment ("NOPAs") that we received in December 2013 as disclosed in our 10-K for the year ended December 31, 2013 and our Form 10-Q for the quarter ended March 31, 2014.

First, the IRS has raised a substance-over-form argument and proposed to currently tax in the United States profits related to certain parts transactions involving our non-U.S. subsidiary, CSARL. Similar questions related to CSARL's operations were discussed in a hearing held by the U.S. Senate's Permanent Subcommittee on Investigations on April 1, 2014. Our basis for contesting these adjustments is that we believe that the relevant transactions complied with all applicable provisions of the U.S. Internal Revenue Code and regulations and did not violate any applicable judicial doctrines, including the substance-over-form and economic substance doctrines as they have been developed under the relevant case law. We strongly believe that CSARL's profits on purchases from, and sales to, unrelated parties are not subject to current U.S. tax. The purchase of parts by CSARL from unrelated parties and the subsequent sale of those parts to unrelated dealers outside the United States have substantial legal, commercial and economic consequences for the parties involved. CSARL (including its predecessor entity) has built, grown and maintained marketing and sales relationships with dealers and customers in foreign markets since the 1960s.

During the taxable years at issue, CSARL contracted with the unrelated suppliers and unrelated dealers. CSARL obtained title to the parts and assumed the typical range of inventory risks assumed by purchasers in commercial transactions. Related parties provided logistical and other services to CSARL in connection with the purchase, warehousing and distribution of the parts in return for a service fee. CSARL also licensed relevant intangible property relating to these products in return for a sales-based royalty. CSARL employees directly interacted with non-U.S. dealers and had primary responsibility for maintaining and growing the dealer network outside the United States. Under these circumstances, we believe the tax law respects CSARL as buying from, and selling to, unrelated

parties, transactions that are not subject to current U.S. tax. Our position was confirmed in writing by our external tax advisors.

U.S. Securities and Exchange Commission
May 30, 2014
Page 7

Additionally, the IRS issued an incomplete, unsigned NOPA proposing to disallow foreign tax credits that arose as a result of certain financings unrelated to CSARL. With that NOPA, the IRS did not provide a technical explanation of their legal rationale for disallowing the foreign tax credits. Although at the time we received this NOPA there was no legal rationale provided, we determined that we would contest this proposed adjustment based on our view that Caterpillar has fully complied with all applicable tax law requirements during the years in which the transactions generating the foreign tax credits at issue occurred.

We note that the IRS did not propose adjustments in these two areas in its previous audits of our U.S. tax returns in which the same tax positions were taken, even after extensive information related to these positions was provided to the IRS. We continue to believe that it is at least more likely than not that both these positions can be sustained based on the technical merits. As of December 31, 2013, our analysis of the largest amount of tax benefit that was more likely than not to be sustained was consistent with our evaluation in prior years. Therefore, the receipt of the NOPAs in December 2013 did not result in a change in our unrecognized tax benefits or the presentation on page A-31 of our 2013 Form 10-K.

In general, a NOPA is used by the IRS to communicate a potential adjustment, but it is not a final tax assessment. Legal theories and calculations provided by the IRS in support of a NOPA are not always fully developed and do not necessarily reflect final conclusions on the part of the IRS examination team. Historically, the IRS and Caterpillar have spent several months agreeing on the inputs and gathering the data for calculations necessary to support the total cash tax impact included in the Revenue Agent's Report ("RAR") issued at the end of the field examination. We expect these calculations will be complete and to receive an RAR in the next twelve months. To the extent that adjustments are assessed upon completion of the field examination relating to these matters, we would vigorously contest the adjustments in appeals. The appeals process can take years to reach resolution and, depending on the outcome, may be followed by a lengthy litigation process.

Please note that we updated the tax disclosure in our Form 10-Q for the quarter ended March 31, 2014 to clarify that the NOPAs related to profits earned by CSARL from certain parts transactions and to the disallowance of foreign tax credits incurred in connection with unrelated financings. In addition, on May 13, 2014, we received a signed NOPA with technical explanation related to the IRS's position on the financing transactions that were subject to the prior unsigned, incomplete NOPA received without a technical explanation in December 2013. We are currently evaluating this NOPA.

* * * * *

Caterpillar hereby acknowledges that:

- Caterpillar is responsible for the adequacy and accuracy of the disclosures it has made in its filings, including the 2013 Form 10-K;
- Staff comments or changes to disclosure in response to Staff comments do not foreclose the Commission from taking any action with respect to Caterpillar's filings; and

U.S. Securities and Exchange Commission
May 30, 2014
Page 8

- Caterpillar may not assert Staff comments as a defense in any proceeding initiated by the Commission or any person under the federal securities laws of the United States.

If you need any further information, please contact Jananne A. Copeland, Chief Accounting Officer by phone at (309) 675-4437 or by email at Copeland_Janie_A@Cat.com or Nick G. Holcombe, Senior Corporate Securities Counsel and Assistant Corporate Secretary by phone at (309) 675-1898 or by email at Holcombe_Nick_G@Cat.com.

Sincerely,

CATERPILLAR INC.

By: /s/ Jananne A. Copeland
Jananne A. Copeland
Chief Accounting Officer

Hearing On
Caterpillar's Offshore Tax Strategy

April 1, 2014

EXHIBIT #57:

Document Locator List and documents cited in footnotes to *Caterpillar's Offshore Tax Strategy*, the Report released in conjunction with the Subcommittee hearing on April 1, 2014. The *Document Locator List* provides the bates numbers of the documents cited in the Report and the hearing record page number where the document can be located. Not included are documents related to Subcommittee interviews, which are not available to the public, and widely available public documents.

REPORT DOCUMENT LOCATOR LIST
Caterpillar's Offshore Tax Strategy

Bates Number	Page Number
CAT-000001-065	654
CAT-000075-077	665
CAT-0002265 (Printed as Exhibit 50e)	575
CAT-000267-269 (Printed as Exhibit 50a)	560
CAT-000270, 273-275, 278, 281-294	668
CAT-000276-277, 279-280, 295-298 (Printed as Exhibit 50b)	563
CAT-000299	684
CAT-000300-302 (Printed as Exhibit 50c)	571
CAT-000306-318 (Printed as Exhibit 51)	576
CAT-000653-663 (Printed as Exhibit 52)	589
CAT-001855-858, 860, 863-864 (Printed as Exhibit 18)	411
CAT-001866 (Printed as Exhibit 50d)	574
CAT-001885-889, 891-898 (Printed as Exhibit 20)	420
CAT-001899, 905-906, 912, 920, 934-935 (Printed as Exhibit 15)	390
CAT-001949-952, 954, 956-965 (Printed as Exhibit 26)	455
CAT-002087, 090-098, 102 (Printed as Exhibit 29)	472
PSI-Caterpillar-04-000002-009 (Printed as Exhibit 47)	548
PSI-Caterpillar-14-000001-010	685
PSI-Caterpillar-17-000003-023	695
PSI-PWC-22-000001-003 (Printed as Exhibit 2)	284
PSI-TWLF-02-000349-352 (Printed as Exhibit 39)	508
PSI-TWLF-02-000368	716
PSI-TWLF-02-000369-379	717
PSI-TWLF-02-000387-392	723
PSI-TWLF-02-000422-436 (Printed as Exhibit 3)	287
PSI-TWLF-02-000469	729
PSI-TWLF-02-001208-222	730
PSI-TWLF-02-001393-396 (Printed as Exhibit 38)	504
PSI-TWLF-02-001625-628	745
PSI-TWLF-04-000004	749
PSI-TWLF-04-000039	750
PSI-TWLF-04-000040-073	751
PSI-TWLF-04-000076-077	763
PSI-TWLF-04-000078 (Printed as Exhibit 23)	449
PSI-TWLF-04-000089 (Printed as Exhibit 24)	450
PSI-TWLF-04-000091-097	765
PSI-TWLF-04-000127 (Printed as Exhibit 28)	471
PSI-TWLF-04-000128	772
PSI-TWLF-04-000341-344	773

REPORT DOCUMENT LOCATOR LIST
Caterpillar's Offshore Tax Strategy

Bates Number	Page Number
PSI-TWLF-04-000345-346	777
PSI-TWLF-04-000356-357	779
PSI-TWLF-04-000358-359	781
PSI-TWLF-04-000368 (Printed as Exhibit 27)	470
PSI-TWLF-04-000381 (Printed as Exhibit 25d)	454
PSI-TWLF-04-000382 (Printed as Exhibit 25a)	451
PSI-TWLF-04-000383 (Printed as Exhibit 25b)	452
PSI-TWLF-04-000384 (Printed as Exhibit 25c)	453
PSI-TWLF-07-000022 (Printed as Exhibit 40)	512
PSI-TWLF-10-000004, 110-112, 116-126	783
PSI-TWLF-10-000004, 113-115 (Printed as Exhibit 34)	493
PSI-TWLF-10-000172-174 (Printed as Exhibit 49)	557
PSI-TWLF-11-000008, 069-075, 112, 115, 224-227	794
PSI-TWLF-11-000008, 113-114 (Printed as Exhibit 32)	487
PSI-TWLF-12-000008, 177-178 (Printed as Exhibit 33)	490
PSI-TWLF-12-000008-031, 034-040, 118-123, 169-176, 179-182, 273-276	808
PSI-TWLF-12-000315-316 (Printed as Exhibit 36)	500
PSI-TWLF-15-000007, 017-018 (Printed as Exhibit 35)	497
PSI-TWLF-16-000114-124	847
PSI-TWLF-16-000167-180 (Printed as Exhibit 22)	435
PSI-TWLF-16-000188-194	856
PSI-TWLF-16-000214	863
PSI-TWLF-16-000215-220	864
PSI-TWLF-16-000262-263	870
PSI-TWLF-16-000330	872
PSI-TWLF-19-000001, 019-020, 090-097	873
PSI-TWLF-21-000001, 227-231	883
PSI-TWLF-34-000002-057	890
PSI-TWLF-35-000004	945
PSI-TWLF-36-000002	946
PwC_PSI_CAT_00001336, 338, 341-342, 344-346, 362, 386,408-409, 411-415 (Printed as Exhibit 9)	350
PwC_PSI_CAT_00002152-164	947
PwC_PSI_CAT_00003406-410, 412-463	956
PwC_PSI_CAT_00003411 (Printed as Exhibit 48)	556
PwC_PSI_CAT_00003830, 833-846, 849-854, 856-870, 872-875	1004

REPORT DOCUMENT LOCATOR LIST
Caterpillar's Offshore Tax Strategy

Bates Number	Page Number
PwC_PSI_CAT_00003830-832, 847-848, 855, 871 (Printed as Exhibit 43)	529
PwC_PSI_CAT_00003876, 906-907 (Printed as Exhibit 45)	542
PwC_PSI_CAT_00003876-877, 881-883, 887-893, 904-905, 908-913	1044
PwC_PSI_CAT_00004349, 365 (Printed as Exhibit 11)	370
PwC_PSI_CAT_00004483, 508-509 (Printed as Exhibit 10)	367
PwC_PSI_CAT_00004483-507, 510-530	1064
PwC_PSI_CAT_00004548, 550-552 (Printed as Exhibit 8)	346
PwC_PSI_CAT_00004548-549, 553-565	1108
PwC_PSI_CAT_00004566, 618-619 (Printed as Exhibit 7)	343
PwC_PSI_CAT_00004632, 636, 640, 646, 674-675 (Printed as Exhibit 6)	337
PwC_PSI_CAT_00004799-827	1115
PwC_PSI_CAT_00004892, 895	1136
PwC_PSI_CAT_00004975, 5008-009, 027-033 (Printed as Exhibit 5)	327
PwC_PSI_CAT_00005163, 211-214	1138
PwC_PSI_CAT_00006338-341 (Printed as Exhibit 41)	513
PwC_PSI_CAT_00007157, 201-202	1143
PwC_PSI_CAT_00007795, 797, 815-820	1146
PwC_PSI_CAT_00008634, 672-674, 684-687, 698-699 (Printed as Exhibit 4a)	302
PwC_PSI_CAT_00008881, 916-922	1154
PwC_PSI_CAT_00008881, 929-932, 958-959, 963 (Printed as Exhibit 4b)	312
PwC_PSI_CAT_00008958-960	1162
PwC_PSI_CAT_00009105, 155-156 (Printed as Exhibit 4c)	320
PwC_PSI_CAT_00009339, 392-394 (Printed as Exhibit 4d)	323
PwC_PSI_CAT_00009613, 674-676	1165
PwC_PSI_CAT_00011180-182	1169
PwC_PSI_CAT_00015198, 218-221	1172
PwC_PSI_CAT_00024439-440 (Printed as Exhibit 19)	418
PwC_PSI_CAT_00024791-808	1177
PwC_PSI_CAT_00028030, 085	1187
PwC_PSI_CAT_00033157-159 (Printed as Exhibit 46)	545
PwC_PSI_CAT_00033229-232	1189
PwC_PSI_CAT_00033241-252 (Printed as Exhibit 42)	517

REPORT DOCUMENT LOCATOR LIST
Caterpillar's Offshore Tax Strategy

Bates Number	Page Number
PwC_PSI_CAT_00036773-791	1193
PwC_PSI_CAT_00058419, 429, 449-452 (Printed as Exhibit 16)	397
PwC_PSI_CAT_00058419, 446-447	1212
PwC_PSI_CAT_00060748-749	1215
PwC_PSI_CAT_00063338-341 (Printed as Exhibit 41)	513
PwC_PSI_CAT_00065585, 589 (Printed as Exhibit 37)	502
PwC_PSI_CAT_00093980-981	1217
PwC_PSI_CAT_00122483-484 (Printed as Exhibit 12)	372
PwC_PSI_CAT_00132905-909	1219
PwC_PSI_CAT_00133088-115	1224
PwC_PSI_CAT_00133120-126	1227
PwC_PSI_CAT_00133127, 129, 148, 164	1232
PwC_PSI_CAT_00142353-367 (Printed as Exhibit 13)	374
PwC_PSI_CAT_00150469 (Printed as Exhibit 14)	389
PwC_PSI_CAT_00150470	1236
PwC_PSI_CAT_00169827-838	1237
PwC_PSI_CAT_00179035-036 (Printed as Exhibit 31)	485
PwC_PSI_CAT_00179037-038 (Printed as Exhibit 30)	483
PwC_PSI_CAT_00194435-436	1249
PwC_PSI_CAT_00199585-862 (Printed as Exhibit 53)	600
PwC_PSI_CAT_00204970-974	1251
PwC_PSI_CAT_00205974, 982	1256
PwC_PSI_CAT_00205974-979, 984-985 (Printed as Exhibit 17)	403
PwC_PSI_CAT_00206146-149	1258
PwC_PSI_CAT_00213059-064 (Printed as Exhibit 44)	536
PwC_PSI_CAT_00224683-686	1262

August 14, 2013

*** CONFIDENTIAL—CONTAINS PROPRIETARY INFORMATION***

Response of Caterpillar Inc. to Inquiry Relating to Treatment and Use of Offshore Funds

This document sets forth Caterpillar Inc.'s ("Caterpillar" or the "Company") responses to Questions 1-5, 7-8, 9a, 9b, 9c and 9e contained in the letter to Caterpillar Inc. dated July 12, 2013.

Caterpillar requests confidential treatment of this response, as it contains Company confidential and proprietary information, the release of which would damage Caterpillar and potentially assist its competitors, particularly its non-U.S. competitors such as Komatsu, Hitachi, Sany, and Volvo.

Company Overview and Background

For more than 85 years, Caterpillar has been making sustainable progress possible by driving positive change on every continent in the world. With 2012 sales and revenues of approximately \$65.9 billion, Caterpillar is the world's leading manufacturer of construction and mining equipment, diesel and natural gas engines, industrial gas turbines, and diesel-electric locomotives. The Company also is a leading services provider through Caterpillar Financial Services, Caterpillar Remanufacturing Services, and Progress Rail Services.

The Company provides more than 300 products available to customers in approximately 180 countries around the world. As a result, Caterpillar is a leading exporter from the United States, with \$22.8 billion of export sales in 2012. In support of the provision of products to global customers, Caterpillar has facilities on six continents around the world.

To understand Caterpillar, it is important to know the background of its international expansion and operations. Caterpillar has exported products since the 1920s. This early international focus helped Caterpillar supply products to meet worldwide demand for construction, earthmoving, mining, and agricultural equipment.

After World War II, there was a worldwide need for construction and road building equipment due to massive rebuilding campaigns in Europe and Japan, as well as pent up U.S. demand for peacetime needs. The post-war demand for new housing, highways, dams, pipelines and other construction required an unprecedented scale of mechanized construction, which supported Caterpillar's expansion around the globe. By the late 1940s, exports averaged about 20 percent of Caterpillar's sales.

In the post-war period, Caterpillar began establishing numerous independent dealerships to sell and service its products overseas. Caterpillar's strong global distribution system and dealer network was one of its major competitive advantages in the second half of the twentieth century. By the early 1950s, there were almost 800 Caterpillar dealer outlets around the world.

Since at least 1960, Caterpillar's primary non-U.S. marketing center has been located in Switzerland, effectively becoming one of Caterpillar's largest non-U.S. headquarters. Caterpillar has long maintained a significant footprint in Switzerland (currently having over 400 Swiss-based personnel), and Caterpillar's Swiss-based managers have played a leading role in Caterpillar's international expansion over a period spanning several decades.

CAT-000001

CONFIDENTIAL & PROPRIETARY

August 14, 2013

As the Asia Pacific market developed, shortly after establishing its Swiss headquarters operations, Caterpillar developed a similar regional center in Hong Kong. The Hong Kong headquarters was later relocated to Singapore and currently is the site of Caterpillar's Asia-Pacific aftermarket distribution center and remanufacturing facility. Singapore is currently home to approximately 400 employees, including a Caterpillar executive office member.

In 2012, the Company spent \$2.5 billion on R&D, with the concentration of that expenditure in the U.S. Further, in 2012, the Company invested approximately \$3.4 billion in property, plant, and equipment around the globe.

In 2012, Caterpillar employed more than 125,000 people around the world, and nearly 55,000 of these employees lived and worked in the United States. For the years ending 2010, 2011, and 2012, Caterpillar wages accounted for approximately \$1.4 billion, \$1.7 billion, and \$1.9 billion, respectively, in U.S. Federal, state, and local employment taxes.

Caterpillar has substantial domestic operations resulting in significant and growing amounts it pays in U.S. Federal, state, and local income taxes, as well as, property, sales, and use taxes. For the years 2010, 2011, and 2012, Caterpillar paid approximately \$27 million, \$500 million, and \$1.2 billion (estimated), respectively, in U.S. Federal income taxes, and approximately \$188 million, \$208 million, and \$220 million (estimated), respectively, in combined state and local income taxes, property taxes, and sales and use taxes.

The effective tax rates (excluding discrete items) for the fiscal years ending 2010, 2011, and 2012, included in the consolidated financial statements of Caterpillar, were 25 percent, 26.5 percent, and 30.5 percent, respectively.

Caterpillar's Responses to Questions 1-5, 7-8, 9a, 9c, and 9e

1. Please provide your corporate legal name and address and the name, address, telephone number and e-mail address of the individual who will serve as our primary contact and who can answer questions about your questionnaire responses.

Caterpillar Inc.
100 N.E. Adams Street
Peoria, IL 61629

Stephen M. Ryan
McDermott Will & Emery LLP
500 North Capitol Street, N.W.
Washington, DC 20001
tel: +1 202 756 8333
email: sryan@mwe.com

CONFIDENTIAL & PROPRIETARY

August 14, 2013

2. Please provide an organizational chart depicting your company's worldwide legal and operational structure, including related offshore entities. In addition, please identify all of your company's offshore headquarters and please indicate the owners and approximate ownership interest of each entity.

The worldwide legal organization charts are included in the enclosed document titled "Caterpillar Inc., its Subsidiaries and Affiliates Corporate Ownership Structure" ("Organization Chart").

There are several locations outside the United States where headquarters are maintained that perform significant strategic management, marketing, administrative and /or operating functions. These headquarters are maintained in Geneva, Switzerland; Singapore, Republic of Singapore; Beijing, China; Peterborough, United Kingdom; Kiel, Germany; and Mannheim, Germany. These functions are carried out through the following entities:

Entity Maintaining Offshore Headquarters	Location of Offshore Headquarters
Caterpillar S.A.R.L.	Geneva, Switzerland
Caterpillar S.A.R.L., Singapore Branch	Singapore, Republic of Singapore
Caterpillar (China) Investment Co. Ltd.	Beijing, China
Perkins Engines Company Limited	Peterborough, United Kingdom
Caterpillar Motoren GmbH & Co. KG	Kiel, Germany
MWM GmbH	Mannheim, Germany

Note that we have included locations that host strategic management or have large dealer networks separate from the historic Caterpillar dealer networks, including in Peterborough, United Kingdom, Kiel, Germany, and Mannheim, Germany. There may be smaller operational locations that might be considered to be headquarters for certain products or lines of business, but the Company does not consider those locations as headquarters as they are not significant to Caterpillar's operations overall. We also have large operations in Piracicaba, Brazil and Tokyo, Japan, which were not included as they are primarily engaged in performing contract manufacturing for headquarter locations.

The owners and approximate ownership interests of each of these entities are reflected on the Organization Chart. These entities are highlighted on the Organization Chart, with the exception of Caterpillar S.A.R.L., Singapore Branch, which is a branch of Caterpillar S.A.R.L. and not a separate legal entity reflected on the Organization Chart.

CONFIDENTIAL & PROPRIETARY

August 14, 2013

3. Please provide the following information:

- a. "Total Income" and "Taxable Income" reported on your company's U.S. tax returns filed in 2010, 2011, and 2012;
- b. "Total Income" and "Provision for Income Taxes" provided on your financial statements for the period described above;
- c. If there is a difference for this requested information on your federal tax return and on your financial statements, please describe the reason for such differences; and
- d. The amount of U.S. tax paid, taking into account, as necessary, any net operating losses or carry backs (line 31 of Form 1120).

For 2010 and 2011, the "total income" and "taxable income" reflected on the U.S. Federal income tax return and amount of U.S. tax paid are set forth in the schedule below. For 2012, these amounts will be provided in the third set of responses on September 30, 2013.

	2010	2011	
3a - Total Income	14,726,214,228	18,800,139,858	
3a - Taxable Income	1,193,370,557	4,096,976,386	*
3d - US Tax Paid	27,065,173	499,549,377	^

* Line 30 of Form 1120 (After NOL and Special Deductions) - See Below for Detail

^ Line 31 of Form 1120

3a - Taxable Income Detail

	2010	2011
Line 28 Before NOL / Special Deductions	3,244,132,193	4,965,134,207
Line 29a NOL Deduction	(49,609,547)	(102,228,073)
Line 29b Special Deductions	(2,001,152,089)	(765,929,748)
Line 30 Taxable Income	<u>1,193,370,557</u>	<u>4,096,976,386</u>

The "Total Income" and "Provision for Income Taxes" as shown on the Caterpillar Inc. consolidated financial statements are as follows (in millions):

	2012	2011	2010
Provision (benefit) for income taxes	2,528	1,720	968
Profit	5,681	4,928	2,700

**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

CONFIDENTIAL & PROPRIETARY

August 14, 2013

4. What percentage of your company's world-wide payroll expenses and what percentage of headcount were attributed to employees and independent contractors in the U.S.?

The percentage of payroll expenses and headcount attributed to employees in the U.S. is as follows:

	2012	2011	2010
Percentage of payroll expenses	56%	57%	59%
Percentage of headcount	44%	43%	45%

Caterpillar utilizes agencies to provide a flexible workforce but does not typically use independent contractors as a general business practice.

5. What percentage of your company's world-wide payroll expenses and percentage of head count were attributed to employees and independent contractors outside of the U.S.?

The percentage of payroll expenses and headcount attributed to employees outside of the U.S. is as follows:

	2012	2011	2010
Percentage of payroll expenses	44%	43%	41%
Percentage of headcount	56%	57%	55%

Caterpillar utilizes agencies to provide a flexible workforce but does not typically use independent contractors as a general business practice.

7. Please provide the total amount of undistributed accumulated foreign earnings and the percentage that such earnings represent of total assets as shown in your financial statements. Please identify the total amount of these earnings held in cash, cash equivalents, or other short term investments, and the total amount of these earnings held in U.S. financial institutions.

The total amounts of undistributed accumulated foreign earnings for 2012, 2011 and 2010 were approximately \$20 billion, \$17 billion, and \$14 billion, respectively. These earnings represent approximately 22 percent of total assets as shown in our financial statements. The total amount of cash, cash equivalents, and other short term investments held by all non-U.S. subsidiaries was about \$2 billion at the end of 2012, 2011, and 2010 with less than 1 percent of this held in U.S. financial institutions.

8. Please identify the total amount of U.S. cash, cash equivalents, and short term investments held by your company, and please identify what percentage of those assets are held in total by non-U.S. subsidiaries.

The total amounts of cash, cash equivalents, and other short term investments held in the U.S. at the end of 2012, 2011, and 2010 were about \$3 billion, \$1 billion, and \$1 billion, respectively. In total, less than 1 percent of these assets were held by non-U.S. subsidiaries.

CONFIDENTIAL & PROPRIETARY
August 14, 2013

9. Please provide the following information for each non-U.S. subsidiary:

- a. the legal name and address of the subsidiary;**
- b. whether the subsidiary is a controlled foreign corporation (CFC), and if so, identify the entity that controls it and the jurisdiction of the controlling entity;**
- c. the date on which the subsidiary was formed, the jurisdiction where it was formed, the jurisdiction where its headquarters are located, and the jurisdiction where it is resident for tax purposes;**
- e. the nature of the business performed by the subsidiary including a description of the subsidiary's functions, operations, and facilities;**

The attached schedule titled "Non-U.S. Subsidiaries (As of July 31, 2013)" provides the legal name, address, jurisdiction of organization, incorporation date and purpose of the business of each non-U.S. subsidiary. This information was imported from the Company's legal entity corporate data sheets. Although Caterpillar believes this information is materially up to date, accurate and complete, there may be instances in which it is not. In particular, note that the description of the purpose of the business varies in level of description, at times setting forth a full description of the subsidiary's functions, operations, and facilities, while in certain instances not including all of this information. Please let us know if any of the information that you would like to see is missing from the description, and we will obtain the necessary information.

The last two columns of this schedule state where the subsidiary is a resident for tax purposes and whether the subsidiary is a controlled foreign corporation (CFC).

**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

[illegible]

Redacted By
Permanent Subcommittee on Investigations

Redacted By
Permanent Subcommittee on Investigations

Country	Company Name	Address	City	State	Zip	Telephone	Facsimile	Internet	Other
China	Caterpillar (China) Co., Ltd.	Room 201, No. 100, Zhongyuan Road	Beijing		100045	86-10-64606000	86-10-64606001	http://www.caterpillar.com.cn	
India	Caterpillar India Pvt. Ltd.	Plot No. 1, Sector 18, Faridkot	Faridkot		145001	91-183-2611111	91-183-2611112	http://www.caterpillar.co.in	
Japan	Caterpillar (Japan) Co., Ltd.	1-1-1, Higashi-Shinjuku	Shinjuku		162-8502	81-3-3346-1111	81-3-3346-1112	http://www.caterpillar.co.jp	
South Korea	Caterpillar Korea Co., Ltd.	10F, 100, Seongnam-daero	Seongnam		461-710	82-31-270-1111	82-31-270-1112	http://www.caterpillar.co.kr	
Taiwan	Caterpillar (Taiwan) Co., Ltd.	Room 201, No. 100, Zhongyuan Road	Beijing		100045	86-10-64606000	86-10-64606001	http://www.caterpillar.com.cn	
Thailand	Caterpillar (Thailand) Co., Ltd.	10F, 100, Seongnam-daero	Seongnam		461-710	82-31-270-1111	82-31-270-1112	http://www.caterpillar.co.kr	
United Kingdom	Caterpillar (UK) Ltd.	10F, 100, Seongnam-daero	Seongnam		461-710	82-31-270-1111	82-31-270-1112	http://www.caterpillar.co.kr	
United States	Caterpillar Inc.	100 N. Zeeb Road	Peoria	IL	61659	1-815-241-1111	1-815-241-1112	http://www.caterpillar.com	

Redacted By
Permanent Subcommittee on Investigations

Redacted By
Permanent Subcommittee on Investigations

**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

CONFIDENTIAL & PROPRIETARY
August 30, 2013

15. For every United States tax position reflected in your total unrecognized tax benefit for the period that involved foreign entities or jurisdictions, including by not limited to APB-23, please provide the following information:

- a. Identify or describe the tax position and the tax period to which it relates;
- b. State how much of the total unrecognized tax benefit is based on this item; and
- c. State what foreign entity(ies) or jurisdiction(s) are involved with this item.

Set forth below is a schedule providing a description of the unrecognized tax benefit items attributable to each of the years that involved foreign entities or jurisdictions, indicating the entity(ies) or jurisdiction(s) that are involved with respect to the item. The schedule reflects the percentage that the described unrecognized tax benefit bears to the total unrecognized tax benefit attributable to each respective year.

	% of Total UTB Related to 2010	% of Total UTB Related to 2011	% of Total UTB Related to 2012
1. A complex partnership structure governed under Section 704 has interrelated elements including earnings allocations that affect Section 951 calculations and Section 482 transfer pricing. This uncertainty relates to Caterpillar S.A.R.L.	19%	13%	33%

Redacted By
Permanent Subcommittee on Investigations

16. Please list and describe all reported uncertain tax positions as identified in your Form 1120 Schedule UTP filed in 2010 through 2012.

Please find attached Form 1120, Schedules UTP for tax years 2010 and 2011. For 2012, this information will be provided in the third set of responses on September 30, 2013.

Redacted by the Permanent Subcommittee on Investigations

CONFIDENTIAL & PROPRIETARY
August 30, 2013

17. For the fiscal years 2010, 2011, and 2012, please provide a breakdown of any research and development expenses attributed to each of the top 5 entities undertaking such activity. In addition, please provide the annual amounts of any research and development tax credits or deductions recorded in the United States during the same period.

The top five legal entities ranked by size of research and development expenses incurred in 2012, 2011, and 2010 are listed below along with the amount incurred in each year:

(All amounts in millions of USD)	2012	2011	2010
Caterpillar Inc.	1,604	1,595	1,383
Caterpillar SARL	172	184	173
[REDACTED]	94	98	86
[REDACTED]	80	63	
[REDACTED]	70	55	44
[REDACTED]			33

The research and development tax credits and deductions reported on the Form 1120 for 2010 and 2011 are listed below. For 2012, this information will be provided in the third set of responses on September 30, 2013.

	2010	2011	
R&D Tax Credits	77,244,586	93,092,284	#
R&D Deductions	2,447,658,554	3,083,566,171	

Note, \$13,538,363 of 2010 R&D Credit is a carryover from 2009

**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

December 3, 2013

*** CONFIDENTIAL--CONTAINS PROPRIETARY INFORMATION***

Response of Caterpillar Inc. to Inquiry Relating to Treatment and Use of Offshore Funds

This document sets forth Caterpillar Inc.'s ("Caterpillar" or the "Company") responses to Questions 2, 3, 5, 7-11, 13-15 and 18 contained in the questionnaire dated October 15, 2013. The response for Question 12 will be provided as soon as it is available.

Caterpillar requests confidential treatment of this response, as it contains Company confidential and proprietary information, the release of which would damage Caterpillar and potentially assist its competitors, particularly its non-U.S. competitors such as Komatsu, Hitachi, Sany, and Volvo.

Throughout the questionnaire, there are references to a "purchased finished replacement part business" or "PFRP business". However, as previously communicated to the PSI, the Company does not manage revenue or profit from parts as a separate business. Rather, parts are managed as an integral part of each segment. We interpret these references to exclude any inference that purchase and / or sale of purchased finished replacement parts or PFRP constitutes a separate business.

Caterpillar's Responses to Questions 2, 3, 5, 7-11, 13-15 and 18

2. **Please provide consolidating financial information for CAT's subsidiary known as CSARL for each of the years 1999 through 2009.**

Set forth below is the consolidated financial information for the group consisting of CSARL and its disregarded entities for U.S. Federal tax purposes for each of the years 1999-2009. Please note that these schedules reflect the consolidated financial information for U.S. tax purposes by eliminating the gross amount of all intra-group transactions for all entities in the group in the "Eliminations" column. These schedules do not reflect eliminations of intra-group balance sheet items, such as intra-group receivables.

Note that the large difference in the Net Sales eliminations between 2007 and 2008 is attributable to the fact that Caterpillar Americas C.V. and Caterpillar North America C.V. are separate disregarded entities in 2007, but are included in the "CSARL Stand Alone" column for 2008 forward.

Redacted By
Permanent Subcommittee on Investigations

CAT-000270

**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

CONFIDENTIAL & PROPRIETARY
December 3, 2013

Redacted By
Permanent Subcommittee on Investigations

3. For COSA and CSARL, for each of the years 1999 through 2012, please provide (a) the total amount of Swiss taxable income, (b) the total amount of Swiss tax paid (national and cantonal), (c) the total amount of Subpart F income, (d) the total amount of US tax paid, (e) the total amount of taxable income reported to any other country, and (f) the amount of tax actually paid to any other country.

The requested information is set forth in the chart below.

Redacted By
Permanent Subcommittee on Investigations

CONFIDENTIAL & PROPRIETARY
December 3, 2013

8. Please provide the portion of CAT's global profit before tax that was attributable to its PFRP business for each year from 1995 through 2012.

Reportable segment profitability is determined based on revenue and costs managed by each segment. Replacement parts are managed as an integral part of each segment. Caterpillar does not determine global profit before tax for PFRP. However, Caterpillar performs an internal calculation to determine certain elements of parts profit strictly for the purpose of assigning parts profit to relevant machine and engine business segments. This calculation is performed based on parts sales for CAT branded business only and is not a determination of profit before tax ("PBT") for parts sales.

The table below contain these amounts for the period 2006 – 2012. Caterpillar does not have these records for years prior to 2006. This calculation differs substantially from a PBT calculation of global parts profits. Significant costs such as research & development ("R&D") are not included in this determination. Some costs that are not directly related to parts profit are included in this determination.

These calculations are subject to certain limitations. The following are important factors to note related to this calculation:

- There is no breakdown between PFRP and "worked" (Caterpillar manufactured) parts.
- There is no breakdown by legal entity. Machine and engine business units span many legal entities both within and without the United States.
- "Costs" included in determining these calculations are accumulated from global sources.
- These calculations are only for the CAT branded portion of the Caterpillar business (i.e., non-CAT branded products are not included in the calculations).
- These calculations do not include R&D expense as this expense has already been included in the machine and engine business unit accountable profit calculations. Caterpillar does not separately determine R&D for parts.
- These calculations do not include cost allocations related to assets employed (e.g., there is no allocation of cost related to storage warehouse and other logistics assets).
- These calculations include expenses related to customer service support, a function that is not a direct cost and would not be included in a PBT calculation.

Internal Calculations for Allocating Certain Elements of Parts Profit (\$Billions)						
2006	2007	2008	2009	2010	2011	2012

9. With regard to the replacement parts business, for each year from 1997 through 1999, please provide the following information:

- The percentage of your company's worldwide headcount and payroll assigned to the PFRP business and located in the United States, and
- The percentage of your company's worldwide headcount and payroll assigned to the PFRP business and located in Switzerland.

This requested information is not available for years 1997 through 1999.

CONFIDENTIAL & PROPRIETARY
December 3, 2013

13. In its September 23, 2013 letter, Caterpillar stated:

“In connection with the restructuring, there has been substantial movement of personnel with significant responsibilities within, and to, Switzerland including: (i) the promotion of a Vice-President as a new Group President responsible for all of EAME operations, (ii) the movement of several Product Managers to Switzerland, and (iii) the appointment of a Parts Purchasing Manager in Switzerland. Further, the Worldwide Parts Manager was later located in Switzerland together with a newly appointed Vice-President in Singapore.”

Please provide a chronology of the personnel changes described above, as well as the dates and descriptions of any other important changes in PFRP-related business operations or facilities following the creation of CSARL. This description should include the names of individuals and a description of their job responsibilities, any differences in business operations, purchasing systems, and employee headcount and function between CSARL and COSA, and include the date that CSARL made such changes.

In 1999 and in the early 2000s, CSARL engaged in an overall plan of restructuring involving a series of steps that included a change to the supply chain of parts, engines and machines. Effective September 1, 1999, Caterpillar granted CSARL the right to have made and/or purchase replacement parts in exchange for a royalty payment from CSARL. CSARL assumed all rights and obligations (liabilities) of the existing contracts and purchase orders for replacement parts concluded or issued by Caterpillar.

In October 2000, Caterpillar announced its intent to restructure its EAME operations in order to combine the manufacturing and marketing operations. The restructuring was proposed to address the challenges Caterpillar was facing in the EAME region that included pricing pressure, increased and intensifying competition with global alliances, significant material cost increases, and difficulty improving EAME market share. These changes were necessary to better position Caterpillar for long-term success and were intended to provide increased focus between the manufacturing operations and marketing companies to facilitate better single-point accountability for the EAME region.

Prior to December 1, 2000, the following individuals performed the listed roles/functions in the entity(ies) indicated:

Name	Role/Function	Location/Company
Gerard Vittecoq	Managing Director	Caterpillar Belgium SA

Redacted By
Permanent Subcommittee on Investigations

CONFIDENTIAL & PROPRIETARY
December 3, 2013

Redacted By
Permanent Subcommittee on Investigations

Effective December 1, 2000, the following individuals had changes in both role/function performed, as well as, change in employer / location to CSARL in Switzerland:

Name	Role/Function	Location/Company
Gerard Vittecoq	Vice President, EAME Operations	CSARL

Redacted By
Permanent Subcommittee on Investigations

Further, effective on December 1, 2000, the following individuals were promoted without a change in location:

Name	Function Before Promotion	Function After Promotion
Vito Baumgartner	VP COSA	Group President
Ed Rapp	Region Manager	VP EAME Marketing

The job responsibilities and roles/functions of the persons above are set forth below.

Gerard Vittecoq's ("Vittecoq") new responsibilities included:

- Joint responsibility with newly created Product Development Division ("PDD") (managed by Chris Schena described below) for EAME results, excluding Marketing (Note, on August 29, 2001, the role of PDD began to report to Vittecoq thus ceasing the joint responsibility);
- Value added efficiency of plant and implementation and performance of certain manufacturing service agreements;
- Enterprise profitability, return on assets of manufacturing facilities within the operations division;

CONFIDENTIAL & PROPRIETARY

December 3, 2013

- Definition and achievement of common EAME goals on non-financial measures;
- Inventory management within plants;
- Investment and long-term manufacturing strategies aligned with product designs
- Bitelli, Fabrications, Engines and Components;
- CAT Work Tools operations; and
- Core components and engine sourcing

As General Manager, EAME Product Development ("PDD"), Chris Schena ("Schena") new responsibilities included:

- Joint responsibility with Vittecoq's new created position (but see note above on August 29, 2001, Schena began reporting to Vittecoq);
- Development and implantation of product strategy and commercial entity responsibility;
- New product introduction management for vehicles including definition of costs, percent industry sales, quality and material cost targets and sources;
- Negotiation of transfer prices and price value optimization with Marketing;
- Worldwide design for certain track type tractors, certain hydraulic excavators, work tools (except commercial engines and components);
- Product quality, warranty, special action pricing action requests;
- Authorization of monthly build schedules based on sales and operation planning meetings;
- Sole accountability for wheeled excavator design in Europe;
- Transfer price for purchases of non-EAME components that are assembled directly into prime product;
- Joint responsibility with Vittecoq for EAME volume, percent industry sales assumptions within the annual business plans and joint sourcing accountability with Vittecoq for prime product manufacture with EAME operations division and for any future additions to EAME manufactured prime product.

The Product Managers' responsibilities generally include managing the bottom line profit and loss with respect to each of their respective products and ensuring the manufacturing of the right product mix to satisfy identified market requirements. Product Managers are also responsible for the development of future product through the new product introduction process ("NPI"). The NPI process generates the R&D activities on machines, engines, and components, including parts for the relevant products. A Product Manager works with the factory to reduce costs of assembly and makes sourcing recommendations with respect to their products. Finally, a Product Manager ensures that customers' needs are met post sales.

CONFIDENTIAL & PROPRIETARY

December 3, 2013

The following provides changes in succession/roles/responsibilities and roles/functions.

Vice Presidents and General Managers

Title	Vice President, EAME Operation Division
Name	Gerard Vintocq
Reports to	Group President
Function	In charge of EAME Manufacturing facilities Prime products: Caterpillar France SAS, Caterpillar Belgium SA Components: Caterpillar Poland, Caterpillar Hungary, Caterpillar Torino, Caterpillar Transmissions France, Caterpillar Skinninggrove, Caterpillar Mec Truck, Caterpillar Bokkiborg, Caterpillar Work Tools, Paving Products
History of the Position until 2012	2000 Position created 2002 Division merged with EAME Product Development to become EAME Product Development and operation Division (PDOD) 2003 Gerard Vintocq replaced by Mike Beanton 2009 Mike Beanton replaced by Chris Schema 2010 Division renamed Europe and South America Operation Division (ESAOD) and includes Caterpillar Brazil Ltd 2012 Chris Schema replaced by Mark Sweeney

Redacted By

Permanent Subcommittee on Investigations

Title	Vice President EAME Marketing
Name	Ed Rapp
Reports to	Group President
Function	In charge of the marketing of all Caterpillar Products, parts and services in the Europe, Africa, Middle East and Commonwealth of Independent States Region
History of the Position until 2012	2000 Position created 2004 Ed Rapp replaced by Paulo Felin 2009 Division renamed EAME Distribution 2012 Paulo Felin replaced by Nigel Lewis Paulo Felin becomes VP for the newly created Global Construction Industries Marketing Division (below)

Redacted By

Permanent Subcommittee on Investigations

**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

CONFIDENTIAL & PROPRIETARY
December 3, 2013

<i>Title</i>	Worldwide Parts Manager
<i>Name</i>	Quentin de Wailhacourt
<i>Reports to</i>	Vice President Customer Support Services Division
<i>Function</i>	In charge of WW Parts Management Accountable for aftermarket strategy for all Machine Business Divisions, and Engine Business DivisionsRuns the WW Parts Roundtable, Drives Implementation through other groups that impact aftermarket business sales and strategy (Components, Logistics, Distribution Services, Purchasing, etc.)
<i>History of the Position until 2012</i>	2009 Position created in 2009

Redacted By
Permanent Subcommittee on Investigations

**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

CONFIDENTIAL & PROPRIETARY
December 3, 2013

**Redacted By The
Permanent Subcommittee
on Investigations**

In January 2003, further operational changes occurred formalizing the role of CSARL Singapore as a headquarters and trading company for the Asia Pacific Division (“**APD**”) region and of Caterpillar of Australia (“**CofA**”) to act as a contract service provider to CSARL Singapore for the following:

- Dealer support in APD on behalf of CSARL Singapore;
- Provider of information technology services to CSARL Singapore;
- Provider of accounting and administrative services to CSARL Singapore;
- Distribution center for replacement parts on behalf of CSARL Singapore; and
- Assembly operation, selling its output to CSARL Singapore.

**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

CONFIDENTIAL & PROPRIETARY
December 3, 2013

Due to constraints in delivering this information within the requested time frame, we have not provided the personnel change information for the above positions.

In 2011, the Excavation Division headquarters relocated to Singapore. The following outlines key individuals and functions moved to Singapore.

Redacted By The Permanent Subcommittee on Investigations

<i>Title</i>	Vice President, Asia Pacific Manufacturing Operations Division
<i>Name</i>	Stu Levenick
<i>Location</i>	Tokyo, Japan
<i>Reports to</i>	Group President
<i>Function</i>	In charge of regional manufacturing operations
<i>History of the Position until 2009</i>	<p>2003 Position created as Vice President, Asia Pacific Division</p> <p>2004 Position split into marketing and operations.</p> <p>2004 Stu Levenick's position split, with Rich Lavin as Vice President, Asia Pacific Manufacturing Operations in Tokyo</p> <p>2007 Rich Lavin replaced by Tom Bluth as Vice President, Asia Pacific Operations</p> <p>2009 Position eliminated (with Tom Bluth transferred to Vice President, Earthmoving Division in Beijing)</p>

Redacted By The Permanent Subcommittee on Investigations

**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

CONFIDENTIAL & PROPRIETARY
December 3, 2013

On July 1, 2002, Caterpillar implemented the inventory management system, ITAS. The implementation of this system improved the existing warehousing and invoicing processes for U.S. warehouse facilities owned by Caterpillar. In addition, as of this date, CSARL entered into an agreement with Caterpillar, as a service provider, for the management of CSARL's inventory of parts to be exported, in exchange for a service fee.

ITAS was developed because Caterpillar and CSARL needed to own separate, identifiable quantities of same part numbers located in the same physical location. The system creates and maintains detailed information with respect to inventory stock records, inventory management, sourcing/availability and physical location.

**Redacted By The
Permanent Subcommittee
on Investigations**

January 14, 2014

*** CONFIDENTIAL—CONTAINS PROPRIETARY INFORMATION*****Response of Caterpillar Inc. to Inquiry Relating to Treatment and Use of Offshore Funds**

This document sets forth Caterpillar Inc.'s ("Caterpillar" or the "Company") response to Questions 1 through 4, 6 and 8 contained in the questionnaire dated December 23, 2013. The information for the other questions is being accumulated and will be provided when available.

Caterpillar requests confidential treatment of this response, as it contains Company confidential and proprietary information, the release of which would damage Caterpillar and potentially assist its competitors, particularly its non-U.S. competitors such as Komatsu, Hitachi, Sany, and Volvo.

Caterpillar's Responses to Questions 1 through 4, 6 and 8

- 1. Please provide the total dollar amount of CSARL's inventory reflected in Caterpillar Inc.'s Inventory Tracking and Accounting System (ITAS) for its purchased finished replacement parts (PFRP) business located in U.S. warehouses for each quarter end in each year from 2009 to the present.**

Please provide the total dollar amount of Caterpillar Inc.'s global inventory for its PFRP business for each quarter end in each year from 2009 to the present.

The question references to a "purchased finished replacement part business" or "PFRP business." However, as previously communicated to the PSI, the Company does not manage revenue or profit from parts as a separate business. Rather, parts are managed as an integral part of each segment. We interpret these references to exclude any inference that the purchase and / or sale of purchased finished replacement parts or PFRPs constitutes a separate business.

The information requested is set forth in the table below, the first column reflecting CSARL's parts inventory held in U.S. warehouses and the second reflecting Caterpillar Inc.'s global parts inventory. Note that inventory records are not separated between worked and purchased finished parts, and therefore the table reflects the total of worked and purchased finished replacements parts. CSARL parts inventory balances reflect inventory located at both U.S. warehouses and at third party contract packagers, and therefore the balances reflected in the table are greater than the inventory balances at the U.S. warehouses. Caterpillar Inc. parts inventory balances reflect parts inventory held in warehouses and in transit inside and outside the United States.

**U.S. Senate Permanent Subcommittee
on Investigations**

February 21, 2014

CATERPILLAR

Introduction to Caterpillar

- Approximately 125 manufacturing locations worldwide
 - U.S.: 54 manufacturing facilities in 18 states
 - Rest of world: 71 manufacturing facilities in 20 countries
- Approximately 52,000 employees in the U.S.; 118,500 worldwide
 - 15,400 in Latin America
 - 25,700 in Asia-Pacific
 - 24,900 in Europe, Africa, and Middle East (EAME)
 - 52,500 in North America
- 178 Dealers worldwide; 48 Dealers in 50 states in the U.S.
- Approximately 48,800 Suppliers; 14,800 in the U.S.



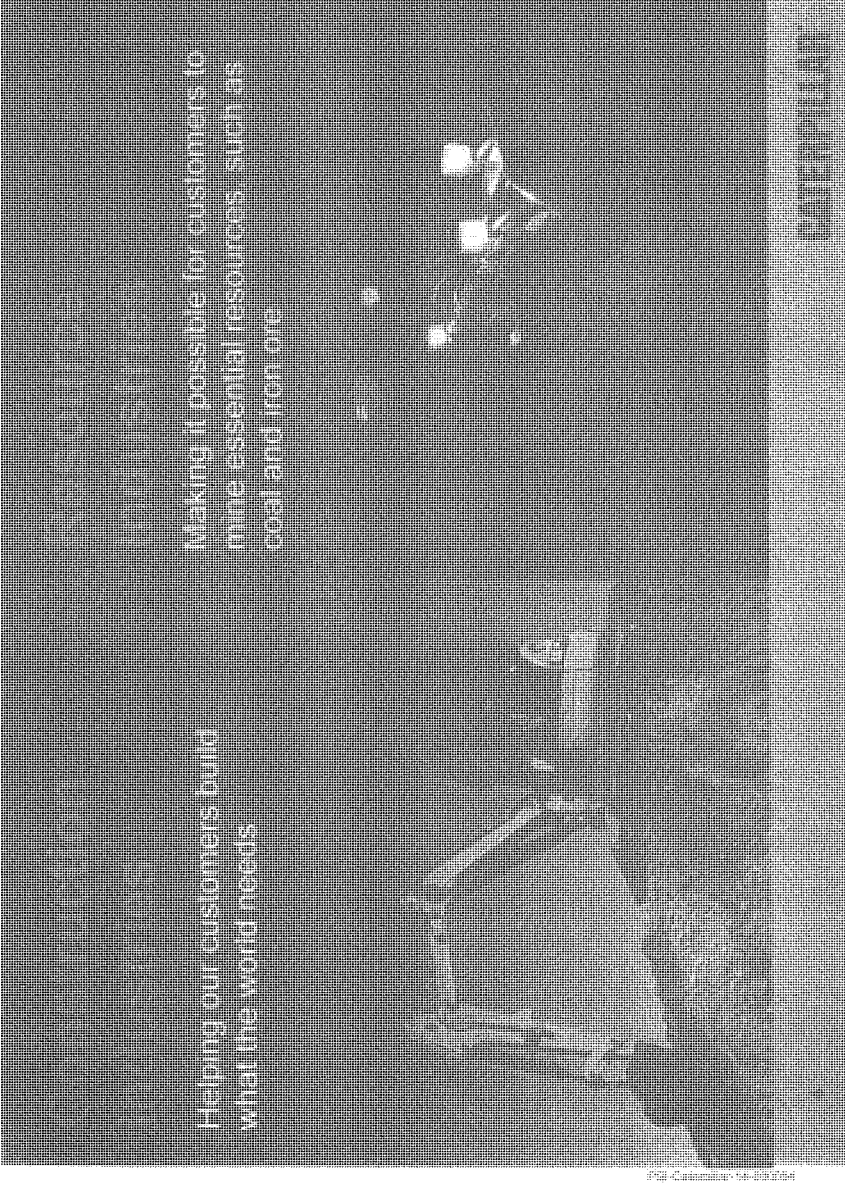
Our History

- We are headquartered in the U.S.
- But, we have always been serving global customers
- We grow and build near our customers in the three spheres of the world
- We are incredibly proud of what we do
- We are proud of our men and women who make it possible
- And, we are equally proud of both our U.S. and global story

687

PSI-Caterpillar-14-000003

CATERPILLAR



Helping our customers build
what the world needs

Making it possible for customers to
mine essential resources, such as
coal and iron ore

CATERPILLAR

For Caterpillar, see page 689

Energy & Transportation
 Focused on meeting the world's increased energy needs

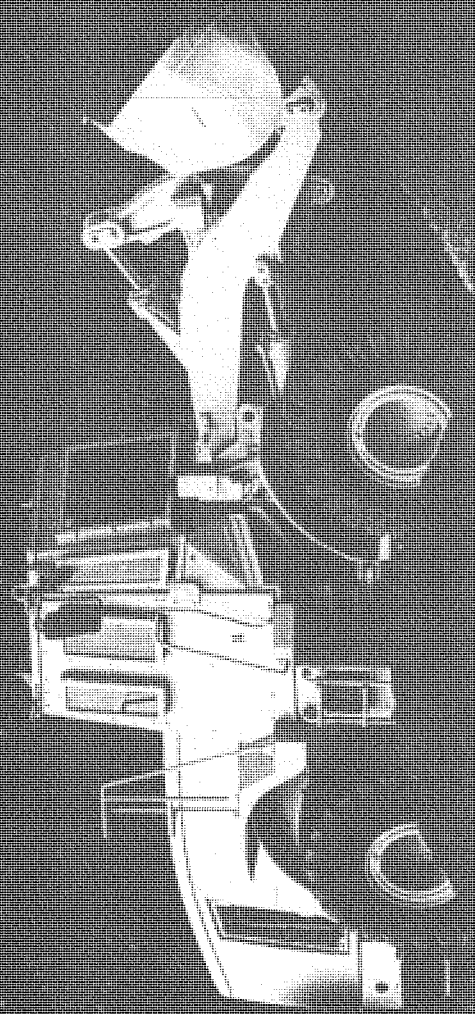
Financial Products
 Offering a wide range of financing and insurance solutions to our customers

CATERPILLAR

PGF-Caterpillar 14-000006

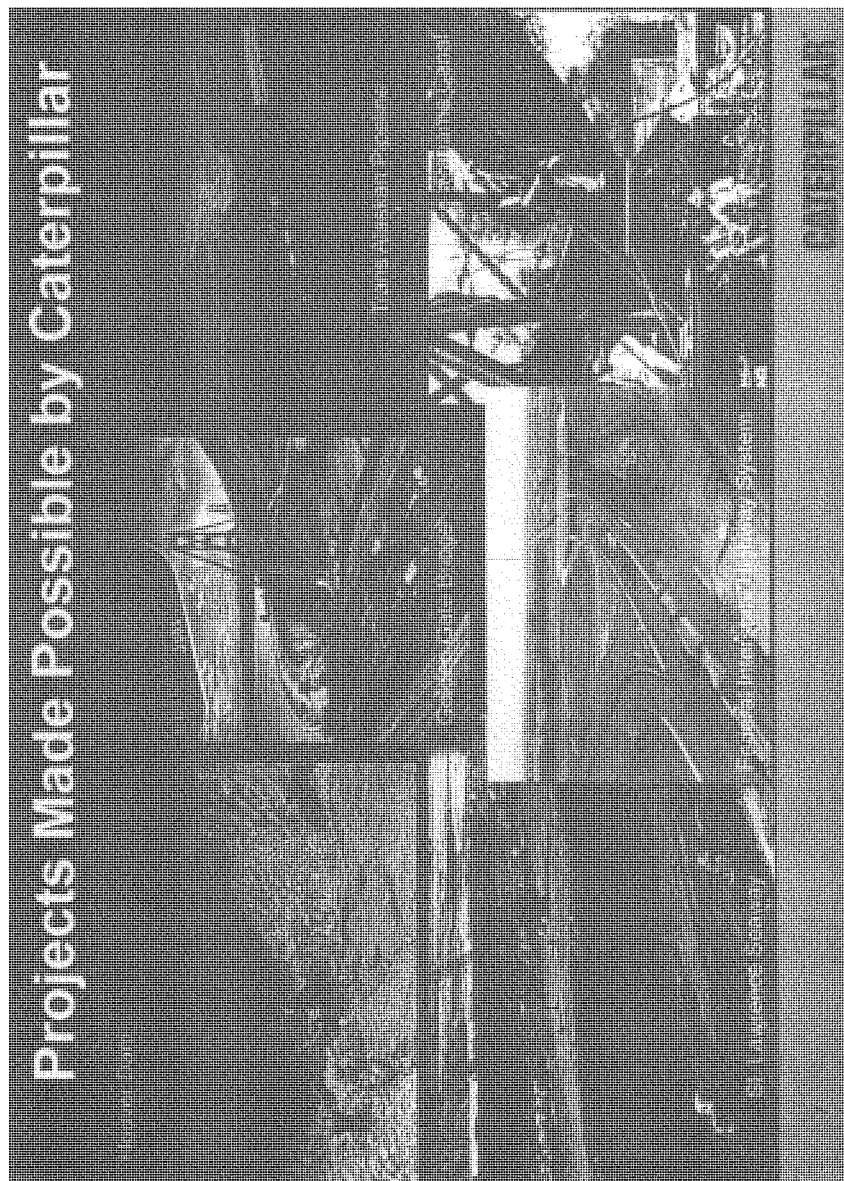
U.S. Military Support

The U.S. Department of Defense is the owner of the world's largest fleet of Cat equipment. We serve all branches of the U.S. armed forces and provide worldwide product support in the theater for America's troops.



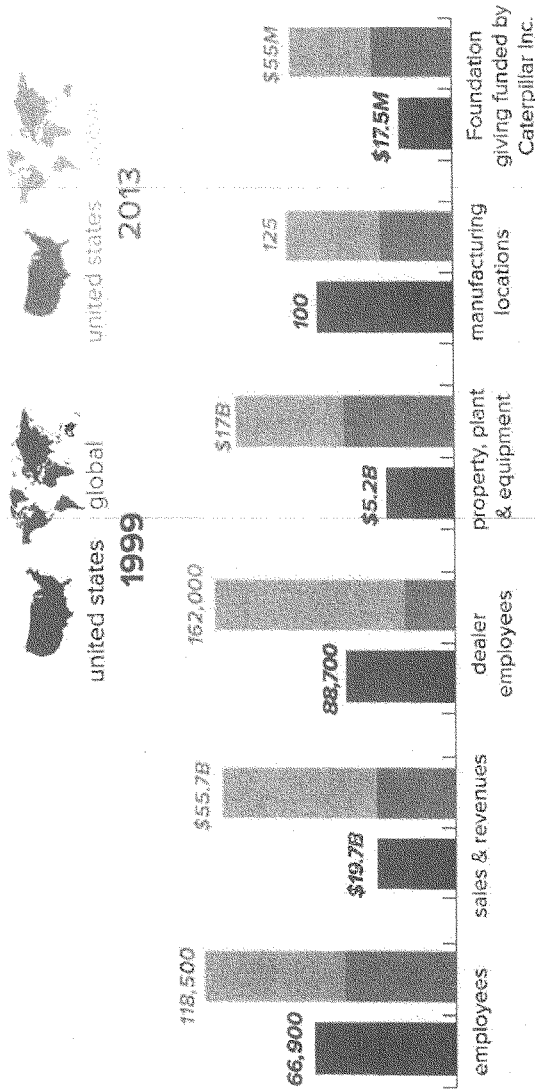
CATERPILLAR

© 2001 Caterpillar Inc. All rights reserved.



A Global Snapshot

We are Growing in the U.S. and Globally

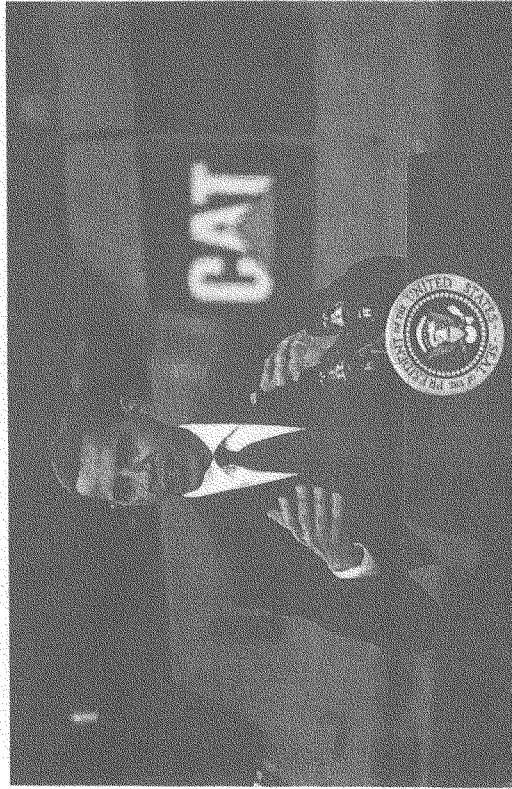


*figures are approximate

CATERPILLAR








A Leading U.S. Exporter

Over \$16 billion in U.S. exports for 2013



CATERPILLAR

For more Caterpillar information,
visit www.caterpillar.com.

P2-Caterpillar-14-000010

CATERPILLAR

695

United States Senate
Committee on Homeland Security and Governmental Affairs
Permanent Subcommittee on Investigations

In the Matter of

Caterpillar Inc.

Expert Witness Report

of

John P. Steines, Jr.
Professor of Law
New York University

March 7, 2014

PSI-Caterpillar-17-000003

Introduction

I am Professor of Law at New York University School of Law. My specialty is U.S. income taxation.

I have been a full-time faculty member at New York University for thirty-five years and have taught a wide variety of courses in the LL.M. program in Taxation, concentrating in those covering domestic and international aspects of corporate and partnership taxation, including the particular issues addressed in this report. I am a former editor-in-chief of the *Tax Law Review*. I have authored a casebook on international aspects of U.S. taxation, which includes chapters on subpart F, transfer pricing, and accumulated offshore funds, and articles on various international, corporate, and partnership tax issues. I have also spoken on most of these subjects at professional conferences. I am Counsel to the law firm of Cooley LLP, where my practice generally involves the same areas of specialization.¹ Prior to affiliating with Cooley, I was a consultant to Deloitte & Touche from 2001 to 2004 and Counsel to the law firm of Weil, Gotshal & Manges LLP from 1984 to 2001. A copy of my curriculum vitae is appended, which includes a list of my publications and other engagements in which I have served as an expert witness.

I have been engaged by counsel to Caterpillar Inc. (“Caterpillar”) to report to the Permanent Subcommittee on Investigations (“Subcommittee”) as an expert witness in taxation on behalf of Caterpillar. Specifically, I have been asked to address the Subcommittee staff’s concern that Caterpillar’s supply chain restructuring executed in 1999 through the early 2000’s, pursuant to which its Swiss affiliate, Caterpillar SARL (“CSARL”), purchases finished replacement parts from unrelated U.S. suppliers and sells them to unrelated dealers and customers abroad, may have lacked sufficient economic substance. I understand that the Subcommittee may have other areas of inquiry, but I do not address those here.

The opinions expressed in the report are based upon my specialized professional knowledge. I confirm that I have included in the report all matters within my knowledge and expertise relevant to the matters on which I have been asked to report. I have made all the

¹ Cooley does not represent Caterpillar, nor did it have any involvement in the restructuring that is the subject of this report. In filing this report, I am acting only in my capacity as Professor of Law, not on behalf of Cooley. My role as expert in this matter is not a conflict of interest.

inquiries that I believe are appropriate and no matters of significance that I regard as relevant have, to my knowledge, been withheld from me or the report.

The report comprises three parts: a summary of conclusions; a statement of facts; and an analysis of the issues I was asked to report on.

Summary of Conclusions

As elaborated below, in my professional judgment, it is extremely unlikely that Caterpillar's supply chain restructuring and the countless ensuing sales conducted pursuant to the restructuring are vulnerable to attack for lack of economic substance.

Summary of Essential Facts

The report is based on my understanding of the essential elements of the supply chain restructuring described below. This understanding is drawn primarily from information provided by Caterpillar to the Subcommittee at its request and, to a lesser degree, on conversations with Caterpillar and its counsel.

The Parties

Caterpillar is the parent company of the Caterpillar group. Where relevant, references to Caterpillar include references to Caterpillar's affiliated U.S. subsidiary companies. CSARL is a limited liability company organized under Swiss law in 1997 as the successor to a Caterpillar company that had conducted overseas operations for decades. CSARL is treated as a partnership for U.S. tax purposes and is owned directly or indirectly (through disregarded entities) by controlled foreign corporations that are directly or indirectly owned by Caterpillar.

Pre-Restructuring Supply Chain in Brief

Before the restructuring, Caterpillar purchased replacement parts for its various products—purchased finished replacement parts (“PFRP”)—from unrelated suppliers located in the United States and sold a portion of them to CSARL (“outbound PFRP”), which in turn sold them to unrelated dealers and customers in foreign markets. Caterpillar's profits from outbound

PFRP sales were taxable in the United States. CSARL's profits were also taxable in the United States as foreign base company sales income (under Section 954(d) of subpart F).

Post-Restructuring Supply Chain in Brief

After the restructuring, CSARL purchased outbound PFRP directly from the unrelated U.S. suppliers and sold them to unrelated dealers and customers in foreign markets. The restructuring simply removed Caterpillar from the outbound PFRP supply chain. As a result, Caterpillar earned no profits (other than royalties and fees paid by CSARL described below) from outbound PFRP sales, and CSARL's profits were no longer taxable under subpart F because there was no longer a related party (Caterpillar under the old structure) in the supply chain, which Section 954(d) requires as a condition of foreign base company sales income.

Elements of the Restructuring

Since at least 1960, Caterpillar's primary non-U.S. marketing center has been located in Switzerland. For several decades, CSARL (and its predecessor) have had several hundred employees in Switzerland, currently approximately 400, engaged in activities involved in manufacturing, marketing, sales, and support of Caterpillar machines, engines, and parts. Swiss-based managers have been instrumental in Caterpillar's international expansion. As the Asia Pacific market developed, CSARL developed a similar regional center in Hong Kong, which was later relocated to Singapore and currently is home to approximately 400 employees and the site of Caterpillar's Asia-Pacific aftermarket distribution center and remanufacturing facility. Presently, roughly 70 percent of the Caterpillar group's sales are to foreign dealers and customers.

The restructuring entailed a broad realignment of many of the Caterpillar group's various functions in foreign markets. An important objective was to facilitate CSARL's functioning as the principal in contract (toll) manufacturing arrangements. Another objective was to remove Caterpillar from the outbound PFRP supply chain in order to eliminate an unnecessary middleman between the supplier and customer and in the process to eliminate unnecessary subpart F income.

Prior to the restructuring, outbound PFRP functions were divided. Caterpillar employees located in the U.S. engaged with U.S. suppliers on design, production, and pricing matters, whereas marketing to foreign customers was carried out by CSARL employees in Switzerland or Singapore. CSARL, operating as a distributor with limited exposure to market risk, earned a relatively small gross profit (approximately four percent of sales revenue).

The restructuring added to CSARL's exposure to market risk by essentially placing it in the position previously occupied by Caterpillar—the entrepreneur between suppliers and customers. In order to take on purchasing functions previously discharged by Caterpillar, CSARL needed continuing support from Caterpillar and the right to use Caterpillar's intellectual property necessary to engage with suppliers and customers (*i.e.*, production technology and trade name). To that end, CSARL entered into a licensing agreement with Caterpillar entitling CSARL to use relevant Caterpillar intellectual property, pursuant to which CSARL pays annual royalties to Caterpillar equal to four to six percent of sales revenue. In addition, CSARL reimburses Caterpillar, at cost plus a five to seven percent mark-up, for various engineering and logistical services provided by Caterpillar personnel located in the United States involved in engaging with suppliers and storing and managing inventory in U.S.-situs warehouses. The adequacy of these royalties and fees is subject to normal audit review under the arm's length principles and rules of Section 482's transfer pricing regime. Although CSARL hired or reassigned two high-level purchasing managers located in Switzerland after the restructuring, much of the purchasing and logistical functions relating to outbound PFRP continued after the restructuring to be carried out by Caterpillar personnel located in the United States.

After the restructuring, some outbound PFRP was shipped directly from suppliers to customers or through unrelated packagers. The balance was stored, intermingled with Caterpillar's goods, in Caterpillar's U.S. warehouses. As a mutual accommodation, if CSARL's or Caterpillar's inventory ran out, the inventory control system ("ITAS") permitted the short party to use the other's inventory and later replenish it from future purchases. Also, because U.S. suppliers did not want to deal with more than one purchaser, CSARL purchased not only outbound PFRP but also goods destined for U.S. dealers and customers. In order to accomplish such inbound sales, CSARL would transfer title ("flash title") to Caterpillar at no mark-up, enabling Caterpillar to close sales to U.S. dealers and customers.

The net U.S. tax effect of the restructuring on outbound PFRP profits, taking into account royalty and service agreement payments made by CSARL to Caterpillar, was to convert some percentage, which varies year-by-year, of the profits from income subject to current U.S. income taxation (either because Caterpillar earned it or it was subpart F income to CSARL) to CSARL's income subject to deferred U.S. taxation.

Economic Substance Requirements

I understand that some members of the Subcommittee staff may be of the view that continued storage of outbound PFRP in the United States (perhaps aggravated by the inventory warehousing features discussed above), combined with continued supplier engagement and inventory warehousing being conducted by Caterpillar personnel located in the United States, means that the restructuring did not accomplish a sufficient change in economic substance to be respected for U.S. income tax purposes. The staff's view may be premised on one or both of two related judicial doctrines: the doctrine that substance prevails over form; and the economic substance doctrine. I will address both doctrines as well as relevant historical policies behind present law, concluding that the restructured outbound PFRP supply chain offends neither the case law nor the relevant underlying statutory purposes.

Substance over Form and Economic Substance in General

The various doctrines employed by courts to police what is perceived as overly aggressive tax planning are somewhat overlapping and draw common support from the bedrock notions that substance generally prevails over form where they conflict and, in addition, economically meaningless transactions devoid of business purpose other than tax avoidance are generally not respected.² Given the potential breadth of these principles, however, it is important to remember that many routine transactions that may superficially seem suspect, such as issuing debt instead of equity in order to obtain an interest deduction or forming a subsidiary to conduct activity instead of operating in branch form or acquiring a target company for stock in a tax-free

² See *Gregory v. Helvering*, 293 U.S. 465 (1935); *Knetsch v. United States*, 364 U.S. 361 (1960); *Frank Lyon Co. v. United States*, 435 U.S. 561 (1978).

reorganization instead of purchasing it for cash in a taxable transaction, are unquestionably above reproach in the vast majority of situations.³

Therefore, in order to put Caterpillar's restructuring in proper perspective, in the following pages I begin with indisputable economic substance principles established by the courts and Congress, then describe cases countenancing legitimate international tax planning, and, finally, catalog some of the transactions that courts of late have unabashedly struck down as objectionable under either the substance-over form doctrine, which holds that economic substance trumps inconsistent formalism, or the economic substance doctrine, which holds that a taxpayer must have a nontax business purpose for entering into a transaction (the "subjective" factor) and/or the transaction must exhibit economic effects other than tax savings (the "objective" factor).⁴ I provide only enough detail to show the contrast between transactions condemned by courts and Caterpillar's restructuring.

Indisputable Judicial Principle Respecting Separateness of Corporation and Shareholder

Seventy years ago, in *Moline Properties*,⁵ the Supreme Court, rejecting the taxpayer's argument that his wholly owned corporation was merely his *alter ego*, established that a corporation cannot be ignored if it engages in even minimal economic activity. The corporation in that case owned real property formerly owned by the shareholder and transferred to the corporation at the insistence of creditors. The corporation sold the property at a gain, which the taxpayer unsuccessfully argued was taxable to him, not the corporation.

From that point on, courts refused to ignore the separate existence of a corporation, even though tax-motivated, unless it was a sham, engaged in no economic activity, or represented itself to be merely an agent. For example, in the *Siegel* case, cited with approval by the Joint

³ See, e.g., *Kraft Foods Co. v. Comm'r.*, 232 F.2d 118 (2d Cir. 1956); Joint Comm. on Tax'n, *Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in Combination with the "Patient Protection and Affordable Care Act."* JCX-18-10 (Mar. 21, 2010), at 152-53.

⁴ The recently codified economic substance doctrine, enacted in 2010, requires a taxpayer to show both a meaningful change in its economic position as a result of the transaction in question and a non-tax business purpose for it. I.R.C. § 7701(o). Pre-codification doctrine, depending on the circuit in which the case arose, sometimes required taxpayers to make both showings, sometimes only one, and sometimes fused the two prongs into one. See David P. Hariton, *When and How Should the Economic Substance Doctrine Be Applied?*, 60 Tax L. Rev. 29 (2006), Martin J. McMahon, *Living with the Codified Economic Substance Doctrine*, 128 Tax Notes 731 (2010); JCX-18-10, *supra* note 3, at 153-54.

⁵ *Moline Properties, Inc. v. Comm'r.*, 319 U.S. 436 (1943).

Committee on Taxation as beyond attack under the economic substance doctrine,⁶ the Tax Court rejected the government's argument that the taxpayer's wholly owned Panamanian corporation, which entered into a farming joint venture in Cuba, where the taxpayer operated as a food broker, should be ignored for lack of economic substance simply because the arrangement deferred U.S. tax, provided the taxpayer had some non-tax reason for using the corporate form (e.g., insulation from liability to creditors, protection of licenses and reputation).⁷ Another oft-cited example is *Northern Indiana Public Service Company*,⁸ where the Court of Appeals refused to ignore the separate existence of a U.S. parent corporation's Netherlands-Antilles subsidiary, which had borrowed funds in the Eurobond market and on-loaned them at a slightly greater rate of interest to the parent company. The subsidiary's retention of the interest rate spread and the need to employ such a structure in order to reduce borrowing costs (by not having to pay increased interest to cover the U.S. withholding tax that would have been due had the parent borrowed directly from the Eurobond market) was enough business justification to fend off an economic substance challenge.

Legislative History

Congress has been equally respectful of the separateness of corporation and shareholder. When subpart F was enacted in 1962, with the approach that only certain types of income ("subpart F income") earned by a controlled foreign corporation would be currently taxable to its U.S. shareholders, it was obvious that other kinds of income could not also be rendered currently taxable through the expedient of simply ignoring the separate existence of the controlled foreign corporation on substance-over-form or related grounds. Legislative history of the codification of the economic substance doctrine in 2010 restates this reality unambiguously:

"The provision is not intended to alter the tax treatment of certain basic business transactions that, under longstanding judicial and administrative practice are respected, merely because the choice between meaningful economic alternatives is largely or entirely based on comparative tax advantages. Among these basic transactions are . . . a U.S. person's choice between utilizing a foreign corporation or a domestic corporation to make a foreign investment . . . and . . . the choice to

⁶ See JCX-18-10, *supra* note 3, at 153.

⁷ *Siegel v. Comm'r*, 45 T.C. 566 (1966).

⁸ *Northern Indiana Public Service Co. v. Comm'r*, 115 F.3d 506 (7th Cir. 1997).

utilize a related-party entity in a transaction, provided that the arm's length standard of section 482 and other applicable concepts are satisfied.”⁹

Also noteworthy is Congress's decision not to trigger taxation under subpart F merely because a controlled foreign corporation holds goods in the United States that are destined for export.¹⁰ This exception to the definition of “United States property” in Section 956, which dates back to the initial enactment in 1962, was justified by Congress as follows:

“Generally, earnings brought back to the United States are taxed to the shareholders on the grounds that this is substantially the equivalent of a dividend being paid to them. The exceptions . . . , however, are believed to be normal commercial transactions without intention to permit the funds to remain in the United States indefinitely”¹¹

Taxpayer Victories in International Tax Planning Cases

Consistent with the foregoing principles, taxpayers have prevailed in cases exhibiting considerable international tax planning.

Relocation of Business Offshore

The most germane of these cases involved United Parcel Service's transfer of its package insurance business to a foreign affiliate. UPS, which had previously conducted the business itself, moved the business (and resulting profit) to its Bermuda sister corporation (which it had formed and spun off to shareholders) by engaging an independent insurance company to accept the insurance risk, in exchange for premiums collected by UPS from customers, followed by a reinsurance agreement between the insurer and the Bermuda sister that passed the premiums and risk on to the Bermuda sister (less a fee for the insurer). The government challenged the arrangement on economic substance grounds, complaining that nothing in substance had changed (UPS continued to administer customer claims) except that UPS's profits were now earned by the Bermuda sister. The court disagreed, finding that the restructuring of an existing, bona fide business with involvement of an independent third-party insurer satisfied the economic substance doctrine, notwithstanding the tax avoidance motive.¹²

⁹ JCX-18-10, *supra* note 2, at 152-53.

¹⁰ See I.R.C. § 956(c)(2)(B).

¹¹ Sen. Rep. No. 1881, 87th Cong., 2d Sess., at 794.

¹² *United Parcel Service of America, Inc. v. Comm'r*, 254 F.3d 1014 (11th Cir. 2001).

Of all the cases mentioned in this report, the one closest to the Caterpillar restructuring is *UPS*. Like the Caterpillar restructuring, it involved dealings between the taxpayer and independent parties (the insurer in *UPS* and unrelated suppliers and customers in this case), and it was a restructuring of an existing, mature business, as opposed to a one-time adventure into unfamiliar terrain motivated exclusively by a desire to generate tax benefits in order to shelter tax on unrelated income.

Hybrid Financing Arrangements

Two recent cases illustrate the degree of international planning permitted under the substance-versus-form doctrine, each involving cross-border tax arbitrage (inconsistent classification by two countries of either an entity or a financial instrument, resulting to some degree in income being taxed in neither country). In the first, a formal debt instrument issued by a domestic reverse hybrid entity (a corporation for U.S. tax purposes), which, if respected, would have resulted in a U.S. interest deduction but little or no taxation in the U.K. due to the issuer's status as a partnership for U.K. purposes, was indeed respected as debt, contrary to the government's argument.¹³ In the second, a hybrid instrument issued by a Dutch subsidiary to its U.S. parent was treated as equity for U.S. purposes, notwithstanding that it was treated as debt for Dutch purposes, resulting in an interest deduction in the Netherlands but asymmetrical tax treatment in the United States (*e.g.*, return of stock basis or dividend sheltered by foreign tax credits).¹⁴

Government Victories in Economic Substance and Substance-Over-Form Cases

In contrast to instances of tax planning sanctioned by the courts and Congress, transactions too heavily freighted with tax-avoidance have been stuck down. These cases demonstrate that, wherever the line drawn by the substance-over-form and economic substance doctrines may be, the Caterpillar restructuring falls easily on the safe side.

SILO/LILO Transactions

Sale-in-lease-out ("SILO") and lease-in-lease-out ("LILO") transactions typically involve a lease (head lease) of a public or quasi-public facility (*e.g.*, a municipal railroad or sewage system or hydroelectric plant) by a U.S. taxpayer from a tax-indifferent user (*e.g.*, a foreign or

¹³ *NA General Partnership v. Comm'r*, T.C. Memo. 2012-172.

¹⁴ *PepsiCo Puerto Rico v. Comm'r*, T.C. Memo. 2012-269.

U.S. municipality) that historically operated the facility, followed by a lease of the facility back (sublease) to the user for continued operation, but for a term shorter than the head lease. Upon expiration of the sublease, the user is generally economically compelled, though not for absolute certain, to exercise an option to reacquire the facility from the taxpayer. The taxpayer has no business interest or acumen in the facility and plays no role in its operation. Rent on the head lease is prepaid, funded approximately one fifth by the taxpayer's equity and four fifths by nonrecourse financing taken out by the taxpayer. Aside from a fee retained by the user to enter into the transaction, the prepaid rent is set aside in special-purpose ("defeasance") accounts dedicated, via rental payments on the sublease, to servicing the taxpayer's nonrecourse financing and to fund the repurchase option, meaning that the taxpayer's equity (net of the user's fee) is returned, the loan is repaid, and ownership of the facility reverts to the user. Because rent on the head lease is prepaid, giving rise (prior to certain changes in the Code) to an immediate deduction for rent (LIFO) or a depreciation stream (SILO), there is a timing advantage due to the relatively deferred inclusions of rental income (net of interest deductions on the loan) from the sublease. As an economic matter, the tax benefit from this deferral is offset by the user's fee and transaction expenses.

Courts have consistently denied the tax benefits of SILOs and LIFOs on substance-over-form grounds, more particularly that the taxpayer did not acquire the economic benefits and burdens of ownership, and in some cases for lack of economic substance as well.¹⁵

The chasm separating Caterpillar's restructuring from SILO/LIFO transactions is obvious. Outbound PFRP is central to Caterpillar's business, there was no use of an indifferent financier to accommodate the restructuring, and the restructuring made permanent economic changes in the relationships among Caterpillar affiliates.

Foreign Tax Credit Generators

"Foreign tax generators" come in many varieties and can be exceedingly complicated.¹⁶ Although there are variations, most generators are duplicate-benefit financing transactions in

¹⁵ *BB&T Corp. v. United States*, 523 F.3d 461 (4th Cir. 2008); *Altria Group, Inc. v. United States*, 658 F.3d 276 (2d Cir. 2011); *Wells Fargo & Co. v. United States*, 641 F.3d 1319 (Fed. Cir. 2011); *Consol. Edison Co. of N.Y., Inc. & Subs. v. United States*, 703 F.3d 1367 (Fed. Cir. 2013); *AWG Leasing Trust v. United States*, 592 F. Supp.2d 953 (N.D. Ohio 2008); *John Hancock Life Insurance Co. (USA) v. Comm'r*, 141 T.C. No. 1 (Aug. 5, 2013).

¹⁶ Yaron Z. Reich, *International Arbitrage Transactions Involving Creditable Taxes*, 85 *Taxes* 53 (2007); Gregory May, *Getting Realistic About International Tax Arbitrage*, 85 *Taxes* 37 (2007).

which a U.S. corporation, usually a financial institution (acting either as borrower or lender), holds a security issued by a foreign special purpose entity (“SPV”) through which the loan proceeds pass and which incurs foreign tax on profits from investment of the loan proceeds (usually a loan to an affiliate of the SPV). Securities issued by the SPV are also owned by a foreign counterparty to the deal, and, with the help of inconsistent classification or ownership of the securities by the United States and the foreign counterparty’s home country, the tax incurred by the SPV is effectively reversed (where the counterparty is the borrower) or is a substitute for tax that the counterparty would have incurred in a straightforward loan (where it is the lender). That being the case, the counterparty is willing to bear, through the pricing of the securities and various associated deals (*e.g.*, interest rate and currency swaps), most of the economic burden of the tax incurred by the SPV. The U.S. corporation obtains a credit for avoidable tax economically borne by the counterparty. In these transactions, it can be demonstrated, by comparison to a straightforward loan, how the U.S. corporation and foreign counterparty (and usually the counterparty’s home country) all benefit at the expense of the U.S. treasury. In result, foreign tax generators are open to attack as a tax shelter in the sense that two parties trade disparate tax positions for their mutual after-tax benefit at the expense of the fisc with virtually no risk.

Regulations invalidating credits for taxes incurred in generator transactions were issued in temporary form in 2008 and finalized in 2011.¹⁷ The government challenged deals pre-dating the regulations in court on several grounds, including substance-over-form and economic substance. Several cases have been decided, all but one in favor of the government, mostly on economic substance grounds.¹⁸

Similar to the comparison with SILO/LILO transactions, the differences between generator transactions and the Caterpillar restructuring are stark. Nothing in the restructuring smacks of a U.S. taxpayer contracting with a tax-indifferent foreign counterparty to their mutual

¹⁷ T.D. 9416, 2008-2 C.B. 1142; Treas. Reg. § 1.901-2(e)(5)(iv).

¹⁸ *Pritired 1, LLC v. United States*, 816 F. Supp. 2d 693 (S.D. Iowa 2011) (economic substance and partnership anti-abuse grounds); *Hewlett-Packard Co. v. Comm’r*, 103 T.C.M. (CCH) 1736 (2012) (debt-equity grounds, finding that HP’s investment in Dutch SPV was debt, destroying its claim to indirect credits); *Bank of New York Mellon Corp. v. Comm’r*, 140 T.C. No. 2 (2013) (economic substance grounds); *Salem Financial, Inc. v. United States*, 112 Fed. Cl. 543 (2013) (economic substance grounds); *American Int’l Group, Inc. v. United States*, 2013-1 USTC ¶ 50,255 (S.D. NY 2013) (rejected taxpayer’s motion for summary judgment on economic substance grounds). But see *Santander Holdings USA, Inc. v. United States*, 2013-2 USTC ¶ 50,564 (D. Mass. 2013) (granting taxpayer’s motion for summary judgment on profit element of economic substance).

advantage to deprive the United States of revenue it would have earned in a straightforward substitute transaction.

Structured Partnership Financings

Subject to the requirement that partnership allocations must have substantial economic effect (Section 704(b)), partnerships offer the potential for taxable partners to deflect income to tax-indifferent partners and, conversely, for tax-indifferent partners to transfer tax benefits to taxable partners. In structured partnership financing transactions, as a general proposition, the accommodating partner earns a debt-like return on its contribution to the partnership with very little economic risk or upside potential beyond a fixed return. The return is somewhat above market where the accommodating partner is tax-indifferent and absorbs income deflected by the taxable partner and somewhat below market where the accommodating partner is allocated a valuable tax benefit deflected by a tax-indifferent partner.

The first wave of these transactions invalidated by the courts on economic substance grounds involved partnerships of U.S. and foreign parties (often banks) where the partnership purchased and sold securities with little economic gain or loss and employed peculiar basis recovery rules (under the installment method of accounting) to allocate gain to tax-indifferent foreign partners followed by an offsetting allocation of loss to taxable partners.¹⁹

Next came a series of two lower court decisions in favor of General Electric and two reversals by the Court of Appeals involving a partnership among GE and foreign banks.²⁰ GE contributed low-basis airplanes to the partnership, and allocations to the banks of rental income from the planes and largely offsetting amounts of book depreciation had the effect of temporarily shifting gain inherent in the airplanes from GE to the foreign banks. The two appellate decisions, sounding a blend of substance-over-form and economic substance criteria, rested on the finding that the lower court erred in rejecting the government's claim that the foreign banks were not bona fide equity partners.

A recent case in which a Dow Chemical Company affiliate formed a partnership with foreign banks reveals a similar pattern.²¹ Dow contributed low-basis patents and operating

¹⁹ See, e.g., *ACM Partnership v. Comm'r*, 157 F.3d 231 (3d Cir. 1998). Several subsequent cases with similar facts were also won by the government.

²⁰ *TIFD III-E, Inc. v. United States*, 342 F.Supp.2d 94 (D. Conn. 2004); *rev'd and rem'd*, 459 F.3d 220 (2d Cir. 2006); 660 F.Supp.2d 367 (D. Conn. 2009); *rev'd*, 666 F.3d 836 (2d Cir. 2012).

²¹ *Chemtech Royalty Associates, L.P. v. United States*, 2013-1 U.S.T.C. ¶50,204 (M.D. La. 2013).

facilities to the partnership and paid royalties and rents to the partnership in order to retain use of the assets. Dow deducted the royalty and rent payments, but partnership royalty income from the patents was disproportionately allocated to the banks and partnership rental income from the facilities allocated to Dow was sheltered by a special partnership basis adjustment (under Section 734(b)). Finding that the transaction had no purpose other than tax avoidance, the court invalidated the arrangement on economic substance grounds and on the finding that the banks were not bona fide equity partners. Finally, a partnership between an arm of the State of New Jersey and Pitney Bowes, where Pitney Bowes earned a low, relatively fixed return on its contribution to the partnership but was allocated virtually all of the partnership's historic rehabilitation credits, was invalidated on the ground that Pitney Bowes was not a bona fide equity partner.²²

The gulf between the Caterpillar restructuring and the foregoing structured partnership financing arrangements resembles the differences noted above regarding SILO/LILO transactions and foreign tax credit generators. Here too, the Caterpillar restructuring exhibits none of the fatal features condemned by the courts.

Repatriation Strategies

Strategies to repatriate earnings and profits from controlled foreign corporations without imposition of residual U.S. tax failed in two recent cases. In the first, Schering-Plough entered into an interest rate swap and sold the receivables leg of the swap to its foreign subsidiary in exchange for a lump sum payment, which would effectively be repaid to the subsidiary as Schering-Plough made payments on the pay leg of the swap to its counterparty (a foreign bank), which in turn would make payments on the receivables leg to the foreign subsidiary. Had the foreign subsidiary simply loaned funds to Schering-Plough, Schering-Plough would have been taxable under Section 956 (investments in U.S. property by a controlled foreign corporation), which the structure was designed to avoid. The lower court treated the transaction as a loan by the subsidiary to Schering-Plough on substance-over-form grounds and also held that the

²² *Historic Boardwalk Hall, LLC v. Comm'r*, 694 F.3d 425 (3d Cir. 2012), *rev'g*, 136 T.C. 1 (2011), *cert. denied*, 186 L.Ed.2d 192 (2013).

transaction violated the economic substance doctrine. The Court of Appeals affirmed only on substance-over-form grounds.²³

In the second case, one controlled foreign corporation (*A*) transferred cash to an affiliated, newly formed controlled foreign corporation (*B*) in exchange for stock of the transferee (*B*), and the transferee (*B*) then transferred the cash and its own stock to a newly formed U.S. sister corporation (*C*) in exchange for the sister's stock. The sister (*C*) then loaned the funds to the U.S. parent company (*D*). The taxpayer took the position, based on a revenue ruling, that *B*'s basis in the *C* stock was zero and, therefore, *B* had not made a taxable investment in U.S. property under Section 956. The court, employing substance-over-form criteria, concluded that transferring the cash from *A* to *D* through *B* and *C* had no business purpose and, consequently, characterized the series of transactions as a dividend from *A* to *D*.²⁴

These attempts at tax-free repatriations were recharacterized because, as the courts assessed the transactions, they employed complicated arrangements to accomplish through a multitude of steps the simple (and taxable) act of paying dividends to the U.S. parent companies. There is no such use of numerous transactions in substitution of a simpler, single transaction in the Caterpillar restructuring. Indeed, the restructuring simplified Caterpillar's business by removing a redundant middleman.

Application of Principles to Caterpillar Restructuring

Legislative history of the codification of the economic substance doctrine makes clear that the decision to remove Caterpillar from the outbound PFRP supply chain did not violate the economic substance doctrine. And case law interpreting the substance-over-form and economic substance doctrines reveals that they are primarily reserved for highly engineered transactions, frequently unrelated to the taxpayer's core business and involving tax-indifferent parties with no stake in the outcome other than a fixed return, that Congress would not have countenanced as consistent with the purpose of the statutes it enacted—in other words, transactions that most impartial tax professionals would concede are tax shelters.

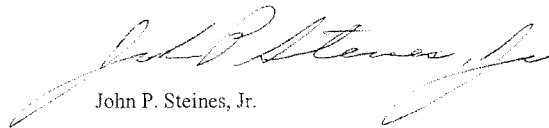
²³ *Schering-Plough Corp. v. United States*, 651 F.Supp. 219 (D. N.J. 2009), *aff'd sub. nom.*, *Merck & Co., Inc. v. United States*, 652 F.3d 475 (3d Cir. 2011).

²⁴ *Barnes Group, Inc. v. Comm'r*, T.C. Memo 2013-109.

Caterpillar's restructuring is of an entirely different realm—a sensible business decision to remove a redundant middleman between supplier and customer, fully within the text and spirit of subpart F, notwithstanding that it deferred some U.S. tax. The inventory accommodation and flash title features of Caterpillar's inventory control system are pragmatic business solutions to normal business problems and do not approach what would raise a problem under the case law digested above.

In my professional judgment, it is extremely unlikely that a court adjudicating with fidelity to the law presented in this report would find that the restructuring or the countless ensuing outbound PFRP transactions offend the doctrines of substance over form or economic substance.

Respectfully submitted,



John P. Steines, Jr.

John P. Steines, Jr.

March 2014

New York University School of Law
40 Washington Square South
New York, New York 10012
(212) 998-6167
john.steines@nyu.edu

Cooley LLP
1114 Ave. of Americas
New York, New York 10036-798
(212) 479-6084
jsteines@cooley.com

Employment

Professor of Law, New York University, 1985-present (on faculty since 1978). Specialty: taxation, with emphasis on corporate, partnership and international matters.

Counsel, Cooley LLP (formerly Kronish, Lieb, Weiner & Hellman), New York, 2004-present, practice in corporate, partnership, and international tax matters.

Consultant, Deloitte & Touche LLP, New York, 2001-2004, practice in mergers and acquisitions, partnerships, and international tax matters.

Counsel, Weil, Gotshal & Manges LLP, New York, 1984-2001, practice in wide variety of tax matters, with emphasis on partnerships and joint ventures.

Associate, Miller, Johnson, Snell & Cumiskey, Grand Rapids, Michigan, 1974-78.

Industrial Engineer, General Motors Corporation, 1970-71.

Education

Graduate study in Economics, New York University, 1982.

LL.M. (in Taxation), New York University School of Law, 1978. Gerald L. Wallace Scholar.

Juris Doctor, *summa cum laude*, The Ohio State University College of Law, 1974. Order of the Coif.

Bachelor of Industrial Engineering, General Motors Institute, 1971.

Miscellaneous Positions

Editor-in-Chief, Tax Law Review, 1980-82.

Committee on Taxation of Partnerships and Other Pass-Through Entities, Association of the Bar of the City of New York, 1990-92.

Personal Information

Age 65, born Warren, Ohio. Married, three children.

Expert Witness

Deutsche Finance New Zealand Limited v. Commissioner of Inland Revenue (on behalf of taxpayer before High Court of New Zealand, 2007).

4145356 Canada Limited v. Her Majesty the Queen (on behalf of government of Canada before Tax Court of Canada, 2009 - 2011).

TD Securities (USA) LLC v. Her Majesty the Queen (on behalf of taxpayer before Tax Court of Canada, 2009 - 10).

GE Capital Finance Australasia Pty Ltd v. Commissioner of Taxation (on behalf of government of Australia, 2010).

Centocor Ortho Biotech Inc. v. Schering-Plough Corporation (on behalf of Centocor in arbitration, 2010).

Mars Australia Property Ltd. v. Commissioner of Taxation (on behalf of government of Australia, 2011).

Citibank Overseas Investment Corporation v. Holmann (on behalf of Citibank in arbitration, 2011).

Tidewater Inc. v. Bolivarian Republic of Venezuela (on behalf of Venezuela in arbitration, 2011 - 12).

Heritage Oil and Gas Ltd. v. Uganda Revenue Authority (on behalf of government of Uganda, 2012-13)

Stop and Shop Supermarket Company v. Massachusetts Dep't of Revenue (on behalf of Mass. DOR, 2012-13)

In the Matter of AMCI Investments Pty Ltd (on behalf of Australia Taxation Office, 2012 – 13)

United States v. Alavi Foundation (on behalf of Alavi Foundation in U.S. District Court, 2013)

Books

Federal Income Taxation of Corporations and Shareholders (Warren, Gorham & Lamont 7th ed.). Was successor to Boris I. Bittker and James S. Eustice from October 2011 through February 2013.

International Aspects of U.S. Income Taxation (4th ed. 2009).

International Aspects of U.S. Income Taxation (3rd ed. 2007).

International Aspects of U.S. Income Taxation (2nd ed. 2005).

International Aspects of U.S. Income Taxation (2004).

Articles

The Foreign Tax Credit at 95: Bionic Centenarian, 67 Tax L. Rev. 545 (2013).

Foreign Tax Credit Reform, 32 Tax Notes Int'l 1213 (Sept. 29, 2003), 101 Tax Notes 134 (Oct. 6, 2003).

Whether, When, and How To Tax the Profits of Controlled Foreign Corporations, International Tax Policy in the New Millennium, 26 Brooklyn Journal of International Law 1595 (2000).

Income Tax Implications of Free Trade, 49 Tax Law Review 675 (1994).
Unneeded Reform, 47 Tax Law Review 239 (1991).
Partnership Allocations of Built-in Gain or Loss, 45 Tax Law Review 615 (1990).
Income Tax Allowances for Cost Recovery, 40 Tax Law Review 483 (1985).
Taxation of Corporation Distributions -- Before and After TEFRA, 68 Iowa Law Review 937 (1983).
A Reappraisal of the Taxation of Wealth Transfers Incident to Divorce, 56 Washington Law Review 217 (1981).
Policy Considerations in the Taxation of B Reorganizations, 31 Hastings Law Journal 993 (1980).

Papers and Lectures

NYU Panel Discussion on Chairman Camp's Proposal to Unify Pass-through Taxation (April 2013).
 NYU/UCLA Symposium on 100th Anniversary of Income Tax, Foreign Tax Credit (October 2012).
 Leiden University, International Tax Center, LL.M. program—teaching course in international aspects of U.S. tax law (May 2012).
 NYU/KPMG Lecture Series, Outbound Transfers of Intangibles (April 2012).
 International Fiscal Association (New York), International Tax Reform (December 2011).
 Vienna University of Economics and Business Administration, Postgraduate International Tax Law—teaching course in international aspects of U.S. tax law (December 2011).
 NYU/IRS CLE Program, Foreign Tax Credit (Winter, 2011).
 NYU/IRS CLE Program, Dual Consolidated Loss and Foreign Currency Issues (Spring, 2010).
 NYU/IRS CLE Program, Cross-Border Acquisitions and Reorganizations (Winter, 2010).
 NYU/IRS CLE Program, Foreign Tax Credit and Subpart F (Fall, 2009).
 Vienna University of Economics and Business Administration, Postgraduate International Tax Law—teaching course in international aspects of U.S. tax law (February 2009).
 NYU/Univ. Conn. EC Tax Policy Conference, European Tax Policy in a Global Context (Spring 2008).
 NYU/IRS CLE Program, Cross-Border Reorganizations and Foreign Currency Issues (Spring, 2008).
 NYU/IRS CLE Program, Foreign Tax Credit and Subpart F (Fall, 2007).
 NYU/IRS CLE Program, Taxation of Inbound Transactions (Fall, 2006).
 NYU Wallace-Lyon Graduate Tax Workshop, International Tax Developments (May, 2006).
 1st Annual NYU/IBA International Tax Law Conference, President's Advisory Panel on Federal Tax Reform (December, 2005).

NYU National Tax Workshop, International Taxation (February, 2005)

ABA/IBA Second International Tax Institute, Optimizing Tax, Financial Accounting, and Cash Management in Multinational Operations (June 2004).

NYU National Tax Workshop, International Taxation (February, 2004)

NYU Seminar for Government, Foreign Tax Credit Reform (February, 2003).

KPMG/NYU Panel Discussion on Electronic Commerce (October, 2000).

NYU Graduate Tax Workshop, International Transactions (February, 2000).

NYU/Tax Analysts Seminar for Government, Deferral and Subpart F (February, 2000).

NYU/IRS CLE Program, Selected Issues in the Substantive Law and Federal Income Tax Treatment of Intangible Property (Autumn, 1999).

Deloitte Touche & Tohmatsu Training Conference on Outbound Mergers, Acquisitions, and Restructurings (July, 1998).

NYU/IRS CLE Program, International Joint Ventures (Autumn, 1997).

State Bar of Michigan, Taxation Section, Summer Tax Conference: Replicating a Corporation Through a Partnership: Cross-Border Transactions After NAFTA (June, 1995).

Tax Law Review, Colloquium on NAFTA and Taxation (September, 1994).

NYU/IRS CLE Program, Seminar on International Joint Ventures (Fall, 1993).

NYU/IRS CLE Program, Partnership Taxation (Spring, 1992).

Tax Law Review, Colloquium on Partnership Taxation (June, 1991).

NYU Graduate Tax Workshop, Restructuring Insolvent Corporations (June, 1991).

NYU Inst. on Fed Tax'n, Partnerships and S Corporations -- Workouts and Bankruptcy (July, 1990).

NYU Graduate Tax Workshop, Restructuring Insolvent Corporations (May, 1990).

NYU Inst. on Fed Tax'n, Corporate Acquisitions (April, 1990).

NYU Seminar for Government, Asset Tracing (March, 1990).

Corporate Tax Planning for Today (NYU) (San Francisco), Restructuring Insolvent Corporations (October, 1989).

NYU Graduate Tax Workshop, Restructuring Insolvent Corporations (June, 1989).

NYU/IRS CLE Program, Partnership Taxation (Summer, 1988).

NYU Graduate Tax Workshop, Partnership Taxation -- Passive Loss and Investment Interest Limitations (June, 1988).

NYU Graduate Tax Workshop, Partnership Taxation -- Debt and Risk-Sharing Issues (August, 1986).

NYU/IRS CLE Program, Seminar on Partnership Taxation Issues (June, 1986).

NYU Graduate Tax Workshop (San Francisco), Partnership Allocations Attributable to Contributed Property (October, 1985).

NYU Graduate Tax Workshop, Partnership Allocations Attributable to Contributed Property (August, 1985).

Advanced Tax Techniques in Real Estate Transactions (NYU), Partnership and Corporate Strategies (May, 1985).

NYU Graduate Tax Workshop (San Francisco), Partnership Taxation Issues (February, 1985).

NYU Graduate Tax Workshop, Partnership Taxation After the Tax Reform Act of 1984 (August, 1984).

Advanced Tax Techniques in Real Estate Transactions (NYU), Corporate Entities -- Problems and Pitfalls (June, 1984).

NYU Graduate Tax Workshop, Changes in the Treatment of Corporate Distributions (August, 1983).

NYU Graduate Tax Workshop, Tax Shelter Problems (August, 1982).

NYU Seminar for Government, Marital Breakups -- Legislative Proposals (May, 1982).

Practising Law Institute, Organization of the Corporation and Tax Benefits of Doing Business as a Corporation (April, 1982).

NYU Graduate Tax Workshop, Tax Planning in Divorce and Separation (August, 1981).

NYU Graduate Tax Workshop, Debt versus Equity Characterization (August, 1980).

NYU Graduate Tax Workshop, Corporate Liquidations (August, 1979).

1:09-cv-01208-MMM -BGC # 120-39 Page 1 of 1

E-FILEDFriday, 23 September, 2011 01:21:03 PM
Clerk, U.S. District Court, ILCDDebra E. Kuper/DA/Caterpillar
07/19/2007 02:56 PM

To: Daniel Schlicksup/DE/Caterpillar@Caterpillar

cc:

bcc:

Subject: Re: Fw: FYI - I assume you want this information as it comes up

Caterpillar Confidential Green

Privileged & Confidential
Attorney Work Product

Thank you Dan. I have forwarded it to outside counsel.

Regards

Debra E. Kuper
Senior Corporate Counsel
Legal Services Division
Caterpillar Inc.
100 N.E. Adams Street
Peoria, Illinois 61629-7316Office: (309) 675-1094
Fax: (309) 675-6620
Cell: [REDACTED]

Integrity. Commitment. Excellence and Teamwork

**[REDACTED] = Redacted by the Permanent
Subcommittee on Investigations**

This e-mail is intended only for the use of the individual or entity to which it is addressed and may contain information that is privileged and/or confidential. If you are not the intended recipient of this e-mail, please delete it and any attachments, without opening them, immediately. This e-mail does not constitute an e-signature, and by this e-mail, neither the sender nor Caterpillar intends to enter into a contract.

Daniel Schlicksup/DE/Caterpillar

Daniel
Schlicksup/DE/Caterpillar
07/19/2007 01:53 PM

To: Debra E. Kuper

Subject: Re: Fw: FYI - I assume you want this information as it comes up

Caterpillar Confidential Green

Retention Link: 07/19/2007

Retention Category: (093) General
Matters Administration

Please review this file and forward it to outside counsel. I believe that it is very relevant to this situation and some of the people involved. If I need to file separate complaints with the OBP, then let me know please. [attachment "Additional information re: taping and concerns expressed to OBP doc" deleted by Debra E. Kuper/DA/Caterpillar] Details support to follow.

Debra E. Kuper/DA/Caterpillar

Debra E. Kuper/DA/Caterpillar
07/19/2007 01:54 PM

To: Daniel Schlicksup

Subject: Re: Fw: FYI - I assume you want this information as it comes up

PSI-TWLF-02-000368



Daniel
Schlicksup@Caterpillar
08/14/2007 05:22 PM

To: James B. Buda@Caterpillar; Caterpillar, Debra E.
Kupper@Caterpillar; Caterpillar

cc

bcc

Subject: CONFIDENTIAL - tomorrow's meeting

Caterpillar: Confidential/Free

Hey Jim and Debra: regarding tomorrow's meeting, I would like to know if there is going to be any follow up on the issues in this document. I will see you at 4PM tomorrow. Thanks



Additional information re filing and concerns expressed to GEP 200

Return Receipt

File # CONFIDENTIAL - tomorrow's meeting
File # James B. Buda 08 Caterpillar
File # 08-15-2007 05:59:16 AM

Outside Council Summary

Question from Outside Council:

**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

Redacted By The Permanent Subcommittee on Investigations

VI. Provision

a. CSARL

- i. There is approximately \$1B on the balance sheet from the CSARL parts tax initiative and this number increases by about \$200M per year I think.
- ii. Recently I have raised the issue of whether the judicial doctrines of economic substance and business purpose have been adequately addressed to both Robin Beran and Corporate accounting. I have not gotten what I believe to be an acceptable response, if any.
- iii. The PwC audit manual requires that they consider these judicial doctrines. PwC did the planning they are auditing.
- iv. The essence of the issue is that the parts business is really run from the U.S. yet we are running all the parts profits through Switzerland.
- v. I have asked if there is any discussion in outside council memos on these issues and did not get any response.
- vi. I have passed along case-law which I think raises some questions. I have not gotten any response.

- vii. I think it is an important enough issue that some discussion needs to occur, but no one seems to want to have any discussion.
- viii. Apparently there was an anonymous letter raising this same issue before I returned to tax that was sent to several officers.
- ix. In the first quarter of 2007, we stopped having meetings to discuss the provision with the full tax council. The prior practice was to have 3 meetings per quarter with the full tax council.
- x. I asked Corporate Accounting why they changed the practice and she said that the tax managers believed the meetings were a waste of time.
- xi. The tax managers told me they did not believe the meetings did not have merit, they just thought it was a waste of time when we would have meetings and then it seemed Robin Beran and Jamie Copeland would make decisions in a private meeting.
- xii. I have informed Corporate Accounting and been told that it's not their job and I should tell Robin.
- xiii. I have told Corporate Accounting that I have told Robin and this is an issue that they should pay attention to. They have indicated that Robin says it's not an issue.
- xiv. Relevance
 - 1. Does a billion dollar financial statement issue warrant some open discussion if someone has concerns?
 - 2. If no one seems to want to have a substantive discussion should an employee be concerned?
 - 3. Does the tax provision warrant a sign-off by the tax council?
 - 4. Why bring up the taping issue if earnings issues do not seem to get discussed and debated?
- b. I have heard Corporate Accounting indicate that PwC allows some things at Cit regarding the tax provision that would not be allowed at other clients.
 - i. Recently a new tax partner came onto the Cit job. I was not in the meeting, but other tax managers indicated that it was a very tense meeting because the new tax partner did not believe we had the appropriate documentation for various items such as the recent FIN 48 implementation. They indicated he said the word fraud. I was told the next day that he seemed to have a different attitude. Concerns over the documentation have been brought up in other meetings.
 - ii. Relevance
 - 1. Does the new tax partners initial response to our tax provision support earlier statements by corporate accounting?

2. Should this concern an employee when they hear this sort of thing and nobody seems to want to talk about it?

**Redacted By The
Permanent Subcommittee
on Investigations**

E-FILED
 Friday, 23 September, 2011 01:21:03 PM
 Clerk, U.S. District Court, ILCD



Daniel
 Schlichte@OE/Caterpillar
 09/27/2007 03:50 PM

To: Nancy L. Snowden OA/Caterpillar/Caterpillar
 Cc:
 bcc:

Subject: CONFIDENTIAL - OBP Complaint - Accounting Practices -
 No 2 - DRAFT as we discussed. (I will send late Monday if
 I do not hear from you - THANKS)

Caterpillar - Confidential Green

Return Date: 09/27/2007

Nancy, this is a follow-up to our discussion Sept 6th determining that this issue should be investigated. This is also a follow-up to my discussion with Jim and Debra on Aug 8th, and the info I sent them during the eavesdropping investigation. Doug Oberhelman has indicated explicitly at each of the last three years' World-Wide Business Manager meetings that if there is even a hint of an issue, we should report it - he says he holds finance personnel to a higher standard. Debra has indicated that not reporting things can lead to worse things in the future, so employees have a duty to report. Also, this scenario from the OBP

website makes it clear that things of a much lesser nature than this should be reported. There are plenty of other scenarios that I believe support the reporting of this issue that I have not copied. These events involve officers of the company, MWE, and PWC.

Car Inc Tax Provision

- There is approximately \$1B on the balance sheet representing profit after tax generated from the CSARL parts initiative. This number increases by about \$200-250M per year. This is the Parts Initiative, and not the Contract or Toll Manufacturing involving CSARL, Gosselies and Grenoble which was a separate transaction.
- In January 2007, I raised the issue of whether the judicial doctrines of Economic Substance and Business Purpose have been adequately addressed, to both Robin Beran and Corporate accounting in writing. I do not believe the response I have received is consistent with the Code of Conduct, Corporate Policy and Procedures and the potential for risk posed to the Company and its shareholders. These judicial doctrines were established decades ago and are a primary tool used by judges (including the 7th Circuit Court of Appeals which has several opinions on this issue) to void the tax benefits of transactions that they believe to be inconsistent with business realities, have no effect on day-to-day operations of the business, are not consistent with the intent of the law, are abusive, etc. These doctrines stand for the premise that it is not enough to merely follow the letter of the law.
- The PwC audit manual states that a sound analysis of tax issues should consider the judicial doctrines of Economic Substance and Business Purpose.
- PwC Accounting Policy Manual - Uncertain Tax Policy Documentation.doc
- The audit manual also states that you should consider the source of third party opinions regarding transactions to be aware of conflicts of interest. PwC was the or a primary tax consultant of the Parts Initiative, establishing the accounting treatment and auditing the same. A subsequent transaction regarding Luxco was done by E&Y, and the tax managers have complained that PwC audits others work with much more rigor than their own.
- The essence of the issue is that to my knowledge, the parts business is managed from the US, yet we are running all the parts profits through Switzerland as if the business was managed by CSARL. This defers the US taxation on this profit. Having a bunch of people in Switzerland for marketing and other purposes is not

Redacted by the Permanent
 Subcommittee on Investigations

PSI-TWLF-02-000387

- necessarily tantamount to managing the parts business
- I have asked if there is any discussion in outside council memos regarding these judicial doctrines and have not received any response
- I have passed along 7th Circuit Court of Appeals case-law (dated prior to parts Initiative) to Robin which I believe at a minimum raises questions such that prudence would require there be some discussion. I have not gotten any response. I think it is an important enough issue that some discussion needs to occur, but no one seems to want to have any discussion. I have tried to raise issues to Dave Burritt and you are aware of the summary outcome of those actions (also the subject of future complaints)
- Apparently there was an anonymous letter raising this same or a similar issue in the 2000-2002 time frame that was sent to JWO and several officers
- I have informed Corporate Accounting and been told that its not their job and I should tell Robin
- I have told Corporate Accounting that I have told Robin, and this is an issue that they should pay attention to. Accounting indicated that because I had told Robin, they did



not raise the issue in meetings with him. email provision 1, robin and Eric Acog doc. In the first quarter of 2007, we stopped having the Quarterly Tax Provision meetings to discuss the provision with the full Tax Council prior to each quarterly release. The prior practice was to have 3 meetings per quarter with the full Tax Council leading up to the financial statement release. Now there are individual meetings with some of Tax Council members. I am no longer part of this process. To my knowledge, I was never informed of the change until I asked someone why we were not having the regular meetings. I asked Corporate Accounting why they changed the practice and was told that the tax managers believed the meetings were a waste of time





email provision meetings.doc. A tax manager told me that the tax managers did not believe the meetings did not have merit, they just thought it was a waste of time when we would have meetings, and then Robin Beran and Jamie Copeland would make decisions in a subsequent smaller meeting

[REDACTED]

I know one's gut response is there can't be anything wrong here at Cat of this magnitude? In that regard, please consider the other events I have raised to your attention. In addition, here are a few other items that provide some reflection on this question

[REDACTED]

- 
- 
- At a May 2007 meeting in Nashville, Corporate Accounting stated that our policy with PwC is we they do not take anything to the Audit Committee that both parties have not agreed on.

I believe an inquiry into this issue is appropriate. I do not make this complaint lightly. This is why we discussed it ahead of time. Assume you investigate and find that the outside council memos and PwC memos address economic substance and business purpose appropriately. Then great! However, if you assume for the moment there is an issue here, I believe it would be of significant concern to Caterpillar shareholders. I do not believe that I am suppose to look the other way when people say there is no issue without providing any credible support or explanation, or just don't respond to concerns - particularly in light of all the other situations we are discussing. I recommend that we request the outside council memos and PwC memos to see if they address these judicial doctrines. I believe this issue raises a host of concerns that I am sure come to your mind and whether there is or is not an issue here. If there are no memos or they do not address these issues then steps should be taken to protect the interests of Caterpillar shareholders and to determine if there is a duty to disclose this issue to anyone (the Cat Inc Board of Directors, Audit Committee, Regulators, etc.)

I have asked John Caviness to look into this with me. First, we would review the MWE memos which John has (he is looking for them) and request the PwC memos. John and I talked about then addressing this with other managers in our Tax Risk Guard Rail review coming up in October. However, this would mean that this would not be resolved within the quarter. Please advise as to whether you would like for me to proceed with John in this fashion. John is NOT aware of this or the other complaints I have filed or will file. I do not believe he has a need to know. What ever you decide to do as a result of this complaint it can be done in a manner that John is not told that I filed a complaint. Please advise.

Despite all the reassurances from you, Jim and Debra, you know I am very concerned about retaliation. I believe there are valid reasons to justify my concern, which I have raised and documented, and will incorporate into additional future complaints, but believe that having this issue addressed is important to Caterpillar shareholders. **Please, in all events and in every way possible, do not disclose my identity as the person filing this complaint. Please do not disclose to anyone (other than Jim and Debra) that I filed this complaint, or any other information that may narrow the population of employees who could**

have done so in anyone's mind, without my prior knowledge or approval. I realize that Dave, Robin and others may be able to figure out this is my complaint, and I can't help that, but few people other than you, Jim and Debra, if any, should have a "need-to-know".

Thank You

Return Receipt

CONFIDENTIAL - CBP Complaint - Accounting Practices - No 2 - DRAFT as we discussed. It will
send late Monday if I do not hear from you. Thank
Nancy L. Snowden/CA Caterpillar
09/07/2007 04:54:49 PM

Return Receipt

CONFIDENTIAL - OBP Complaint - Accounting Practices - No 2
Nancy L. Snowden, 9A Caterpillar
09/12/2007 at 4:33 PM

1:09-cv-01208-MMM -BGC # 120-61 Page 1 of 1

E-FILED
 Friday, 23 September, 2011 01:21:04 PM
 Clerk, U.S. District Court, ILCD



Robin D Beran/OS/Caterpillar
 03/24/2008 10:51 AM

To: Daniel Schlicksup/IE/Caterpillar@Caterpillar
 cc:

Re: Audit Comm meeting

Caterpillar Confidential Green

Retain Until: 03/24/2011

History

This message has been replied to

Dan, both did I confirmed with Dave and Lowell on theirs. I didn't get a chance to mention it to you. Thurs. It's covered extensively in the 4 memos they prepared, including the issues related to the conversion phases. I can have Lowell discuss their review process with you if you want. But the issues on this were well considered.

Robin

beranrd@cater.com - 309.675.4478

Every transaction has tax consequences

Daniel Schlicksup

----- Original Message -----

From: Robin D Beran/OS/Caterpillar
 Sent: Friday, March 24, 2008 10:51 AM
 To: Daniel Schlicksup/IE/Caterpillar
 Subject: Audit Comm meeting

Ed keeps saying in his emails that "The presentation should cover the most important Tax risks."
 Does he understand CSAPL and it's related risks?
 Did MWE or PwC address the substance vs. form risk?
 I have to assume the answer is "no" since this would be easy to verify and no one has answered the question to-date.

----- Forwarded by Daniel Schlicksup/IE/Caterpillar on 03/24/2008 10:51 AM -----



Daniel
 Schlicksup/IE/Caterpillar
 03/19/2008 03:08 PM

To: Robin D Beran/OS/Caterpillar
 cc:

Subject: Audit Comm meeting

Caterpillar Confidential Green

Retain Until: 03/19/2011

Robin, here is a new file. Best thing to do is to get it to Dave tomorrow. That way if he wants a meeting we have time to have one. This is what I told Ed Scott when he asked today. Also, I have to get him a summary of the presentation as soon as he gets me the format. Dry run is on 31st. Your notes are on your desk.
 [attachment "031908 Apr 2008 Audit Comm Pres.ppt" deleted by Daniel Schlicksup/IE/Caterpillar]

On the new page 10 on risk management I don't know how BRM fits into it as BRM is at a very high level but the label is in there as requested.



Facility	Administration Building	Plant/Office	Department	Attention
Date	May 1, 2008			
Plant/Office	Administration Building			
Department	Executive Office			
Attention	Doug Oberhelman, Group President Ed Rapp, Group President "Daniel J. Schlicksup personnel folder", Human Resources			

Caterpillar Inc. Code of Conduct

Executive Summary

Doug stated in the last three World-Wide Finance Manager Meetings that if anyone detects a hint of an ethical issue we should report it and he holds finance personnel to an even higher standard. This year Ed and Gene Fife spoke about the importance of integrity also. Gene also discussed the importance of the Board being able to trust what they are told. Jim Owens closed the meeting stating he doesn't understand why other companies have integrity lapses that should have been known earlier. He said he couldn't imagine this happening at Cat and he sleeps well. He said we should have the highest integrity, always. He said that questions about integrity should be put on the table right away and we should not be afraid to do that.

The facts and issues below speak directly to your. Gene's and Jim's comments. I believe these facts are important to you, the Board, and Caterpillar Shareholders.

The lynchpin of a corporate ethics program is the willingness of people to report the appearance of improprieties. You and the Board cannot manage risk you do not know about, particularly ethical risk. I have observed conduct that appears contrary to Company Policy and in some cases applicable law. I complied with Company Policy and reported several situations. There are many others.¹ As a result, I have experienced threats, intimidation, and retaliation, particularly from Dave Burritt.

Dave Burritt told me that if I reported any ethical issues neither Doug nor the Board would do anything, and I would be "toast".² Dave cited a significant financial statement issue he claimed was quietly dealt with recently as evidence that both Doug and the Board would do nothing. Dave lured me to a private meeting under false pretenses in which he made it clear he had begun to and would continue to, retaliate.³ He said he was very concerned about my "approach" and had already talked to other Officers and Succession Planning about me.⁴ I believe unsubstantiated language in my current performance review is a continuation of this retaliation.

In my current review Robin Beran told me that filing ethical complaints has made his and Dave Burritt's lives difficult, and he asked me if there were not better alternatives such as working through Robin and Dave. I am being told my sense of integrity is misguided. I am being told my "approach" is problematic which is exactly what Dave Burritt told me when the threats and intimidation began more than 18 months ago.⁵

1 - general accounting practices, tax accounting practices, PwC independence issues, earnings issues, Board reporting issues, structured finance, etc.

2 - see Attachment 11 - email to Dave Burritt dated September 28, 2005 at 04:55pm

3 - see Attachment 21 - email to Dave Burritt dated November 15, 2006

4 - see Attachment 35 - email to Jim Buda dated August 14, 2007 with attached memo (p. 6 of 9)

5 - see Attachment 11 - email from Dave Burritt dated September 28, 2005 at 05:21pm

Caterpillar Form No. 01-080505-06 PG (2402) MS Word 97

1:09-cv-01208-MMM -BGC # 120-257 Page 5 of 50

My current review includes negative statements about me with no facts to support the allegations. Nor was there any interim notice that there were any allegations. I have worked for Robin and Dave for many years with excellent ratings and all positive comments in the past. It is only after reporting Robin and Dave for ethical violations that were acted upon that the allegations appeared.

I requested supporting facts from Robin Beran on February 26, 2007. Robin told me that he has requested and received supporting facts at least once, but has not articulated any facts to-date. Robin and I worked through 2 drafts of the review from February 25th to March 6th. I did not hear back from him for 35 days.

On April 11th Robin Beran presented me with a newly rewritten review document. Robin could not answer questions about some of the wording because these "were not his words". I again asked Robin for facts to substantiate the negative statements, but he did not have any.

I was invited to a meeting on April 17th with HR and Robin. I was told to either sign the new performance review or they would sign it and submit it without me. I felt pressured to sign it on the spot, but did not. Robin and HR told me that they and Legal jointly authored and/or edited the new document.

In the new document my proficiency ratings for competencies were significantly reduced from what Robin had previously agreed to 35 days earlier.⁶ It appears that if I had not persisted in requesting facts to substantiate the negative statements, Legal and HR would not have been involved and these ratings would not have been reduced. These new ratings are significantly lower than the prior two years and even lower still than the 5 years I reported directly to Dave Burritt.⁷

Robin indicated that I received a good rating (PL2) and should be happy. No rating can justify unsubstantiated negative statements that appear to echo prior comments of Dave Burritt that were threatening, intimidating and retaliatory, and in response to my raising ethical issues in accordance with Company Policy.

I asked for a few days to review the new document and to suggest some alternative language in a half dozen sentences. I believe this was fair since Robin, HR and Legal took 35 days to draft the document. Robin and HR told me "no" I could not do this. The only reason given was that the review was late and they track late paper.

On April 18th Robin and HR signed and submitted the performance review. They told me to file my comments with HR within 30 days. They never answered simple questions such as why the negative statements were included in the review without the specifics required by GF&SSD Performance Review Instructions.⁸ Neither Robin nor HR would articulate an appeal process. Instead, I was told Legal and Corporate HR had "already" been involved.

Is what Dave Burritt told me true?

- You cannot and should not raise ethical issues at Caterpillar?
- Neither Doug nor the Board will do anything if you raise an issue?
- If you raise any ethical issues you will be "toast"?

Based on my experience thus far, the retaliatory part appears to be correct. However, it also appears that neither you nor the Board may be aware of some critical facts and risks.

I have found the process for handling ethical complaints to be incomplete, subjective, unclear and cumbersome, the practical effects of which are to discourage individuals from coming forward, to protect those who act improperly, and to disenfranchise those who follow Company Policy. The Office of Business

6 - see Attachment 61 - Summary of Competency ratings from Beran and Burritt, including previous drafts of 2007 review.

7 - see Attachment 61 - Summary of Competency ratings from Beran and Burritt, including previous drafts of 2007 review.

8 - see Attachment 60 - Global Finance & Strategic Support Division's Performance Summary Document Checklist For Leaders
Caterpillar Form No. 01-080505-06 PC (2402) 1/03 Word 97

1:09-cv-01208-MMM-BGC # 120-257 Page 6 of 50
 Practices and the Office of the General Counsel told me there is no Caterpillar process for appealing issues you believe were not handled correctly.⁹

The following is a summary of facts with documentation required to understand issues important to you, the Board and Caterpillar Shareholders and, therefore, my position regarding my review.¹⁰ I will forward this memo and documentation to HR to be included in my personnel history folder as I was instructed to do. I will forward this to Human Resource after we discuss it. Alice Barbour requested it, but indicated she will show this to Robin Beran and he will definitely show it to Dave Burritt, both of which would be inappropriate. I do not understand why I was not allowed a few extra days to respond.

If you believe this is intended to be harassing, based on personal opinion only, or is otherwise trivial, please let me know immediately. My employee record, leadership testing and actual results, upward and peer feedback, and employee survey results at Caterpillar are all very good and in most cases excellent. I would simply like to be treated consistent with written Company Policy and have accurate reviews substantiated by facts.

I would like to discuss this at your earliest convenience. Please let me know how you would like to proceed. Thank you in advance.

With respect and deference,



Daniel J. Schlicksup

⁹ - see Attachment 38 - email from Nancy Snowden dated April 3, 2008

¹⁰ - There is approximately 120 pages of documentation that could not be sent by email. I have forwarded this by inter-company mail. The complete documentation is much more extensive.

Caterpillar Form No. 01-080505-06 PC (2402) MS Word 97

SummaryIssue-1, page 3

Appearance of improper reporting to the Executive Office
 Appearance of improper reporting to the Board
 Appearance of improper public statements
 Appearance of Group President retaliation
 Appearance of Sarbanes-Oxley violations

Issue-2, page 4

Appearance of improper reporting to the Audit Committee
 Appearance of improper reporting in the public proxy
 Appearance of threats and intimidation by the Chief Financial Officer
 Appearance of intimidation by PwC
 Appearance of improper reporting to the PwC National Office
 Appearance of Sarbanes-Oxley violations

Issue-3, page 6

Given advice from the legal department to engage in conduct that was dishonest & illegal

Issue-4, page 7

Appearance of improper income and expense reported on the financial statements
 Appearance of retaliation by the Chief Financial Officer and Assistant Treasurer
 Appearance of poor judgment
 Appearance of wasting corporate assets
 Appearance of possible fraud
 Appearance of Sarbanes-Oxley violations

Issue-5, page 10

Appearance of poor judgment
 Appearance of a wasting of corporate assets
 Appearance of possible fraud
 Appearance of Sarbanes-Oxley violations

Issue-6, page 11

Appearance of poor judgment
 Appearance of retaliation by the Chief Financial Officer
 Appearance of Sarbanes-Oxley violations

Issue-7, page 11

Appearance of continued retaliation by the Chief Financial Officer and Assistant Treasurer
 Appearance of Sarbanes-Oxley violations

ISSUE - 1

November 2003: I was told to go to Cat Logistics to help with cost problems. Steve Wunning told me he was pricing contracts below cost and, therefore, needed to reduce operating costs.

Spring 2004: While analyzing financial data from 1993 to 2003, it appeared to me that the financial data for the "external logistics business" contradicted what was being presented to the Executive Office, the Board, and Shareholders. For example:

- June 2003 Executive Office Review states the "external logistics business" has a profitable track record and "Cat Logistics" is an outstanding investment.¹¹

Contemporaneous internal documents state the "external logistics business" profit decreased from a \$61M profit in 2001 to a \$7M loss in 2003.^{12, 13} An outside consulting report states that post-investment analyses show consistent under performance by the "external logistics business" against projected ROI targets by over \$123M, and that margins have eroded over time and the trend is continuing.¹⁴

- February 2004 operations report to the Board states "Cat Logistics" is expected to grow profitably at 15% annually and potential business revenue in the pipeline supports revenue targets.¹⁵

Contemporaneous internal documents state a trend of decreasing profits for the "external logistics business" to a loss situation.^{16, 17} An external consulting report states if the "external logistics business" signed every deal they had in the pipeline they would still be \$500M below revenue targets.¹⁸

- June 2003 Executive Office Review states "Cat Logistics" is an outstanding investment, and we should increase the visibility of the "logistics business" in external financial reporting.¹⁹ Press releases, annual reports, etc. all put forth an increasingly positive image of the "logistics business" and notably the "external logistics business".²⁰

I asked Bob Sweikert, then CFO of Cat Logistics, if Jim Owens was aware of the actual data.²¹ Bob told me he did not have time to address this. Talking about the financial problems I was asked to resolve was not encouraged.

December 2004: Dave Burritt told me that Mary Bell was trying to move me out of Logistics, unknown to me. I accepted a newly created job Dave Burritt offered me in Corporate Tax in March 2005. Later in 2005 an attorney from Cat Logistics told me he heard I was moved out of Logistics because I was talking about the profitability problems of the external logistics business.

April 2005: I asked Robin Beran why I did not get a lateral move increase. Robin said he understood that it was a mandate from Steve Wunning that I was not to get a lateral increase.²² I told Dave Burritt. He wouldn't

11 - see Attachment 1 - June 2003 Cat Logistics Executive Office Review

12 - see Attachment 3 - December 2003 Steve Wunning staff meeting

13 - see Attachment 4 - February 2004 Mary Bell staff meeting

14 - see Attachment 6 - Marx Consulting report on "Cat Logistics Update". Prior to 2002 the external logistics business had one client providing 20% of the revenue and 80% of the profit, which skewed the profitability potential of this business. Documentation is available upon request.

15 - see Attachment 2 - February 2004 Cat Logistics Operating Comments for the Board

16 - see Attachment 3 - December 2003 Steve Wunning staff meeting

17 - see Attachment 4 - February 2004 Mary Bell staff meeting

18 - see Attachment 6 - Marx Consulting report on "Cat Logistics Update"

19 - see Attachment 1 - June 2003 Cat Logistics Executive Office Review

20 - Documentation is significant and can be provided upon request

21 - see Attachment 7 - email to Bob Sweikert dated September 23, 2004

22 - see Attachment 8 - Personnel Change Form dated March 14, 2005

Caterpillar Form No. 01-080505-05 PC (2402) MS Word 97

say who did this and did not deny it was Steve. I have quietly got the lateral increase for me. Neither Dave nor Robin addressed the fact that Steve Wunning did this.

April 2005: I reported my concerns about the external logistics business to Dave Burritt as required by Company Policy.²³

July 2005: I suggested to Dave Burritt that we go to Doug Oberhelman.²⁴

September 2005: Dave Burritt told me if I pursued reporting this issue that Doug Oberhelman, Jim Owens and the Board would not do anything and I would be "toast" for having reported it to either the OBP or Doug Oberhelman.²⁵ Dave told me about a significant past financial statement issue that was not addressed by Management, PwC or the existing Board, as an example of the futility of reporting anything. When I asked to talk again he told me he now had concern about my "approach".²⁶ The message was back off, be quiet, or else.

November 2005: I received a pointed voice mail from Dave telling me to stop sending him emails on this issue.²⁷

November 2005: I became concerned that this issue may constitute inside information. I raised the issue to Dave Burritt and he was not concerned, but it appeared he had already traded Company stock.²⁸ I reported this issue to the OBP who, with Legal, assured me that it was "ok" for me to sell Cat stock. I do not believe the issue of proper reporting to the Executive Office and the Board, or the denial of my lateral increase, was addressed.

ISSUE - 2

October 2005: I was asked by Jim Bowers of PwC to include about \$1-2M of audit fees in the "Tax Consulting" category in the December 2005 report to the Audit Committee. There was significant pressure from the Audit Committee at this time that PwC "Audit" fees were too high, particularly from John Dillon.

I asked Jim what activities generated the fees. Jim told me the fees were for PwC activity to review tax consulting done by Ernst & Young to be sure the tax benefits were correctly stated on the financial statements as part of the PwC audit of the Caterpillar financial statements. Jim agreed that the only role of PwC personnel was as the auditor of the financial statements. Jim agreed that "but-for the fact that PwC was Cat's auditor, these fees would not have been incurred".

I told Jim to include these fees in the "Audit" category and explain the overage to the Audit Committee. I told Jim that it was much better to have to explain an overage to the Audit Committee, however painful that might be, than to be found later to have misled them, particularly since the level of "Audit" fees was an issue.

December 2005: PwC and Internal Audit included the fees under the heading of "Tax Consulting" for the December 2005 Audit Committee meeting. The total amount was broken into smaller amounts.²⁹ Jim Bowers from PwC told me that Internal Audit requested the fees not be characterized as "Audit". Steve Christiansen of Internal Audit told me that PwC requested the fees not be characterized as "Audit".

January 2006: I raised the issue that the December 2005 report to the Audit Committee was wrong, as required by Company Policy. We had a meeting. Sharad Jain said that, because the fees were incurred during the year as opposed to the end of the year, they were not "Audit" fees. I told him that the character of the work

²³ - see Attachment 9 - email to Dave Burritt dated April 28, 2005

²⁴ - see Attachment 10 - email to Dave Burritt dated July 22, 2005

²⁵ - see Attachment 11 - email to Dave Burritt dated September 28, 2005 at 04:53pm.

²⁶ - see Attachment 11 - email from Dave Burritt dated September 28, 2005 at 05:21pm.

²⁷ - tape of voice mail message from Dave Burritt dated November 16, 2005 available if requested.

²⁸ - see Attachment 11 - email from Dave Burritt dated September 28, 2005 at 04:53pm.

²⁹ - see Attachment 12 - email to Dave Burritt dated January 20, 2006

Caterpillar Form No. 01-080505-06 PC (2402) MS Word 57

determines the character of the fee, not the timing of the work and there was plenty of evidence that these were "Audit" fees. He did not respond.

Sharad then said that it would be more conservative to characterize these fees as "Audit Related", not "Audit", since the PCAOB was concerned about audit firms performing non-audit work for audit clients. I told him that while this sounded reasonable there was plenty of documentation showing that this was audit work and, therefore, these were audit fees. He did not respond.

January 2006: I informed Dave Burritt and Robin Beran as required by Company Policy.³⁰

April 2006: After resisting any change for 5 months, it appears PwC and Internal Audit reclassified the fees from "Tax Consulting" to "Audit Related" for the April 2006 Audit Committee meeting.³¹ I believed this to be incorrect since based on the facts and internal documentation these were "Audit" fees. I continued to maintain that there was no factual basis for including these fees in the "Audit Related" category.

July 2006: I brought this issue up to Dave Burritt again and told him people were not happy with me for raising it, that it would likely be glossed over in a meeting scheduled for the next day, and asked for his advice.³² The next day when this issue was raised, Sharad Jain said, "Why are we discussing this issue again? I don't know why it keeps coming up?" I did not say anything in this meeting. Later that day Dave Burritt sent me an email presuming my silence in the meeting was my agreement the issue was resolved.³³ I responded to Dave telling him there still was an issue and why.³⁴

September 2006: I raised the issue again to Dave Burritt and suggested that he simply request PwC time keeping records that have an activity code and a charge code that would resolve the matter.³⁵ Dave responded with a threatening email implying that I was working behind peoples' backs, would not speak up in meetings, and that "we needed to talk".³⁶ I responded telling Dave his accusations were unfair and why, and again suggested he merely get the PwC billing records to resolve the issue.³⁷

November 2006: I sent Dave an email fully documenting the facts including an invoice for some of the fees in question signed by Robin Beran with Robin's note that "This is financial audit, not tax services".³⁸

November 2006: I was invited to a meeting in Dave Burritt's office entitled "STIP". I was not integrally involved with the "Short Term Incentive Plan". I confirmed the need to attend the meeting and was told by Dave's assistant that "yes" I had to attend.³⁹ I knew there had already been several meetings the week before on STIP and there was another meeting later that day.

When I entered Dave's office his assistant closed the door behind me, which had never happened before. Dave's body language and the tone of his voice were very threatening and intimidating. He said:

- He could not believe I sent him the information documenting the PwC fee issue.
- Because I sent him written documentation, now he would have to do something.
- He would have to get an outside investigator.
- The PwC issue was like the logistics issue that was also inappropriate to raise.
- He couldn't believe I was wasting my time on this.
- What is the big deal about the classification of fees to the Board.

30 - see Attachment 12 - email to Dave Burritt dated January 20, 2006

31 - see Attachment 62 - spreadsheet from Internal Audit

32 - see Attachment 13 - email to Dave Burritt dated July 24, 2006

33 - see Attachment 14 - email from Dave Burritt dated July 25, 2006

34 - see Attachment 15 - email to Dave Burritt dated July 26, 2006

35 - see Attachment 16 - email to Dave Burritt dated September 29, 2006

36 - see Attachment 17 - email from Dave Burritt dated September 29, 2006

37 - see Attachment 18 - email to Dave Burritt dated October 3, 2006

38 - see Attachment 19 - email to Dave Burritt dated November 3, 2006 and attached invoice dated October 25, 2005

39 - see Attachment 20 - emails to & from Marilyn Huson dated November 13, 2006

Caterpillar Form No. 01-080505-06 PC (2402) MS Word 97

- 1:09-cv-01208-MMM-BGC # 120-257 Page 11 of 50
- He has more important things to spend time on.
- This was poor judgment to send him this information.
- I should have resolved this without bringing him into it

Dave then told me that he had been talking to other Officers and Succession Planning, and that people have a hard time working with me and I have a problematic history. He said I should be aware that his direct reports were beginning to complain about me that I was hard to get along with. He said he thought I should be aware of this and he was just "coaching" me regarding my career.

I had very little, if any, contact with Dave's direct reports. I asked him for names and examples. The only example he had was that it annoyed him when I multi-tasked in large meetings using my computer. I was very upset after this meeting and responded to Dave telling him that his behavior was intimidating and I should not be retaliated against for following Company Policy.⁴⁰

December 2006: I received an email from Dave Burritt stating that the intimidating meeting was just a misunderstanding and indicating that Sharad Jain sent a letter to the PwC National Office asking for a determination as to whether these fees were "Audit" or "Audit Related".⁴¹ The determination letter came back stating the fees were "Audit Related".⁴²

December 2006: I brought this to the attention of the OBP and was told that the determination letter was a final resolution of the issue. I explained that the determination letter is wholly dependent upon the facts presented by Sharad Jain. I asked the OBP why the facts provided by Sharad to the PwC National Office did not include the PwC invoice for this work upon which the Caterpillar Tax Director had written a note stating "This is financial audit, not tax services", or other internal Caterpillar documents indicating these were "audit" services, or the PwC billing records, etc. I asked how this could be an objective review. I have not received an answer to these questions. I was told that this issue is closed and there is no avenue for appeal.

ISSUE - 3

May 2007: On a Friday morning I sold 9958 shares of Caterpillar stock through the Cat broker. Later that day I realized I sold too many shares and would not meet my share ownership requirements. On the following Monday I called the Cat broker to purchase 3400 shares.

The broker said he could "rescind" the sale using the brokerage company's "error" account. This would mean that the broker and I would pretend that I did not sell 3400 shares the previous Friday and the broker would issue relevant documentation showing a sale of only 6558 shares. This would avoid the payment of income tax on the sale of 3400 shares. The broker made it sound like he had done this before for others at Cat.

I asked Legal for advice. I was told to rescind the sale as the broker suggested to avoid a negative appearance for the company.⁴³ I ignored this advice because I believe what Legal advised me to do is tax fraud and would be akin to back-dating-stock-options.⁴⁴ I explained my rationale to the Legal⁴⁵ and never heard back, except for them to say I should inform my supervisor, Robin Beran.

Robin at first tried to tell me the advice from Legal was ok from a tax point of view.⁴⁶ He recanted when I challenged his tax analysis.⁴⁷ I told Robin that if this is being done at Cat, it should stop immediately.⁴⁸

40 - see Attachment 21 - email to Dave Burritt dated November 15, 2006
 41 - see Attachment 22 - email from Dave Burritt dated December 4, 2006
 42 - see Attachment 23 - memo from PwC National Office dated November 17, 2006
 43 - see Attachment 24 - email from Babatunde Awordian dated May 7, 2007
 44 - see Attachment 25 - email to Robin Beran dated May 7, 2007
 45 - see Attachment 26 - email to Babatunde Awordian dated May 8, 2007
 46 - see Attachment 27 - email from Robin Beran dated May 8, 2007
 47 - see Attachment 28 - email to Robin Beran dated May 9, 2007
 Caterpillar Form No. 01-090505-06 PC (3402) WS Word 37

1:09-cv-01208-MMM -BGC # 120-257 Page 12 of 50

I reported this to the OBP⁴⁹ as required by Company Policy, indicating that if this advice is being given to others at Caterpillar (employees, Officers, Board members) by either Legal or the Cat broker, then this should stop. I suggested that they find out if that is the case so they could have people file correct 2007 tax returns and amend prior year tax returns to avoid the apparent fraud.

I was told in a meeting with the OBP that such a rescission was ok because they called their personal broker who said this practice is common in the industry, called "busting the deal", and it's ok. I believe it is fraud. I told the OBP Cat should not advocated this practice and they should get an independent legal opinion.⁵⁰

ISSUE -- 4

July 2007: I reported the eavesdropping event involving Dave Burritt and Robin Beran as required by Company Policy. There was a lot of discussion among my colleagues and I about the certain retaliation that would occur if we reported this incident. I followed Company Policy. My 6 colleagues chose not to. Recently I asked Robin if he addressed my colleagues' failure to comply with Company Policy in their performance reviews. He said no.

During the eavesdropping incident I told Debra Kuper in Legal that I had several other issues to report including past retaliation.⁵¹ She told me to report the other issues to the Outside Counsel investigating the eavesdropping and they would address them.⁵² The Outside Counsel ran out of time while interviewing me and did not discuss these additional issues.⁵³ I forwarded a summary and detailed documentation of these issues to Debra who indicated she would pass it on to Outside Counsel who would address them.⁵⁴ I do not know if she in fact did this.

August 2007: I met with Jim Buda and Debra Kuper to follow-up on these other issues because they were not addressed by Outside Counsel. I sent them the summary of these issues prior to the meeting.⁵⁵ Jim stated that what I was trying to say was that this was a history or pattern of retaliation. Jim said that Legal would not follow-up on these issues and that I would have to file separate complaints with the OBP. Jim knew many issues involved Dave Burritt and the OBP would recuse itself because it reports to Dave Burritt, and send the issues right back to Legal. These other issues included the following.

(1) Accounting Practices: This is the issue Dave Burritt told me about in 2005 as an example why Doug and the Board would not act on reported ethical issues.

It appears an asset was put on the books and profit recorded in the 1970's with no basis for doing so. Increases and decreases were made to this asset over more than two decades. Dave indicated to me they "quietly" amortized this asset balance off the books around 2003-4 time frame. Several Tax Managers referred to this as "Mickey Mouse Accounting".

I filed a complaint with Legal and the OBP on August 8, 2007⁵⁶, as required by Company Policy. I was told that this would not be investigated. The OBP said they talked with Janie Copeland who was not working at Cat when this happened. The OBP said this issue was just a difference of opinion and the Board thought Al Hagen, who reported it, was wrong. The OBP said this issue was amortized off

48 - see Attachment 29 - email to Robin Beran dated May 9, 2007

49 - see Attachment 30 - email to Nancy Snowden dated May 8, 2007

50 - see Attachment 31 - email to Nancy Snowden dated May 14, 2007

51 - see Attachment 32 - email to Debra Kuper dated July 10, 2007 at 04:39pm

52 - see Attachment 32 - email to Debra Kuper dated July 10, 2007 at 04:48pm

53 - see Attachment 33 - email to Debra Kuper dated July 17, 2007

54 - see Attachment 34 - email to Debra Kuper dated July 19, 2007

55 - see Attachment 35 - email to Jim Buda dated August 14, 2007 with attached memo

56 - see Attachment 36 - email to Nancy Snowden, Debra Kuper & Jim Buda dated August 8, 2007

Caterpillar Form No. 01-080505-06 PC (2432) MS Word 97

1:09-cv-01208-MMM-BGC # 120-257 Page 13 of 50
the books before Sarbanes-Oxley was effective and there is nothing we would do now anyway as the unsubstantiated assets were already amortized back into expense.

I asked why they did not talk to Al Hagen who still works in the Tax Department and is intimately familiar with this issue. I received no response. I asked if the "current" Board knew there was an issue. I received no response.

(2) By Passing Standard Accounting Controls To Pay Fees to PwC: In 1998/9, I told a staff not to pay PwC because there had been no results yet from a large project. Two months later the staff worked with PwC to return a \$1M invoice to PwC, who then issued a \$1M credit memo and two new invoices for \$500K each. The staff then had these smaller invoices paid without my approval.

I reported this to Dave Burritt and Robin Beran as required by Company Policy. Nothing substantive was done. Robin wanted to reconsider the whole situation and thought that I had made too much of it by reporting it.⁵⁷ He told me we had to get the staff to stay at Cat. The staff was a friend of Robin.

The staff left Cat and went to work for the PwC Office to whom the money was paid. He still works on Cat issues. I had to throw a party for him before he left.

This staff always maintained he never did anything he wasn't supposed to do. I never understood why he would say this until I was in a meeting with Rod Perkins on July 8, 2007, and he told me that Robin Beran was behind this whole event. It appears that Dave Burritt was also. Dave was very upset when I raised this issue with him in the discussions about proper characterization of PwC fees to the Audit Committee (discussed above) and paying PwC based on unsupported invoices (discussed below).

I was subsequently forced to leave the Tax Department. Robin Beran told me that the only job for me was in Nashville and that he had already confirmed this with Succession Planning and others – there would be no other job for me at Caterpillar. I believe this was in retaliation for reporting the invoicing issue that precipitated Robin's friend leaving the Company. Dave Burritt was aware of all this.

I filed a complaint with Legal and the OBP on August 8, 2007,⁵⁸ just after I learned from Rod Perkins that Robin Beran was behind this event and as required by Company Policy. The complaint included all the documentation necessary to investigate this issue (invoices, journal entries, etc.). The OBP kept asking me questions about Dave and Robin's motives, and how the OBP could investigate something that happened 8 years earlier.⁵⁹ The legal department told me they would not investigate this issue due to the passage of time.⁶⁰

My question to the OBP and Legal was how can you not investigate what appears to be improper financial dealings between Cat and PwC when you have all the

57 - see Attachment 36A – email from Robin Beran dated February 5, 2000

58 - see Attachment 37 – email to Nancy Snowden, Debra Kuper & Jim Buda dated August 8, 2007

59 - see Attachment 38 – email to Nancy Snowden & Debra Kuper dated August 8, 2007

60 - see Attachment 39 – email from Debra Kuper dated September 6, 2007

Caterpillar Form No. 01-080505-06 PC (2402) MS Word 97

1:09-cv-01208-MMM-BGC # 120-257 Page 14 of 50
 written documentation in your hands and all of the people involved still work for Cat and PwC?⁶¹ I received no response.

(3) Steve Wunning Denial of My Lateral Increase: This is discussed above in Issue-1. I have never filed a complaint regarding this issue. I have told several officers and others, but no one has addressed what appears to be retaliation.

(4) Dave Burritt's Attempts To Discourage Me From Raising Ethical Issues: As discussed above in Issue - 1. Dave Burritt told me I would be "toast" for raising ethical issues. He told me neither Doug nor the Board would do anything about ethical issues. He told me to stop communicating to him about these issues.

(5) Are the PwC Audit Fees Reported Correctly to the Board: This was discussed in Issue - 2 including threats, intimidation and retaliation from Dave Burritt and intimidation by PwC.

(6) Tax Provision on the Financial Statements: The CSARL tax structure accounts for more than \$1 Billion on the Caterpillar balance sheet. This number increases by more than \$50 Million each quarter. Around 2002 someone else, other than me, anonymously raised concern about the propriety of this structure to the Executive Office.

In January 2007, I raised the issue of whether this structure has the required level of "business substance" to Robin Beran.⁶² I raised the "business substance" issue to Janie Copeland and was told that since I already raised the issue to Robin, Janie did not bring it up in the Tax Provision meetings.⁶³ Up until I raised this issue, I was included in the Tax Provision meetings, but have not been invited since.⁶⁴

On September 11, 2007, I filed a complaint with Legal and the OBP⁶⁵ as required by Company Policy. On September 27th Legal told me to follow-up with the Tax Counsel to work this out.⁶⁶ Four days later on October 1st Legal told me they had concluded the investigation and the matter was closed.⁶⁷

In February 2008, during a meeting regarding my performance review, Robin Beran asked what the tax issues were that I was "bringing up". We discussed the CSARL "business substance" issue. Robin debated this with me, but he could not answer basic questions to defend his position. Robin asked for me to help resolve the issue. It appeared this issue was not resolved.

On March 24, 2008, I followed-up as we were preparing for the April Audit Committee meeting⁶⁸ in which CSARL was to be discussed. Robin assured me the "business substance" issue was resolved, said he forgot to tell me, and asked if

61 - see Attachment 40 - email to Debra Kuper dated September 6, 2007

62 - see Attachment 41 - email to Robin Beran dated January 22, 2007

63 - see Attachment 43 - emails from Terri Pierpont dated June 1, 2007

64 - see Attachment 42 - emails to Terri Pierpont dated May 31, 2007

65 - see Attachment 44 - email to Nancy Snowden, Debra Kuper & Jim Buda dated September 11, 2007

66 - see Attachment 45 - email to Debra Kuper dated September 27, 2007

67 - see Attachment 46 - email from Debra Kuper dated October 1, 2007

68 - see Attachment 47 - email to Robin Beran dated March 24, 2008

Caterpillar Form No. 01-080505-06 PG (2402) MS Word 97

1:09 PM 04/20/08 MMM-BGC #120,257* Page 15 of 50
 called to call one of the consultants.⁷⁰ I would like to read the consultants' memos and would be happy to call the consultants.⁷¹

On April 1, 2008, Robin stopped by my office to give me the latest changes to the April 2008 Audit Committee meeting presentation. We began discussing CSARL because he said he was taking "poetic license" in explaining CSARL related risks.

Robin reiterated that he had resolved the "business substance" issue with the consultants, but could not explain its resolution or answer basic questions again. He then indicated that he didn't think I could see the consultants' memos, but did not give valid reasons. He also does not want me to call the consultants. He said he would have to think about this.⁷² Robin has never gotten back to me.

I told Robin that I did not believe he could have a fair discussion with the Audit Committee about CSARL without addressing the "business substance" issue. I asked him why no one is able to simply explain the facts and the law related to this issue.⁷³ I received no response.

I did not include Robin's "poetic licensing" in the Audit Committee presentation because I thought it was false and misleading.⁷⁴ Robin appeared to want to make it seem as if all CSARL risks had been accounted for. I have not seen what was actually presented. Ed Scott was aware of this prior to the meeting so I am assuming he told you (i.e. Ed Rapp).

The essence of the CSARL "business substance" issue can be summarized by a simple question. Does the day-to-day management and operations of the Caterpillar purchased-finished-parts business reflect how these operations are being represented to the IRS and the SEC? Merely following the letter-of-the-law is not enough -- there is a landmark U.S. Supreme Court case that clearly establishes this principle. This risk could be mitigated. I do not see it being addressed.

I believe Robin reduced the tax reserves related to CSARL by an amount exceeding \$100M+ upon adopting FIN 48 in the first quarter of 2007. Our current tax reserves for CSARL appear to be less than 20% and maybe only 6% of the \$1 billion. I do not believe the reserves include or consider the "business substance" issue because no one will discuss the issue.

The 6 issues above were presented to Legal in July 2007 during the eavesdropping investigation.

September 2007: There is a provision in the Illinois eavesdropping law that "requires" anyone who becomes aware of an eavesdropping which they do-not-know-to-be-legal (ie: pursuant to a court order or with consent) to report the situation to the local State Attorney's Office for investigation. I was in a meeting prior to 2007 that included Dave Burritt and some 20 other people. Dave wanted the meeting recorded. Nancy Snowden made every single person in the meeting state on tape that they consented to being taped, as required by law. Therefore, Dave knew prior to 2007 that you must have consent to legally record people.

Knowing Dave Burritt knew that taping without consent was illegal; I cannot say that I know the 2007 eavesdropping to be legal. Instead, I know for a fact Dave had already been told taping people without consent

69 - see Attachment 48 -- email from Robin Beran dated March 24, 2008

70 - the consultants are PriceWaterhouseCoopers and McDermott Will & Emery

71 - see Attachment 49 -- email to Robin Beran dated March 25, 2008

72 - see Attachment 50 -- notes re meeting with Robin Beran dated April 1, 2008

73 - see Attachment 51 -- email to Robin Beran dated April 1, 2008

74 - There are other issues communicated by Robin to Ed Rapp and the Board that I consider misleading.

1:09-cv-01208-MMM-BGC, # 120-257 Page 16 of 50
 was illegal. Therefore, I wanted some advice on whether you, the Board members, I or anyone else aware of this situation, was required to report this event to the Peoria County States Attorney.

I inquired with Legal to get some advice as an employee of Caterpillar because reporting a potential felony on the part of the Chief Financial Officer could have negative repercussions for Caterpillar.⁷⁵ However, Company Policy requires that we comply with the law. I believe Legal should provide advice when complying with the law appears inconsistent with what is good for the Company.

Legal told me they do not give "personal" legal advice, but implied that they had considered this issue (i.e. I should not report this event to the States Attorney).⁷⁶ I don't really think this is a personal matter. From a purely personal perspective and as a citizen, I should simply report this to the States Attorney. It is only as an employee of Caterpillar that a conflict arises.

I am still not comfortable that you, the Board, I or other employees do not have a duty to report this incident. I do not believe it is appropriate for Legal to leave employees hanging like this. I assume you and the Board were given advice on this issue. I believe the Company should provide a reasoned answer to employees. Legal has said the matter is closed.

ISSUE -- 5

Between 1997 and 2007 the Tax Department spent \$240 million on tax consulting services.⁷⁷ When I returned to the tax department in 2005 I found that 7 figure invoices were being paid with little or no supporting detail. I held an invoice from Ernst & Young (E&Y) that had been signed and approved for payment by Robin Beran because there was no supporting detail.⁷⁸ Nor was it the practice to get the detail after the fact.

On November 22, 2005, I called E&Y and asked if they would get us the detail for invoices and they assured me they would.⁷⁹ Subsequently E&Y left a voice mail indicating that they already given Cat the detail, but maybe not with the invoices.⁸⁰ In January 2006, E&Y left a voice mail indicating they could not get the records to support the invoices because it was not their practice to record this information.⁸¹ I asked for written confirmation of their statement and did not receive any.⁸² I believe Cat paid E&Y more than \$10 Million in 2005. There were PwC invoices for large amounts with similar documentation issues.

I raised this issue to Dave Burritt 6 different times from December 20, 2005 through March 7, 2006,⁸³ as required by Company Policy. Dave Burritt left me a voice mail⁸⁴ in January 2006 stating the following in response to my request to ask E&Y for the detail to support their invoices.

- He didn't want us to be alarmist.
- He thought I could start a coalition to see if other companies ask for supporting detail.
- He didn't want us to approach this in an unmeasured way.
- He didn't want us to be belligerent.
- He didn't want us to be unique from other companies.

Subsequently, it appears Robin Beran paid the invoices without any supporting detail.⁸⁵ Another manager told me that various tax managers were being asked in 2006 to validate and sign 2005 E&Y invoices that they had not previously approved.⁸⁶ I informed Dave Burritt of this.⁸⁷

⁷⁵ - see Attachment 34A - email to Jim Buda and Debra Kuper dated September 19, 2007

⁷⁶ - see Attachment 34B - email to Jim Buda and Debra Kuper dated September 21, 2007

⁷⁷ - see Attachment 52 - chart of tax consulting spend history

⁷⁸ - see Attachment 53 - invoice dated November 4, 2005

⁷⁹ - see Attachment 53 - invoice dated November 4, 2005

⁸⁰ - tape of voice mail available if needed

⁸¹ - tape of voice mail available if needed

⁸² - see Attachment 54 - email to Tom Lawrence dated January 6, 2006

⁸³ - see Attachment 55 - emails to Dave Burritt dated December 20, 2005, January 6/12/13/20, 2006, and March 7, 2006

⁸⁴ - tape of voice mail available if needed

Caterpillar Form No. 01-080595-06 PC (2402) MS Word .97

1:09-cv-01208-MMM-BGC # 120-257 Page 17 of 50

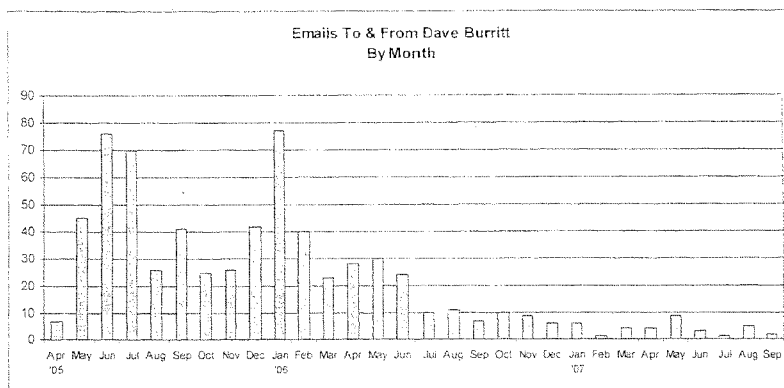
I raised this issue to the OBP as required by Company Policy. The OBP believes the facts are not sufficient for them to investigate. The OBP states that Company policy requires that I specifically tell them what part of the Code of Conduct, Company Policy or applicable law appears to have been violated.⁸⁵

The Code says that I have the "responsibility to report any circumstances or action that violates or appears to violate, the Code of Conduct, enterprise policy or applicable law". I believe the facts mentioned above regarding E&Y invoices appear to violate the Code of Conduct, enterprise policy, applicable law, and/or internal controls required by Sarbanes-Oxley. The outcome could be anything from poor judgment to wasting corporate assets to civil or criminal fraud. I believe that should be for an investigation to resolve. Our policy should not be to accuse people before there has been an independent investigation of the facts. Does it encourage people to report events if they have to evaluate them like a lawyer and make accusations?

ISSUE - 6

When I took this job in Corporate Tax, I told Dave Burritt that we would need to have a lot of "direct" communication.⁸⁹ Dave agreed. He and I corresponded on average 2 times every day (see graph below) until I chose to follow Company Policy and raise ethical issues to him. Then the communication stopped.

The message from Dave is clear – if you raise ethical issues, he will ignore them, and if you persist to get him to follow Company Policy himself, he will excommunicate you and attack your reputation.



⁸⁵ - see Attachment 56 – email from Robin Beran dated March 2, 2006

⁸⁶ - see Attachment 57 – emails to Dave Burritt dated March 7, 2006

⁸⁷ - see Attachment 57 – emails to Dave Burritt dated March 7, 2006

⁸⁸ - see Attachment 58 – email from Nancy Snowden dated April 3, 2008

⁸⁹ - see Attachment 59 – email to Dave Burritt dated December 13, 2004

Caterpillar Form No. 01-080506-06 PC (7402) MS Word 97

ISSUE – 7

February 2007: Some of the issues in my current performance review were covered in the Executive Summary above.⁹⁰ Additional documentation regarding this issue is attached.⁹¹

In short, I don't think that Dave Burritt and Robin Beran like my "approach" to ethics, which is uncompromising. Jim Owens states in his introductory message accompanying the Code of Conduct, that:

...Our World-Wide Code of Conduct, first published in 1974, defines what we stand for and believe in, documenting the uncompromisingly high ethical standards our company has upheld since its founding in 1925...

Jim reaffirmed this in his comments today. I do not believe the Board or Caterpillar Shareholders think this is an area for compromise.

Dave and Robin rated me the lowest they have ever rated me for the Decision Making, Flexibility, and Conflict Resolution competencies. They have never made mention of any problems of this kind before. I believe Dave and Robin do not like my "decision" to report them for ethical violations nor my unwillingness to be "flexible" and ignore Company Policy to resolve this "conflict" quietly with them by looking the other way.

Final Comment

The behavior of Dave Burritt, Robin Beran and others violate many of the "monthly scenarios" on the Code of Conduct website that demonstrate behavior that is not acceptable according to Company Policy. Throughout all of these events no one, except Robin Beran and Dave Burritt, has ever said or implied that my conduct in reporting these events has been inappropriate in any manner. Nor has anyone ever been able to answer simple questions about the proper handling of these issues or indicated that the simple questions were not relevant and proper. Is it Company Policy that there is no appeal process beyond the OBP that reports to Dave Burritt and the Office of the General Counsel?

END

90 - There are others issues such as raising events outside the review period, internal inconsistencies within the document itself, not complying with the language on the form itself, not providing explanations for ratings, removing facts relevant to the level of difficulty of the job, etc.

91 - see Attachment 62 – email to Robin Beran dated February 26, 2008, email to Robin Beran dated March 6, 2008, email to Nancy Snowden and Ed Scott dated April 1, 2008, notes dated April 11, 2008, email to Robin Beran dated April 14, 2008, and email to Alice Barbour and Robin Beran dated April 18, 2008.

Caterpillar Form No. 01-080505-06 PC (2402) MS Word 97

Subject: Topic: **U.S. Environmental Service Changes**[illegible]

With that said about maintenance, we should still pay for expansion, would you agree?

— = Redacted by the Permanent Subcommittee on Investigations

To: Rod J. Feltz, Inc. US Caterpillar (US Caterpillar)
 Attn: Daniel Schickel, Jr. RE Caterpillar Caterpillar, Sony A
 5105 US Caterpillar (US Caterpillar)
 Subject: Re: Fw: 2008 US Purchased Service Charges

Copyright © 2004 John Wiley & Sons, Ltd.

$$\begin{aligned}
 & \text{where } \mathbf{A} = \begin{bmatrix} 1 & 0 & 0 \\ 0 & 1 & 0 \\ 0 & 0 & 1 \end{bmatrix}, \quad \mathbf{B} = \begin{bmatrix} 1 & 0 & 0 \\ 0 & 1 & 0 \\ 0 & 0 & 1 \end{bmatrix}, \quad \mathbf{C} = \begin{bmatrix} 1 & 0 & 0 \\ 0 & 1 & 0 \\ 0 & 0 & 1 \end{bmatrix}, \\
 & \text{and } \mathbf{D} = \begin{bmatrix} 1 & 0 & 0 \\ 0 & 1 & 0 \\ 0 & 0 & 1 \end{bmatrix}.
 \end{aligned}$$

Rod J. Parkinson/OS/Caterpillar



08/21/2008 09:10 AM

Re: [REDACTED] [REDACTED] [REDACTED]
 Subject: Service Charges [REDACTED] [REDACTED] [REDACTED]
 Subject: Re: Fw: 2008 Q1 S Financial Service Charges [REDACTED]

Subject: [REDACTED]

Subject: [REDACTED]

Robin

Very early, her charges were primarily implementation, then they became primarily maintenance. We've been paying for both since Day 1. We always urged you to push for the maintenance charges to be kept in their business unit. And, the development charges, in our view, probably included more than we really needed to expand. But, you'll recall you were willing in the very early years to pay those additional developments, beyond our joined site scope, to ensure the expansion remained on track. However, as time has passed, nearly most of those charges are maintenance related, not necessarily hard core maintenance for CSARL benefits. Trying to distinguish between the two, in terms of splitting those costs, would be very difficult, I'm sure.

Rob Perkins
 International Tax Manager (Europe Africa & Middle East)
 Global Tax & Trade, Caterpillar Inc.
 100 NE Adams, Peoria, Illinois 61629-4200
 Email: rperkins@caterpillar.com
 Telephone: (309) 675-4490
 Mobile: [REDACTED]
 Fax: (309) 675-6573

Redacted by the Permanent Subcommittee on Investigations

Robin D. Beran (S/Caterpillar)



Robin D. Beran (S/Caterpillar)
 08/21/2008 12:03 PM

To: Daniel Bernickson (S/Caterpillar), Caterpillar
 Allen B. Hager (M/Caterpillar), Caterpillar, Gary L. West (S/Caterpillar), Caterpillar, James R. Dine (S/Caterpillar), Caterpillar, John F. Townsend (A/Caterpillar), Caterpillar, Michael Monahan (A/Caterpillar), Rod J. Perkins (S/Caterpillar), Caterpillar, Sally A. Stueps (S/Caterpillar), Caterpillar
 Subject: Re: Fw: 2008 Q1 S Purchased Service Charges [REDACTED]

Subject: [REDACTED]

Subject: [REDACTED]

Subject: [REDACTED]

Do we know how much of their charges is "maintenance" vs. "expansion"? The maintenance is really accounting work it seems. So is the expansion, but I'm more willing to pay that to get them to implement. I guess I'd forgotten or missed that they were including the maintenance costs. The original premise was we'd absorb the start up when it came up initially and they couldn't budget for it. The view was we could explain it best. We went a little further with CLS, as they were a contractor for the Product Managers.

Robin D. Beran

International Tax Manager (Europe Africa & Middle East)
 Global Tax & Trade, Caterpillar Inc.
 100 NE Adams, Peoria, Illinois 61629-4200
 Email: rperkins@caterpillar.com
 Telephone: (309) 675-4490
 Mobile: [REDACTED]
 Fax: (309) 675-6573

Daniel Schicksup/DE/Caterpillar



Daniel
Schicksup/DE/Caterpillar
08/21/2008 01:44 PM

To: Rod J Parks/US/Caterpillar/Caterpillar; Sally A
Sherry/US/Caterpillar/Caterpillar; Gary L
Sherry/US/Caterpillar/Caterpillar; James R
Sherry/US/Caterpillar/Caterpillar; Allen B
Hager/US/Caterpillar/Caterpillar;
Michael M. Hager/US/Caterpillar; Robin D.
Borah/US/Caterpillar/Caterpillar; John P.
Carmichael/US/Caterpillar/Caterpillar

Subject: RE: 2008 QLS Purchased Service Charges

Daniel Schicksup/DE/Caterpillar

08/21/2008 01:44 PM

**Redacted by the Permanent
Subcommittee on Investigations**

See below

----- Forwarded Email -----
From: Daniel Schicksup/DE/Caterpillar
To: Daniel Schicksup/DE/Caterpillar/Caterpillar
Cc:
Subject: RE: 2008 Purchased Service Charges

Barbara J
Church/DO/Caterpillar
08/21/2008 12:17 PM

To: Daniel Schicksup/DE/Caterpillar/Caterpillar
Cc:

Subject: RE: 2008 Purchased Service Charges

Daniel Schicksup/DE/Caterpillar

08/21/2008 01:44 PM

We can't stop all work as the CSART ownership of inventory in our plants and around the world goes on and the financial reporting, tracking of inventory (SLR/SRI scrap-closing accommodations/etc. work) has to be done

I will continue to look for ways to reduce the CSART work and not lose benefits
Daniel Schicksup/DE/Caterpillar



Daniel
Schicksup/DE/Caterpillar
08/21/2008 10:31 AM

To: Barbara J. Church/DO/Caterpillar/Caterpillar
Cc:

Subject: RE: 2008 Purchased Service Charges

Daniel Schicksup/DE/Caterpillar

08/21/2008 01:44 PM

What reduction can you get if you stop all work and delay it until next year. What additional savings would this produce. We are getting a lot of cost pressure to cut R&D by Monday. Please respond ASAP

Also, what tax benefits would be forgone

Barbara J. Church/DO/Caterpillar

Barbara J
Church/DO/Caterpillar
08/21/2008 10:03 AM

To: Steve McMichael/DO/Caterpillar/Caterpillar; Daniel
Schicksup/DE/Caterpillar/Caterpillar
Cc: Robin D Borah/US/Caterpillar/Caterpillar; Rod J

PSI-TWLF-02-001627

Perkins/OS/Caterpillar@Caterpillar, Sally A
 Stiles/OS/Caterpillar@Caterpillar, Gary L
 Vest/OS/Caterpillar@Caterpillar, Gail A
 McCabe/OS/Caterpillar@Caterpillar
 Subject: 2008 Purchased Service Charges

Caterpillar: Confidential Green

Retain Until: 09/20/2008

The monthly charge from [REDACTED] (Cat Log [REDACTED] Parts Initiative) to [REDACTED] Purchased
 Service to Corp Services Div/Corp Tax) [REDACTED]

This reduction of 2008 expense is primarily due to redirected resources to internal projects delaying the work on the Cat Africa project.

Let me know if you have questions about this change.

[REDACTED] = Redacted by the Permanent
 Subcommittee on Investigations

**Fw: General Mailing - Personnel Announcement**

Iris Fortan-Struelens for: D7 Bus Svs - Morton, D7 Bus Svs
R-O-W

02/21/2005 02:53 PM

From: Iris Fortan-Struelens/0Q/Caterpillar
To: D7 Bus Svs - Morton, D7 Bus Svs R-O-W

Caterpillar: Confidential Green

History: This message has been forwarded.

FYI.

Iris



Debbie L.
Schrader/7B/Caterpillar
02/21/2005 02:06 PM

To: Elaine R. Atchley, Sarah Barnes, Patricia L. Benko, Linda K....
Subject: General Mailing - Personnel Announcement

Caterpillar: Confidential Green

Retain Until: 03/23/2005

Retention Category: G90 - General
Matters/Administration

Effective March 1, D.J. (Dan) Schlicksup will become Tax Strategy Manager for Corporate Tax Services. In this new role, Dan's primary function will be to provide leadership to our Global Tax Strategy, including benchmarking our performance and processes versus world-class and developing metrics to measure our progress. In addition, Dan will help provide leadership to Global Tax Communications, Personnel and Succession Planning.

Dan's educational background and work experience brings additional diversity to the Corporate Tax team. Dan has a very strong educational background with a Law degree and a Masters in Taxation coupled with a CPA. His previous experience working at Price Waterhouse in the tax department and at Cat as a Tax Manager in Peoria, Accounting & Tax Strategy Manager in Gosselies, and Director of European Tax Services in Geneva will serve him well in this new role.

Dan gained vital process improvement and systems knowledge from the installation of PeopleSoft globally and is currently on special assignment leading a cross-organizational supply chain cost reduction initiative in the Logistics Division. We would like to take this opportunity to thank Dan for his contributions to Cat Logistics over the past 16 months.

Please join us in congratulating Dan on his new and challenging assignment.

Robin Beran
Director
Corporate Tax

Bob Sweikert
Business Services Manager
Logistics Division

750

FYI Only - Meeting with Gene Fife on Sept 26

Dave B. Burritt to: Douglas R. Oberhelman

09/23/2005 08:01 AM

Cc: Ali M. Bahaj, John S. Heller, Sharad P. Jain

Bcc: Daniel Schlicksup

From: Dave B. Burritt/0G/Caterpillar

To: Douglas R. Oberhelman/0C/Caterpillar@Caterpillar

Cc: Ali M. Bahaj/0C/Caterpillar@Caterpillar, John S. Heller/0C/Caterpillar@Caterpillar, Sharad P. Jain/0A/Caterpillar@Caterpillar

Bcc: Daniel Schlicksup/0E/Caterpillar

Caterpillar: Confidential Green

Doug,

As you know, Gene Fife will be visiting us on Monday for another "deep dive" session. We will cover Income Taxes and IT Security. The key message points are as follows:

Income Taxes

- Global Tax Management (Robin Beran & Dan Schlicksup): We do a good job today of managing tax risks but plan to become world-class. We will follow a process based on research done by the Corporate Executive Board that enables us to better analyze and understand our risks.
- Accounting for Income Taxes (Brad Halverson & Janie Copeland): Tax accounting theory matches the provision for income taxes to U.S. GAAP income. (This is a review of FAS 109 from a Caterpillar perspective.)

Information Technology Security (John Heller and Paul Joseph)

- The IT environment is changing rapidly and we are taking numerous steps to mitigate our risk of security problems. Presentation will include a review of the August 2005 incident.

We will also discuss potential future topics with Gene.

Attached are drafts of the GF&SS presentations. Please let me know if you have any questions.

[attachment "Gene-Fife_Sep_2005-v1.9 Draft.ppt" deleted by Daniel Schlicksup/0E/Caterpillar]

[attachment "Income Taxes - Fife v5 including Corp Tax.ppt" deleted by Daniel Schlicksup/0E/Caterpillar]

Dave Burritt
Caterpillar Inc.
309-675-4020

PSI-TWLF-04-000039

Global Tax Management

Purpose of Meeting

- To inform you why and how we are strengthening Tax Risk Management

People

**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

Global Tax Management

Purpose of Meeting

- To inform you why and how we are strengthening Tax Risk Management

Key Message Points

- We are taking Tax Risk Management to a new level
- Qualified people are the key to World-Class Tax Risk Management

Agenda

What we'll
cover today

- What is Tax Management ?
- State of the Tax Business at Caterpillar
- State of the Tax Business....Current Headlines, Research & Data Points
- Path to World-Class Tax Risk Management

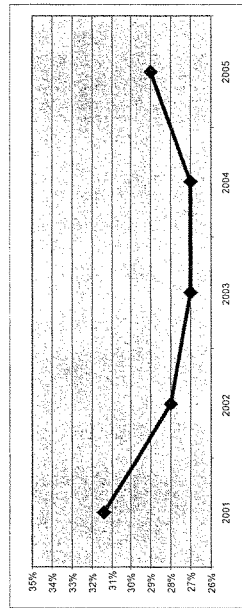
754

**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

State of Tax Business at Caterpillar

Things are fine.
Where do we go from here?
Any changes?

No Sarbanes Oxley Material Weaknesses



Low Effective
Tax Rate

Significantly reduced cash tax paid	Taxes Paid To U.S. IRS		Taxes Paid To U.S. IRS	
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
	130	160	(97)	65
	Non-U.S. Taxes Paid		Non-U.S. Taxes Paid	
	229	219	221	231
				261

**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

Agenda

What we'll
cover today

- What is Tax Management ?
- State of the Tax Business at Caterpillar
- State of the Tax Business . . . Current Headlines, Recent A & Data Points
- Path to World-Class Tax Risk Management

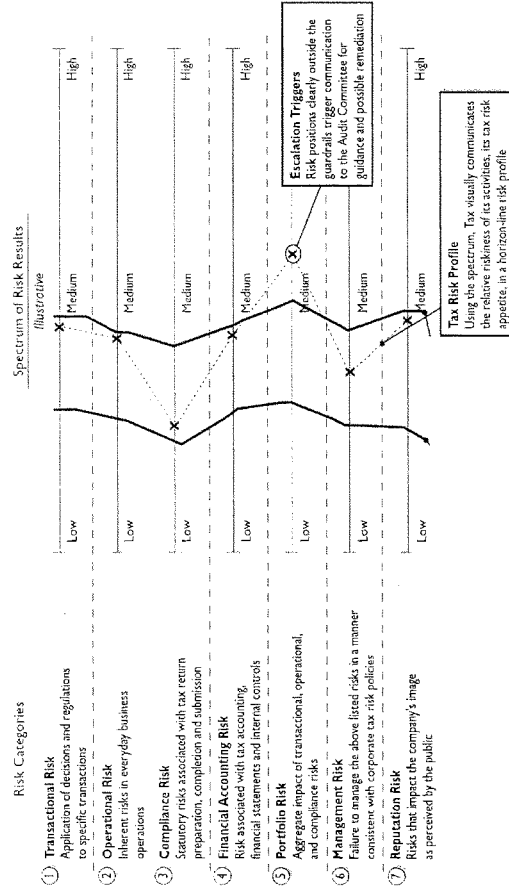
758

**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

World-Class Tax Risk Management

We must clearly define & communicate Caterpillar's Tax Risk Profile to the Audit Committee.

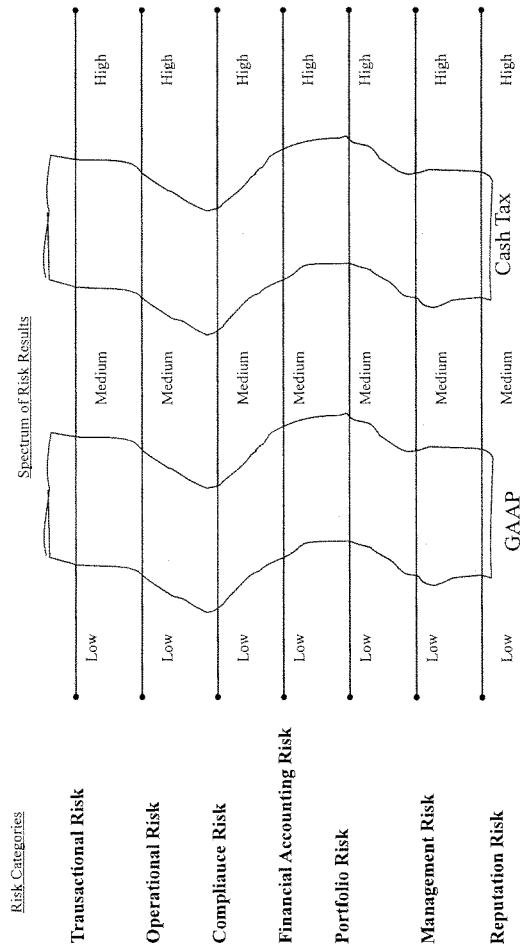
Audit Committee – Risk Guard Rails



World-Class Tax Risk Management

"Risk Guard Rails" facilitate mgmt. decision making within board policy, and Board understanding of mgmt. decisions.

Audit Committee – Risk Guard Rails



**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**



Re: Audit Committee Meeting & Tax Risk Guardrails
 Daniel Schlicksup to: Dave B. Burritt

01/11/2006 04:51 PM

From: Daniel Schlicksup/0E/Caterpillar
 To: Dave B. Burritt/0G/Caterpillar@Caterpillar

Caterpillar: Confidential Green

I will be ready for Feb or April, whatever you need.

Dave B. Burritt/0G/Caterpillar

Dave B. Burritt/0G/Caterpillar To: Daniel Schlicksup
 01/11/2006 03:01 PM Subject Re: Audit Committee Meeting & Tax Risk Guardrails

Caterpillar: Confidential Green

Retain Until: 02/10/2006

Retention Category: G90 - General
 Matters/Administration

Please plan to include in Feb advance material...

Dave Burritt
 Caterpillar Inc.
 309-675-4020
 Daniel Schlicksup/0E/Caterpillar



Daniel
 Schlicksup/0E/Caterpillar
 01/11/2006 02:43 PM

To: Terri A. Pierpont, Janie Copeland, Bradley M. Halverson, Rob...
 Subject Audit Committee Meeting & Tax Risk Guardrails

Caterpillar: Confidential Green

Retain Until: 02/10/2006

Retention Category: G90 - General
 Matters/Administration

Based on the current agenda, the tax risk guard rails will not be on the feb agenda. I have a draft completed and will start socializing them soon. Thanks.

----- Forwarded by Daniel Schlicksup/0E/Caterpillar on 01/11/2006 02:38 PM -----

Linda K.
 Caldwell/0Y/Caterpillar
 01/11/2006 01:35 PM

To: Daniel Schlicksup
 Subject Re: Audit Committee Meeting

Caterpillar: Confidential Green

Retain Until: 02/10/2006

Retention Category: G90 - General
 Matters/Administration

Dan,

I do have an agenda and there isn't anything for Robin this time - mostly the 10K and year end items.

Linda Caldwell
 Executive Assistant to the Vice President
 Caterpillar Inc.
 Corporate Auditing and Compliance Div.

764

Ph: 309-675-4762
Fax: 309-675-6803
Email: caldwell_linda_k@cat.com

Caterpillar Inc.

Global Finance - Tax Risk Management

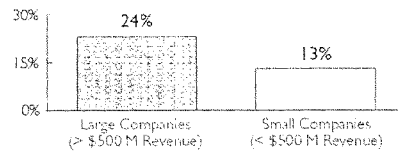
World Class Global Finance Operations to Support Vision 2020

Background

Large companies have been disproportionately affected by material weaknesses related to tax accounting issues. The chart below demonstrates that for companies reporting material weaknesses, large companies have reported nearly double the number of tax accounting issues as compared to small companies. This is not be surprising given the significant difference in the complexity of tax issues for global multi-national companies as compared to small companies.

Percentage of Weakness-Disclosing Companies with Tax Accounting Issues

2005



Corporate Executive Board – 2005

**Redacted By The
Permanent Subcommittee
on Investigations**

Redacted By
Permanent Subcommittee on Investigations

The objective of the "Tax Risk Guard Rail Process" is to develop a documented, more objective process that is capable of conveying the degree of business risk created by the portfolio of tax positions (i.e. risk profile) to Global Finance, the Executives and the Audit Committee in a non-technical manner.

Below are the activities taken to develop the Tax Risk Guard Rail Process. These activities were undertaken by personnel of the Tax Function and Tax Accounting Function. This is the same group of people that meets each quarter to discuss the tax provision for the consolidated financial statements. A straw-man was developed by the Tax Function which was then refined over 4 days of off-site meetings between the two groups.

Process

Step 1 in the process was to determine what business risks are created by tax planning so that we could compare each tax position to specific business Risk Categories. The following are the Risk Categories and their definitions. The list is patterned after a basic list obtained from the Corporate Executive Board. This list is very common sense oriented and has a broad application to all businesses.

- Technical Risk: The level of risk a structure or transaction creates regarding full compliance with the law, regulations and court decisions.
- Operational Risk: The level of risk a structure or transaction creates for everyday business operations.
- Compliance Risk: The level of risk a structure or transaction creates for tax return preparation, completion and submission.
- Financial Statement Risk: The level of risk a structure or transaction creates regarding tax accounting, financial statements or internal controls.
- Management Risk: The probability the above risks can be managed consistent with corporate tax risk policies.
- Reputational Risk: The probability a structure or transaction will generate a negative impact on the company's image.

Step 2 in the process was to determine what criteria were indicative of the level of risk created by each tax position for each business Risk Category. The following are the Indicative Criteria chosen for the 6 business Risk Categories stated above.

- Technical Risk:
 - Tax Law
 - Tax Personnel Continuity
 - Industry Practice
 - Business Purpose & Substance
 - Consistency with Prior Positions
 - Magnitude of Cash Impact
 - Documentation
- Operational Risk:
 - Degree of Operational Change Required
- Compliance Risk:
 - Compliance Requirements
 - Availability of Data
- Financial Statement Risk:
 - GAAP Rules
 - Ability to Estimate Reserves & Allowances
 - Documentation
 - Impact on Financial Reporting Processes
 - Magnitude of Financial Statement Impact
- Management Risk:
 - Presence of Documented Tax Risk Process
 - Alignment Between Actual Operations and Tax Requirements
 - Potential for Operational Change w/o Tax Advice
- Reputational Risk:
 - Wall Street Journal Test

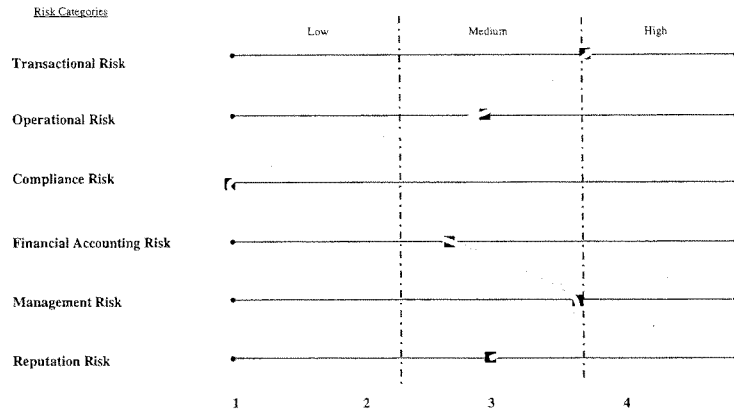
Step 3 in the process was to develop Determinative Questions for each Indicative Criteria so that simple yes or no questions could determine the level (low, medium or high) of risk created by a particular tax position for each Indicative Criteria. The following are 3 examples of the Determinative Questions for various Indicative Criteria of 3 different business Risk Categories.

- Risk Category - Technical Risk:
 - Criteria - Tax Law
 - Determinative Questions
 - Low Risk: If the structure or transaction is completely consistent with the applicable laws, administrative rules, and judicial decisions of the applicable jurisdiction(s), then the risk is low.
 - Medium Risk: If the structure or transaction is consistent with the applicable laws, administrative rules, and judicial decisions of the applicable jurisdiction(s) in all significant respects, but not in some other respects, then the risk is medium.
 - High Risk: If the structure or transaction is not consistent with the applicable laws, administrative rules, or judicial decisions of the applicable jurisdiction(s) in some significant respect, or we cannot determine the level of significance or consistency for any reason, or the structure or transaction is not consistent with outside advice in some significant respect, then the risk is high.

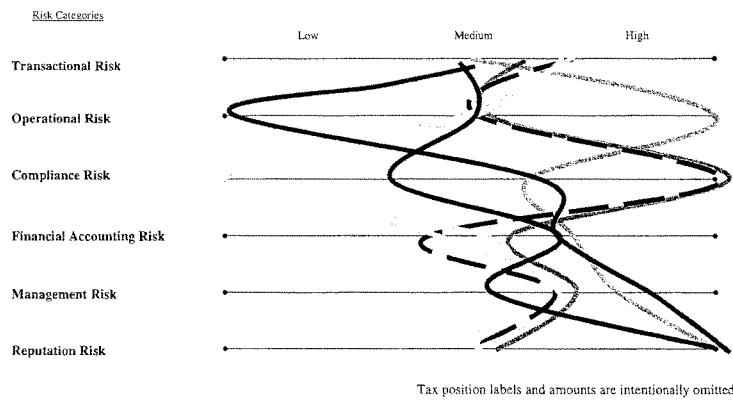
- Risk Category - Financial Statement Risk:
 - Criteria - Ability to Estimate Reserves & Allowances
 - Determinative Questions
 - Low Risk: If the amount of the required reserve is reasonably estimable within one-tenth of one percent of the effective tax rate, then the risk is low.
 - Medium Risk: If the amount of the required reserve is reasonably estimable within one-half point of the effective tax rate, then the risk is medium.
 - High Risk: If the amount of the required reserve is not reasonably estimable within one-half point of the effective tax rate, then the risk is high.

- Risk Category - Reputational Risk:
 - Criteria - Wall Street Journal Test
 - Determinative Questions
 - Low Risk: If the Company would not be opposed to voluntarily disclosing this structure or transaction for a WSJ article or to employees, then the risk is low.
 - Medium Risk: If the Company would be opposed to voluntarily disclosing this structure or transaction for a WSJ article or employees, but would feel comfortable discussing it if asked, then the risk is medium.
 - High Risk: If the Company would not want to have to answer questions from the press or employees about this topic, then the risk is high.

These are just 3 examples. There are Determinative Questions for each Indicative Criteria for each business Risk Category. Each tax position was given a score of 1 (low risk), 3 (medium risk) or 5 (high risk) for each Indicative Criteria. The scores for the Indicative Criteria were then weighted and averaged to compute a score for the tax position for the business Risk Category. The scores and weightings were provided by the personnel of the Tax Function and Tax Accounting Function. Then each tax position was plotted on a scale as illustrated below.



Step 4 in the process was to determine which of the hundreds of tax positions should be plotted in this manner. The positions plotted are those for which reserves have been established that exceed \$10 million per position, and other items for which there are no reserves established (consistent with Generally Accepted Accounting Principles), but are important for other reasons such as the dollar magnitude of the issue. In essence, these are the tax positions that warrant monitoring and attention. These positions collectively define Caterpillar's Tax Risk Profile. There were 12 positions plotted. The chart below shows the plotting of 7 of the 12 positions that scored the highest overall risk.



Each colored line represents a tax position. The point at which the colored line for each tax position intersects the black horizontal line for each business Risk Category indicates the risk level that the tax position creates for that business Risk Category. The results of this process were not surprising to the personnel of the Tax Function or Tax Accounting Function. Questions you may have about this chart will be answered as part of the next steps.

Next Steps

At the June Audit Committee meeting, Robin Beran will provide the annual update on the Tax Function. He will present the full results of the Tax Risk Guard Rails Process, conclusions drawn from the results, and answer questions from the Audit Committee. The Audit Committee will then be able to discuss and determine whether Caterpillar's Tax Risk Profile is appropriate.

The Tax Risk Guard Rail Process will be an ongoing process to take into account new tax positions, new legislation, new court decisions and settlements with the IRS. The Audit Committee will be updated annually or more frequently if appropriate.

Summary

Tax Risk Management is a function of balancing risk and return (i.e. tax savings). Prudent risk management requires companies to manage risk within a defined and documented "risk profile".

The objective of the "Tax Risk Guard Rail Process" is to develop a documented, more objective process that is capable of conveying the degree of business risk created by the portfolio of tax positions (i.e. risk profile) to Global Finance, the Executives and the Audit Committee in a non-technical manner.

Many companies have recognized that the context of tax function within the company must change from a "Black Box" or "Technical Silo" to an "Integrated" part of the business. The Tax Risk Guard Rail Process is the first step in the transformation of the Caterpillar Tax Function into a World Class, totally integrated part of the business.

772

Guard Rails

Dave B. Burritt to: Daniel Schlicksup

08/14/2006 01:36 PM

From: Dave B. Burritt/OG/Caterpillar

To: Daniel Schlicksup/OE/Caterpillar

Caterpillar: Confidential Green

Focus now is on Oct A/C meeting. Let's meet after that. But no more emails on this, pls. I get too many already.

PSI-TWLF-04-000128



fyiFw: Dec. audit comm mtg
Daniel Schlicksup to: Dave B. Burritt

10/28/2005 12:12 PM

From: Daniel Schlicksup/0E/Caterpillar
To: Dave B. Burritt/0G/Caterpillar@Caterpillar

Caterpillar: Confidential Green

----- Forwarded by Daniel Schlicksup/0E/Caterpillar on 10/28/2005 12:10 PM -----



Robin D Beran
<Beran_Robin_D@cat.com> To: Daniel Schlicksup
Subject Re: Fw: Dec. audit comm mtg
10/28/2005 10:09 AM

Caterpillar: Confidential Green

Retain Until: 11/27/2005

Retention Category: G90 - General
Matters/Administration

You're right, it's just that talking about risk management for half an hour
sounds kind of boring!
Robin
309.675.4478 - beranrd@CAT.com

Daniel Schlicksup
<Schlicksup_Daniel@cat.com>

10/28/2005 08:25
AM

Robin D Beran
<Beran_Robin_D@cat.com>

To
To
cc

Subject
Re: Fw: Dec. audit comm mtg

Caterpillar: Confidential Green

Retain Until: 11/27/2005
Retention Category: G90 -
General
Matters/Administration

Robin, my advise is to stick to the agenda that was given to you. They gave you 30 min to talk about tax risk management -- we spent more than 30min on this just with Gene. No other area was given 30min for the dec meeting, you pointed that out to me. Gene was very excited about this when we met with him, indicated that he wants this to be part of every audit committee meeting and obviously wanted it on the Dec agenda (Doug even mentioned that to us). I would ask, when was the last time Gene acted in this manner about a tax issue? My advice is that the board is interested in the tax risk management policy and process, not the details of a transaction that may or may not come about. While the details of tax transactions our interesting to us, a transparent tax risk management policy and process is paramount to the audit committee, and others within the company.

Let me know your thoughts.

Robin D Beran <Beran_Robin_D@cat.com>

10/27/2005 05:58 PM

To
To
Schlicksup_Daniel@cat.
com
cc

Subject
Fw: Dec. audit
comm mtg

Caterpillar: Confidential Green Retain Until: 11/26/2005
Retention Category: G90 - General Matters/Administration

This is something to consider with our Risk Management presentation.
Robin
309.675.4478 - beranrd@CAT.com
----- Forwarded by Robin D Beran/OS/Caterpillar on 10/27/2005 05:56 PM

775

Sally A
Stiles/OS/Caterpillar

10/06/2005 09:52
AM

To
To
Robin D
Beran/OS/Caterpillar@Caterpillar
cc

Subject
Re: Dec. audit comm mtg(Document
link: Robin Beran)

Caterpillar: Confidential Green

Retain Until: 01/24/2007
Retention Category: G90 -
General
Matters/Administration

I don't have any travel scheduled for Dec. and I can rearrange anything
else so yes I'm free.

Robin D
Beran/OS/Caterpillar

10/06/2005 09:19
AM

To
To
Sally A
Stiles/OS/Caterpillar@Caterpillar
cc

Subject
Dec. audit comm mtg

PSI-TWLF-04-000343

776

Caterpillar: Confidential Green

Retain Until: 11/05/2005
Retention Category: G90 -
General
Matters/Administration

Sal, Are you free during the December board meeting days? We may want to add a bit on SCM/MHI to the presentation I'm going to do on risk management, and we thought it would be good if you could do that part.
Robin
309.675.4478 - beranrd@CAT.com

PSI-TWLF-04-000344


Re: Need asap pleaseCreating Tax Rick Guard Rails

Rodney J Perkins to: Daniel Schlicksup

01/03/2006 03:14 PM

 Allen B. Hagen, David S. Poling, Gary L. Vest, Giles A. Parsons,
 Cc: Gregg M. Grierson, James R. Crook, James W. Gates, Janie
 Copeland, Mary A. Miller, Robin D. Beran, Sally A. Stiles, Stephanie

From: Rodney J Perkins/OS/Caterpillar

To: Daniel Schlicksup/OE/Caterpillar@Caterpillar

 Cc: Allen B. Hagen/OA/Caterpillar@Caterpillar, David S. Poling/OS/Caterpillar@Caterpillar, Gary L.
 Vest/OS/Caterpillar@Caterpillar, Giles A. Parsons/1B/Caterpillar@Caterpillar, Gregg M.
 Grierson/OS/Caterpillar@Caterpillar, James R. Crook/OS/Caterpillar@Caterpillar, James W.

Caterpillar: Confidential Green

Retain Until: 02/02/2006

Beyond the list you have started....in no particular order...

Assessment of resource commitments to deliver the idea
 Accounting & S-Ox considerations (idea too complex to administer???)
 Consistency with internal past tax practice
 Consistency with internal related issues
 Outside opinion
 Magnitude of penalty
 Magnitude of risk
 Frequency of risk, e.g. OTO or multiyear, single entity or multiple entity
 Magnitude of benefit
 Existence/absence of treaties (if cross-border type planning idea)
 Consistency with contra-country law (if cross-border type planning idea)
 Existence/absence of safe harbors
 Disclosure requirements
 Visibility of issue (where no disclosure is required)
 Likelihood of IDRs (i.e. the audit lottery)
 IRS skillsets (i.e. the audit lottery)
 S-Ox considerations
 Treatment for US GAAP tax reserve as an uncertain tax position (as tax mgrs, point here is "do we
 evaluate risk solely from a tax cashflow perspective with no concern how US GAAP views the
 transaction...or do we manage ideas that will deliver immediate US GAAP benefits?...or do we manage
 risk to deliver US GAAP benefits long-term?")

Rod Perkins
 Intl Tax Manager (Europe Africa & Middle East)
 Corporate Tax, Caterpillar Inc.
 100 NE Adams, Peoria Illinois 61629-4230
 E-mail: rjperkins@cat.com
 Telephone: (309) 675-4499
 Fax: (309) 494-4543

Daniel Schlicksup/OE/Caterpillar


 Daniel
 Schlicksup/OE/Caterpillar
 01/03/2006 02:43 PM

 To: Janie Copeland, Terri A. Pierpont, Stephanie M. Harms, Rod...
 Subject: Need asap pleaseCreating Tax Rick Guard Rails


Caterpillar: Confidential Green

Retain Until: 02/02/2006

 Retention Category: G90 - Information and
 Reports

Can you please send me a list of the items/factors that come to mind when you are evaluating the amount of tax risk involved with a planning idea. For example:

1. Court decisions
 2. Consistency with regulations
 3. Consistency with the law
 4. Industry practice
- ETC.

Re: Fw: Tax Risk Guardrails 
 Bradley M. Halverson to: Daniel Schlicksup

02/09/2006 05:44 PM

From: Bradley M. Halverson/OC/Caterpillar
 To: Daniel Schlicksup/OE/Caterpillar@Caterpillar


Caterpillar: Confidential Green

Thanks for your comments. Please work with Janie. Proper planning is vital given the many things are doing.
 I do appreciate your leadership in tax on the many areas quite an improvement. You are appreciated.

Brad Halverson
 Corporate Controller
 (309) 675-4437 Fax: (309) 494-1989
 e-mail: Brad_Halverson@cat.com
 Daniel Schlicksup/OE/Caterpillar



Daniel
 Schlicksup/OE/Caterpillar
 02/09/2006 05:30 PM

To: Bradley M. Halverson
 Subject Re: Fw: Tax Risk Guardrails 

Caterpillar: Confidential Green

Retain Until: 03/11/2006

Retention Category: G90 - General
 Matters/Administration

Brad, Terri and I met this week to cover the strawman as Janie and Terri have been a bit out-of-pocket in January. I began meeting with the Tax Managers in the Tax Council today. Terri and I meet with Janie next week. I have received good responses so far from Terri and the Tax Managers present at the meeting today. There is some nervousness on the part of Tax as this will highlight areas where we need to improve. Quite honestly this will provide a view into tax quite different than the past. I think you will like it.

I will publish a meeting schedule tomorrow leading up to the GeneF visit and April A/C meeting. This will be a time commitment for Janie and Terri. We also need to get going on the GAAP part of this.

I think it would be good if we met for 30 minutes. What do you think.

Thanks

Bradley M. Halverson/OC/Caterpillar

Bradley M.
 Halverson/OC/Caterpillar
 02/09/2006 05:08 PM

To: Daniel Schlicksup
 Subject Fw: Tax Risk Guardrails

Caterpillar: Confidential Green

Retain Until: 03/11/2006

Retention Category: G90 - General
 Matters/Administration

Dan, this work needs to be from a robust process using 6 Sigma with deep involvement from Janie's area and the full tax dept. I would suggest you get a black belt, charter and get the work plan going. When this is developed a more reasonable deliverable date should be provided to Dave, Robin and me. I would be happy to discuss further if you like.

Brad Halverson

Corporate Controller
(309) 675-4437 Fax: (309) 494-1989
e-mail: Brad_Halverson@cat.com
----- Forwarded by Bradley M. Halverson/OC/Caterpillar on 02/09/2006 05:06 PM -----



Janie
Copeland/0B/Caterpillar
02/09/2006 04:59 PM

To: Bradley M. Halverson cc: Daniel Schlicksup
Subject Re: Fw: Tax Risk Guardrails

Caterpillar: Confidential Green

Retain Until: 03/11/2006

Retention Category: G90 - General
Matters/Administration

Brad,

We have not been deeply involved in this and have concerns. Most importantly, this process needs to be developed with detailed involvement of the managers in Tax.

Janie

Bradley M. Halverson/OC/Caterpillar

Bradley M.
Halverson/OC/Caterpillar
02/09/2006 08:55 AM

To: Janie Copeland cc: Daniel Schlicksup
Subject Fw: Tax Risk Guardrails

Caterpillar: Confidential Green

Retain Until: 03/11/2006

Retention Category: G90 - General
Matters/Administration

What do you think? Has Terri reviewed or been involved.

Brad Halverson
Corporate Controller
(309) 675-4437 Fax: (309) 494-1989
e-mail: Brad_Halverson@cat.com
----- Forwarded by Bradley M. Halverson/OC/Caterpillar on 02/09/2006 08:55 AM -----



Daniel
Schlicksup/0E/Caterpillar
02/07/2006 10:26 AM

To: Dave B. Burnitt, Bradley M. Halverson, Robin D Beran
Subject Tax Risk Guardrails

Caterpillar: Confidential Green


Retain Until: 03/09/2006

Retention Category: G90 - General
Matters/Administration

Here is a short powerpoint indicative of the direction if you want to give Gene a heads up , etc..[attachment "020706 Tax risk Guardrails.ppt" deleted by Daniel Schlicksup/0E/Caterpillar]

Here is the excel file with much more detail [attachment "020806 guard rails.xls" deleted by Daniel Schlicksup/0E/Caterpillar]

I will set up a series of meetings to have these reviewed and vetted before Gene's visit in March.

Re: Fw: Meeting re Tax Guardrails 

Dave B. Burritt to: Daniel Schlicksup

02/10/2006 04:32 PM

From: Dave B. Burritt/0G/Caterpillar

To: Daniel Schlicksup/0E/Caterpillar@Caterpillar

Caterpillar: Confidential Green

Thanks, Dan for the focus. Given that we're past the due date to the A/C, it's good this is getting attention.

Dave Burritt
Caterpillar Inc.
309-675-4020

This message and any material contained in any attachment are intended only for the use of the addressee and may contain information that is privileged or confidential. If you are not the intended recipient, you are hereby notified that any disclosure, copying, distribution, dissemination, or use of any information contained in this message is strictly prohibited. If you have received this e-mail in error, please notify the sender listed above immediately.

Daniel Schlicksup/0E/Caterpillar



Daniel
Schlicksup/0E/Caterpillar
02/10/2006 04:15 PM

To: Rodney J Perkins, Sally A Stiles, Gary L Vest, James R Croo...
Subject: Fw: Meeting re Tax Guardrails

Caterpillar: Confidential Green

Retain Until: 03/12/2006

Retention Category: G90 - General
Matters/Administration

Folks, Jane is going to schedule the meetings below leading up to the visit by Gene Fife. Please review and comment if necessary. Please try and reschedule some things if necessary to help Jane get these meetings scheduled.

Robin, I have you invited to the working sessions but know your calendar is pretty full this month and next. In order to keep this going I propose that you make the meetings if possible, and if not I can brief you and keep you up to speed.

Giles, I would propose that you attend as many hours of the morning sessions as possible.

Please call me with questions.

----- Forwarded by Daniel Schlicksup/0E/Caterpillar on 02/10/2006 03:30 PM -----



Daniel
Schlicksup/0E/Caterpillar
02/10/2006 11:42 AM

To: Jane M. Bolton cc: Bradley M. Halverson
Subject: Meeting re Tax Guardrails

Caterpillar: Confidential Green

Retain Until: 08/10/2007

Retention Category: G90 - General
Matters/Administration

Jane,

Gene Fife visits on Tues. Mar 28. Therefore we need the following meetings leading up to this. Topic of each meeting is "Prepare for Gene Fife visit re Tax Risk Guardrails".

Meeting with Dave Burritt early week of Mar. 20 - 1 hour (DaveB, BradH, RobinB, DanS, Janie Copeland)

Meeting with Brad Halverson and Robin Beran week of Mar 13 - 2 hours (BradH, RobinB, DanS, Janie Copeland)

Meeting week of Feb 20 off-site, all day at Ivy Club (Rod, Sally, Gary, JimC, Al, Robin, JohnC, DanS, JanieC and Terri Pierpont)

Meeting week of Feb 27 off-site, all day at Ivy Club (Rod, Sally, Gary, JimC, Al, Robin, JohnC, DanS, JanieC and Terri Pierpont)

Brad, please let me know if you think this is not adequate .

IN THE UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF ILLINOIS
PEORIA DIVISION

DANIEL J. SCHLICKSUP,)	
)	
Plaintiff,)	
)	
vs.)	No. 09-1208
)	
CATERPILLAR, INC.,)	
DAVID B. BURRITT, ALICE)	
BARBOUR, ROBIN D.)	
BERAN, JAMES B. BUDA,)	
DOUGLAS R. OBERHELMAN,)	
and EDWARD J. RAPP,)	
)	
Defendants.)	

THE DEPOSITION of RODNEY PERKINS, called
for examination pursuant to notice, and
pursuant to the provisions of the Code of Civil
Procedure, and the Rules of the Supreme Court
thereof pertaining to the taking of
depositions, taken before me, Donna F. Banks,
CSR, a Notary Public in and for the County of
Peoria and State of Illinois, at 415 Hamilton
Boulevard, in the City of Peoria, County of
Peoria and State of Illinois, on March 10,
2011, at 9:00 a.m.

**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

1 Q So if we would look at exhibit 9 on the amounts
 2 that would be leading to consolidated profit
 3 before taxes, would the legal fees and
 4 accounting fees be, on a consolidated basis,
 5 make that number on that line lower?

6 MR. TURNER: Object, form.

7 A I don't understand the question.

8 Q All right. If you look at exhibit 9.

9 A Okay.

10 Q The line consolidated profit before taxes.

11 A Yes.

12 Q [REDACTED]

13 [REDACTED]

14 A [REDACTED]

15 Q [REDACTED]

16 [REDACTED]

17 [REDACTED]

18 A [REDACTED]

19 Q Do you know where under the operating costs
 20 accounting and legal fees fall?

21 A Under the SG&A, selling general and
 22 administrative.

23 Q Is that the line where there's an arrow on

— = Redacted by the Permanent
 Subcommittee on Investigations

1 deceased?

2 A This draft would have been prepared by
3 her.

4 Q Is there anything on the draft that you
5 disagree with?

6 MR. TURNER: Object, foundation.

7 A With this limited review of skimming the draft,
8 I don't find anything objectionable.

9 Q To your knowledge, is there any other document
10 that sets forth in a single place the
11 transactions that comprise the changes in
12 international operations from 1997 to 2002?

13 A Other than subsequent drafts of this document?

14 Q Yes.

15 A No.

16 Q Do you know where the final version of this is
17 maintained?

18 A At the time of my employment, this document was
19 not intended to be truly final.

20 Q Was it an ongoing work?

21 A Yes.

22 Q Is that because the CSARL structure was dynamic
23 and changing?

1 A Any changes in international operations were
2 intended to be embodied in this document.

3 Q [REDACTED]

4 [REDACTED]

5 A [REDACTED]

[REDACTED] = Redacted by the Permanent
Subcommittee on Investigations

6 Q [REDACTED]

7 A [REDACTED]

8 [REDACTED]

9 Q [REDACTED]

10 A [REDACTED]

11 Q [REDACTED]

12 [REDACTED]

13 A [REDACTED]

14 Q So there would be subsequent iterations of this
15 document based on changes that happened since
16 2002, is that right?

17 A Yes.

18 Q But there would not be any changes for the
19 period on the document of '97 through 2002, is
20 that correct?

21 A To my knowledge, that is indeed correct.

22

23

1 (Deposition Exhibit Number 10 was
2 identified for the purpose of
3 the record.)

4 Q I'll show you what's been marked as exhibit 10
5 for your deposition. Is exhibit 10 something
6 that pertains to the tax risk guardrails?

7 A Yes.

8 Q Was the use of the tax risk guardrails an
9 effort by the Tax Council, c-i-1, to have an
10 orderly process to assess risks?

11 A In a limited time period, yes.

12 Q Do you know if the use of the tax risk
13 guardrails was ever presented to the board of
14 directors or to a portion of the board?

15 A I don't know if it was.

16 Q When risks were assigned pursuant to use of the
17 tax risk guardrails, was that arrived at by a
18 majority vote, a consensus, or how was that
19 judged by the Tax Council, c-i-1?

20 A Consensus.

21 Q Did you have any role in establishing the
22 methodology in the tax risk guardrails? Did
23 you have any input into that?

1 A Yes.

2 Q What input did you have into the methodology?

3 A The initial input was reactionary in nature to
4 the proposed approach as designed by Dan.

5 Q And when you say Dan, is that Dan Schlicksup?

6 A Yes.

7 Q Did your comments that you made on a
8 reactionary basis to what he presented get
9 incorporated into the methodology?

10 A I'm sure some did, some didn't.

11 Q Was that on a consensus basis in the Tax
12 Council?

13 A Yes.

14 Q Is it fair to say that there were tax managers
15 on the Tax Council who wanted the executive
16 office and others to understand that there were
17 risks associated with tax positions?

18 MR. TURNER: Object, form.

19 Q I'll withdraw the question. Let me --

20 A Clarify it.

21 Q Let me ask it this way. Did you ever want to
22 make sure that people outside the tax
23 department understood that tax positions

1 sometimes have risks associated with them?

2 A No, I do not.

3 Q What was the purpose of the tax risk
4 guardrails?

5 A We understood that it was going to be used to
6 identify areas of potential tax risks, assign a
7 degree of tax risks, categorize them, and
8 eventually submit them to upper management in
9 terms of the internal consumptive usage of the
10 document. Within corporate tax, it had no
11 value.

12 Q When you say that -- well, when you reference
13 upper management in your last answer, who were
14 you referring to?

15 A Officers of the company and above.

16 Q And what were you trying to communicate to them
17 by these assessments of risk?

18 A I was not trying to communicate anything.

19 Q Was it your opinion that these only had value
20 inside the tax department?

21 A To reiterate, I didn't find any value that we
22 could use within the tax department to change
23 anything that we were doing.

1 Q Then why did you go along with preparing --

2 A I'm a team player, and it became one of the
3 goals of our department to prepare the tax risk
4 guardrails and update them periodically.

5 Q So you went along with that?

6 A Yes.

7 Q Do you think that the assessments of risk in
8 exhibit 10 were a result of an honest, good
9 faith effort by the Tax Council to quantify the
10 risks?

11 A Yes.

12 Q

13

14

15

16

17

18

19

20

21 A

22 Q

23

**Redacted By The
Permanent Subcommittee
on Investigations**

**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

1

2

3 A

4

5 Q

6

7

8 A

9 Q

10

11

12 A

13 Q Did you become aware at some point that Dan

14 Schlicksup was maintaining that the finish

15 replacement parts aspect of the CSARL structure

16 lacked economic substance?

17 A Repeat the question.

18 (The requested portion of the

19 record was read back by the

20 Court Reporter.)

21 A Yes.

22 Q When did you become aware of that?

23 A I don't recall that date.

IN THE UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF ILLINOIS

DANIEL J. SCHLICKSUP,)	
)	
Plaintiff,)	
)	
VS.)	No. 09-1208
)	
CATERPILLAR, INC., DAVID B.)	
BURRITT, ALICE BARBOUR, ROBIN))	
D. BERAN, JAMES B. BUDA,)	
DOUGLAS R. OBERHELMAN, and)	
EDWARD J. RAPP,)	
)	
Defendants.)	

The deposition of SALLY A. STILES, called for examination pursuant to the provisions of the Federal Rules of Civil Procedure of the United States District Courts as they apply to the taking of depositions, taken before Paula A. Morsch, C.S.R. License No. 84-002965, a Certified Shorthand Reporter in the State of Illinois, on the 24th day of February, 2011, commencing at the hour of 12:00 p.m. and ending at 6:00 p.m., at 415 Hamilton Boulevard, in the City of Peoria, County of Peoria, State of Illinois.

ADVANTAGE REPORTING SERVICE
(309) 673-1881 or (800) 347-3124

1 A I also don't know if the red is true. The
2 blue, yes, I would agree but the others, I don't
3 know how the determinations were made on that chart.

4 Q Looking at Exhibit 4B, do you see that the
5 United States, including Alaska, is in blue?

6 A Yes.

7 Q And do you see that the rest of the world
8 is in green?

9 A Yes.

10 Q Do you agree that in the blue areas, the
11 United States, that the effective tax burdens
12 associated with operating income would be 35 percent
13 plus?

14 A Yes.

15 Q And do you agree that in the green areas
16 on Exhibit 4B, that the taxable in local country and
17 Geneva would be nine percent?

18 A In most parts of the world, yes.

19 Q You had given a range that was not exactly
20 nine percent?

21 A I said eight to eleven.

22 Q Right. How would there be variations from
23 nine percent in that range that you gave?

1 A It depends on how the earnings are taxed
2 as they come through CSARL. Earnings are taxed,
3 different earnings are taxed different ways in
4 CSARL. It depends on mix.

5 MR. TURNER: I'm sorry, Dan. Can I
6 see the other one? Mine has handwriting on it, 25
7 to 40 percent on 4B.

8 MR. O'DAY: I'll get you a copy of
9 this one.

10 MR. TURNER: Okay.

11 MR. O'DAY: The exact one.

12 Q BY MR. O'DAY: So on Exhibit 2 when we see
13 \$41 million in the first row with any data and in
14 the second column of that row under the heading
15 parts, is that a difference in effective tax burden?

16 A Yes.

17 Q Due to CSARL?

18 A Yes.

19 Q And going down the second column, in each
20 instance under parts for 2001 through 2007 then, is
21 that a reflection of differences in effective tax
22 burdens in each instance?

23 A Yes.

1 Q Now, in the fourth column under reserve,
2 do you understand what that is on Exhibit 2?

3 A I don't know what makes up those numbers
4 on Exhibit 2.

5 Q Do you know what the numbers under reserve
6 mean even if you don't know how they're calculated?

7 A Generally I know what a reserve number
8 means.

9 Q Do you know what these reserve numbers
10 mean?

11 A Not those exact numbers, no. I know a
12 reserve would mean there is uncertainty with regard
13 to benefit that is reported in this column.

14 Q Have you ever heard of guardrails for
15 determining uncertainty?

16 A I have.

17 Q What are guardrails?

18 A I don't know that I can explain what the
19 term means. It was a methodology that was an
20 attempt to examine tax risk within the company.

21 Q If I use the term tax council,
22 C-O-U-N-C-I-L, at Caterpillar, what is that?

23 A Tax council was a term that was designated

1 to reflect the group that met on a regular basis
2 consisting of Robin's direct and at some times
3 indirect or dotted line reports.

4 Q Did the tax council use guardrails to
5 assess the risk associated with CSARL?

6 A Among other things.

7 Q And when it considered CSARL, do you
8 recall what the level of risk was as decided by the
9 tax council?

10 A I don't recall.

11 Q Did the tax council in deciding the
12 outcome of using the guardrails have designations
13 such as high risk, or what did they have?

14 A I don't remember.

15 Q Was the outcome of those kinds of analyses
16 the product of consensus in the tax council?

17 A The intent was for there to be consensus.
18 There wasn't always consensus.

19 Q Was there always consensus for the
20 assessment of the risk associated with CSARL?

21 A I don't recall.

22 Q Do you recall any lack of consensus?

23 A No.

1 Q Did you regard CSARL as having a high risk
2 associated with it?

3 A No.

4 Q You thought it was a low risk?

5 A Middle of the road.

6 Q Do you know how much Caterpillar paid in
7 consulting fees to law firms and accounting firms to
8 create CSARL?

9 A I do not.

10 Q Do you know if it was more than
11 \$100 million?

12 A I don't know.

13 Q When Caterpillar reports its earnings on
14 its income statements for purposes of satisfying its
15 reporting obligations to shareholders, not on tax
16 returns, are the CSARL revenues included in overall
17 sales?

18 A Yes.

19 Q Is there also a line on those same reports
20 for income taxes?

21 A Yes.

22 Q Is it fair to say that on the consolidated
23 basis reporting of those documents, that there's

1 little, if any, impact on the sales line for the
2 consolidated statement but there would be a
3 reduction in income taxes paid on such a statement
4 as a result of the use of CSARL?

5 A No.

6 Q Where is my statement wrong?

7 A If CSARL has true sales that are in the
8 sales line which is what you asked me a minute ago,
9 then how can they not impact, how can they not be
10 relative to the impact on the tax line?

11 Q Well, wouldn't the tax line be lower by
12 using CSARL than things would have been had they
13 just been done the way they were done before CSARL?

14 A Yes.

15 Q So on Exhibit 2 for your deposition, if
16 these numbers are right, I realize you say you don't
17 know how they were calculated but if these numbers
18 are right, that would be reflected in income tax
19 savings on the consolidated statements, is that
20 correct?

21 A Yes.

22 Q And if the reserve numbers are right on
23 this document, Exhibit 2 for your deposition, those

1 amounts would be reflected as additions to the
2 income tax line, is that correct?

3 A Yes.

4 Q Did CSARL pay Caterpillar anything other
5 than a royalty on an ongoing basis for the
6 transaction of the business being shifted to CSARL
7 that formerly was owned by COSA?

8 A I don't -- I'm struggling with what
9 exactly you mean. There are many payments that go
10 from CSARL to Caterpillar for services, for other
11 transactions that happen associated with this parts
12 business.

13 Q Was there any kind of lump sum payment?

14 A Not to my knowledge.

15 Q Is there a tax department white paper?

16 A During what period?

17 Q Any period. Are there tax department
18 white papers?

19 A There is a tax department white paper.

20 Q Is there always a tax department white
21 paper?

22 A It's not updated, no. There was one. It
23 was written.

1 either direct or indirect report of his who was
2 involved in establishing CSARL or Glove or
3 implementing it that you recall?

4 A Indirect reports.

5 Q Who?

6 A Barbara Church. I think she's an
7 indirect. I'm not even absolutely sure. She works
8 for Logistics. She was involved, or she was
9 involved during that time period. I don't know that
10 she was involved actually at the inception, but she
11 was involved during that time period.

12 Q Besides this person from Logistics, was
13 there anybody else that you're aware of from the
14 parts area who was involved in the formation or
15 implementation of Glove or CSARL?

16 A There was a team. I don't know all the
17 names. There was a team though that involved
18 several people from Logistics. I don't know all the
19 names.

20 Q How about from the parts areas of the
21 company?

22 MR. TURNER: Object, form.

23 Q Product support. Was there anybody from

1 A I have not.

2 Q Have you ever seen anything in writing
3 analyzing the adequacy of the business or economic
4 substance of having the finished replacement parts
5 dealt with by CSARL instead of under the old
6 arrangement?

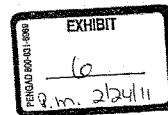
7 A From an economic substance perspective, I
8 have not.

9 Q From any perspective?

10 A Throughout the -- economic substance just
11 happened here as far as really getting a big look
12 from the tax community, so it wasn't even really
13 something you would have looked at throughout the
14 formation of this structure. There were memos as we
15 went along on various small issues, you know. When
16 you do a reorganization of this size, all the way
17 along there are issues that develop. So I would
18 have seen those memos. I don't remember exactly
19 what all the topics were but I would have seen some
20 memos throughout the process, but I do not recall at
21 any time anything being labeled as economic
22 substance.

23 Q When you say that the tax community only

Categories	Definition	Indicative Criteria
Transactional	Level of risk structure or transaction creates associated with full compliance with the law, regulations and case law.	Tax Law Tax Personnel Continuity Industry Practice Business Purpose & Substance Consistency Magnitude of Cash Impact Documentation
Operational	Level of risk structure or transaction creates for everyday business operations.	Operational Change
Compliance	Level of risk structure or transaction creates associated with tax return preparation, completion and submission.	Compliance Requirements Availability of the Data
Financial Accounting	Level of risk structure or transaction creates associated with tax accounting, financial statements, SEC disclosure issues or internal controls.	US GAAP Interpretation - Decision to Reserve, Provide Valuation Allowance, M&A Accounting or Indefinite Reinvestment Allowances for Deferred Tax Assets Documentation Impact on Financial Reporting Processes Magnitude of \$ Impact on Financial Statements
Management	Probability above risks can be managed consistent with corporate tax risk process.	Documented Corporate Tax Risk Process BU versus Legal Entry Functional Alignment
Reputational	Probability structure or transaction will generate negative impact on the Company's image as perceived by the public.	WSJ Test



[illegible]

1	15	1.52
1	2	
2	18	
2	15	
4	50	
5	15	1.71
2	30	1.60

[illegible]

<p>1. Name of the structure or transaction</p> <p>None of the structure or transaction created association with the company or the law, regulations and order.</p>	<p>2. Level of the structure or transaction</p> <p>The structure or transaction is not a significant request.</p>	<p>3. The structure or transaction</p> <p>The structure or transaction is not a significant request.</p>	<p>4. The structure or transaction</p> <p>The structure or transaction is not a significant request.</p>	<p>5. The structure or transaction</p> <p>The structure or transaction is not a significant request.</p>	<p>6. The structure or transaction</p> <p>The structure or transaction is not a significant request.</p>	<p>7. The structure or transaction</p> <p>The structure or transaction is not a significant request.</p>	<p>8. The structure or transaction</p> <p>The structure or transaction is not a significant request.</p>	<p>9. The structure or transaction</p> <p>The structure or transaction is not a significant request.</p>	<p>10. The structure or transaction</p> <p>The structure or transaction is not a significant request.</p>	<p>11. The structure or transaction</p> <p>The structure or transaction is not a significant request.</p>	<p>12. The structure or transaction</p> <p>The structure or transaction is not a significant request.</p>	<p>13. The structure or transaction</p> <p>The structure or transaction is not a significant request.</p>	<p>14. The structure or transaction</p> <p>The structure or transaction is not a significant request.</p>	<p>15. The structure or transaction</p> <p>The structure or transaction is not a significant request.</p>	<p>16. The structure or transaction</p> <p>The structure or transaction is not a significant request.</p>	<p>17. The structure or transaction</p> <p>The structure or transaction is not a significant request.</p>	<p>18. The structure or transaction</p> <p>The structure or transaction is not a significant request.</p>	<p>19. The structure or transaction</p> <p>The structure or transaction is not a significant request.</p>	<p>20. The structure or transaction</p> <p>The structure or transaction is not a significant request.</p>	<p>21. The structure or transaction</p> <p>The structure or transaction is not a significant request.</p>	<p>22. The structure or transaction</p> <p>The structure or transaction is not a significant request.</p>	<p>23. The structure or transaction</p> <p>The structure or transaction is not a significant request.</p>	<p>24. The structure or transaction</p> <p>The structure or transaction is not a significant request.</p>	<p>25. The structure or transaction</p> <p>The structure or transaction is not a significant request.</p>	<p>26. The structure or transaction</p> <p>The structure or transaction is not a significant request.</p>	<p>27. The structure or transaction</p> <p>The structure or transaction is not a significant request.</p>	<p>28. The structure or transaction</p> <p>The structure or transaction is not a significant request.</p>	<p>29. The structure or transaction</p> <p>The structure or transaction is not a significant request.</p>	<p>30. The structure or transaction</p> <p>The structure or transaction is not a significant request.</p>
---------------------------------------------------------------------------------------------------------------------------------------------------------------------------	--------------------------------------------------------------------------------------------------------------------------	-----------------------------------------------------------------------------------------------------------------	-----------------------------------------------------------------------------------------------------------------	-----------------------------------------------------------------------------------------------------------------	-----------------------------------------------------------------------------------------------------------------	-----------------------------------------------------------------------------------------------------------------	-----------------------------------------------------------------------------------------------------------------	-----------------------------------------------------------------------------------------------------------------	------------------------------------------------------------------------------------------------------------------	------------------------------------------------------------------------------------------------------------------	------------------------------------------------------------------------------------------------------------------	------------------------------------------------------------------------------------------------------------------	------------------------------------------------------------------------------------------------------------------	------------------------------------------------------------------------------------------------------------------	------------------------------------------------------------------------------------------------------------------	------------------------------------------------------------------------------------------------------------------	------------------------------------------------------------------------------------------------------------------	------------------------------------------------------------------------------------------------------------------	------------------------------------------------------------------------------------------------------------------	------------------------------------------------------------------------------------------------------------------	------------------------------------------------------------------------------------------------------------------	------------------------------------------------------------------------------------------------------------------	------------------------------------------------------------------------------------------------------------------	------------------------------------------------------------------------------------------------------------------	------------------------------------------------------------------------------------------------------------------	------------------------------------------------------------------------------------------------------------------	------------------------------------------------------------------------------------------------------------------	------------------------------------------------------------------------------------------------------------------	------------------------------------------------------------------------------------------------------------------

[illegible]

IN THE UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF ILLINOIS

DANIEL J. SCHLICKSUP,	}	
	}	
Plaintiff,	}	
	}	
VS.	}	No. 09-CV-1208
	}	
CATERPILLAR, INC., et al,	}	
	}	
Defendants.	}	

The deposition of ROBIN BERAN, called for examination pursuant to the provisions of the Federal Rules of Civil Procedure of the United States District Courts as they apply to the taking of depositions, taken before Paula A. Morsch, C.S.R. License No. 64-002965, a Certified Shorthand Reporter in the State of Illinois, on the 15th day of March, 2011, at the hour of 9:00 a.m., at 415 , in the city of Peoria, County of Peoria, State of Illinois.

1 PRESENT:

2 CUSACK, GILFILLAN & O'DAY, LLC
3 BY: Daniel G. O'Day, Esq.
4 and Mr. Robert Hanover,
5 415 Hamilton Boulevard
6 Peoria, Illinois 61602
7 309-637-5282
8 for Plaintiff Daniel J. Schlicksup;

9 SEYFARTH SHAW, LLP
10 BY: Joseph S. Turner, Esq.
11 and Steven J. Pearlman, Esq.
12 131 S. Dearborn Street, Suite 2400
13 Chicago, Illinois 60603
14 312-460-5000
15 for Defendants Caterpillar, Inc.,
16 Robin Beran, et al.

17 ALSO PRESENT: Daniel J. Schlicksup, Plaintiff

18

19

20

21

22

23

24

25

26

27

28

29

1	I N D E X	
2	WITNESS	PAGE
3	ROBIN BERAN	
4	Direct By Mr. O'Day	5
5		
6	E X H I B I T S (ATTACHED)	
7	NUMBER	MARKED FOR ID
8	Deposition Exhibit	
9	No. 1	11
10	No. 2	13
11	No. 3	16
12	No. 4	20
13	No. 5	31
14	No. 6	38
15	No. 7	41
16	No. 8	48
17	No. 9	53
18	No. 10	84
19	No. 11	98
20	No. 12	103
21	No. 13	107
22	No. 14	114
23	No. 15	116

1	INDEX (Contd):	
2	No. 16	124
3	No. 17	141
4	No. 18	143
5	No. 19	156
6	No. 20	159
7	No. 21	162
8	No. 22	163
9	No. 23	181
10	No. 24	198
11	No. 25	202
12	No. 26	207
13	No. 27	216
14	No. 28	217
15	No. 29	219
16	No. 30	220
17	No. 31	220
18	No. 32	221
19	No. 33	222
20	No. 34	225
21	No. 35	227
22	No. 36	229
23	No. 37	232

**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

**Redacted By The
Permanent Subcommittee
on Investigations**

1
2
3
4
5
6
7
8
9
10 Q Showing you what's been marked for your
11 deposition as Exhibit 4, back in December of 2005 do
12 you recall there was a board meeting where you
13 presented [REDACTED]

14 [REDACTED] [REDACTED] = Redacted by the Permanent
Subcommittee on Investigations
15 A [REDACTED] I do talk to the
16 audit committee.

17 Q Do you know if you gave the presentation
18 that's marked as Exhibit 4 for your deposition?

19 A This would not have been a complete
20 presentation.

21 Q Are these portions of the presentation?

22 A I am not sure. I'm puzzled by the
23 December 13th date. I didn't remember doing an

1 audit committee presentation in December, but it's
2 possible.

3 Q If I call these sheets slides, would that
4 be consistent with the way you refer to Power Point
5 sheets?

6 A I wouldn't say I'm consistent with that.
7 I might call them overheads. I'm getting old enough
8 that I call things a lot of different names because
9 I've heard a lot of different names, but slides
10 might be something I might use.

11 Q Do you know whether you ever presented the
12 overhead or slide that's the first page of Beran
13 Deposition Exhibit 4 to either the board or a
14 committee of the board at Caterpillar?

15 A I'm not positive. I would say this is
16 familiar. We did discuss these points in general.
17 I recall presenting this risk guard rail piece in a
18 preliminary form, I believe it was with the audit
19 committee, to say that we were going to work on tax
20 risk guard rails.

21 Q On the second page of Exhibit 4 do you
22 know whether you ever in about December of 2005
23 presented this overhead or slide to the board or a

1 committee of the board?

2 A I don't recall for sure. I recall this
3 chart being something out of standard presentation
4 we had gotten from some outside service.

5 Q Did you use the Converse Marketing firm
6 sometimes for presentations?

7 A Converse, not to my recollection.

8 Q What outside firm do you think you got
9 slides or overhead from for the presentations?

10 A Where I think we got this, and I'm not
11 positive, would have been the Corporate Executive
12 Board.

13 Q What is the Corporate Executive Board?

14 A The Corporate Executive Board is a
15 DC-based for profit firm that runs a number of, I
16 think they call them councils, including a tax
17 council.

18 Q So is it your belief that this overhead or
19 slide was with reference to tax departments
20 generally and not yours specifically?

21 A Correct.

22 Q But for some reason your department
23 obtained this slide from the organization in

1 Washington DC and thought for some reason that it
2 was apt, is that right?

3 MR. TURNER: Object to form.

4 A Well, apt, I received materials on tax
5 department management on a regular basis and I'm
6 always evaluating things for many purposes from
7 technical tax to board presentation to audit
8 committee presentations, and so this was one of
9 them. To be perfectly honest, Dan mostly drove
10 this. I was skeptical of how useful it was going to
11 be from the beginning.

12 Q Do you know whether you ever -- strike
13 that.

14 Do you see the graph here shows that
15 whoever developed this slide or overhead viewed tax
16 at one time at the earliest point in time depicted
17 on the slider overhead as a cost center in the
18 pre-1990's period?

19 A Uh-huh, I see that.

20 Q Do you agree with that portrayal of tax
21 departments generally in the pre-1990 area?

22 A I don't have that much direct knowledge
23 with large corporate tax departments pre-1990 so

1 it's a little hard to say.

2 Q Was the tax department at Caterpillar a
3 cost center in the pre-1990 area?

4 A I wasn't there.

5 Q Did there come a time when tax departments
6 became viewed as profit centers generally?

7 MR. TURNER: Object, form. By who?

8 A In the general press and in some people's
9 mind quite possibly because people were marketing
10 tax shelters and companies like Enron were in the
11 press.

12 Q Going to the third page of the Beran
13 Deposition Exhibit 4, is this a slide or overhead
14 that you presented to the board in or about December
15 of 2005?

16 A I believe it is. Again I'm puzzled by the
17 December date, but it's possible.

18 Q Did you tell the board of directors that
19 your department was working on tax risk guard rails?

20 A I recall at one of the audit committee
21 meetings I told the audit committee that we were
22 going to work on this, on tax risk guard rails. I
23 believe I also told them that I was skeptical that

1 A Not for sure but I reasonably would
2 believe it's part of another, if not the same,
3 corporate executive board material because the
4 graphics are very similar.

5 Q Did there come a time when in 2005 you
6 came to regard the roles in tax as being different
7 from the old roles which were technically based?

8 MR. TURNER: Object, form.

9 A Could you repeat that?

10 Q I can restate it I think. Do you see
11 under project manager a sentence that says no prior
12 tax expertise is required?

13 A Yes.

14 Q Or a portion of a sentence?

15 A Yes.

16 Q Did there come a time in 2005 when you
17 came to view a project manager role in tax as being
18 one that could be filled by someone without prior
19 tax expertise?

20 A I can't say that I ever even considered
21 it.

22 Q Would you turn to the next page in
23 Deposition Exhibit 4, please? Do you recall ever

1 presenting this slide or overhead to the audit
2 committee of the board of directors?

3 A I believe I did, yes.

4 Q Do you know when that would have been?

5 A Not for sure. Again it has a date on it
6 so it's probably correct, but I really don't recall
7 the dates, even the years.

8 Q Do you recall how you came to have this
9 slide or overhead to present it?

10 A Reasonably certain Dan put it together at
11 the time.

12 Q Do you recall any of the discussion when
13 you presented this overhead or slide?

14 A My recollection when I would have
15 presented it, it was just a chronological chart. It
16 had nothing to do with promotion, successors, or
17 anything. Basically everyone stays in place until
18 they retire or were expected to retire.

19 Q What was your point in showing this to the
20 audit committee?

21 A That we had needs to develop people.

22 Q Could you turn to the last page then of
23 Beran Deposition Exhibit 4? Do you think you ever

1 presented this slide or overhead to the audit
2 committee of the board of directors?

3 A Again I don't recall specifically.

4 Q Do you know if, when you presented slides
5 or overhead to the audit committee of the board of
6 directors, whether the directors who were a part of
7 that committee would get materials that would
8 include your slides or overhead?

9 A I was never responsible for distributing
10 it so I can't say for sure, but I do know that
11 certainly recently, from what I do recall, they do
12 get advanced material.

13 Q Do you know if anyone keeps track of the
14 materials that are used at the audit committee
15 meetings of the board of directors in terms of
16 retaining a copy for the archives of the committee?

17 A I don't really know for a fact, no.

18 Q Would the next meeting of the audit
19 committee of the board of directors after December
20 be the February meeting typically?

21 A Typically, yeah, they are held like every
22 other month.

23 Q And then would the next one after the

1 February meeting then be the one in April typically?

2 A Typically.

3 Q Do you recall whether you were tasked with
4 a deliverable for the February audit committee
5 meeting to present tax risk guard rails?

6 A Only based on the fact that this page is
7 in front of me. I don't remember otherwise
8 six years ago.

9 Q Do you recall any discussion with the
10 members of the February -- or I'm sorry, with the
11 audit committee of the board of directors regarding
12 the task risk guard rails?

13 A Only in the fact that I presented the
14 materials to them.

15 Q And then you also mentioned that you think
16 you told them you were skeptical about whether the
17 task risk guard rails would correctly quantify risks
18 in an understandable way, is that right?

19 A I generally recall that, but I don't
20 really remember at what point it would have been.

21 Q Do you know whether for the April audit
22 committee meeting you were going to plot the current
23 tax positions on the guard rails?

1 A April of which year?

2 Q 2006.

3 A My recollection was that we were going to
4 work on plotting them. Again it's likely it would
5 have been for April because that's normally when I'm
6 on the schedule, but I don't really know or recall
7 what or when we committed to do that.

8 (At this point in the proceedings Deposition
9 Exhibit No. 5 was marked for identification.)

10 Q Showing you what's been marked for your
11 deposition as Exhibit 5, have you ever seen that
12 document before, Mr. Beran?

13 A I have seen similar documents that would
14 contain similar information. I don't know if I have
15 seen this particular version.

16 Q Do you know if your tax council did plot
17 risks in discussions using the tax risk guard rails?

18 A You mean the tax council being the group
19 of senior tax managers?

20 Q Yes.

21 A Yes, we worked on that.

22 Q And in this circumstance tax council is
23 C-O-U-N-C-I-L, right?

1 A Correct.

2 Q And then Caterpillar also has a tax
3 counsel, C-O-U-N-S-E-L, is that right?

4 A That's correct.

5 Q At this time we're talking about the C-I-L
6 tax council being the one to come up with
7 assignments of risk using the tax risk guard rails,
8 is that correct?

9 A That's correct.

10 Q Did you participate in that process of the
11 tax council of assigning risks?

12 A On occasion, yes.

13 Q In order to reach an assignment of risk,
14 was there an effort to reach a consensus on the tax
15 council?

16 A I would say there was an effort to reach
17 consensus, though different people add different
18 levels of expertise so, therefore, more influence,
19 say, on some points than others.

20 Q Would the manager for a particular risk
21 have more influence for that risk than, say, someone
22 would have who was in charge of a different risk?

23 A Typically.

1 Q Were there any rules about majority votes
2 or anything like that?

3 A Not that I recall. Maybe it sort of
4 worked that way, I don't know, but I don't remember
5 that we went that far.

6 Q Would you turn to the second page of
7 Exhibit 5 for your deposition? Do you see a column
8 that reads bundled royalty?

9 A Yes.

10 Q And do you see an entry in the leftmost
11 column that says business purpose and substance?

12 A Yes.

13 Q Going over from on the row in the left
14 most column that says business purpose and substance
15 over to the column under bundled royalty, what is
16 the number that's assigned there or what are the
17 numbers?

18 A If I'm seeing it right, it's five and
19 fifty.

20 Q And then do you know what that means in
21 this context?

22 A Do I know what it means in this context?

23 Q Yes.

1 would have to be paid when that one billion dollars
2 was brought in, is that correct?

3 A That's correct.

4 Q Did that have to be done before the end of
5 the year?

6 A That's my recollection. There was a
7 relatively short time period we had to implement and
8 pay the dividend.

9 Q In Caterpillar's case did it have to
10 borrow the cash in order to bring the money into the
11 United States?

12 A I don't remember what we ended up having
13 to do.

14 Q Do you recall becoming involved in a
15 billion dollars being borrowed by Caterpillar in
16 order to take advantage of the provisions of the tax
17 act?

18 A I don't recall the actual meetings. I
19 really don't remember.

20 Q Do you see in the last full paragraph on
21 the second page of Deposition Exhibit 13 where it
22 says failure to proceed will result in significant
23 additional tax costs, approximately 15 to 25 percent

1 of any cash moved to the U.S. or the need to stop
2 sweeping all cash to the U.S. which may require
3 borrowing in the U.S. while holding cash off shore.
4 What did you mean by that?

5 A That if it got to the point that we had to
6 just pay an outright dividend, we would incur
7 significant extra tax costs.

8 Q Had the company been sweeping all cash to
9 the U.S.?

10 A I use the term sweeping, but it wasn't
11 necessarily sweeping in the sense of our, what do we
12 call it, daily cash sweeps that the treasury guys
13 do.

14 Q Is that what you were referring to?

15 A Different terms of art for sweeping but --

16 Q In what sense did you use the word
17 sweeping here?

18 A In the sense more of we would lend money
19 back, we would purchase product from Cat, Inc.,
20 various forms that were approved under the law.

21 Q Did you typically keep, as of the time
22 that you wrote this, cash off shore in sums of one
23 billion dollars or larger?

1 MR. TURNER: Object, form.

2 Q By you, I mean Caterpillar.

3 A I don't deal with it on a day-to-day,

4 month-to-month basis so I don't remember.

5 Q When you say repatriation without planning

6 would cost over \$200 million for 2005, do you

7 remember how you forecast that?

8 A Not off the top of my head.

9 Q Where you say that such a course would

10 move the ETR over one half point, what is the ETR?

11 A Effective tax rate.

12 Q Then on the first page of Deposition

13 Exhibit 13, is there an E-mail to Rod Perkins dated

14 February 28, 2005?

15 A You mean my sending it to Rod and Giles?

16 Q Yes, are you simply forwarding the E-mail

17 that you had sent to Mr. Burritt to Mr. Perkins,

18 Mr. Giles Parsons, and John Caviness?

19 A Yeah. Yes.

20 Q Is that what this shows?

21 A Yes.

22 Q And then up above that does that appear to

23 be an E-mail from Rod Perkins to Daniel Schlicksup?

1 A Yes.

2 Q Did Mr. Burritt approve the idea that you
3 had discussed in your E-mail dated February 25,
4 2005, to Mr. Burritt where you said in the subject
5 line, authorization to proceed, et cetera?

6 A He would have or we wouldn't have
7 proceeded.

8 Q Did Mr. Oberhelman also approve it?

9 A I really don't remember who all approved
10 it. I know Dave would have approved it though.

11 Q Do you see where Mr. Perkins says that
12 Mr. Oberhelman approved it?

13 A Yeah, I see that.

14 Q Is that accurate?

15 A I have no reason to question Rod's
16 recollection or Rod's comment on here.

17 (At this point in the proceedings Deposition
18 Exhibit No. 14 was marked for identification.)

19 Q Do you know if Exhibit 14 consists of
20 slides or overheads that were used in a presentation
21 to the audit committee of the board of directors?

22 A It looks like it's part of one of the
23 presentations, yes.

1 Q Do you know if you gave this presentation
2 or did someone else give it?

3 A I don't know for sure.

4 Q Does the front page refer to a June 2006
5 date?

6 A Yes.

7 Q Do you know if at the December 2005
8 meeting your department had been tasked to make a
9 further presentation about tax risks later on in the
10 year?

11 A Only from what we've reviewed today.

12 Q Were you ever present for any
13 presentations that Dan Schlicksup made to the audit
14 committee of the board of directors?

15 A I don't remember.

16 Q Did you give a presentation with Janie
17 Copeland on or about April 10, 2007, to the audit
18 committee of the board of directors?

19 A I can't tell you that that was the date
20 but based on what you've got here, it probably was.

21 Q Did Ms. Copeland have some slides and you
22 had some slides?

23 A Yes.

1 (At this point in the proceedings Deposition
2 Exhibit No. 15 was marked for identification.)

3 Q Now, on the first page of Beran Deposition
4 Exhibit 15, do you see in the lower left corner
5 where it says Caterpillar confidential red?

6 A Yes.

7 Q Is that the highest form of
8 confidentiality at Caterpillar?

9 A To my knowledge, yeah.

10 Q Does it go green, yellow, and red?

11 A Yes.

12 Q Do you see on the third page of Beran
13 Deposition Exhibit 15 that there is a slide or an
14 overhead and in the bubble, the yellow bubble it
15 says purchased finished parts distribution? Do you
16 see that?

17 A Yes.

18 Q Then on the next page in a yellow bubble
19 it says purchased finished parts distribution
20 relative to the heading of that page saying after
21 Cat SARL. Do you see that?

22 A Yes.

23 Q Then in the next page do you see where it

1 Q And then it says current cash sweep policy
2 from non-U.S. sources through CSARL to offset a Cat,
3 Inc., cash shortage position will eventually trigger
4 U.S. tax, as tax free mechanisms for cash
5 repatriation will soon be exhausted. Do you see
6 that?

7 A Yes.

8 Q What were the tax free mechanisms for cash
9 repatriation that you were referring to there?

10 A It would include a lot of things but
11 principally it would be the payment of a dividend or
12 the lending back pools of previously taxed income
13 which can be rotated amongst the different lending
14 subsidiaries. It could have included the purchase
15 of exports from Cat, Inc. or other Cat U.S. subs for
16 sale outside the U.S. Those would be the principal
17 ones that come to mind.

18 (At this point in the proceedings Deposition
19 Exhibit No. 21 was marked for identification.)

20 Q What was COSA, C-O-S-A?

21 A Caterpillar Overseas SA. SA stands for
22 something like societe anonyme.

23 Q Do you know what the COSA structure was

1 that you were referring to in this E-mail that
2 appears to be from you to Dan Schlicksup from 1999?

3 A I'll have to read this closer. What was
4 your question again?

5 Q Do you know what the COSA structure was
6 that this was referring to?

7 A COSA structure, I don't necessarily use
8 COSA structure here.

9 Q Well, on the subject line.

10 A Oh, okay, up there, the old COSA. I'm not
11 really sure. CCHSA is another or was, as I recall,
12 another one of our Swiss companies. COSA was the
13 original Swiss marketing and parts distribution
14 company going back to the early '60s.

15 Q Do you know why in the third paragraph
16 you're concerned about what would be said in
17 overheads and handouts with respect to the COSA
18 structure?

19 A Not for sure.

20 (At this point in the proceedings Deposition
21 Exhibit No. 22 was marked for identification.)

22 Q Showing you what's been marked for
23 identification for your deposition as Exhibit 22,

1 what was CLS?

2 A CLS is Caterpillar Logistics Services.

3 Q Did CLS have to bear any of the costs
4 internally that were associated with --

5 A Is this an extra page?

6 Q It might be. Why don't we just put that
7 away and I'll just ask you some questions about CLS.

8 A Okay.

9 Q Did CLS have to bear any of the costs
10 associated with creating the CSARL structure insofar
11 as it concerned the distribution of purchased
12 finished replacement parts?

13 A CLS can mean two different things. CLS in
14 some context when we talk purchased service charges,
15 it would generally mean more from a management
16 accounting point of view. CLS, as I recall, many of
17 these years was viewed as a business unit, logistics
18 business. And so there's kind of a -- there could
19 be a difference between business measurements
20 charges and legal entity charges without getting
21 into the details here. I'd have to study it to
22 figure out what we are talking about.

23 Q Did you ever make a distinction between

1 maintenance costs and expansion costs when it came
2 to the CSARL structure for distributing purchased
3 finished replacement parts outside the United
4 States?

5 A Yes.

6 Q Who did you think should bear the
7 maintenance costs?

8 A Because maintenance was known and could be
9 budgeted in advance, we generally wanted the
10 existing business units and legal entities to budget
11 for it and absorb it themselves.

12 Q How about for the expansion costs?

13 A It wouldn't just be expansion costs. It
14 would be any time that a change was pushed in after
15 budgets were established that we'd consider some
16 other business measurement approach.

17 Q On the second page down at the bottom of
18 Exhibit 22 for your deposition there appears to be
19 an E-mail from you to Dan Schlicksup along with a
20 number of your direct reports and some others from
21 you dated August 21, 2008. Do you see that?

22 A Uh-huh.

23 Q It says, "Do we know much of their charges

1 as maintenance versus expansion? The maintenance is
2 really accounting work it seems. So is the
3 expansion, but I'm more willing to pay that to get
4 them to implement it. I guess I had forgotten or
5 missed that they were including the maintenance
6 costs. The original premise was we'd absorb the
7 start-up when it came up midyear and they couldn't
8 budget for it."

9 A I think that's what I just said before.

10 Q "The view was that we could explain it
11 best. We went a little further with CLS as they
12 were a contractor for the product managers." Do you
13 see that?

14 A Uh-huh.

15 Q Who are the product managers?

16 A Who are they?

17 Q Yes.

18 A I can't name names. I can't remember, but
19 they are accountable for different of our products.

20 Q How was CLS a contractor for the product
21 managers?

22 A In the context of business measurement
23 system?

1 Q Well, in the context of purchase service
2 charges.

3 A Because the product managers don't have a
4 clue what our legal structure looks like and what it
5 actually takes to sell a part so they basically
6 enter into a contract with CLS to move the parts
7 around. Accounting tax and others end up dealing
8 with the legal structure of the company and making
9 sure that everything actually flows and comports
10 with law.

11 Q When you say that the product managers
12 don't have the slightest idea how a part is sold,
13 how can you say that?

14 A All they know is it goes through a
15 warehouse and gets to a dealer. They know more than
16 that, but I'm just saying they don't deal with the
17 entire legal structure of the company.

18 Q So are you saying that they don't
19 understand all of the entities that are involved?

20 A Correct.

21 Q Did you cover in the tax department all of
22 the expenses of CLS when it came to having the
23 purchased finished replacement parts sold worldwide

1 other than in the United States through CSARL?

2 A I don't know if it was all, but in general
3 from a measurements point of view it would be
4 charged to me and I would explain what the costs
5 were as part of the business measurements process.

6 Q In the E-mail up at the top of the second
7 page of Beran Deposition Exhibit No. 22, do you see
8 an E-mail that is to you from Rod Perkins?

9 A Uh-huh.

10 Q And it says, "Robin, very early her
11 charges were primarily implementation, then they
12 became primarily maintenance. We've been paying for
13 both since day one." Was that accurate as of August
14 of 2008?

15 A If Rod informed me of it, I would believe
16 Rod.

17 Q Did you pay the maintenance and expansion
18 charges because you were worried that if you didn't,
19 the product managers would not go along with the
20 expansion?

21 A Product managers? No.

22 Q Do you see where Rod Perkins says, "but
23 you will recall, you were willing in the very early

1 years to pay those additional developments beyond
2 our immediate scope to ensure the expansion remained
3 on track"?

4 A Uh-huh, I see it.

5 Q What was the concern about the expansion
6 not remaining on track if you didn't pay those
7 expenses?

8 A Just the speed and complexity of working
9 it through our approvals processes within the
10 company, how many different people would be brought
11 in routing and charging it one way versus another.

12 Q Did you indicate to the product managers
13 that they wouldn't have to worry about changing the
14 way they did business if they went along with this
15 expansion?

16 A Product managers in the parts
17 distribution, I don't really recall ever discussing
18 parts piece directly with any product managers.

19 Q Did you ever assure anyone at Caterpillar
20 that the product managers would not have to change
21 the way that they and their people did business if
22 they would go along with implementation of the
23 expansion?

1 Q Yes.

2 A I have no idea.

3 Q Did the tax department cover maintenance
4 and expansion costs for other areas of the company
5 to the extent they had to become involved with
6 regard to changes in entities?

7 A Changes in entities? That seems kind of
8 an open-ended question. Could you repeat it?

9 Q Why don't I ask it this way. What was the
10 expansion that you were referring to in your E-mail
11 at the bottom of page two, or the second page
12 rather, of Beran Deposition Exhibit 22 in the E-mail
13 dated 8/21/2008?

14 A In '08?

15 Q What's being expanded in the word
16 expansion there?

17 A I don't really remember.

18 Q Do you remember when we talked about how
19 the CSARL project, insofar as it related to changes
20 in the entities that would handle purchased finished
21 replacement parts, would create expenses that would
22 go into the line on the income statement below cost
23 of goods sold for administrative costs? It would be

1 Exhibit 9. Do you remember how we talked about
2 where that arrow was pointed and it was pointed
3 towards selling general and administrative expenses?

4 A Uh-huh.

5 Q Would the maintenance and expansion costs
6 be part of the administrative expenses of the
7 consolidated statement?

8 A You know, I don't really know.

9 Q When you said in the second line of that
10 E-mail that we've been talking about at the bottom
11 of the second page of Exhibit 22 that you said "so
12 is the expansion but I'm more willing to pay that to
13 get them to implement," are you saying you don't
14 remember what charges were for expansion? Weren't
15 the charges hundreds of millions of dollars for
16 accounting and other work?

~~For~~ = Redacted by the Permanent
Subcommittee on Investigations

17 A No. [REDACTED]

18 [REDACTED]

19 [REDACTED]

20 [REDACTED]

21 [REDACTED]

22 Q Well, let's look at that one specifically
23 then. For that one did the product managers that

1 were involved in that limited circumstance have to
2 eat any of the maintenance or expansion costs?

3 A From an accountable profit point of view?

4 Q Well, whose department bore the expense?

5 A From an accountable profit point of view,
6 I believe they were charged to corporate tax as it
7 would have been called, or global tax and trade. I
8 don't know. Yeah, global tax and trade.

9 Q Was that true with respect to all of the
10 maintenance and expansion costs as CSARL gained more
11 and more of the territory of the rest of the world
12 other than the United States?

13 A Well, I don't know what you're actually
14 asking me. Could you repeat that?

15 (Record read as requested.)

16 A I think with what's happened over the last
17 couple years they don't charge us anymore. I'm not
18 sure.

19 Q Why have they stopped charging?

20 A It's an internal measurement system so
21 people change things because they think there's a
22 better way to measure. I don't get to make that
23 decision.

1 Q Why was Dan Schlicksup moved out of the
2 tax department?

3 A Why?

4 Q Yes.

5 MR. TURNER: Object to foundation.

6 A Why was he moved in?

7 MR. TURNER: The question is do you
8 know why he was moved out?

9 A Not really.

10 Q Do you know why he was moved in?

11 A I was told a reason.

12 Q Who told you a reason?

13 A Dave Burritt.

14 Q What did he tell you?

15 A That he needed, Dan needed a home because
16 he needed to be moved out of the job he had been on.

17 Q What job had he been on?

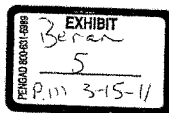
18 A Something in logistics. I don't know
19 exactly what it was.

20 Q Did Mr. Burritt tell you why he needed to
21 be moved out of logistics?

22 A Not in any detail.

23 Q What was the substance of what you were

Categories	Definition	Indicative Criteria
Transactional	Level of risk structure or transaction creates associated with full compliance with the law, regulations and case-law.	Tax Law Tax Personnel Continuity Industry Practice Business Purpose & Substance Consistency Magnitude of Cash Impact Documentation
Operational	Level of risk structure or transaction creates for everyday business operations.	Operational Change
Compliance	Level of risk structure or transaction creates associated with tax return preparation, completion and submission.	Compliance Requirements Availability of the Data
Financial Accounting	Level of risk structure or transaction creates associated with tax accounting, financial statements, SEC disclosure issues or internal controls.	US GAAP Interpretation - Decision to Reserve, Provide Valuation Allowance, M&A Accounting or Indefinite Reinvestment Allowances for Deferred Tax Assets Documentation Impact on Financial Reporting Processes Magnitude of \$ Impact on Financial Statements
Management	Probability above risks can be managed consistent with corporate tax risk process.	Documented Corporate Tax Risk Process BU versus Legal Entity Functional Alignment
Reputational	Probability structure or transaction will generate negative impact on the Company's image as perceived by the public.	WSJ Test



10. Collected transaction	Definition Level of risk structure of transaction creates associated with all compliance with the law, regulations and case-law	Criteria Low Medium High	Tax Law The structure of transaction is consistent with the applicable law, administrative rules, and judicial decisions of the appropriate jurisdiction(s) in all significant respects. The structure of transaction is consistent with the applicable law, administrative rules, and judicial decisions of the appropriate jurisdiction(s) in some significant respects. The structure of transaction is inconsistent with the applicable law, administrative rules, and judicial decisions of the appropriate jurisdiction(s) for any reason. The structure of transaction is not consistent with outside advice in some significant respect.	
Tax Planning Consistency	None of the Counselor Tax Managers or Planning Managers, or significant consultants involved in the planning will leave Carl's employment in the next 10 Years. Less than 50% of the Counselor Tax Managers or Planning Managers, and less than 50% of the significant consultants involved in the planning will leave Carl's employment in the next 10 Years. 50% or more of the Counselor Tax Managers or Planning Managers, or 50% or more of the significant consultants involved in the planning will leave Carl's employment in the next 10 Years.			
Industry Practice	This structure of transaction is relatively common in the industry based on networking with consultants and tax professionals at other companies. We are aware of other companies in the industry that have engaged in a similar structure or transaction based on networking with consultants and tax professionals at other companies. The structure of transaction represents a novel application of the law, regulations and/or other decisions.			
Business Purpose & Substance	One or more business units or service centers fully participated in the implementation of the structure of transaction. The tax structure of transaction is actually run by the business units prior to the structure of transaction. Some change was required by the business units for the structure of transaction. The business unit made changes, but the tax structure of transaction does not reflect the way the business is actually run by the business unit in some significant respect. There is more than one business unit that participated in the implementation of the structure of transaction. Significant change was required by the business unit for the structure of transaction to have substance. The business unit made changes, but the tax structure of transaction does not reflect the way the business is actually run by the business unit in some significant respect. The business unit or service centers were not in line with a "Tax" transaction. We are relying on the form (legal documents, etc.) of the structure of transaction to provide the substance.			
Consistency	The filing position is consistent with prior planning and positions taken in all significant respects. The filing position is consistent with prior planning and positions taken in most significant respects, but inconsistent with prior practice and planning in one or more minor respects. The filing position is inconsistent with prior planning and positions taken in one or more significant respects. There has been a change in a significant aspect of the tax impact with no change in the business facts or law.			
Adequacy Draft Report	The IPFR of combination of tax, interest, and penalties is less than \$10,000,000. The IPFR of combination of tax, interest, and penalties is \$10,000,000 or more and less than \$50,000,000. The IPFR of combination of tax, interest, and penalties is \$50,000,000 or more.			
Documentation	Adequate documentation exists and is in the form of documents. Adequate documentation exists and is in the form of documents. Adequate documentation exists and is in the form of documents. Adequate documentation exists and is in the form of documents.			

[illegible]

EXHIBIT

Burnitt 6

4-20-11 CP

CATERPILLAR INC.
Report to the Audit Committee

Global Finance and Strategic Support Transformation

August 8, 2006

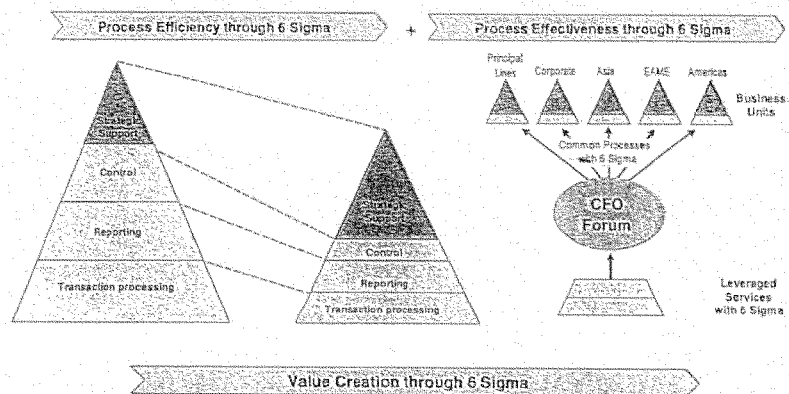


Table of Contents

Global Finance and Strategic Support Transformation

Global Finance & Strategic Support Transformation Update	3
Accounting and Disclosure Matters	
Statement of Cash Flow - - Update	5
World Class Accounting Update	5
Accounting Pronouncements Update	7
Tax	
World Class Tax Update	8
1995 – 1999 Audit Update	8
Treasury	
World Class Treasury Update	9
Derivative Policy and Usage Review	10

Global Finance and Strategic Support Transformation Update

The CFO Forum is leveraging the common commitment and understanding forged at the May GF&SS Managers' Conference to lay the foundation for the transformation. Multiple 6 Sigma projects are underway to achieve our global 2006 SMART goals, and we are seeing a shared global focus on substantially reducing complexity and risk.

To continue the momentum from May, we have instituted global bi-weekly meetings to help drive the Global Finance & Strategic Support Transformation. One meeting includes the 100+ business managers across the globe, focused on sharing progress on current initiatives underway, highlighting achievements, and providing a forum to introduce key messages aligned with the CFO Forum. The second meeting includes designates of the CFO Forum and is focused on driving the disciplined program management, prioritizing transformation projects, and discussing and resolving transformation related issues. Lessons learned from prior global deployments continue to be embedded within the fabric of the transformation.

We expect to deliver a business proposal in October with emphasis on 2007 plans but outlines the longer-term benefits of the process and systems efforts required for the investment in the SAP solution. This is a combined effort across Cat Production System Division (CPSD), the CFO Forum, and Systems+Processes Division (S+PD) as we collaborate with the business units to achieve Vision 2020.

Within the CFO Critical Success Factors, we have made excellent progress but have much more to do.

People – Getting the right people on the bus

- Global Finance Transformation- We continue to round out the core team, most recently adding key resources for EAME leadership, Change Management and Communications, and continued strengthening of the Global Process teams.

Process Excellence – Reducing risk and complexity

- Global Finance Transformation- Multiple projects are underway, including Integration Partner selection, Transformation Deployment Strategy, Change Management and Communications Strategy, and 2007 SMART Goals Rollout and Metrics.
- World Class Accounting—We have globally deployed the business manager toolkit as the foundation for our common processes. Recruiting efforts for mid-career professionals have increased to ensure we have the right people at the right time.
- World Class Treasury—We are deploying Phase II SunGard with 6 Sigma.



Global Finance and Strategic Support Transformation Update

- World Class Tax—We are documenting the “as is” and “to be” customs and VAT processes, which are nearly complete. Training and implementation are scheduled for the 4Q.
- World Class Strategic Support—We rolled out the new front end M&A process with 100% of the applicable units adopting the process in Executive Office Reviews.

Trough – Being ready for whatever economic circumstances brings

World Class Strategic Support – We have gained agreement on the trough planning assumptions and actions in the Executive Office Reviews. This includes a trough planning review in every Executive Office Review.

Systems Moratorium- We are working with CPSD and S+PD to develop a systems moratorium that stops the vast majority of changes to legacy finance and order fulfillment systems, with the noted exceptions of mandatory/regulatory requirements.

Accounting and Disclosure Matters

Statement of Cash Flow - Update

[REDACTED]

World Class Accounting Update

Our global efforts on three key initiatives: a lower cost sustainable Sarbanes-Oxley process led by Corporate Auditing, Best GAAP, and our Global Finance and Strategic Support Transformation are all integral to World Class Accounting and to achieving our Global Finance and Strategic Support Transformation. Through a number of 6 Sigma projects, the first phase of our Best GAAP initiative has been completed with deployment to over 90% of our accountants globally. Succeeding phases will include enhancements to the tools as well as provide "make up" training to accountants missing the first phase. The following summarizes the deployment to date:

People:

We have completed a number of actions to ensure we have the right people in the right place for our financial reporting and fiduciary responsibilities. These actions include:

1. Formation of the CFO Forum and Controller's Council. These teams include the senior-most financial leaders across the globe that will lead process simplification and standardization.
2. Placement of technical accounting managers throughout the globe based on risk assessment.
3. Continued recruitment of high potential outside hires and development of our current team members.
4. [REDACTED]

[REDACTED] Focused courses are now available to individuals based on their business unit type, experience levels and corresponding responsibility combined with a few common core courses for all. The importance of our fiduciary work and maintaining technical competence is clearly visible through these actions.

Accounting and Disclosure Matters

Process -- Business Manager Toolkit:

A business manager toolkit has now been fully deployed globally to assist business managers with fulfilling their fiduciary responsibilities. The remainder of 2006, the Controller's Council and Corporate Accounting will assist business units implement the toolkit. Beginning next year, business unit usage of the toolkit will be audited.

The toolkit provides business managers a structured approach to identify, assess and address financial reporting risks. This approach includes:

1. Evaluation of critical accounting policies and assessment of business unit financial statement risks.
2. Rotating deep dive 6 Sigma projects to eliminate or mitigate financial statement risks.
3. Monthly financial reporting checklist to provide best fiduciary practices aligned with Sarbanes-Oxley controls evaluation.
4. Formal balance sheet and reserve reviews.
5. More accessible accounting policies and practices with technical updates.

These tools provide an auditable measurement of each legal entity's status with the focus on helping each unit improve.

Process -- Core Fiduciary Projects:

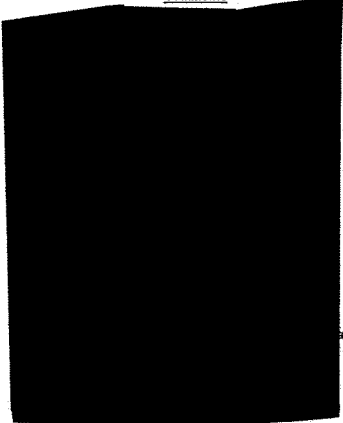
Global deep dive 6 Sigma projects launched from the core and aimed at reducing financial reporting risk have continued on target in 2006. This year, primary areas of focus include: revenue recognition, intercompany receivables / payables, stock-based compensation, deferred tax assets and liabilities, post-retirement benefits and accounting for new entities.

Accounting and Disclosure Matters

Redacted by the Permanent Subcommittee on Investigations

Accounting Pronouncements Update

Following is a summary of guidance we expect to be issued in 2006 and its impact on Caterpillar:

2006 Accounting Pronouncements			
Upcoming Guidance	Effective Date	Impact On Cat	Comments
<ul style="list-style-type: none"> Pending Implementation <ul style="list-style-type: none"> Amendment of SFAS 140 Income Taxes (FIN 48) Awaiting Guidance <ul style="list-style-type: none"> Retirement Benefits Earnings Per Share Fair Value Measurements Accounting for Transfers - Amendment of SFAS 140 Business Combinations 	<ul style="list-style-type: none"> Final guidance effective in 1st Qtr 2007 Final guidance effective in 1st Qtr 2007 Final guidance expected in 3rd Qtr 2006 Final guidance expected in 2006 Final guidance pending FASB deliberations Final guidance expected in 2007 Final guidance expected in 2007 		<div>Guidance expected in 2006</div> 
Financial Impact ● Minimal ○ Some ● Significant			

Tax Update

World Class Tax Update

Right People, Right Place, Right Time

Increasing Global Tax presence in strategic global locations.

- Global Tax Strategy Manager (Peoria)
- APD Tax Planning Manager (Singapore)
- China Tax Manager (Beijing)
- Caterpillar SARL Tax Manager (Geneva)

Improve Efficiency/Effectiveness/Flexibility/Timeliness

Developing common global processes.

- Customs
- Vat

Simplifying the business.

- Global Direct Tax Process Review

Reduce Risk and Complexity

Implemented Tax Risk Guard Rails

1995 – 1999 Audit

•

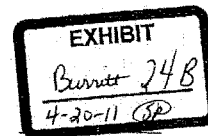
**Redacted By The
Permanent Subcommittee
on Investigations**

**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

Caterpillar Inc.

Global Finance - Tax Risk Management

World Class Global Finance Operations to Support Vision 2020



**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

Redacted By The Permanent Subcommittee on Investigations

The objective of the "Tax Risk Guard Rail Process" is to develop a documented, more objective process that is capable of conveying the degree of business risk created by the portfolio of tax positions (i.e. risk profile) to Global Finance, the Executives and the Audit Committee in a non-technical manner.

Below are the activities taken to develop the Tax Risk Guard Rail Process. These activities were undertaken by personnel of the Tax Function and Tax Accounting Function. This is the same group of people that meets each quarter to discuss the tax provision for the consolidated financial statements. A straw-man was developed by the Tax Function which was then refined over 4 days of off-site meetings between the two groups.

Process

Step 1 in the process was to determine what business risks are created by tax planning so that we could compare each tax position to specific business Risk Categories. The following are the Risk Categories and their definitions. The list is patterned after a basic list obtained from the Corporate Executive Board. This list is very common sense oriented and has a broad application to all businesses.

- Technical Risk: The level of risk a structure or transaction creates regarding full compliance with the law, regulations and court decisions.
- Operational Risk: The level of risk a structure or transaction creates for everyday business operations.
- Compliance Risk: The level of risk a structure or transaction creates for tax return preparation, completion and submission.
- Financial Statement Risk: The level of risk a structure or transaction creates regarding tax accounting, financial statements or internal controls.
- Management Risk: The probability the above risks can be managed consistent with corporate tax risk policies.
- Reputational Risk: The probability a structure or transaction will generate a negative impact on the company's image.

Step 2 in the process was to determine what criteria were indicative of the level of risk created by each tax position for each business Risk Category. The following are the Indicative Criteria chosen for the 6 business Risk Categories stated above.

- Technical Risk:
 - Tax Law
 - Tax Personnel Continuity
 - Industry Practice
 - Business Purpose & Substance
 - Consistency with Prior Positions
 - Magnitude of Cash Impact
 - Documentation
- Operational Risk:
 - Degree of Operational Change Required
- Compliance Risk:
 - Compliance Requirements
 - Availability of Data
- Financial Statement Risk:
 - GAAP Rules
 - Ability to Estimate Reserves & Allowances
 - Documentation
 - Impact on Financial Reporting Processes
 - Magnitude of Financial Statement Impact
- Management Risk:
 - Presence of Documented Tax Risk Process
 - Alignment Between Actual Operations and Tax Requirements
 - Potential for Operational Change w/o Tax Advice
- Reputational Risk:
 - Wall Street Journal Test

Step 3 in the process was to develop Determinative Questions for each Indicative Criteria so that simple yes or no questions could determine the level (low, medium or high) of risk created by a particular tax position for each Indicative Criteria. The following are 3 examples of the Determinative Questions for various Indicative Criteria of 3 different business Risk Categories.

- Risk Category – Technical Risk:

- Criteria – Tax Law

- Determinative Questions

- Low Risk: If the structure or transaction is completely consistent with the applicable laws, administrative rules, and judicial decisions of the applicable jurisdiction(s), then the risk is low.
 - Medium Risk: If the structure or transaction is consistent with the applicable laws, administrative rules, and judicial decisions of the applicable jurisdiction(s) in all significant respects, but not in some other respects, then the risk is medium.
 - High Risk: If the structure or transaction is not consistent with the applicable laws, administrative rules, or judicial decisions of the applicable jurisdiction(s) in some significant respect, or we cannot determine the level of significance or consistency for any reason, or the structure or transaction is not consistent with outside advice in some significant respect, then the risk is high.

- Risk Category – Financial Statement Risk:

- Criteria – Ability to Estimate Reserves & Allowances

- Determinative Questions

- Low Risk: If the amount of the required reserve is reasonably estimable within one-tenth of one percent of the effective tax rate, then the risk is low.
 - Medium Risk: If the amount of the required reserve is reasonably estimable within one-half point of the effective tax rate, then the risk is medium.
 - High Risk: If the amount of the required reserve is not reasonably estimable within one-half point of the effective tax rate, then the risk is high.

- Risk Category – Reputational Risk:

- Criteria – Wall Street Journal Test

- Determinative Questions

- Low Risk: If the Company would not be opposed to voluntarily disclosing this structure or transaction for a WSJ article or to employees, then the risk is low.
 - Medium Risk: If the Company would be opposed to voluntarily disclosing this structure or transaction for a WSJ article or employees, but would feel comfortable discussing it if asked, then the risk is medium.
 - High Risk: If the Company would not want to have to answer questions from the press or employees about this topic, then the risk is high.

These are just 3 examples. There are Determinative Questions for each Indicative Criteria for each business Risk Category. Each tax position was given a score of 1 (low risk), 3 (medium risk) or 5 (high risk) for each Indicative Criteria. The scores for the Indicative Criteria were then weighted and averaged to compute a score for the tax position for the business Risk Category. The scores and weightings were provided by the personnel of the Tax Function and Tax Accounting Function. Then each tax position was plotted on a scale as illustrated below.

Risk Categories

Transactional Risk

Operational Risk

Compliance Risk

Financial Accounting Risk

Management Risk

Reputation Risk

Redacted By The Permanent Subcommittee on Investigations

Step 4 in the process was to determine which of the hundreds of tax positions should be plotted in this manner. The positions plotted are those for which reserves have been established that exceed \$10 million per position, and other items for which there are no reserves established (consistent with Generally Accepted Accounting Principles), but are important for other reasons such as the dollar magnitude of the issue. In essence, these are the tax positions that warrant monitoring and attention. These positions collectively define Caterpillar's Tax Risk Profile. There were 12 positions plotted. The chart below shows the plotting of 7 of the 12 positions that scored the highest overall risk.

Risk Categories

Transactional Risk

Operational Risk

Compliance Risk

Financial Accounting Risk

Management Risk

Reputation Risk

Redacted By The Permanent Subcommittee on Investigations

Tax position labels and amounts are intentionally omitted.

Each colored line represents a tax position. The point at which the colored line for each tax position intersects the black horizontal line for each business Risk Category indicates the risk level that the tax position creates for that business Risk Category. The results of this process were not surprising to the personnel of the Tax Function or Tax Accounting Function. Questions you may have about this chart will be answered as part of the next steps.

Next Steps

At the June Audit Committee meeting, Robin Beran will provide the annual update on the Tax Function. He will present the full results of the Tax Risk Guard Rails Process, conclusions drawn from the results, and answer questions from the Audit Committee. The Audit Committee will then be able to discuss and determine whether Caterpillar's Tax Risk Profile is appropriate.

The Tax Risk Guard Rail Process will be an ongoing process to take into account new tax positions, new legislation, new court decisions and settlements with the IRS. The Audit Committee will be updated annually or more frequently if appropriate.

Summary

Tax Risk Management is a function of balancing risk and return (i.e. tax savings). Prudent risk management requires companies to manage risk within a defined and documented "risk profile".

The objective of the "Tax Risk Guard Rail Process" is to develop a documented, more objective process that is capable of conveying the degree of business risk created by the portfolio of tax positions (i.e. risk profile) to Global Finance, the Executives and the Audit Committee in a non-technical manner.

Many companies have recognized that the context of tax function within the company must change from a "Black Box" or "Technical Silo" to an "Integrated" part of the business. The Tax Risk Guard Rail Process is the first step in the transformation of the Caterpillar Tax Function into a World Class, totally integrated part of the business.

Agenda
Audit Committee
Caterpillar Inc.
June 13, 2006

1. Approve minutes of Board Audit Committee meeting of April 11 and April 21.

20

95

20

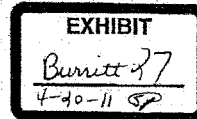
**Redacted By The
Permanent Subcommittee
on Investigations**

135

2. This annual presentation will provide an update on World Class Tax initiatives supporting our Global Finance Transformation, including "tax guard rails".

**Redacted By
Permanent Subcommittee on Investigations**

Audit Committee
Eugene V. Fife, Chairman
W. Frank Blount
John T. Dillon
David R. Goode
Gordon R. Parker
Edward B. Rust, Jr.



Caterpillar Confidential: Red

PSI-TWLF-16-000214

Dave B. Burritt/OG/Caterpillar To: Daniel Schlicksup/0E/Caterpillar@Caterpillar
 05/17/2006 06:50 PM cc
 bcc
 Subject Re: Fw: Audit Committee - June [E]

Caterpillar: Confidential Green

High level detail... first chart s/b the governance chart to show how Tax Council supports GFT... It's from our EOR... Robin's 1st Chart.


Present very high level... it's for the Board. Only dive deep to show an example...

Make sure I see charts before we dry-run, too... get calendars marked, etc...

Dave Burritt
 Caterpillar Inc.
 309-675-4020

This message and any material contained in any attachment are intended only for the use of the addressee and may contain information that is privileged or confidential. If you are not the intended recipient, you are hereby notified that any disclosure, copying, distribution, dissemination, or use of any information contained in this message is strictly prohibited. If you have received this e-mail in error, please notify the sender listed above immediately.

Daniel Schlicksup/0E/Caterpillar

 Daniel Schlicksup/0E/Caterpillar To: Dave B. Burritt
 05/17/2006 10:20 AM Subject Re: Fw: Audit Committee - June [E]
 Caterpillar: Confidential Green Retain Until: 06/16/2006 Retention Category: G50 - General Matters/Administration

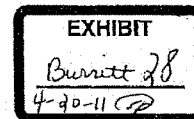
I am working on a presentation. Any thoughts on the level of detail you want on g/r's?
 Dave B. Burritt/OG/Caterpillar

Dave B. Burritt/OG/Caterpillar To: Daniel Schlicksup
 05/15/2006 05:55 PM Subject Re: Fw: Audit Committee - June [E]
 Caterpillar: Confidential Green Retain Until: 06/14/2006 Retention Category: G90 - General Matters/Administration


Agenda is being changed... guard rails w/b covered, too.

Dave Burritt
 Caterpillar Inc.
 309-675-4020

This message and any material contained in any attachment are intended only for the use of the addressee and may contain information that is privileged or confidential. If you are not the intended recipient, you are hereby notified that any disclosure, copying, distribution, dissemination, or use of any information contained in this message is strictly prohibited. If you have received this e-mail in error, please notify the sender listed above immediately.



Daniel Schlicksup/0E/Caterpillar


 Daniel Schlicksup/0E/Caterpillar To: Dave B. Burritt
 Subject: Fw: Audit Committee - June
 05/15/2006 05:08 PM
 Caterpillar: Confidential Green Retain Until: 06/14/2006 Retention Category: G90 - General Matters/Administration

Hey, the only question is what role you want the guardrails to take in the annual presentation? Two options at this point....

1. Annual update with some info on the guard rails - we did them and review an example
2. Short cut the annual update and do deep dive on the guard rails

Your comments please.

— Forwarded by Daniel Schlicksup/0E/Caterpillar on 05/15/2006 11:19 AM —

 Robin D Beran To: "Daniel Schlicksup"
 <Beran_Robin_D@cat.com> Subject: Fw: Fw: Audit Committee - June
 05/12/2006 06:11 PM
 Caterpillar: Confidential Green Retain Until: 06/11/2006 Retention Category: G90 - General Matters/Administration

Dan, we need to do a refresher review early next week.
 Robin
 Beranrd@cat.com 309.675.4478

From: Robin D Beran
 Sent: 05/12/2006 06:08 PM
 To: Dave Burritt
 Subject: Re: Fw: Audit Committee - June

We're done with them from about 5 weeks ago.
 Robin
 Beranrd@cat.com 309.675.4478

From: Dave B. Burritt
 Sent: 05/12/2006 06:07 PM
 To: Robin Beran
 Subject: Re: Fw: Audit Committee - June

Are the guard rails not ready?

Dave Burritt
 Caterpillar Inc.
 309-675-4020

This message and any material contained in any attachment are intended only

for the use of the addressee and may contain information that is privileged or confidential. If you are not the intended recipient, you are hereby notified that any disclosure, copying, distribution, dissemination, or use of any information contained in this message is strictly prohibited. If you have received this e-mail in error, please notify the sender listed above immediately.

Robin D
Beran/OS/Caterpillar

05/12/2006 06:05
PM

To
To
Dave B.
Burrirtt/OG/Caterpillar@Caterpillar
cc

Subject
Re: Fw: Audit Committee - June

Caterpillar: Confidential Green

Retain Until: 06/11/2006
Retention Category: G90 -
General
Matters/Administration

True, but I don't recall Gene ever indicated a timetable. We had said we'd have the first phase done for Feb (you probably recall our emails on that), but it wasn't put on the agenda. We're ready to go, either way.
Robin
Beranrd@cat.com 309.675.4478

----- Original Message -----
From: "Dave B. Burrirtt" [BURRITT_DAVE_B@cat.com]
Sent: 05/12/2006 06:01 PM
To: Robin D Beran <Beran_Robin_D@cat.com>
Cc: "Daniel Schlicksup" <Schlicksup_Daniel@cat.com>
Subject: Re: Fw: Audit Committee - June

I will call Ali but our instruction from Gene was on guard rails....
Dave Burrirtt

Dave Burritt
Caterpillar Inc.
309-675-4020

This message and any material contained in any attachment are intended only for the use of the addressee and may contain information that is privileged or confidential. If you are not the intended recipient, you are hereby notified that any disclosure, copying, distribution, dissemination, or use of any information contained in this message is strictly prohibited. If you have received this e-mail in error, please notify the sender listed above immediately.

Robin D Beran
<Beran_Robin_D@cat.com>

05/12/2006 04:19 PM

"Dave B. Burritt"
<BURRITT_DAVE_B@cat.com>

To
To

cc

"Daniel Schlicksup"
<Schlicksup_Daniel@cat.com>
"Daniel Schlicksup"
<Schlicksup_Daniel@cat.com>

Subject

Fw: Audit Committee - June

Caterpillar: Confidential Green

Retain Until: 06/11/2006
Retention Category: G90 -
General
Matters/Administration

Dave, I'm OK with this if you are.
Robin
Beranrd@cat.com 309.675.4478

From: Linda K. Caldwell
Sent: 05/12/2006 04:16 PM
To: Robin Beran
Subject: Re: Audit Committee - June

Robin,

Ali said that you have 20 minutes and he wants you to focus on the usual "annual presentation" and not to bring up guardrails. If you think we need to discuss guardrails, we can do in a separate presentation at a later A/C meeting. If you have any questions, please give Ali a call or send him an email.

Linda Caldwell
Executive Assistant to the Vice President
Caterpillar Inc.
Corporate Auditing and Compliance Div.
Ph: 309-675-4762
Fax: 309-675-6893
Email: caldwell_linda_k@cat.com

Robin D.
Beran/OS/Caterpillar

05/11/2006 12:31
PM

To
To

Linda K.
Caldwell/OY/Caterpillar@Caterpillar
cc

Subject

Re: Audit Committee - June

Caterpillar: Confidential Green

Retain Until: 06/10/2006
~~Retention Category: G90~~
General
Matters/Administration

I think this works. I plan to spend a bit of time on so-called risk guardrails, but I don't think we need to mention that specifically. I'm hoping to cover in 20 minutes, but if we get into much discussion of how the guardrails work we could take a lot of time. Not sure how we control/plan for that.

Robin
Beranrd@cat.com 309.675.4478

From: Linda K. Caldwell
Sent: 05/10/2006 09:06 AM
To: Robin Beran

Subject: Audit Committee - June

Robin,

~~Income Tax Matters is on the agenda for the June Audit Committee meeting.~~
The description we used before was:

This annual presentation will describe the process used for establishing income tax reserves for potential future claims and any related risks, as well as current tax issues and planning.

Is this description ok to use in the agenda materials? Also, do you need 20-30 minutes for this presentation?

Linda Caldwell
Executive Assistant to the Vice President
Caterpillar Inc.
Corporate Auditing and Compliance Div.
Ph: 309-675-4762
Fax: 309-675-6803
Email: caldwell_linda_k@cet.com



Interoffice Memorandum

Facility ADMINISTRATION BUILDING
 Date July 14, 2006
 Plant/Office AB5390
 Department Administrative
 Attention D. B. Borritt

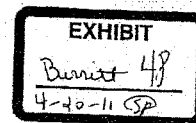
Plant/Office	Department	Attention

Divisional Operating Comments
Corporate Tax – May/June 2006

2006 Summary & Significant Events

-
-
-
-
-
-
-
-
-
-

**Redacted By The
 Permanent Subcommittee
 on Investigations**



2006 Challenges

- Ever-increasing cashflows from non-US sources to service US cash needs continue to place pressure on the indefinite reinvestment status of CSARL earnings. We are working on planning, which is projected to provide between \$1 billion to \$1.5 billion repatriation relief.

-


-

-

-

RDBeran
Director, Corporate Tax
AB4295 – Ext. 5-4478

Redacted By
Permanent Subcommittee on Investigations


 Daniel
 Schlicksup/OE/Caterpillar
 01/12/2006 04:09 PM
 To: Dave B. Burnett@G/Caterpillar@Caterpillar
 cc:
 bcc:
 Subject: Confidential Followup re consultants' fees

Caterpillar Confidential Green

Dave, Please consider the facts below in order to assess where to go from here regarding the invoices in hand that do not have sufficient detail to review. Data on the 2005 PwC and E&Y invoices.....

	<u>Paid</u>	<u>To Be Paid</u>	<u>Total</u>
Based on one-line invoices	\$8,831,852	\$2,238,552	\$11,070,404
Based on little, but insufficient detail	\$1,494,741	\$893,103	\$2,387,844
Based on sufficient detail		\$242,035	\$242,035
Total	\$10,326,594	\$3,373,690	\$13,700,284

Examples of one-line invoices include:

- Progress billing for professional services rendered for the valuation and restructuring of the international operations of Caterpillar Inc. for November 2005.....\$595,000
- Progress billing for professional services rendered for the valuation and restructuring of the international operations of Caterpillar Inc. for December 2005.....\$650,000
- Progress billing for professional services rendered in connection with Fair Market Value Interest Apportionment and FSC consulting services for audit years 1995-1999.....\$950,000
- Progress billing for professional services rendered for the valuation and restructuring of the international operations of Caterpillar Inc.\$1,175,000
- Progress billing for professional services rendered for the valuation and restructuring of the international operations of Caterpillar Inc.\$1,225,000

Invoices with a little, but insufficient detail include a description similar to above, and names with total hours by name, but not what the time was for.

With regard to the consultants themselves -- a couple of facts. First, when asked PwC said they would provide the detail, but hinted to me that the requesting person was being unreasonable. On one PwC invoice a tax manager found 40 hours for an item we told them that we would do -- it appears we are going to pay it anyway. 2 PwC invoices totaling 274K were for audit services, not tax services -- but were recorded as tax services, not audit fees. Second, re E&Y, I received a 600k one-liner on Nov 22 marked ok to pay. I called E&Y and told them we needed the backup (who, # of hours, rate etc.) and was told they would send the detail. 6 weeks later the same person says it was not E&Y policy to record what they were doing for us beyond the name of a project, and wants us to pay the rest of the 2005 invoices. The 600k was paid.


I think there are two options. One -- pay the past bills without supporting detail. Two -- politely ask for detail prior to payment. I think a level-set to consider is how many people would pay a personal Master Charge bill with this level of detail? Please let me know where you want to go with this. I am working quickly to impose some process discipline.

This is where cost management begins. I will get you a draft of a new policy for GF&SSD.

Redacted by the Permanent Subcommittee on Investigations

EXHIBIT
 Burnett 69
 4-20-11 (SP)

PSI-TWLF-16-000330

<p>IN THE UNITED STATES DISTRICT COURT CENTRAL DISTRICT OF ILLINOIS PEORIA DIVISION</p>	<p>***** INDEX DEPONENT PAGE NUMBER Examination by Mr. O'Day 4</p>
<p>DANIEL G. SCHLICKSUP, Plaintiff, vs. CATERPILLAR, INC., DAVID R. BURNETT, ALICE BARBOUR, ROBIN D. TERAM, JAMES P. BUDA, DOUGLAS R. OSTERMEIER and EDWARD G. RAPP, Defendants.</p> <p>THE DEPOSITION of EDWARD RAPP called to a Witness pursuant to notice and pursuant to the provisions of the Federal Rules of Civil Procedure pertaining to the taking of depositions, taken before SUE A. PHILIPS, CSR, State of Illinois, at 415 Hamilton Blvd., Peoria, Illinois, on the 4th day of May, 2011, commencing at 9:00 a.m.</p> <p> ORIGINAL</p>	<p>EXHIBITS NUMBER MARKED FOR IDENTIFICATION Rapp No. 1 7 Rapp No. 2 12 Rapp No. 3 28 Rapp No. 4 35 Rapp No. 5 36 Rapp No. 6 71 Rapp No. 7 91 Rapp No. 8 104 Rapp No. 9 107 Rapp No. 10 112 Rapp No. 11 113 Rapp No. 12 126 Rapp No. 13 150 Rapp No. 14 155 Rapp No. 15 157 Rapp No. 16 157 Rapp No. 17 158 Rapp No. 18 160 Rapp No. 19 164 Rapp No. 20 185 Rapp No. 21 191 All exhibits attached</p>
<p>APPEARANCES MR. DANIEL G. O'DAY, ESQ. Cusack, Gilfillan & O'Day, LLC 415 Hamilton Blvd. Peoria, Illinois 61602 (309) 637-5282 appeared on behalf of the Plaintiff; MR. JOSEPH S. TURNER, ESQ. Seyfarth Shaw LLP 131 South Dearborn Street, Suite 2400 Chicago, Illinois 60603-5577 (312) 460-5000 appeared on behalf of the Defendants.</p>	<p>EDWARD RAPP, being first duly sworn, deposes and says as follows, in answer to: EXAMINATION BY MR. O'DAY Q. Will you state your name for the record please? A. Ed Rapp. Q. A. Q.</p>
<p>Also Present: Mr. Alex Gittos, Esq. Mr. Daniel Schlicksup</p>	<p>Redacted By Permanent Subcommittee on Investigations</p> <p>17 A. 18 Q. 19 A. 20 Q. 21 A. 22 Q.</p>

<p style="text-align: right;">73</p> <p>1 return. Do you see that?</p> <p>2 A. Yes.</p> <p>3 Q. Do you know if that was part of the</p> <p>4 presentation?</p> <p>5 A. Yes.</p> <p>6 Q. Was it?</p> <p>7 A. Yes.</p> <p>8 Q. It was part. At the top of the third page of</p> <p>9 that exhibit do you see the slide that talks</p> <p>10 about what is an effective tax rate?</p> <p>11 A. The bottom or the top? Okay.</p> <p>12 Q. I thought it was at the top.</p> <p>13 A. Yep.</p> <p>14 Q. Did you already know before this presentation</p> <p>15 what an effective tax rate was?</p> <p>16 A. At a high level.</p> <p>17 Q. Did you already know what GAAP or general</p> <p>18 accepted accounting principles were before this</p> <p>19 presentation?</p> <p>20 A. At a high level.</p> <p>21 Q. And then did you learn during this presentation</p> <p>22 about how the effective tax rate and GAAP</p> <p>23 related to the Tax Department at Caterpillar?</p>	<p style="text-align: right;">75</p> <p>1 A. Caterpillar Overseas.</p> <p>2 Q. In looking at the second slide on the third</p> <p>3 page of Exhibit 6 for your deposition do you</p> <p>4 see the green line that's labeled export</p> <p>5 incentives?</p> <p>6 A. Yes.</p> <p>7 Q. Do you know what that referred to?</p> <p>8 A. No.</p> <p>9 Q. Do you see the green line that refers to</p> <p>10 foreign earnings?</p> <p>11 A. Yes.</p> <p>12 Q. Do you know as you sit there today what that</p> <p>13 referred to?</p> <p>14 A. As I sit here today based on understanding of</p> <p>15 the way our taxes work?</p> <p>16 Q. Yes.</p> <p>17 A. Yes.</p> <p>18 Q. What did that refer to at that time?</p> <p>19 A. What it refers to today is the foreign earnings</p> <p>20 that we have in operations that we have outside</p> <p>21 the United States.</p> <p>22 Q. Do you see where it says impact of CSARL there</p> <p>23 appears to be a bracket that is covering</p>
<p style="text-align: right;">74</p> <p>1 A. At a high level.</p> <p>2 Q. The slide that's the second slide on the third</p> <p>3 page which refers to an ETR, do you know what</p> <p>4 ETR means in that context?</p> <p>5 A. Yes.</p> <p>6 Q. Is that an effective tax rate?</p> <p>7 A. Yes.</p> <p>8 Q. Was this slide part of the presentation that</p> <p>9 you received when you took over?</p> <p>10 A. Yes.</p> <p>11 Q. Do you see the identification of impact of</p> <p>12 CSARL on that slide?</p> <p>13 A. Yes.</p> <p>14 Q. Were you in Geneva when CSARL started?</p> <p>15 A. I left Geneva in 2004.</p> <p>16 Q. And when did you get there?</p> <p>17 A. In 1995.</p> <p>18 Q. Were you familiar with CSARL when you were in</p> <p>19 Geneva?</p> <p>20 A. No.</p> <p>21 Q. Were you familiar with COSA?</p> <p>22 A. Yes.</p> <p>23 Q. Do you know what COSA stood for?</p>	<p style="text-align: right;">76</p> <p>1 somewhere between 31 and 32 percent at the top</p> <p>2 and somewhere between 28 and 27 percent at the</p> <p>3 bottom?</p> <p>4 A. Yes.</p> <p>5 Q. Did you understand that to be a reference to a</p> <p>6 lowering of the effective tax rate at</p> <p>7 Caterpillar because of CSARL?</p> <p>8 A. Yes.</p> <p>9 Q. Did you have an understanding about why the</p> <p>10 effective tax rate went down as a result of the</p> <p>11 impact of CSARL?</p> <p>12 A. No.</p> <p>13 Q. Do you have an understanding today?</p> <p>14 A. Yes.</p> <p>15 Q. What is your understanding today?</p> <p>16 A. The understanding is that -- is with a CSARL</p> <p>17 structure overseas as kind of the hub or</p> <p>18 headquarters of our non-U.S. operations and the</p> <p>19 tax rates there and that combined with the fact</p> <p>20 that with our global growth and the need for</p> <p>21 cash offshore that we bring it through the</p> <p>22 CSARL structure and then re-invest the money</p> <p>23 outside the United States.</p>

<p>77</p> <p>1 Q. Did you have any understanding at all before 2 you took over in December of 2007 the 3 responsibilities for the Global Finance and 4 Strategic Support area what the impact of CSARL 5 was? 6 A. No. 7 Q. When you were in Geneva in your three positions 8 there, did you ever have to do anything 9 different when CSARL started? 10 A. No. 11 Q. Did you in any of those three positions that 12 you had in -- Well, strike that. When you were 13 in Geneva, who was the head of the Geneva 14 facility? Was it Mr. Baumgartner? 15 A. You used the term facility. Are you talking 16 about the building? 17 Q. Well, who was in charge in Geneva? 18 MR. TURNER: Object to form. 19 THE WITNESS: There's multiple business 20 units that operated in Geneva. 21 BY MR. O'DAY: 22 Q. Did you become a vice president while you were 23 in Geneva?</p>	<p>79</p> <p>1 Q. Pardon me? 2 A. No. 3 Q. Did you notice while you were there that some 4 product managers moved to the Geneva facility? 5 A. Yes. 6 Q. How many product managers moved to the Geneva 7 facility? 8 A. I don't know the exact number. 9 Q. Do you know where they came from? 10 A. No. 11 Q. Do you know what they were in charge of? 12 A. They were in charge of product development and 13 design. 14 Q. Do you know for which products? 15 A. Wheel loaders, excavators, medium tractors were 16 the ones that I would recall. 17 Q. Do you recall where those had been being built 18 in terms of the ones they had responsibility 19 for? 20 A. Where the products were built? 21 Q. Yes. 22 A. Yes. 23 Q. Where were they built?</p>
<p>76</p> <p>1 A. Yes. 2 Q. Who did you report to when you were a vice 3 president? 4 A. Vito Baumgartner. 5 Q. When you -- Were you a direct report then of 6 his? 7 A. Yes. 8 Q. And were there other direct reports of 9 Mr. Baumgartner? 10 A. Yes. 11 Q. Who were the other direct reports? 12 A. Gerard Vittecoq would have been a direct 13 report. Chris Schena would have been a direct 14 report. He had strategy and business -- kind 15 of a strategy group that would have been a 16 direct report into him. Stu Levenick was 17 running the Moscow operation. Would have been 18 a direct report. Those would be the ones I'd 19 recall. 20 Q. Did any of the three jobs that you have -- you 21 had in Geneva concern themselves with 22 purchased-finished-replacement parts? 23 A. No.</p>	<p>80</p> <p>1 A. Grenoble, Gosselies -- Grenoble, France; 2 Gosselies, Belgium. 3 Q. Were they responsible for anything on a global 4 basis that you know of? 5 A. I don't know. 6 Q. When I use the term purchased-finished- 7 replacement parts in the context of Caterpillar 8 Inc., do you know what those are? 9 A. Yes. 10 Q. What are those? 11 A. Parts that go on our machines after the initial 12 sale as a replacement for a component or a part 13 that wears out. 14 Q. And are those parts that are manufactured 15 outside Caterpillar? 16 A. Not in all cases. 17 Q. Are you familiar with the term called worked 18 parts? 19 A. No. 20 Q. What would you call parts manufactured inside 21 Caterpillar? 22 A. Caterpillar parts. 23 Q. And then in the words purchased-finished do you</p>

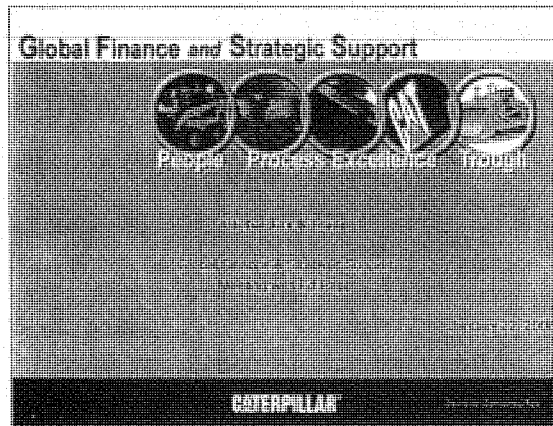


EXHIBIT
 Page 6
 5-4 P31 TW 2000000

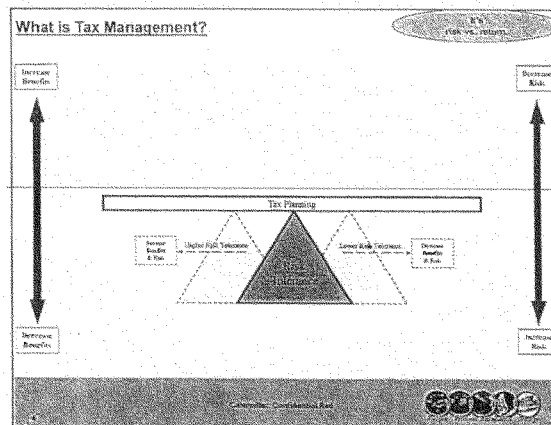
Agenda

Overview of Tax & Trade with GPESD

- The few critical issues you should know
 - What is Tax Management?
 - What is an Effective Tax Rate (ETR)?
 - What is the Corporate ETR?
 - Primary Tax Structure – CSARL
 - Cash Source and Use Dilemma
- People
 - Who and Where
 - Aging Workforce
- Process
 - Basic Tax Processes
 - Transformation – Hackell Findings
 - Transformation – Slide Path
- Trough

Copyright © 2008 PSI-TWLF

PSI-TWLF

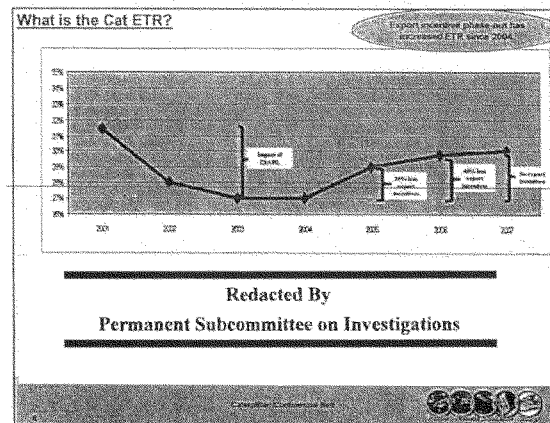


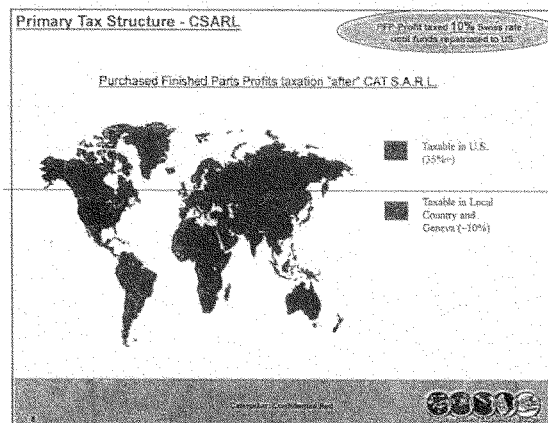
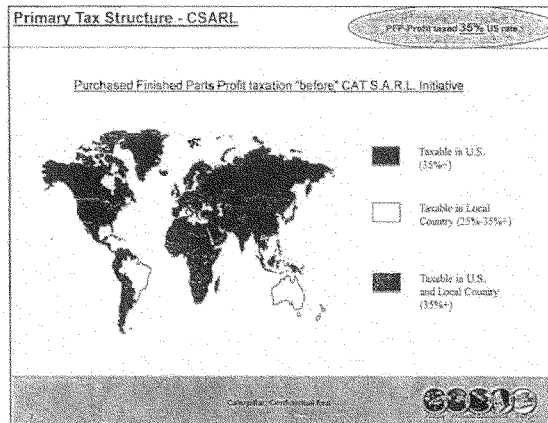
What is an Effective Tax Rate?

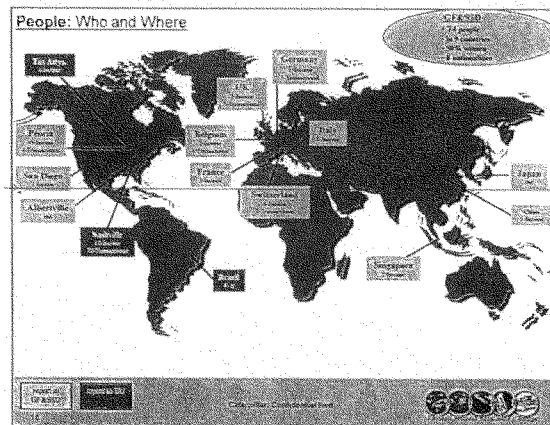
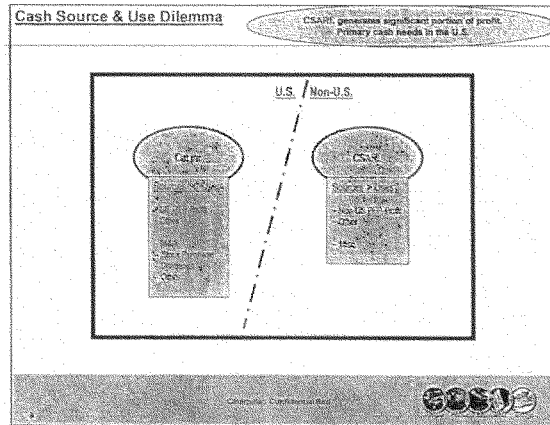
Taxes are calculated according to Generally Accepted Accounting Principles - that's why it's not easy

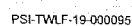
Redacted By The Permanent Subcommittee on Investigations

EISS









**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

1 IN THE UNITED STATES DISTRICT COURT
 2 FOR THE CENTRAL DISTRICT OF ILLINOIS
 PEORIA DIVISION

3 DANIEL J. SCHLICKSUP,)
 4 Plaintiff,)
 5 VS.)
 6)
 7 CATERPILLAR, INC., DAVID)
 8 BURRITT, JAMES BUDA, ROBIN)
 9 BERAN, ALICE BARBOUR, et al,)
 Defendants.)

 COPY

VOLUME 1
 No. 09-CV-1208

10
 11 The deposition of DANIEL J. SCHLICKSUP,
 12 called for examination pursuant to the provisions of
 13 the Federal Rules of Civil Procedure of the United
 14 States District Courts as they apply to the taking
 15 of depositions, taken before Paula A. Morsch, C.S.R.
 16 License No. 84-002965, a Certified Shorthand
 17 Reporter in the State of Illinois, on the 8th day of
 18 March, 2011, at the hour of 9:00 a.m., at
 19 415 Hamilton Boulevard, in the City of Peoria,
 20 County of Peoria, State of Illinois.
 21
 22
 23

PAULA A. MORSCH, C.S.R.
 ADVANTAGE REPORTING SERVICE, 309-673-1881

22

Dave B. Burritt/OG/Caterpillar To Daniel Schlicksup/OE/Caterpillar
 12/04/2008 04:56 PM cc
 bcc
 Subject Classification of PwC Fees

Caterpillar: Confidential Green

Den,

As a result of your concern about the categorization of the audit/audit related service fees, I asked Sharad Jain to ask PwC National Office for their interpretation. Attached is the conclusion reached by PwC that the fees are classified correctly as audit related. I trust this addresses your concern about the categorization of these fees.

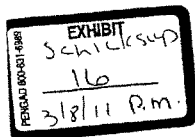
Regarding our meeting, I did not intend for you to feel intimidated by me. We have worked together a long time and you know I can become enthusiastic about a subject. You can trust I have confidence in your ability, and I want you to raise ethical issues with me that you feel are important for me to address. Likewise, I hope that you are able to raise issues with Robin, Al and your peers too when it is appropriate to do so. That was my point in our meeting. Please do not feel that as a result of you raising this concern, or for any other reason that I would not continue to deal fairly with you.



Document.pdf

Dave Burritt
 Caterpillar Inc.
 309-675-4020

This message and any material contained in any attachment are intended only for the use of the addressee and may contain information that is privileged or confidential. If you are not the intended recipient, you are hereby notified that any disclosure, copying, distribution, dissemination, or use of any information contained in this message is strictly prohibited. If you have received this e-mail in error, please notify the sender listed above immediately.



46

23

Independence Consultation Database

PROXY/ISSUER/CPERS

Tracking Number	0611130002
Status	Closed
Requested by	Sharad P. Jain/US/ABAS/PwC
Consultant	Kevin M. Mitchell/US/ABAS/PwC
Date Submitted	11/13/2006
Engagement Contact	Sharad P. Jain/US/ABAS/PwC
Additional Contacts	
Phone No.	309-675-6574
Office	Peoria/Chicago
Are you a member of the Audit Engagement Team or the Project Engagement Team?	<input checked="" type="radio"/> Yes <input type="radio"/> No
Entity Name	Caterpillar Inc.
Local Engagement Code	
Entity Location (country)	United States
Lead Audit Partner Name	Sharad P. Jain/US/ABAS/PwC
Lead Audit Partner Phone No.	309-675-6574
Concurring Partner Name	Jay Henderson/US/ABAS/PwC
Concurring Partner Phone No.	312-298-4900
Lead Manager Name	Tom Hoekstra/US/ABAS/PwC
Lead Manager Phone No.	309-675-4231
Is PwC the principal auditor of the entity?	<input checked="" type="radio"/> Yes <input type="radio"/> No
Entity's fiscal year end	December 31, 2006
Entity's audit (or other attest) report date	02/13/2007
Is entity (or entity affiliate) listed in the PwC Independence List or GEMS?	<input checked="" type="radio"/> Yes <input type="radio"/> No
Is entity (or entity affiliate) an SEC registrant?	<input checked="" type="radio"/> Yes <input type="radio"/> No
If entity is affiliate of an SEC registrant, indicate name of SEC registrant	n/a
Is entity subject to Governmental Audit Standards (Yellow Book)?	Yes <input checked="" type="radio"/> No

Please answer the following questions as fully as possible. Questions preceded by an asterisk require your response in order to submit the inquiry.

- * 1. Is PwC the principal auditor of the entity (i.e., SEC Issuer audit client or the issuer's subsidiary) whose fees are being reported upon?
(14 November 2006 Sharad P. Jain) Yes.
2. If your question relates to the proper categorization of the services, describe the services.
(14 November 2006 Sharad P. Jain) See description in 6. below.
- * 3. To which period(s) does the disclosure relate?
(14 November 2006 Sharad P. Jain) Calendar 2006 and Calendar 2006
- * 4. Has the audit committee pre-approved our services?
(14 November 2006 Sharad P. Jain) Yes.

47

- 5. Your question(s)
(14 November 2006 Sharad P. Jain) Is the classification of certain services and fees described below as "audit-related" appropriate?
- 6. Based on the facts provided, state your analyses and conclusions on the application of PwC policy and/or professional rules and regulations.
(14 November 2006 Sharad P. Jain) 1. Quarterly and annual reviews of CSARL's reporting (2005 and 2006)

Beginning in 1998, PwC's tax department was engaged by McDermott Will & Emery (Caterpillar's tax counsel) to assist them in various structural tax rate planning initiatives for Caterpillar that resulted in substantial legal restructuring of Caterpillar's non US operations to better align the taxation of transaction flows with how Caterpillar manages those operations. Conceptually two key changes were made:

1. Caterpillar, Inc. (the US company) was removed as the global purchaser of all purchased finished parts, replaced by CSARL an entity comprised of numerous legal entities. 2. Various changes were made by Caterpillar to plan and implement CSARL as the entrepreneur of the manufacturing operations of France and Belgium. The tax planning resulted ultimately in 37 partnerships. PwC fees received related to this work were reflected in the respective years' annual 10K filings as fees for tax planning.

Due to CSARL's structural complexity and the materiality of the related tax effects, Robin Beran, Caterpillar's tax director, and Rod Perkins, International Tax Planning Manager engage PwC each year to perform reviews to assess Caterpillar's compliance with the accounting and reporting requirements of the various CSARL partnership agreements. These reviews generally occur quarterly, supporting the year end preparation by Caterpillar of a US GAAP report on the results of operations of CSARL by partner, and the annual report is the subject of a review report issued by PwC Geneva. The only user of this US GAAP review report is Rod Perkins, International Tax Planning Manager, who uses the report as the starting point in preparing the US tax compliance reporting of the CSARL partners subject to US tax. These quarterly and annual reviews and annual preparation of a special report by partner have continued since the inception of the CSARL structure.

PwC fees related to these services have been reflected in the annual 10K filings as "audit related" fees.

The reason for this characterization by Caterpillar was that the nature of these particular PwC's services was no longer tax planning. We also agreed with the Company that their nature was not tax compliance because at the core of the nature of our work were activities that culminated in the preparation of results of operations by CSARL partner using US GAAP. We did not classify these services as audit, as the scope of the services was much more extensive than PwC would have used for our global audit. The global audit does not rely on this report by partner. Therefore we categorized these services as audit related. During our year end audit of the income tax provision, we leverage some of the work involved and essentially not again perform some of the review procedures already made. Because the use of this information developed is secondary, no attempt is made to reclassify part of the audit related fees as audit.

2. Review of Formation of Luxembourg Holding Company (Luxco) by Caterpillar (2005):

Caterpillar engaged Ernst & Young and McDermott Will & Emery to perform the tax planning to implement a holding company structure for their European operations to facilitate future dividend repatriations. PwC was engaged to periodically review key technical positions established by the client and these (non-PwC) tax consultants before the planning was implemented. The business reason for Caterpillar engaging PwC to review the planning prior to implementation was that their tax planning comprised many steps and Caterpillar did not want to take the risk that they would complete these complex restructuring steps and then have PwC find a technical flaw in the planning. Finding a technical flaw after implementation could mean unexpected taxation that could not be reversed. During this process, the restructuring plan changed many times, so during this engagement, PwC reviewed technical issues that later became moot because the plan changed. Additionally the benefits from the Luxco structure will be recognized in the financial statements in future years. Because the scope of PwC's review was more detailed and occurred before the planning was executed, the fees for this service were reflected as audit related.

3. Review of Caterpillar's Section 965 Dividend Planning (2005):

Caterpillar engaged Ernst & Young and McDermott Will & Emery to assist in the planning and execution of the dividends Caterpillar made during 2005 to take advantage of Section 965 of the Internal Revenue Code. Dividends were paid from numerous sources. Similar to the Luxco planning, Caterpillar engaged PwC to review the planning as key decisions were made rather than merely have PwC review at the completion as

48

part of the annual audit. Because our timing and scope were much different than if we would have merely audited the results at completion, we concurred with the Company's decision to classify these fees as audit related. Note that the testing of the actual dividend repatriation was performed as part of the year end audit and the relevant time and fees included in the tax provision review as part of the annual audit.

7. Provide appropriate citations from PwC policy and/or professional rules and regulations.
(14 November 2006 Sharad P. Jain) See discussion in text in 6. above.

Excerpt, US Independence Policy section 4170: The rule requiring disclosure of auditor fees does not use the broader definition of audit client that is applied for personal financial and scope of service restrictions. Instead, the rule regarding the proxy/information disclosures applies to the SEC issuer audit client and its subsidiaries. Specifically, equity investments that are material and are considered affiliates for personal financial and scope of service restrictions are excluded from the pre-approval and proxy/information disclosure requirements.

Requestor and Engagement Team Comments

(14 November 2006 Sharad P. Jain) Audit team believes the fees are properly classified as audit related in the client's disclosure. Client CFO has asked us to consult with the Independence Office to confirm our views. SPJ/Nov 14, 2006

Additional Contacts Comments

Consultant Comments

Reviewer Comments

Final Conclusion

(17 November 2006 Kevin M. Mitchell) My comments related to each of the items are as follows:

(1) I concur with the conclusion of the engagement team with respect to classification of the fees as audit related for the reasons cited. We also discussed the nature of the work performed with respect to the quarterly reviews and special report issued and concluded PwC was not involved in the preparation of financial statements that are filed with the SEC or form the basis of financial statements filed with the SEC.

(2) & (3) We discussed the nature of the services provided and the fact that PwC was being engaged to provide a contemporaneous review of the tax planning advice being provided by 3rd party advisors engaged by the company to make sure PwC understood the tax planning and agreed with the treatment in connection with our role as auditors. The fact that the work performed was in greater detail than what would have normally been required from an audit perspective supports the classification as audit related. Additionally, as PwC was not hired to provide tax advice in connection with this engagement but to review the tax advice provided by others in our role as auditors, I concur with the engagement team that it is appropriate to disclose the fees as audit related as opposed to tax fees.

Reason for Cancellation

Attachments

Memos

49

Title

Created

Audit Trail

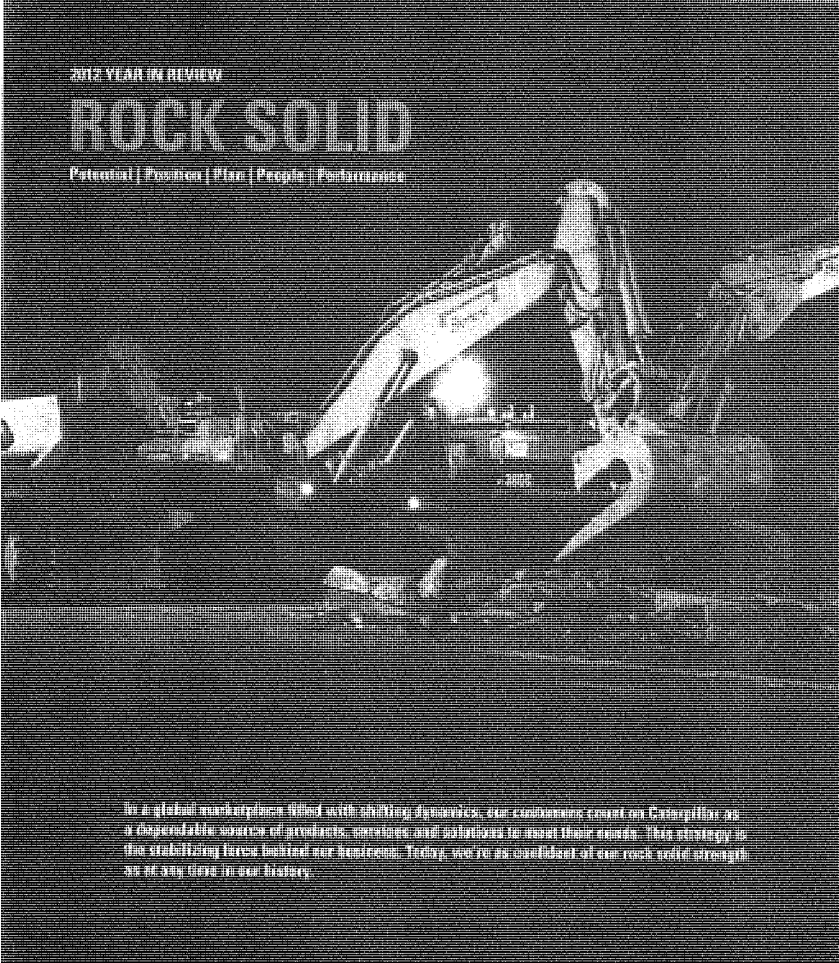
50

CATERPILLAR®

2012 YEAR IN REVIEW

ROCK SOLID

Potential | Position | Plan | People | Performance



In a global marketplace filled with shifting dynamics, our customers count on Caterpillar as a dependable source of products, services and solutions to meet their needs. This strategy is the stabilizing force behind our bottom line. Today, we're as confident of our rock solid strength as at any time in our history.



Forward-Looking Statements

Certain statements in this 2012 Year in Review relate to future events and expectations and are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as "believe," "estimate," "will be," "will," "would," "expect," "anticipate," "plan," "project," "intend," "could," "should" or other similar words or expressions often identify forward-looking statements. All statements other than statements of historical fact are forward-looking statements, including, without limitation, statements regarding our outlook, projections, forecasts or trend descriptions. These statements do not guarantee future performance, and we do not undertake to update our forward-looking statements.

Caterpillar's actual results may differ materially from those described or implied in our forward-looking statements based on a number of factors, including, but not limited to: (i) global economic conditions and economic conditions in the industries and markets we serve; (ii) government monetary or fiscal policies and infrastructure spending; (iii) commodity or component price increases, fluctuations in demand for our products, or limited availability of raw materials and component products, including steel; (iv) our and our customers', dealers' and suppliers' ability to access and manage liquidity; (v) political and economic risks and instability, including national or international conflicts and civil unrest; (vi) our and Cat Financial's ability to maintain credit ratings, avoid material increases in borrowing costs, and access capital markets; (vii) the financial condition and credit worthiness of Cat Financial's customers; (viii) changes in interest rates or market liquidity; (ix) changes in financial services regulation; (x) inability to realize expected benefits from acquisitions, including ERA Mining Machinery Limited, and divestitures, including the divestiture of the Bucyrus International, Inc. distribution business to our independent dealers; (xi) international trade and investment policies; (xii) market acceptance of our products and services; (xiii) changes in the competitive environment, including market share, pricing and geographic and product mix of sales; (xiv) successful implementation of capacity expansion projects, cost reduction initiatives and efficiency or productivity initiatives, including the Caterpillar Production System; (xv) inventory management decisions and sourcing practices of our dealers or original equipment manufacturers; (xvi) compliance with environmental laws and regulations; (xvii) alleged or actual violations of trade or anti-corruption laws and regulations; (xviii) additional tax expense or exposure; (xix) currency fluctuations; (xx) our or Cat Financial's compliance with financial covenants; (xxi) increased pension plan funding obligations; (xxii) union disputes or other labor matters; (xxiii) significant legal proceedings, claims, lawsuits or investigations; (xxiv) compliance requirements imposed if carbon emissions legislation and/or regulations are adopted; (xxv) changes in accounting standards; (xxvi) failure or breach of information technology security; (xxvii) adverse effects of natural disasters; and (xxviii) other factors described in more detail under "Item 1A. Risk Factors" in our Form 10-K filed with the SEC on February 19, 2013 for the year ended December 31, 2012. This filing is available on our website at www.caterpillar.com/secfilings.

Trademark Information

CAT, CATERPILLAR, their respective logos, "Caterpillar Yellow" and the POWER EDGE trade dress, as well as corporate and product identity used herein, are trademarks of Caterpillar and may not be used without permission. Cat and Caterpillar are registered trademarks of Caterpillar Inc., 100 N.E. Adams, Peoria IL 61629.

© 2013 CATERPILLAR PUBLIC RELEASE All Rights Reserved. Printed in the U.S.A.

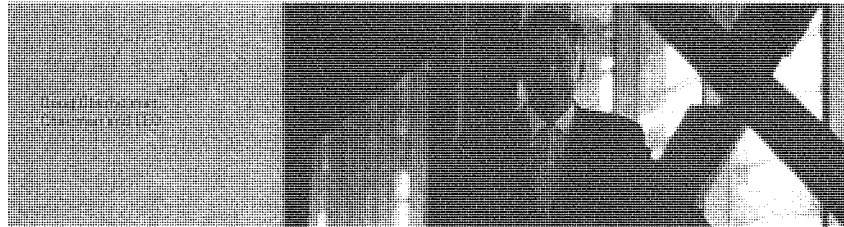
CATERPILLAR®

	ROCKWELL STOCK LIST	2013 Year in Review
2	2013-2014 Financial Statements	2013 Year in Review
4	2013-2014 Financial Statements	2013 Year in Review
6	2013-2014 Financial Statements	2013 Year in Review
11	2013-2014 Financial Statements	2013 Year in Review
16	2013-2014 Financial Statements	2013 Year in Review
21	2013-2014 Financial Statements	2013 Year in Review
27	2013-2014 Financial Statements	2013 Year in Review
31	2013-2014 Financial Statements	2013 Year in Review
39	2013-2014 Financial Statements	2013 Year in Review
47	2013-2014 Financial Statements	2013 Year in Review
50	2013-2014 Financial Statements	2013 Year in Review
51	2013-2014 Financial Statements	2013 Year in Review
52	2013-2014 Financial Statements	2013 Year in Review
54	2013-2014 Financial Statements	2013 Year in Review


ROCK SOLID 2012 Year in Review

Chairman's Message

When faced with challenges, it's how we respond that defines us. 2012 was full of challenges for the Caterpillar team, but our response to everything that was thrown at us was rock solid.



FURTHER POSITIONING OURSELVES FOR SUCCESS: GLOBAL GOVERNMENT & CORPORATE AFFAIRS

We believe that Caterpillar and our dealers deliver the best products and services in the world. However, the actions that governments take around the world can have significant impact on our business, our employees, customers and stockholders. The world is a big place, and we have big issues to face. But at Caterpillar, we don't just watch the world go by — we get involved.

We have a strong voice on the key issues — trade, energy, infrastructure and tax — that ensure growth and global competitiveness in the world's economy. In 2012, we led the way in support of a new U.S. highway bill — sending over 40,000 letters from employees, dealers, suppliers and customers for legislation that will provide investment in robust, modern infrastructure that can handle the rising exports to our customers around the world.

(continued)

Nowadays it seems there aren't many things that are rock solid. The global marketplace is constantly shifting and economies around the world face uncertainty on a variety of fronts — fiscally, politically and socially. The world struggles to address concerns like energy, infrastructure, workforce readiness and how to compete in the global economy. And our customers also face challenges like never before.

It's hard to grasp anything solid, steady and reliable anymore. But that's exactly what we try to be for our customers, stockholders, employees, dealers and suppliers. We live by our core values of Integrity, Excellence, Teamwork and Commitment. And as we do business in every corner of the globe, our values guide us to be fair and consistent. You know what to expect when you deal with Caterpillar.

Our products have always been made to be tough, durable and reliable. And we keep a constant focus on quality. In 2012 product quality was at a historically high level. Great news! But it's even better when you note that we also had historically high volumes and were introducing Tier 4 Interim products to the market.

The team has really delivered. I'm happy with quality, but even more importantly, our customers are happy. We are receiving very positive input from the field — rock solid!

But our job doesn't end there. Today our customers count on us for much more.

That's why we innovate. In 2012 we spent \$2.5 billion on research and development. Our engineers and technologists are working on products and services for our customers both today and well into the future.

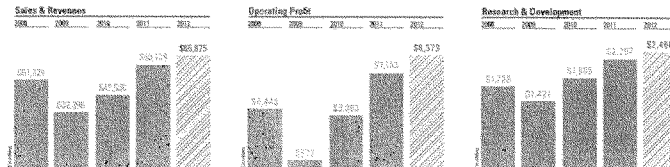
That's why we lead. Caterpillar has been an outspoken voice on the issues that affect our customers. It's up to us to educate our employees, communities and government officials on our position regarding topics like trade, tax, infrastructure and energy.

(continued)

PSI-TW1F-34-000005


ROCK SOLID 2012 Year in Review

Chairman's Message (continued)



(continued)

We were also a leading voice in urging Congress to establish Permanent Normal Trade Relations (PNTR) with Russia — another step toward job creation and investment that will open markets and increase economic growth.

While these are important victories, we still have a lot of work to do. We've repositioned our global engagement strategy and created a new division, Global Government & Corporate Affairs, to ensure we are even better positioned to make a positive difference around the world. Under the leadership of our new Vice President Kathryn Karol, we have an even stronger business focus that will further align global government teams across the enterprise. It's a commitment to our customers, dealers, employees and all of our stockholders. We'll continue to ensure we have the right team in place to tell our story and share the challenges we face as a global corporation. To learn more about our involvement, visit caterpillar.com/company/global-issues.

And that's why we maintain internal strength. At Caterpillar, we talk about controlling what we can within our four walls. The world around us is going to keep changing, and we have to be ready for anything. We do that with rock solid operations. We focus on maintaining a strong balance sheet, having efficient processes in our factories and offices and developing the best team. That's how we stay strong.

Rock solid doesn't imply perfection. We make mistakes — everyone does. But we learn from them, and the lessons we learn make us stronger.

And you'll see that strength throughout our Year in Review. Our customers, our employees and our communities are doing amazing work, and I'm proud to share their stories with you!

Here are just a few highlights of some of the rock solid accomplishments we had in 2012.

- Achieved record sales, revenues and profit in 2012
- Opened the Caterpillar Visitors Center
- Displayed our largest exhibits ever at Bauma China and MineExpo
- Invested \$60 million in our communities through the Caterpillar Foundation
- Announced eight new facilities and expansions
- Registered the 100,000th machine using VisionLink™
- Manufactured the first ever machine in Thailand

It's been a big year for our team! I'm proud of all that we have accomplished, and I look forward to much of the same in 2013. I can't predict the future, and 2013 could be a tough year. But our team is prepared to execute and deliver no matter what the circumstances.

We have big plans for our people, our customers and our stockholders, and we will deliver the rock solid performance they have all come to expect! That's what makes our company rock solid. No matter what is happening in the world around us, we will always be prepared and ready to act.

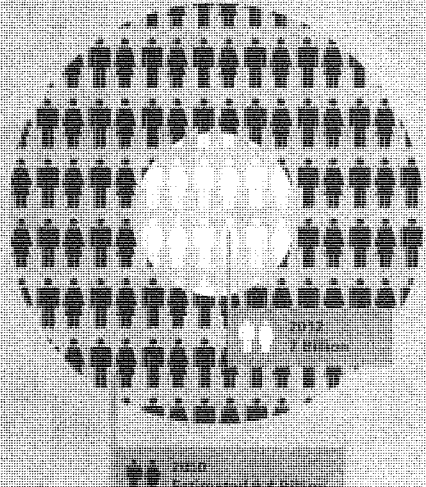
Doug Oberhelman
Caterpillar Inc. Chairman and CEO

PSI-TWLF-34-000006

CATERPILLAR®

ROCK SOLID 2012 Year in Review

PEOPLE IN THE WORLD

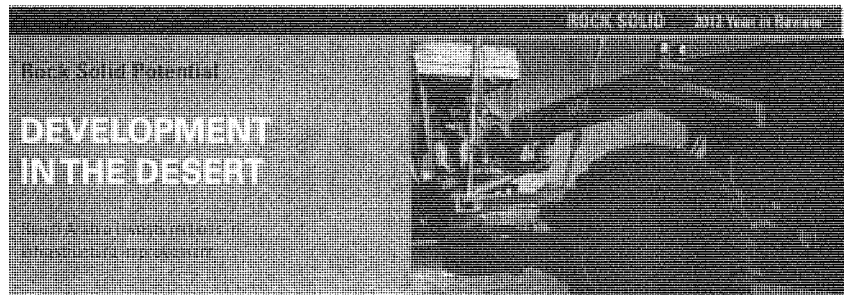


2012 7 Billion
2010 Estimated 6.6 Billion

ROCK SOLID
POTENTIAL

Energy, Commodities, Infrastructure.
 Easier to think of another company, dedicated in many industries with an effective, resilient, diverse leadership of people. A growing global population needs more energy, water, food, schools, power, health care, housing, and transportation — all needs that our infrastructure equipment has decades to serve.

FOR YOUR BUSINESS



Saudi Arabia's typical harsh desert conditions are occasionally interrupted by sudden, torrential rainfall that usually results in serious flooding. For the town of Jeddah, Saudi Arabia's second-largest city, the problem is an outdated sewer and drainage system that cannot handle large water volumes in downpours, according to Caterpillar Industry Sales Manager Maarten de Haas. In 2009 and 2011, the city experienced devastating floods that destroyed businesses, left roads submerged and killed nearly 500 people.

This recurring devastation prompted the Saudi government to develop a permanent solution for the water drainage problem — a \$171 million citywide stormwater, flood-control and wastewater infrastructure improvement program. The program calls for the construction of five dams, the expansion of existing stormwater canals in northern, southern and eastern Jeddah, and the construction of a new canal adjacent to a major, international airport. The new system will allow water to be collected in dams and then channeled underneath and around the city to the sea to prevent future flooding in the city.

At the heart of this long-awaited resolution are Cat® machines. More than 100 Cat machines will support this much-needed project, working around the clock to complete it in less than eight months.

"We are using Cat machines because they have the best up time and best productivity," said Caterpillar customer and Chairman of the Board of Directors of the Saudi Pan Kingdom Company (SAPAC) Shaikh Sulaiman Al-Harbi, one of the major contractors on the project. "Our main challenge for this project is its short time frame, so we wanted to ensure we were dealing with reliable machines, as well as working with a dealer with a good reputation that could support our project needs."

Al-Harbi said the aftersales support provided by Cat® dealer Zahid Tractor was a major factor in their decision to use Cat machines. Throughout the project, Zahid has provided unmatched support, parts and service support, as well as weekly operator training and demonstrator visits.

The Jeddah stormwater and drainage program is just one of many projects improving the infrastructure in Saudi Arabia. The country has infrastructure development and improvement projects under way at all levels. In 2012 alone, nearly \$25 billion was budgeted for infrastructure development.

For instance, the Saudi Railway Organization awarded Caterpillar customer Saad Al Mobty & Partners a \$1.7 billion-plus contract for the construction of a bypass to move its existing railway from the city center of Al-Hofuf. The new railway will reduce the amount of traffic in the city significantly, while improving its current railway system.

"We consider Cat® products to be the best brand with the best value and quality worldwide," said Majed Al Mobty of the Mobty Company, who is using Cat® equipment exclusively for this job. "The machines offer the best productivity and best product support with the least running cost."

Mobty has more than 100 Cat machines on the job site, in addition to three Cat® generators. The machines are working in harsh conditions, cutting nearly 10 million cubic meters of limestone and filling 8 million cubic meters of desert sand, while constructing nine bridges and 3,000 meters of pipeline protection. Zahid Tractor has provided two qualified technicians to remain on site to perform warranty repairs and preventive maintenance throughout the duration of the project, as well as a certified demonstrator to train operators on site.

The nearly \$200 million USD (\$R 750M) project began in April 2011 and is estimated to take three years to complete. To date, more than 35 percent of the project is already complete.

PSI-TWLF-34-000008



Energy consumption is rising rapidly, driven by worldwide population growth, developing economies, improving global living standards and the use of ever more energy-dependent technologies. Access to affordable and dependable energy is also critical to energy security and economic prosperity.

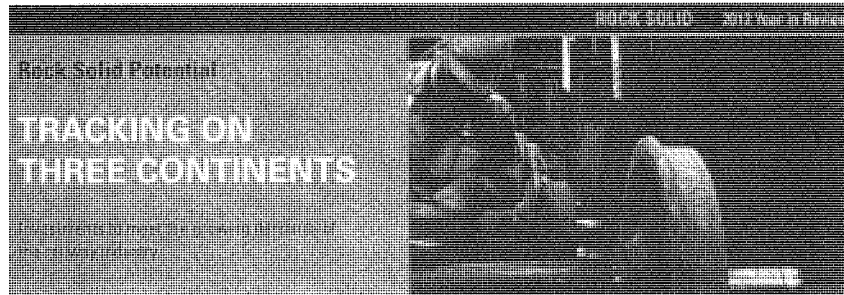
At Caterpillar, there is support for the development and utilization of all energy resources — both traditional and alternative. The world needs more of everything — and when Caterpillar thinks power, it's not considered in terms of diesel or gas, but diesel *and* gas.

Natural gas presents important opportunities as its availability increases, along with the development of technologies to use natural gas in more products. Caterpillar has announced its intent for developing the technologies our customers need to accompany the growth in natural gas. To this end, Caterpillar acquired MWM Holding GmbH (MWM) in

2011, enabling the company to significantly expand customer options for sustainable, natural gas-powered solutions. Caterpillar announced that mining trucks and locomotives will be among the first Cat® machines to incorporate high pressure direct injection (HPDI) technology, extending the commitment to natural gas across its high-horsepower product lines. Additionally, the Dynamic Gas Blending line of retrofit kits for energy exploration and production engines was introduced.

Caterpillar is one of the world's leading technology suppliers to the diverse energy market, and leverages its technology and innovation to meet the world's growing energy needs. Gas continues to be a significant opportunity for the company and its customers. Natural gas could be a game-changer, and, at Caterpillar, there is a clear strategy to enable success in this exciting market.

To learn more more, visit caterpillar.com/naturalgas.



Progress Rail Services and Electro-Motive Diesel (EMD) are committed to increasing capacity to produce locomotives globally. Rising oil costs in recent years have made railroads a more efficient transportation alternative than trucking for long hauls.

Since acquiring EMD in 2010, Caterpillar and Progress Rail have made significant investments in new equipment and plant improvements to enable the creation of new products and services to meet the growing demands of the international railway industry. With new locations located strategically around the world, Caterpillar is well-positioned to meet the challenging competitive realities of the global rail industry and to provide quality products to customers around the world.

The Muncie, Ind., facility is the first locomotive assembly plant to open in the U.S. in many years and marks Progress Rail's strategic approach to compete and win in the global railway industry. In less than two years, this facility has completed 100 diesel-electric locomotives for customers.

In South America, Progress Rail, through its subsidiary, MGE Equipamentos e Serviços Ferroviários Ltda. (MGE), has located a locomotive manufacturing facility in Sete Lagoas, in the state of Minas Gerais, Brazil, to better serve the diesel-electric locomotive market in this region. The company made an investment to open and modernize the existing manufacturing plant to produce world-class locomotives. This state-of-the-art facility, which has the potential to create jobs, assembles and manufactures EMD-branded locomotives in a 12,000-square-meter space on a 100,000-square-meter site.

Since 2006, Caterpillar has demonstrated its rail commitment by investing more than \$2 billion to meet customers' growing needs. Through these collective investments, Progress Rail and EMD are positioned to produce the most durable, reliable and sustainable locomotives in the world.

CATERPILLAR®



Caterpillar's forestry roots date back to the 1890s, when the Best Manufacturing Company and The Holt Manufacturing Company used steam traction engine tractors in logging applications. Today, forestry is a strategic business for Caterpillar and its dealers. The "skidder," a machine used to pull harvested trees out of the forest, was not expected to replace Cat® track-type tractors for logging — even with its advantages of speed, power to pull big loads and maneuverability around stumps. But loggers saw production improve with a machine designed to meet their unique needs, and the skidder became the first in a full line of Caterpillar timber harvesting machines marketed worldwide.

"In 2012, Caterpillar Forest Products improved product quality, introduced new machines and work tools and expanded our presence in international markets," explained John T. Carpenter, who led Caterpillar Forest Products through 2012.

NEW PRODUCTS

During 2012, Forest Products added a third model to the Cat® C Series wheel feller buncher. Through a new design, this machine meets more stringent EPA emissions regulations while delivering more horsepower and burning less fuel than competitive machines. For loggers working in rough terrain, a new track feller buncher went into production in preparation for an early 2013 launch. And in Brazil, where eucalyptus is the primary timber crop, a specialized work tool to delimb and strip the bark was introduced.

Collaborations blended the best of Caterpillar with other companies to produce additional new forestry products. The Prentice/Epsilon self-loader, which is mounted on a log truck, brings exceptional speed and precision to loading and unloading logs, and the Demlone high-lift log handler stacks logs up to 6.1 meters for more efficient use of ground space in a wood yard.

EDUCATION

Increasingly, logging contractors are having a difficult time finding qualified equipment operators. To answer that need, a community college in North Carolina launched a course in 2012 to train operators. Caterpillar Forest Products is an important partner in this program by providing guest instructors on maintenance and safety and loaning the machines needed to teach students how to harvest trees, transport them out of the forest and load them onto trucks.

CUSTOMER FOCUS

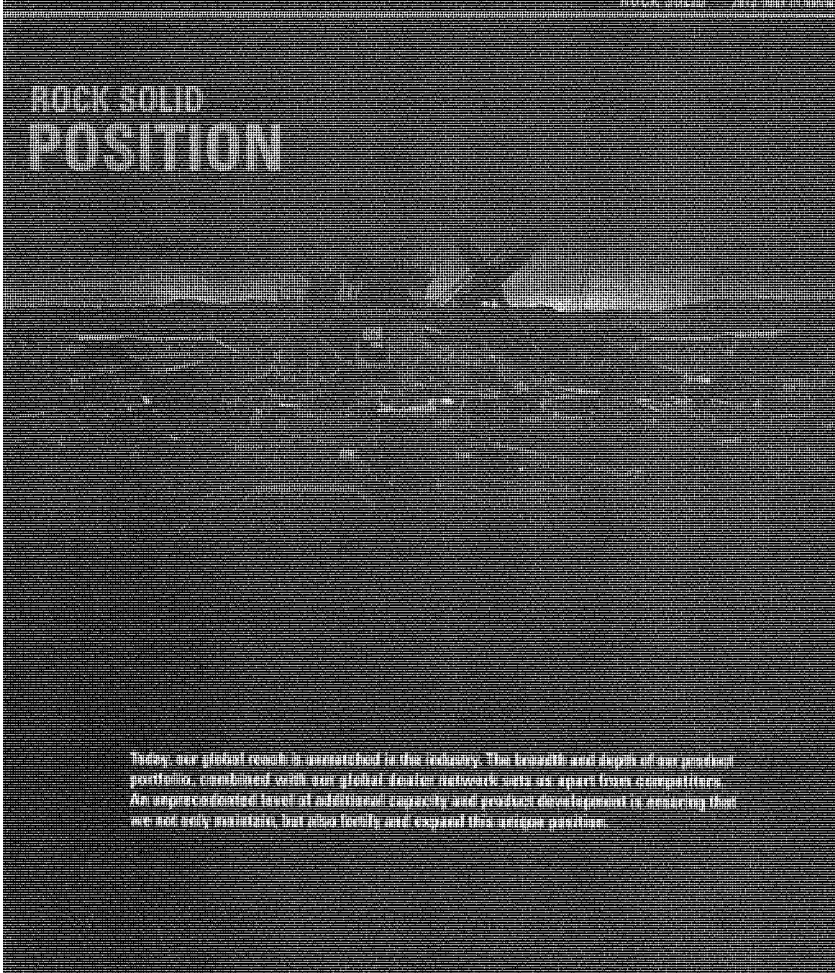
The foundation for Caterpillar's growth in the forestry market and the origin of all accomplishments in the last year is the business unit's focus on the "Voice of the Customer." Product councils consisting of loggers and dealer representatives are involved in new product design. Customer plant tours include give-and-take discussions with product engineers. And product specialists and engineers visit customer job sites to see firsthand what loggers need to do their jobs.

"We design products that originate from a deep understanding of customers' needs. Our daily focus in all we do is on our customers. This customer-first focus is ingrained in the business' culture and is what will propel Caterpillar Forest Products to even greater success," notes Carpenter.

CATERPILLAR®

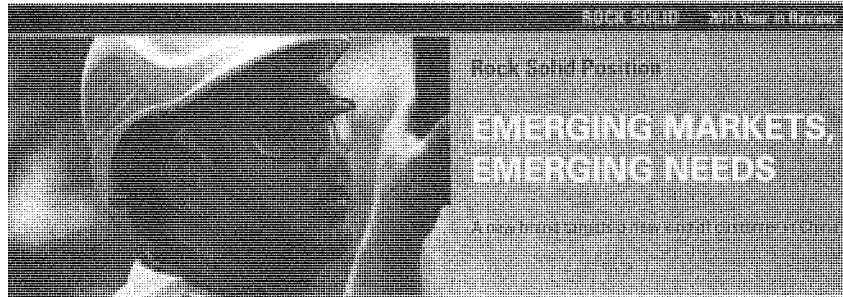
ROCK SOLID 2011 Index in Review

ROCK SOLID POSITION



Today, our global reach is unmatched in the industry. The breadth and depth of our product portfolio, combined with our global dealer network sets us apart from competitors. An unprecedented level of additional capacity and product development is ensuring that we not only maintain, but also fortify and expand this unique position.

CONSTRUCTION



ROCK SOLID 2012 Year in Review

Rock Solid Position

EMERGING MARKETS, EMERGING NEEDS

A new brand enters a new market to meet a new need.

Caterpillar's 85-year leadership position has been largely built on the ability to listen and respond to customers. In recent years, emerging markets have produced a new type of customer with new needs.

"Over the past two decades, new customers in developing economies have increasingly comprised a larger portion of the global industry, especially in countries like China where a lot of newer contractors are entering the business," explained retired Construction Industries Group President Rich Lavin. "These newer contractors value an entry-level product as they come into the industry. They're looking for a machine that performs well, but with different features and service support."

Emerging economies are not only producing a new type of customer, but also developing a new type of competitor.

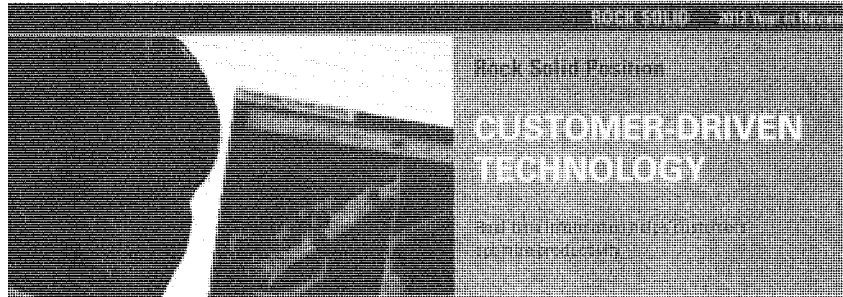
"These new competitors are entering the market aggressively, and clearly targeting these new customers by providing products and services aimed at their unique requirements," said Lavin. "If we're going to compete effectively against the growing number of emerging competitors — especially our Chinese competitors — we must have a utility product line that meets the needs of our customers."

Caterpillar's utility brand, Shandong SEM Machinery Co., Ltd. (SEM), targets this fast-growing customer base in China, as well as other parts of the world. Although the value proposition of SEM is fundamentally different than that of the Cat brand, SEM offers sturdy machines with greater parts availability and support than other utility competitors.

Since purchasing SEM in 2005, Caterpillar has invested significant resources to develop new utility models with improved product quality and reliability. SEM has expanded its historical product line of wheel loaders to cover a range of utility requirements from two to six tons. It has also added three motor graders and three soil compactors to its product line. In 2013, SEM is introducing SEM-branded track-type tractors to further expand its product portfolio.

In addition to expanding the product line, SEM has also added capacity. When complete in 2014, SEM™ wheel loader capacity will have nearly tripled since becoming part of Caterpillar. SEM has expanded manufacturing to begin production of SEM-branded track-type tractors for China and other growth countries, ramping up through 2013 and 2014. Beyond product and manufacturing expansions, SEM also has expanded its sales and service support. SEM™ dealers are now in 33 countries to provide sales, parts and basic service support capabilities. In 2013, SEM is adding dedicated parts distribution centers outside China.

"Our SEM™ product line serves us very well," explained Caterpillar Vice President Tom Bluth, who had responsibility for earthmoving in 2012. "It gives us the opportunity to position ourselves in China and other growth markets, but more importantly, it enables us to serve customers early in their industry experience and move them over time toward the Cat brand value proposition, establishing a relationship that will keep them with Caterpillar for the long term."



In today's world of instant information and smart devices, job sites are becoming increasingly connected. Customers are demanding real-time information to assist in effectively and efficiently managing their business.

Caterpillar recognizes that technology-enabled business solutions differentiate themselves from the competition. To achieve success in this rapidly changing technology space, Caterpillar has developed an enterprise-wide Technology Enabled Solutions (TES) Strategy. Our solutions will include such capabilities as equipment management, asset management, condition and remote monitoring, as well as prognostic and diagnostic tools.

Our technology solutions are tailored to meet customer requirements and will be fully integrated into our machines and engines at first fit, or through aftermarket retrofit options. The goal is for Caterpillar's fleet management approach to become the industry standard, by leveraging proven cross industry applications, and modules, which will give customers a competitive advantage.

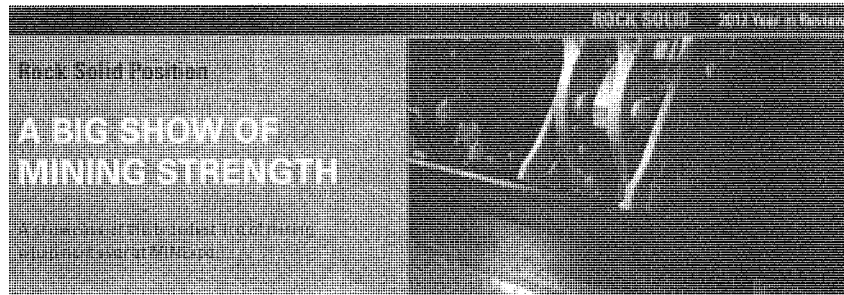
Customers receive support for technology solutions through our unrivalled dealer network. Dealers provide technical expertise in the deployment of these technologies, and product support of machines and engines, to help customers be more successful.

"Operationally, telematics will give us access to a database of information that will allow us to hone that information to unprecedented levels," said Brett Lehmann, national survey manager at Abigroup Ltd. "We have a mature relationship with Caterpillar and our dealer which allows the use of telematics to be mutually beneficial. We have real-time, fleet-efficiency data sent directly to our supervisors in the field ... the power of that is phenomenal."

Caterpillar is partnering with the best suppliers and development partners to ensure all customer work streams are enabled by technology solutions. From grade control, to global positioning, to industry-specific services, Caterpillar is committed to improving customer productivity with lower operating costs through technology.

"Technology is going to be the deciding factor in the industry moving forward. Caterpillar technology touches every piece of our equipment, and with that information we can continue to drive our efficiency and effectiveness," said Chad Jessen, a Caterpillar customer and development and innovation partner, Kiewit. "It's no secret that the Cat® dealer network and parts availability are best in class. As customers, we know Caterpillar's technology platform is the next area where Caterpillar will serve customers as best in class. Working together we will set ourselves apart from everyone else."

The rapid implementation of the Technology Enabled Solutions (TES) strategy will ensure success jointly for Caterpillar, Cat dealers and customers far into the future.



No matter what their interests — surface or underground, hard rock or soft rock — MINExpo International visitors experienced machines and technology at the Caterpillar exhibit to help them mine and move minerals safely and productively. MINExpo International, the world's largest and most comprehensive trade show dedicated to mining, truly brought the theme "Wherever There's Mining, We're There" to life. With more than 52,000 square feet at the Las Vegas Convention Center, Caterpillar showcased the broadest line of mining and materials-handling equipment available — backed by the most extensive and capable product support team in the worldwide mining industry.

"There is no bigger stage to give us this remarkable opportunity to tell the Caterpillar mining story. We recognize that mining is at the core of an unprecedented drive for urbanization and modernization," explained Caterpillar Chairman and Chief Executive Officer Doug Oberhelman. "We believe the long-term outlook is positive for this industry, and we're uniquely positioned to capitalize on that growth. That's why the company has made major investments in mining across the Caterpillar organization, plus expanding and modernizing our factories and developing even better mining products and solutions."

Since July 2011, Caterpillar has added more than 100 products to its mining portfolio, many of which were showcased at the MINExpo exhibit. Divided into two areas, surface and underground, the Caterpillar exhibit

featured more than two dozen products and technologies, including an off-highway mining truck, hydraulic shovel, next-generation Cat® D11T Track-type Tractor and a variety of underground mining machines such as continuous miners, a longwall shearer and plow, as well as other support equipment. Among the new products introduced at MINExpo was the Cat® 6120B H FS Hydraulic Shovel. The Cat 6120B is the first diesel-electric hybrid ultra-class shovel available in the industry — promising to lower cost per ton in world-class mining operations.

"Like our customers, Caterpillar is committed to building a better world. That's why when customers asked us to provide more products and solutions for the mining industry, the company responded in a big way," said Steve Wunning, Caterpillar group president with responsibility for Resource Industries. "Beyond just the iron, we understand the issues our customers face, such as safety, environmental stewardship, emissions standards and skills shortages and training, and we work together to address them. This will continue to be our focus."

Unique among all machines within the Caterpillar exhibit and throughout the hundreds of MINExpo displays, the Electro-Motive Diesel (EMD) SD70ACe locomotive — painted in Caterpillar yellow — gave the mining world an opportunity to explore the railroad technology that transports minerals to market. EMD™ SD70ACe locomotives run in mining operations across the globe.



Cat® machines are at work around the clock in every corner of the globe. When customers buy yellow iron, they expect the legendary Caterpillar product support that helps them to be more productive and profitable than anyone else in the industry. Making sure customers have the right part, at the right place, at the right time is what Caterpillar does.

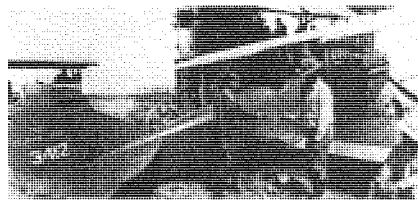
Parts support to dealers and customers is a 24 hours per day, seven days per week, 365 days per year business. Minutes matter to customers — and they matter to Caterpillar, which ships more than 158 million parts orders a year. That translates into 400,000-plus orders per day, 18,000-plus orders per hour, 300-plus orders per minute of every day of every year. That kind of around-the-clock global support doesn't happen without a world-class distribution network.

The Caterpillar distribution network is second to none, yet improvement and expansions are always occurring to ensure customers have support when and where they need it. In fact, in 2012, Caterpillar invested in product support capabilities in every region of the world and announced new distribution facilities in Yatafa, Australia, and San Luis Potosi, Mexico, as part of a multiyear modernization plan to enhance the global Caterpillar parts distribution network and to get parts to dealers and customers faster.

These facilities will join new distribution facilities in Waco, Texas; Clayton, Ohio; Spokane, Washington; Arvine, California; and Dubai, United Arab Emirates (UAE). These new facilities represent an increase of nearly 4.5 million square feet to the overall distribution network and support the commitment to providing unmatched parts availability to customers and dealers around the world.

In addition to creating new distribution centers, Caterpillar invested in the expansion of existing parts distribution facilities in Grimbergen, Belgium; Melbourne, Australia; and Shanghai, China. All of these facilities are leveraging common systems and processes in addition to deployment of SAP's Service Parts Management (SPM), a global solution that replaces multiple legacy software systems supporting the Caterpillar parts network.

"We are focused on ensuring our customers' success through a global, high-velocity network that delivers the industry's best parts availability," said Steve Larson, president of Caterpillar Logistics Inc. "All of these investments have the singular purpose of ensuring that Caterpillar and Cat® dealers support our customers' success better than anyone else."



ROCK SOLID HISTORY

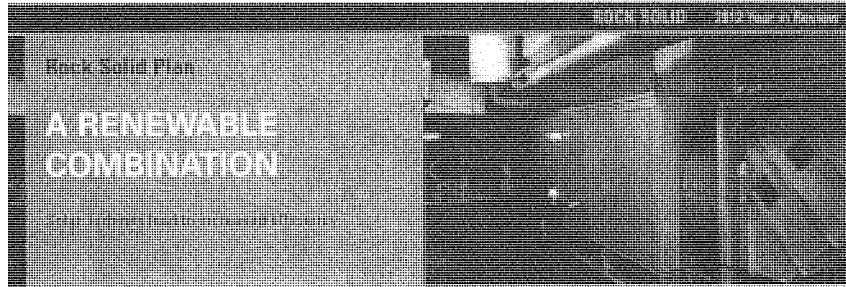
In August 1928, a customer called a Cat® dealership at 6 a.m. during harvest time. This customer had a machine broken down in the field and lived 40 miles from the dealership. The Cousins Tractor Co. made arrangements for airplane service and delivered the parts the customer needed, just one hour after the call came in.

CATERPILLAR®

ROCK SOLID
PLAN

Caterpillar's strength depends on providing customers with the best products, the best service and the best value proposition in the marketplace. Our updated Vision 2020 strategy is squarely focused on these goals. Two years into executing this strategy, we are more confident than ever that we have the right plan to pursue.

PSI TWLF 34 000017



Rising demand for sustainable power is driving the use of renewable fuels in power generation applications. The prospect of meeting global energy needs while minimizing the impact on the environment is presenting real opportunities. Solar Turbines, a Caterpillar company, is seizing this opportunity by developing new Combined Heat and Power (CHP) technology.

CHP, also known as cogeneration, is an efficient, clean and reliable approach to generating power and thermal energy from a single fuel source. Installation of a CHP system can greatly increase operational efficiency, while at the same time decrease energy costs.

Customers such as Veolia Environmental Services, located outside of Paris, France, have installed a 15-megawatt landfill gas-fueled combined-cycle plant. The plant uses a Mars 100 Solar™ Gas Turbine Generator Set, packaged by Turbomach at its European facility in Switzerland.

Renewable fuels in CHP applications make sense for efficiency, sustainability and energy security. Caterpillar continues to commit research and development resources to supporting renewable fuels as part of a winning solution for clean energy and a sustainable future.



ROCK SOLID HISTORY

In 1946, Solar capitalized on the opportunity to design a gas turbine — a product that would go on to become Solar's signature product, and remains a focus today ... 85 years after Solar started as an airplane manufacturing company in 1928.



When Caterpillar acquired mining equipment company Bucyrus in 2011, there was a need to align their distribution capabilities within Caterpillar's dealer-oriented distribution model. Through a series of divestitures, Caterpillar is engaging dealers in the product distribution and product support aspects of the business.

"The primary focus of the divestitures is to improve service to end-users by leveraging the proven distribution capabilities we have with our dealers," explained Dave Hoffman, chief financial officer for Resource Industries with responsibility for leading the divestiture team. By the end of 2012, Caterpillar had successfully completed 13 sale transactions to dealerships accounting for a significant portion of the Bucyrus distribution business. This is in line with Caterpillar's plan to engage dealers in Bucyrus opportunities as quickly as possible.

"Our dealers have a long history of exceptional service to mining customers around the world, and they know what is needed in local markets and individual mines. As service to our customers improves, our dealers will be rewarded and ultimately Caterpillar will be rewarded with higher customer satisfaction and sales," said Hoffman.

Each transition is unique and requires professional handling with a sharp focus on quality. In addition, the territories do not directly overlap with Cat® dealers, so the divestiture process ensures a smooth transition and uninterrupted service to customers.

"From a 20,000-foot perspective, it looks pretty simple to insert the dealers into the value chain, but it's all the details that make it challenging," said Hoffman. "We are focused on doing it right the first time and have a dedicated team in place to ensure a smooth transition."

To date, the transitions have been successful with limited disruption to Caterpillar customers. Clive Thomson, chief executive officer of Barloworld, Cat dealer in South Africa and Botswana, said, "This acquisition is perfectly aligned with the group's growth strategy. It builds on our existing strengths and will enhance our leading position in the mining industry by significantly expanding the range of equipment solutions we are able to provide to customers operating across southern Africa."



What does the future look like for Caterpillar and its customers? How and where will Cat® products work in 2030? What technologies will customers need to be successful? The Caterpillar product development community is thinking about these questions today in order to meet customer needs well into the future.

The enterprise product and technology strategy is the foundation of Caterpillar's future vision. The strategy, conceived in 2011 and introduced in 2012, defines the key technologies and areas of research and development investment necessary to meet customer needs and sustain Caterpillar's competitive advantage for the long term.

It is focused on three themes — Energy & Power Systems, Machines & Machine Systems and Automation & Enterprise Solutions. Each theme has bold goals serving as targets against which development progress can be measured. Research and advanced engineering activities currently under way within these areas include opportunities to reduce customer owning and operating costs; improve productivity and safety; and improve the environment.

In 2012 the technology strategy came to life in the form of several innovative technologies and products with customer value outcomes.

Energy & Power Systems: For some customer applications, natural gas can represent a breakthrough opportunity for fuel-cost savings when compared to diesel power alone. Efforts to expand natural gas-fueled power system products are well under way with the acquisition of MWM and an agreement with Westport Innovations to develop dual-fuel (diesel and gas) injectors for large mining trucks and EMD locomotives. "Dual-fuel and natural-gas engines can bring a significant cost advantage to many customers' bottom line. We are introducing a complete lineup of gas-capable power systems across the market segments — electric power, petroleum, mining, rail and marine — to provide this value," said Joel Feucht, general manager for Gas/Medium Speed Engines in Caterpillar's Large Power Systems and Growth Markets Division.

Machines & Machine Systems: A suite of advanced machine system technologies brings innovations in hydraulics and transmissions together to enable unprecedented efficiency and productivity. The Cat® 336E H, Caterpillar's first hydraulic hybrid excavator, uses up to 25 percent less fuel than the standard Cat® 336E excavator, while delivering equal or better performance. "We are applying technologies which reduce our customers' owning and operating costs to ensure they make more money when they choose Cat products and the Cat® dealer network than they can with any competitive alternative. This new generation of machines uses far less fuel, which translates to lower cost for customers and lower emissions for the environment," said Ken Gray, global product manager for Large Hydraulic Excavators in Caterpillar's Excavation Division.

Automation & Enterprise Solutions: The autonomous mine site of the future is becoming a reality with the development of Cat Command for Hauling. Since March of 2011, Caterpillar, in alliance with BHP Billiton, has commissioned Billiton's Navajo mine site in New Mexico to trial a small fleet of autonomous Cat® 793 Mining Trucks, 24 hours per day, seven days per week.

"The technology that we use in these unmanned machines will revolutionize the way we approach mining in the future. These trucks are able to operate in hazardous conditions, on continual shifts without putting our operators in harm's way," explained Jim Humphrey, the program's first project manager and member of the mining solutions team. "It's been a very successful trial program to date."

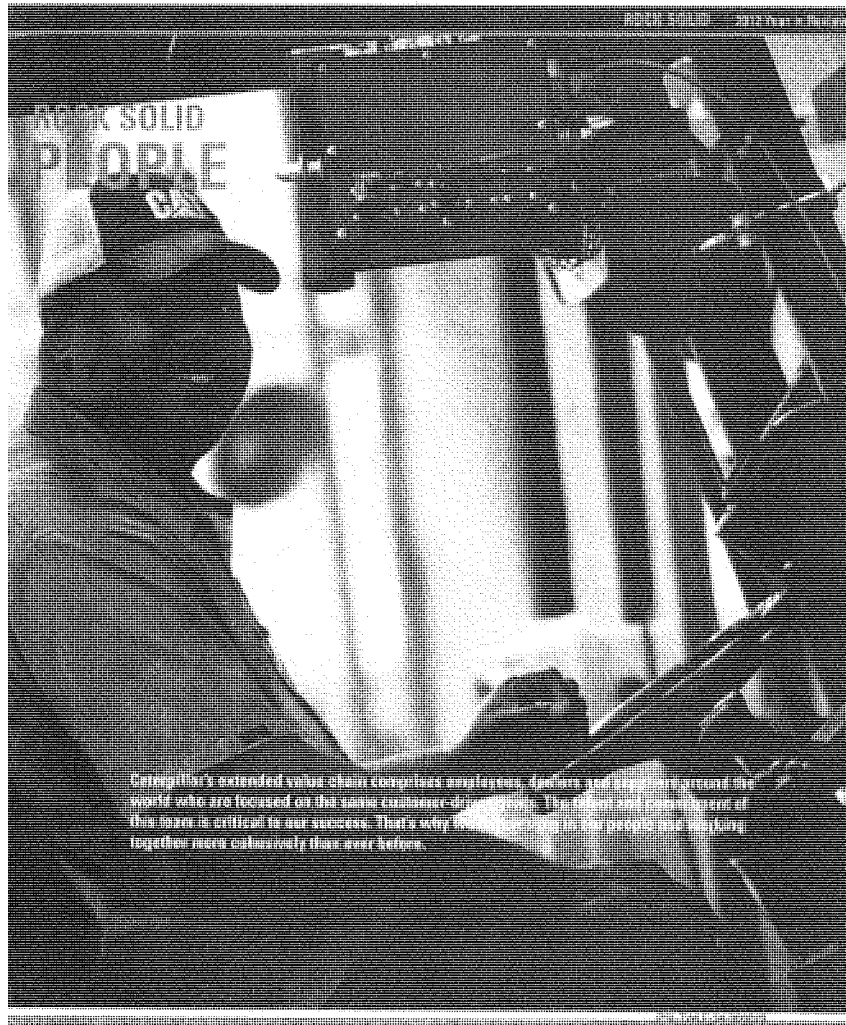
The world of the future holds many challenges for Caterpillar customers. Caterpillar's product development community is working now to bring innovation to bear on those future challenges and turn them into opportunities for long-term success.

PSI-TWLF-34-000020

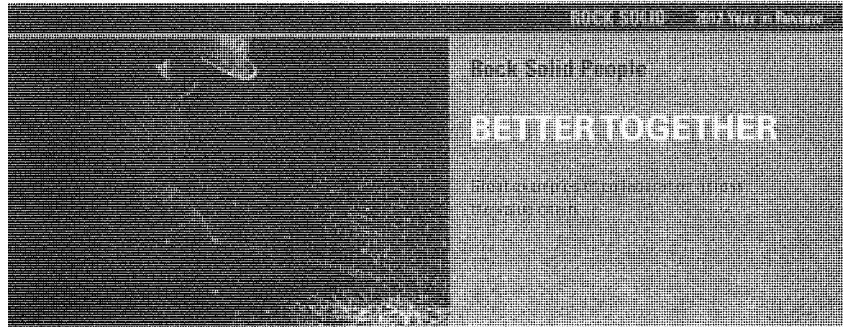


Machine downtime means lost profit. That's why parts availability can be the lifeblood of a Caterpillar customer's business. It's also the single biggest driver of customer loyalty and integral to the Cat brand ... a key part of the Caterpillar Business Model.

In 2008, Caterpillar launched a sweeping new plan to address parts quality issues and turn a laser-like focus on customers' needs. This plan has led to a dramatic reduction in errors, defects and waste, even with today's higher volume. Learn more about this initiative to reduce claims and better position customers for success at <http://youtu.be/6i49wZWHw0M>.

CATERPILLAR®


CATERPILLAR®



Efforts to drive an enterprise point of view across the value chain with suppliers, dealers and ultimately customers are under way at Caterpillar. Multiple internal initiatives are now extending to increase collaboration across the entire value chain.

Suppliers in China, for example, are deploying the Caterpillar Production System (CPS) in order to experience the same transformation that the system has delivered in our own manufacturing operations. The Cat brand and a focus on brand advocacy was a key initiative with dealers, and Caterpillar's flagship leadership development program is now inviting leaders from critical suppliers, dealer principals and select customers ... all in an effort to develop rock solid people.

CPS FOR SUPPLIERS

In 2006, Caterpillar rolled out CPS, focusing first on internal operations. Three years later, CPS was extended to its supply base through the CPS for Suppliers program in an effort to drive collaboration across its entire value chain. Today, that program is driving significant results around the world, creating long-term relationships with key suppliers sharing a common goal to produce the highest-quality products as efficiently and safely as possible.

"The introduction of CPS has brought significant changes in the ideas of Chinese suppliers," explained Gao Erging, general manager of BUT Construction Machinery Manufacturing in Xuzhou, China. "We are more confident about the elimination of waste and cost reduction, and about maintaining our competitiveness for Cat® products."

According to Erging, who has been a Caterpillar supplier for nearly 17 years, they reduced the amount of space in their production area by nearly 40 percent by following the CPS Principles. "We use only three-fifths of the production area originally planned to achieve the same production capacity in layout," said Erging. "CPS has helped us greatly reduce our investment in the plant and improve our efficiency, so it is of great significance to us."

DEALERS ADVOCATING THE CAT BRAND

For more than 85 years, Caterpillar has had a unique relationship with its dealers. This simple yet powerful partnership has combined the capabilities of a global technology and manufacturing leader with dealers who enjoy close relationships with their customers in their own language and culture.

The dealer network helps Caterpillar and customers win around the world. Cat® dealers share the Caterpillar passion, enhance the competitive edge and ensure customers receive maximum business value from Cat products and services. Most Cat dealers are independently owned, locally operated businesses and benefit from strong, longstanding customer relationships.

They are an integral part of the enterprise strategy and play a key role in the Caterpillar business model. They are at the front lines of serving our customers. They are a competitive advantage that competitors simply cannot match. That's why Cat dealers were a key player in the rollout of Caterpillar's revitalized brand strategy in 2012, which focused on energizing and developing a culture that has an intense, acute focus on the customer.

(continued)

PSI-TWLF-34-000023



(continued)

"We are rededicating ourselves to living up to our brand promise. To ensure that the way we present ourselves, both internally and externally, reflects our unwavering dedication to ensuring our customers' success," stated Caterpillar Group President Stu Levenick. In addition to the more than 9,000 Caterpillar employees worldwide who completed the brand experience training, more than 800 dealer marketing managers from 114 dealerships in 13 regions of the world and 22 of their agencies also learned about the Cat brand promise and updated global advertising framework. Working together with a common understanding of what the Cat brand stands for, we are champions for our customers' enduring success.

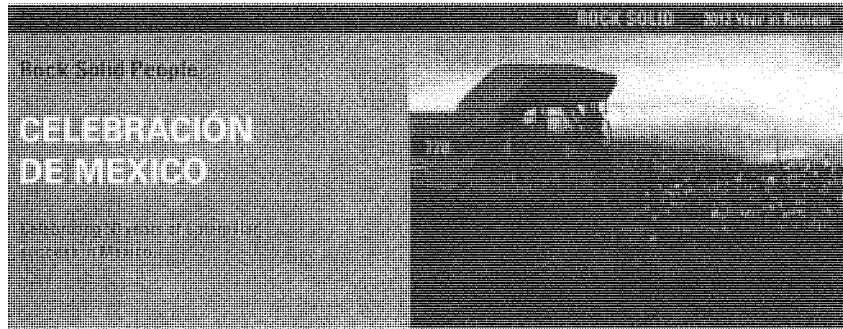
SUPPLIERS/DEALERS/CUSTOMERS LEARNING TO L.E.A.D.

Leadership Excellence in Accountability and Development (L.E.A.D.), Caterpillar's leadership development program, has a flagship program designed specifically to prepare future Caterpillar leaders for executive-level positions. Developed in partnership with Stanford University's Graduate School of Business, this program includes intense week-long

sessions spread over 12 months in different locations around the world, allowing participants to experience Caterpillar's global footprint with an emphasis on growth markets.

While the program was initially designed to develop Caterpillar leaders for senior roles in the enterprise, it quickly became evident that leaders from the entire value chain would benefit from participation and bring another dimension to the program. Now, critical suppliers, dealer leadership teams and selected Caterpillar customers comprise about one-third of program participants.

"The intent is to have the entire value chain represented to truly provide the enterprise point of view," said Group President Ed Rapp. "Participants see the value in having open, honest dialogue with one another and see the power of the entire value chain, including customer leaders, there in the same room to work on project teams to solve real business challenges we're facing."



It was February 1963 when Caterpillar broke ground on its first operations in Mexico. The facility opened its doors with 130 employees, and the production and distribution facility proudly called Monterrey its home.

Fifty years later, Caterpillar's Mexico operations now include several facilities, with four of them directly supporting the Integrated Manufacturing Operations Division (IMOD). Today, more than 5,000 IMOD employees specialize in large fabrications to support the construction and mining businesses.

To celebrate the first 50 years, a grand ceremony was held during September 2012. With the assistance of several managers, business partners and special guests, employees were thanked for their hard work that has helped pave Caterpillar's road to success through the years.

"We celebrated in Monterrey because this is where we began," said Ron Riekema, managing director and Mexico country manager. "And we continued the celebrations all through our Mexico facilities."

Two days after the celebration, an open house was held at the Monterrey, Mexico, facility for all employees and their families. This was the first time in more than 10 years that the facility was open to employees to share with their families. As a result, there was a lot of anticipation leading up to the event. Approximately 10,000 attendees visited the facility for tours of the production building, where they were able to learn how one of the main products, the small truck body, is built.

"The open house was great for some of our newest employees," said Logistics Manager Roberto Tellez Gonzalez, who has been with Caterpillar for 14 years. "They had the opportunity to show their families everything that the Monterrey facility does. We all had the opportunity to go on a facility tour, and it was amazing."

Maria Carvajal Fernandez, a service technician, said the open house was very well organized, and she was proud to bring her family.

"Caterpillar is the only company that I have worked for, and I have seen many changes over the past 24 years since I began working," Fernandez said. "I think that the open house was a great opportunity for our families to see and understand what we do and where we work. I was very proud because I came with my mom, who had the opportunity to come to the open house more than 10 years ago, and now she could compare and see many positive changes have been made."

Families who explored the Monterrey facility not only enjoyed Cat® products, but also a playground for children, a presentation from a local TV children's show and a museum that focuses on Caterpillar's presence and contributions in Mexico.

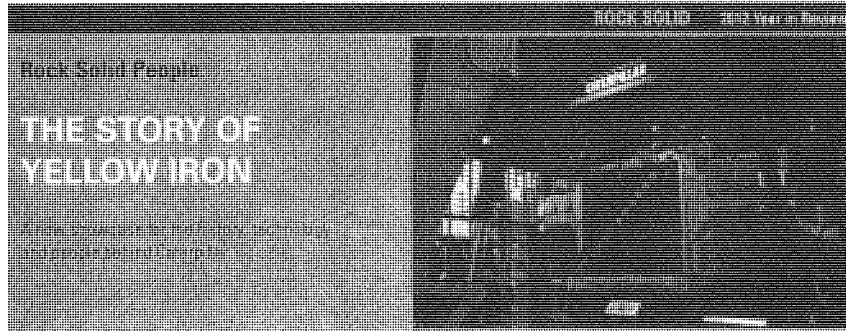
For many who participated, the main attraction was an interactive show that involved Cat® machines, dancers, musicians and acrobats. Among the many performers was a Cat® 416E Backhoe Loader, a Cat® 966E Wheel Loader and a Cat® 770 Off-highway Truck.

Employees were thankful for this great opportunity to share their Caterpillar pride with their families.

"I'm very proud of the team who has pulled together over the years, whether it was for the business or for our communities," Riekema said.

PSI-TWLE-34-000025

CATERPILLAR®

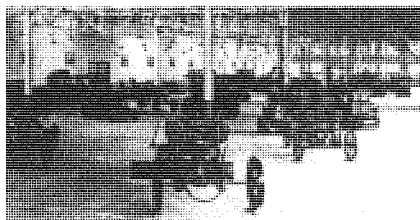


People know the yellow iron. Now they can understand the history, technology and global team behind it. A once-empty block on the Peoria, Ill., riverfront is now occupied by the Caterpillar Visitors Center, which offers a wide range of interactive exhibits to thousands of visitors every week. Just six weeks after opening on October 20, 2012, the Caterpillar Visitors Center had already counted more than 20,000 visitors.

To commemorate the opening, a time capsule was placed in the globe of the Visitors Center lobby. The capsule includes 78 different items, such as a Cat® D73 machine blueprint, diesel exhaust fluid tank cap and a pair of Cat® work boots, to be revealed in 38 years on the 125th anniversary of Caterpillar.

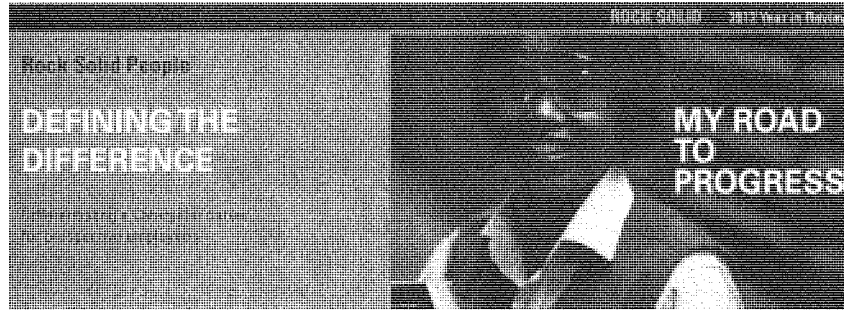
The Center itself is a state-of-the-art, LEED-certified building and provides a fascinating look at the company, the iron and the rock solid people making sustainable progress possible around the world. With nearly 50,000 square feet to explore, employees, retirees, dealers, customers, suppliers and the general public learn the story of Caterpillar through 28 exhibits, 53 videos, and approximately 775 photographs throughout the experience.

Possibly the most notable feature is the massive, life-size Cat® 797 Mining Truck at the heart of the building. Each visitor's journey begins in the bed of the Cat 797, which is home to a 62-person, rumble-seat theater. The featured video begins with stories from Caterpillar customers who talk about the work they do and how it impacts the world around them — every day, across the globe. These customers are the heart of Caterpillar's business — and the spotlight of the Visitors Center.



ROCK SOLID HISTORY

Recognized at the time as the largest showroom of its kind anywhere in the world, the Building HH Showroom in East Peoria, Ill., was 308 feet long, 108 feet wide and featured at least one sample of every machine Caterpillar built at any given time. Opened in 1929, thousands of people visited the showroom each year, including dealers, customers and the public. In 1938 alone, the showroom saw 14,566 visitors.



What is it like to work at Caterpillar?

"At Caterpillar, you work for a *global leader with global resources to support your career. You work with a talented team grounded in timeless values. And as all of us work together, Caterpillar provides the opportunity to make a transformational, tangible impact on your community and the world.*"

These statements are the pillars of Caterpillar's employment brand message, developed in 2012 to describe what differentiates the Caterpillar career experience from other employers' — it's why employees choose to work here and why job candidates should consider a career at Caterpillar.

Extensive research was conducted with current employees, recent new hires, executive leaders and potential candidates to define the employment brand and to be certain it matched the real work experience that makes Caterpillar unique among other companies. The employment brand message is now being used to describe the Caterpillar work experience to potential candidates, while improving the career experience for current employees.

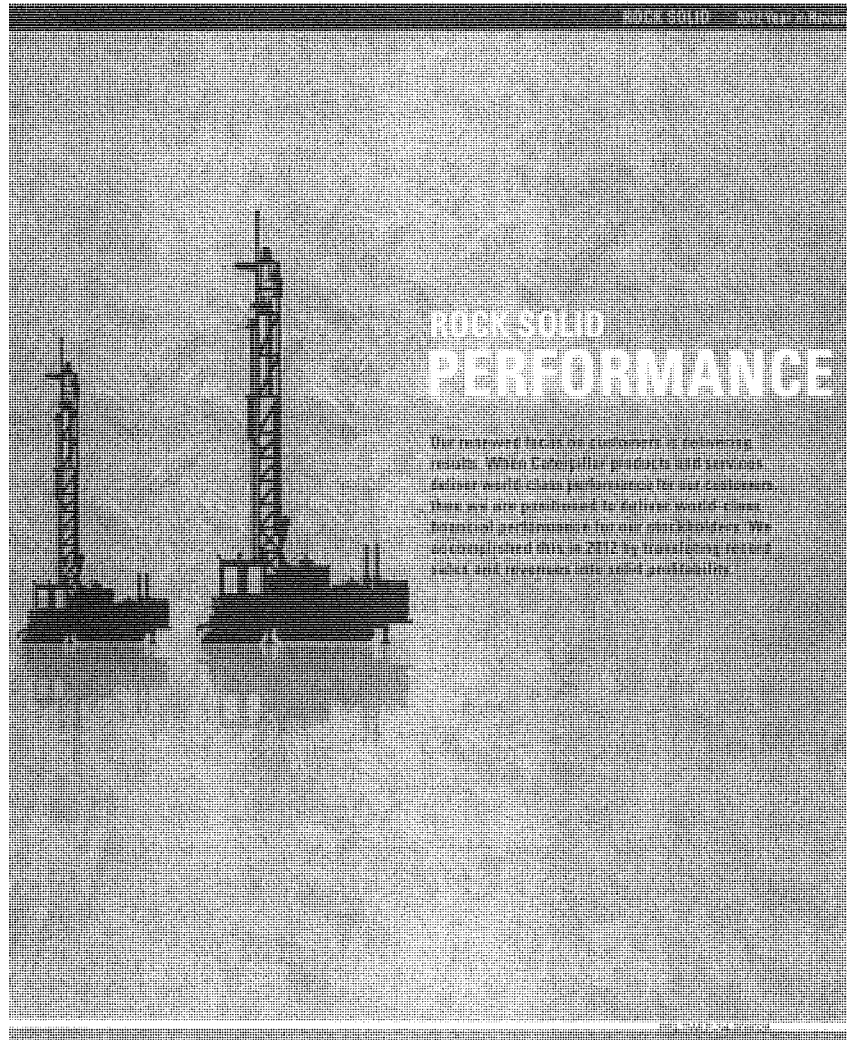
"As we have added more than 30,000 new employees globally in the last two years through direct hires and acquisitions, we believed it was important strategically to develop a consistent message of what it is like to work at Caterpillar," explained Vice President and Chief Human Resources Officer Kim Hauer. "As we grow globally we want to reinforce and perpetuate the Caterpillar culture and brand that we have inherited from previous generations."

As a global leader with global resources, Caterpillar offers:

- More than 85 years of industry leadership through its broad product line, a respected and admired corporate leader as a Fortune 50 company listed in the Dow Jones Industrial Average.
- Dynamic and flexible careers with boundless growth throughout hundreds of facility locations globally and diverse career paths, allowing employees to gather deep expertise in their fields and move between product lines and business areas.
- Opportunities to work with a team committed to customer success and living by Our Values in Action — Caterpillar's Worldwide Code of Conduct.
- Innovation that is purposeful and tangible. Currently, Caterpillar has more than 10,000 engineers. Historically, more than 7,000 patents have been granted.
- The opportunity to make a difference. Caterpillar equipment plays an unmistakable role in developing countries and creating economic growth. Employment with Caterpillar is truly an opportunity to change the world.

It's been said around Caterpillar for decades that the road to progress begins with a road, period. So, as Caterpillar makes progress possible around the world through its powerful machine and engine products and solutions, Caterpillar employs "rock solid people" who can say, "My road to progress begins with a career at Caterpillar."

The employment brand message on "Why Caterpillar" can be found on the caterpillar.com/careers website.

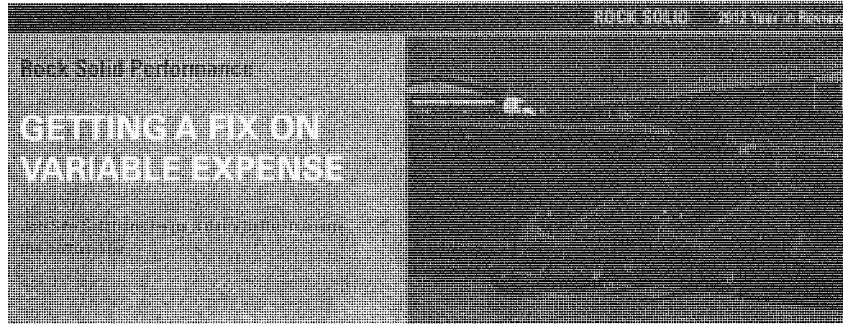
CATERPILLAR®


ROCK SOLID 2012 Year in Review

ROCK SOLID PERFORMANCE

The renewed focus on customers is delivering results. When Caterpillar products and services deliver world-class performance for our customers, then we are positioned to deliver world-class financial performance for our stockholders. We accomplished this in 2012 by transitioning realty value and revenues into solid profitability.

© 2013 Caterpillar Inc.



Spend any time with the McCarty family at their dairy operation and you're likely to hear the words family, relationship, trust and integrity, along with analysis and innovation. All of this played a part in a recent deal from Foley Equipment for 17 new Cat® machines to handle feed and manure for McCarty Family Farms.

The McCarty family transplanted their entire operation to Kansas from Pennsylvania, where rising costs made it difficult to acquire acreage needed to grow the business. With this expansion came the need for more machines to run the operation. The McCartys turned to their equipment partner, Foley Equipment, and Caterpillar for an analysis of their purchase and operating options.

As with most businesses, the dairy business is considerably more competitive today than in the past, so watching costs is critical. "In any given month, we might find a \$30,000 or \$40,000 'surprise expense' for machine or equipment repairs," said Ken McCarty, who operates the Flexford dairy with his brother Clay.

"Our goal is to minimize the up-and-down fluctuations in operating costs. We're really tuned in to finding partners and ways of doing business where the unknowns become known," said Clay. "Foley made it so we know how much machine operating expenses will be for the long term," Ken continued. "This brings incredible stability to our operating cost, which ultimately flows to the bottom line."

Long-time Foley sales representative Dustin Daniels and Scott Bailey of Caterpillar's Job Site Solutions team conducted an exhaustive, top-to-bottom analysis of the entire operation, including capital and cash flow; machine requirements and their fit to operational tasks; work flows and productivity; and safety and maintenance.

The outcome of the analysis is a solution that optimizes machine utilization, component life, operator performance, fuel consumption and total fleet

availability at a fixed cost. The end result is a fleet fully integrated with dairy operations to significantly improve the bottom line.

Monitoring and managing each machine wouldn't be possible without technology. Each machine is outfitted with Cat® Product Link™ and monitored by Foley through VisionLink™ desktop and mobile monitoring applications. Machines are set up with limits on certain operating parameters, based on the site and the work required and monitored on a number of productivity measures, as well.

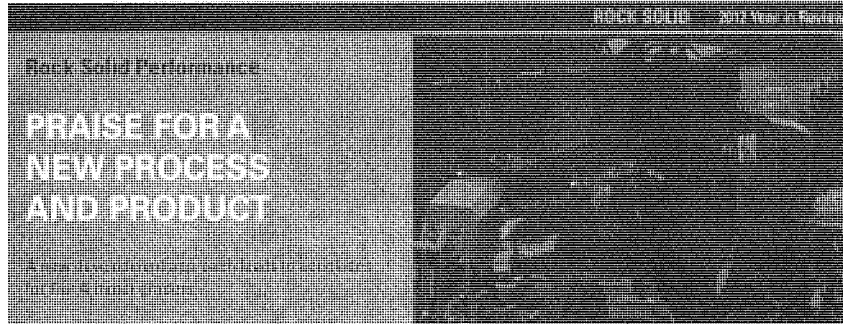
Issues such as engine overspeeds, improper shift points or excessive idling that could create a safety issue, an unplanned repair or higher operating costs are now visible. In doing so, Foley will be able to identify issues and develop remedies before they turn into costly downtime.

Productivity of the machines will also be tracked in an effort to optimize efficiency. Load volumes and cycle times will provide insight into inefficiencies or bottlenecks in the day-to-day operations, with the goal of eliminating them.

Delton Taylor, equipment solutions manager for Foley Equipment, will be the primary point of contact for much of this information called Condition Monitoring. "What's neat about this is that it's going to be transparent to the customer. In most instances we're going to know a problem exists before the customer has a chance to pick up the phone. In fact, we'll likely be reporting the problem to them," explained Taylor.

"The more we looked at this, the more it appeared to be a no-brainer on so many levels," said Mike McCarty. "Think about it this way: we've taken a variable expense and made it fixed. That's huge. We've taken the machine maintenance and off-loaded it to the people who really know the machines. As the technology advances it's tougher to train workers and keep them up-to-date. Plus, with an operation this large, we're increasingly looking for a better quality of life, and that doesn't include spending our free time wrenching on a machine." McCarty concluded.

PSI-TMLE-34-00029



Just one year after its release, Caterpillar's new Cat® M2-Series motor grader continues to gain accolades for its superior performance, reliability and productivity. Although customer satisfaction is what really counts, the process leading up to its release gained praise itself — raising the bar and setting higher standards for new product introduction at Caterpillar.

The Cat M2 was Caterpillar's first machine introduced to meet a new round of emission standards in North America and Europe — Tier 4 Interim (Tier 4i) standards for the United States and Stage IIIB standards in the European Union (EU).

According to Caterpillar Motor Grader New Product Introduction (NPI) Manager Jeff Castleman, the sheer magnitude of teamwork and collaboration involved was extremely well orchestrated — spanning four continents and representing Caterpillar's product development team, manufacturing facilities and supply base.

"This truly is a great example of Caterpillar at its best, in terms of global collaboration, to make sure we excel at product development," explained Castleman. "The team went in with a very aggressive plan to execute and deliver a new product introduction that not only met emission requirements, but also offers superior value to our customers."

One year post-introduction, Castleman said, "The dealer's feedback on the Cat M2-Series has been very positive. They specifically saw improvements in machine performance, as well as feature improvements that not only provide value to the customer, but also make their jobs easier."

Cat® dealer Empire Machinery Sales Manager Kevin Shanley said the introduction of Tier 4i emissions technology to the Cat M2 has been a seamless transition for Empire and its clients. "From our perspective,

Cat M2 motor graders have been outstanding," he explained. "We've had several customers tell us the initial difference in performance is excellent, and over time they have seen considerable fuel savings, excellent reliability and improved uptime. Based on positive customer feedback, strong initial quality metrics and the high confidence of our account managers, the Cat M2 has more than delivered in performance and reliability."

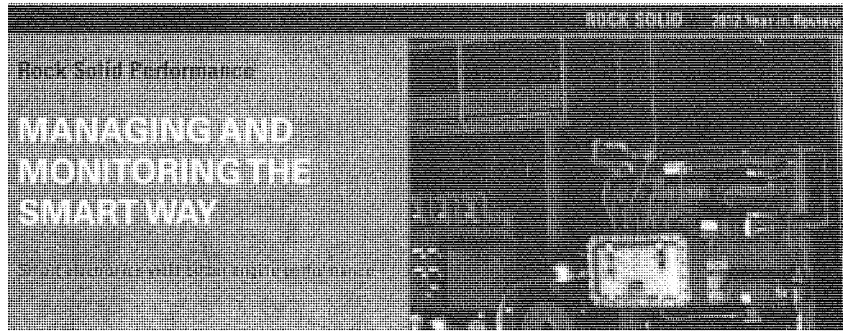
Built on the strengths of the M-Series predecessors, the Cat 120M2, Cat 12M2, Cat 140M2 and Cat 160M2 feature new engines, revolutionary joystick controls and integrated technologies that help the customer do more work in less time at a lower total cost. Other added features include a new ripper design, swing open cooling package, anti-icing glass and Cat® Grade Control.

"The new swing out radiator on the M2-Series makes our routine maintenance a lot easier," said Bobby Aiken, road department Superintendent for Seminole County, Georgia. "It's a lot less downtime for us."

Since the release of the Cat M2, multiple products have gone into production with Tier 4i — medium wheel loaders, articulated trucks, track-type tractors and more. The next round of emissions regulations, Tier 4 Final, takes effect January 1, 2014.

"Throughout the introduction of the Cat M2, the commitment to continuously improve the overall development and execution process was unprecedented," said Global Motor Grader Product Manager Pat O'Connell. "We're building and improving on this foundation as we prepare for Tier 4 Final."

PSI-TWLF-34-000030



Caterpillar is constantly developing and refining advanced technologies to help make customers' equipment more productive and efficient, and to help them more effectively manage fleets and operations.

Smart electronics, for example, help to monitor and control Caterpillar-powered gas compression stations around the world. These innovative solutions also help Energy & Power Systems customers utilize equipment data for proactive asset management, ranging from basic location tracking to advanced condition monitoring.

The value of these smart electronics is evident at the Atmos Energy Corporation Ponder Compressor Station, located northwest of Fort Worth, Texas. Here, Atmos operates two Cat® G3612 Engines. Both units are required to run 24 hours per day, seven days per week, but the station is unmanned at night and on the weekends. By filling this gap in operational surveillance, the Caterpillar monitoring system provides value and helps to enable customer success.

As a result of implementing the monitoring system, the customer has achieved 99 percent runtime, and the interaction between the operator and Caterpillar experts has proved very helpful by increasing operator knowledge of this equipment.

Business pressures to improve reliability and reduce costs have increased the challenge faced by operations and maintenance organizations as they acquire and maintain engines with the newer technology. Caterpillar has a long history of innovating on behalf of its customers. Energy & Power Systems customers are choosing to address these challenges by leveraging Caterpillar equipment monitoring solutions to assist in the proactive management of their equipment.



Few organizations in the world can boast such well-established, successful relationships as those that exist between Caterpillar and its dealers, who continually look for ways to work together more efficiently and effectively to benefit customers. A 2012 initiative between Caterpillar and Cat® dealers to improve the assembly time of the Cat® 793F Large Mining Truck is a great example of how this collaboration benefits customers.

The massive truck is more than 18 feet tall, 44 feet long, weighs upwards of 270,000 pounds and has a payload of 250 tons. The assembly of this workhorse is a massive undertaking. Historically, assembly took many weeks with multiple technicians, depending upon the truck's configuration. This process tied up the skilled technicians at the dealership and kept them from addressing other customer needs.

A global core team of 15 individuals, with an additional 60 people representing 13 different dealerships and seven different Caterpillar business units, collaborated to improve the process.

"As the team started to get into the real details of the problem, it became apparent very quickly that the challenge had many dimensions, the solution had to be global and sustainable, and the project would require an extraordinary degree of communication and collaboration amongst multiple divisions and dealers," explained Cameron Ferguson, dealer capability manager. "With an issue as complex as assembling large product consistently around the world, involving hundreds of people, thousands of parts, several languages and local customization, this project showed that with the right tools and commitment, a flexible but consistent solution can be achieved and exceed customer expectations."

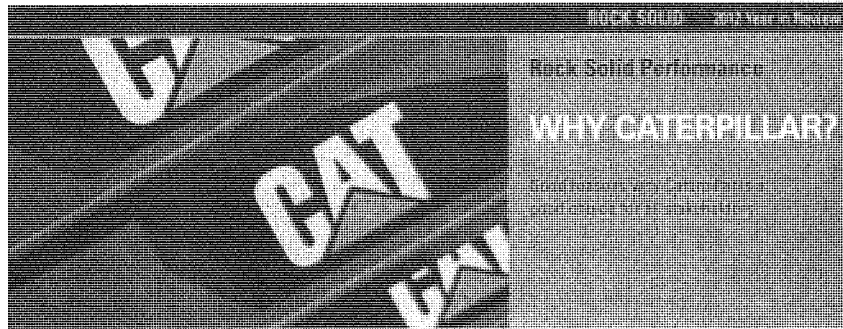
The team used the rigor of 6 Sigma methodology and the discipline of the Caterpillar Production System (CPS) to identify areas of opportunity and define sustainable solutions. The overall goals were to best match the labor force to tasks, reduce cycle time, reduce total labor hours, deliver the standard work in a sustainable way and improve safety by identifying the right specialty and shop tools for the tasks.

The results have been remarkable. Using the new processes and tools, the base assembly time has been reduced by an average of 40 percent. In addition to the faster assembly, the quality levels of the machines have been significantly improved, due to the focus on standard processes and tools, which are being replicated for other large mining trucks. This global collaboration leads to a better product delivered faster and more cost effectively to customers.

Darren Tasker, chief operating officer of WesTrac, one of the pilot dealers heavily involved in the project noted, "WesTrac has been focused on driving continuous improvement throughout its entire organization, including the large mining truck 'order to delivery' cycle. Through the collaboration of both Caterpillar and WesTrac, the project quickly gathered momentum with immediate benefits."

These benefits included elimination of waste, reduced defects/rework and predictable cycle times and man hours required to perform the assembly of the machines.

"There is no doubt that without the expertise provided by Caterpillar, WesTrac would not have realized this level of benefits, which also will benefit other Cat dealers," added Tasker.



With more than seven billion people in the world who need infrastructure, energy and power, and the world's commodities, Caterpillar is in a great position to win in the global marketplace. Group President Ed Rapp describes a number of factors that put Caterpillar ahead of the competition:

- The broadest line of products and services in the industry, and vertical integration of products, components and systems that provide unique advantages over the competition.
- A global manufacturing footprint that helps balance the shifting world economies.
- A dealer network that is unmatched and a supply chain that facilitated the ramp-up to record levels.
- A Caterpillar business model that puts the largest population of machines in the field at the lowest life-cycle cost for the customer.
- A diverse and talented team of great people.
- A strong balance sheet that provides financial strength as Caterpillar delivered another year of record sales and revenues and profits in 2012.

To learn more, visit <http://youtu.be/GETaxNQ9mw>.



ROCK SOLID

2011 Year in Review

Business Segments

CONSTRUCTION INDUSTRIES

Construction Industries is focused on helping our customers build what the world needs — new highways, railroads, airports, water systems, housing, hospitals and schools, to name a few. Primarily responsible for supporting customers using machinery in infrastructure and building construction applications. Responsibilities include business strategy, product design, product management and development, manufacturing, marketing, and sales and product support. The product portfolio includes backhoe loaders, small wheel loaders, small track-type tractors, skid steer loaders, multi-terrain loaders, mini excavators, compact wheel loaders, select work tools, small, medium and large track excavators, wheel excavators, medium wheel loaders, medium track-type tractors, track-type loaders, motor graders, telehandlers, pipelayers and related parts.

ENERGY & POWER SYSTEMS

Energy & Power Systems is focused on supporting customers to meet increasing demand for energy through a variety of solutions and applications. This segment is primarily responsible for supporting customers using reciprocating engines, turbines and related parts across industries serving electric power, industrial, petroleum and marine applications as well as rail-related businesses. Responsibilities include business strategy, product design, product management, development, manufacturing, marketing, sales and product support of reciprocating engine powered generator sets, integrated systems used in the electric power generation industry, reciprocating engines and integrated systems and solutions for the marine and petroleum industries; reciprocating engines supplied to the industrial industry as well as Caterpillar machinery; the business strategy, product design, product management, development, manufacturing, marketing, sales and product support of turbines and turbine-related services; the development, manufacturing, remanufacturing, maintenance, leasing and service of diesel-electric locomotives and components and other rail-related products and services.

RESOURCE INDUSTRIES

Resource Industries helps customers mine and harvest resources like coal, iron ore and lumber. Responsibilities include business strategy, product design, product management and development, manufacturing, marketing and sales and product support. The product portfolio includes large track-type tractors, large mining trucks, underground mining equipment, tunnel boring equipment, large wheel loaders, off-highway trucks, articulated trucks, wheel tractor scrapers, wheel dozers, compactors, select work tools, forestry products, paving products, machinery components and electronics and control systems. In addition, Resource Industries manages areas that provide services to other parts of the company, including integrated manufacturing, research and development and coordination of the Caterpillar Production System. Since the acquisition of Bucyrus in 2011, additional responsibilities were added and include business strategy, product design, product management and development, manufacturing, marketing and sales and product support for electric rope shovels, draglines, hydraulic shovels, drills, highwall miners and electric drive off-highway trucks.

CUSTOMER & DEALER SUPPORT

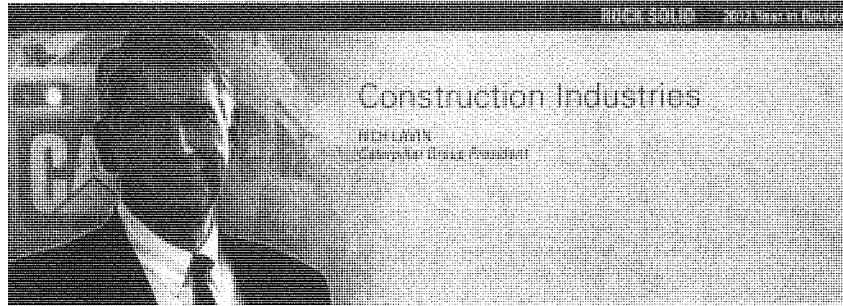
Customer & Dealer Support strengthens Caterpillar's product support excellence by bringing a strong focus to Cat branded parts and customer service and delivering outstanding dealer development. This segment supports customers and dealers in a variety of ways, such as providing employee equipment training on job sites, supplying aftermarket parts and service support, and offering eBusiness and Equipment Management solutions. A key strength is the ability to manufacture parts and components, provide remanufacturing solutions and deliver unmatched parts availability to dealers and customers anywhere in the world.

FINANCIAL PRODUCTS

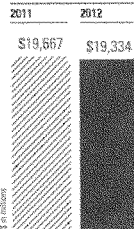
Caterpillar sustains sound relationships with its dealers, customers and suppliers by providing customized financing solutions through offices in more than 35 countries. Financing plans include operating and finance leases, installment sale contracts, working capital loans and wholesale financing plans. The segment also provides various forms of insurance to customers and dealers to help support the purchase and lease of Cat® equipment.

PSI TMLF-34-000034

CATERPILLAR®



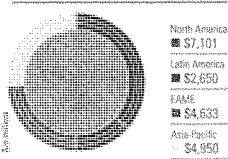
Sales



Segment Profit



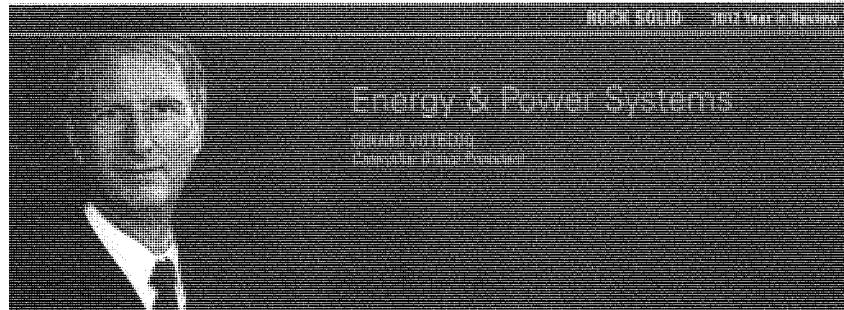
2012 Sales by Geography



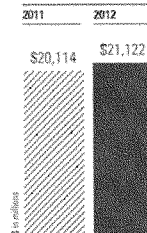
Despite a difficult and challenging year, Construction Industries (CI) contributed to yet another record year for the enterprise and had some incredible accomplishments.

- We achieved historical bests in both quality and safety.
- We improved our overall industry leadership position.
- We made progress in China — bauma China 2012 was an excellent example that displayed the strength of our product offerings in China.
- We improved the diversity of our leadership in Asia-Pacific.
- We made considerable strides in becoming the lowest cost producer (LCP).
- We deployed Tier 4i, while improving overall customer value and maintaining excellent quality.
- We saw positive expansion of global facilities and continue to have success on those in progress.

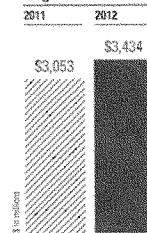
At the end of last year, I entered a new chapter in my life to begin my retirement, with Group President Ed Rapp taking leadership of Construction Industries. I'm confident that Ed will take the performance of our business to the next level and build on the tremendous foundation that has already been established. I leave Caterpillar very optimistic about its long-term future and the success it will bring in the years ahead.



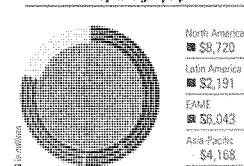
Sales



Segment Profit



2012 Sales by Geography



In 2012, the Energy & Power Systems team delivered record results, making significant progress toward our 2015 goals.

We expanded capacity with the opening of a new Rail facility in Sete Lagoas, Brazil, and a new Solar Turbines facility in Zatec, Czech Republic. We continued to make great strides in integrating MWM into Caterpillar following our acquisition in 2011, ultimately enabling us to significantly expand customer options for sustainable power generation solutions. We made a number of exciting announcements as well, including a joint venture with Ariel Corporation to provide complete pressure-pumping solutions to global oil and gas customers and an agreement with Westport to develop natural gas technology for off-road equipment. We also added to our growing list of agreements with International Power Project (IPP) providers to develop temporary power solutions to meet the needs of the growing IPP segment.

I also marked a personal milestone with an announcement at the end of the year of my retirement after more than 37 years with the company. Earlier this year, Jim Umpleby assumed responsibility as group president with responsibility for Energy & Power Systems. I have tremendous confidence in Jim's ability to lead this business and continue to build on the successes we've achieved thus far. When it comes to our Energy & Power Systems businesses, we are in the right businesses at the right time, for a long time. Our potential is rock solid, and I look forward to the many great things to come from this group in the future.



As we enter into a new year that looks to be as challenging as 2012, it's important that we not forget just how far we've come in Resource Industries. We have had many remarkable accomplishments, and I would like to take the opportunity to mention a few. The integration of Bucyrus is going very well and is delivering our commitments made to our customers and stakeholders. On-time shipping performance from our plants is more than 85 percent compared to less than 40 percent five years ago. We've expanded and modernized our machine and component manufacturing plants all around the world, making our manufacturing facilities world class.

New startup facilities in Asia separate Caterpillar even more from competition with the largest, most modern and global manufacturing presence in the mining industry. The showcase of all our new products, technologies and solutions at MINExpo was a powerful example to our customers that we take our leadership in the mining industry very seriously.

Our diversified businesses continue to respond to a difficult and uncertain business climate, particularly in our Forest Products, Tunneling Products and Paving Products businesses. Our new Industrial & Waste strategic business is providing the necessary focus to this important segment. And, our Defense & Federal Products, DEM Solutions and Work Tool businesses are performing exceptionally well, making important contributions to the enterprise.

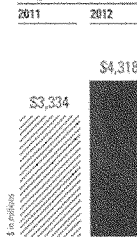
Product quality has improved tremendously, continuing the legacy that's been our foundation for more than 85 years. We continue to successfully invest and deploy the Caterpillar Production System (CPS) with all of our newly acquired plants from South Milwaukee, Wisconsin, to Thiruvallur, India, which is leading the pack in manufacturing excellence. The component business has been equally successful with improved delivery performance, and the investments in our product technology strategy and Tier 4 deployment continue to differentiate us, providing greater value to our customers today and into the future. Most importantly, we've seen outstanding improvement in employee safety over a 10-year journey. We are pleased with our progress, but recognize we still have a long way to go to reach Vision Zero.

Throughout 2013, Resource Industries will have to be flexible, but there is one constant and that is this ... our team of dedicated employees always delivers, no matter the challenge.

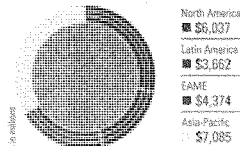
Sales



Segment Profit



2012 Sales by Geography



PSI-TWLF-34-000037



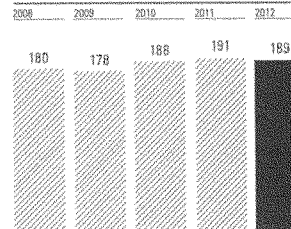
The Customer & Dealer Support (C&DS) organization faced a number of challenges in 2012, but we continued to focus on our customers and execute the key role we play in the Caterpillar Business Model. We have a rock solid strategy and a well-aligned organization that is executing very well.

I am proud of my organization's accomplishments as progress continues to be made toward our very aggressive 2015 goals and our safety targets have again been exceeded. We invested heavily in our parts distribution network in every region of the world and in our Reman and Components global capacity. Despite the economic headwinds during the year, we continued to improve quality. We made great strides in our efforts to provide world-class support to the greatest dealer network in the world. Our eBusiness capabilities continued to expand, we accelerated our penetration into telematics and Equipment Management, and we launched our revitalized Global Brand strategy that uniquely positions and strengthens our Cat brand in the global marketplace.

These are just a few of the 2012 Customer & Dealer Support organization's accomplishments. I encourage you to read about the many things Caterpillar delivered in 2012. Whether it was dealer collaboration, innovation, supplying power to the world or building more infrastructure, you will quickly learn why I am proud to be part of the remarkable accomplishments at Caterpillar and get the opportunity to lead a great team of employees.

What we do makes a difference — not only for Caterpillar, but more importantly for our dealers and customers.

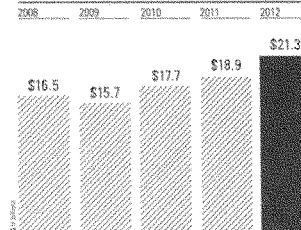
Global Cat® Dealers



Dealer Employees



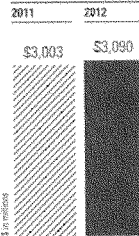
Dealer Net Worth



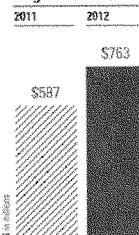
PSL TWLF 34-000038



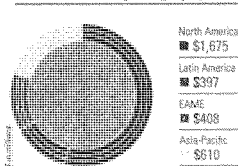
Revenues



Segment Profit



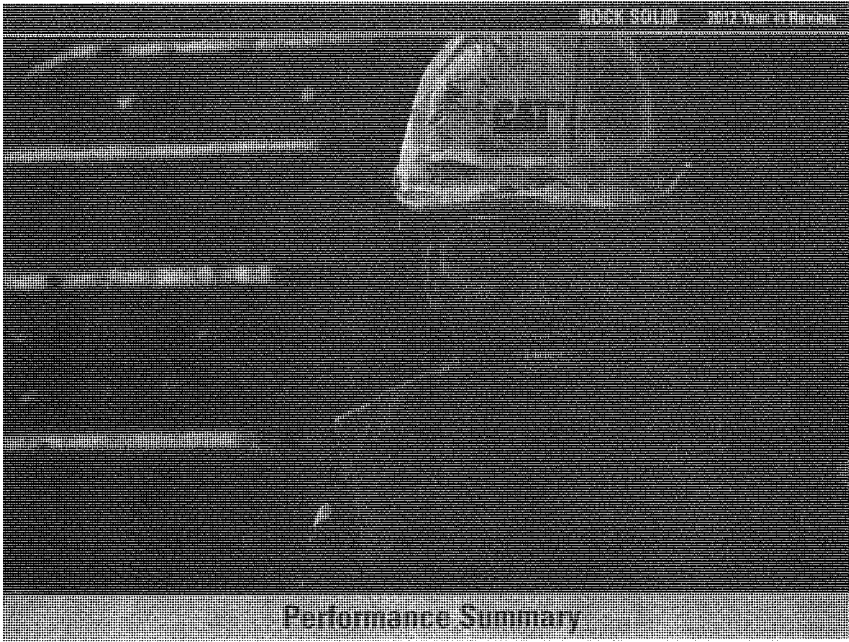
2012 Revenues by Geography



As I reflect on 2012 as Group President of Financial Products & Corporate Services, I realize our employees of the services groups and Financial Products have accomplished much as you consider:

- Our recovery since the "Great Recession" has been the fastest ramp-up in company history, stretching all of us and our supply chain. I think we have made good progress in building these supplier relationships.
- Cat Financial came out of this challenging period even stronger and we have improved alignment.
- Add to that, we're integrating four major strategic acquisitions, including the largest in company history, the largest capital expansion program ever, and our largest divestiture. All of those activities involved our entire suite of support services. Now, as a company we need to stay focused on execution.
- All of our groups have had major transformations underway that are truly making us more effective and efficient at delivering services to the business, supply chain and customers: People initiatives to help us develop the Best Team, Purchasing transformation, Order to Delivery/Finance Transformation (Mach 1) and our strategy to deliver as a captive finance company.
- That doesn't even begin to touch all of the aspects of deep expertise and fundamentals that are executed without a hitch day in and day out in Cat Financial, information technology, human resources, procurement and finance.

There is considerable capability across Corporate Services and Cat Financial to bring value to the business. We are using those capabilities to solve real business problems and to chase that value add to the bottom line. I'm proud to say I've been a part of Corporate Services as I move to leadership of Construction Industries in 2013.



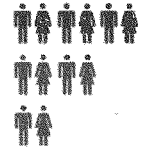
Financial Performance



Market Performance



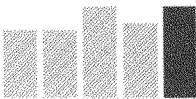
Business Performance



2012 Regional Performance



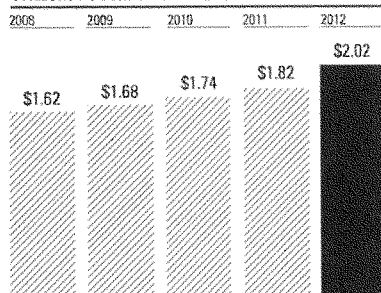
5-Year Financial Summary




ROCK SOLID 2012 Year in Review

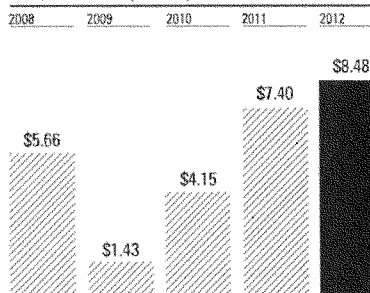
Financial Performance

Dividends Declared Per Share



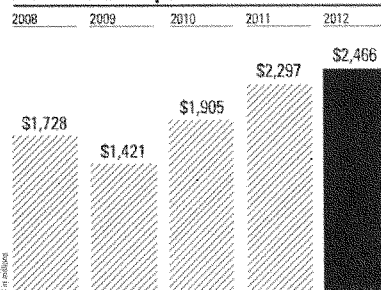
2012 marked the 19th consecutive year Caterpillar has paid an increased dividend to stockholders.

Profit Per Share (diluted)



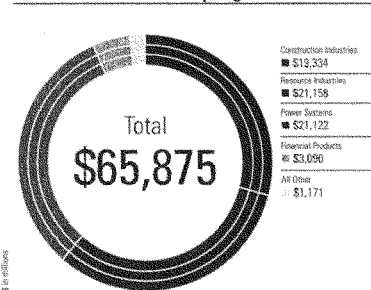
A significant increase in profit per share in 2012 reflected effective profit pull-through, one of our "Big 8" strategic imperatives.

Research & Development



Investment in research and development reached record levels in 2012.

2012 Sales & Revenues By Segment



Sales and revenues were \$65.88 billion compared with \$60.14 billion in 2011. The increase in sales and revenues is a result of the net impact of acquisitions and divestitures, higher sales volume and improved price realization.

PSI-TWLF-34-000041

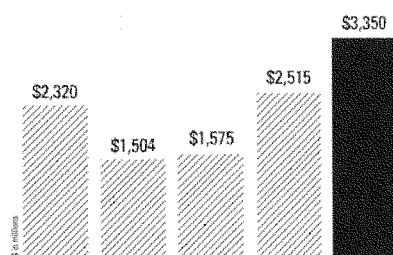


ROCK SOLID 2012 Year in Review

Financial Performance

Capital Expenditures (excludes equipment leased)

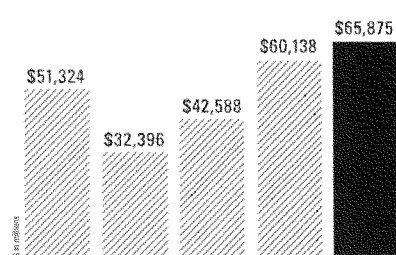
2008 2009 2010 2011 2012



Caterpillar invested more than \$3.35 billion in capital expenditures during 2012, reflecting capacity expansion around the world to support customer demand.

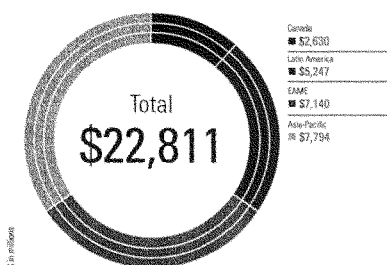
Sales & Revenues

2008 2009 2010 2011 2012



Sales and revenues increased 10 percent to \$65.88 billion in 2012, an all-time record.

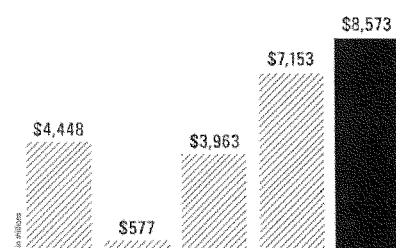
2012 Exports From U.S. By Region



U.S. exports of \$22.81 billion increased 16 percent from 2011 to 2012.

Operating Profit

2008 2009 2010 2011 2012

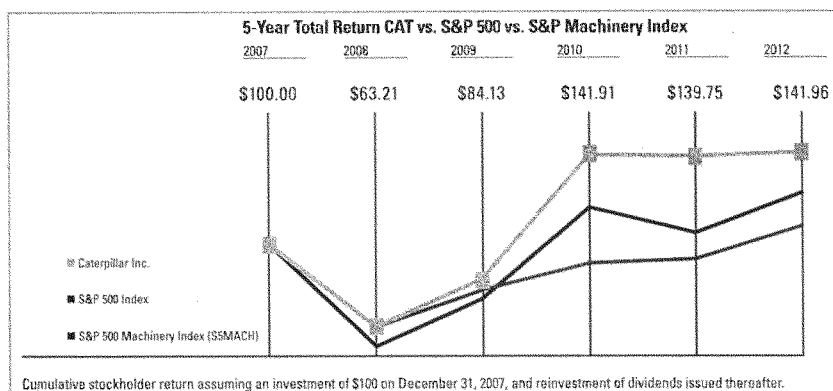


Operating profit was \$8.57 billion compared with \$7.15 billion in 2011.

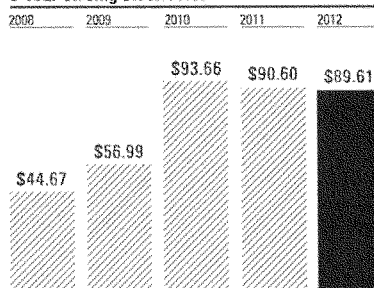
PSI-TWLE 34-000042


ROCK SOLID 2012 Year in Review

Market Performance



5-Year Closing Stock Price



Caterpillar shares have enjoyed a significant level of appreciation since the downturn of 2008.


ROCK SOLID 2012 Year in Review

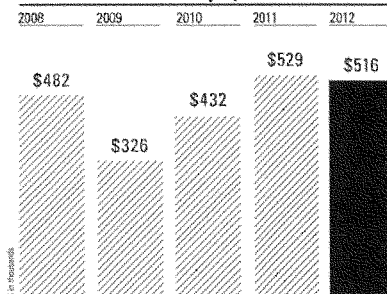
Business Performance

Global Employees (at year end)



Worldwide full-time employment was 125,341 at the end of 2012 compared with 125,099 at the end of 2011.

Sales & Revenues Per Employee

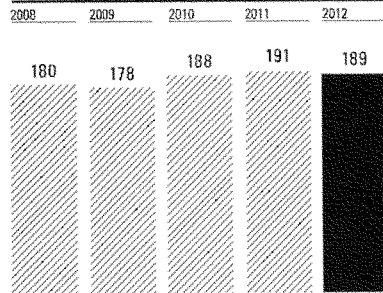


Sales and revenues per employee in 2012 were \$516,000.


ROCK SOLID 2012 Year in Review

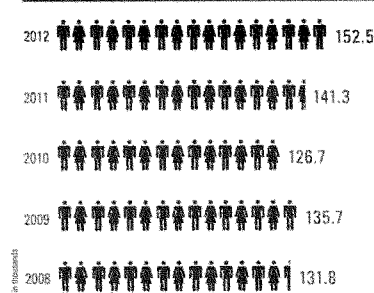
Dealer Statistics

Global Cat® Dealers



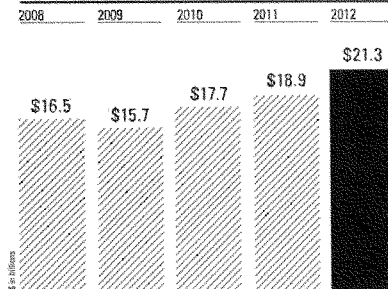
Our vast dealer network offers comprehensive solutions for customers worldwide.

Dealer Employees



Cat® dealer employees share our commitment to customers and ensure maximum business value from our products and services.

Dealer Net Worth



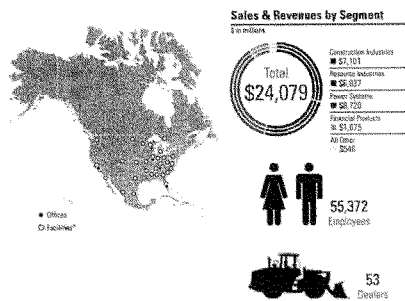
Most Cat® dealers are independently owned, locally operated businesses and benefit from strong, longstanding customer relationships.



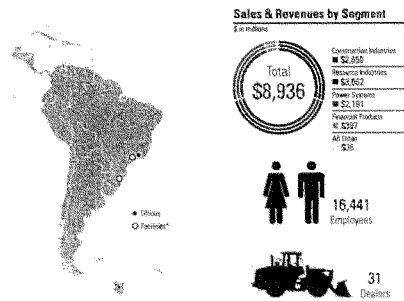
ROCK SOLID 2012 Year in Review

Regional Performance

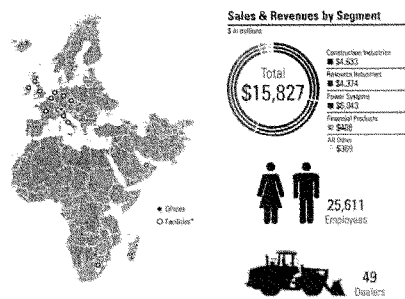
North America



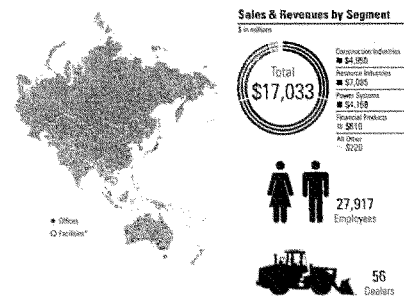
Latin America



EAME



Asia-Pacific



*Facilities include principal locations where manufacturing, parts distribution, rail, and remanufacturing work takes place. In certain geographic areas, the facility symbol may represent multiple facilities.

PSI-TWLF-34-000046



ROCK SOLID 2012 Year in Review

5-YEAR FINANCIAL SUMMARY

(dollars in millions except per share data)

Years ended December 31,	2012	2011	2010	2009	2008
Sales and revenues	\$ 65,875	\$ 60,138	\$ 42,588	\$ 32,396	\$ 51,324
Percent inside the United States	31%	30%	32%	31%	33%
Percent outside the United States	69%	70%	68%	69%	67%
Sales	\$ 63,068	\$ 57,392	\$ 39,867	\$ 29,548	\$ 48,044
Revenues	\$ 2,807	\$ 2,746	\$ 2,721	\$ 2,856	\$ 3,280
Profit ⁴	\$ 5,681	\$ 4,928	\$ 2,700	\$ 895	\$ 3,557
Profit per common share ¹	\$ 8.71	\$ 7.64	\$ 4.28	\$ 1.45	\$ 5.83
Profit per common share — diluted ²	\$ 8.48	\$ 7.40	\$ 4.15	\$ 1.43	\$ 5.66
Dividends declared per share of common stock	\$ 2.020	\$ 1.820	\$ 1.740	\$ 1.680	\$ 1.620
Return on average common stockholders' equity ^{3,5}	37.2%	41.4%	27.4%	11.9%	46.8%
Capital expenditures:					
Property, plant and equipment	\$ 3,350	\$ 2,515	\$ 1,575	\$ 1,504	\$ 2,320
Equipment leased to others	\$ 1,726	\$ 1,409	\$ 1,011	\$ 968	\$ 1,566
Depreciation and amortization	\$ 2,813	\$ 2,527	\$ 2,296	\$ 2,336	\$ 1,980
Research and development expenses	\$ 2,466	\$ 2,297	\$ 1,905	\$ 1,421	\$ 1,728
As a percent of sales and revenues	3.7%	3.8%	4.5%	4.4%	3.4%
Wages, salaries and employee benefits	\$ 11,756	\$ 10,994	\$ 9,187	\$ 7,416	\$ 9,076
Average number of employees	127,758	113,620	98,554	99,359	106,518
December 31,					
Total assets	\$ 89,356	\$ 81,446	\$ 64,020	\$ 60,038	\$ 67,782
Long-term debt due after one year:					
Consolidated	\$ 27,752	\$ 24,944	\$ 20,437	\$ 21,847	\$ 22,834
Machinery and Power Systems	\$ 8,666	\$ 8,415	\$ 4,505	\$ 5,852	\$ 5,736
Financial Products	\$ 19,086	\$ 16,529	\$ 15,932	\$ 16,195	\$ 17,098
Total debt:					
Consolidated	\$ 40,143	\$ 34,592	\$ 28,418	\$ 31,631	\$ 35,535
Machinery and Power Systems	\$ 10,415	\$ 9,065	\$ 5,204	\$ 6,387	\$ 7,824
Financial Products	\$ 29,728	\$ 25,526	\$ 23,214	\$ 25,244	\$ 27,711

1. Computed on weighted-average number of shares outstanding.

2. Computed on weighted-average number of shares outstanding diluted by assumed exercise of stock-based compensation awards, using the treasury stock method.

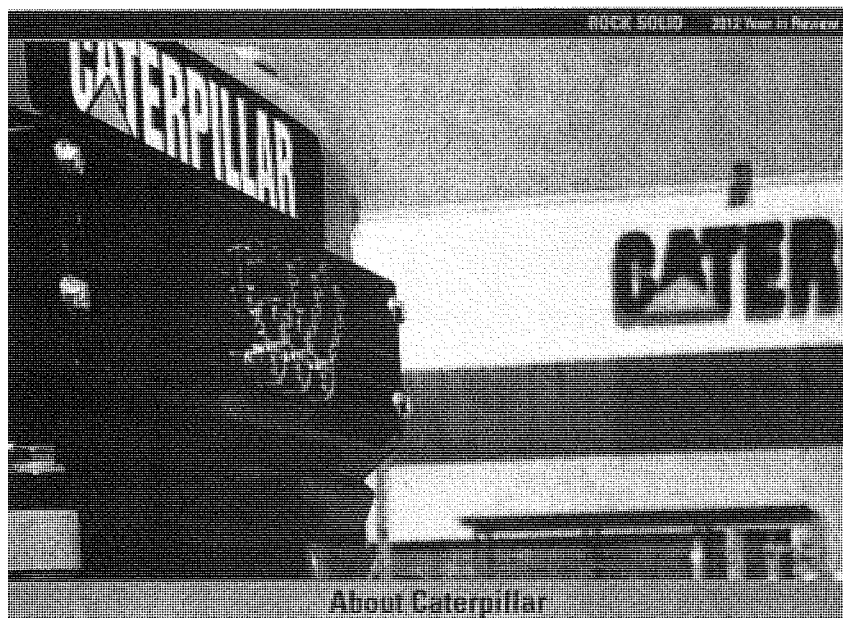
3. Represents profit divided by average stockholders' equity (beginning of year stockholders' equity plus end of year stockholders' equity divided by two).

4. Profit attributable to common stockholders.

5. Effective January 1, 2009, we changed the manner in which we accounted for noncontrolling interests. Prior periods have been revised, as applicable.

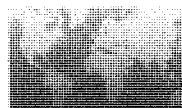
PSI-TWLF-34-000047

CATERPILLAR®



Business Overview

We are the world's leading manufacturer of construction and mining equipment, diesel and natural gas engines, industrial gas turbines and diesel-electric locomotives.



Global Snapshot

With offices and facilities that span six continents, our global reach is unmatched in the industry.



Leadership Team

Our officers and directors lead more than 125,000 employees around the world in executing our strategy.



The Caterpillar Foundation

Founded in 1952, the Caterpillar Foundation helps make sustainable progress possible around the world.

PSI-TWLF-34-000048


ROCK SOLID 2012 Year in Review

Business Overview

Caterpillar powers world progress. Cat® equipment — more than three million units around the world — is at work for our customers on highways, rail lines, oceans and rivers, in forests, quarries and oil fields. We supply the machines, solutions and support so our customers can excel under varying terrain, soil and climate conditions. Our engines and gas turbines provide the horsepower for customers to move goods and commodities across the globe, while generators deliver power wherever it is needed. Caterpillar manufacturing excellence is supplemented by world-class service businesses, supported by logistics, financial products and remanufacturing. More information about Caterpillar products, services and solutions can be found at www.cat.com.

Major Product Groups

Articulated Truck	Locomotive	Pipelay	Track-Type Tractor
Backhoe Loader	Material Handler	Scraper	Turbine
Compactor	Motor Grader	Skid Steer Loader	Underground Mining Vehicles
Engine	Off-Highway Truck	Surface Mining	Wheel Dozer
Forestry Machines	On-Highway Truck	Telehandler	Wheel Excavator
Generator Set	Paving Equipment	Track Loader	Wheel Loader
Hydraulic Excavator			

Major Industries Served

Demolition and Scrap	Industrial/OEM	Oil & Gas	Railroad
Forestry	Landscaping	Paving	Road Construction
General Construction	Logistics	Pipeline	Underground Utilities
Governmental	Marine	Power Generation	Waste Services
Heavy Construction	Mining	Quarry & Aggregate	

Major Service Areas

Customer Services	Locomotive & Railcar	Remanufacturing	Turbines
Financing	Maintenance and Repair	Rental	Training
Insurance	OEM Solutions	Safety	

Brands

Caterpillar Inc. owns a portfolio of brands. These brands help support our growth strategy and achieve our enterprise goals. The Caterpillar brand represents our corporation with the investment community, employees, public policymakers and other key stakeholders. Built on decades of performance, our portfolio of brands — including our primary public-facing brand name, Cat® — speaks quality, reliability and an assurance of the finest in design, engineering and customer service. For an overview of the Caterpillar brand portfolio, visit caterpillar.com/brands.

PSI-TWLF-34-000049



Global Snapshot



**Facilities include principal locations where manufacturing, parts distribution, call, and remanufacturing work takes place. In certain geographic areas, the facility symbol may represent multiple facilities.*



Executive Officers (Data based on 2012 year-end)

Doug Oberhelman, Chairman and CEO

Doug Oberhelman joined Caterpillar in 1975 and was elected a vice president in 1995. In 2002, he was elected a group president and became a member of Caterpillar's executive office. In October 2009, the Caterpillar Board of Directors named Mr. Oberhelman vice chairman and CEO-elect. During this time, he led a team that developed the future strategic plan for the company. Mr. Oberhelman was elected chief executive officer and a member of the board of directors effective July 1, 2010, and became chairman effective November 1, 2010.

Rich Lavin, Construction Industries

During 2012, Rich Lavin served as group president and executive office member of Caterpillar with responsibility for Construction Industries, which included the Earthmoving, Excavation, Building Construction Products, Europe/South America Operations and Caterpillar Japan Ltd. (CJL) divisions, as well as Global Construction & Infrastructure and China/India/ASEAN. Mr. Lavin retired at the end of 2012. His areas of responsibility have been assumed by Ed Rapp.

Stuart L. Levenick, Customer & Dealer Support

Stu Levenick is group president of Caterpillar with responsibility for Customer & Dealer Support, which includes Europe-Africa-Middle East (EAME), Americas and Asia-Pacific Distribution divisions, Remanufacturing & Components, Customer Services Support and Parts Distribution & Logistics.

Ed Rapp, CFO, Financial Products & Corporate Services

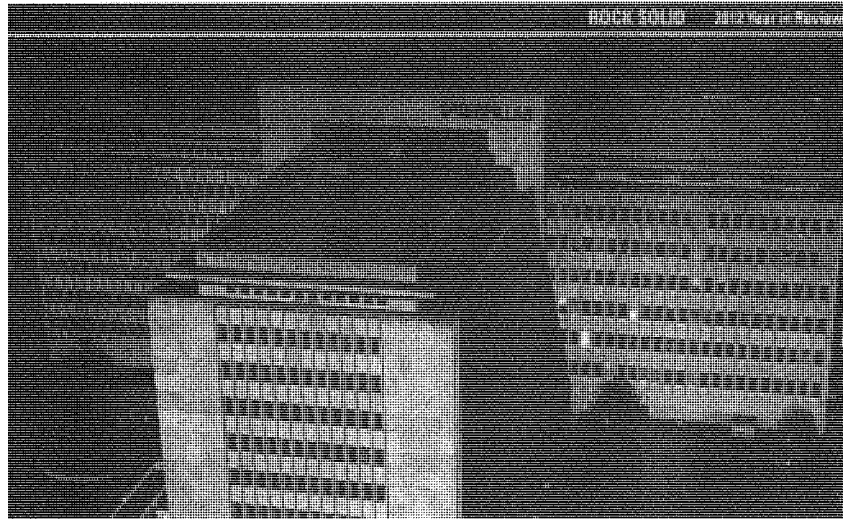
During 2012, Ed Rapp served as group president and CFO of Caterpillar with responsibility for the Finance Services, Human Services, Global Information Services, Global Purchasing and Financial Products divisions. He is also responsible for Strategy & Business Development, Corporate Auditing, Shared Services and Investor Relations. Effective January 1, 2013, Mr. Rapp became group president, Construction Industries, and Bradley Halverson was named CFO and group president.

Gerard Vittecoq, Energy & Power Systems

During 2012, Gerard Vittecoq served as group president of Caterpillar with responsibility for Caterpillar's Energy & Power Systems group, which includes the Industrial Power Systems & Growth Markets, Large Power Systems & Growth Markets, Marine & Petroleum Power, Electric Power, Progress Rail and Solar Turbines divisions. At the end of 2012, Mr. Vittecoq announced his upcoming retirement effective May 31, 2013. James Umpleby became group president responsible for Energy & Power Systems effective January 1, 2013.

Steve H. Wunning, Resource Industries

Steve Wunning is group president of Caterpillar with responsibility for the Resource Industries Group, which includes the Advanced Components & Systems, Diversified Products, Integrated Manufacturing Operations, Mining Sales & Support, Mining Products, and Product Development & Global Technology divisions.



Officers (Data based on 2012 year-end)

Chairman and Chief Executive Officer

Douglas R. Oberhelman

Group Presidents

Richard P. Lavin
Stuart L. Levenick
Edward J. Rapp
Gerard R. Vittecoq
Steven H. Wunning

Executive Vice President, Law and Public Policy

James B. Buda

Vice Presidents

Kent M. Adams
William P. Ainsworth
Mary H. Bell
Thomas J. Bluth
David P. Bozeman
Robert B. Charter
Frank J. Crespo
Christopher C. Curfman
Paolo Fellin
William E. Finerty
Steven L. Fisher
Gregory S. Folley
Thomas G. Frake
Stephen A. Gosselin
Hans A. Haefeli
Bradley M. Halverson
Kimberly S. Hauer
Gwenne A. Henricks
Kathryn Dickey Karol
Randy Krotowski
Stephen P. Larson
William J. Rohner
Mark E. Sweeney
D. James Umpleby, III
Tana L. Utley

Chief Financial Officer

Edward J. Rapp

Treasurer

Edward J. Scott

Chief Audit Officer

Matthew R. Jones

Chief Ethics and Compliance Officer

Christopher C. Spears

Controller and Chief Accounting Officer

Jananne A. Copeland

Corporate Secretary

Christopher M. Reitz

Assistant Treasurer

Robin D. Beran

Assistant Secretary

Patrick G. Holcombe
Joni J. Funk

PSI-TWLE-34-000052



Board of Directors

David L. Calhoun, 55

Chief executive officer (since May 2010) and a director (since January 2011) of Nielsen Holdings N.V. (marketing and media information) and chairman of the executive board and chief executive officer of The Nielsen Company B.V. (since September 2006). Prior to his positions at Nielsen, Mr. Calhoun served as vice chairman of General Electric Company and president and chief executive officer of GE Infrastructure. Other current directorships: The Boeing Company. Other directorships within the last five years: Medtronic, Inc. Mr. Calhoun has been a director of the Company since 2011.

Daniel M. Dickinson, 51

Managing partner of HCI Equity Partners (private equity investment). Other current directorships: MISTRAS Group, Inc. and HCI Equity Partners. Other directorships within the last five years: Progressive Waste Solutions Ltd. Mr. Dickinson has been a director of the Company since 2006.

Eugene V. Fife, 72

Managing principal of Vawter Capital, LLC (private investment). Mr. Fife served as the interim CEO and president of Eclipsys Corporation (healthcare information services) from April to November of 2005 and the nonexecutive chairman from 2001 until 2010, when Eclipsys merged with Allscripts Healthcare Solutions, Inc. Mr. Fife was formerly a partner of The Goldman Sachs Group, Inc., retiring in 1995. Other directorships within the last five years: Allscripts Healthcare Solutions, Inc. and Eclipsys Corporation. Mr. Fife has been a director of the Company since 2002 and retired from the board at the end of 2012.

Juan Gallardo, 65

Chairman and former CEO of Grupo Embotelladoras Unidas S.A.B. de C.V. (beverages and bottling). Other current directorships: Lafarge SA. Other directorships within the last five years: Grupo Mexico, S.A. de C.V. Mr. Gallardo has been a director of the Company since 1998.

David R. Goode, 71

Former chairman, president and CEO of Norfolk Southern Corporation (holding company engaged principally in surface transportation). Other current directorships: Delta Air Lines, Inc. and Texas Instruments Incorporated. Mr. Goode has been a director of the Company since 1993.

Jesse J. Greene, Jr., 67

Instructor at Columbia Business School in New York City, where he teaches corporate governance, risk management and other business topics at the graduate and executive education levels. He was formerly vice president of financial management and chief financial risk officer of International Business Machines Corporation (computer and office equipment). Mr. Greene has been a director of the Company since 2011.

Jon M. Huntsman, Jr., 52

Former United States Ambassador to China (2009-2011) and former governor of Utah (2005-2009). Other current directorships: Ford Motor Company and Huntsman Corporation. Mr. Huntsman has been a director of the Company since April 2012.

(continued)

PSI-TWLF-34-000053



Board of Directors (continued)

Peter A. Magowan, 70

Former president and managing general partner (1993-2008) of the San Francisco Giants (Major League Baseball team) and chairman (1980-1998) and chief executive officer (1980-1993) of Safeway Inc. (food retailer). Other directorships within the last five years: DaimlerChrysler AG. Mr. Magowan has been a director of the Company since 1993.

Dennis A. Muilenburg, 48

Executive vice president of The Boeing Company (aerospace/defense products and services) and president and chief executive officer of Boeing Defense, Space & Security since September 2009. Prior to his current position, Mr. Muilenburg was president of Boeing Global Services & Support (2008-2009) and vice president and general manager of the Boeing Combat Systems division (2006-2008). Mr. Muilenburg has been a director of the Company since 2011.

Douglas R. Oberhelman, 59

Chairman and chief executive officer of Caterpillar Inc. (machinery, power systems and financial products). Prior to his current position, Mr. Oberhelman served as vice chairman and chief executive officer-elect and as a group president of Caterpillar Inc. Other current directorships: Eli Lilly and Company. Other directorships within the last five years: Ameren Corporation. Mr. Oberhelman has been a director of the Company since 2010.

William A. Osborn, 65

Former chairman and CEO of Northern Trust Corporation (multibank holding company) and the Northern Trust Company (bank). Other current directorships: Abbott Laboratories and General Dynamics Corporation. Other directorships within the last five years: Nicor Inc., Tribune Company and Northern Trust Corporation. Mr. Osborn has been a director of the Company since 2000.

Charles D. Powell, 71

Chairman of Capital Generation Partners (asset and investment management), LVMH Services Limited (luxury goods) and Magna Holdings (real estate investment). Prior to his current positions, Lord Powell was chairman of Sagitta Asset Management Limited (asset management). Other current directorships: LVMH Moët-Hennessy Louis Vuitton and Textron Inc. Lord Powell has been a director of the Company since 2001.

Edward B. Rust, Jr., 62

Chairman, CEO and president of State Farm Mutual Automobile Insurance Company (insurance). He is also president and CEO of State Farm Fire and Casualty Company, State Farm Life Insurance Company and other principal State Farm affiliates, as well as trustee and president of State Farm Mutual Fund Trust and State Farm Variable Product Trust. Other current directorships: Helmerich & Payne, Inc. and The McGraw-Hill Companies, Inc. Mr. Rust has been a director of the Company since 2003.

Susan C. Schwab, 57

Professor at the University of Maryland School of Public Policy and a strategic advisor for Mayer Brown LLP. Prior to her current positions, Ambassador Schwab held various positions, including United States trade representative (member of the U.S. president's cabinet) and deputy United States trade representative. Other current directorships: FedEx Corporation and The Boeing Company. Ambassador Schwab has been a director of the Company since 2009.

Joshua I. Smith, 71

Chairman and managing partner of Coaching Group, LLC (management consulting). Other current directorships: Comprehensive Care Corporation, FedEx Corporation and The Allstate Corporation. Other directorships within the last five years: CardioComm Solutions Inc. Mr. Smith has been a director of the Company since 1993.

Miles O. White, 57

Chairman and chief executive officer of Abbott Laboratories (pharmaceutical and medical products). Other current directorships: McDonald's Corporation. Other directorships within the last five years: Motorola, Inc. and Tribune Company. Mr. White has been a director of the Company since 2011.



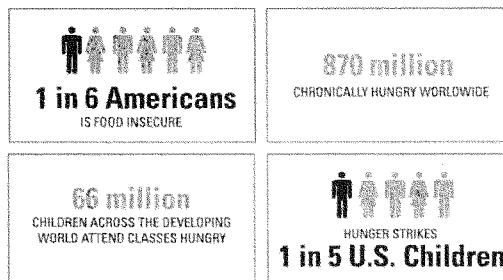
ROCK SOLID 2012 Year in Review

The Caterpillar Foundation

The Caterpillar Foundation reflects the philanthropic efforts of Caterpillar Inc. Founded in 1952 by Caterpillar, the Caterpillar Foundation has contributed more than \$550 million to help make sustainable progress possible around the world by providing program support in the areas of environmental sustainability, access to education and basic human needs. To learn more about the Foundation's investments, please visit caterpillar.com/foundation.

Food

In the U.S. and around the world, the Caterpillar Foundation invests in many programs focused on ensuring disadvantaged populations have enough to eat.



WORLD FOOD PROGRAMME

The World Food Programme (WFP) operates school meal programs in 60 countries. In the poorest nations, this program has shown to as much as double primary school enrollment and greatly equalizes gender disparities. With support from the Caterpillar Foundation, WFP reaches about **22 million** children annually.

FEEDING AMERICA

Feeding America's network of over 200 food banks across the United States will serve **8 million** meals because of the Caterpillar Foundation's investment.

Water

For many, fresh, clean water is not as simple as turning on the tap. The Caterpillar Foundation supports organizations that are striving to bring potable water to those in need.

CHARITY: WATER

Since 2010, charity: water has funded **6,994 water projects in 20 countries**. These well and filtration system projects in Southeast Asia and Africa will serve more than 2.5 million people. In 2012, the Caterpillar Foundation provided support for their work in Tanzania, Liberia and Malawi.

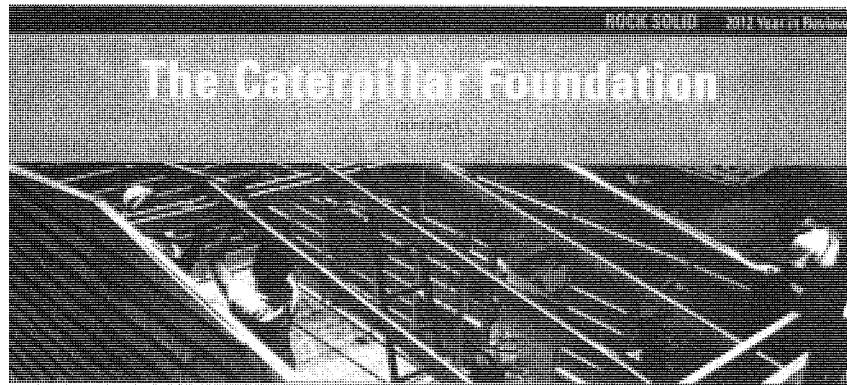


WATER.ORG

Water.org works to provide microloans for clean water access and the construction of household sanitation facilities. The Caterpillar Foundation's investment in Water.org has helped thousands of people in India gain access to fresh water and the dignity of sanitation facilities.

PSI-TWLF-34-000055

CATERPILLAR®



Shelter

The Caterpillar Foundation works with a number of organizations specializing in providing those in need with temporary, transitional and permanent housing.

HABITAT FOR HUMANITY

60,000+

affordable homes built since 1976

REBUILDING TOGETHER

\$25,000

provided to provide food, shelter, clothing, and other necessities

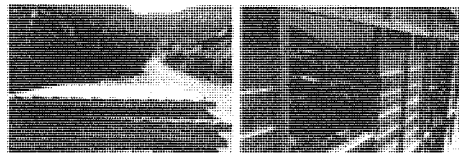
AMERICAN RED CROSS



the world's largest relief organization, dedicated to disaster relief and emergency assistance

TECHO

	<p>of</p> <p>19 Latin American Countries</p> <p>TECHO provides transitional housing for the poor in Latin America, the Caribbean, and Central America.</p>	<p>245,000 volunteers</p>	<p>50,000 transitional homes</p>	<p>200,000 people in need</p>
--	------------------------------------------------------------------------------------------------------------------------------------------------------------	---------------------------	----------------------------------	-------------------------------



PSI-TWLF-34-000056

Caterpillar Inc.
100 N. Adams Street
Peoria, Illinois 61629 USA
1 (309) 675-4000

CATERPILLAR[®]

LEADERSHIP • EXECUTIVE OFFICERS

REALIZING VALUE THROUGH THE LIFE CYCLE

Our Business Model is the foundation of our success and, like everything we do, it begins and ends with the customer. We win by delivering valued, quality products, services and solutions that provide the lowest total owning and operating life cycle costs to our customers. This value proposition, enabled by our unmatched customer support, creates the largest global field population, highest customer loyalty and most attractive profitability through the business cycle.

Our ability to help our customers maximize the return they get from the products, services and solutions we provide is one of the fundamentals of our business. Unlike our competition, the initial sale of a Caterpillar product is only the beginning of the product life cycle value opportunities.

A strong focus on aftermarket parts and service is a vital element in all three phases of our Business Model. We SEED the business with great products, services and unique solutions that meet our customers' needs and support their businesses. We understand what customers value, then design and build products and solutions with these values in mind. We take a life cycle perspective during product development. Caterpillar's differentiated and proprietary parts are a key part of that equation.

We GROW the business by building the largest global field population of products. This large field population helps us sell parts and services, which leads to increased customer loyalty. To get there, we take advantage of rental and used equipment sales opportunities, as well as new machine sales.

By supporting our customers over the long run, we HARVEST the opportunities we create in the SEED and GROW phases of our Business Model. We seize parts and services opportunities and provide our customers with the solutions they value throughout the life cycle – whether they are the first, second or third owner of the equipment.

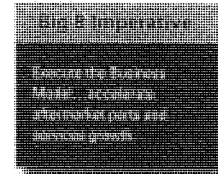
To efficiently execute the Business Model, we've established our new Customer & Dealer Support Organization to bring strong focus to aftermarket parts and customer services and to deliver outstanding dealer development. For the first time, this new organization brings together the primary divisions that are fundamental to the execution of our Business Model.

On behalf of our strategic businesses, Customer & Dealer Support will drive the actions necessary to grow our Cat parts sales and services opportunities. This includes substantial design/manufacturing, distribution, planning/support, dealer development and sales execution responsibilities related to Cat parts.

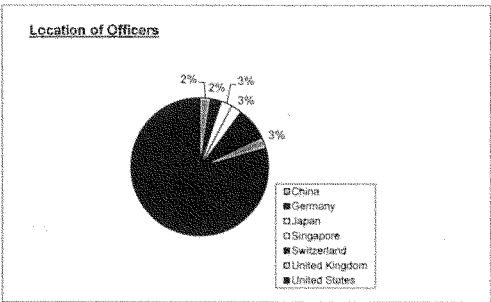
We have the right Business Model and the right team in place to execute.

**Stu Levenick**

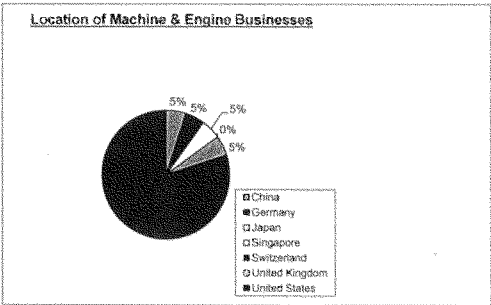
Levenick joined Caterpillar as a sales and marketing development representative in 1977 and brings a strong background in marketing and general management as well as broad global experience from the United States, Canada, Russia, Asia Pacific and Japan. After serving in various management positions in marketing, commercial management and product source planning, he became a division manager in 1989, regional manager for Cat Asia Pte. Ltd. in 1995 and general manager for company operations in the Commonwealth of Independent States (CIS) in 1998. Prior to becoming group president in 2004, he served as vice president of Caterpillar's Asia Pacific Division and chairman of Shin Caterpillar Mitsubishi Ltd. (SCM) – now Caterpillar Japan Ltd. (CJL).



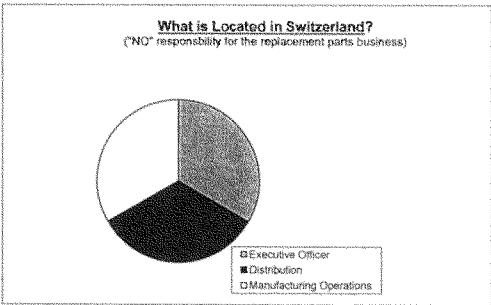
China	1
Germany	1
Japan	1
Singapore	1
Switzerland	3
United Kingdom	1
United States	31
	<u>39</u>



China	1
Germany	1
Japan	1
Singapore	1
Switzerland	1
United Kingdom	1
United States	16
	<u>20</u>



Executive Officer	1
Distribution	1
Manufacturing Ops	1
	<u>3</u>



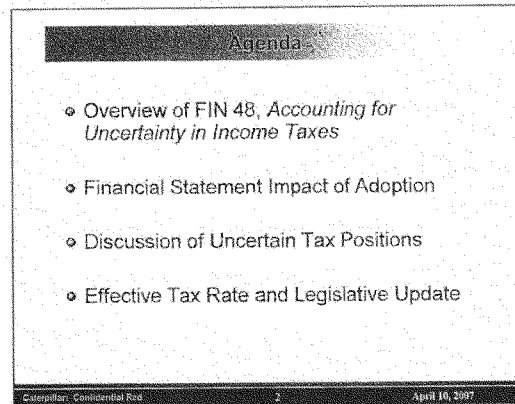
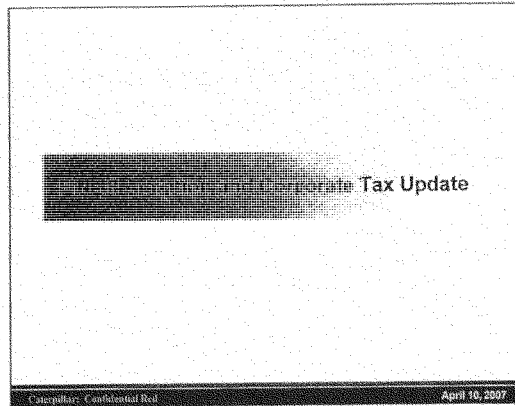
Supply Chain and Parts business

Larson	Logistics	US
Murphy	Purchasing	US
Beeler	Marketing & Product Supp	US

Audit Committee
Presentation April 2007

370-23

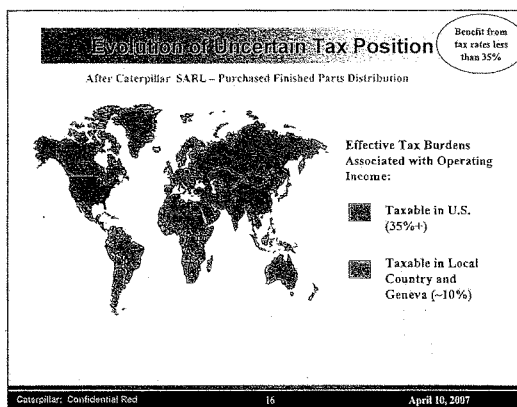
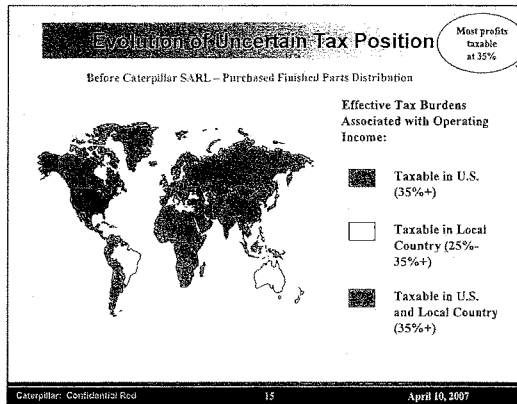
COPY



**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

Tax Reserves by Type			
Millions of USD			
Reserve Category	12/31/2006	FIN 48 Adoption	1/1/2007
CSARL	\$184	(\$135)	\$49
Transfer Pricing	125	(17)	108
<p>Redacted By The Permanent Subcommittee on Investigations</p>			
<p>Caterpillar: Confidential Red 13 April 10, 2007</p>			

Tax Reserves by Type			
Millions of USD			
Reserve Category	12/31/2006	FIN 48 Adoption	1/1/2007
CSARL	\$184	(\$135)	\$49
Transfer Pricing	125	(17)	108
<p>Redacted By The Permanent Subcommittee on Investigations</p>			
<p>Caterpillar: Confidential Red 14 April 10, 2007</p>			



Caterpillar SARL Tax Reserves

CSARL reserves
before FIN 48

(in millions USD)

Year	12/31/2006
1999	2
2000	15
2001	15
2002	15
2003	33
2004	33
2005	41
2006	30
Total	184

- A new arrangement with many internal transactions
 - Pricing of products and services between CSARL and Cat Inc. and other subsidiaries
 - Use of intellectual property, including trademark, by CSARL
- Numerous internal transactions considered "untested"
 - Reserves focused on royalty for intellectual property
 - Calculations consistent once methodology established

Caterpillar: Confidential Res

17

April 10, 2007

Caterpillar: Confidential Red

17

April 10, 2007

Caterpillar SARL Tax Reserves

CSARL reserves after
FIN 48

(in millions USD)

Year	FIN 48 Adoption
1999	2
2000	2
2001	4
2002	6
2003	6
2004	6
2005	11
2006	12
Total	49

- FIN 48 requires a re-evaluation based on settlement position
- Comfort has increased over time
 - With 6 years of history, analysis shows stable comparables and range of profitability is consistent within accepted range
- Largest benefit likely to sustain is 95% of total

Caterpillar: Confidential Red

13

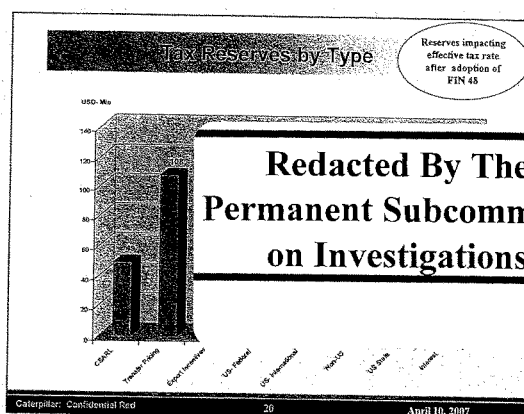
April 10, 2007

Caterpillar: Confidential Red

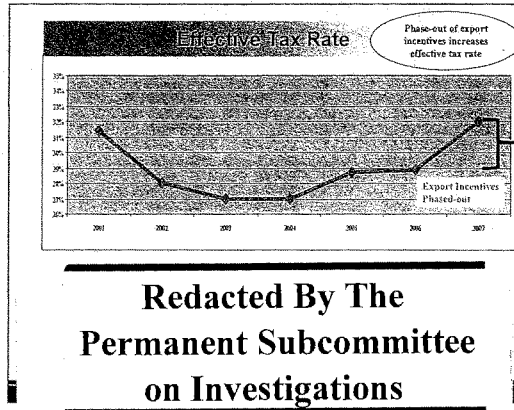
18

April 10, 2007

**Redacted By The
Permanent Subcommittee
on Investigations**



**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**



Benchmark Tax Rate

Rank due to export benefits and earnings in low-tax jurisdictions

Dow 30	2006	2005	Rank	Competitors	2006
DuPont de Nemours	1.8%	21.3%	1		
Hewlett-Packard Co.	13.8%	22.3%	2		
Pfizer Inc.	16.3%	25.4%	3	Calsonic Chrysler	17.2%
General Electric Co.	16.1%	17.8%	4	Johnson & Johnson	17.8%
Coca-Cola Co.	22.8%	27.2%	5		
Johnson & Johnson	24.2%	23.2%	6	Oracle	24.0%
Alcoa Inc.	24.3%	23.0%	7		
Honeywell Int'l Inc.	25.1%	31.9%	8		
China Group, Inc.	25.3%	28.9%	9		
United Technologies Corp.	27.2%	26.8%	10		
Citigroup Inc.	27.3%	30.8%	11	Sunshine	27.8%
Intel Corp.	28.0%	31.3%	12		
Merck & Co. Inc.	28.1%	27.1%	13		
Caterpillar Inc.	28.8%	28.0%	14	Caterpillar Inc.	28.8%
International Bus. Machs.	29.0%	35.0%	15	Comcast	28.9%
Johnson & Johnson	30.0%	26.2%	16		
Procter & Gamble Co.	30.0%	30.8%	17		
American International Group	30.1%	28.0%	18		
IBM Corp.	30.8%	33.7%	19		
Bombard Co.	30.9%	31.1%	20		
Microsoft Corp.	31.0%	26.3%	21		
McDonald's Corp.	31.0%	29.6%	22	PARSONS INC.	31.2%
P.F. Muller Chocolate & Co.	31.4%	30.2%	23		
AT&T Inc.	32.4%	16.3%	24		
Verizon Communications, Inc.	32.8%	28.7%	25	Dynex & Co.	34.1%
Qualcomm Inc.	34.1%	34.7%	26		
Walt Disney Co.	34.1%	31.1%	27	Twitter Corp.	35.0%
Home Depot Inc.	37.3%	37.1%	28		
Exxon Mobil Corp.	43.0%	41.4%	29		
General Motors	56.0%	35.0%	30		

Calcpillar: Confidential Red 31 April 10, 2007

Legislative Update

Proactive participation
has large, quantifiable
ROI for Cat

- Extension of R&D Credit
- Pending IRS Notice regarding Tolling and Contract Mfrg.
- Expiry of Active Finance exception to "Subpart F"
- Likely Codification of Business Purpose & Economic Substance
- Possible Executive Deferred Compensation changes
- Threats to repeal LIFO and "Deferral"
- Numerous Illinois tax increases -- especially new Gross Receipts Tax
- German and UK Tax Rate Reduction

Caterpillar: Confidential Red
25
April 10, 2007

COPY

Summary

- ♦ Determination of tax reserves requires significant judgment
 - FIN 48 provides consistent framework
 - Expect more volatility in effective tax rate as settlement positions more subject to change
- ♦ Effective tax rate increasing in 2007
- ♦ Proactively participating in legislative actions

Caterpillar: Confidential Red
26
April 10, 2007

Caterpillar Inc
CSARL Permanent File
Chronological History: 1999-2010

Executive Summary

The following document is intended to provide a summary of the Caterpillar SARL (CSARL) operating and legal structure.

Background on CSARL Legal Entity Structure

CSARL is a Swiss SARL legal entity that is treated as a corporation for Swiss tax purposes and a partnership for US tax purposes. There are six legal entities that are partners in CSARL. The use of a partnership structure for US tax purposes followed a careful deliberation which concluded a partnership form of business best reflected the operational structure and economic results of the underlying Caterpillar business. A diagram of the CSARL legal entity structure (CSARL structure) and a list of the various CSARL classes of interest are included as Appendix 1. The structure of the partnership, the economic effect of the contributions, and the contribution of each business was incorporated into the CSARL Joint Venture Agreement (JV Agreement). A copy of the most recent version of the JV Agreement is included as Appendix 2.

Background on the CSARL Operating Model

CSARL operates as a "principal company" with responsibility for managing the non-US Caterpillar business enterprise, including the machines and purchased finished replacement parts (Parts) businesses. The CSARL operating structure contains numerous discrete, yet interdependent, activities. It is the aggregation of these activities which allows CSARL to create economic value. In other words, each of these businesses would not be successful without one another and each of the businesses is successful only if the others are successful. For example, the sale of replacement parts is dependent upon the sale of machines and the sale of machines is equally dependent upon the ability to sell replacement parts. Each of these interrelated businesses is represented by a particular class of partnership interest.

Business Purpose for the CSARL Operating Model

During 1999, the business processes at Caterpillar were reviewed as part of a program of continuous improvement to evaluate their efficiencies and overall contribution to the effectiveness of the enterprise. The review process of the Parts business identified potential changes in the purchasing and sales functions that could enhance the competitiveness of Caterpillar. The changes proposed were in response to several factors inherent in the Caterpillar business model, including:

- 1) The increasing globalization of the company. At the time of the review, 50% of net revenue in the business was attributable to non-US sources. This percentage was expected to increase to 70% of total worldwide net revenue by 2010;

Last Updated: February 16, 2010

CONFIDENTIAL

PwC-CAT-00001576

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00003406

- 2) The increasing globalization of the customer base of Caterpillar. Customers tend to favor relationships with suppliers presenting a global face to the market, rather than a US centric approach;
- 3) The increasing globalization of the supplier base of the company. Caterpillar historically sourced its parts supply from a broad global marketplace. Managing parts supply relationships locally increases logistics, efficiency, quality and price; and
- 4) A critical need to remove unnecessary cost from the Caterpillar supply chain.

The aforementioned changes proposed to the Parts supply chain related principally to the appointment of CSARL as the worldwide purchaser of Parts (hereafter referred to as the "Parts Planning"). The Parts Planning reflected the importance of the non-US parts business and removed unnecessary costs from the acquisition process for Parts. Under revised procedures, *the legal relationships* were changed such that CSARL began purchasing all global demand for Caterpillar Parts from third party suppliers for eventual sale to third party dealers. The result of this was an absence of any related party in the legal title flow for Parts. Consistent with the change in legal relationships, *the intercompany financial relationships* of CSARL were modified to properly reflect the arms length value of its increased functions and risks, as well as existing valuable marketing intangibles. Appropriate transfer prices and fees between CSARL and Caterpillar related entities were established. Finally, an accommodating *legal entity structure* to encompass the Parts Planning was developed. Key aspects of the Parts Planning which required changes in the existing legal entity structure included:

- 1) The consolidation of the existing business activities of Caterpillar Overseas SA ("COSA") and Caterpillar Commercial SARL ("CCSARL") into a single legal entity: CSARL (the former CCSARL legal entity);
- 2) The addition of responsibility for worldwide replacements parts purchasing activities to CSARL;
- 3) The incorporation of existing branches in Spain and Belgium;
- 4) The "tracking" of income associated with the distribution, licensing and entrepreneurial business activities of the consolidated legal entity;
- 5) The transfer by COSA of an existing branch in Singapore to CSARL; and
- 6) The establishment of regional marketing subsidiaries for other non-US territories of CSARL.

Last Updated: February 16, 2010

CONFIDENTIAL

PwC-CAT-00001577

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00003407

As previously mentioned, CSARL was reconstituted to serve as the "entrepreneur" for the European business, including assuming the functions, risks and intangibles consistent with this role. Four commercial activities which CSARL began engaging in at this time within the European region included:

- 1) Marketer and distributor of Caterpillar manufactured prime product and replacement parts;
- 2) Entrepreneur for replacement parts produced by outside suppliers under contract with CSARL pursuant to a license from Caterpillar;
- 3) Entrepreneur for replacement parts produced by Caterpillar France SA ("CAT France") and Caterpillar Belgium SA ("CAT Belgium") pursuant to a license from Caterpillar;
- 4) Entrepreneur for prime product, components & replacement parts manufactured under contract manufacturing arrangements for F2000, Forestry Products, Articulated Truck and other specified business units.

As the Caterpillar global business model evolved after 1999, the CSARL operating and legal structure similarly evolved to remain consistent with Caterpillar's strategic objectives. Specifically, a series of operational restructurings occurred since the creation of the initial CSARL structure in 1999. A summary of the operational restructurings is listed below:

1. European Parts and Parts 2000	September 1, 1999
2. EAME Reorganization	January 1, 2001
3. 2001 Parts Initiative – Latin America (CAmSARL)	December 1, 2001
4. Inventory Tracking and Accounting Systems (ITAS)	July 1, 2002
5. 2002 Parts Initiative – Canada (CNAmsARL)	September 1, 2002
6. Asia Pacific Division 2002	January 1, 2003
7. U.S. Dealers – Direct Sales	May 1, 2003
8. Asia Pacific Division 2003	June 1, 2003
9. Caterpillar Brazil Ltda. (CBL) Legal Entity Alignment	December 1, 2005
10. Dutch CV Planning	December 1, 2007
11. CBL Business Alignment	March 1, 2010

A separate target design document was prepared and reviewed for each of these restructurings and was subject to QRM review procedures. The target design summary generally included (1) a description of the change in the business model serving as the catalyst for the restructuring, (2) the operational model before and after the restructuring, (3) the legal structuring steps required to implement the operational changes, (4) a list of the legal agreements necessary for the restructuring, and (5) transfer pricing considerations.

Redacted – Caterpillar Inc. Privilege

Redacted – Caterpillar Inc. Privilege

Last Updated: February 16, 2010

CONFIDENTIAL

PwC-CAT-00001578

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00003408

Redacted – Caterpillar Inc. Privilege

Tax Result of CSARL Operating Model

As previously mentioned, in order to manage the non-US Caterpillar business enterprise, CSARL contractually assumed various business and economic risks, performed the key entrepreneur functions, and licensed the economic ownership of the intangibles related to the non-US business. As such, CSARL was, and continues to be, characterized as the "entrepreneur" of the non-US business for the Caterpillar enterprise. Consistent with these facts, the sales income related to the non-US business was aligned with the CSARL operating model and, consequently, the sales income was subject to Swiss income tax in accordance with the terms of a Swiss tax ruling. The Swiss tax ruling was obtained by Caterpillar through negotiations with the Swiss tax authorities after an agreement was reached on headcount and local investment which Caterpillar committed to place in Geneva, Switzerland. In other words, the benefits of the tax ruling are achieved through the creation of operational substance consistent with the terms required by the Swiss tax authority. Moreover, this operational substance must be maintained throughout the effective period of the ruling. A copy of this ruling is included as Appendix 3. Lastly, it should be noted that while the majority of the aforementioned sales income is only subject to current tax in Switzerland, a material amount of the sales income since implementation of the CSARL structure has also been subject to current US taxation under the Subpart F rules. Accordingly, such income has been subject to "double taxation" under both Switzerland and US tax laws.

Review of CSARL Operating Model

Caterpillar is able to record an annual tax and financial statement benefit for the CSARL structure only to the extent the legal and operating model is properly maintained.

Broadly speaking, proper maintenance of the CSARL structure requires managing the following potential risk areas:

- 1) US tax deferral: ensuring legal title flow for product sold by CSARL is characterized as "unrelated-to-unrelated" for US tax purposes. By doing so, such sales income can be deferred from current US taxation.
- 2) Transfer pricing: ensuring the CSARL profit alignment is supportable from a local country transfer pricing perspective and under US transfer pricing principles summarized in IRC Sec. 482.
- 3) Permanent establishment: ensuring the operating substance for the non-US business is centralized within CSARL to avoid a taxable presence outside of Switzerland.

Caterpillar has developed and institutionalized processes to annually review the CSARL operating model for these areas. These processes focus on ensuring (a) the CSARL operating model continues to maintain the appropriate level of entrepreneurial substance

Last Updated: February 16, 2010

CONFIDENTIAL

PwC-CAT-00001579

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00003409

to manage the aforementioned three areas and (b) all known risks related to the CSARL structure have been recognized and measured. These processes include:

- 1) Quarterly review meetings by the Caterpillar Corporate Tax and CSARL European Tax groups are held to analyze the tax, financial, and transfer pricing results of the CSARL operating structure. These meetings have been held since the inception of the CSARL structure in 1999.
- 2) Quarterly provision reviews and FIN48 analysis are prepared by Caterpillar and reviewed by PwC to ensure all material exposures have been identified and quantified. Several uncertain tax positions (UTPs) in the FIN48 analysis relate either the CSARL structure or related transfer pricing issues. The FIN48 analysis memorandums for these UTPs should be viewed as supplemental documentation to this memo.
- 3) A post-implementation review of the CSARL operating model was performed in 2007 by Caterpillar Corporate Tax. The focus of the review was the CSARL operational substance and whether the operational substance at that time of the review was sufficient to support the tax positions being taken by Caterpillar. An ability to affirm the operational substance directly correlates Caterpillar's ability to manage the three aforementioned risk areas. The conclusion of the report was sufficient substance was maintained by CSARL such material exposure should not exist.

Conclusion

For the aforementioned reasons, PwC has maintained a high level of comfort that not only the implementation but also the annual maintenance of the CSARL operating model has been compliant with US and non-US tax and transfer pricing rules. Moreover, PwC also has a high level of comfort that the annual documentation should provide sufficient support for the resulting tax and financial benefits.

Last Updated: February 16, 2010

CONFIDENTIAL

PwC-CAT-00001580

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00003410

CSARL Legal Structuring (cont.)

- A** Purchased finished parts (exclusive of reallocated purchased finished parts and G Parts)
- B** Worked parts and prime product (including reallocated purchased finished parts)
- C** Forest products, compact equipment, articulated trucks, MAK engines, and drag line buckets
- D** Historic COFA, China and Singapore activities, (exclusive of purchased finished parts and SCM completed product and sub-assemblies)
- E** SCM completed prime product and sub-assemblies (exclusive of parts)
- F** Manufactured prime product, components and parts from CBSA and CFSA
- G** Purchased finished parts for Asia Pacific Division

H CBL-manufactured Machines (RPM)

CSARL 2009 activities
PricewaterhouseCoopers

January 2010
Slide 38

CONFIDENTIAL

PwC-CAT-00001582

Confidential Treatment Requested by PwC

PwC_PSL_CAT_00003412

**THIRD AMENDED AND RESTATED CATERPILLAR SARL
JOINT VENTURE AGREEMENT**

THIS THIRD AMENDED AND RESTATED CATERPILLAR SARL JOINT VENTURE AGREEMENT of 1 November 2009 (the "Third Restated JV Agreement") is by and among **Caterpillar Commercial Holding SARL**, a société a responsabilité limitée organized under the laws of Switzerland, formerly known as "Caterpillar Commercial Holding S.A." ("CCH"), **Caterpillar Overseas Credit Corporation SARL**, a société a responsabilité limitée organized under the laws of Switzerland, formerly known as "Caterpillar Overseas Credit Corporation S.A." ("COCCSARL"), **Caterpillar Overseas Investment Holding SARL**, a société a responsabilité limitée organized under the laws of Switzerland ("COIHSARL"), **Caterpillar Product Development SARL**, a société a responsabilité limitée organized under the laws of Switzerland ("CPDSARL"), **Caterpillar Asia Pacific L.P.**, a limited partnership organized under the laws of Bermuda ("CAPLP"), and **Caterpillar International Product SARL**, a société a responsabilité limitée organized under the laws of Switzerland ("CIPSARL").

Recitals

Whereas, Caterpillar Overseas SARL, a société a responsabilité limitée organized under the laws of Switzerland, formerly known as "Caterpillar Overseas S.A." ("COSARL"), CCH, COCCSARL and COIHSARL entered into the Caterpillar SARL Restated Joint Venture Agreement of 1 December 2001 (the "JV Agreement");

Whereas, effective 19 December 2002, COSARL, CCH, COCCSARL, COIHSARL and CPDSARL entered into the First Amendment to Caterpillar SARL Restated Joint Venture Agreement (the "First Amendment") to reflect (among other things) certain transfers by CCH and the admission of CPDSARL as a Partner in Company;

Whereas, effective 23 December 2002, CCH, COCCSARL, COIHSARL and CPDSARL entered into the Second Amendment to Caterpillar SARL Restated Joint Venture Agreement (the "Second Amendment"), to reflect (among other things) certain transfers by COSARL, and the withdrawal of COSARL as a Partner in the Company;

Whereas, effective 1 January 2003, CCH, COCCSARL, COIHSARL, CPDSARL and CAPLP entered into the Third Amendment to Caterpillar SARL Restated Joint Venture Agreement (the "Third Amendment") in connection with the realignment of the Asia Pacific operations of Caterpillar Inc., a corporation incorporated under the laws of the State of Delaware, United States ("CAT"), and the admission of CAPLP as a Partner in the Company;

Whereas, in or about November 2005, CCH and COCCSARL each converted from a société anonyme to a société a responsabilité limitée under the laws of Switzerland;

Whereas, effective 1 December 2005, CCH, COCCSARL, COIHSARL, CPDSARL and CAPLP entered into the Fourth Amendment to Caterpillar SARL Restated Joint Venture Agreement (the "Fourth Amendment") in connection with the further realignment of the Asia Pacific operations of CAT and the foregoing entity conversions by CCH and COCCSARL;

Whereas, effective 1 December 2005, CCH, COCCSARL, COIHSARL, CPDSARL and CAPLP entered into the Second Amended and Restated Caterpillar SARL Restated Joint Venture Agreement (the "Second Restatement") in connection with (i) sales by the Company of certain business lines within the Class C Company Activity and (ii) the minimal amount of Company treasury functions formerly known as "Class D Treasury Functions" and the Partners' desire to optimize the Company's overall treasury functions, and to reflect clarifications of, and corrections to, the CSARL JV Agreement as so amended and consolidate such amendments in a single document; and

Whereas, as a result of CAT's recent, global business realignment initiative, the Partners now desire to amend and restate the Second Restatement to, among other things, approve and authorize the (i) admission of CIPSARL as a Partner in the Company, (ii) modification of the Class H Company Activity, and (iii) assignment of all of CCH's Company Activity Percentage Interest in the Class H Company Activity to CIPSARL.

NOW, THEREFORE, in consideration of the mutual covenants and agreements set forth herein and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, CCH, COCCSARL, COIHSARL, CPDSARL, CAPLP and CIPSARL hereby amend and restate the JV Agreement (as amended by the First Amendment, Second Amendment, Third Amendment, Fourth Amendment and Second Restatement) effective as of the date first set forth above.

ARTICLE 1 DEFINITIONS

Section 1.1 Definitions. The following capitalized terms shall have the following meanings:

"Accounting Manual" has the meaning set forth in Section 4.5.

"Affiliate" means, as to any Person, any other Person that directly, or indirectly through one or more intermediaries, controls or is controlled by or is under common control with such Person. For purposes of this definition, "control" of a Person means the power, direct or indirect, to direct or cause the direction of the management and policies of such Person whether by contract or otherwise and, in any event, any Person owning more than 50% of the voting securities of another Person shall be deemed to control that Person.

"APD Territory" means the following territories associated with the Company's Singapore branch: American Samoa, Australia, Bangladesh, Bhutan, Cambodia, Fiji Islands, Hong Kong, India, Indonesia, Lao PDR, Malaysia, Mongolia, Myanmar, Nepal, New Caledonia, New Zealand, Papua New Guinea, People's Republic of China, Philippines, Republic of China (Taiwan), Singapore, Solomon Islands, South Korea, Sri Lanka, Tahiti, Thailand, Tonga and Vietnam.

"Articles of Association" means the Articles of Association of the Company originally registered with the Commercial Register in Geneva, Switzerland, on 14 July 1997, as amended on 1 September 1999, and as they may be further amended from time-to-time.

"Book Depreciation or Amortization" means depreciation or amortization with respect to Section 704(c) Property in an amount equal to (x) such depreciation or amortization as computed for United States federal income tax purposes multiplied by (y) a fraction (i) the numerator of which is the fair market value of such Section 704(c) Property on the date of its contribution to the Company and (ii) the denominator of which is the basis of such Section 704(c) Property for United States federal income tax purposes on the date of its contribution to the Company; and in the case of any Section 704(c) Property having a zero tax basis for income tax purposes, the fair market value of such property shall be depreciated at the rate that would be used for United States federal income tax purposes if such property's basis for United States federal income tax purposes were more than zero.

"Brazil Territory" means the territory of the Federative Republic of Brazil.

"Business Day" means a day on which banks are generally open for business in Switzerland.

"CAPLP" has the meaning set forth in the introductory paragraph of this Third Restated JV Agreement, which entity has elected, under section 301.7701-3 of the Regulations, to be treated as an association taxable as a corporation for United States federal income tax purposes.

"CAT" has the meaning set forth in the fourth recital of this Third Restated JV Agreement.

"CCH" has the meaning set forth in the introductory paragraph of this Third Restated JV Agreement.

"Changed Company Activity" has the meaning set forth in Section 3.2(a).

"CIPSARL" has the meaning set forth in the introductory paragraph of this Third Restated JV Agreement.

"Class A Company Activity" means the assets and activities described on Exhibit A attached to this Third Restated JV Agreement.

"Class B Company Activity" means the assets and activities described on Exhibit B attached to this Third Restated JV Agreement.

"Class B Treasury Functions" means the following functions performed by the Class B Company Activity: cash management, accounts receivable management, provision of foreign exchange, currency risk management, financial analysis, and control and reporting for past due accounts, contingent liabilities and country exposure functions performed by the Class B Company Activity for the Company Activities and certain Affiliates of the Company, management of pension funds, borrowing and investment of funds, the funding of cash requirements of Company Activities as contemplated by Section 2.2(d), and other similar functions.

"Class B Treasury Functions Aggregate Net Preferred Income" means for any Fiscal Year (or other period agreed by the Partners) the sum of the Class B Treasury Functions Net

Preferred Income of all Company Activities (other than the Class B Company Activity) having Class B Treasury Functions Net Preferred Income for such Fiscal Year (or such other period agreed by the Partners).

"Class B Treasury Functions Company Activity Priority Gross Profit Shortfall" has the meaning set forth in Section 3.1(b)(ii).

"Class B Treasury Functions Monthly Cash Balance" means the positive cash balance of the Class A Company Activity, Class C Company Activity, Class D Company Activity, Class E Company Activity, Class F Company Activity, Class G Company Activity or Class H Company Activity, as applicable, as of the close of business on the last day of each month.

"Class B Treasury Functions Monthly Cash Deficit" means the negative cash balance of the Class A Company Activity, Class C Company Activity, Class D Company Activity, Class E Company Activity, Class F Company Activity, Class G Company Activity or Class H Company Activity, as applicable, as of the close of business on the last day of each month.

"Class B Treasury Functions Net Preferred Income" means for each Fiscal Year (or other period agreed by the Partners) for each Company Activity (other than the Class B Company Activity) the excess, if any, of the Class B Treasury Functions Preferred Income of each such Company Activity for such Fiscal year (or such other period) over the Class B Treasury Functions Priority Expense of each such Company Activity for such Fiscal year (or such other period).

"Class B Treasury Functions Net Preferred Income Shortfall" means for each Fiscal Year (or other period agreed by the Partners) for each Company Activity (other than the Class B Company Activity) the excess of the Class B Treasury Functions Preferred Income of each such Company Activity for such Fiscal Year (or such other period) over the amount of Priority Gross Profit of the Class B Company Activity allocated to of each such Company Activity under Section 3.1(a)(i) for such Fiscal Year (or such other period).

"Class B Treasury Functions Net Priority Expense" means for each Fiscal Year or other period agreed by the Partners) for each Company Activity (other than the Class B Company Activity) the excess, if any, of the Class B Treasury Functions Priority Expense of each such Company Activity for such Fiscal year (or such other period) over the Class B Treasury Functions Preferred Income of each such Company Activity for such Fiscal year (or such other period).

"Class B Treasury Functions Preferred Income" means for each Fiscal Year (or other period agreed by the Partners) for each Company Activity (other than the Class B Company Activity) having Class B Treasury Functions Preferred Monthly Income for such Fiscal Year (or other period agreed by the Partners) the sum of the Class B Treasury Functions Preferred Monthly Income of each such Company Activity for such Fiscal Year (or such other period).

"Class B Treasury Functions Preferred Monthly Income" means for each Company Activity (other than the Class B Company Activity) the product of multiplying (x) the amount of Class B Treasury Functions Monthly Cash Balance, if any, of each such Company Activity as of

the close of business on the last day of each month by (y) the Monthly Percentage applicable to such month.

“Class B Treasury Functions Priority Expense” means for each Fiscal Year (or other period agreed by the Partners) for each Company Activity (other than the Class B Company Activity) having Class B Treasury Functions Priority Monthly Expense for such Fiscal Year (or other period agreed by the Partners) the sum of the Class B Treasury Functions Priority Monthly Expense of each such Company Activity for such Fiscal Year (or such other period).

“Class B Treasury Functions Priority Monthly Expense” means for each Company Activity (other than the Class B Company Activity) the product of multiplying (x) the amount of Class B Treasury Functions Monthly Cash Deficit, if any, of each such Company Activity as of the close of business on the last day of each month by (y) the Monthly Percentage applicable to such month.

“Class C Company Activity” means the assets and activities described on Exhibit C attached to this Third Restated JV Agreement.

“Class D Company Activity” means the assets and activities described on Exhibit D attached to this Third Restated JV Agreement.

“Class E Company Activity” means the assets and activities described on Exhibit E attached to this Third Restated JV Agreement.

“Class F Company Activity” means the assets and activities described on Exhibit F attached to this Third Restated JV Agreement.

“Class G Company Activity” means the assets and activities described on Exhibit G attached to this Third Restated JV Agreement.

“Class H Company Activity” means the assets and activities described on Exhibit H attached to this Third Restated JV Agreement.

“COCCSARL” has the meaning set forth in the introductory paragraph of this Third Restated JV Agreement.

“Code” means the United States Internal Revenue Code of 1986, as amended.

“COIHSARL” has the meaning set forth in the introductory paragraph of this Third Restated JV Agreement and is a Disregarded Entity.

“Company” means Caterpillar SARL, as a Swiss société à responsabilité limitée organized on 14 July 1997 (originally under the name “Caterpillar Commercial SARL”) to conduct a joint venture for the purposes set forth in the Articles of Association.

“Company Activity” means a Class A Company Activity, a Class B Company Activity, a Class C Company Activity, a Class D Company Activity, a Class E Company Activity, a Class F Company Activity, a Class G Company Activity or a Class H Company Activity.

“Company Activity Percentage Interest” means a Partner’s percentage interest, as set forth on Schedule 1 hereto, as amended from time-to-time in accordance with Section 8.6, in Net Income, Net Loss and Distributable Amounts of each Company Activity.

“Company Activity Sub Income and Loss Account” has the meaning set forth in Section 3.2(a).

“Company Activity Sub Income and Loss Change Amount” has the meaning set forth in Section 3.2(a)(ii).

“COSARL” has the meaning set forth in the first recital of this Third Restated JV Agreement.

“COSARL Contribution Agreement” means the Contribution In Kind Agreement between COSARL and the Company dated 1 September 1999.

“CPDSARL” has the meaning set forth in the introductory paragraph of this Third Restated JV Agreement.

“CSARL Territory” has the meaning set forth in the License Agreement.

“Disregarded Entity” means a business entity that is a legal entity under the laws of the jurisdiction where it is organized that for United States federal income tax purposes is disregarded as an entity separate from its sole owner under section 301.7701-3 of the Regulations.

“Disregarded Entity Subsidiary” means a Disregarded Entity all the ownership interests of which are owned by the Company directly or directly and/or indirectly through one or more intermediate Disregarded Entity Subsidiaries.

“Distributable Amount” of each Company Activity means (i) cash on hand of a Company Activity at the end of each Fiscal Year (or other period ending at the end of a month agreed by the Partners) that is available for distribution to the Partners (including for this purpose the excess of (x) the Class B Treasury Functions Monthly Cash Balance, if any, of such Company Activity over (y) the Class B Treasury Functions Monthly Cash Deficit, if any, of such Company Activity, as of the close of business on the last day of such Fiscal Year (or last day of such other period agreed by the Partners)) taking into account any cash needed to be retained for working capital or as a reserve for liabilities or contingencies of such Company Activity and (ii) any other property (tangible or intangible) of a Company Activity that is available for distribution to the Partners at the end of each Fiscal Year (or other period ending at the end of a month agreed by the Partners) taking into account any such property needed to be retained for working capital or as a reserve for liabilities or contingencies of such Company Activity; provided, however, in no event shall the sum of the Distributable Amounts of all Company Activities for any Fiscal Year exceed the amount of profits and reserves that the Company is permitted to distribute for such Fiscal year under articles 804 and 805 of the Swiss Code.

“Extra-APD Territory” means the entire world, excepting only Japan and the APD Territory.

"First Amendment" has the meaning set forth in the second recital of this Third Restated JV Agreement.

"Fiscal Year" means the year set forth in article 27 of the Articles of Association.

"Fourth Amendment" has the meaning set forth in the sixth recital of this Third Restated JV Agreement.

"GAAP" means generally accepted accounting principles as in effect in the United States from time-to-time.

"Geneva Office Building" means the office building included in the assets set forth on Exhibit A to the COSARL Contribution Agreement.

"Governmental or Regulatory Authority" means any court, tribunal, arbitrator, authority, agency, commission, official or other instrumentality of the United States, including its territories and possessions, Switzerland and its cantons, and any foreign country or any domestic or foreign state, county, city or other political subdivision.

"Income and Loss Account" means with respect to a Partner an account that establishes the amount such Partner is entitled to receive under Section 5.3 on liquidation of the Company, which account shall equal the sum of (x) the total of the balances (whether positive or negative) of all Company Activity Sub Income and Loss Accounts of such Partner and (y) the amount of the balance (whether positive or negative) of the Other Income and Loss Account of such Partner. The provisions of Section 3.2(a) relating to the maintenance of Company Activity Sub Income and Loss Accounts, and the provisions of Section 3.2(b) relating to the maintenance of Other Income and Loss Accounts, are intended to comply with section 1.704-1(b), *et seq.*, of the Regulations and shall be applied in a manner consistent therewith.

"JV Agreement" has the meaning set forth in the first recital of this Third Restated JV Agreement.

"Laws" means all laws, statutes, rules, regulations, ordinances and other pronouncements having the effect of law of any Governmental or Regulatory Authority.

"License Agreement" means the Seventh Amended And Restated License Agreement between CAT and the Company effective 1 January 2006, as the same may be amended, restated, renewed or superseded, except as otherwise stated therein.

"Monthly Percentage" means a monthly percentage that is consistent with the monthly interest rate charged by the Company for loans made by the Company to CAT and CAT Affiliates (other than the Company) in performing Class B Treasury Functions.

"Net Book Value" means (i) the fair market value of Section 704(c) Property of a Company Activity on the date of its contribution to the Company, less the accumulated Book Depreciation or Amortization with respect to such Section 704(c) Property for the period beginning on the date of its contribution to the Company and ending on each date for which Net Book Value is being determined, and (ii) the purchase price paid by the Company for property of

a Company Activity, less the accumulated depreciation or amortization with respect to such property for the period beginning on the date of its purchase by the Company and ending on each date for which Net Book Value is being determined.

"Net Income" or "Net Loss" means income or loss for United States federal income tax purposes derived by, or attributable to, a Company Activity for any Fiscal Year (or other period agreed by the Partners), computed taking into account the adjustments provided for in Section 3.1(a)(iii), 3.1(b)(iii) and 3.1(c)(iv), and the allocations provided for in Section 3.1(c)(i) and (ii); provided, however, that in the case of any Section 704(c) Property of the Company, (i) in lieu of the depreciation or amortization with respect to such Section 704(c) Property used in calculating income or loss for United States federal income tax purposes for such Fiscal Year (or such other period), there shall be substituted Book Depreciation or Amortization and (ii) in lieu of the actual basis of such Section 704(c) Property for United States federal income tax purposes, the Net Book Value of such Section 704(c) Property shall be used in computing gain or loss arising from any sale or other disposition of such Section 704(c) Property.

"Other Loss" means any loss or expense other than Net Loss (or items thereof) or Class B Treasury Functions Priority Expense.

"Other Income" means any income or gain other than Net Income (or items thereof) or Class B Treasury Functions Preferred Income.

"Other Income and Loss Account" has the meaning set forth in Section 3.2(b).

"Paid-In Surplus" means amounts of cash or property transferred by a Partner to the Company as "*apport à fonds perdu*."

"Partner" means CCH, COCCSARL, COIHSARL, CPDSARL, CAPLP and CIPSARL, as the case may be, and any permitted successors or assigns thereof.

"Partners Meeting" has the meaning set forth in Section 3.7.

"Person" means any corporation, company or other business entity or a natural person.

"Prime Products, Components & Parts" means products of the character of those in which CAT now or at any time hereafter does business, but excluding Purchased Finished Replacement Parts/Components.

"Priority Gross Profit" means, with respect to a Company Activity, the gross income of such Company Activity computed excluding any Class B Treasury Functions Preferred Income, Class B Treasury Functions Priority Expense, interest income or interest expense of such Company Activity.

"Purchased Finished Replacement Parts/Components" means parts for the repair or maintenance of, or components associated with, products manufactured and/or sold by CAT and/or CAT Affiliates that are manufactured by Third Parties and purchased directly from such Third Parties by the Company and/or any Disregarded Entity Subsidiary.

"Registered Capital" has the meaning set forth in article 5 of the Articles of Association.

"Regulations" means regulations promulgated under the Code as in effect from time-to-time.

"Second Amendment" has the meaning set forth in the third recital of this Third Restated JV Agreement.

"Second Restatement" has the meaning set forth in the seventh recital of this Third Restated JV Agreement.

"Section 704(c) Property" means any property that is contributed to the Company by a Partner if the fair market value of such property on the contribution date differs from its tax basis for United States federal income tax purposes on such date.

"Singapore Office Building" means the office building located in Singapore and included in the assets set forth on Exhibit A to the COSARL Contribution Agreement.

"Singapore Warehouse" means the warehouse building located in Singapore and included in the assets set forth on Exhibit A to the COSARL Contribution Agreement.

"Singapore Warehouse Charge" means an arm's length charge for the use of the Singapore Warehouse by a Company Activity (other than Class D Company Activity) determined each Fiscal Year (or other period agreed upon by the Partners) in accordance with the applicable principles of the Accounting Manual.

"Singapore Warehouse Charge Shortfall" means the excess, if any, of the Singapore Warehouse Charge to a Company Activity for a Fiscal Year (or other period agreed by the Partners) over the gross income of such Company Activity for such Fiscal Year (or such other period).

"Subordinated Loan" means an advance of funds by a Partner to the Company pursuant to a Variable Amount Subordinated Loan Agreement in the form of Schedule 2 to this Third Restated JV Agreement.

"Swiss Code" means the Swiss Code of Obligations.

"Third Amendment" has the meaning set forth in the fourth recital of this Third Restated JV Agreement.

"Third Parties" means any company other than CAT or a CAT Affiliate.

"Third Restated JV Agreement" has the meaning set forth in the introductory paragraph of this Third Restated JV Agreement.

Section 1.2 Statutory Provisions. References in this Third Restated JV Agreement to any provision of any enactment, statute or any other legislation or to any rules or regulations

promulgated thereunder or other subordinate legislation include any modification, amendment or re-enactment of that provision then in force.

ARTICLE 2 JOINT VENTURE

Section 2.1 Purpose of Company. The Company is a joint venture organized and existing for the purposes set forth in article 2 of the Articles of Association.

Section 2.2 Capital Contributions and Subordinated Loans

(a) CCH shall transfer as Paid-In Surplus and/or Subordinated Loans, as agreed by the Partners, to the Company all funds required for the reasonable commercial conduct of the Class C Company Activity in such amounts and at such times as determined by the managers of the Company in accordance with the Articles of Association.

(b) No Partner shall have any obligation to transfer cash or property to the Company as Registered Capital, Paid-In Surplus or Subordinated Loans other than the transfers of cash and property provided for in this Section 2.2 and Section 5.2.

(c) In the event that pursuant to Sections 3.7 and/or 3.8 all or a portion of CCH's Distributable Amount of any Company Activity is not distributed by the Company to CCH, CCH may fund its obligations under Section 2.2(a) by instructing the Company to transfer for the benefit of the Class C Company Activity such portion of such undistributed Distributable Amount as CCH designates.

(d) As part of the Class B Treasury Functions, the Company shall fund its business needs to the extent not funded by the Partners as set forth in this Section 2.2, and any such funding shall be accounted for as provided in Section 3.1(a) and (b).

Section 2.3 Withdrawal or Distribution of Capital; Other Distributions. Unless the Partners unanimously agree otherwise, no Partner shall be entitled to withdraw or otherwise receive a return of any part of its capital contribution to the Company except under Section 5.3 on liquidation of the Company, or to receive any other distribution from the Company except as provided in Sections 3.7 and 3.8.

Section 2.4 Management of the Company

(a) The Company shall be managed as set forth in the Articles of Association and herein.

(b) The Company shall not acquire a new business or assets other than assets needed for conduct of the Company Activities or admit an additional partner without the consent of all Partners which, if granted, shall be reflected by execution by all Partners in accordance with Section 8.6 of an amendment to this Third Restated JV Agreement reflecting such acquisition or admission of an additional partner.

ARTICLE 3
ALLOCATIONS; INCOME AND LOSS ACCOUNTS;
OTHER TAX MATTERS; DISTRIBUTIONS

Section 3.1 Allocations. For United States federal income tax purposes and for purposes of making distributions to Partners under Sections 3.7, 3.8 and/or Section 5.3, Net Income and Net Loss (and items thereof), Priority Gross Profit, and Other Income and Other Loss (and items thereof) shall be allocated among the Partners as set forth below in this Section 3.1 in the following order and manner.

(a) Allocations in respect of Class B Treasury Functions Net Preferred Income

(i) An amount of Priority Gross Profit of the Class B Company Activity for each Fiscal Year (or other period agreed by the Partners) shall be allocated to each other Company Activity having Class B Treasury Functions Net Preferred Income for such Fiscal Year (or such other period) up to, but not in excess of, the amount of such Class B Treasury Functions Net Preferred Income of such other Company Activity in the ratio that such Class B Treasury Functions Net Preferred Income of such other Company Activity bears to the Class B Treasury Functions Aggregate Net Preferred Income for such Fiscal Year (or such other period).

(ii) If the Priority Gross Profit of the Class B Company Activity for such Fiscal Year (or other period) is less than the Class B Treasury Functions Aggregate Net Preferred Income for such Fiscal Year (or such other period), in addition to the allocations under Section 3.1(a)(i), expense or loss (other than interest expense) of each such other Company Activity for such Fiscal Year (or other period) shall be allocated to the Class B Company Activity in an amount equal to the Class B Treasury Functions Net Preferred Income Shortfall, if any, of each such other Company Activity for such Fiscal Year (or such other period).

(iii) The Net Income or Net Loss, as the case may be, of each Company Activity for each Fiscal Year (or other period agreed by the Partners) allocated under Section 3.1(d) shall be adjusted prior to the allocations under Section 3.1(d) to reflect: first, any amounts of Class B Company Priority Gross Profit allocated under Section 3.1(a)(i) to the Class A Company Activity, Class C Company Activity, Class D Company Activity, Class E Company Activity, Class F Company, Class G Company Activity or Class H Company Activity, as applicable, for such Fiscal Year (or such other period); and second, any amounts of expense or loss of the Class A Company Activity, Class C Company Activity, Class D Company Activity, Class E Company Activity, Class F Company, Class G Company Activity or Class H Company Activity, as applicable, allocated under Section 3.1(a)(ii) to the Class B Company Activity for each Fiscal Year (or other period agreed by the Partners).

(b) Allocations in Respect of Class B Treasury Functions Net Priority Expense

(i) An amount of Priority Gross Profit for each Fiscal Year (or other period agreed by the Partners) of each Company Activity (other than the Class B Company Activity) having a Class B Treasury Functions Net Priority Expense for such Fiscal Year (or other period agreed by the Partners) shall be allocated to the Class B Company Activity in an amount equal to the Class B Treasury Functions Net Priority Expense of such Company Activity for such Fiscal Year (or such other period).

(ii) If the Priority Gross Profit of a Company Activity (other than the Class B Company Activity) having a Class B Treasury Functions Net Priority Expense for such Fiscal Year (or such other period) is less than such Class B Treasury Functions Net Priority Expense of such Company Activity ("Class B Treasury Functions Company Activity Priority Gross Profit Shortfall"), in addition to the allocations under Section 3.1(b)(i), expense or loss (other than interest expense) of the Class B Company Activity for such Fiscal Year (or such other period) shall be allocated to such Company Activity in an amount equal to the Class B Treasury Functions Company Activity Priority Gross Profit Shortfall of such Company Activity.

(iii) The Net Income or Net Loss, as the case may be, of each Company Activity for each Fiscal Year (or other period agreed by the Partners) allocated under Section 3.1(d) shall be adjusted prior to the allocations under Section 3.1(d) to reflect: first, any amounts of Priority Gross Profit of the Class A Company Activity, Class C Company Activity, Class D Company Activity, Class E Company Activity, Class F Company, Class G Company Activity or Class H Company Activity, as applicable, allocated under Section 3.1(b)(i) to the Class B Company Activity for such Fiscal Year (or such other period); and second, any amounts of expense or loss of the Class B Company Activity allocated under Section 3.1(b)(ii) to the Class A Company Activity, Class C Company Activity, Class D Company Activity, Class E Company Activity, Class F Company, Class G Company Activity or Class H Company Activity, as applicable, for each such Fiscal Year (or such other period).

(c) Geneva and Singapore Office Buildings and Warehouses and Factory – Allocations of Operating Expenses and Use Charges

(i) Notwithstanding that the Geneva Office Building is an asset of the Class B Company Activity, any expense (other than depreciation) for a Fiscal Year (or other period agreed by the Partners) of operating such office building shall be allocated to each Company Activity in accordance with its respective usage of such office building during such Fiscal Year (or such other period).

(ii) Notwithstanding that the Singapore Office Building and Singapore Warehouse are assets of the Class D Company Activity, any expense (other than depreciation) for a Fiscal Year (or other period agreed by the Partners) of operating each such building shall be allocated to each Company Activity in accordance with its respective usage of each such building during such Fiscal Year (or such other period).

(iii) In addition to the allocation of operating expenses to Company Activities as provided in Section 3.1(c)(ii), the Class D Company Activity shall be compensated for the use of the Singapore Warehouse by any Company Activity (other than the Class D Company Activity) as follows:

(A) An amount of gross income of each Company Activity (other than the Class D Company Activity) shall be allocated to the Class D Company Activity in an amount equal to each such Company Activity's Singapore Warehouse Charge for each Fiscal Year (or other period agreed by the Partners).

(B) If the gross income of a Company Activity for such Fiscal Year (or such other period) is less than such Company Activity's Singapore Warehouse Charge for such Fiscal Year (or such other period), in addition to the allocation of all remaining gross income of such Company Activity for such Fiscal Year (or such other period) to the Class D Company Activity under Section 3.1(c)(iii)(A), expense or loss of the Class D Company Activity for such Fiscal Year (or such other period) shall be allocated to such Company Activity in an amount equal to such Company Activity's Singapore Warehouse Charge Shortfall for such Fiscal Year (or such other period).

(iv) The Net Income or Net Loss, as the case may be, of each Company Activity for each Fiscal Year (or other period agreed by the Partners) allocated under Section 3.1(d) shall be adjusted prior to the allocations under Section 3.1(d) to reflect any amounts of gross income, expense or loss allocated under Section 3.1(c)(iii), for each such Fiscal Year (or such other period).

(d) Allocations of Net Income and Net Loss of Each Company Activity. Net Income or Net Loss (and items thereof) derived from or attributable to each Company Activity for each Fiscal Year (or other period agreed by the Partners), in each case determined after the allocations set forth in Section 3.1(a), (b) and (c), shall be allocated among the Partners in accordance with each Partner's Company Activity Percentage Interest for such Fiscal Year (or such other period) for each such Company Activity.

(e) Allocations of Other Income and Other Loss. Other Income and Other Loss, if any, for each Fiscal Year (or other period agreed by the Partners) shall be allocated among the Partners as they shall mutually agree.

Section 3.2 Company Activity Sub Income and Loss Accounts; Other Income and Loss Accounts

(a) Company Activity Sub Income and Loss Accounts. There shall be established for each Partner a separate account in respect of each Company Activity which shall be maintained and adjusted as provided in this Section 3.2(a) (a "Company Activity Sub Income and Loss Account").

(i) Each Partner's Company Activity Sub Income and Loss Account shall be increased by (A) any Net Income (or items thereof) allocated to such Partner pursuant to Section 3.1(d) in respect of the Company Activity for which such Company Activity Sub Income and Loss Account has been established and is being maintained, (B) the amount of cash contributed by such Partner to the Company (including cash deemed contributed under section 752 of the Code by reason of a Partner's assumption of a liability of the Company Activity for which such Company Activity Sub Income and Loss Account has been established and is being maintained, other than a liability specified in Section 3.2(a)(i)(C)) as Registered Capital, Paid-In Surplus and/or Subordinated Loans in respect of the Company Activity for which such Company Activity Sub Income and Loss Account has been established and is being maintained, and (C) the value of any property (net of any liabilities secured by such property that the Company is considered to assume or take subject to under section 752 of the Code) transferred by such Partner to the Company as Registered Capital, Paid-In Surplus and/or Subordinated Loans in respect of the Company Activity for which such Company Activity Sub Income and Loss Account has been established and is being maintained. In the event that there is an increase in a Partner's, or a Partner receives a, Company Activity Percentage Interest (the "Changed Company Activity"), such Partner's Company Activity Sub Income and Loss Account for the Changed Company Activity shall be increased by, or such Partner shall receive, any Company Activity Sub Income and Loss Change Amount for such Changed Company Activity.

(ii) Each Partner's Income and Loss Account shall be decreased by: (A) the amount of any Net Loss (or items thereof) allocated to such Partner pursuant to Section 3.1(d) in respect of the Company Activity for which such Company Activity Sub Income and Loss Account has been established and is being maintained, (B) the amount of any cash distributed to such Partner (including cash deemed distributed under section 752 of the Code by reason of the Company's assumption of a liability of such Partner relating to the Company Activity for which such Company Activity Sub Income and Loss Account has been established and is being maintained, other than a liability specified in Section 3.2(a)(i)(C), and (C) the fair market value (net of any liabilities secured by such property that the Company is considered to assume or take subject to under section 752 of the Code) of any property of the Company Activity for which such Company Activity Sub Income and Loss Account has been established and is being maintained distributed in kind to such Partner pursuant to Sections 3.7 and 3.8. Any cash or property transferred to a Partner in respect of a Subordinated Loan (including any amounts distributed under Section 5.3) shall be treated as a distribution of such cash or property for purposes of the preceding sentence and for all other purposes of this Third Restated JV Agreement. In the event that any property (tangible or intangible) of a Company Activity is distributed in kind to any Partner (whether in connection with a liquidation of the Company or otherwise), the Company Activity Sub Income and Loss Account of such Partner shall be adjusted to reflect the allocation of Net Income (or items thereof) or Net Loss (or items thereof) that would be made under Section 3.1(d) if such property had been sold by the Company for its fair market value rather than distributed in kind. In the event that there is a decrease in a Partner's Company Activity Percentage Interest in a Changed Company Activity, such Partner's Company Activity Sub Income and Loss Account for the Changed Company Activity shall be reduced by an amount

equal to the product of multiplying (x) the balance of such Company Activity Sub Income and Loss Account immediately prior to such decrease by (y) the percentage reduction in such Partner's Company Activity Percentage Interest (the "Company Activity Sub Income and Loss Change Amount").

(b) Other Income and Loss Accounts. There shall be established for each Partner a separate account in respect of Other Income and Other Loss allocated to such Partner under Section 3.1(e) which shall be maintained and adjusted as provided in this Section 3.2(b) (an "Other Income and Loss Account"). Each Partner's Other Income and Loss Account shall be (i) increased by any Other Income allocated to such Partner under Section 3.1(e), and (ii) decreased by any Other Loss allocated to such Partner under Section 3.1(e) and the amount of any cash distributed to such Partner and the fair market value of any property distributed in kind to such Partner (net of any liabilities secured by such asset that such Partner is considered to assume or take subject to under section 752 of the Code) pursuant to Sections 3.7 and 3.8 in respect of such Partner's Other Income and Loss Account. In the event that any property (tangible or intangible) is distributed in kind to any Partner (whether in connection with a liquidation of the Company or otherwise) in respect of its Other Income or Loss Account, such Other Income or Loss Account shall be adjusted to reflect the allocation of Other Income or Loss that would be made under Section 3.1(e) if such property had been sold by the Company for its fair market value rather than distributed in kind.

Section 3.3 Interest on Capital. No interest shall be paid by the Company on the Registered Capital, Paid-In Surplus or Subordinated Loans transferred by a Partner to the Company and, except as provided in Section 3.1(a) and (b), no interest or equivalent amount shall be allocated by the Company to a Partner.

Section 3.4 Tax Elections. Except as otherwise expressly provided herein, all elections required or permitted to be made by the Company under the Code or other applicable tax law shall be made in such manner as may be reasonably determined by the Partners.

Section 3.5 Allocations for Tax Purposes. Each item of gross income, gain, loss and deduction of the Company as determined for tax purposes shall be allocated to the Partners in the same proportion as the corresponding item of gross income, gain, loss and deduction is allocated to them pursuant to Sections 3.1 and 3.6; provided, however, that any item of gross income, gain, loss or deduction with respect to any Section 704(c) Property shall be allocated to the Partners in accordance with section 704(c) of the Code and section 1.704-1(b)(2)(iv)(g) of the Regulations so as to take into account the difference between the fair market value and the basis for tax purposes of such Section 704(c) Property on the date of its contribution to the Company. The allocations made pursuant to this Section 3.5 shall not be reflected in the Income and Loss Accounts of the Partners or affect any cash or property distributions to the Partners under Sections 3.7, 3.8 and/or 5.3.

Section 3.6 Allocations Attributable to Transferred Interests. In the event that any Partner transfers all or any part of its interests in the Company, or any Company Activity Percentage Interest of a Partner is increased or decreased, any Net Income or Net Loss (or item thereof), depreciation and amortization, and Other Income and Other Loss attributable to such interest or such Company Activity for the Fiscal Year during which such transfer or increase or

decrease occurs shall, subject to any applicable Regulations under section 706 of the Code, be allocated between the applicable Partners on a pro rata basis based upon the number of days during such Fiscal Year that the transferor Partner and the transferee Partner each owned such interest, or the number of days during such Fiscal Year before and after such increase or decrease in Company Activity Percentage Interest, as the case may be; provided, however, that the Company shall allocate such Net Income or Net Loss (or item thereof), depreciation and amortization and Other Income and Other Loss based upon an interim closing of the Company's books as of the date of such transfer, or such increase or decrease in Company Activity Percentage Interest, as the case may be, at the request of any Partner and at the sole expense of such Partner if such Partner delivers a written request for an interim closing of the books to all other Partners within ten Business Days of such transfer or increase or decrease.

Section 3.7 Swiss Law Dividends. The Partners hereby agree and covenant to each other that, at each annual general meeting of the shareholders of the Company or any extraordinary general meeting of the shareholders of the Company at which payment of dividends is to be considered (either such meeting, a "Partners Meeting"), they shall unanimously vote pursuant to the option provided in article 29 of the Articles of Association to make dividend distributions in accordance with Section 3.8.

Section 3.8 Distributions

(a) Except for distributions under Section 5.3 made in connection with the liquidation of the Company, distributions of cash or property by the Company shall be made strictly in accordance with this Section 3.8 and, as dividends for Swiss law purposes, shall be made consistently with the applicable provisions of the Swiss Code and article 29 of the Articles of Association. Prior to each Partners Meeting, (i) the Partners shall determine the Distributable Amount for each Company Activity and any balance in each Partner's Other Income and Loss Account for the Fiscal Year (or other period agreed by the Partners) with respect to which such Partners Meeting is to be held, (ii) the Partners having a Company Activity Percentage Interest in a Company Activity shall determine by unanimous agreement, or if one Partner has the entire Company Activity Percentage Interest in a Company Activity, such Partner shall determine, the portion, if any, of the Distributable Amount of such Company Activity to be distributed to such Partners or Partner by the Company, and (iii) in the case of Other Income and Loss Accounts, the Partners shall determine by unanimous agreement the portion, if any, of any positive balance in a Partner's Other Income and Loss Account that is to be distributed to such Partner by the Company. If the Partners make no determination under this Section 3.8(a) for the Fiscal Year (or other period agreed by the Partners) with respect to which such Partners Meeting is to be held, each Partner shall be deemed to have agreed that no portion of (i) any such Distributable Amounts, or (ii) positive balances of Other Income and Loss Accounts, is to be distributed with respect to such Fiscal Year (or such other period).

(b) Any portion of the Distributable Amount of a Company Activity, for the Fiscal Year (or other period agreed by the Partners) with respect to which such Partners Meeting is to be held, that the Partners have determined in accordance with Section 3.8(a) is to be distributed shall be paid to the Partners in accordance with each Partner's Company Activity Percentage Interest for such Company Activity for such Fiscal Year (or such other period); provided, however, that the amount distributed to a Partner shall not exceed the positive balance

in such Partner's Company Activity Sub Income and Loss Account for such Company Activity immediately prior to such distribution.

(c) Subject to Sections 3.7 and 3.8(a), the Partners having a Company Activity Percentage Interest in a Company Activity may determine by unanimous agreement, or if one Partner has the entire Company Activity Percentage Interest in a Company Activity, such Partner may determine, at any time that all or a portion of any Distributable Amount of such Company Activity that has been retained by the Company under Section 3.8(c) shall be distributed to such Partner.

(d) Any portion of the amount of any cash on hand and/or the value of any property on hand derived from or attributable to Other Income that has been allocated to a Partner under Section 3.1(e) that such Partner has determined is to be distributed to it shall be distributed up to, but not in excess of, any positive balance of such Partner's Other Income or Loss Account immediately prior to such distribution.

(e) Any portion of a Distributable Amount for a Company Activity for such Fiscal Year (or such other period) that the Partners have determined is not to be distributed shall be retained by the Company and the use thereof compensated by the allocations of gross income and expense and loss set forth in Section 3.1(a).

(f) Any portion of any positive balance in a Partner's Other Income Account that the Partners have determined is not to be distributed (i) shall be retained by the Company and the use thereof compensated as mutually agreed by the Partners, and (ii) the Partners shall mutually agree on the time or times that such positive balance in a Partner's Other Income Account is to be distributed.

Section 3.9 Allocation of Certain Liabilities

(a) **Excess Nonrecourse Liabilities.** A Partner's share of "excess nonrecourse liabilities" (as defined in sections 1.752-1(a)(2) and 1.752-3(a)(3) of the Regulations) of each Company Activity shall be allocated under section 1.752-3(a)(3) of the Regulations to each Partner in accordance with its Company Activity Percentage Interest, if any, in each such Company Business Activity.

(b) **Guaranteed Partner/Affiliate Loan.** In accordance with section 1.752-2 of the Regulations, if a Partner is the sole guarantor of a loan made to the Company for use in the Class C Company Activity, including a loan made by another Partner or an Affiliate of the Partner guaranteeing such loan, such liability shall be allocated solely to the Partner guaranteeing such loan.

ARTICLE 4 ACCOUNTING MATTERS

Section 4.1 Books of Account. In addition to the reports and accounts specified in article 28 of the Articles of Association, the Partners shall maintain, or cause the Company to maintain, such books and records as shall be necessary or appropriate to comply with section 704

of the Code, the Regulations promulgated thereunder and the provisions of this Agreement. The Company also shall maintain books of account on an accrual basis in accordance with GAAP.

Section 4.2 Financial Information; Financial Statements. In addition to the reports and accounts specified in article 28 of the Articles of Association, as soon as practical after the end of each Fiscal Year, the Partners shall prepare, or cause the Company to prepare (or cause to be prepared) and deliver to each Partner, (i) statements of Class B Treasury Functions Preferred Income, Class B Treasury Functions Priority Expense, Net Income or Net Loss (and items thereof) derived from or attributable to each Company Activity and Other Income or Other Loss for such Fiscal Year (or other period agreed by the Partners) and statements of each Partner's Company Activity Sub Income and Loss Account, Other Income and Loss Account, and Income and Loss Account as of the end of such Fiscal Year (or other period), each computed in accordance with the terms of this Third Restated JV Agreement, and (ii) statements of income (or loss) and cash flow for such Fiscal Year, and a balance sheet as of the end of such Fiscal Year, each computed in accordance with GAAP.

Section 4.3 Partners' Approval of Financial Information. The calculation of the Financial Information specified in clause (i) of Section 4.2 shall be approved by all Partners within a commercially reasonable period after receipt thereof by the Partners pursuant to Section 4.2. If the Partners cannot agree, such calculations shall be promptly submitted to a internationally recognized public accounting firm selected by the public accounting firm then serving as the Company's auditor and which shall not at such time be an auditor of the Company, any Partner or any Affiliate of any Partner. Such public accounting firm shall promptly (i) undertake an independent review of such calculations, make any corrections thereof that it deems appropriate and consistent with the terms of this Third Restated JV Agreement, and (ii) submit a report approving the calculations submitted to it for review or setting forth its corrected calculations. Such report shall be binding on the Partners.

Section 4.4 Tax Year. For United States federal income tax purposes, and Swiss tax and financial reporting purposes, the Company's taxable year shall end on November 30th.

Section 4.5 Accounting Manual. The Partners shall adopt principles, procedures and instructions (the "Accounting Manual") for determining all accounting matters under this Third Restated JV Agreement, including but not limited to: (i) the Distributable Amount, Net Income, Net Loss, Monthly Cash Balance, Monthly Cash Deficit and Net Book Value of assets of each Company Activity, (ii) the usage for purposes of Section 3.1(c) of the Geneva Office Building and Singapore Buildings by each Company Activity, and (iii) any other item to be taken into account in effectuating allocations under Sections 3.1 and 3.6, or distributions under Section 3.8, for which establishing principles for determining such item for each Company Activity and/or for determining Other Income or Other Loss is necessary or useful. The auditors of the Company shall review the Accounting Manual annually to: first, determine whether clarifications, corrections, improvements or refinements should be made to the Accounting Manual taking into account the facts and circumstances of the Company Activities at that time; and second, ensure that the Accounting Manual reflects principles, procedures and instructions that result in fair and reasonable determinations of the accounting matters under this Third Restated JV Agreement. Partners shall approve the Accounting Manual annually taking into account such annual review by the Company auditors. The Partners acknowledge that changes

to the Accounting Manual may affect their economic rights with respect to the Company. Accordingly, such annual approval shall be by unanimous agreement of the Partners.

ARTICLE 5
TRANSFER OF INTERESTS; WINDING UP; LIQUIDATION

Section 5.1 Limitation on Right to Transfer Interest in the Company and Subordinated Loans

(a) The limitations on a Partner's right to transfer its interest in the Company are set forth in the Articles of Association.

(b) A Partner shall not be entitled to transfer or otherwise assign all or any part of its rights and obligations under a Subordinated Loan made by such Partner; provided, that, in the event a Partner transfers all of its interest hereunder in respect of a Company Activity, as a condition to such transfer, such transferor Partner shall transfer, and the transferee of such interest shall acquire, all of the transferor Partner's rights under, and such transferee shall assume all of the transferor Partner's obligations under, any Subordinated Loan made by such transferor Partner for use in or by such Company Activity.

Section 5.2 Dissolution of the Company; Pre-Liquidating Distribution Actions

(a) Dissolution of the Company. The Company shall be dissolved upon the occurrence of any event specified in article 820 of the Swiss Code. After (i) payment of, and/or provision for the payment or assumption of, liabilities of the Company (other than any Subordinated Loans) and (ii) adjustments to Income and Loss Accounts specified in Section 5.2(b) and contributions specified in Section 5.2(c) and (d):

(i) the assets of the Company shall be distributed to the Partners as provided in Section 5.3(a), (b) and (c);

(ii) adjustments to Income and Loss Accounts under, and any contributions by the Partners in accordance with, Section 5.2 (e) shall be made; and

(iii) any remaining assets of the Company shall be distributed in accordance with Section 5.3(d).

(b) Pre-Liquidation Income and Loss Account Adjustments. The Income and Loss Accounts of the Partners shall be adjusted immediately prior to the distributions provided for in Section 5.3 to reflect all adjustments to such Income and Loss Accounts for the Fiscal Year during which such liquidation occurs that have not been previously made (including adjustments pursuant to the penultimate sentence of Section 3.2(a) and the last sentence of Section 3.2(b) with respect to any assets of the Company that are to be distributed in-kind to any Partner under Section 5.3).

(c) Contributions in respect of Subordinated Loans. If the outstanding amount of any Subordinated Loans made by a Partner to the Company exceeds the balance in its Income and Loss Account (after giving effect to all adjustments specified in Section 5.2(b))

immediately prior to the distributions set forth in Section 5.3, such Partner shall be unconditionally obligated to contribute to the Company as Paid-In Surplus, immediately prior to the distributions set forth in Section 5.3, the portion of its Subordinated Loans that exceeds such balance in its Income and Loss Account.

(d) Contributions in respect of Registered Capital. If a Partner's Registered Capital in the Company immediately before the liquidation of the Company exceeds the amount of cash and/or assets available to distribute to such Partner under Section 5.3(b), such Partner shall be unconditionally obligated to contribute cash to the Company as Paid-In Surplus in an amount equal to such excess, and for purposes of Section 5.3(b) such contribution shall be treated as an asset of separate Company Activities in proportion to the Company Activity Percentage Interests held by such Partner in a Company Activity, and such Partner shall be treated as having a Company Activity Percentage Interest in such Company Activity to the extent of such contribution.

(e) Qualified Income Offset. Notwithstanding Section 3.1, if a Partner unexpectedly receives any adjustments, allocations or distributions described in Regulations section 1.704-1(b)(2)(ii)(d)(4), (5) or (6), or any other event creates a deficit balance in such Partner's Company Activity Sub Income and Loss Account, or Other Income and Loss Account, in excess of such Partner's share of "partnership minimum gain" (as defined in Regulations section 1.704-2(d)), items of Company income and gain shall be specially allocated to such Partner in an amount and manner sufficient to eliminate such excess deficit balance as quickly as possible. Any special allocations of items of income and gain pursuant to this Section 5.2(e) shall be taken into account in computing subsequent allocations of income and gain pursuant to Article 3 so that the net amount of any item so allocated and the income, gain and losses allocated to each Partner pursuant to Article 3, to the extent possible, shall be equal to the net amount that would have been allocated to each such Partner pursuant to the provisions of this Section 5.2(e) if such unexpected adjustments, allocations or distributions had not occurred.

Section 5.3 Liquidating Distributions. Each Partner hereby agrees and covenants to each other Partner that, upon liquidation of the Company, it shall vote in accordance with the option provided in article 32 of the Articles of Association to cause (i) the proceeds from any disposition of any assets of any Company Activity, (ii) any other assets of each Company Activity, and (iii) any other assets on hand, to be distributed, after payment of, and/or provision for the payment or assumption of, liabilities of the Company (other than any Subordinated Loans), in the following order and manner:

(a) In Respect of Subordinated Loans. First, the Company shall distribute cash to each Partner in an amount equal to the sum of the amounts, if any, of all Subordinated Loans made by each Partner that are outstanding immediately prior to the distributions under this Section 5.3(a).

(b) Return of Registered Capital. Second, the Company shall distribute cash to each Partner in return of its Registered Capital contributed in respect of a Company Activity in the amount, or if there is insufficient cash, other assets of such Company Activity with a value, of such Partner's Registered Capital contributed in respect of such Company Activity.

(c) Distributions of Company Activity Assets. Third, in the case of each Company Activity, to each Partner a percentage interest in each asset of each such Company Activity (including but not limited to the proceeds from the sale or other disposition of any assets of each such Company Activity) remaining after the distributions provided for in Section 5.3(a) and (b) equal to such Partner's Company Activity Percentage Interest, if any, for each such Company Activity.

(d) Final Liquidating Distributions. After the distributions to Partners have been made in accordance with Section 5.3(a), (b) and (c) and adjustments and contributions, if any, have been made in accordance with Section 5.2(e), any remaining assets of the Company shall be distributed to each Partner in accordance with the positive balance, if any, in its Income and Loss Account.

ARTICLE 6 REPRESENTATIONS AND WARRANTIES

Section 6.1 Representations and Warranties of Each Partner. Each Partner hereby represents and warrants to the other Partner as of the date of execution of this Third Restated JV Agreement as follows.

(a) Existence. In the case of CCH, it is a société à responsabilité limitée, in the case of COCCSARL, it is a société à responsabilité limitée, in the case of COIHSARL, it is a société responsabilité limitée, and in the case of CPDSARL, it is a société responsabilité limitée, duly organized, validly existing and in good standing under the laws of Switzerland; in the case of CAPLP, it is a limited partnership duly organized, validly existing and in good standing under the laws of Bermuda; and in the case of CIPSARL, it is a société responsabilité limitée, duly organized, validly existing and in good standing under the laws of Switzerland.

(b) Authority. It has all requisite power to execute and deliver this Third Restated JV Agreement and to perform its obligations hereunder. The execution and delivery by it of this Third Restated JV Agreement and its performance of its obligations hereunder have been duly and validly authorized and no other authorization or consent is required in connection therewith. This Third Restated JV Agreement constitutes the legal, valid and binding obligation of such Partner enforceable in accordance with its terms.

(c) No Conflicts. The execution and delivery by such Partner of this Third Restated JV Agreement does not, and the performance by such Partner of its obligations under this Third Restated JV Agreement will not:

(i) conflict with or result in a violation or breach of any of the terms, conditions or provisions of its articles of association;

(ii) conflict with or result in a violation or breach of any term or provision of any Law or writ, judgment, decree, injunction or similar order of any Governmental or Regulatory Authority (in each such case whether preliminary or final) applicable to it or any of its assets (other than such conflicts, violations or breaches which could not in the aggregate reasonably be expected to affect adversely the validity or

enforceability of this Third Restated JV Agreement or the matters contemplated hereby);
or

(iii) except as could not, individually or in the aggregate, reasonably be expected to affect adversely the ability of such Partner to perform its obligations hereunder, (A) conflict with or result in a violation or breach of, (B) constitute (with or without notice or lapse of time or both) a default under, (C) require such Partner to obtain any consent, approval or action of, make any filing with or give any notice to any Person as a result of or under the terms of, or (D) result in the creation or imposition of any mortgage, pledge, assessment, security interest, lease, lien, adverse claim, levy, charge or other encumbrance of any kind, or any conditional sale contract, title retention contract or other contract to give any of the foregoing upon such Partner or any of its assets under, any contract, license or other agreement to which such Partner is a party or by which any of its assets is bound.

(d) Governmental Approvals and Filings. No consent, approval or action of, filing with or notice to any Governmental or Regulatory Authority on the part of such Partner is required in connection with the execution, delivery and performance of this Agreement, except to the extent that the failure to obtain any such consent, approval or action, to make any such filing or to give any such notice could not reasonably be expected to affect adversely the ability of such Partner to perform its obligations hereunder.

(e) Legal Proceedings. There are no actions, suits, proceedings, arbitrations or Governmental or Regulatory Authority investigations pending or, to the knowledge of such Partner, threatened against, relating to or affecting such Partner or any of its assets which would reasonably be expected to result in the issuance of a writ, judgment, decree, injunction or similar order of any Governmental or Regulatory Authority (in each such case whether preliminary or final) restraining, enjoining or otherwise prohibiting or making illegal the performance by such Partner of its obligations under this Third Restated JV Agreement.

ARTICLE 7 INDEMNIFICATION

Section 7.1 Indemnification by CCH. CCH agrees to indemnify and hold COCCSARL, COIHSARL, CPDSARL, CAPLP and CIPSARL harmless from all claims, liabilities, damages, losses, expenses (including, without limitation, legal fees), obligations, liens, assessments, judgments and fines (all of the foregoing being a "Claim") suffered or paid as a result of (i) the failure of any of the representations or warranties made by CCH in this Third Restated JV Agreement to be true in all material respects as of the date hereof or (ii) any breach by CCH of any terms of this Agreement.

Section 7.2 Indemnification by COCCSARL. COCCSARL agrees to indemnify and hold CCH, COIHSARL, CPDSARL, CAPLP and CIPSARL harmless from all Claims suffered or paid as a result of (i) the failure of any of the representations or warranties made by COCCSARL in this Third Restated JV Agreement to be true in all material respects as of the date hereof or (ii) any breach by COCCSARL of any terms of this Agreement.

Section 7.3 Indemnification by COIHSARL. COIHSARL agrees to indemnify and hold CCH, COCCSARL, CPDSARL, CAPLP and CIPSARL harmless from all Claims suffered or paid as a result of (i) the failure of any of the representations or warranties made by COIHSARL in this Third Restated JV Agreement to be true in all material respects as of the date hereof or (ii) any breach by COIHSARL of any terms of this Agreement.

Section 7.4 Indemnification by CPDSARL. CPDSARL agrees to indemnify and hold CCH, COCCSARL, COIHSARL, CAPLP and CIPSARL harmless from all Claims suffered or paid as a result of (i) the failure of any of the representations or warranties made by CPDSARL in this Third Restated JV Agreement to be true in all material respects as of the date hereof or (ii) any breach by CPDSARL of any terms of this Agreement.

Section 7.5 Indemnification by CAPLP. CAPLP agrees to indemnify and hold CCH, COCCSARL, COIHSARL, CPDSARL and CIPSARL harmless from all Claims suffered or paid as a result of (i) the failure of any of the representations or warranties made by CAPLP in this Third Restated JV Agreement to be true in all material respects as of the date hereof or (ii) any breach by CAPLP of any terms of this Agreement.

Section 7.6 Indemnification by CIPSARL. CIPSARL agrees to indemnify and hold CCH, COCCSARL, COIHSARL, CPDSARL and CAPLP harmless from all Claims suffered or paid as a result of (i) the failure of any of the representations or warranties made by CIPSARL in this Third Restated JV Agreement to be true in all material respects as of the date hereof or (ii) any breach by CIPSARL of any terms of this Agreement.

ARTICLE 8 GENERAL

Section 8.1 Assignment and Binding Effect. Neither this Third Restated JV Agreement nor any of the rights or obligations hereunder shall be assignable by either Partner without the prior written consent of the other Partner hereto. This Third Restated JV Agreement shall be binding upon, and inure to the benefit of, the Partners and their respective permitted successors and assigns.

Section 8.2 Notices. All notices, demands, requests and other communications required or permitted to be given hereunder shall be in writing and deemed duly given on the date delivered by hand, by overnight courier or by facsimile transmission the receipt of which is confirmed by facsimile transmission, to the respective Partner at the following addresses (or at such other address as shall be specified by like notice):

if to CCH:

76, route de Frontenex
P.O. Box 6000
1211 Geneva 6
Switzerland
Attn: Thomas Zihlmann (or any then successor Manager)
Facsimile: +41 22 849 49 11

if to COCCSARL:

76, route de Frontenex
P.O. Box 6000
1211 Geneva 6
Switzerland
Attn: Craig Johnson (or any then successor Manager)
Facsimile: +41 22 849 4982

if to COHSARL:

76, route de Frontenex
P.O. Box 6000
1211 Geneva 6
Switzerland
Attn: Michael Baunton (or any then successor Managing Officer)
Facsimile: +41 22 849 4375

if to CPDSARL:

76, route de Frontenex
P.O. Box 6000
1211 Geneva 6
Switzerland
Attn: Mark Thompson (or any then successor Managing Officer)
Facsimile: +41 22 849 4386

if to CAPLP:

Caterpillar Overseas Credit Corporation SARL, general partner
76, route de Frontenex
P.O. Box 6000
1211 Geneva 6
Switzerland
Attn: Craig Johnson (or any then successor Manager)
Facsimile: +41 22 849 4982

if to CIPSARL:

76, route de Frontenex
P.O. Box 6000
1211 Geneva 6
Switzerland
Attn: Thomas Zihlmann (or any then successor Manager)
Facsimile: +41 22 849 49 11

Section 8.3 Governing Law; Jurisdiction. This Third Restated JV Agreement shall be governed, construed and enforced in accordance with the laws of Switzerland without regard to the principles of conflicts of law.

Section 8.4 No Third-Party Beneficiaries. Nothing in this Agreement, express or implied, is intended or shall be construed to confer upon or give to any Person other than the Partners any rights, benefits or remedies of any nature whatsoever under or by reason of this Agreement, all of which shall be for the sole and exclusive benefit of the Partners.

Section 8.5 Headings; References; Meanings of Words. The headings of the Sections and Articles of this Third Restated JV Agreement are inserted as a matter of convenience and for reference and, in no way, define, limit, extend or describe the scope of this Third Restated JV Agreement or the intent of any of its provisions. Unless otherwise stated, any reference contained in this Agreement to an Article, Section or subsection or clause refers to the provisions of this Third Restated JV Agreement. All capitalized terms defined herein are equally applicable to both the singular and plural forms of such terms.

Section 8.6 Entire Agreement; Conflict with Articles of Association; Amendment. This Third Restated JV Agreement represents the entire understanding and agreement between the Partners with respect to the subject matter hereof as of the date set forth in Section 8.7. In the event of any conflict between any provision of this Third Restated JV Agreement and the Articles of Association, as between the Partners, the provisions of this Third Restated JV Agreement shall prevail and control their rights and obligations, and the Partners agree to cause the Articles of Association to be amended so as not to conflict with this Agreement. This Third Restated JV Agreement may not be amended, modified, supplemented, extended, terminated, discharged or changed except by an amendment (including an additional or amended schedule or exhibit hereto) in writing signed by each of the Partners.

Section 8.7 Effective Date. This Third Restated JV Agreement is effective for all purposes and in all respects commencing on the date first set forth above.

Section 8.8 Waiver and Compliance. Any failure of a Partner to comply with any obligation, covenant, agreement or condition herein contained may be expressly waived, in writing only, by the other Partner and such waiver shall be effective only in the specific instance and for the specific purpose for which it is made or given.

Section 8.9 No License. Nothing in this Third Restated JV Agreement shall be deemed to constitute the grant of any license or other right in either party to or in respect of any product, patent, trademark, confidential information, trade secret or other data or any other intellectual property of the other party except as expressly set forth herein.

Section 8.10 Specific Enforcement. Each Partner acknowledges and agrees that the other Partner would be irreparably damaged in the event any of the provisions of this Third Restated JV Agreement were not performed by it in accordance with their specific terms or were otherwise breached. It is accordingly agreed that each Partner hereto shall be entitled to an injunction or injunctions to prevent breaches of such provisions and specifically to enforce such provisions, in addition to any other remedy to which such Partner may be entitled, at law or in equity.

Section 8.11 Cooperation. Each Partner agrees to sign and deliver all documents and instruments, and take such other actions, as may be necessary or advisable to comply with all applicable Laws in connection with this Third Restated JV Agreement.

Section 8.12 Counterparts. This Third Restated JV Agreement may be executed in counterparts, each of which shall be deemed an original, but all of which shall constitute one and the same instrument.

[Remainder of page intentionally left blank]

IN WITNESS WHEREOF, each of the Partners has caused this Third Restated JV Agreement to be duly executed in its name and on its behalf on the 29th day of October 2009.

"CCH"

CATERPILLAR COMMERCIAL HOLDING
SARL

"COCCSARL"

CATERPILLAR OVERSEAS CREDIT
CORPORATION SARL

By _____
(signature)

(printed name)

Title _____

By _____
(signature)

(printed name)

Title _____

"COIHSARL"

CATERPILLAR OVERSEAS INVESTMENT
HOLDING SARL

"CPDSARL"

CATERPILLAR PRODUCT
DEVELOPMENT SARL

By _____
(signature)

(printed name)

Title _____

By _____
(signature)

(printed name)

Title _____

"CAPLP"

CATERPILLAR ASIA PACIFIC L.P.

By Caterpillar Overseas Credit
Corporation SARL, General Partner

"CIPSARL"

CATERPILLAR INTERNATIONAL
PRODUCT SARL

By _____
(signature)

(printed name)

Title _____

By _____
(signature)

(printed name)

Title _____

I. LIST OF EXHIBITSExhibit Reference

- A Description of Class A Company Activity
- B Description of Class B Company Activity
- C Description of Class C Company Activity: (i) Compact Construction Activity, (ii) Articulated Trucks Activity, (iii) Dragline Buckets Activity, (iv) MaK Engines Activity and (v) Telescopic Materials Handler Company Activity
- D Description of Class D Company Activity
- E Description of Class E Company Activity
- F Description of Class F Company Activity
- G Description of Class G Company Activity
- H Description of Class H Company Activity

II. LIST OF SCHEDULESSchedule Reference

- 1 Company Activity Percentage Interest
- 2 Form of Variable Amount Subordinated Loan Agreement
- 3 Purchased P 2000 Intellectual Property
- 4 Developed P2000 Intellectual Property
- 5 Purchased Articulated Trucks and Dragline Buckets Intellectual Property
- 6 Developed MaK Engines Intellectual Property
- 7 Telescopic Material Handler Intellectual Property

Exhibit A**Description of Class A Company Activity:**

The Class A Company Activity includes the commercial activities conducted by the Company and Disregarded Entity Subsidiaries pursuant to the License Agreement, and the associated tangible and other intangible assets utilized by the Company and the Disregarded Entity Subsidiaries, in connection with the acquisition, promotion and sale in the Extra-APD Territory of Purchased Finished Replacement Parts/Components.

Excluded Activities:

The Class A Company Activity does not include any assets or activities set forth in Exhibits B, C, D, E, F, G and/or H.

Exhibit B**Description of Class B Company Activity:**

The Class B Company Activity includes the commercial activities conducted by the Company and Disregarded Entity Subsidiaries, and the associated tangible and intangible assets utilized by the Company and Disregarded Entity Subsidiaries, in connection with the acquisition, promotion and sale in the Extra-APD Territory of Prime Products, Components & Parts manufactured by, or acquired from, CAT and/or CAT Affiliates (other than the Company), but excluding Prime Products, Components & Parts sourced from the Brazil Territory.

The Class B Company Activity includes compensation and commissions received related to use of the Extra-APD Territory.

The Geneva Office Building is an asset of the Class B Company Activity.

The Class B Company Activity includes the results of Class B Treasury Functions that are not conducted on behalf of the other Company Activities. Such Class B Treasury Functions which are not conducted on behalf of the other Company Activities shall be determined and agreed by the Partners from time to time (and recorded in the Accounting Manual) and may include the results of activities related to excess cash management and foreign exchange hedging.

Excluded Activities:

The Class B Company Activity does not include any assets or activities set forth in Exhibits A, C, D, E, F, G and/or H.

EXHIBIT CDescription of Class C Company Activity:

The Class C Company Activity is comprised of the following activities:

Compact Construction Activity

The Compact Construction Equipment Activity includes the assets and activities supported by the ownership or license of patents, trademarks, trade names, know how and other intangibles for compact construction equipment applications as further described at Schedules 3 and 4 as "Zeppelin Intellectual Property" and "Compact Construction Equipment Intellectual Property" (together the "Compact Construction Activity Technology"). The Compact Construction Equipment Activity includes the development, promotion, manufacture and sale of products and equipment for compact applications, and includes, but is not limited to, the development, manufacture and marketing of the "Skid Steer Loader," "Mini-Hex," and "Compact Wheel Loader." Also included within this activity are the activities and assets associated with the acquisition, promotion and sale of replacement parts and work tools related to compact construction equipment emanating from the Compact Construction Equipment Technology and the licensing of Compact Construction Equipment Technology.

Articulated Trucks Activity

The Articulated Trucks activity includes the assets and activities supported by the ownership or license of the patents, trademarks, trade names, know how and other intangibles for the Articulated Trucks product family described as the "Articulated Trucks Intellectual Property" on Schedule 5 ("Articulated Trucks Intellectual Property"). This product family includes, but is not limited to, the development, manufacture and marketing of articulated trucks including the "E2" and "X" models of Articulated Truck. This activity includes, but is not limited to, the development, promotion, manufacture and sale of products and equipment utilizing the Articulated Trucks Intellectual Property. Also, included within this activity are the activities and assets associated with the acquisition, promotion and sale of replacement parts, components and work tools related to the Articulated Trucks product family emanating from the Articulated Trucks Intellectual Property and the licensing of Articulated Trucks Intellectual Property.

Dragline Buckets Activity

The Dragline Buckets activity includes the assets and activities supported by the ownership or license of the patents, trademarks, trade names, know how and other intangibles for the Dragline Buckets product family described as the "Dragline Buckets Intellectual Property" on Schedule 5 ("Dragline Buckets Intellectual Property"). This product family includes, but is not limited to, the development, manufacture and marketing of Dragline Buckets. This activity includes, but is not limited to, the development, promotion, manufacture and sale of products and equipment utilizing the Dragline Buckets Intellectual Property. Also, included within these

activities are the activities and assets associated with the acquisition, promotion and sale of replacement parts, components and work tools related to the Dragline Buckets product family emanating from the Dragline Buckets Intellectual Property and the licensing of Dragline Buckets Intellectual Property.

MaK Engines Activity

The MaK Engines activity includes the assets and activities supported by the ownership or license of the patents, trademarks, trade names, know how and other intangibles for the MaK Engines product family described as the "MaK Intellectual Property" on Schedule 6 ("MaK Intellectual Property"). This product family includes, but is not limited to, the development, manufacture and marketing of G340-16 engines. This activity includes, but is not limited to, the development, promotion, manufacture and sale, of products and equipment utilizing the MaK Intellectual Property. Also, included within these activities are the activities and assets associated with the acquisition, promotion and sale of replacement parts, components and work tools related to the MaK Engines product family emanating from the MaK Intellectual Property and the licensing of MaK Intellectual Property.

Telescopic Material Handler Company Activity

The telescopic material handler activity includes the assets and activities supported by the ownership and license of the patents, trademarks, trade names, know how and other intangible property for the Telescopic Material Handler ("TMH") product family further described on Schedule 7. The TMH activity includes, but is not limited to, the development, manufacture and marketing of mobile material handling machines with telescopic booms for industrial and agricultural applications. Included within this activity are the activities and assets associated with the acquisition, promotion and sale of replacement parts, accessories, tooling and attachments related to the TMH product family.

Each of the Partners acknowledges that the Company sold the TMH business and TMH Intellectual Property (described on Schedule 7) to an unrelated third party. Each of the Partners and the Company agrees that, to the extent the Company has any residual rights, liabilities or inventories in, under or with respect to the TMH business and/or TMH Intellectual Property, such shall continue to constitute a Class C Company Activity.

Excluded Activities:

The Class C Company Activity does not include any assets or activities set forth in Exhibits A, B, D, E, F, G and/or H.

Exhibit D**Description of Class D Company Activity:**

The Class D Company Activity includes the commercial activities conducted by the Company and Disregarded Entity Subsidiaries, and the associated tangible and intangible assets utilized by the Company and Disregarded Entity Subsidiaries, in connection with the acquisition, promotion and sale in the APD Territory of Prime Products, Components & Parts manufactured by, or acquired from, CAT and/or CAT Affiliates (other than the Company), but excluding Prime Products, Components & Parts sourced from the Brazil Territory.

The Class D Company Activity includes compensation and commissions received related to use of the APD Territory.

Real estate located in Singapore is an asset of the Class D Company Activity.

Excluded Activities:

The Class D Company Activity does not include any assets or activities set forth in Exhibits A, B, C, E, F, G and/or H.

EXHIBIT E**Description of Class E Company Activity:**

The Class E Company Activity includes the commercial activities conducted from and after 1 July 2000 by the Company and Disregarded Entity Subsidiaries involving, and the associated tangible and intangible assets utilized by the Company and Disregarded Entity Subsidiaries in connection with, the acquisition, promotion and sale of completed machines and machine subassemblies treated as completed machines manufactured by Caterpillar Japan Ltd. (formerly known as "Shin Caterpillar Mitsubishi").

Excluded Activities:

The Class E Company Activity does not include any assets or activities set forth in Exhibits A, B, C, D, F, G and/or H.

E-1

CONFIDENTIAL

PwC-CAT-00001616

Confidential Treatment Requested by PwC

PwC PSI CAT 00003446

EXHIBIT FDescription of Class F Company Activity:

The Class F Company Activity includes the commercial activities conducted by the Company pursuant to the License Agreement, and the associated tangible and other intangible assets utilized by the Company, in the manufacture of Prime Products, Components & Parts and the promotion and sale by the Company and Disregarded Entity Subsidiaries of such Prime Products, Components & Parts, but excluding Prime Products, Components & Parts sourced from the Brazil Territory.

Excluded Activities:

The Class F Company Activity does not include any assets or activities set forth in Exhibits A, B, C, D, E, G and/or H.

EXHIBIT G**Description of Class G Company Activity:**

The Class G Company Activity includes the commercial activities conducted by the Company and Disregarded Entity Subsidiaries pursuant to the License Agreement, and the associated tangible and other intangible assets utilized by the Company and the Disregarded Entity Subsidiaries, in connection with the acquisition, promotion and sale in the APD Territory of Purchased Finished Replacement Parts/Components.

Excluded Activities:

The Class G Company Activity does not include any assets or activities set forth in Exhibits A, B, C, D, E, F and/or H.

CONFIDENTIAL

PwC-CAT-00001618

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00003448

EXHIBIT HDescription of Class H Company Activity:

The Class H Company Activity includes the commercial activities conducted by the Company pursuant to the License Agreement, and the associated tangible and other intangible assets utilized by the Company, in the manufacture in the Brazil Territory of Prime Products, Components & Parts, and the promotion and sale by the Company and Disregarded Entity Subsidiaries of such Prime Products, Components & Parts.

Excluded Activities:

The Class H Company Activity does not include any assets or activities set forth in Exhibits A, B, C, D, E, F and/or G.

SCHEDULE 1

COMPANY ACTIVITY PERCENTAGE INTEREST

<u>Company Activity</u>	<u>Partner</u>	<u>Company Activity Percentage Interest</u>
Class A	COCCSARL	100%
Class B	CCH	100%
Class C	CCH	100%
Class D	COCCSARL	100%
Class E	COIHSARL	135/136 (99.2647%)
	CAPLP	1/136 (00.7353%)
Class F	CPDSARL	100%
Class G	CAPLP	100%
Class H	CIPSARL	100%

CONFIDENTIAL

PwC-CAT-00001620

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00003450

SCHEDULE 2

FORM OF VARIABLE AMOUNT SUBORDINATED LOAN AGREEMENT

THIS VARIABLE AMOUNT SUBORDINATED LOAN AGREEMENT made the ____ day of _____, 200_,

BETWEEN:

(1) _____, whose registered office is at _____ ("Lender"); and

(2) Caterpillar SARL, whose registered office is at 76, route de Frontenex, Geneva, Switzerland ("Borrower").

Whereas:

(A) Lender holds part of the capital of Borrower;

(B) The subordinated loan hereunder is intended for financing the general working capital requirements of Borrower;

(C) Lender has agreed to provide such financing by means of a loan under the terms and conditions set forth herein; and

(D) To provide protection to the creditors of Borrower (including Lender for any claims not originating from this loan);

IT IS AGREED:

1. Purpose

a. Lender hereby agrees to lend to Borrower a maximum aggregate principal amount in Schedule A, as determined and amended from time to time by mutual written agreement of the parties (the "Loan"), under the terms and conditions set forth herein.

b. The Loan is granted to enable Borrower to finance its general working capital requirements and to cover operating losses.

c. Lender shall lend funds to Borrower within 10 business days after the date Lender has received from Borrower a request therefor.

2. Interest. No interest shall be due on the Loan for its entire duration.3. Repayment

a. Lender hereby subordinates its claims deriving from this Variable Amount Subordinated Loan Agreement to any and all other claims of all other creditors of Borrower.

b. Lender hereby waives any claim for repayment it may have for the amount necessary to cover Borrower's accumulated deficit exceeding its equity (the "Subordinated Amount").

c. The Subordinated Amount cannot be repaid in cash, or by setting off the obligations of Borrower under the Loan with counterclaims of Borrower against Lender, secured, pledged, assigned or otherwise altered, either in whole or in part. However, nothing in this Variable Amount Subordinated Loan Agreement shall prevent the parties from agreeing to convert any part of the Subordinated Amount into equity of Borrower, or Lender to waive its all or any portion of its claim for repayment.

d. The Loan will be shown separately in the balance sheet and the subordinated character of the Loan will be disclosed in the balance sheet.

e. As a general rule, the Loan cannot be reimbursed in cash or by setting off, secured, pledged, assigned or otherwise altered in whole or in part until such time as the statutory auditors of, or, if Borrower has not designated statutory auditors, until such time as the management of Borrower, shall have certified that the accounts of Borrower show that none of the situations described in article 817 of the Swiss Code of Obligations arises, even if the Loan is treated as regular debt of Borrower. However, the part of the Loan which exceeds the Subordinated Amount can be reimbursed in cash or by setting off, secured, pledged assigned or otherwise altered, even if one of the situations described in article 817 of the Swiss Code of Obligations arises, if all other creditors of Borrower have given their consent in writing and if the statutory auditors of, or if Borrower has not designated statutory auditors, the management of Borrower confirms that the Subordinated Amount is sufficient to cover the accumulated deficit exceeding the equity of Borrower.

f. The Loan can be repaid only if the partners in Borrower have unanimously approved the repayment at a Partners' Assembly.

4. Costs. All costs and other expenses, including legal fees, incurred by Lender in connection with the preparation and execution of this Variable Amount Subordinated Loan Agreement or in preserving or enforcing or seeking to preserve or enforce any of Lender's rights hereunder shall be reimbursed by Borrower to Lender upon demand.

5. Notice. All notices and other communications required or permitted hereunder shall be in writing, addressed to the address of such party set forth below, or to such other address as such party shall communicate to the other.

For Lender:

Caterpillar [REDACTED]
76, Route de Frontenex
P.O. Box 6000
1211 Geneva 6
Switzerland
Attn: [REDACTED]
Facsimile: +41 [REDACTED]

Schedule 2-2

CONFIDENTIAL

PwC-CAT-00001622

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00003452

For Borrower:

Caterpillar SARL
76, Route de Frontenex
P.O. Box 6000
1211 Geneva 6
Switzerland
Attn: Craig Johnson, Deputy General Counsel (or any then successor)
Facsimile: +41 22 849 4982

6. Severability. If any provision contained in this Variable Amount Subordinated Loan Agreement or any document executed in connection herewith shall be invalid, illegal or unenforceable in any respect under any applicable law, the validity, legality and enforceability of the remaining provisions contained herein shall not in any way be affected or impaired, and such invalid, illegal or unenforceable provision shall at the request of Lender be replaced by other provisions in accordance with the purpose and meaning of this Variable Amount Subordinated Loan Agreement.

7. Governing Law. This Variable Amount Subordinated Loan Agreement shall be governed by and construed and enforced in accordance with the laws of Switzerland without regard to the principles of conflicts of law.

8. Jurisdiction. Any dispute arising from or in relation to this Variable Amount Subordinated Loan Agreement shall be subject to the exclusive jurisdiction of the Courts of the Canton of Geneva, Switzerland, with the right to appeal to the Swiss Federal Supreme Court in Lausanne, where allowed by law, whose judgment shall be final.

[Signature Blocks]

Schedule 2-3

CONFIDENTIAL

PwC-CAT-00001623

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00003453

1003

Schedule A

Loan amount (<i>maximum aggregate principal amount</i>)	Date	Lender	Borrower

Schedule 2-4

CONFIDENTIAL

PwC-CAT-00001624

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00003454

SCHEDULE 3

P2000 INTELLECTUAL PROPERTY

P2000 Intellectual Property

Intellectual and Industrial Property Rights, Know-how, Trademarks and Trade names, and Supplier and Customer Lists relating to the design, manufacture, assembly and sale of Skid Steer Loaders ("SSL"), as defined in the Purchase Agreement by and between Caterpillar Building Construction Products AG and Zeppelin GmbH and Zeppelin Technologie GmbH (the "Zeppelin Purchase Agreement") including but not limited to:

A. All patents, utility models, industrial designs, copyrights and similar rights and applications therefor, including those in computer software or on compact disc, and in particular those items as listed in Exhibit A of the Zeppelin Purchase Agreement;

B. All trade secrets, inventions, research and development results, test results, production techniques, specifications and formulas, and in particular those items listed in Exhibit B of the Zeppelin Purchase Agreement;

C. The SSL's under development as listed in Exhibit C of the Zeppelin Purchase Agreement;

D. All supplier and customer lists and related information, and in particular those suppliers and customers listed in the Exhibit D of the Zeppelin Purchase Agreement;

E. All prototypes, documents and bills of material, and in particular those items listed in Exhibit E of the Zeppelin Purchase Agreement;

F. All SSL product designations, trade appearance and get-up, whether registered or not, including all rights to use the "ZK" and (to the extent Zeppelin, or its affiliates have any rights thereto) "Zetcat" marks, excluding the usage of the "blue stripes" designation; and

G. All derivatives, improvements, and updates to the foregoing, which relate to the design, manufacture, assembly, inspection, test, sale, distribution, operation, use, maintenance, servicing or repair of existing or future SSL's.

SCHEDULE 4

DEVELOPED P2000 INTELLECTUAL PROPERTY

Research and Development relating to P2000 Intellectual Property

All research and development performed subsequent to the date of the Purchase Agreement among Caterpillar Building Construction Products AG, Zeppelin GmbH, and Zeppelin Technologie GmbH relating to "Skid Steer Loaders", "Mini Hex", "Compact Wheel Loaders", other compact construction equipment and work tools relating thereto, including but not limited to layout, design testing, engineering, engineering analysis, software development, computer simulation, finite element analysis and CAD-CAM input.

CONFIDENTIAL

PwC-CAT-00001626

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00003456

SCHEDULE 5PURCHASED ARTICULATED TRUCKS AND
DRAGLINE BUCKETS INTELLECTUAL PROPERTYArticulated Trucks Intellectual Property

Intellectual Property and goodwill associated therewith, relating to articulated trucks and work tools developed after 31 December 1995 by Caterpillar Inc. and Caterpillar Peterlee Limited for use in Caterpillar E2 and X series articulated trucks and successor models thereto as described in the Purchase Agreement between Caterpillar SARL (formerly Caterpillar Commercial SARL), Caterpillar Inc. and Caterpillar Peterlee Limited.

Such intellectual property shall include (but is not limited) to all of the below referenced property:

- A. All inventions (whether patentable or unpatentable and whether or not reduced to practice) and all improvements thereto, all patents, patent applications and similar rights, and patent disclosures, together with all reissuances, continuations, continuations-in-part, revisions, extensions and reexaminations thereof;
- B. All trademarks, service marks, trade dress, logos, and trade names, together with all translations, adaptations, derivations and combinations thereof, and including all goodwill associated therewith, and all applications, registrations and renewals in connection therewith;
- C. All copyrightable works, all copyrights and all applications, registrations and renewals in connection therewith;
- D. All trade secrets and confidential business and technical information (including ideas, know-how, formulas, compositions, manufacturing and production processes and techniques, technical data and designs (including applications and registrations in connection therewith), drawings, specifications, customer and supplier lists, pricing and cost information, and business and marketing plans and proposals);
- E. All research and development performed subsequent to 31 December 1995 with respect to the intellectual property as described in the introductory paragraph including layout, design testing, engineering, engineering analysis, software development, computer simulation, etc;
- F. All computer software (including data and related documentation);
- G. All other proprietary rights;
- H. All copies and tangible embodiments thereof (in whatever form or medium including electronic); and

CONFIDENTIAL

PwC-CAT-00001627

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00003457

I. All right, title and interest in and rights thereunder, remedies against infringements thereof, and rights to protection of interests therein under the laws of all jurisdictions.

Such intellectual property shall not include background technology developed for the E series model which has been, under a separate agreement, licensed by Caterpillar Inc. for use by Caterpillar SARL in the E2 and X series.

Dragline Buckets Intellectual Property

All intellectual property of Wright Equipment Company (Proprietary) Limited, a company incorporated in South Africa, Registration No 64/01056/07 (the "Company") as described in:

1. Annexe "B" of the Sale of Shares Agreement between John Louis Van Reenen, Van Reenen Steel (Proprietary) Limited, and Caterpillar Inc. signed September 23 and effective September 25, 1998,

2. Annexe "B" of the Sale of Shares Agreement between Barlow Limited, Wrightech (Proprietary) Limited and Caterpillar Inc. signed September 23 and effective September 25, 1998, and

3. Exhibit A of the purchase Agreement between Wright Equipment Company (Proprietary) Limited and the Company dated December 18, 1998.

It shall include all intellectual property which is owned by, licensed to, licensed by, used or held for use by the Company (including all copies and embodiments thereof in electronic, written or other media) and shall include in particular and without limitation:

A. All trademarks (both registered and unregistered) service marks, logos and trade names of the Company including the names "Wright" and "Wrightech" and any derivative of such names and all applications to register same;

B. All patents held by the Company (together with pending patent disclosures and improvements), including, without limitation, the following:

- * 95/5038 dragline bucket (in force)
USA patent #5,575,092
Australian Appl. 21751/95
Canadian Appl. 2,152,252
- * 97/2755 Nose piece for attaching GET (in force)
- * 97/8705 Wear resistant block (pending)

Schedule 5-2

CONFIDENTIAL

PwC-CAT-00001628

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00003458

- * 98/0789 Ground Engaging Tool Components

Australian Appl. 53866/98

Canadian Appl. 2,229,112

USA Appl. 09/021,747

C. All registered and unregistered designs owned by the Company including in particular and without limitation those depicted on the drawings relating to:

- * Transporter
- * P & H Dipper Stick
- * Shovel Bucket

D. All computer software programs, databases designed or created, owned or used by the Seller or under development for the Seller by third parties by or on behalf of the Company;

E. All categories of trade secrets, know-how, skills, techniques, current and accumulated procedures, inventions (whether or not patentable and whether or not reduced to practice), inventor's certificates, processes, procedures, drawings, specifications, designs, plans, proposals, technical data, words capable of copyright, financial, marketing and business data, pricing and cost information, business and marketing plans, client and supply lists and other confidential and proprietary information relating to the Company; and

F. The Company's interest in a consultancy agreement dated March 16, 1998, entered into with Oswarld Zaayman.

Schedule 5-3

CONFIDENTIAL

PwC-CAT-00001629

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00003459

SCHEDULE 6

DEVELOPED MaK INTELLECTUAL PROPERTY

All intellectual property related to the G340-16 Engine Program as described in the development agreement between Caterpillar Inc., MaK Motoren GmbH & Co. KG, and the Company, effective August 1, 1997.

Such intellectual property shall include (but not limited to) the following:

A. All inventions (whether patentable or unpatentable and whether or not reduced to practice) and all improvements thereto, all patents, patent applications and similar rights, and patent disclosures, together with all reissues, continuations, continuations-in-part, revisions, extensions and reexaminations thereof, all engineering work in the form of test results and engineering drawings, made or conceived by either Caterpillar or MaK, either alone or with others subsequent to August 1, 1997 relative to the G340-16 Engine Program;

B. All trademarks, service marks, trade dress, logos, and trade names, together with all translations, adaptations, derivations, and combinations thereof and including all goodwill associated therewith, and all applications, registrations and renewals in connection therewith;

C. All copyrightable works of authorship, all copyrights, and all applications, registrations, and renewals in connection therewith created under the development agreement;

D. All trade secrets and confidential business and technical information (including ideas, know-how, formulas, compositions, processes including manufacturing and production processes and techniques, technical data and designs (including applications and registrations in connection therewith), drawings, specifications, customer and supplier lists, pricing and cost information, and business and marketing plans and proposals, systems, formula, pattern, model, device, compilation or other information), received or developed by either Caterpillar or MaK, not known by either party without restriction on its use or disclosure prior to the development agreement and not generally known by others; but excluding knowledge, skills or information which is common to Caterpillar's or MaK's business;

E. All research and development performed subsequent to August 1, 1997 with respect to the intellectual property as described in the introductory paragraph including layout, design testing, engineering, engineering analysis, software development, computer simulation, etc;

F. All computer software (including data and related documentation);

G. All other proprietary rights;

H. All copies and tangible embodiments thereof (in whatever form or medium including electronic); and

CONFIDENTIAL

PwC-CAT-00001630

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00003460

I. All right, title, and interest in and rights thereunder, remedies against infringements thereof, and rights to protection of interests therein under the laws of all jurisdictions.

Schedule 6-2

CONFIDENTIAL

PwC-CAT-00001631

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00003461

SCHEDULE 7

TELESCOPIC MATERIAL HANDLER INTELLECTUAL PROPERTY

The Telescopic Material Handler ("TMH") Intellectual Property includes, but is not limited to:

(a) Inventions (whether patentable or not), patents, patent applications, know-how, topographic rights in computer components, trade secrets, prototypes, design models, design documents, drawings, sketches, concept studies, and other engineering, technical or regulatory information of any kind related to the Family 1, Family 2 and Family 3 Telehandlers acquired on 18 April 2000 from Class Holdings Limited and Teleporters Limited;

(b) Intellectual property licensed from Cat relating to TMH Series "A" models, including the manufacturing and marketing rights thereto; and

(c) Intellectual property arising from research and development with respect to the TMH Series "B" models, including exploitation of the Series "A" intellectual property licensed from Caterpillar Inc.

EUROPEAN PARTS
& PARTS 2000

PWC-CAT-00001633

CONFIDENTIAL

Caterpillar Inc
CSARL 2009 activities
Report to Audit team
January 2010

Tom Quinn, Tax ITS
Steve Williams, Tax Transfer Pricing
Ed Bodham, Tax ITS

PRICEWATERHOUSECOOPERS 

CONFIDENTIAL

PwC-CAT-00002431

Unauthorized Transmission Prohibited by Law

PwC PSI CAT 0000350

1. Regional Product Managers in CSARL

The Enterprise Alignment White Papers established the key entrepreneurial role of the **"Worldwide Product Managers"** in the Machine Business Divisions. **"Regional Product Managers"** would have regional authority over products manufactured/sold in regions.

- Corporate Tax and PwC worked to ensure that the responsibilities of the Geneva-based "Regional Product Managers" complied with new Treas Reg. 1.954-3 which required CSARL employees demonstrate "substantial contribution" in the manufacturing process, in order for CSARL's income to be excluded from FBCSI (deferral)
 - For Earthmoving: Remy Bouteille (already in place)
 - For Excavation: Zach Kauk (already in place)
 - For CBL production: Quentin de Warlincourt from Nov 2009, and Andre Christophe as of April 2010.

CSARL 2009 activities
PricewaterhouseCoopers

January 2010
Slide 4

CONFIDENTIAL

PwC-CAT-00002434

**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

1. Regional Product Managers in CSARL, p 3

Supporting Evidence:

- Target Design (excerpts attached)
- Revised White Paper with language supporting substantial contribution
- Roles and Responsibilities checklists
- CSARL Accounting: new Class H
- Legal Agreements: amend license agreement, create new Class H.
- Pricing and transaction flow: minor changes. (sales to US routed through CSarL or CNAmSarL.
 - Since 2005, CBL has sold its exports to CSARL/CAM SARL at a "contract manufacturing" price. This pricing continued unchanged.

I. RPMs	
Contents of Closing Book	
1. Final Target Design	<ul style="list-style-type: none"> • RPM Roles and Responsibilities • Powerpoint • Broad Compulsions Deliverable • Class H Structuring
2. Implementation Checklist	<ul style="list-style-type: none"> • Project Workplan
3. Legal Agreements	<ul style="list-style-type: none"> • Amendment to CAT-CSARL • License Agreement • Assignment of Class H Interest • CSARL 3rd Amended and Restated JV Agreement
4. Other*	<ul style="list-style-type: none"> • RPM Announcement

CSARL 2009 activities
PricewaterhouseCoopers

January 2010
Slide 6

[illegible]

Organizational chart of the RPM Group Alignment:

- RPM Group
 - Business Units
 - Retail
 - Wholesale
 - Direct
 - Service
 - Logistics
 - Manufacturing
 - Distribution
 - Support Functions
 - Finance
 - Marketing
 - Sales
 - Operations
 - Technology
 - Legal
 - Human Resources

Units reporting to the RPM Group currently members of the "RPM Group" located in Germany are also included.

January 2010
Slide 7

1. Regional Product Managers in CSARL, p 5 Excerpts from Target Design: Substantial Contribution

Substantial Contribution Factor #1	
1. Oversight and direction of the manufacturing activities or process.	
<p>Oversees/controls RPM job responsibility as demonstrated to Respective Office</p> <ul style="list-style-type: none"> - RPM has sole authority over the machine assembly/production capacity in the plant (RPM makes determination and RPM scheduling) - RPM responsible for ensuring the regional source Executive Product Program (EPP) launch 	<p>Process design for RPM responsibility to meet Substantial Contribution requirements</p> <p>DAOP PROCESS</p> <ul style="list-style-type: none"> - The RPM will have direct management and direct accountability for the DAOP process, as evidenced by creating documentation within 171 factory designable responsibility from the RPM to the RPM and 2) factory inventory the RPM as having the leading role of the RPM in the DAOP design. - The RPM will actively engage with the Chief Production Officer throughout the design process to ensure the RPM's DAOP design, which the RPM will lead. - The RPM will work with relevant manufacturing facility at least once a year for plant history and control for the DAOP process. - The RPM will not have approved the last mile through participation in any responsibility under the DAOP process. <p>EPP and Alternative Sources</p> <ul style="list-style-type: none"> - The RPM will work with the Manufacturing Engineering Manager to jointly develop and execute plans to meet the targeted EPP production volume. - The RPM will be responsible for approving and executing the regional source EPP. - The RPM is the first to determine the EPP and the local managers on sourcing decisions, including alternative sources. - The RPM will identify opportunities for alternative sources for prime product manufacturing to enhance profitability.

... etc for five other Sub Con factors...

CSARL 2009 activities
PricewaterhouseCoopers

January 2010
Slide 6

CONFIDENTIAL

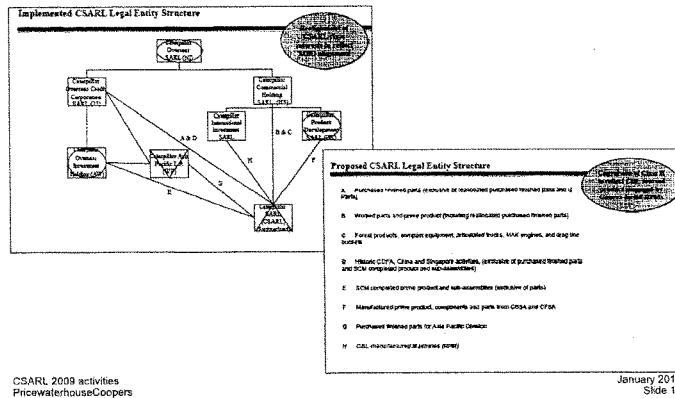
PwC-CAT-00002438

[illegible]

<p>➤ With the implementation of the ITSM, each report is far more active involvement from management as compared with current and previously proposed structures.</p>	
<p>Business to Business</p> <ul style="list-style-type: none"> ➤ Product Manager (PM) is responsible for the product and should also be the interface between the product and the customer. ➤ Product Manager is responsible for the product and should also be the interface between the product and the customer. ➤ Product Manager is responsible for the product and should also be the interface between the product and the customer. 	<p>Business to Business</p> <ul style="list-style-type: none"> ➤ Product Manager (PM) is responsible for the product and should also be the interface between the product and the customer. ➤ Product Manager is responsible for the product and should also be the interface between the product and the customer. ➤ Product Manager is responsible for the product and should also be the interface between the product and the customer.

January 2010
Slide 9

1. Regional Product Managers in CSARL, p 7 New Class H for CBL Product

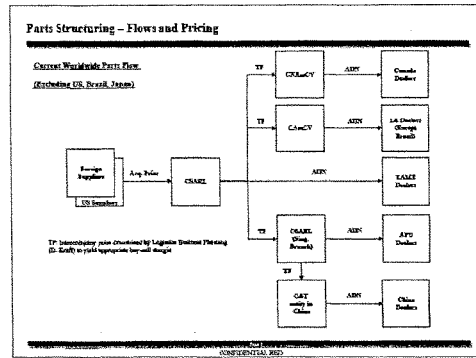


CONFIDENTIAL

PwC-CAT-00002440

**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

3. WW Parts Management in Geneva, p 3
Selected slides from Target Design



CSARL 2009 activities
PricewaterhouseCoopers

January 2010
Slide 20

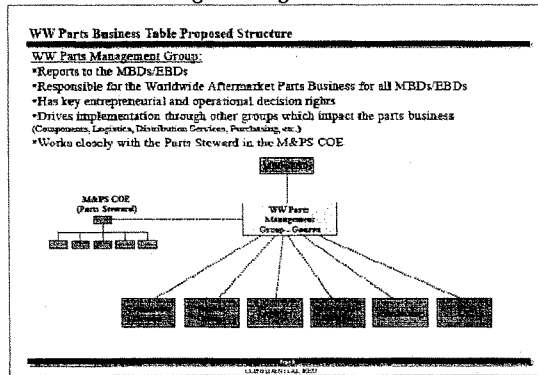
Confidential Treatment Requested by DoD

PwC PSI CAT 0000394

CONFIDENTIAL

PwC-CAT-00002450

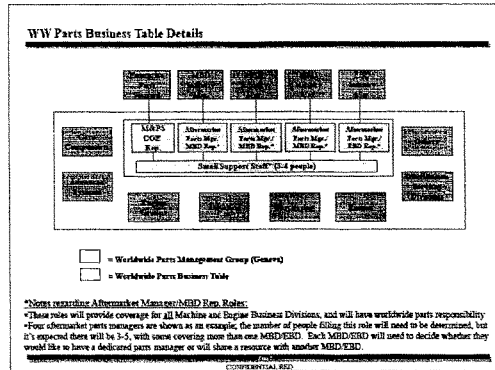
3. WW Parts Management in Geneva, p 4 Selected slides from Target Design



CSARL 2009 activities
PricewaterhouseCoopers

January 2010
Slide 21

3. WW Parts Management in Geneva, p 5
Selected slides from Target Design



CSARL 2009 activities
PricewaterhouseCoopers

January 2010
Slide 22

CONFIDENTIAL

PwC-CAT-00002452

3. WW Parts Management in Geneva, p 6 Selected slides from Target Design

WW Parts Business Table Details

The following are the most critical activities impacting Parts Sales & Profit, which the Parts Management Group will manage:

- Parts Business Strategy
- Sales/Share targets
- Margin targets
- Cost Targets
- NPQ
- Customer offerings
- Distribution Services Alignment
- Pricing / Sales Volume

This group brings needed focus to the parts business and is key to effective implementation of Enterprise Alignment changes on parts

- Without this group, some MBDs may not be ready to assume responsibility for the parts business due to other priorities (Time IV, cost reduction, etc.)

A Parts "Business Table" would now periodically drive execution of parts business initiatives

- Chaired by the Geneva-based Parts Management group
- Forum for reviewing the state of the business, making/communicating decisions, discussing progress toward meeting business goals (e.g. targets for revenue, share, cost reduction, availability), etc.
- Bring together various groups which impact the parts business (Compensation Groups, Logistics, DSDs, Purchasing, MAPS COR, etc.) to implement parts strategies and coordinate parts activities

In addition to the Parts Management group, there are others in Geneva & Singapore who are key contributors to parts sales and profit (provide additional relevance from a TSM perspective)

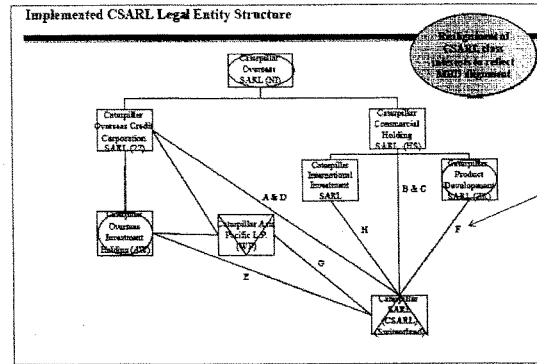
- Regional MBD Product Manager (2 in Geneva)
- MBD Industry Manager (3 in Geneva; 2 in Singapore)
- Dist Services Division (Various personnel up through VP in Geneva & Singapore)
 - Each DSD currently has a Product Support group to help ensure timely product support activities

CONFIDENTIAL

CSARL 2009 activities
PricewaterhouseCoopers

January 2010
Slide 23

4. Reorganization of CSARL Structure Utilization of Class F losses



CSARL 2009 activities
PricewaterhouseCoopers

January 2010
Slide 24

CONFIDENTIAL

PwC-CAT-09002454

Redacted by the Permanent
Subcommittee on Investigations

Summary and Next Steps

1. Corporate Tax, with PwC Assistance, leveraged Enterprise Alignment to preserve and enhance CSARL tax structure:

- Separated parts sales out of CBL, move to CBCL; CBCL will be disregarded under CSARL. Result: more of CAmCV is now non-FBCSI.
- Established Worldwide Parts Management group in Geneva, comprising personnel from MBDs/EBDs, and M&PS COE.
- Reorganization of CSARL structure to utilize Class F tolling losses

2. Now compiling "closing books" of target designs and workplans, agreements, personnel announcements, memoranda, etc. Target completion: March 31, 2010

CSARL 2009 activities
PricewaterhouseCoopers

January 2010
Slide 25

CONFIDENTIAL

PwC-CAT-00002455

Confidential - Permanent Subcommittee on Investigations

PwC-PRI CAT 00003854

Appendices

The following are larger versions of the slides presented in the earlier slides.

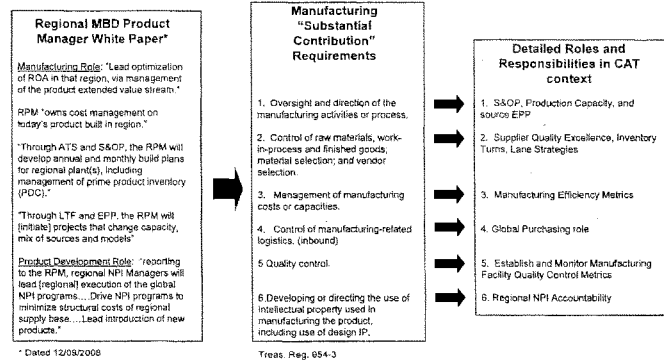
CSART 2009 activities
PricewaterhouseCoopers

January 2010
Slide 27

CONFIDENTIAL

PwC-CAT-00002457

Roles and Responsibilities



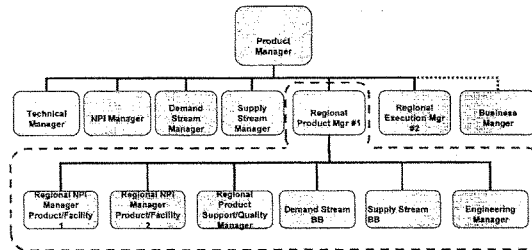
CSARL 2009 activities
PricewaterhouseCoopers

January 2010
Slide 28

CONFIDENTIAL

PwC-CAT-00002468

Roles and Responsibilities



*When referring to the RPM, certain members of the "RPM Group" located in Geneva are also included

Substantial Contribution Factors

1. Oversight and direction of the manufacturing activities or process.

Geneva-based RPM job responsibility as communicated to Executive Office	Process design for RPM responsibility to meet Substantial Contribution requirements
<ul style="list-style-type: none"> - Short term S&OP must belong to the RPM - RPM has sole authority over the machine assembly footprint (production capacity) in the plant (WWPM makes determination and RPM executes). - RPM responsible for executing the regional source Executive Product Program (EPP) forecast 	<p><u>S&OP Processes</u></p> <ul style="list-style-type: none"> - The RPM will have direct management and direct accountability for the S&OP process, as evidenced by creating documentation which (1) formally delegates responsibility from the WWPM to the RPM and (2) formally identifies the RPM as having the leading role of the RPM in the S&OP meetings. - The RPM will actively engage with the Order Fulfillment group throughout the month prior to the formal monthly "board level" S&OP meeting, which the RPM will lead. - The RPM will visit each relevant manufacturing facility at least twice a year to retain familiarity and control for the S&OP process. - The RPM will review and approve the build rates through participation in and responsibility over the S&OP process. <p><u>EPP and Alternate Sourcing</u></p> <ul style="list-style-type: none"> - The RPM will work with the Manufacturing Engineering Manager to jointly develop and execute plans to meet the assigned EPP production volume. - The RPM will be responsible for approving and executing the regional source EPP. - The RPM is the link between the WWPM and the local managers on sourcing decisions, including alternative sources. - The RPM will identify opportunities for alternative sources for prime product manufacturing to enhance profitability.

CSARL 2009 activities
PricewaterhouseCoopers

January 2010
Slide 30

CONFIDENTIAL

PwC-CAT-00002460

Substantial Contribution Factors

2. Control of raw materials, work-in-process and finished goods; material selection; and vendor selection.

Geneva-based RPM job responsibility as communicated to Executive Office	Process design for RPM responsibility to meet Substantial Contribution requirements
<ul style="list-style-type: none"> - RPM responsible for supplier quality excellence - Inventory turns for RPM at plant level (RPM is responsible for inventory levels). WPPM can have inventory turn metric, but must be rollup of worldwide production facilities - RPM responsible for developing and executing Lane strategies, configurations to offer 	<p>Supplier Quality</p> <ul style="list-style-type: none"> - The RPM will establish, through the NPI process, specific targets for supplier quality: (a) Defective Parts Per Million ("PPM") and (b) CPK (process repetition-certification). - The RPM will monitor specific targets for supplier quality: (a) PPM, (b) CPK, and (c) Delivery Performance. - The RPM will review and formally approve any new suppliers and will actively participate in the Global Purchasing local site Supplier Quality council. - RPM will participate in setting Supplier Day messages and guidelines and attend Supplier Day in person (proficiency in local language of the manufacturing facility and supplier base is necessary). <p>Prime Product Inventory</p> <ul style="list-style-type: none"> - Through ATS and S&OP, develop annual and monthly build plans for his/her regional manufacturing facilities. This includes management of Prime Product inventory levels (PDC). - Accountable for Prime Product inventories: sets availability targets for all Lanes (not configuration for Lanes 2 & 3). <ul style="list-style-type: none"> - The RPM will define configurations and is responsible for finished Lane 1 product definition. - The RPM will develop a relationship with the Industry Group to coordinate Lane 2 strategies by meeting with the Industry Group at least twice a year. - The RPM will manage inventory levels through their his/her involvement in the S&OP process. - The RPM must understand the unique factors influencing inventory turns by visiting each manufacturing facility at least twice a year. <p>Material Costs</p> <ul style="list-style-type: none"> - The RPM is responsible for all material costs.

CSARTL 2008 activities
PricewaterhouseCoopers

January 2010
Slide 31

Confidential Treatment Requested by PwC

PwC PSI CAT 0003986

CONFIDENTIAL

PwC-CAT-00032461

Substantial Contribution Factors

3. Management of manufacturing costs or capacities.

Geneva-based RPM job responsibility as communicated to Executive Office	Process design for RPM responsibility to meet Substantial Contribution requirements
<ul style="list-style-type: none"> Monthly and annual build rates belong to RPM Manufacturing efficiency metrics belong to the RPM. VWRPM should not have any efficiency metrics (Cost per Base Hour, Class A Metrics, CPS Score Assessment) for the regional plants. 	<p><u>Build Rates</u></p> <ul style="list-style-type: none"> RPM will review and approve build rates through participation in and responsibility over the S&OP. <p><u>Efficiency metrics</u></p> <ul style="list-style-type: none"> Efficiency metrics should be applied to each manufacturing facility and the RPM. Efficiency metrics include an escalation procedure to the RPM for resolution where factors beyond a manufacturing facility's control impact such manufacturing facility's metrics. <p><u>Cost Measurement targets</u></p> <ul style="list-style-type: none"> The RPM will be responsible for each manufacturing facility's cost measurement processes, which include manufacturing costs and logistic and transportation costs, by establishing manufacturing facility level cost targets.

Substantial Contribution Factors

4. Control of manufacturing-related logistics (Inbound)

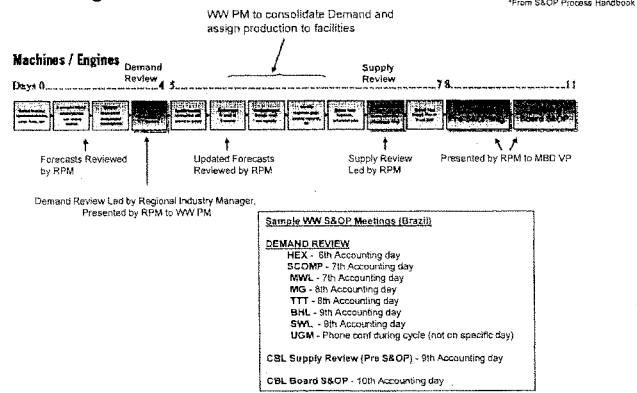
Geneva-based RPM job responsibility as communicated to Executive Office	Process design for RPM responsibility to meet Substantial Contribution requirements
- Global Purchasing assumes inbound logistics role, but the position would be in Geneva	- TBD

Substantial Contribution Factors

5. Quality control.

Geneva-based RPM job responsibility as communicated to Executive Office	Process design for RPM responsibility to meet Substantial Contribution requirements
<ul style="list-style-type: none"> - VWV product manager has worldwide design quality control metric. Regional Product Manager has regional design quality control metric. - Regional product manager has plant quality control metric, emphasizing that the regional product manager is highly engaged with improving regional manufacturing processes; VWV PM should not have any regional manufacturing quality control metric. - Regional product manager picks up the role of product development manager - Local engineering maintenance must report to the RPM - Engineering maintenance reports to the RPM 	<p><u>NPI Process</u></p> <ul style="list-style-type: none"> - Through management of the regional NPI process, the RPM will have responsibility for the quality of regional product design as applicable to each facility. <p><u>Quality Control metrics</u></p> <ul style="list-style-type: none"> - The RPM will have responsibility for setting and monitoring the accountable metrics for each manufacturing facility's quality control on the assigned products (but not including inbound components). - The RPM's quality metrics must be aligned with the existing specific metrics for each manufacturing facility, including Prime Products (VEHR, DRF), components (PPM, CPK, Delivery Performance), and warranty costs as percentage of sales. - The RPM will be responsible for approving each manufacturing facility-developed action plan to address quality issues. <p><u>Engineering Maintenance (Manufacturing Process Improvement)</u></p> <ul style="list-style-type: none"> - To the extent applicable for each manufacturing facility, NPI activities related to manufacturing process improvement should report to the RPM. - (In EAME, these "engineering maintenance" activities are involved to CSARL separately from the manufacturing service agreement.)

S&OP Changes



CSARL 2008 activities
PricewaterhouseCoopers

January 2010
Slide 35

CONFIDENTIAL

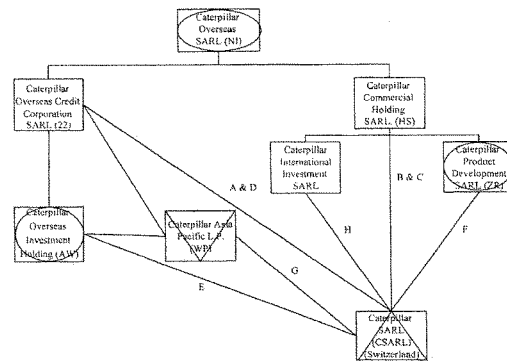
PwC-CAT-00002465

S&OP Changes (cont.)

- With the implementation of the RPM, each region will see more active involvement from management as compared with current and previously proposed structures.

PM Role in S&OP	RPM Role in S&OP
Product Manager (from S&OP FAQs): <ul style="list-style-type: none"> - Product Manager and MBD VP are required to attend the demand review for each region. - Product Manager is owner of Supply Review and Pre S&OP but not Demand Review. - Product Manager coordinates with Worldwide Product Manager for production output information for each respective region. - The MBD VP will lead the Board S&OP meeting. - The MBD VP attends all board S&OP meetings for products. 	Recommendations for Regional Product Manager: <ul style="list-style-type: none"> - The RPM is the owner Supply Review and Pre S&OP process for the assigned Region and will lead the respective meetings. - Managers in each respective region (NPI, Demand, etc) report to the RPM for review and signoff. - Instead of having a WW Product Manager and MBD VP at each review meeting, the RPM will take the role of regional leader, reporting developments and regional S&OP updates to the MBD VP and WWPM. - The RPM will have responsibility for ensuring production from plants in his/her respective region meets the agreed demand targets. - The RPM will lead the S&OP Supply Review and Pre-S&OP process for each manufacturing facility - The MBD Industry manager is the owner of the Demand Review in order to give expertise on the surrounding markets. - The RPM will act as a liaison between facility/process managers and management, and will represent the facility at the Board S&OP.

CSARL Legal Structuring



CSARL 2009 activities
PricewaterhouseCoopers

January 2010
Slide 37

CSARL Legal Structuring (cont.)

- A Purchased finished parts (exclusive of reallocated purchased finished parts and G Parts)
- B Worked parts and prime product (including reallocated purchased finished parts)
- C Forest products, compact equipment, articulated trucks, MAK engines, and drag line buckets
- D Historic COFA, China and Singapore activities, (exclusive of purchased finished parts and SCM completed product and sub-assemblies)
- E SCM completed prime product and sub-assemblies (exclusive of parts)
- F Manufactured prime product, components and parts from CBSA and CFSA
- G Purchased finished parts for Asia Pacific Division
- H *CBL-manufactured Machines (RPM)*

CSARL 2009 activities
PricewaterhouseCoopers

January 2010
Slide 38

CONFIDENTIAL

PwC-CAT-00002468

Parts Planning Initiative – Target Parts Flow

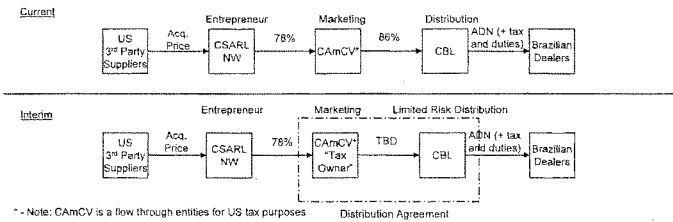
Objectives

- Add CBCL in the purchase and sale of domestic replacement parts to Brazilian dealers.
- Replace CBL with CBCL in the purchasing flow for imported parts purchased from CAMCV (via the bonded warehouse).
- Maintain compliance with all corporate policies and procedures and U.S., Brazilian and other legal requirements.

Secondary Objectives

- Minimize indirect local taxes paid on replacement part transactions.
- Minimize impacts to bonded warehouse benefits.

Interim Solution



- From a Brazilian title flow perspective, the current flow and interim solution are the same.
- The difference is due to the benefits and burdens residing in CAMCV/CSARL.

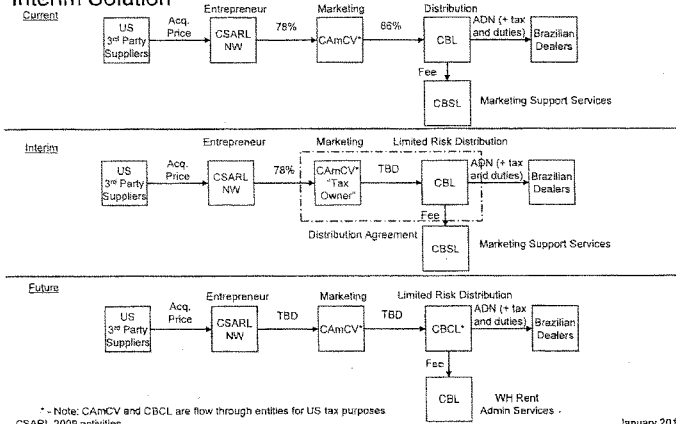
- The interim solution is a viable way to accelerate the Parts benefit due to the delay in systems readiness for CBCL. However, the interim solution is only meant to be a SHORT TERM solution.
- From a US tax perspective, the interim solution views CSARL as selling to dealers

- LEGAL ownership passes the same way as the current flow, however ECONOMIC ownership changes from CBL to CAMCV/CSARL.

- TBD – Price changes to reflect reduced risk in CBL
- CSARL 2009 activities
PricewaterhouseCoopers

January 2010
Slide 40

Interim Solution

January 2010
Slide 41

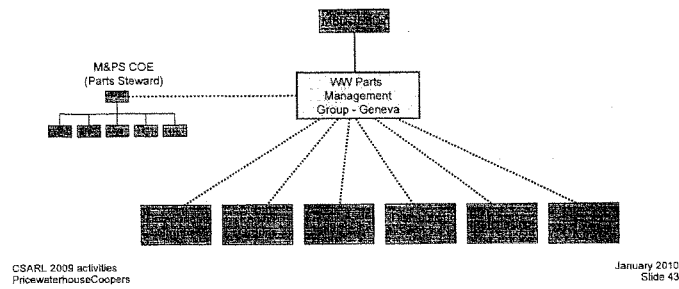
CONFIDENTIAL

PwC-CAT-00002471

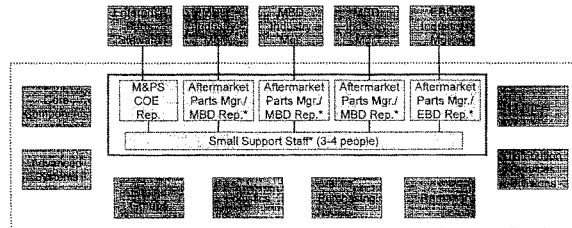
Worldwide Parts Business Table

WW Parts Management Group:

- Reports to the MBDs/EBDs
- Responsible for the Worldwide Aftermarket Parts Business for all MBDs/EBDs
- Has key entrepreneurial and operational decision rights
- Drives implementation through other groups which impact the parts business (Components, Logistics, Distribution Services, Purchasing, etc.)
- Works closely with the Parts Steward in the M&PS COE



Worldwide Parts Business Table



☐ = Worldwide Parts Management Group (Geneva)

☐ = Worldwide Parts Business Table

*Notes regarding Aftermarket Manager/MBD Rep. Roles:

- These roles will provide coverage for all Machine and Engine Business Divisions, and will have worldwide parts responsibility
- Four aftermarket parts managers are shown as an example; the number of people filling this role will need to be determined, but it's expected there will be 3-5, with some covering more than one MBD/EBD. Each MBD/EBD will need to decide whether they would like to have a dedicated parts manager or will share a resource with another MBD/EBD.

CSARL 2009 activities
PricewaterhouseCoopers

January 2010
Slide 44

Worldwide Parts Business Table

The following are the most critical activities impacting Parts Sales & Profit, which the Parts Management Group will manage:

- Parts Business Strategy
- Sales/Share targets
- Margin targets
- Cost Targets
- NPI
- Customer offerings
- Distribution Services Attributes
- Pricing / Sales Variance

This group brings needed focus to the parts business and is key to effective implementation of Enterprise Alignment changes on parts

- Without this group, some MBDs may not be ready to assume responsibility for the parts business due to other priorities (Tier IV, cost reduction, etc.)

A Parts "Business Table" would meet periodically to drive execution of parts business initiatives

- Chaired by the Geneva-based Parts Management group
 - Forum for reviewing the state of the business, making/communicating decisions, discussing progress toward meeting business goals (i.e. targets for revenue, share, cost reduction, availability), etc.
 - Brings together various groups which impact the parts business (Component Groups, Logistics, DSDs, Purchasing, M&PS COE, etc.) to implement parts strategies and coordinate parts activities
- In addition to the Parts Management group, there are others in Geneva & Singapore who are key contributors to parts sales and profit (provides additional substance from a Tax perspective)
- Regional MBD Product Managers (2 in Geneva)
 - MBD Industry Managers (3 in Geneva; 2 in Singapore)
 - Dist. Services Divisions (Various personnel up through VP in Geneva & Singapore).
 - Each DSD currently has a Product Support group to help ensure dealer product support excellence

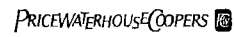
CSARL 2009 activities
PricewaterhouseCoopers

January 2010
Slide 45

Confidential Treatment Requested by PwC

PwC PS CAT 10003975

© 2010 PricewaterhouseCoopers. All rights reserved. "PricewaterhouseCoopers" refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.



CONFIDENTIAL

PwC-CAT-00002476

Caterpillar Inc.
Worldwide Parts
Management
Final Closing Book

Draft Version as of March 15, 2010

CONFIDENTIAL

PwC-CAT-00002477

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00003876

Table of Contents - Worldwide Parts Management

Title	Date	Document Origin	Page	Status
Section I - Roundtable Meetings				
Worldwide Parts Management ("WWPM") Agenda Slides	11/4/2009	John Caviness	3	Completed
Roundtable Meeting Pre-Work Email	2/25/2010	John Caviness	19	Completed
Roundtable Meeting Agenda Email	3/8/2010	John Caviness	24	Completed
Section II - Other				
WWPM Announcement	11/10/2009	Rod Beeler	27	Completed
Worldwide Parts Strategy Table Meeting Summary	11/16/2009	Quentin DeWallincourt	28	Completed
WWPM Key Responsibilities	6/23/2009	Kent Melum	30	Completed
Worldwide Parts Whitepaper	6/25/2009	Kent Melum	32	Draft - Final Version Pending

Closing Book page 1 of 39

CONFIDENTIAL

PwC-CAT-00002478

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00003877

WW Parts Strategy Roundtable - Participants

• Vice President M&PS COE	Rod Beeler
• WW Parts Manager	Quentin de Watincourt
• Electric Power	Willy Schumacher
• Marine, Oil & Gas	Jaime Tetrault
• Q&A Division	John Calder
• Earthmoving/Excavation	Mark Teel
• BCP	Stephen Schoening
• Americas South	Paul Knollmaier
• EAME	Dave Picard
• M&PS COE	Denny Vosberg
• Global Purchasing	Carlton Adams
• CAT Logistics	Steve Ivaska
• Core Components	Jack McQuellon
• Advanced Systems	Geoff Turk
• Remanufacturing	Ken Hoefling
• EAME Global Mining	Mike Unes
• Perkins Product Support	Mike Perez
• Tax	Robin Beran, Sally Stiles, John Caviness

CONFIDENTIAL (RFD)

Closing Book Page 5 of 38

CONFIDENTIAL

PWC-CAT-00002482

Background

- Burning Platform – importance of global Parts sales to enterprise profitability
- Business Realignment
 - reinvigorated role of Product Managers
 - creation of MBDs & DSDs
 - identified need for single point of contact for Parts
 - changed fiscal footprint through realignment of responsibilities and decision-making
- Business Response to These Forces
 - WW Parts Manager = Global Parts Steward
 - WW Parts Strategy Roundtable = Global Parts Board of Directors, representing all MBDs and EBDs, and providing single point of contact for Parts

CONFIDENTIAL RED

Closing Book page 6 of 30

CONFIDENTIAL

PwC-CAT-0002483

Confidential Treatment Requested by PwC

PwC_PSI_CAT_0003882

Historical Role of CSARL as Global Parts Entrepreneur

- Legal and commercial aspects of global Parts sales have been centralized in CSARL in Geneva since 1999:
 - o CSARL has exclusive rights to sell Parts outside of U.S. and Japan
 - o CSARL is global acquirer of Purchased Finished Replacement Parts
 - o CSARL is the Parts entrepreneur, while Grimbergen is the warehouse and logistics provider
- Business Realignment provides a unique opportunity to reinforce CSARL's role as entrepreneur for global Parts sales and strategy by centralizing a Worldwide Parts Strategy Group in CSARL.
- This opportunity represents the next step in the continuing expansion of CSARL as the entrepreneur for Parts.
 - o Enterprise benefits from enhanced Parts commonality, sustainability and branding
 - o Capturing these benefits in CSARL provides significant economic benefits

CONFIDENTIAL RED

Closing Book page 7 of 39

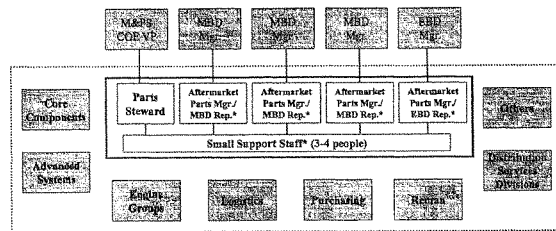
CONFIDENTIAL

PwC-CAT-00002484

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00003683

WW Parts Strategy Roundtable



= Worldwide Parts Management Group (Geneva)
 = Worldwide Parts Strategy Roundtable

***Notes regarding Aftermarket Manager/MBD Rep. Roles:**

• These roles will provide coverage for all Machine and Engine Business Divisions and will have worldwide parts responsibility
 • Four aftermarket parts managers are shown as an example; the number of people filling this role will need to be determined, but it's expected there will be 3-5, with some covering more than one MBD/EBD. Each MBD/EBD needs to decide whether it will have a dedicated parts manager or share a resource with another MBD/EBD.

CONFIDENTIAL RED

Closing Book page 11 of 38

CONFIDENTIAL

PwC-CAT-00002480

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00003887

WW Parts Management Group

Parts Strategy components are the key economic activities impacting Parts Sales & Profit and will be managed by the WW Parts Management Group:

- o Sales/Share targets
- o Margin targets
- o Cost Targets
- o NPI
- o Customer offerings
- o Distribution Services Attributes
- o Pricing / Sales Variance
- o Availability

CONFIDENTIAL RED

Closing Book page 12 of 35

CONFIDENTIAL

PwC-CAT-00002489

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00003858

WW Parts Manager Roles & Responsibilities

- Develop a WW Parts strategy
 - » Vision, Mission, CSF's, Actions Plans & Metrics
- On the sign-line for all aftermarket parts strategy proposals
- 8 Core Activities – decision rights between WW Parts Manager & Strategy Roundtable to be defined
 - » Margin Targets:
 - Recommend Margin targets at parts product level, & later by industry.
 - Identify & address parts margin gaps by product & industry (cost reduction, resourcing, design...)
 - Review progress at *quarterly* Strategy Roundtable meetings
 - » Sales/Share Targets
 - Recommend targets for sales growth & Pops-C at parts product level, & later by industry
 - Identify & address parts sales/Pops-C gaps by product & industry (Variance actions, New offerings...)
 - Review progress at *quarterly* Strategy Roundtable meetings
 - » Cost Targets
 - Recommend cost targets at parts product level, and later by industry to achieve LCP status
 - Identify & address cost reduction requirements (material, manufacturing, design...)
 - Develop ATS material cost plan w/ Purchasing

Page 10
CONFIDENTIAL REF

Closing Book page 13 of 39

CONFIDENTIAL

PwC-CAT-00002490

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00003889

WW Parts Manager Roles & Responsibilities

» **Price/sales Variance:**

- Develop the annual parts price plan based on EO PR targets, parts pricing analysis (premiums, margins, currency), MBD input and support from GRMG

» **Availability:**

- Recommend targets & monitor performance
- Identify & address gaps with Cat Logistics & Strategy Roundtable partners
- Review progress at *quarterly* Strategy Roundtable meetings

» **NPI**

- Provide input on parts & service related elements of Product & Component groups NPI programs
 - Develop & monitor implementation of Parts NPI guidelines w/ Product & Component groups: commonality, serviceability, sustainability, branding, proprietary, safety
 - Review balance between machine cost & downstream parts profit (Parts financials at gate reviews).

CONFIDENTIAL RED

Closing Book page 14 of 38

CONFIDENTIAL

PwC-CAT-00002491

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00003890

WW Parts Manager Roles & Responsibilities

» **Distribution Services Attributes**

- Recommend dealer product support excellence targets
- Identify & address gaps at dealers (availability, capacity, capability, parts programs...)
- Review progress at *quarterly* Strategy Roundtable meetings

» **Customer offerings**

- Define customer centric solutions
 - Repair options, CSAs etc.

CONFIDENTIAL RED

Closing Book page 15 of 38

CONFIDENTIAL

PwC-CAT-00002492

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00003891

WW Parts Management – RACI Chart

	WW Parts Management Group		Component Groups	Svc. Groups	Logistics Div.	Comments
	M&PS COE Rep.	MBD/EBD Sales				
Parts Business Strategy	A	R	R	C	I	
Sales/Share Targets	A	C	C	R		
Margin Targets	R	A	R			
Cost Targets	R	A	R			
Parts Pricing/Sales Variance	A	R	R	C		
NPI	I	R	R			
Distribution Services Attributes	R	C		A		
Customer Offerings	R	A		R		
Availability	A	R	I	I	R	

RACI Definitions
 R = Recommend
 A = Approve/Accountable
 C = Contribute
 I = Inform / Execute

CONFIDENTIAL RED

Closing Book page 16 of 39

CONFIDENTIAL

PwC-CAT-00002493

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00003892

WW Parts Strategy Roundtable

WW Parts Strategy Roundtable brings needed focus to global Parts sales and strategy and is key to effective implementation of the Enterprise's Business Realignment for Parts

Roundtable meets *quarterly* to determine and drive execution of global Parts initiatives

- o Chaired by the Geneva-based WW Parts Manager (M&PS Parts Steward)
- o Forum for reviewing the state of the business, making/communicating decisions, discussing progress toward meeting goals (*i.e.*, targets for revenue, share, cost reduction, availability), etc.
- o Brings together various groups (Component Groups, Logistics, DSDs, Purchasing, M&PS COE, etc.) to determine and implement Parts strategies and coordinate Parts activities

CONFIDENTIAL RED

Closing Book page 17 of 39

CONFIDENTIAL

PwC-CAT-00002494

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00003883

1059



Quentin
DeWahlincourt@Caterpillar
11/16/2009 02:38 PM

To: Carlton B. Adams/Caterpillar@Caterpillar, David H
Picard/Caterpillar@Caterpillar, Dennis M.
Vosberg/Caterpillar@Caterpillar, Geoff M.
cc: Rodney C. Beeler/Caterpillar@Caterpillar, John P.
Caviness/Caterpillar@Caterpillar, Kent E
Melum/Caterpillar@Caterpillar, Kristina A.
bcc:

Subject: WW Parts Business Table (BT)

Caterpillar: Confidential Green

Retain Until: 11/16/2012

For Follow Up: P- Low Priority

History: This message has been forwarded.

Parts BT Partners,

On behalf of Rod and myself, I would like to thank you for participating to our first WW Parts Business Table last Nov 4th. I think we had a really good discussion which Mike Unes probably summarized best by stating: "now that we have defined world hunger, what can this team deliver in the short run that gets us going?". Let me first summarize what we heard (and look forward to any further feedback) and I will then touch base on next steps.

Our first Parts BT had the following objectives:

- share the reasons that drove to the creation of a WW Parts Management position
 - provide a first overview of the Parts Mgr's R&R
 - gather your feedback on the BT concept & deliverables.
- You will find our presentation materials attached.

Participant feedback:

Here is what we heard during the meeting in no specific order of importance:

1. We need to consider product manager participation to the BT (especially w/ Emerging markets' product developments/parts for Mid-Tier products), Legal & get confirmation on APD participation.
2. This team needs to look at sponsoring a higher POPS target and drive implementation across the enterprise.
3. This team needs to drive Parts margins improvements. I'll bring to the next BT parts margin information as available today so that we can level set based on some actual data & define where we want to go from there.
4. We need to understand competitive developments in pursuit of incremental POPS. This should probably encompass benchmarking other companies & leads into discussions into how we fund BT activities.
5. The BT should be engaged in parts quality as well to address things like:
 - acceleration of top level parts issue resolution (such as system one)
 - CPI from the perspective of IP when developing solutions (Find, Fix & Protect)
 - Product upgrades and retrofits (Integration to the design process)
6. We heard a resounding need for the Parts BT to engage in NPI whether from the perspective of setting NPI guidelines for parts (use of proprietary, branding...) or managing the balance between machine cost and downstream parts profit. We should add design for re-use/reman under this NPI banner. We also discussed the possibility of having this team driving the impact of our tax strategy on make/buy decisions.
7. We will need to figure out what this team can contribute in the area of coverage/"feet on the street".
8. We will consider bringing in dealers to selected BT to re-inforce the importance of the Parts business in dealer portfolios while helping validate the parts strategy that we will be pursuing.
9. Suggestion was raised relative to the possibility of having a parts EOR - Rod and I will investigate this idea which - to me - provides real legitimacy to this Parts BT.
10. Finally, we also concurred that it would be good to have each group come to the next meeting ready to share their approach to the overall parts business - great opportunity to learn about some best

Closing Book page 28 of 39.

CONFIDENTIAL

PwC-CAT-00002505

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00003904

practices.

Next Steps

- I'll be following up with many of you to get into more of the details of this parts BT, learn about your businesses & what we can accomplish together, close the loop on the above suggestions & how we can get launched. I'll be scheduling meetings with you over the next month or 2. Meanwhile, I'll be working with Rod on finalizing the team based off your recommendations.
- We'll run a couple more of these introductory sessions with other key players - WW Product & Component Mgrs, VP's and possibly members of the EO - to make sure we are on the right track.
- I'll investigate the financials & bring the currently available data to our next Business Table. I'll get your feedback on what you/your respective divisions would like to see to drive better parts decisions and get a better understanding of what we can afford to publish. I think this should be an excellent topic of discussion for our next session.
- I'll be working on the details of our BT R&R & decision rights and will keep you in the loop on progress.

One of our key deliverables will be to develop a WW Parts Strategy which could be one of the critical outcomes of a Parts EOR (to be confirmed). Meanwhile, I fully subscribe to Mike's idea of getting going on a couple of key projects that we could launch short term. I hope to reach some consensus on this as we ramp-up towards our next business table.

Our next meetings will be on March 19th, June 29th & either Sept 15 or 16th. December date will be confirmed at a later stage. I'll soon be getting back to you with a suggested agenda for our March face-to-face meeting.

Looking forward to working with you towards improving our WW Parts business.
Regards,
Quentin.



WW Parts Business Table Agenda Slides (4-Nov-2009).ppt

Closing Book page 29 of 39

CONFIDENTIAL

PwC-CAT-00002506

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00003905

Enterprise Alignment
Parts Management in the New Organization
 August 25, 2009

Purpose

The purpose of this document is to define ownership, structure and responsibilities for parts management in the new organization.

Today

The major drivers of Caterpillar's historical parts sales success (in order of importance/impact) are: a strong and growing machine population, world class parts availability, component design (for longevity, remanufacturing, etc.), dealer product support excellence and customer-centric product support solutions.

Availability

After a strong and growing machine population (requiring continued focus on prime product differentiation and effective sales and marketing to drive PINS and fully capitalize on robust industry demand), the most critical element of parts success is **parts availability**. Availability is a function of on-time shipments by suppliers (internal and external), proper management of parts supply within the Caterpillar Logistics organization, and dealer capability to meet customer parts demand and manage his parts inventory.

Today, responsibility for these activities is spread across many organizations. Cat Logistics, MPSD, Global Purchasing and Caterpillar plants all play roles in sourcing, manufacturing, and expediting parts from our plants and suppliers. With unprecedented growth in orders of both prime products and parts, supply of parts has been severely constrained, resulting in an erosion of Caterpillar's reputation for world class parts availability. The challenge to meet our customer's demands and expectations for parts supply has spotlighted a need to bring greater focus and accountability in this area. Left unchecked, an erosion of our parts availability leadership will impact both parts and machine sales.

The Parts Distribution and Marketing & Product Support COE white papers identify how the roles and responsibilities for parts availability will be clearly identified and concentrated. These improvements should contribute to a return to world class levels of parts availability.

Design

Component and part design can have a critical impact on parts sales as it influences repair practices, remanufacturing, and copying by will-fitters. Proprietary designs can add to product cost but will lock-in down-stream parts sales. Understanding this tradeoff (initial cost versus life-cycle company and customer value) and when to utilize it can add significantly to parts sales growth. The corporate spin-on filter and K-Series GET System (both within MPSD design control) are two highly successful examples of how design influences parts sales. Leveraging this strategy across a larger band of components will improve long-term parts sales growth.

Today, component design responsibility is spread throughout a number of internal organizations and external suppliers. The Component Business Divisions bring these key organizations together to collectively influence parts sales growth through design. The Component Business Divisions will have design control over a portion of the parts business through component and parts design, and engines and remanufacturing will also have this responsibility for their components.

Dealer Capability

Dealer capability to provide excellent customer service is the third tool in the parts sales tool box. Dealer capability differs from dealer to dealer and territory to territory. The Distribution Services Divisions, with support from the Marketing & Product Support COE, will focus on bringing consistency (one 'Brand') and process excellence to the dealer organization.

Customer Solutions

Finally, our efforts to promote and 'market' our parts and service capability add some 'icing to the cake'. Historically, many solutions (parts and service sales) initiatives have had mixed success and mixed sustainability. This is due, in part, to the sheer number and complexity of these initiatives. In the past, program 'creation' has far outstripped the MPCs / districts and dealers' ability to implement. Concentrating these efforts in the Industry Groups (for clear customer understanding) with support from the Marketing & Product Support COE, will improve customer focus and implementation effectiveness.

Parts Stewardship

The Marketing & Product Support COE becomes the 'steward' of the parts business. While the COE does not have accountability for parts sales, service levels or POPS, they will provide subject matter expertise for parts and service excellence, own important parts processes (such as calculation of POPS-C), and determine key parts policies (such as Parts Service Life Policy, Policy Letter #22, etc.) and serve as the Enterprise Process Owner for key product support processes. In this role, the COE also has strong 'dotted line' relationships to Industry Product Support Managers, Distribution Managers, and Machine and Component Product Managers. It is our intent to transfer full P&L accountability for the parts business to customer-facing Machine Business Divisions as soon as practical.

Worldwide Parts Management Group

A Worldwide Parts Management Group is being established to ensure appropriate focus on the parts business and drive coordination and consistency on parts issues impacting multiple Machine/Engine Business Divisions. This group will consist of several aftermarket parts managers for all Machine and Engine Business Divisions as well as a representative from the M&PS COE, who will serve as the group's chairperson. The group will have decision rights for key parts activities and will bring together various groups that are critical to parts business success (e.g., Component Divisions, Logistics, Distribution Services, Purchasing, etc.) through a parts "business table." The business table will meet regularly to review the state of the parts business, identify initiatives to improve performance, and drive execution of those initiatives, but ultimate authority and accountability remain with the VWV Parts Management Group. Appendix 1 graphically depicts the Worldwide Parts Management Group and Parts Business Table structure.

There are 9 key activities the group will be responsible for managing:

Parts Business Strategy	Customer Offerings
Sales/POPS-C Targets	Distribution Services Attributes
Margin Targets	Pricing/Sales Variance
Cost Targets	Availability
NPI	

Appendix 2 provides 'RACI' charts to provide further details on the roles and responsibilities of the Worldwide Parts Management Group, as well as other groups involved in the parts business. A RACI chart is shown for the 2009/2010 transition period, as well as 2011 and beyond when full parts accountability has transitioned to the Machine & Engine Business Divisions (MBDs/EBDs).

S.H. Wunning / S.L. Levenick

Enterprise Alignment

Metrics

A critical few metrics, placed in the appropriate organizations, can drive improved results. Accountability for enterprise parts profitability and parts sales moves to Prime Product Managers (enterprise entrepreneurs) in 2011.

Other key metrics:**Availability & Inventory Metrics**

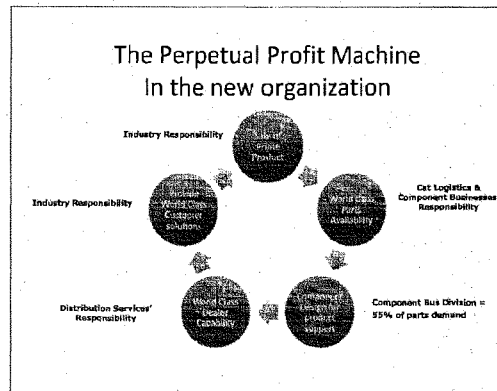
Components/Plants	Committed ship dates to parts
Cat Logistics	Order Fill Rate, Inventory turns
Dealers	Parts Service Percentage, Inventory turns

Financial Metrics

Prime Product	Accountable Profit for parts	Manager
Parts sales compound annual growth		

McFee

During 2009 McFee will be calculated for Component and Prime Products to provide a complete view of the Prime Product and Component Groups' contribution to parts sales and profitability. A project will be undertaken during 2009 to determine the future structure and need for a McFee process.

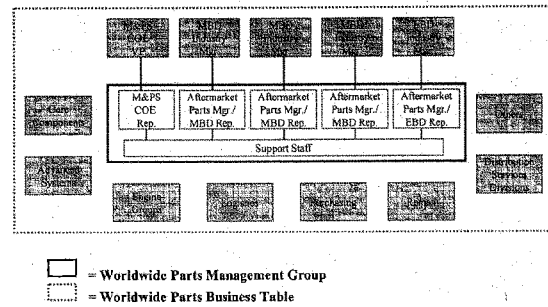


Original author of Perpetual Profit Machine: Dave Lewis

Note

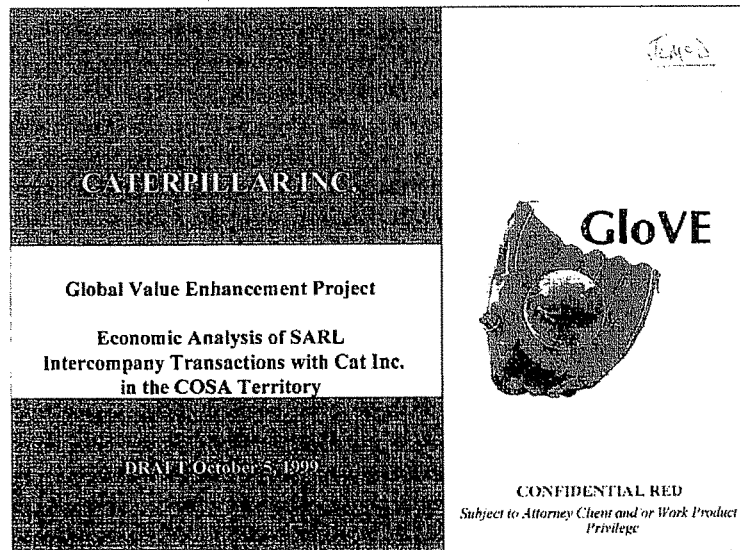
Detailed descriptions of roles and responsibilities for the organizations described above will be found in white papers on Machine Business Divisions, Distribution Services, Parts Distribution (Logistics), Marketing & Product Support COE, and the Component Businesses.

Appendix 1: Worldwide Parts Management Group & Business Table Structure



Confidential Treatment Requested by PwC

PwC PSI CAT 0000493



CONFIDENTIAL

PwC-CAT-00003499

T-CV2

CONFIDENTIAL

Confidential Treatment Requested by PwC

PwC CAT 00003900

PwC_PSI_CAT_0000434

**SARL Replacement Parts & Prime Product
Intercompany Transactions with CAT Inc**

**DRAFT
International
Competitiveness**

Contents

- Summary Diagrams
- Replacement Parts Licenses and Royalty Rates
- Worked Parts and Prime Product Transfer Pricing
- Market Creation Fee Considerations
- Service Fees

Draft, October 5, 1999

CONFIDENTIAL RED

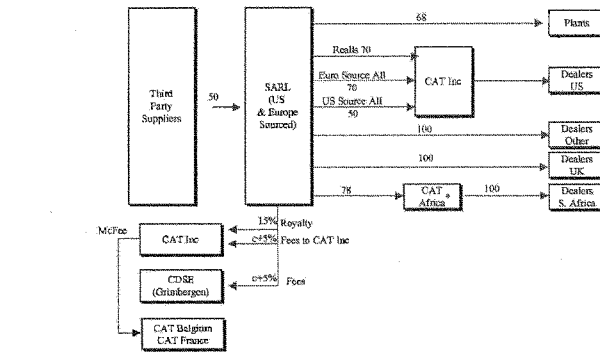


CONFIDENTIAL

PwC-CAT-0003501

SARL Purchased Finished Parts

DRAFT International Competitiveness



* Possible eventual conversion to disregarded entity.

Draft, October 5, 1999

CONFIDENTIAL RED

Glove

CONFIDENTIAL

PwC-CAT-00003502

**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

Summary of Pricing

DRAFT International Competitiveness

Phone fee @ Cat + 5%

Product	Characteristic of SARI	Implementation of Intercompany Pricing
P/F - US Source	Entrepreneurial Licensee	<ul style="list-style-type: none"> Royalty to Cat Inc.: 15.2% x USDN Agency fee to Cat Inc.: 3.3% x acquisition cost Services fee to Cat Inc.: 10.4% x USDN
P/F - Euro Source	Entrepreneurial Licensee	Royalty to Cat Inc.: 15.2 % x USDN

6%

Fee to Cat (Shareholder) (Cost + 5%)

Redacted By
Permanent Subcommittee on Investigations

Draft, October 5, 1999

CONFIDENTIAL RED

CIVE

CONFIDENTIAL

PwC-CAT-00033505

DRAFT

Replacement Parts Licenses**International
Competitiveness**

The slides in this section of the presentation will cover the following topics:

- The Intangibles that are licensed by CAT Inc to SARL in the *purchased finished replacement parts* and *worked parts* license agreements
- Recommended royalty rates and underlying economic analysis

Draft, October 5, 1999

CONFIDENTIAL RED



CONFIDENTIAL

PwC-CAT-00003506

**Purchased Finished
Replacement Parts License**

**DRAFT
International
Competitiveness**

The Intangibles that are licensed by CAT Inc to SARL in
the purchased finished replacement parts license

CAT Inc grants to SARL a license

- *To have made and/or purchase P/F replacement parts for sale to third-parties in the SARL Territory or to CAT Inc and Cat affiliates for resale outside of the SARL Territory,*
- *To use CAT Inc's Intellectual Property for this purpose, and*
- *To purchase P/F replacement parts from CAT Inc's network of third-party P/F parts suppliers for this purpose.*

Draft, October 5, 1999

CONFIDENTIAL RED



CONFIDENTIAL

PwC-CAT-00003507

**Purchased Finished
Replacement Parts License**

**DRAFT
International
Competitiveness**

The Intangibles that are licensed by CAT Inc to SARL in
the purchased finished replacement parts license

Intellectual property means know-how, processes, designs,
specifications, trade secrets, patents, copyrights, trademarks,
tooling, etc., relating to the manufacture and sale of P/F
replacement parts

SARL Territory means Africa, Eastern Europe, Western
Europe, the Middle East, the CIS, Nordic countries and the
Near East

Draft, October 5, 1999

CONFIDENTIAL RED



CONFIDENTIAL

Draft CAT 0000000

**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

DRAFT

**International
Competitiveness****Royalty Rates**

- SARL shall pay CAT Inc a royalty of 15% of SARL's net sales (or 15.2% of USDN) of P/F replacement parts to third-parties in the SARL territory.
- SARL shall pay CAT Inc a royalty of 7% of SARL's net sales (or 7.1% of USDN) of the worked parts covered under the worked parts license agreement to third-parties in the SARL territory.

Draft, October 5, 1999

CONFIDENTIAL RED



CONFIDENTIAL

PWC-CAT-00003511

**Economic Analysis of Royalty
Rates and Transfer Prices****DRAFT
International
Competitiveness**

Summary and overview of the approach taken

1. Determine the appropriate level of profitability for SARL on an aggregated or overall basis; this represents a joint analysis of all of SARL's transfer pricing associated with its various activities (i.e., distribution of prime product and worked parts, license of parts intangibles, etc.)
2. Given the findings of the joint analysis, determine the appropriate transfer pricing for the separate categories of activities (i.e., prime product and replacement parts)
3. For licensed parts, evaluate appropriate royalty rates

Draft, October 5, 1999

CONFIDENTIAL RED



CONFIDENTIAL

PwC-CAT-00003512

**Economic Analysis of Royalty Rates
and Transfer Prices****DRAFT
International
Competitiveness**

Because SARL's prime product and replacement parts activities are interrelated (see next slide), a joint economic analysis of royalty rates (licensed P/F and worked parts) and transfer prices (U.S. worked parts and prime product) is conducted.

- This "interrelated transactions" approach accords with provisions in Regs. sec. 1.482-1(b)(2)(ii) (Selection of category of method) and Regs. sec. 1.482-1(f)(2)(i) (Aggregation of transactions).

Draft, October 5, 1999

CONFIDENTIAL RED



CONFIDENTIAL

PwC-CAT-00003513

Economic Analysis of Royalty Rates and Transfer Prices

DRAFT International Competitiveness

SARL's intercompany transactions in connection with its prime product and replacement parts activities represent "interrelated transactions" because:

- The field population of Cat prime products, which is created as SARL markets prime products in its territory, creates the demand for Cat genuine replacement parts, and SARL is the sole source of these goods in its territory.
- The reputation of SARL and its dealer network for aftermarket support for Cat products (parts and service) helps distinguish Cat-brand prime product from the competition, and thereby helps create greater demand for the prime product.
- The engineering and design of Cat prime products takes into account the needs of the aftermarket business that a field population of those products will create.
- Financial accounting practices in the construction equipment industry do not separately report segment prime product results versus replacement parts results - they are reported jointly as, for example, "machinery", as in CAT Inc's Form 10-K (FYE December 31, 1998, p.1).

Draft, October 5, 1999

CONFIDENTIAL RED



CONFIDENTIAL

PwC-CAT-00003514

— = Redacted by the Permanent
Subcommittee on Investigations

Confidential Treatment Requested by PwC

Economic Analysis of Royalty Rates and Transfer Prices

DRAFT International Competitiveness

Step One: The Comparable Profits Method (CPM) was applied to SARL on an overall basis. Distributor / dealer comparables were used because [REDACTED] of SARL's revenues are derived from its resale business.

Redacted By
Permanent Subcommittee on Investigations

Note: Prime product revenue shown is 1998 actual, and parts revenue is from 1999 P&SS Plan.

Draft, October 5, 1999

CONFIDENTIAL RED

Globe

CONFIDENTIAL

PwC-CAT-00003515

PwC_PSI_CAT_0000459

**Economic Analysis of Royalty Rates
and Transfer Prices****DRAFT
International
Competitiveness****CPM METHOD**

- This method establishes a reasonable range of after-royalty net profitability for SARL. Then, royalty rates and transfer prices that leave the target level of post-royalty profit at SARL -- as refined below -- are considered appropriate.

Draft, October 5, 1999

CONFIDENTIAL RED



CONFIDENTIAL

PwC-CAT-00003516

**Economic Analysis of Royalty Rates
and Transfer Prices****DRAFT
International
Competitiveness****CPM METHOD**

- We performed an extensive search for independent companies operating in Europe that have comparable business profiles to SARL, with SARL's primary characterization as a distributor and reseller of prime product and replacement parts.

Draft, October 5, 1999

CONFIDENTIAL RED



CONFIDENTIAL

PwC-CAT-00005517

**Economic Analysis of Royalty Rates
and Transfer Prices**

DRAFT
**International
Competitiveness**

CPM METHOD

- The primary sources of information used to find and evaluate comparables were:
 - Financial databases
 - *Off Highway Research* reports on the European construction equipment industry
 - Construction equipment trade associations
 - Lexis Nexis
 - Yahoo and other Internet resources
 - Annual Reports

Draft, October 5, 1999

CONFIDENTIAL RED



CONFIDENTIAL

PwC-CAT-0000351A

**Economic Analysis of Royalty Rates
and Transfer Prices****DRAFT
International
Competitiveness****CPM METHOD**

- We focused on European distributors and dealers of equipment and parts, and compiled a refined set of 15 companies (see list on next slide). These companies exhibited an interquartile range of operating profit to sales (ROS) of 2.1% to 6.5%, with a median ROS of 4.9%.*
- These companies exhibited an interquartile range of gross profit to operating expenses (GP/OE) of 131.0% to 152.0%, with a median GP/OE of 142.0%.*

*The financial data from each comparable were adjusted to account for the effect on profitability measures of differences with SARL in working capital and fixed asset intensity.

Draft, October 5, 1999

CONFIDENTIAL RED



CONFIDENTIAL

PwC-CAT-0003519

Economic Analysis of Royalty Rates and Transfer Prices

DRAFT International Competitiveness

<u>COMPANY</u>	<u>OPERATIONS</u>
Baynes Plc	Distributor
Beers N.V.	Dealer
Bergman & Beving AB	Distributor
Brammer Plc	Distributor
Caverdale Group Plc	Dealer
Eriks Holding N.V.	Distributor
Finelist Group Plc	Distributor
Geveke N.V.	Dealer
Him Furness N.V.	Dealer
Inchcape Plc	Dealer
Lex Services Plc	Dealer
Partco Group Plc	Distributor
Ring Plc	Distributor
Unidare Plc	Distributor
Wyko Group Plc	Distributor

Draft, October 5, 1999

CONFIDENTIAL RED



CONFIDENTIAL

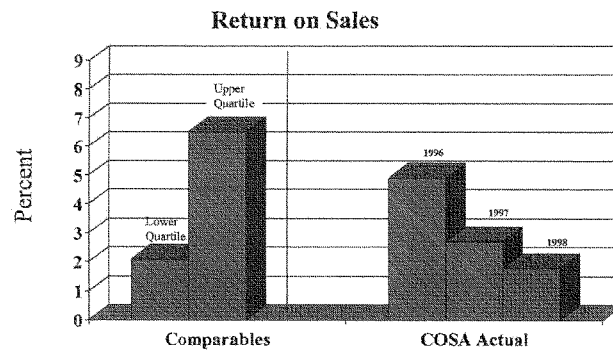
PwC-CAT-00003520

Confidential Treatment Requested by PwC

PwC PSI CAT 0003521

Economic Analysis of Royalty Rates and Transfer Prices

DRAFT
International
Competitiveness



Draft, October 5, 1999

CONFIDENTIAL RED



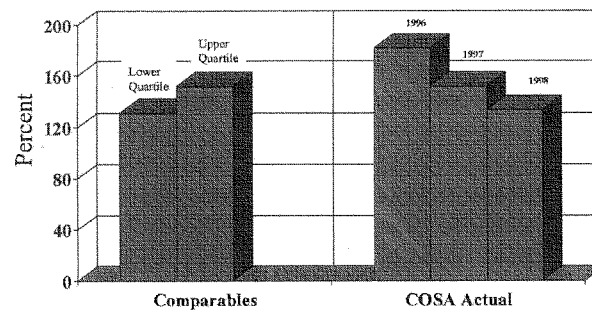
CONFIDENTIAL

PwC-CAT-0003521

**Economic Analysis of Royalty Rates
and Transfer Prices**

DRAFT
**International
Competitiveness**

Ratio of Gross Profit to Operating Expenses



Draft, October 5, 1999

CONFIDENTIAL RED



Economic Analysis of Royalty Rates and Transfer Prices

DRAFT International Competitiveness

Step Two: Establish appropriate relative levels of target profitability for prime product versus replacement parts.

This step is accomplished by estimating a proximate net profitability differential ratio:

- Cat dealers in SARL's territory realize, on average, a ratio of net profitability (profit after direct expenses) on parts to machines of 7:1.
- We were unable to obtain published information from European sources on the relative profitability earned by dealers or distributors of parts and original equipment. However, we found information published in the National Automobile Dealers Association (NADA) survey of independent new vehicle dealers in the U.S. This survey indicated that the ratio of net profitability (net profit before taxes) on service and parts to new vehicles is 8:1 for the average dealer.*

* From NADA's *Automotive Executive*, August 1999

Draft, October 5, 1999

CONFIDENTIAL RED



CONFIDENTIAL

PwC-CAT-00003523

Economic Analysis of Royalty Rates and Transfer Prices

DRAFT International Competitiveness

Step Three: Establish royalty rate for licensed replacement parts.

For this step, the comparable uncontrolled transaction (CUT) method is used. The CUT method estimates an arm's length royalty by reference to royalty rates in comparable licensing arrangements between third-parties. Comparability focuses on similarity of:

- Intangibles being licensed (types and value)
- Other circumstances (e.g., terms of the transfer, stage of development of the intangibles, etc.)

Draft, October 5, 1999

CONFIDENTIAL RED



CONFIDENTIAL

PwC_CAT_0004510

**Economic Analysis of Royalty Rates
and Transfer Prices****DRAFT
International
Competitiveness****CUT METHOD**

1. Eckler Industries licensed by General Motors, on a non-exclusive basis, to use GM technology, tools and trademarks to make and sell obsolete or restoration GM replacement parts for Corvette cars.

- Body panels, parts and assemblies
- Soft trim; interior panels and covers
- Convertible tops; wheels

Royalty: 8% of net sales

Draft, October 5, 1999

CONFIDENTIAL RED



CONFIDENTIAL

PwC-CAT-00003527

**Economic Analysis of Royalty Rates
and Transfer Prices**

DRAFT
**International
Competitiveness**

CUT METHOD

2. Sundstrand Corp. v. Commissioner (1991)

- U.S. parent licensed Singaporean subsidiary to use parent's technology to make and sell spare parts worldwide. Parent provided subsidiary with copies of existing industrial property rights.
- "... in essence [parent] gave [subsidiary] a portion of the spare parts market which for all intents and purposes already belonged exclusively to [parent]."
- Court finds that an arm's length royalty is 10% of net sales.

Draft, October 5, 1999

CONFIDENTIAL RED



CONFIDENTIAL

PwC-CAT-00003529

**Economic Analysis of Royalty Rates
and Transfer Prices**

DRAFT
**International
Competitiveness**

CUT METHOD**3. Other third-party royalty rates**

—An extensive search of SEC filings for third-party technology licenses involving replacement parts yields no closely comparable situations but nevertheless evidence of royalty rates as high as 18% of net sales for certain parts and components.

Draft, October 5, 1999

CONFIDENTIAL RED



CONFIDENTIAL

PwC-CAT-0003573

Economic Analysis of Royalty Rates and Transfer Prices

DRAFT International Competitiveness

Balancing the three findings, (1) CPM, (2) 8:1 profit ratio and (3) the CUT information, leads to the validation of royalty rates of 15% for P/F parts and 7% for worked parts; these rates together produce a weighted-average royalty rate of 14% for all licensed parts, the effects of which are illustrated in the schedule below.

**Redacted By
Permanent Subcommittee on Investigations**

Draft, October 5, 1999

CONFIDENTIAL RED

CleVE

CONFIDENTIAL

PwC-CAT-00003530

Economic Analysis of Royalty Rates and Transfer Prices

DRAFT International Competitiveness

The P/F replacement parts royalty rate, 15%, is higher than the worked parts royalty rate, 7%, because there is a higher rate of enterprise profitability earned on P/F parts, and SARL earns a higher gross margin and pre-royalty ROS on P/F parts than it does on its licensed worked parts.

- The P/F enterprise ROS is approximately 35%, whereas the enterprise ROS for worked parts is approximately 20%.*

* At U.S. dealer net, before royalty, McFee, marketer profit and P&SS profit.

Draft, October 5, 1999

CONFIDENTIAL RED



CONFIDENTIAL

PwC-CAT-00003531

Economic Analysis of Royalty Rates and Transfer Prices

DRAFT International Competitiveness

Sensitivity Analysis: SARL earns Prime Product ROS at target level and pays royalty of 11% on P/F parts.

- The ratio of parts ROS to prime product ROS would rise to approximately 10:1 (20% parts ROS compared to the 2% target prime product ROS).
- SARL's COSA territory results would approximate those shown below. The SARL ROS is 6.0%, and the GP/OE is 160.4%. This ROS is near the top of the range (6.5%), and the GP/OE is above the top of the range (152.0%).

**Redacted By
Permanent Subcommittee on Investigations**

Draft, October 5, 1999

CONFIDENTIAL RED



CONFIDENTIAL

PwC-CAT-00003533

Confidential Treatment Requested by PwC

PwC PSI CAT 0004518

**Intercompany Pricing:
Tangible Property**

**DRAFT
International
Competitiveness**

Effect of P/F license on

- SARL purchases of machines/engines
- SARL purchases of worked parts

Draft, October 5, 1999

CONFIDENTIAL RED

GloVE

CONFIDENTIAL

PwC-CAT-00003534

DRAFT

**International
Competitiveness**

Issue: Pricing of Prime Product

Retain machine/engine pricing in current format

- 2% target reasonable, if achieved (balances parts profit)
- Most regions achieve approximately 1.5%
- However, COSA rarely achieved 2% on machines
- Need to monitor COSA-region pricing

Draft, October 5, 1999

CONFIDENTIAL RED

Cleve

CONFIDENTIAL

PwC-CAT-00003535

DRAFT

Issue: Worked Parts Pricing**International
Competitiveness**

- SARL purchases worked parts from CAT Inc at lower transfer price, to better reflect the higher profit on parts vs machines.
- Allow SARL to earn operating margin of 12% on U.S. worked parts (vs 8% previously).
- Estimated transfer price of 70% of USDN, vs 77% currently (COSA territory).

Draft, October 5, 1999

CONFIDENTIAL RED



CONFIDENTIAL

PwC-CAT-00005536

Confidential Treatment Review

**Summary Operating Income
(After Royalty)**

**DRAFT
International
Competitiveness**

**Redacted
by
Permanent Subcommittee
on Investigations**

SAO PSI CAT 0004621

Draft, October 5, 1999

CONFIDENTIAL RED



CONFIDENTIAL

PwC-CAT-00003537

— Redacted by the Permanent
Subcommittee on Investigations

Confidential Treatment Requested by PwC


PwC PS CAT 00004522


DRAFT

Market Creation Fee

International Competitiveness

- McFee currently paid out of P&SS margin
- Only paid to intangible owners or licensees
- 1998 payments from COSA territory: (U.S.\$ millions)

Cat Belg		(all McFee rec'd from COSA territory)
Cat France		(25% of McFee rec'd from COSA territory)
CMR		
US comm'l ent.		
Total		

McFee as % of parts sales 20.8% 

Draft, October 5, 1999

CONFIDENTIAL RED



CONFIDENTIAL

PwC-CAT-00003530

DRAFT

Change to McFee**International
Competitiveness**

With Cat Inc "out of chain," the Parts Royalty from SARL to Cat Inc must cover the McFee.

McFee as % of Sales, 1998 (COSA territory)	21%
-----------------------------------------------	-----

Royalty as % Sales, 1999 (15% P/F, 7% worked)	14%
--------------------------------------------------	-----

Conclusion: Reduction in McFee by approximately 1/3 for McFee derived from COSA territory.

Draft, October 5, 1999

CONFIDENTIAL RED



CONFIDENTIAL

PwC-CAT-00003630

DRAFT

Cat Belgium's McFee

**International
Competitiveness**

Cat Belgium relies on McFee from COSA territory.

**Redacted
by
Permanent Subcommittee
on Investigations**

Draft, October 3, 1999

CONFIDENTIAL RED



CONFIDENTIAL

PwC-CAT-00001640

DRAFT

Implications of Change in McFee**International
Competitiveness**

- McFee and License Fee (L/F) are interrelated--only entities which pay L/F are entitled to receive McFee.
- If McFee is reduced for Cat Belgium from ~4% of machine/engine sales to ~2.6% of machine/engine sales.
- Consider reducing machine/engine license fee from ~3% of machine engine sales to ~2%.
- Under European Commercial Management, Belgium pays no L/F and receives no McFee.

Draft, October 5, 1999

CONFIDENTIAL RED



CONFIDENTIAL

PwC-CAT-0003541

DRAFT

**International
Competitiveness****Service Fees: Overview**

- SARL benefits from the services provided by P&SS (US) and CDSE (Grimbergen).
- P&SS provides the following types of non-agency services to SARL:
 - Assistance with service manuals and literature, inventory availability management, parts customer service to dealers, parts pricing, human resources assistance, information systems assistance, marketing consulting, and strategic planning consulting.
- CDSE provides primarily warehousing and inventory management services to SARL. (In addition, PTE provides purchasing and traffic services to SARL, which are charged to SARL separately.)

Draft, October 5, 1999

CONFIDENTIAL RED



CONFIDENTIAL

PwC-CAT-00003542

DRAFT

Service Fees: Regulations**International
Competitiveness**

- Regs. §1.482-2(b) provides guidance on determining an arm's length charge for services between related parties:
 - Under the benefit test, a charge must be made if the services were performed for the benefit of a controlled entity.
 - Under the integral part test, a services charge should be greater than fully-absorbed cost if the services are an integral part of the business activity of either the provider or recipient of the services.

Draft, October 5, 1999

CONFIDENTIAL RED



CONFIDENTIAL

PwC-CAT-00003543

DRAFT

**International
Competitiveness****Service Fees: P&SS**

In accordance with §1.482-2(b), it was determined that the non-agency services provided by P&SS (US) on behalf of SARL pass both the benefit test and integral part test. Therefore, P&SS costs that are allocable to SARL will be charged as a service fee and marked up by approximately 5 percent.

- Certain P&SS costs will be excluded from the service charge since these costs are incurred for intangible development already covered by SARL's royalty payment to CAT Inc.
- The 5 percent markup on cost is supported through a sample of independent U.S. management service companies, which exhibits an interquartile range of 4.3% to 14.2%.

Draft, October 5, 1999

CONFIDENTIAL RED



CONFIDENTIAL

PwC-CAT-00005944

— = Redacted by the Permanent
Subcommittee on Investigations

Confidential Treatment Requested by PwC

PwC PSI CAT 00004538

**Service Fees:
Excluded P&SS Costs**

**DRAFT
International
Competitiveness**

The excluded P&SS costs are as follows:

- Costs associated with the GET (Ground Engaging Tool) Product Center
 - these costs include design and development of parts technology, already covered by the royalty. [REDACTED]
- Costs associated with the development and maintenance of the DRP system (Distribution Requirements Plan) -- these costs include parts system know-how, already covered by the royalty. [REDACTED]

Draft, October 5, 1999

CONFIDENTIAL RED



CONFIDENTIAL

PwC-CAT-00003545

**Service Fees:
CDSE****DRAFT
International
Competitiveness**

- A Belgian ruling has agreed to the 5 percent markup on cost for CDSE.
- The 5 percent markup on cost is also supported through a broad sample of independent European warehouses, which exhibits an interquartile range of 4.1% to 24.6%.

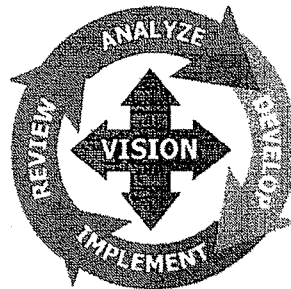
Draft, October 5, 1999

CONFIDENTIAL RED



CONFIDENTIAL

PwC-CAT-0000546



For Discussion Purposes Only
Company Confidential: Do Not Copy

Version 1.1 (2/16)

PRICEWATERHOUSECOOPERS

CONFIDENTIAL

PwC-CAT-00003588

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00004548

T-CV2



B2. COSA as Entrepreneur: European Manufactured Products High-Level Target Design

A. Solution Description

Caterpillar France SA ("France") and Caterpillar Belgium SA ("Belgium") will enter into a toll manufacturing agreement with Caterpillar Overseas SA ("COSA"). The tolling relationship is targeted at eliminating the existing inter-company sale of parts and prime product within the COSA commercial division (Belgium, France, Geneva). In order to accomplish this objective, raw materials, work-in-process and finished goods inventory will always be owned by the COSA legal entity. The existing license with Caterpillar Inc. ("CAT Inc.") and corresponding obligation for the license fee will be transferred from the manufacturers to COSA. COSA will pay a tolling fee to the manufacturers for their manufacturing services. The manufacturer's income will be based on the tolling fee, rather than arising out of a buy-sell relationship. The manufacturer's income is not guaranteed, but will continue to be based on the ability of the manufacturer to control costs.

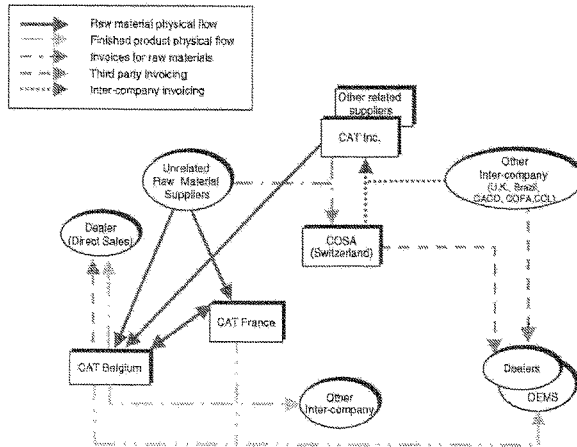
Redacted By
Permanent Subcommittee on Investigations

Note: Benefit assumes 1997 levels of profit for France and Belgium. Each dollar of profit in Belgium and France over 1997 levels provides potential for 30 cents of additional benefit.

Annual earnings and cash flow benefit are offset by a one-time local LIFO recapture of (The impact of these costs may be offset through US foreign tax credit planning).

B2. COSA as Entrepreneur: European Manufactured Products High-Level Target Design

Diagram



B. Main Implementation Observations

1. There will be no change in physical product flow (major flows depicted on attached diagram).
2. There will be no change in dealer invoicing or receivable management (including Belgian Dealer).
3. COSA will purchase all raw materials and will own all inventories. Current purchasing functions will continue under service agreements with COSA.
4. COSA will become the Principal in prime product sales to CACO, CAT Inc, CCL and COFA.
5. COSA will become the Principal in inter-company production material and OEM sales.



B2. COSA as Entrepreneur: European Manufactured Products High-Level Target Design

B. Main Implementation Observations (cont.)

6. COSA will replace Belgium and France in CAT inc. license agreement.
7. Tolling agreements and the arrangements will be concluded between COSA and Belgium/France.
8. Transfers between Belgium and France become "interplant" transfers supported by an intra-company invoice.

C. Preliminary Operational Issues

1. Raw material and component part supplier legal relationships will change from Belgium and France to COSA. PTE will continue functional supplier relationship and will receive a service fee from COSA.
2. Coordination of inventory logistics systems with inventory ownership change.
3. Management of accounting for "inventory away from plant".
4. Changes in inter-company sales processing resulting from the role of COSA as as supplier to other marketing companies including need for pro forma invoices in support of customs and VAT.
5. Movement of functions (personnel or payroll)
6. Time to consolidate and close in support of concurrent processing initiative.
7. OEM sales invoiced by COSA rather than Belgium/France. (CIP).
8. Reconciliation of divergence between legal entity and accountable profit.
9. Methodology for management of manufacturing efficiency through tolling agreement.
10. Inventory accounting for inter-plant transfers.
11. Inclusion of CMR France in tolling structure.



B2. COSA as Entrepreneur: European Manufactured Products High-Level Target Design

D. Tax Issues

1. Belgium and France PE
 - Purchasing activity
 - Production scheduling etc
 - Other existing marketing activities
2. LIFO cost triggered in Belgium and France
 - Quantification
 - U.S. recovery via foreign tax credit
3. Goodwill transfer protection
4. Customs and VAT issues with regard to changes in raw material invoicing.
5. Documentation of Transfer Pricing with respect to any profit migration from Belgium/France to Switzerland.
6. Review of local tax rulings
 - Switzerland
 - Belgium

E. Agreements with COSA

1. CPI; OEM Commissions
2. Tolling/Belgium
3. Tolling/France
4. License agreement with CAT Inc.
5. Royalty-free sublicense to CAT France and CAT Belgium
6. Sublicense of SCM agreement
7. Amend global transfer pricing agreement
8. Revised engineering service / Contract R&D agreement
9. Service agreements / Service charges

**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

1118



Robin D Beran
<Beran_Robin_D@cat.com>

08/08/2006 06:09 PM

To: Jim Bowers/US/TLS/PwC@Americas-US
cc:

bcc

Subject: Fw: FYI - 2006 Corporate Tax Audit Committee Presentation

Jim, this is the version after review with Dave, but without Doug's review. We go over it with him on Monday.

Robin
909.675.4478 - beranrd@CAT.com

Every transaction has tax consequences.

--- Forwarded by Robin D Beran/US/Caterpillar on 08/08/2006 08:58 PM ---

Kathy A. Mans/OC/Caterpillar

08/08/2006 04:57 PM

Douglas R. Oberhelman/OC/Caterpillar@Caterpillar

Dave B. Burn/OC/Caterpillar@Caterpillar

To: Bradley M. Huiverson/OC/Caterpillar@Caterpillar

To: Janto Copeland/OC/Caterpillar@Caterpillar

Daniel Schlicksma/OC/Caterpillar@Caterpillar

cc: Robin D Beran/US/Caterpillar@Caterpillar

cc: Robin D Beran/US/Caterpillar@Caterpillar

Subject: FYI - 2006 Corporate Tax Audit Committee Presentation

Caterpillar Confidential Green Retain Until: 07/09/2006 Release Category: G90 - General Matters/Administration

Attached please find the 2006 Corporate Tax Audit Committee PowerPoint Presentation.

Thank you and have a good evening.

Kathy Mans
Admin. Assistant
Corporate Tax



Ext. 5-4479 June 2006 Audit Committee Pres.Z.ppt

CONFIDENTIAL

PwC-CAT-00005954


Confidential Treatment Requested by PwC

PwC_PSI_CAT_00004799

Confidential Treatment Requested by PwC

PwC_Ps_CAT_000480

Global Finance and Strategic Support



People Process Excellence Trough

Income Tax Update

June 13, 2016

*Building momentum on the journey
to Global Finance & Strategic Support Transformation*

CATERPILLAR

© 2016 Caterpillar Inc. All rights reserved.

CONFIDENTIAL

PwC-CAT-0000985

Tax Agenda

Tax and Risk Management
RISK MANAGEMENT

• Key Messages

- Effective Tax Rate trending up
- Difficult IRS exams
- Adequate reserves
- Complex risk environment, but well managed
- Complex reporting environment, but integrated with Global Finance & Strategic Support Transformation

**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

Effective Tax rate

2005 rank primarily due to earnings in low-tax jurisdictions

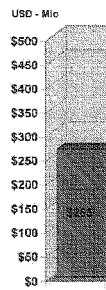
Dow 30	2005 ETR	2004 ETR	Rank	Competitors	ETR
Boeing Co.	9.1%	7.1%	1		
AT&T - Formerly SBC Communications Inc.	16.3%	36.5%	2	Ingersoll Rand Co. Ltd.	16.3%
General Electric Co.	17.4%	17.6%	3		
Alcoa Inc.	22.8%	25.1%	4		
Johnson & Johnson	23.6%	33.7%	5		
American Express Co.	24.2%	28.6%	6		
Microsoft Corp.	26.3%	33.0%	7		
United Technologies Corp.	26.6%	26.2%	8		
Coca-Cola Co.	27.2%	22.1%	9	Volvo	27.0%
American International Group	28.0%	25.7%	10		
Caterpillar Inc.	28.7%	27.0%	11	Caterpillar Inc.	28.7%
Pfizer Inc.	29.7%	19.0%	12		
McDonalds Corp.	29.7%	26.9%	13		
Altria Group, Inc.	29.9%	32.4%	14		
Verizon Communications, Inc.	30.3%	28.2%	15	Cummins	30.0%
Procter & Gamble Co.	30.6%	30.7%	16		
J.P. Morgan Chase & Co.	30.6%	27.6%	17		
Citigroup Inc.	30.6%	28.4%	18		
Walt Disney Co.	31.1%	32.0%	19		
Intel Corp.	31.3%	27.6%	20		
Honeywell Int'l. Inc.	31.9%	23.6%	21		
Hewlett-Packard Co.	32.3%	16.7%	22		
General Motors	33.5%	33.0%	23	Deere & Co.	33.1%
3M Company	34.0%	33.0%	24		
International Bus. Mach.	34.6%	28.7%	25		
Walmart Stores, Inc.	34.7%	36.1%	26		
Merck & Co. Inc.	37.1%	27.1%	27	Komatsu	36.5%
Home Depot, Inc.	37.1%	36.8%	28		
DuPont (E. I.) de Nemours	41.3%	22.8%	29		
Exxon Mobil Corp.	41.4%	40.3%	30		

**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

Confidential Treatment Requested by PwC

PwC PSI CAT 0000985

Tax Reserves



Transfer Pricing

Ending 2005 Tax Reserves

Redacted By
Permanent Subcommittee on Investigations

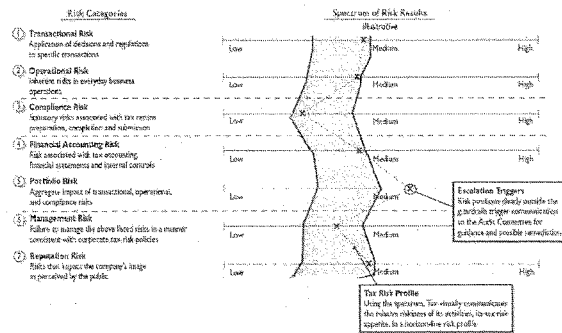
Caterpillar reserves are immaterial

CONFIDENTIAL

PwC-CAT-0000986

**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

December 2005 Meeting

**Audit Committee – Risk Guard Rails**

CONFIDENTIAL

PwC-CAT-00005952

Tax Risk Guard Rails - Process

- Step 1 – Identify & Define Risk Categories
- Step 2 – Identify Criteria for Risk Categories
- Step 3 – Define Risk Level for each Criteria

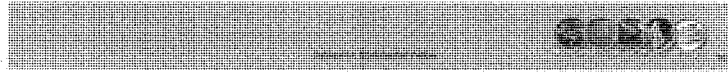


CONFIDENTIAL

PwC-CAT-00005963

Step 1: Identify & Define Risk Categories

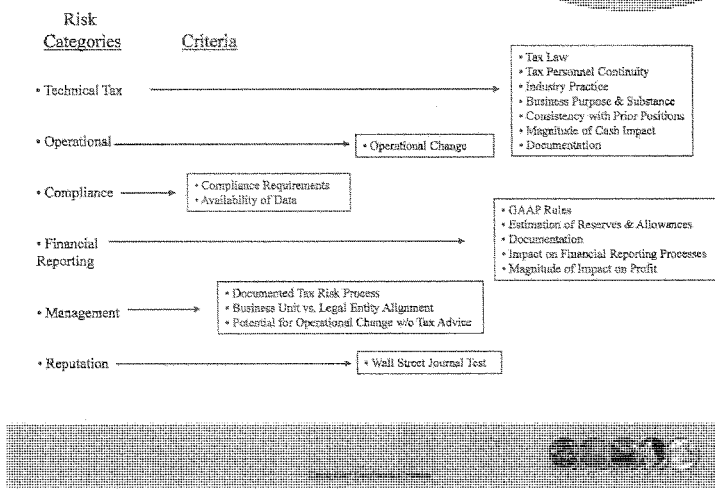
<u>Risk Categories</u>	<u>Definition</u>
• Technical Tax	• Level of risk the structure or transaction creates with full compliance with the law, regulations and court decisions.
• Operational	• Level of risk the structure or transaction creates for everyday business operations.
• Compliance	• Level of risk the structure or transaction creates for tax return preparation, completion and submission.
• Financial Reporting	• Level of risk structure or transaction creates associated with tax accounting, financial reporting or internal controls.
• Management	• Probability above risks can be managed consistent with corporate tax risk policies.
• Reputation	• Probability the structure or transaction will generate negative impact on the Company's image.



CONFIDENTIAL

PwC-CAT-00005964

Step 2: Identify Criteria for Risk Categories



Step 3: Define Risk Level for Each Criteria - Example

• Simple
• Manageable
• Nontechnical

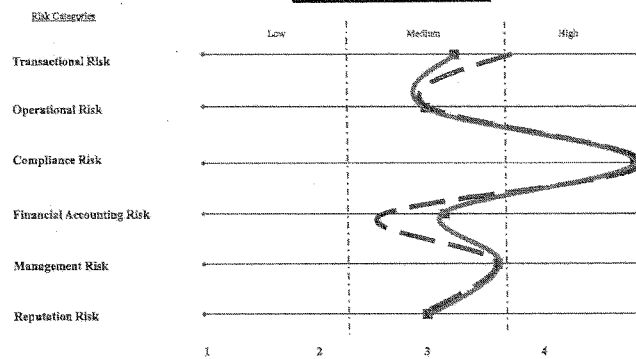
Risk Categories	Criteria	
• Technical Tax	<ul style="list-style-type: none"> • Tax Law • Tax Personnel Continuity • Industry Practice • Business Purpose & Substance • Consistency with Prior Positions • Magnitude of Cash Impact • Documentation 	<ul style="list-style-type: none"> • Low: The structure or transaction is completely consistent with the applicable laws, administrative rules, and judicial decisions of the applicable jurisdiction(s). • Med: The structure or transaction is consistent with the applicable laws, administrative rules, and judicial decisions of the applicable jurisdiction(s) in all significant respects. • High: The structure or transaction is not consistent with the applicable laws, administrative rules, or judicial decisions of the applicable jurisdiction(s) in some significant respect, <i>or</i> We cannot determine the level of significance or consistency for any reason, <i>or</i> The structure or transaction is not consistent with outside advice in some significant respect.
• Operational		
• Compliance		
• Financial Reporting		
• Management		
• Reputation		



Redacted by the Permanent Subcommittee on Investigations

Tax Risk Guard Rails - Examples

Other tax positions followed the same process



Confidential Treatment Requested by PwC

PwC_PSI_CAT_00001872

CONFIDENTIAL

PwC-CAT-00005967

**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

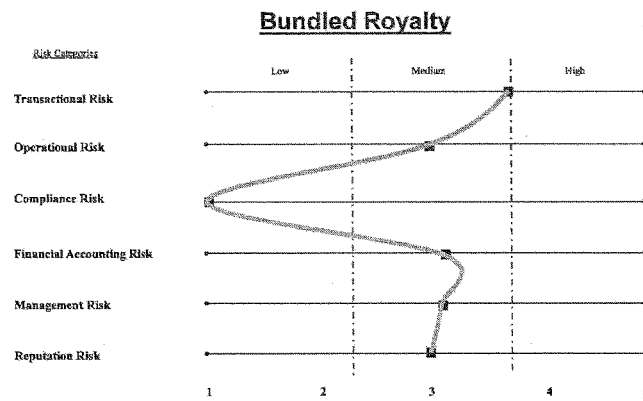
In Summary• **Key Messages**

- Effective Tax Rate trending up
- Difficult IRS exams
- Adequate reserves
- Complex risk environment, but well managed
- Complex reporting environment, but integrated with Global Finance & Strategic Support Transformation



**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

Step 4: Plot Tax Positions on Guard Rails

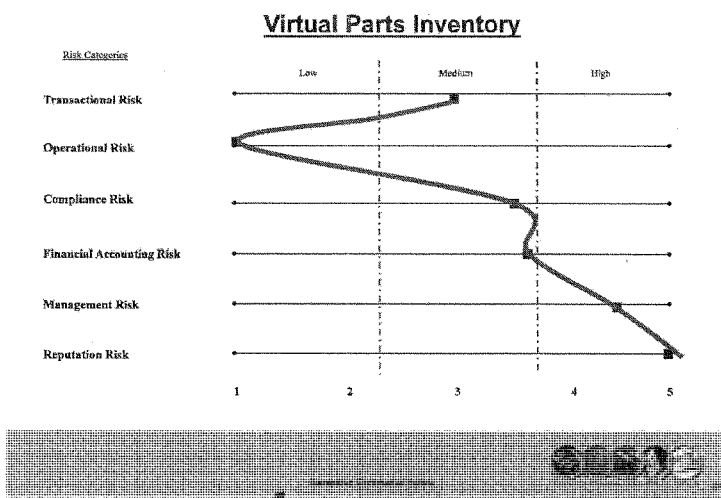


CONFIDENTIAL

PwC-CAT-00005978

**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

Step 4: Plot Tax Positions on Guard Rails



**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

T-CV2



Global Tax Optimization

Presentation to Caterpillar April 14, 1998

Price Waterhouse 

CONFIDENTIAL

PwC-CAT-00006973
PwC_PSI_CAT_00034892



What is GTOP?

The Global Tax Optimization Program ...



"a coordinated, tailored approach to achieving
your lowest sustainable tax rate"

Price Waterhouse 

CONFIDENTIAL

PwC-CAT-00006976
PwC_PSL_CAT_00004895

Final Report

Caterpillar

U.S. Transfer Pricing Documentation Report

Year Ended December 31, 2001

September 16, 2002

PRICEWATERHOUSECOOPERS 

**2001 Documentation
Final Report**

customers to observe Caterpillar equipment in action. Approximately 150-200 customers per day visit the Malaga facility.

Pricing. Pricing has both strategic and tactical components. The strategic economic choice of trading off margins for sales volumes is one that Caterpillar has faced often in recent years, especially in certain product lines and geographical markets. On a micro level, adjustments to pricing may be required to meet local or temporary market conditions, to establish prices for product improvements, or to help dealers in competitive situations.

The entrepreneurial entities are responsible for worldwide pricing policy for their respective product lines, in conjunction with local market knowledge contributed by the marketing companies. Therefore, Cat Inc. and Cat SARL have predominant roles in establishing pricing policies.

The marketing companies also have input into their local area dealer net prices. Cat SARL, for example, can recommend a change to base prices in certain countries with significant competitive price pressures or unusual market conditions. Any base price changes, however, have to be approved by the entrepreneurial entity responsible for the product. Alternatively, Cat SARL may decide to offer promotional pricing or merchandising programs; these discounts are reflected as Cat SARL's sales variance.

Marketing and Sales Operations. Caterpillar performs a variety of marketing programs, both at a general corporate level and in cooperation with its dealers. For example, Caterpillar marketing companies advertise directly (and join with dealers in cooperative advertising), develop marketing programs, and conduct marketing education for its dealers. The marketing companies all have significant day-to-day responsibility for marketing.

**2001 Documentation
Final Report**

With the exception of certain kinds of sales such as those to some government financing programs and some direct engine sales to large manufacturers, Caterpillar does not generally sell directly to end users. However, Caterpillar sales representatives will make joint sales calls with dealers when needed and when the size or importance of the prospective sale warrants.

Actual sales to dealers, as well as the occasional sales to end users, are of course arranged predominantly by the marketing companies. In addition, the manufacturing companies may in some instances make sales to dealers in their own countries. When manufacturing companies sell directly to dealers, whether in their own country or another, they pay a commission to the relevant marketing company as compensation for the services that the marketing company provides.

Dealer Administration and After-Sales Service. Maintaining Caterpillar's dealer network requires significant day-to-day effort including visits to dealers by Caterpillar field staff. Providing support to dealers in the area of financial management and financing, for example, are important activities in the overall marketing scheme.

All companies with marketing responsibilities are actively involved in dealer administration. These include Cat Inc. and the three principal marketing companies. Caterpillar's after sales service, which includes supporting dealers in the servicing of equipment and the timely provision of parts around the world, is one of its major competitive tools. Caterpillar's role in after sales service includes developing servicing procedures and standards, technical manuals, technical support, training for dealers, and warranty support.

The dealer network and parts distribution capabilities are the two keys to after sales service. The marketing companies have responsibility for the dealer network and manage the replacement parts distribution warehousing and activities in their regions. Cat SARL and CofA also employ parts marketing specialists for their regions.

Specific dealer development activities undertaken by Cat SARL, for example, include installation and training on dealer information systems; dealer process improvement assistance (consulting and best practices advice on sales, parts, service, tools, etc.); and dealer business and financial assistance (reviewing dealer business plans and financial results, benchmarking dealer results against established standards, making recommendations to improve dealer efficiency and profitability, sharing new business opportunities, etc.).

Parts Distribution. Parts distribution is one of Caterpillar's most important competitive advantages in the marketplace. Caterpillar's guarantee to deliver parts anywhere in the world on very short notice enables it to sell more machines, since customers know that they will not be idled by missing parts. The parts distribution function at Caterpillar is very closely associated with the marketing functions because of its strategic importance in sales and aftermarket services.

Caterpillar operates a network of parts distribution centers, and other parts facilities around the world. The major parts distribution center is located in Morton, Illinois, which is part of Cat Inc. Other major parts distribution centers are part of Cat SARL. Cat SARL operates distribution centers in Grimbergen, Belgium and in Singapore. CofA also maintains a distribution center. In these non-US parts facilities, the inventory is typically owned by the marketing companies.

Marketing companies acquire replacement parts from two sources, Cat Inc. and Cat SARL. Parts manufactured in Caterpillar factories ("worked parts") in the U.S. and in non-European factories (e.g., Cat Mexico and Cat Brasil) are acquired by Cat Inc. Parts acquired from third party vendors ("purchased finished parts") are acquired by Cat SARL. Worked parts manufactured in European plants are sourced by Cat SARL.

Cat SARL pays a license fee and various service fees to Cat Inc. related to the purchased

finished and European worked replacement parts business.

b. Marketing Risks

Inventory Risk. Inventory risk for finished product remains for a limited period of time with the marketing companies, who hold title only for the time in transit from the factory to the dealer. The factories usually have minimal inventory risk for finished product since assembly for most product is typically based on dealer orders. Inventory risk for replacement parts rests entirely with the marketing entities, who own the finished parts inventory for their territories.

Foreign Exchange Risk The foreign exchange risk for the marketing operations rests with the marketing companies. Marketing companies hedge their exchange rate exposure on an annual basis against changes in local currencies vs. the US dollar. Most marketing companies purchase in US dollars from related entrepreneurial companies.

c. Marketing Assets

Name. Caterpillar's name and reputation have worldwide recognition. Caterpillar has promoted its name and related trademarks, logos, etc. and defended them as necessary. Development and maintenance of the Caterpillar name, and related trademarks, are performed, or paid for, by Cat Inc. and Cat Inc. owns all rights thereof.

Established Dealer Network The foreign marketing companies hold the dealer contracts. Caterpillar has a network of worldwide dealers that provide sales and service support to customers.

Cat Inc., with assistance from the foreign marketing companies, spends significant resources in supporting and improving the dealer network, through sales and service training, dealer administration support, financial advice, and other programs.

Caterpillar Inc.

U.S. Transfer Pricing Documentation Report

Year Ended December 31, 2008

Final Report

August 25, 2009

3. Entities Covered in This Report

Table IV-1 briefly summarizes the characteristics of each entity tested in this report. It is important to note that several entities have characteristics of more than one type of activity. With the exception of Caterpillar Inc. ("Cat Inc."), each of these entities is described in detail in Chapters VI through XI, respectively. Cat Inc., headquartered in Peoria, IL, is an entrepreneurial entity that owns intangible assets. Cat Inc. is the entrepreneurial entity for prime products manufactured in the U.S. such as track type tractors, mining equipment, motor graders, and other products. Cat Inc. is the entrepreneurial entity (in the U.S. territory) for replacement parts supporting Caterpillar machines and engines. Cat Inc. is also a marketing entity for products manufactured in the U.S. or for products which Cat Inc. purchases from non-U.S. affiliates and sells to U.S. dealers. Cat Inc. acts as a supplier factory to Cat SARL for skid steer loaders and for multi terrain loaders produced in the Sanford, NC facility for export from the U.S. In addition, Cat Inc. manufactures production material for sale to its U.S. and foreign affiliates.

TABLE IV-1 OVERVIEW OF ENTITIES			
<i>Legal Entities</i>	<i>Entrepreneurial Entity</i>	<i>Supplier Factory</i>	<i>Marketing Entity</i>
<i>Cat Inc.</i>	✓✓	✓	✓
<i>Cat SARL</i>	✓✓		✓
<i>Cat (UK) Ltd.</i>		✓✓	
<i>Cat Brasil</i>		✓✓	✓
<i>Cat Mexico</i>		✓✓	
<i>FG Wilson</i>	✓✓	✓	✓
<i>Perkins</i>	✓✓		✓

✓✓ Primary classification
✓ Secondary classification



B. Legal Transaction Flows

Caterpillar entities participate in multiple intercompany transactions. This section discusses the principal intercompany transactions that are reviewed in this report.

1. Tangible Property

Tangible property transactions consist of intercompany sales of prime product, production components, and replacement parts. Prime product refers to completed machines and engines that are purchased by dealers for resale to end-users. Production components refer to inter-plant and intercompany sales of subassemblies or parts that are used in further manufacturing or assembly by the acquiring facility. Replacement parts are designed and manufactured to Caterpillar specifications and are sold to dealers for installation on Caterpillar equipment in the field.

a. *Prime Product*

Prime product is generally acquired by a marketing entity from an entrepreneurial or manufacturing entity. Prime product may also be sold from entrepreneurial entities directly to dealers (e.g., from Cat Inc. or Cat SARL to their dealers) when they are acting as marketing entities. The Caterpillar entrepreneurial entity will either manufacture the product itself, or will contract with a related Caterpillar company to assemble the product. The entrepreneurial entities are responsible for developing and implementing product strategy for their designated products and territories and for the strategic pricing decisions. Prime products can be fitted with attachments for the specific requirements of the end user.

Transactions from Entrepreneurial Entity to Marketing Entity. Marketing entities are responsible for maintaining the dealer network in their regions, and for developing and implementing marketing strategies. Marketing entities provide input to the entrepreneurial entities on appropriate dealer prices in their regions ("area dealer net" or "Area D/N") and establish policies for discounts from dealer net (including sales variance, special marketing programs, etc.).

The intercompany price for the prime product, from the entrepreneurial entity to the marketing entity, is generally set at a discount from the marketing entity's area dealer net price, which represents the list price of the machine sold to dealers in the specific geographic territory. Prices at which the marketing entities purchase product from entrepreneurial entities are established annually between



Mr. David S. Poling
Intercompany Pricing Manager, Tax & Trade
Caterpillar Inc.
100 North East Adams Street
Peoria, Illinois 61629

September 15, 2011

Dear Dave

We have prepared and enclosed our transfer pricing analysis and report in connection with the intercompany arrangements between Caterpillar Inc. and its foreign affiliates pursuant to our statement of work dated February 11, 2011.

The analyses and conclusions contained in the report are based on information that has been furnished to us by Caterpillar Inc. It is our understanding that the information described in this report is accurate. We have not independently verified the information contained in this report.

The scope of our analysis contained in this report is limited to the U.S. federal income tax issue of whether Caterpillar Inc. should be treated as having reasonably concluded that its selection and application of the transfer pricing methods described in this report provide the most reliable measure of an arm's length result.

Based on the analysis performed, from a U.S. federal income tax perspective, Caterpillar Inc. should be treated as having reasonably concluded that its selection and application of the transfer pricing methods described in this report provide the most reliable measure of an arm's length result for FY2010.

We greatly appreciate your assistance as well as the assistance of Marina Wirtz, Crystal Carter, Seth Nettles and others at Caterpillar throughout this project.

If you have any questions, please contact me at 312-298-2464.

Very truly yours,

Garry Stone
PricewaterhouseCoopers LLP

Enclosures

PricewaterhouseCoopers LLP, One North Wacker, Chicago IL 60606
T: (312) 298 2000, F: (312) 298 2001, www.pwc.com/us



Caterpillar Inc.

Transfer pricing analysis and report

For fiscal year ended December 31, 2010

Final Report
September 14, 2011

Caterpillar Inc. was established in 1925 and is headquartered in Peoria, Illinois, U.S. Caterpillar Inc. has developed its global footprint and is a truly global company with more than 450 subsidiaries and branches in operating 57 different countries operating hundreds of facilities. Caterpillar and its subsidiaries employ more than 104,000 employees and are engaged in the design, manufacture, and worldwide distribution of machines, engines and replacement parts as well as in the provision of services to third-party customers,

**Redacted By The
Permanent Subcommittee
on Investigations**

2.2. Legal structure

Caterpillar Inc., a Delaware, U.S. corporation, is the parent company of the Caterpillar group. Caterpillar Inc. is a U.S. Securities and Exchange Commission registrant listed on exchanges in the United States, Belgium, France, Germany, Switzerland, and the United Kingdom.

Caterpillar Inc. directly and indirectly owns approximately 450 subsidiary entities incorporated or established in 57 different countries. Caterpillar Inc. is the group's sole publicly traded company and its subsidiaries are private entities. Group entities vary significantly in type and scope of activity. Legal entity organization charts are presented in Appendix E.

² Caterpillar Inc. 2010 Form 10-K. Service activities are combined with the relevant business segment.

2.3. Nature of operations³

2.3.1. Principal lines of business

Caterpillar operates in the following three principal lines of business: machinery, engines, and financial products.

Machinery

The Machinery principal line of business includes the design, manufacture, marketing, and sales of construction, mining, and forestry machinery. Examples of machinery include track and wheel tractors, track and wheel loaders, pipe layers, motor graders, wheel tractor-scrappers, track and wheel excavators, backhoe loaders, log skidders, log loaders, off-highway trucks, articulated trucks, paving products, skid steer loaders, underground mining equipment, tunnel boring equipment, and related parts. In addition, this line of business also includes Electro-Motive Diesel Inc. ("EMD"), a manufacturer of diesel-electric locomotives. This line includes logistics services for uncontrolled companies and design, manufacturing, remanufacturing, maintenance, and services connected with rail-related products.

Engines

The Engines principal line of business includes the design, manufacture, marketing, and sales of engines for Caterpillar machinery, electric power generation systems, locomotives, marine, petroleum, construction, industrial, agricultural and other applications and related parts. It also includes remanufacturing of Caterpillar engines and a variety of Caterpillar machine and engine components and remanufacturing services for other companies. Reciprocating engine power output ranges from 10 to 21,700 horsepower (8 to over 16,000 kilowatts) and turbine engines range from 1,600 to 30,000 horsepower (1,200 to 22,000 kilowatts).

Financial products

The Financial Products principal line of business consists primarily of Caterpillar Financial Services Corporation ("Cat Financial") and Caterpillar Insurance Holdings, Inc. ("Cat Insurance") and their respective subsidiaries. Cat Financial provides a wide range of financing alternatives to customers and dealers for Caterpillar-branded machinery and engines, Solar gas turbines, other equipment, and marine vessels. Cat Financial also extends loans to customers and dealers. Cat Insurance provides various forms of insurance to customers and dealers to help support the purchase and lease of Caterpillar equipment.

2.3.2. Additional information on principal lines of business

Competitive conditions

The Machinery and Engines lines of business operate in highly competitive conditions with intense price competition. Great emphasis is placed on quality and performance of products and on dealer service support. Although no single competitor is known to produce all of the same types of machines and engines as Caterpillar, there are many companies, large and small, that compete with Caterpillar for the sale of each of its products.

³ Caterpillar Inc. 2010 Form 10-K.

The Financial Products line of business also conducts operations under highly competitive conditions. Financing for users of Caterpillar products is available through a variety of competitive sources, principally commercial banks and finance and leasing companies. Financial Products activity is conducted primarily in the United States, with additional offices in Asia, Australia, Canada, Europe, and Latin America.

Manufacturing and distribution activities

Manufacturing activities of the Machinery and Engines lines of business take place at various facilities around the world, including facilities in the United States, Europe, Asia, Latin America, and Australia.

Machines are distributed primarily through a worldwide network of independent Caterpillar dealers located inside (50) and outside (138) the United States. Worldwide, these Caterpillar dealers serve 182 countries and operate 3,475 places of business, including dealer rental outlets. Caterpillar products are the principal business of most Caterpillar dealers, but Caterpillar is not an exclusive supplier to its dealers.

Reciprocating engines are sold primarily through the Caterpillar dealer network and to other manufacturers for use in products they manufacture. Some reciprocating engines manufactured by Perkins are also sold through a worldwide Perkins network of 142 distributors located in 183 countries.

FG Wilson branded electric power generation systems are sold through a worldwide network of 154 distributors located in 179 countries. Some large, medium speed reciprocating engines are sold under the MaK brand through a worldwide network of 19 dealers located in 130 countries.

Caterpillar replacement parts distribution centers are located inside and outside the United States.

Caterpillar products are sold primarily under the brands "Caterpillar", "CAT", "Electro-Motive", "Solar Turbines", "MaK", "Perkins", "FG Wilson", "Olympian", and "Progress Rail".

2.4. Management organization structure

In the early 1990s, Caterpillar organized into Business Divisions. A Caterpillar Vice President leads each Business Division and reports to the Caterpillar Executive Office. Each Business Division operates as an autonomous organization, focusing on a certain business segment, process, or region. As a management organization, a Business Division can include several subsidiaries or branches ("legal entities"), or a legal entity can contain the activities of several Business Divisions. The function, risk, and asset profile of a given legal entity therefore generally results either from the role given to that legal entity within a Business Division, or from the combination of a Business Division's attributes within that legal entity. The transfer pricing model for the legal entity is set in consideration of that function, risk, and asset profile and is implemented in accordance with the relevant Caterpillar Corporate Procedures.

As Caterpillar's business model evolves to better serve its customers, employees, and shareholders, the scope and role of the Business Divisions are refined or redefined. Intercompany transactions are therefore periodically re-evaluated to ensure fair and consistent market compensation for each Caterpillar legal entity.

In 2010, Caterpillar operated its 29 Business Divisions through nine Division Types. The Division Types and Business Divisions are summarized in Figure 2-2. Caterpillar's management organization chart is presented in Appendix E.

Transfer pricing analysis and report for Caterpillar Inc.
For fiscal year ended December 31, 2010

Final

Figure 2-2 – Summary of Caterpillar business divisions and division types

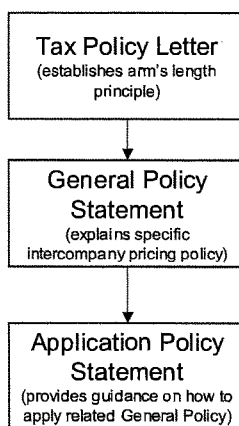
Division Number	Division Name	Division Type	General Division Type Description	Specific Division Name
1	Machine Business Divisions	Machine Business Divisions	Machine business divisions are profit centers primarily responsible for product management, development, marketing, sales and product support. Machine business divisions also have select manufacturing responsibilities. These activities were previously included within product and component divisions, manufacturing divisions and machinery/marketing divisions. Inter-segment sales of components may also be a source of revenue for these divisions.	1 Mining
				2 Earthmoving
				3 Excavation
				4 Building Construction Products
				5 Diversified Products
				6 Cat Japan
2	Component Business Divisions	Component Business Divisions	Component business divisions are profit centers primarily responsible for product management, development, manufacturing, marketing and product support for internal and external customers. Some of these activities were previously included within product and manufacturing divisions. Inter-segment sales are a source of revenue for these divisions.	7 Advanced Components & Systems (See Components as combined with Remanufacturing division in next table)
3	Service Business Divisions	Service Business Divisions	Service business divisions are profit centers primarily responsible for various services and service-related products to customers including financial, logistics, remanufacturing and rail services. Inter-segment sales of services and service-related products are a source of revenue for some of these divisions.	8 Progress Rail
				9 Logistics
				10 Financial Products
				11 Remanufacturing & Core Components
4	Engine Business Divisions	Engine Business Divisions	Engine business divisions are profit centers primarily responsible for product management, development, manufacturing, marketing, sales and product support. Inter-segment sales of engines and/or components may also be a source of revenue for these divisions.	12 Industrial Power Systems
				13 Electric Power
				14 Marine & Pleasure Power
				15 Large Power Systems
				16 Turbines
5	Center of Excellence Divisions	Center of Excellence Divisions	Centers of excellence divisions are cost centers primarily responsible for Caterpillar's most critical manufacturing processes in the areas of Marketing and Product Support, Production and Product Development. Previously these organizations were considered service divisions.	17 Product Development & Global Technology
				18 Customer Services Support
6	Corporate Services Divisions	Corporate Services Divisions	Corporate services divisions are cost centers primarily responsible for the performance of certain support functions globally (e.g., Finance, Human Resources, Information Technology, Legal and Purchasing) and to provide centralized services.	19 Global Purchasing
				20 Legal Services
				21 Global IT Services
				22 Human Services
7	Regional Distribution Services Divisions	Regional Distribution Services Divisions	Regional distribution services divisions are cost centers primarily responsible for the total portfolio of business with each dealer, the dealer relationship, dealer development and ensuring the most efficient and effective distribution of machinery, engines and parts. Previously these functions were primarily performed by machinery marketing divisions.	23 Finance Services
				24 Asia Pacific Distribution
				25 Americas Distribution
8	Manufacturing Services Divisions	Manufacturing Services Divisions	Manufacturing services divisions are cost centers primarily responsible for the manufacture of products and/or components within the geographic regions of the Americas and E&ME. Previously manufacturing divisions were profit centers with inter-segment sales of components, machines and/or engines to product divisions as the primary sources of revenue.	26 E&ME Distribution
				27 E&ME & S America Operations
9	Other	Other		28 Integrated Manufacturing Operations
				29 Cat China

2.5. Caterpillar transfer pricing policy

Caterpillar's integrated business model and global footprint generates, by nature, a significant volume of transactions between legal entities. Compliance with laws and regulations is an obligation for Caterpillar employees in accordance with the principle of integrity set by Caterpillar's Values in Actions and defined by the Caterpillar Worldwide Code of Conduct.

Consistent with its values, Caterpillar establishes intercompany transactions and prices transactions in compliance with the "arm's length principle" as defined in relevant transfer pricing legislation. A global Caterpillar "Tax Policy Letter" states: "Caterpillar legal entities comply with all applicable laws and regulations regarding the pricing of transactions between related parties. Intercompany transaction prices are determined under the arm's length principle." An "Intercompany Pricing Policy Letter" ("Pricing Policy") further defines specific transfer pricing policy statements. Policies exist within a hierarchy, beginning with the global Tax Policy Letter. Caterpillar's intercompany pricing policy hierarchy is diagramed in Figure 2-3.

Figure 2-3 – Caterpillar intercompany pricing policy hierarchy



**CATERPILLAR INC.
EVALUATION OF ARM'S LENGTH
PRICING FOR INTERCOMPANY
TRANSACTIONS**

Year Ended December 31, 1995

Prepared by Price Waterhouse LLP

**FINAL REPORT
December 19, 1996**

Price Waterhouse LLP 

2. An Overview of Caterpillar Inc.

A few relevant paragraphs from a recent Caterpillar document, "The Caterpillar Story,"¹⁶ provide an overview for the functional analysis:

"Caterpillar, Inc., headquartered in Peoria, Illinois, is the world's largest manufacturer of earthmoving, construction, and materials handling equipment, and a major manufacturer of diesel and natural gas engines and gas turbines.

The [company's] products have a wide variety of uses, including highway, dam, pipeline, and other construction; petroleum, agricultural, industrial, and other applications; and electric power generation systems."

Caterpillar products are sold and serviced principally through a worldwide network of more than 200 independently owned dealers and one company-owned dealership.

This report focuses on intercompany transactions for earthmoving and construction equipment, machines, engines, and production components and replacement parts for these segments. The industrial turbine power systems designed, manufactured, and marketed by Caterpillar's Solar Turbines Inc. subsidiary are not part of this report.

a. **Structure**

Caterpillar was formed in 1925 by two companies which produced wheel and crawler tractors principally for agricultural uses. Until 1950, all manufacturing was performed in the United States, although there had been overseas sales by the predecessor companies since 1909. Exports represented about 20% of sales by the late 1940's. In the 1950's and 1960's, Caterpillar established manufacturing operations in the United Kingdom, Brazil, Australia, Canada, France, Mexico, and

¹⁶Peoria, IL., April 1989.

**1995 Documentation
FINAL REPORT**

Belgium. The original purpose of these international operations was to overcome barriers such as foreign exchange shortages, tariffs, import controls, and other difficulties in supplying replacement parts to customers. Later, the manufacturing plants were established to enable Caterpillar to provide prime products to users in all parts of the world.

In addition to these manufacturing operations, marketing subsidiaries were established to market product and to provide product support outside the United States. Caterpillar Americas Company (CACO) was established in 1957 to serve the Western Hemisphere;¹⁷ Caterpillar Overseas, S.A. (COSA) was first established in 1957 as Caterpillar Overseas C.A. in Venezuela and was organized and relocated in Switzerland in 1960 to serve the rest of the world outside the U.S. In 1967, Caterpillar Far East, Ltd (CFEL) was formed by COSA to serve Asian markets. In 1994, CFEL became a separate branch of COSA, COSA - Singapore.

Caterpillar has established a number of subsidiary companies generally organized according to their principal function as either marketing and manufacturing companies and, within these, by geographic area of responsibility. For example, Caterpillar Overseas S.A. is the marketing company for Europe, the Middle East, and Africa and is a subsidiary of Caterpillar, Inc. By contrast, Caterpillar Belgium S.A. (Cat Belgium) is a manufacturing subsidiary supplying a range of products across a number of markets.

No corporate entity is "pure" in terms of functions, however. Because of local needs, almost all Caterpillar manufacturing companies perform some marketing, and vice versa. For example, Cat Belgium sells its own manufactured product directly to dealers in Belgium, although COSA performs all of the other marketing functions that enhance Cat Belgium's ability to make these sales. On the other side, the Australian company (Caterpillar of Australia, Ltd -- COFA), predominantly a

¹⁷ CACO is consolidated with Caterpillar Inc. in the U.S. tax return and hence, is not discussed in detail in the remainder of this report.

marketing company, also has a minor manufacturing function, assembling motor graders for its own market.

COSA is the shareholder for many of Caterpillar's foreign manufacturing companies (including Caterpillar's share of overseas joint venture companies) and marketing companies. The remaining companies are generally subsidiaries of Caterpillar, Inc. For the purposes of this transfer price review, the ownership structure of the entities is not as important as the business relationships among them. Our description and analysis focuses on intercompany transactions and the economic functions exercised by each company. The legal structure is not discussed further in this report, except as needed.

b. Product Flow

Generally, Caterpillar product flows from a manufacturing company to a related marketing company, to independent dealers, and finally to end-users. Departure from this flow occurs only when and where conditions require a departure. The following is a brief description of the normal flow of prime products, parts, and components among related Caterpillar companies.

i. Manufacturing

Prime Product. Prime product refers to the completed machines or engines sold by Caterpillar entities to their dealer network. Prime product is manufactured at Caterpillar owned plants or (in a few instances) by a third party manufacturer.

Sourcing for products is generally based on geography, so that the nearest plant that manufactures an item is typically the source of that product for the local marketing company. Because sales volumes for some large machines do not justify multiple manufacturing sites, these machines are usually sourced at a single plant and sold to each of the marketing companies.

**1995 Documentation
FINAL REPORT**

Replacement Parts. Caterpillar maintains three primary parts distribution centers serving parts depots worldwide. Morton, IL is headquarters of the Parts & Service Support (P&SS) business unit and the primary parts distribution center for North America; Grimbergen, Belgium is a branch of COSA (and owns the inventory therein); and COSA Singapore sells to dealers in the Far East region. Thus, P&SS sells the requisite replacement parts to the marketing company, which then sells to dealers, who in turn sell to the customer. In addition, other Caterpillar companies maintain parts depots or facilities in Australia, Brazil, Canada, Mexico, and South Africa.

Components. Components (also referred to as "production material" in this report) are parts or assemblies supplied by a Caterpillar manufacturer for use by another in the production of prime product. Purchases of components are made directly by the manufacturing plant and generally are not purchased from marketing companies. A component may be physically the same in appearance as a replacement part (although they may be packaged differently). What distinguishes the two, aside from differences in packaging, is that replacement parts are ultimately destined for a customer without further assembly, while components will be incorporated into a prime product or replacement part by a further manufacturing process.¹⁸

ii. Marketing

Marketing companies purchase from Caterpillar commercial entities (i.e., Cat Inc., Cat Belgium, or Cat France) and sell to dealers. With the exception of one dealer in the United States that is owned by Caterpillar, dealers are unrelated parties. The marketing companies are organized geographically and operate only in their respective regions.

The general function of a Caterpillar marketing company is to purchase products from manufacturers

¹⁸Throughout this report, the term "parts" will refer to replacement parts and the term "components" will refer to component parts.

**1995 Documentation
FINAL REPORT**

for sale to independent dealers and to provide marketing services for Caterpillar products within its geographic area. These services include developing new markets for Caterpillar products. Marketing companies advise and consult with dealers, who, in turn sell and provide services to end users. Caterpillar marketing companies are responsible for developing and implementing marketing strategies within their geographic regions. Two of the marketing operations, COSA and COSA-Sing also own and manage the parts distribution centers in Grimbergen, Belgium and in Singapore, respectively.

c. Summary of Caterpillar Companies

Altogether, Caterpillar has a direct or indirect ownership interest in more than 100 companies around the world. Most are wholly owned by Caterpillar, Inc., by one of its wholly-owned subsidiaries, or in conjunction with one of its wholly-owned subsidiaries. Some are owned jointly with an unrelated party.

Our transfer pricing analysis is concerned with the 8 wholly-owned companies which conduct the bulk of Caterpillar's related party transactions. The companies included in the analysis are:

1. Caterpillar Inc. ("Cat Inc."): the parent company, a US company that manufactures in its own plants for sale to foreign marketing companies and markets all Caterpillar products in the U.S. Cat Inc. performs R&D, designs products and processes, and has broad management and financial responsibilities for the corporate group. Cat Inc. owns all the patents, technology, know how, names, and other valuable intangibles.
2. Caterpillar Overseas S.A. ("COSA"), a Swiss company responsible for marketing of prime products and the marketing and distribution of parts in Europe, Africa, the Middle East, and Eastern Europe.

**1995 Documentation
FINAL REPORT**

3. Caterpillar Americas Co. ("CACO"), a U.S. company responsible for marketing in the Western Hemisphere outside the U.S. (Included in the U.S. tax return.)

4. COSA-Singapore ("COSA-Sing"), a Singapore branch company responsible for the marketing of prime product and the marketing and distribution of parts in the Far East, exclusive of Japan and Australia. For the purpose of this report, COSA-Sing is evaluated separately for the testing of 1995 transactions.

5. Caterpillar of Australia Ltd. ("COFA"), an Australian company responsible for marketing in Australia, New Zealand, and nearby islands. COFA also assembles motor graders, but derives more than 95 percent of its revenues from marketing activities.

6. Caterpillar Belgium S.A. ("Cat Belgium"), a Belgian company that manufactures products for sale primarily to COSA.


7. Caterpillar France S.A. ("Cat France"), a French company that manufactures products for sale primarily to Cat Inc. and COSA, in roughly equal amounts.

8. Caterpillar (U.K.) Ltd. ("Cat (UK) Ltd."), a U.K. company that manufactures smaller machines for sale primarily to Cat Inc. and COSA.

9. Caterpillar Brasil S.A. ("Cat Brazil"), a Brazilian Company that manufactures products for sale in its market and for export to Cat Inc. and CACO.

In addition to its own manufacturing companies, Caterpillar also employs third party suppliers (i.e., where Caterpillar owns the product designs). Caterpillar's major unrelated supplier is Artix Ltd, which manufactures articulated dump trucks for Caterpillar. There are other unrelated manufacturers, but the volume of product they produce for Caterpillar is significantly smaller.

II-15

Price Waterhouse LLP 

(Potentially comparable transactions with Artix are discussed in more detail in Appendix D of this report.)

d. Transactions with SCM

Shin Caterpillar Mitsubishi (SCM) is a Japanese joint venture between Caterpillar Inc. and Mitsubishi Heavy Industries (MHI), engaged in the manufacturing and marketing of construction and heavy equipment in Japan. Transactions between Caterpillar and SCM are governed by the joint venture (with amendments) signed by Cat Inc. and MHI. These transactions are considered uncontrolled by Caterpillar for purposes of section 482. For example, SCM has a seventeen-member board of directors, of which only seven are Caterpillar employees. Accordingly in this report, we do not evaluate the Cat-SCM transactions for purposes of section 6662 documentation.

Caterpillar's tangible property transactions with SCM are significantly different from transactions with its controlled marketing companies (e.g., COFA, COSA, or COSA-Sing), or its transactions with its controlled manufacturers (e.g., Cat Belgium or Cat France). These differences include differences in terms and conditions of pricing, economic factors (strategic pricing decisions vs. Japanese-based competitors) and risk (exchange rate risk). We were not able to make accurate and reliable adjustments for these differences. Accordingly, we do not use transactions with SCM as comparable uncontrolled transactions under the tangible property methods (CUP, cost plus, or resale price methods). See further discussion of tangible property transactions with SCM in Appendix A.

SCM and Cat Inc. cross-license design technology to each other (SCM owns the design for small hydraulic excavators, and Cat Inc. owns the design for other products). We determined that Cat's tangible licenses to/from SCM are sufficiently similar to Cat Inc.'s licenses to Cat Belgium and Cat France that the SCM licenses could be used as comparable uncontrolled transactions under the intangible property methods (Comparable Uncontrolled Transactions and Comparable Profit Split Methods). See more detailed discussion in Section IV.B.5.

PARTS PROFIT DISTRIBUTION CONCEPTS			
PROFIT CENTER	PARTS PROFIT DISTRIBUTION OBJECTIVES	METHODOLOGY	
MARKETING ORGS	Motivate to maximize parts POPS & price realization	Distribute a % of parts sales	
PRIME PRODUCT PROFIT CENTERS	Motivate to create machine populations with high degree of proprietary components which have high parts margins & high POPS	Distribute a portion of residual profit	
COMPONENT PROFIT CENTERS	Motivate to develop differentiated & proprietary components for prime products which are profitable for profit centers & the enterprise	Mfg parts: market-based transfer prices Pur parts: distribute a portion of residual profit	
MANUFACTURING PLANTS	Motivate to lower plant costs	Market-based transfer prices	
P&SS	Motivate to: 1) Drive overall parts profit 2) Achieve acceptable ROA (on \$1.5B in assets) 3) Keep owning & operating costs of CAT equipment best value in the industry	Distribute a % of enterprise profit	



Price Waterhouse LLP

PARTS PROFIT DISTRIBUTION

PARTS PROFIT RECIPIENTS

	PORTION OF TOTAL
MARKETING:	4 %
CACO CFEL COSA	
CBSA COFA NACD	
ENGINE DIVISION CIP1	
MANUFACTURING PLANTS:	3 %
ALL US MFG PLANTS	
ALL SUB MFG PLANTS	
COMPONENT PROFIT CENTERS:	4 %
CHEM PRODUCTS TRANSMISSIONS	
HYDRAULICS UNDERCARRIAGE	
ENGINE DIV (for captive engines)	
COMMERCIAL ENTITIES:	16 %
44 PRODUCT GROUPS	
P&SS	3 %
TOTAL	30 %

PARTS PROFIT DISTRIBUTION

PROFIT CENTERS FOR WHICH A DISTRIBUTION IS MADE

CONSTRUCTION & MINING
PRODUCTS

AURORA:

EXCAVATORS
MED WHEEL LOADERS
LRG WHEEL LOADERS

DECATUR:

ARTICULATED DUMP TRUCKS
OFF-HIGHWAY TRUCKS
MOTORGRADERS
SCRAPERS
LRG MINING VEHICLES

EAST PEORIA:

MED TRACK TRACTORS
LRG TRACK TRACTORS

ENGINE DIVISION

SMALL ENGINES:

3100
3200
3200 NON-CUR

MEDIUM ENGINES:

3300
3300 NON-CUR
3400
3400 NON-CUR

LARGE ENGINES:

3500
3500 NON-CUR
3600
SPARK IGNITED
SPARK IGNITED - NC
SINGLE CYL TEST ENGINES

OTHER

AG PRODUCTS:

AG MACHINES
CHALLENGER

BUILDING & CONSTR PROD:

BACKHOE LOADER
SML EXCAVATORS
SML TRACK TRACTORS
SML WHEEL LOADERS

COSA:

CMR
GOSSELIES:
COMM ENG
EXCAVATORS
WHEEL LOADERS

GRENOBLE:

EXCAVATORS
TRACK LOADERS
TRACK TRACTORS

PAVING PRODUCTS:

BARBER GREENE
PAVING PRODUCTS

CAT WORLD TRADE

CBSA

CIPi

CUSTOM PRODUCTS

DEFENSE PRODUCTS

FOREST PRODUCTS

FINAL REPORT

Caterpillar

1998 Documentation Report

September 15, 1999



**1998 Documentation
Final Report**

COSA-Sing, and COFA undertake substantial activities in this area, as they employ parts marketing specialists for their regions.

Specific dealer development activities undertaken by COSA, for example, include installation and training on dealer information systems (the systems themselves are designed by Cat Inc.); dealer process improvement assistance (consulting and best practices advice on sales, parts, service, tools, etc.); and dealer business and financial assistance (reviewing dealer business plans and financial results, benchmarking dealer results against established standards, making recommendations to improve dealer efficiency and profitability, sharing new business opportunities, etc.).

- 2.1.6 Parts Distribution. Parts distribution is one of Caterpillar's most important competitive advantages in the marketplace. Caterpillar's guarantee to deliver parts anywhere in the world on very short notice enables it to sell more machines, since customers know that they will not be idled by missing parts. The parts distribution function at Caterpillar is very closely associated with the marketing functions because of its strategic importance in sales and aftermarket services.

Caterpillar operates a network of parts distribution centers, parts distribution centers, and other parts facilities around the world. Parts distribution and management of parts facilities rests principally with P&SS, a division of Cat Inc. The major parts distribution center is located in Morton, Illinois, which is part of Cat Inc. Other major parts distribution centers are part of COSA (located in Grimbergen, Belgium) and COSA-Sing (located in Singapore).¹⁴ COFA maintains a distribution center. In these non-US parts facilities, the inventory is managed by P&SS, although it is owned for legal purposes by the marketing companies. The intercompany price for the sale of spare parts from P&SS to the marketing companies includes a component for the interest costs of the marketing companies' ownership of the parts.

¹⁴Cat Africa owns a parts distribution center in Johannesburg, South Africa.

2.2 Marketing Risks

2.2.1 Inventory Risk. Inventory risk for finished product remains with the marketing companies, who hold title only for the time in transit from the factory to the dealer. The factories have more limited inventory risk for finished product since assembly for most product is based on dealer orders. Inventory risk for replacement parts is entirely with the marketing entities, who own the finished parts inventory for their territories.

2.2.2 Foreign Exchange Risk (See 1.2.4 above.) The foreign exchange risk for the marketing operations rests with the marketing companies. Marketing companies hedge their exchange rate exposure on an annual basis against changes in local currencies vs. the US dollar. Most marketing companies purchase in US dollars from related manufacturing companies.

2.3 Marketing Assets

2.3.1 Name. Caterpillar's name and reputation have worldwide recognition. Caterpillar has promoted its name and related trademarks, logos, etc. and defended them as necessary. Development and maintenance of the Caterpillar name, and related trademarks, are performed, or paid for, by Cat Inc. and Cat Inc. owns all rights thereof.

2.3.2 Established Dealer Network. The dealer network is one of Caterpillar's most valuable assets. The foreign marketing companies hold the dealer contracts. Caterpillar has a network of worldwide dealers that provide sales and service support to customers. In 1996, the chairman and CEO of Caterpillar made this statement, "...We are convinced that our single greatest advantage over our competition was and still is our system of distribution and product support. The

**1998 Documentation
Final Report**

backbone of that system is our 186 independent dealers around the world who sell and service our machines and diesel engines.”¹⁵

Foreign marketing companies spend significant resources in supporting and improving the dealer network, through sales and service training, dealer administration support, financial advice, and other programs.

The marketing companies are primarily responsible for maintaining the dealer relationships that form the basis of the dealer network. As detailed above, the marketing companies provide dealer services that range from market strategy and market development to specific business and financial assistance to dealers. Furthermore, the marketing companies receive dealer feedback and work in cooperation with the dealers in order to obtain current market, product, and customer information. In the COSA territory, for example, COSA has dedicated significant resources to dealer development and relationship building. As a result, the average length of a dealer relationship in the COSA territory is 46.5 years and dealer turnover is rare.

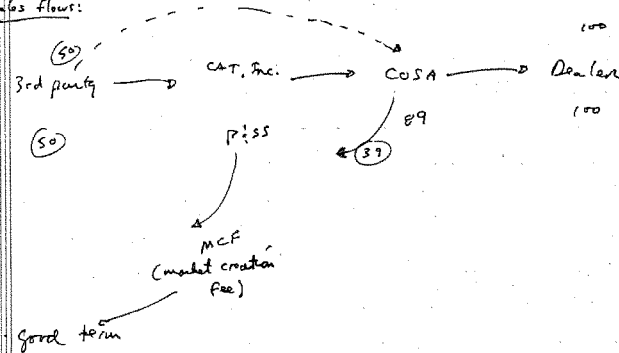
¹⁵“Make Your Dealers Your Partners,” *Harvard Business Review*, March/April 1996.

CAT - Dave Burritt
COSA

①

- Ability to shift costs from Switzerland to Belgium, etc. Maybe just charge out? Would like to move admin. people from COSA to Belgium, etc.
- COSA - low-margin sales.
 - marketers given small rewards.
- Substance in COSA - presents opportunities.
- Shifting money to COSA - does this impair CAT system?
 - 64M question.

Sales flows:



(2)

↑ COSA Profit

↓ US

↓ Foreign

Purchase Finished Parts

	Current	US on
Swiss Marketing - routine	4%	4%
- Dealer Network		5
- Field Population		3
US/Swiss P:SS - routine function	3%	3%
- Logistics		3
Bel/France/US Mfg Plant (procurement)		
Procurement Function	3%	3
Market Creation Fee		
Components	4%	
CE (commercial entity)	16%	
Field Population		3
Design Fee		6
	30%	30

COSA 4% before, 15% after.

Key: now, P:SS is under-compensated by 3%.

Key don't want to change accountabilities. People will ~~not~~ not like.

Dealers - ^{even though} ~~unrelated~~, if they see COSA has more leverage after our strategies, they will say "why aren't I earning more"? The dealers already feel pinched, they think COSA

(3)

Wages too much money as it is.

$$8\% \text{ on } 200M = \underline{16M} \times 18\% = 3M.$$

~~Plan~~

Benefits - 40M - 70M per year ~~forever~~ forever.

Translate into value builder - shareholder value.

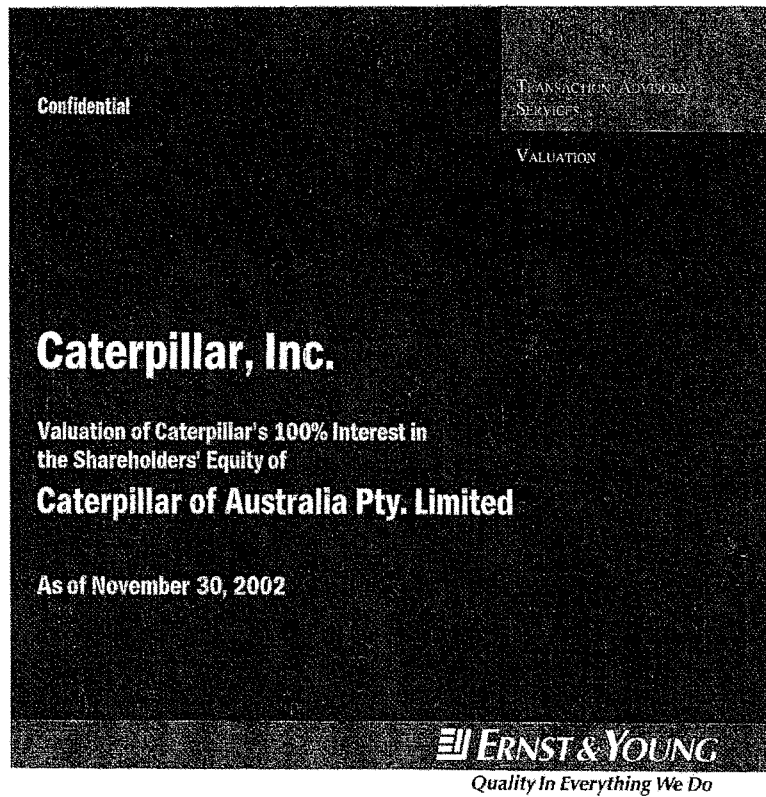
Or really likes value builder, neat package!!

Implementation time - 6-8 months.

Costa Rica, Puerto Rico, Barbados \Rightarrow places to take GACO.

* * [Could be catalyst for other change!!!!

Belgium - good time to do it hasn't ramped up yet.
- 6 unions in Belgium.



II. GENERAL OVERVIEW

A. Description of Caterpillar Inc.¹

1. General

In 1925, Caterpillar was formed by two companies that produced wheel and crawl tractors primarily for agriculture. Headquartered in Peoria, Illinois, in the United States ("U.S."), Caterpillar is the world's largest manufacturer of construction and mining equipment, diesel and natural gas engines, and industrial gas turbines. It is a Fortune 100 company, ranked first in its industry, with more than US\$30 billion in assets. Caterpillar is a U.S. based global competitor, however more than half of all Caterpillar's sales in 2001 were to customers outside of the U.S.. Caterpillar has maintained its position as a leading U.S. exporter, with U.S. exports of US\$4.8 billion in 2001.

Prior to 1950, all products were manufactured in the U.S.. In the 1950s and 1960s, Caterpillar established manufacturing operations in Australia, Belgium, Brazil, Canada, France, Mexico and the United Kingdom, overcoming barriers such as tariffs and import restrictions. Subsequently, Caterpillar also established manufacturing facilities and specialist marketing subsidiaries to market and provide products to users worldwide. Currently, Caterpillar products and components are manufactured in 50 U.S. facilities and in 65 other locations around the world.

2. Principal Lines of Business

Caterpillar operates in three principal lines of business:

Machinery

This line is responsible for the design, manufacture, and ongoing support of small, medium and large machinery used in a variety of construction, mining, industrial quarry, waste, agricultural and forestry applications. Additionally, it includes the design, manufacture, procurement, and marketing of components and control systems that are primarily consumed in the manufacturing of Caterpillar machinery. Items of machinery produced by Caterpillar include: track and wheel tractors; loaders - log loaders, telescopic loaders, skid steer loaders; pipe layers; motor graders; mining shovels; off highway trucks, articulated trucks; paving products; log skidders; and related parts.

¹ Source: Caterpillar's website, available at www.cat.com, and the December 31, 2001 Form 10-K.

Engines

Caterpillar designs, manufactures and markets engines for the machinery business line, on-highway trucks and locomotives; marine, petroleum, construction, industrial, agricultural and other applications; electric power generation systems (primary and standby); and related parts. Caterpillar is the world's largest manufacturer of medium speed engines and is also the world's largest manufacturer of high-speed diesel engines with ratings available from 54 to 13,600 hp (40 to 10,000 kW).² Caterpillar produces an extensive range of reciprocating engines that meet power needs ranging from 5 to 22,000 hp (4 to 16,200 kW) and turbines rating from 1,600 to 19,500 hp (1,000 to 14,000 kW).

Financial Products

Caterpillar provides financing to customers and dealers for the purchase and lease of Caterpillar and noncompetitive related equipment, as well as some financing for Caterpillar sales to dealers. Additionally, Caterpillar provides various forms of insurance to customers and dealers to help support the purchase and lease of its equipment. This line of business consists primarily of Caterpillar Financial Services Corporation ("Cat Financial"), its subsidiaries, and Caterpillar Insurance Co. Ltd. Cat Financial has more than doubled its earnings in the last five years. For the 2001 financial year more than 60% of new Caterpillar machines delivered worldwide were financed by Cat Financial.

3. Primary Business Units³

Caterpillar's operations are organized into various business units. A legal entity or division can be characterized either as an entrepreneurial entity, a marketing company, a supplier factory or a service support operation.

Entrepreneurial Entities

The primary responsibility of entrepreneurial entities is to develop and implement product strategies for their assigned product lines. These entities are also responsible for manufacturing the products either through their manufacturing facilities or through supplier relationships with other Caterpillar facilities; customizing the products; and developing the marketing strategy. Typically, entrepreneurial units have a global responsibility for their allocated products. Although they design and manufacture products, they do not generally sell the products directly to the dealers.

² www.Cat.com/products/engines.

³ CoFA's internal management documents.

Marketing Companies

The marketing companies purchase products from the entrepreneurial entities, sell the products to the independent dealers and maintain dealer relationships. They are responsible for all sales to dealers in their designated geographic regions. Marketing companies, along with entrepreneurial entities, establish dealer prices in their territories. Prices at which the marketing companies purchase products from entrepreneurial entities are established in annual price negotiations between the business units.

Supplier Factories

Certain Caterpillar factories manufacture and/or assemble products under contract to other Caterpillar entities. These factories manufacture products under the supervision of other Caterpillar entities that own the intangible assets. A manufacturing facility can be an entrepreneurial entity for an assigned product line in its region, as well as a supplier factory for other product lines or territories.

Service Support Operations

Caterpillar has established service support operations to assist the various marketing companies in supporting the local independent dealer networks responsible for selling Caterpillar products to end customers. CofA's role is that of a service support operation. Caterpillar has similar support service operations in Canada, Latin America, Europe and Asia.

4. Other Business Units*

Product Support Division and Caterpillar Logistics Services

Caterpillar Replacement Parts Business Units comprise two divisions. The first, referred to as the Product Support Division ("PSD"), works with the marketing companies to formulate and implement strategies to increase parts sales growth. The second, Caterpillar Logistics Division ("CLS"), manages the worldwide parts inventory, the various parts distribution centers, and the traffic operations.

Parts distribution is a significant competitive advantage for Caterpillar worldwide, due to the group's ability to deliver parts to any location in the world on very short notice. Caterpillar markets this capability and uses it as a means of differentiation from its competitors. The capacity to quickly deliver replacement parts translates to less downtime for clients, resulting from delays in the arrival of replacement parts.

The Caterpillar parts distribution network consist of 23 distribution centers in 11 countries, and 13 distribution centers in the U.S.

* CofA's internal management documents.

Component Business Unit

The Component Business Unit manufactures precision components that are required for Caterpillar's machines and engines. Located principally in the U.S., this business unit sells its products to U.S. and foreign manufacturing facilities.

**Redacted By The
Permanent Subcommittee
on Investigations**

⁵ CoA's internal management documents.



CSARL Technology Ownership

July 02, 2002

Outline

► Objective:

- Briefly introduce tax efficient methods of technology ownership
- Evaluate the feasibility for CSARL to invest in technology

► Key Question:

- Does it make sense for CSARL to invest in future technology?

► Preliminary Findings:

- Based on stylized but representative facts, there are significant tax benefits of investing in certain technologies

***Technology Ownership:
“Efficient” vs. “Inefficient”***

- Technology ownership must be aligned with enterprise and relevant affiliates’ tax footprint.
- In cases where sales predominantly occur in jurisdictions different from the owner of the technology, there can be a negative impact related to the ownership of the underlying technology.
- Technology ownership creates significant tax benefits mainly in cases where the underlying sales occur in the technology owner’s jurisdiction.

***Technology Ownership:
Relevance of Sales Profile***

- In cases where sales are in markets separate from the technology owner, the benefit of ownership is limited to license revenue.
- In addition, it must be noted that license revenue related to products that are produced and sold in the US is treated as US-source Subpart F income.
- Such income is often taxed at higher rates than the standard corporate tax rate.

Efficient Technology Ownership

Page(s)
Redacted By The
Permanent Subcommittee
on Investigations

Need to Repatriate Cash in the US

- CSARL needs to repatriate \$60-\$70m per year.
- Any cash repatriated from non-Subpart F sources diminishes the effect of tax planning
- Projections show Subpart F after-tax income alone may be insufficient to meet cash repatriation needs







Page(s)
Redacted By The
Permanent Subcommittee
on Investigations

— = Redacted by the Permanent Subcommittee on Investigations

Confidential Treatment Requested by PAC

CSARL's Profit in Licensed Business

• CSARL's profit in Licensed Business Increases as new territories added.

	Licensed	Distribution	Total
2001	 5.2%	 4.3%	 4.7%
2002/03 incl CACo, Cdn	 8.9%	 4.3%	 6.2%

High profit in Licensed Business puts pressure on 4% bundled royalty;
Cost Sharing will provide additional support for 4% royalty

PAC_PSL_CAT_00024799

July 02, 2002

Draft for Discussion Purposes - Page 9

Page 9

Page(s)
Redacted By The
Permanent Subcommittee
on Investigations

Confidential Treatment Requested by PwC

Caterpillar

European Business Model Review

September 2006

PwC_PSI_CAT_00029700

Financial reporting (continued)

- Value added statements for plants focus on key cost, efficiency, quality and manpower issues
- Accountable (vs legal entity) concepts are often referred to. However the key personnel who would be involved in a tax audit are well educated regarding legal entity. The risk of people in the business without an understanding of the differences between the two should be closely managed.

From: CN=Steven R. Williams/OU=US/OU=TLS/O=PwC
 To: CN=Thomas F. Quinn/OU=US/OU=TLS/O=PwC
 Sent: 11/06/2008 06:12:48 PM EST
 CC: CN=Ed Bodnam/OU=US/OU=TLS/O=PwC@Americas-US;CN=Michael T Murphy/OU=US/OU=TLS/O=PwC@Americas-US
 Subject: Re: Fw: slides for Ed Rapp

yeah, boiling it down to a 3 page presentation really concentrates the mind.
 wish we could do that with our 200 page TP reports.....

Redacted by the Permanent
 Subcommittee on Investigations

Steve Williams | Managing Director | Global Transfer Pricing |
 PricewaterhouseCoopers | Telephone: +1 703 918 3339 | Mobile: [REDACTED]
 steven.r.williams@us.pwc.com

Thomas F. Quinn/US/TLS/PwC
 11/06/2008 04:54 PM
 Local: 312-298-2733
 Intl: mobile: [REDACTED]
 One North Wacker Drive Chicago IL 60606
 US

To:
 Steven R. Williams/US/TLS/PwC
 cc:
 Ed Bodnam/US/TLS/PwC, Michael T Murphy/US/TLS/PwC@Americas-US
 Subject:
 Re: Fw: slides for Ed Rapp

Michael,

See how we can distill all of your hard work into a 5 minute presentation...

Nice job guys. They would never have gotten there without the dedicated effort over the last several days.

- Tom

Thomas F. Quinn | Int'l Tax Services | PricewaterhouseCoopers | Telephone: +1 312 298 2733 | Mobile: [REDACTED] | thomas.f.quinn@us.pwc.com

Steven R. Williams/US/TLS/PwC
 11/06/2008 02:58 PM
 Local: 703-918-3339
 Intl: cell [REDACTED]
 *Reply to All is disabled

To:
 Thomas F. Quinn/US/TLS/PwC, Ed Bodnam/US/TLS/PwC
 cc:
 Michael T Murphy/US/TLS/PwC@Americas-US
 Subject:
 Fw: slides for Ed Rapp

Rod is going with his slides (three slides-- see below). He called and asked our help to validate some of his benefit assumptions-- I made a few suggestions. They only have half an hour with Rapp, so our slides, clean as they are, were still "too much"....

so the basic message is
 1. Need five guys outside US to maintain CSARL benefits (250 in parts, 50+ in machines in normal years) == MITT, MWL, LHEX, MHEX, MWEX
 2. Add benefit for Brazil-- [REDACTED]
 3. Other possibilities: [REDACTED]

so our slides become the background and support for what they are going to take to Rapp..

Rod will add a few points on outcome-- accretive in year 1 (through planning), sustainable and low risk, etc. Since Rapp was in Geneva, I suggested that Rod emphasize that adding Brazil is a lot easier than implementing tolling (assuming Treasury issues these regs before Jan 2011). All you need is some do's and don'ts, some interco contracts, and some interco pricing.

Rod thanked us all for the work and he was feeling confident.

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00033229

Redacted by the Permanent
Subcommittee on Investigations

Steve

Steve Williams | Managing Director | Global Transfer Pricing |
PricewaterhouseCoopers | Telephone: +1 703 918 3339 | Mobile: [REDACTED]
steven.r.williams@us.pwc.com

----- Forwarded by Steven R. Williams/US/TLS/PwC on 11/06/2008 03:50 PM -----

Rod J Perkins <Perkins_Rodney_J@cet.com>
11/06/2008 03:26 PM

"Reply to All" is Disabled

To
Steven R. Williams/US/TLS/PwC@Americas-US
cc
Ed Bodnam/US/TLS/PwC@Americas-US, Michael T Murphy/US/TLS/PwC@Americas-US,
Thomas F. Quinn/US/TLS/PwC@Americas-US
Subject
Re: slides for Ed Repp

Rod Perkins
International Tax Manager (Europe Africa & Middle East)
Global Tax & Trade, Caterpillar Inc.
100 NE Adams, Peoria Illinois 61629-4230
E-mail: rjperkins@cet.com
Telephone: (309) 675-4499
Mobile: [REDACTED]
Fax: (309) 675-6573

steven.r.williams@us.pwc.com
11/06/2008 11:23 AM

To
Perkins_Rodney_J@cet.com
cc
thomas.f.quinn@us.pwc.com, ed.bodnam@us.pwc.com, michael.t.murphy@us.pwc.com
Subject
Re: slides for Ed Repp

Caterpillar: Confidential Green Retention Category: L21 -
Contracts/Agreements - Compliance and Support Records

I'll see if Tom is available at 2p Central. Pls give our best to Boyd.

There are 3 new slides in the front (beginng, slide 2-3-4) plus a minor change
on the Exec Summary (listing all nine PMs)

Steve Williams | Managing Director | Global Transfer Pricing |
PricewaterhouseCoopers | Telephone: +1 703 918 3339 | Mobile: [REDACTED]
steven.r.williams@us.pwc.com

Rod J Perkins <Perkins_Rodney_J@cet.com>
11/06/2008 12:09 PM

"Reply to All" is Disabled

To
Steven R. Williams/US/TLS/PwC@Americas-US
cc
Thomas F. Quinn/US/TLS/PwC@Americas-US
Subject
Re: slides for Ed Repp

Here are my latest slides, the only difference is I've added some subtitles on
the Parts page....entrepreneur, contract marketer, licensor...

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00033230

I'm very open this afternoon after two.

You all set the time.

[REDACTED]

Thanks,

Rod Perkins
International Tax Manager (Europe Africa & Middle East)
Global Tax & Trade, Caterpillar Inc.
100 NE Adams, Peoria Illinois 61629-4230
E-mail: rjperkins@cat.com
Telephone: (309) 675-4499
Mobile: [REDACTED]
Fax: (309) 675-6373

[REDACTED] = Redacted by the Permanent
Subcommittee on Investigations

steven.r.williams@us.pwc.com
11/06/2008 10:13 AM

To
Perkins_Rodney_J@cat.com
cc
thomas.f.quinn@us.pwc.com
Subject
Re: slides for Ed Rapp

Caterpillar: Confidential Green Retention Category: L21 -
Contracts/Agreements - Compliance and Support Records

Our two slides will be ready within half an hour.

they will be a high level "what is current benefit for CSARL parts and machines" and "what is needed to maintain the benefits, what are challenges, and how can the benefits be extended".
We'll send them to you, and can you suggest a time that works for you and we can discuss....what's needed to tell a concise story to Ed Rapp.

thanks!

Steve

Steve Williams | Managing Director | Global Transfer Pricing |
PricewaterhouseCoopers | Telephone: +1 703 918 3339 | Mobile: [REDACTED]
steven.r.williams@us.pwc.com
Rod J Perkins <Perkins_Rodney_J@cat.com>
11/06/2008 10:29 AM

"Reply to All" is Disabled

To
Steven R. Williams/US/TLS/PwC@Americas-US
cc
Thomas F. Quinn/US/TLS/PwC@Americas-US
Subject
Re: slides for Ed Rapp

Steve and Tom,

Per Burritt's request to better understand how we benefits were created, here are a couple slides I've put together to depict how CSARL gets its benefits. Keep in mind they have to be really simple. Obviously there will still have to be some oral explanation.

Rod Perkins
International Tax Manager (Europe Africa & Middle East)
Global Tax & Trade, Caterpillar Inc.
100 NE Adams, Peoria Illinois 61629-4230
E-mail: rjperkins@cat.com
Telephone: (309) 675-4499
Mobile: [REDACTED]
Fax: (309) 675-6373
steven.r.williams@us.pwc.com
11/06/2008 09:13 AM

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00033231

To
Perkins_Rodney_J@cat.com
cc
"Robin D Beran" <Beran_Robin_D@cat.com>, Caviness_John_P@cat.com,
ed.bodnam@us.pwc.com, michael.t.murphy@us.pwc.com, Poling_David_S@cat.com,
thomas.f.quinn@us.pwc.com
Subject
slides for Ed Rapp

Caterpillar: Confidential Green Retention Category: L21 -
Contracts/Agreements - Compliance and Support Records

Redacted by the Permanent
Subcommittee on Investigations

Hi Rod.

the email you received at 8pm last night was the long-delayed email of the
slides we sent at 10am yesterday [REDACTED]
Based on your call with Tom Q last night, we were starting to prepare the two
additional high-level slides to send to you by noon today. But if you've got
that in progress already, we'll hold off.
Best,
Steve

Steve Williams | Managing Director | Global Transfer Pricing
PricewaterhouseCoopers | Telephone: +1 703 918 3339 | Mobile:
steven.r.williams@us.pwc.com
Rod J Perkins <Perkins_Rodney_J@cat.com>
11/06/2008 10:04 AM

"Reply to All" is Disabled

To
Steven R. Williams/US/TLS/PwCAmericas-US
cc
"Robin D Beran" <Beran_Robin_D@cat.com>, Caviness_John_P@cat.com, Ed
Bodnam/US/TLS/PwCAmericas-US, Michael T Murphy/US/TLS/PwCAmericas-US,
Poling_David_S@cat.com, Thomas F. Quinn/US/TLS/PwCAmericas-US
Subject
Re: New Slides-- Pls Confirm Receipt

Steve,

At this time, we're working on some very simplified slides that Dave Burritt
requested for our meeting with Ed Rapp on Friday. So, any further detailed
analysis on your part or work on slides should be "put on hold" unless we
notify differently.
Rod Perkins
International Tax Manager (Europe Africa & Middle East)
Global Tax & Trade, Caterpillar Inc.
100 NE Adams, Peoria Illinois 61629-4230
E-mail: rjperkins@cat.com
Telephone: (309) 675-4499
Mobile: [REDACTED]
Fax: (309) 675-6573
steven.r.williams@us.pwc.com
11/05/2008 08:31 PM

To
"Robin D Beran" <Beran_Robin_D@cat.com>, Caviness_John_P@cat.com,
ed.bodnam@us.pwc.com, Perkins_Rodney_J@cat.com, Poling_David_S@cat.com,
thomas.f.quinn@us.pwc.com
cc
michael.t.murphy@us.pwc.com
Subject
New Slides-- Pls Confirm Receipt

Caterpillar: Confidential Green Retention Category: L21 -
Contracts/Agreements - Compliance and Support Records

also sending by other means [REDACTED]

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00033232

1196

From: CN=Sharad P. Jain/OU=US/OU=ABAS/O=PwC
To: CN=Jim Bowers/OU=US/OU=ILS/O=PwCAmericas-US
Sent: 05/13/2008 09:06:14 AM EST
Subject: Tax presentation

Sharad P. Jain | Assurance | PricewaterhouseCoopers | Telephone: +1 309 675
6574 | Mobile: +1 [REDACTED] | sharad.p.jain@us.pwc.com

**Redacted by the Permanent
Subcommittee on Investigations**

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00036773

Confidential Treatment Requested by PwC




2008 CACD and PwC Audit Plan Summary

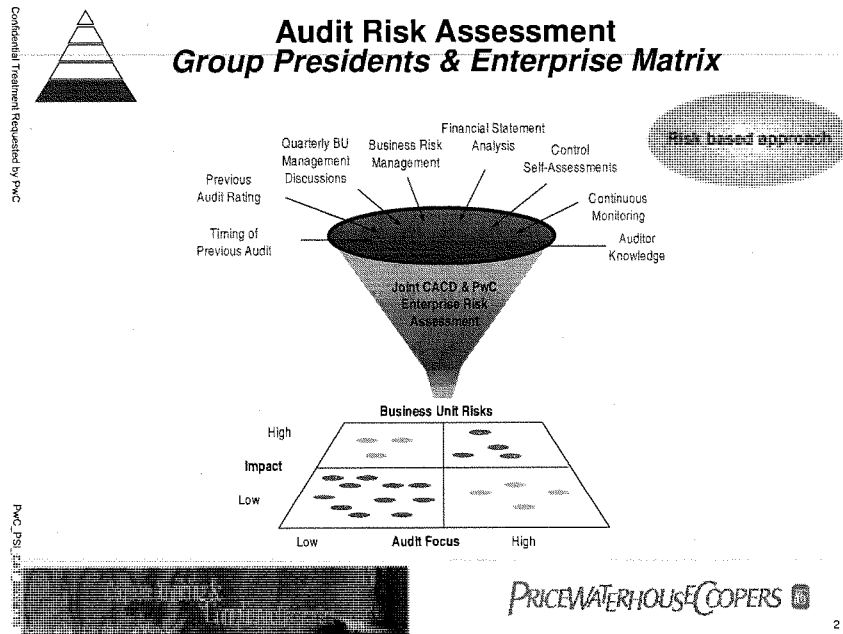
2008 Plan
meets our reporting
objectives

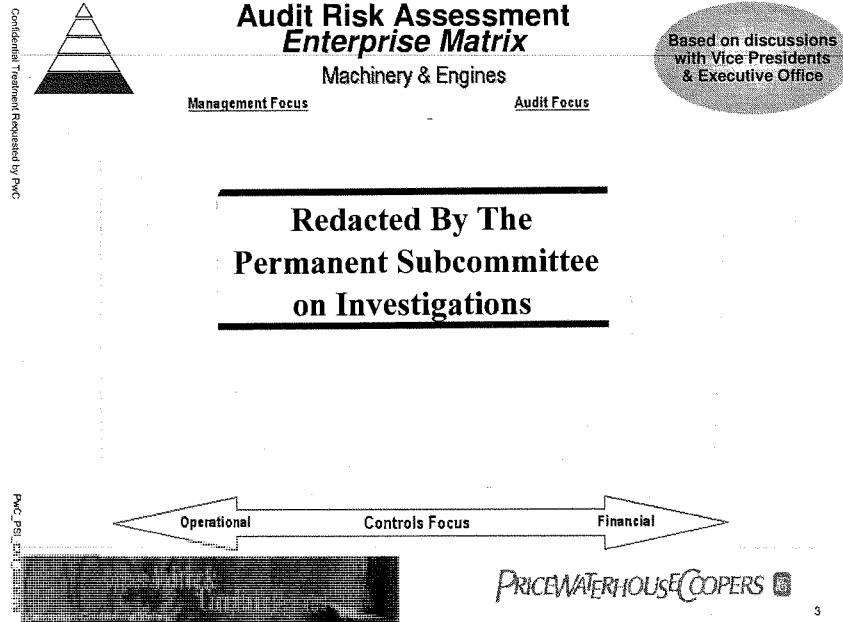
Responsibility	Corporate Auditing	PwC
Add credibility to financial information by providing opinions on		
- Financial Statements		X
- Effectiveness of internal controls	X	X
Perform pre-issuance reviews of quarterly financial information filed with the SEC		X
Provide observations and advice on financial reporting, accounting, tax and internal control matters	X	X
Assist the Audit Committee in your governance role	X	X

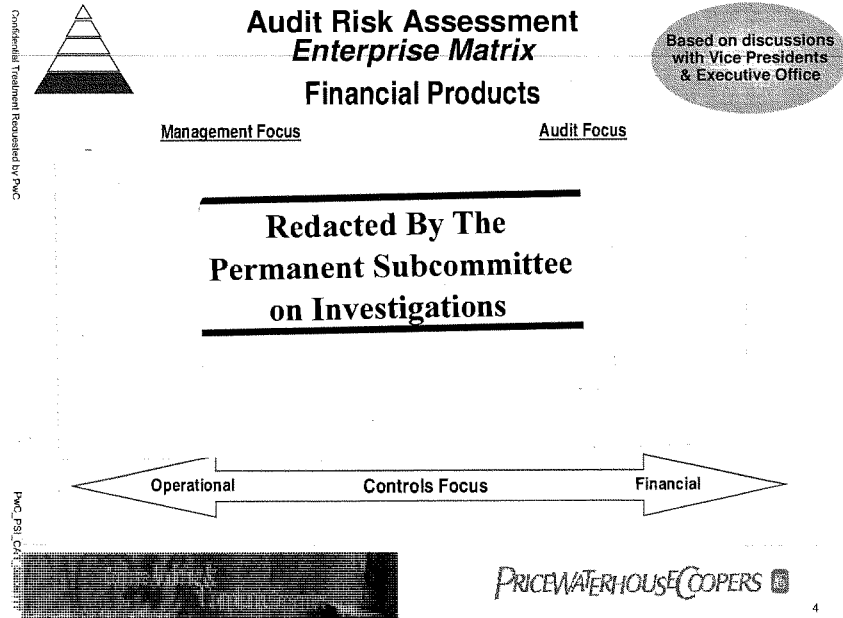
PwC, PwS, Deloitte, Ernst & Young



PRICEWATERHOUSECOOPERS 



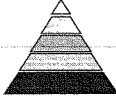




Page(s)
Redacted By The
Permanent Subcommittee
on Investigations

— = Redacted by the Permanent
Subcommittee on Investigations

Confidential Treatment Requested by PwC



PwC Audit Scoping Focus Locations/Entities

Auditing Standard
No. 5 focus

Level	Legal Entities Covered	
1 Significant	Parent Company CSARL Geneva CSARL Grenoble	[REDACTED] CSARL Gosselies CSARL Singapore
2 Known Risk	[REDACTED] [REDACTED]	[REDACTED] [REDACTED]
3 Leveraging Stat Audits	[REDACTED] [REDACTED]	[REDACTED] [REDACTED]
Other	[REDACTED]	

PwC PSI, Inc. 12/15/2017



PRICEWATERHOUSECOOPERS

**Page(s)
Redacted By The
Permanent Subcommittee
on Investigations**

Processes are robust.

- Tax Risk Guard Rails

- Global Central Committee review of uncertain tax positions
 - Representatives from Accounting and Tax who consider risk factors: Transactional, Operational, Compliance, Financial Reporting, Management and Reputation.

Page(s)
Redacted By The
Permanent Subcommittee
on Investigations

Issues – Risk Management

Confidential Treatment Requested by PwC



<u>Risk Categories</u>	<u>Definition</u>
• Transactional	• Compliance with the law, regulations and court decisions.
• Operational	• Impact on business operations.
• Compliance	• Tax return preparation, completion and submission.
• Financial Reporting	• Tax accounting, financial statements or internal controls.
• Management	• Consistency with corporate tax risk policies.
• Reputation	• Impact on the Company's image.

PwC, PwL, LLP, member firm



PRICEWATERHOUSECOOPERS 

— Redacted by the Permanent Subcommittee on Investigations

Issues – Risk Management

High risk areas are actively managed.

Confidentiality Treatment Requested by PWC

Higher Risk Areas

Mitigation

• CSARL – Parts Distribution - Management & Reputation

• Developed plan with outside counsel and accountants

PWC PSI CAT 00000000

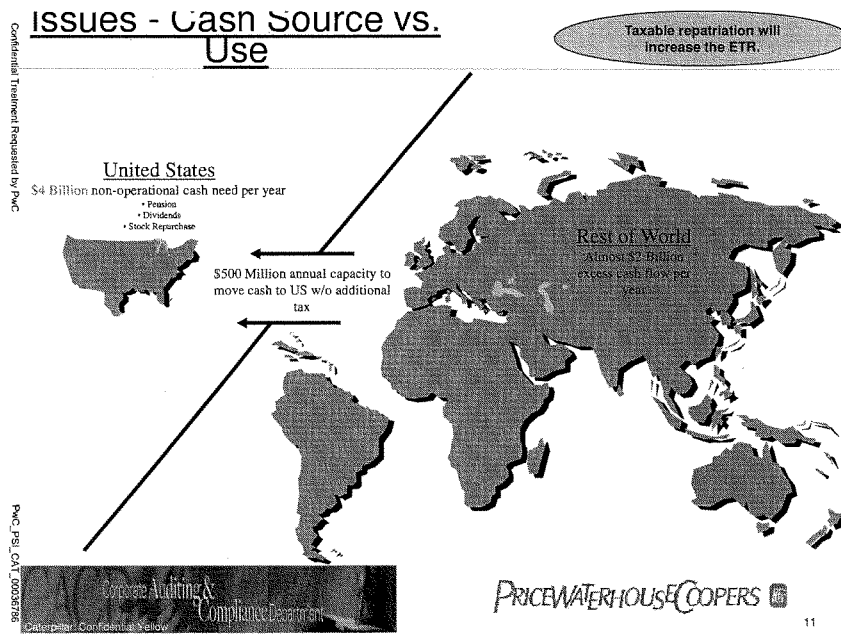
Price Waterhouse & Coopers
Confidentiality Treatment Requested by PWC

PRICEWATERHOUSECOOPERS

SLIDE 10

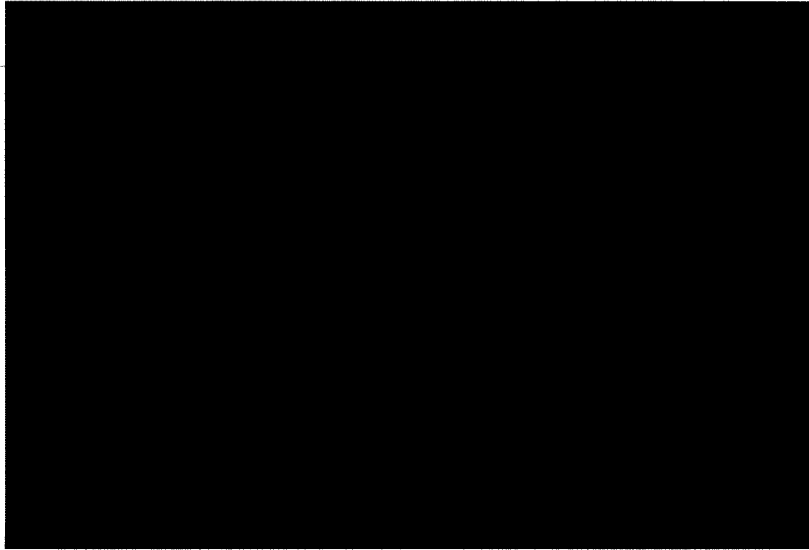
Redacted By
Permanent Subcommittee on Investigations


CSARL - Parts Distribution - Management - Reputation - CSARL and Cat Inc. trade parts in a manner that increases the Parts Sales that qualify for favorable tax treatment. The complexity of the activity could be cast in an unfavorable light. To ensure our position is correct, we worked extensively with outside counsel and accountants on the processes involved.



Confidential Treatment Requested by PwC

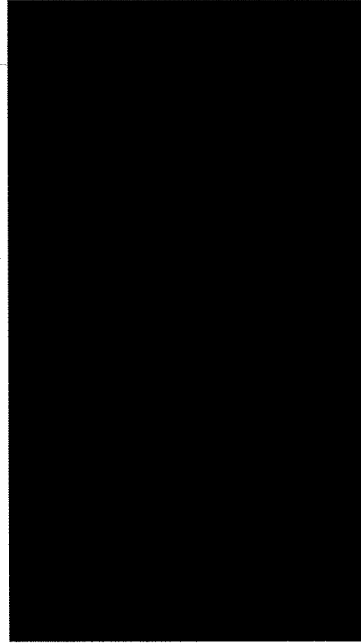
PwC, PwL, and Coopers



PRICEWATERHOUSECOOPERS 

Confidential Treatment Requested by PwC

PwC_PSI_GAT_0006783



Confidential Treatment Requested by PwC

In Summary – PwC Perspective

- Cat's tax risk management processes are robust
- Tax matters and related accounting handled by highly qualified and committed resources
- Long standing and trusted PwC relationship
- Robust communication on complex matters
- Focus "Linkage" in emerging areas (IFRS, LEO, Statutory)
- Good documentation!!

PwC PS (2/1/2010)



PRICEWATERHOUSECOOPERS 

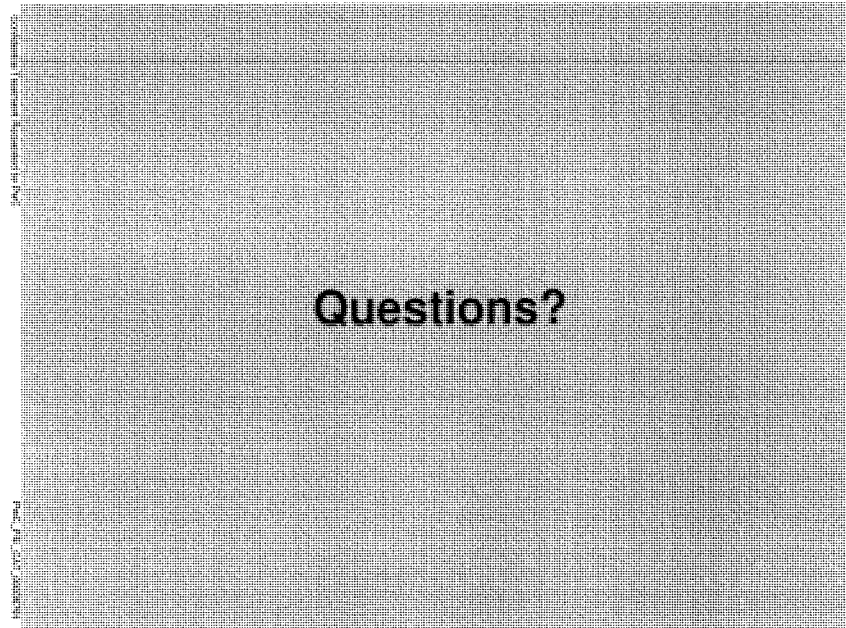
SLIDE 13

NOTES

Issues
Risk Management
Business
Cash Source vs. Use
Diamond
IRS Audit and Litigation
Legislation

Confidential Treatment Requested by PwC

PwC_PSI_CAT_0003790



1215

8/22/2008 2:15 PM

Delivering Vision 2020

Value Transformation: An After-tax View

Prepared jointly by Corporate Tax and Corporate Accounting Services

Mary Miller
Terri Pierpont
Rod Perkins
Matt Dobberfuhr

Confidential - RED

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00058419

Confidential - RED

range effect. The reason for this difference is currently incurred R&D in many locations throughout the world benefits from an immediate tax incentive, either in the form of a tax credit or an additional deduction beyond the amount expended. In contrast, the useful life of the rights from this intellectual property can extend several years. Here, the location and manner in which the property is utilized are key drivers to a sustainable longer-term effect upon the effective tax rate.

X₄= Location of key functions. Location, location, location--- the key to business success or failure. Indeed, location is also critical to effective tax rate optimization. It begins with critical, executive decisions where to build production facilities and which products to source in each of those manufacturing plants. In particular, due to expected useful life of such facilities and costs associated with changes in sourcing, these decisions can have the greatest, sustainable effect upon the enterprise effective tax rate.

Beyond where and what to produce in a particular country, the locations of the responsible product manager are vitally important. The role of such managers is clearly viewed by tax authorities as entrepreneurial in nature. Their functions and responsibilities, from product design to commercial pricing, from S&OP processes to executive production scheduling, significantly impact enterprise profits. And, therefore, the specific country where the seat of such management and control exists is where residual risk and reward is attributed.

In summary, each location, whether the administrative headquarters or the site of a shared-service provider, whether it is the facility of a contract manufacturer or the base of the principal entrepreneur, whether it is where funding of risk occurs or where funds are applied, is entitled to its appropriate share of enterprise profits. With disparate tax regimes, the location mix of enterprise profit sharing can be quite favorable or unfavorable on an after-tax basis.

X₅= Business measurements. Historically, with limited exceptions, legal entity intercompany pricing on cross-border transactions (goods, services, royalties, and financing) follow business measurement processes. Concepts include commercial entity, currency neutralization, revenue recognition, transfer pricing mechanisms, purchased services, design control, product support

Confidential - RED

charges, and market creation fees. Each concept has an associated business measurement methodology, producing both a product line profit cascade and a business unit accountable profit. Such processes ultimately separate enterprise profitability between Caterpillar legal entities. Where such processes fail to optimize effective tax rates, exceptions to business measurements methods are frequently implemented. For this reason and others, differences between legal entity and business measurements continue to grow. Each business measurements exception requires special handling and must meet arm's length intercompany pricing standards.

X₆ = Highly trained, motivated personnel. Critical to the success of an effective tax rate optimization strategy is having the "right people on the bus." This includes not only tax advisors, but also operational personnel who develop action plans to implement tax optimization strategies coincident to operational changes. In addition, it's imperative to have world-class reporting throughout the GF&SSD organization; this includes personnel charged with financial accounting and reporting, plus those responsible for tax accounting and tax compliance.

X₇ = Corporate commitment to change. A change to one or more of the above X factors can deliver an extraordinary impact upon Caterpillar's effective tax rate. The pursuit of legislative reductions in statutory rates, changing the location of a worldwide product manager, converting an entrepreneurial facility to a subcontractor—all require a strong corporate commitment to change. After-tax benefits of such change cannot be achieved without some pain, in some instances relatively minor, in others major. As pros and cons of change are balanced, the challenge remains to optimize the effective tax rate, without any sacrifice to business focus. While such changes must have "buy-in" at all levels of management, corporate commitment from senior management is a critical success factor.

X₈ = Corporate risk tolerance. Historically, Caterpillar's tax optimization strategies have been intentionally designed to withstand intense scrutiny by any tax authority, US or non-US. Where required, complete disclosures are submitted in tax returns as well as SEC filings. Any change towards a more aggressive strategy will require additional review for adequacy of tax reserves. Also, as risk tolerance increases by pursuit of such strategy, the likelihood of unfavorable publicity on the corporate image can occur, whether warranted or not.

From: Rod J Perkins <Perkins_Rodney_J@cat.com>
 To: Thomas F. Quinn/US/TLS/PwC@Americas-US
 Sent: 12/05/2008 04:22:22 PM
 Subject: Fw: Business Alignment - Product Manager Conference Calls - Global Tax Observations

fyi

Rod Perkins
 International Tax Manager (Europe Africa & Middle East)
 Global Tax & Trade, Caterpillar Inc.
 100 NE Adams, Peoria Illinois 61629-4230
 E-mail: rjperkins@cat.com
 Telephone: (309) 675-4499
 Mobile: [REDACTED]
 Fax: (309) 675-6573

[REDACTED] - Redacted by the Permanent Subcommittee on Investigations

----- Forwarded by Rod J Perkins/OS/Caterpillar on 12/05/2008 03:22 PM -----

Rod J Perkins/OS/Caterpillar

12/04/2008 04:28 PM

To
 Steve M. Ferguson/0A/Caterpillar, Michael A. Carr/0C/Caterpillar, Steven L. Guse/0Z/Caterpillar, Mark A. Thompson/0B/Caterpillar
 cc
 Robin D. Beran/0S/Caterpillar@Caterpillar, John P. Caviness/0A/Caterpillar@Caterpillar, Dave B. Burritt/0G/Caterpillar@Caterpillar, Bradley M. Halverson/0C/Caterpillar@Caterpillar, Kenneth J. Templin/1D/Caterpillar@Caterpillar, Giles A. Parsons/1B/Caterpillar@Caterpillar, Sally A. Stiles/0S/Caterpillar@Caterpillar
 Subject
 Business Alignment - Product Manager Conference Calls - Global Tax Observations

Caterpillar: Confidential Green Retain Until: 01/03/2009
 Retention Category: L21 - Contracts/Agreements - Compliance and Support Records

Regarding our recent conference calls with the product managers and you, the following are some of our observations.

Relative to CSARL benefits, they are dependent upon two key criteria:

Deferral from US taxation (worldwide product manager in Geneva clearly achieves this; regional product manager in Geneva might). This requires that CSARL be viewed as the manufacturer, which is accomplished by "substantial contribution" to the manufacturing activity by Geneva-based employees [nine factors under the IRS regs].
 Maximizing residual entrepreneurial profits (only worldwide product manager in Geneva with [REDACTED] achieves this; entrepreneurial substance in Geneva). After realignment, benefits for both machine and parts are at risk unless there's sufficient entrepreneurial substance in Geneva (worldwide product managers, not regional product managers, achieve this).

Relative to the calls themselves:

Design, manufacture, sell—key elements of entrepreneurship—it's difficult

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00060748

to make a case the regional product mgr is a regional entrepreneur for the entire supply chain of profits when this position for example has no decision rights on design, acts in an advisor role on pricing changes, and relies on the industry manager to handle sales execution
Even if we could get to the point the regional product manager is the regional entrepreneur--

Regional entrepreneurial profits in 2008 for Belgium and France are LOSSES (residual losses in CSARL at low tax rates hurts the enterprise effective tax rate)

Regional entrepreneurship doesn't create worldwide entrepreneurship for parts--PARAMOUNT IMPORTANCE

CSARL is not regional; with its Singapore branch, plus CNAMCV and CAMCV which are treated as branches for US tax purposes, CSARL is primarily ROW outside the US & Japan

It fails to support the objective of lowering the enterprise effective tax rate

Regional product manager is inconsistent with white paper alignment principles where the worldwide product manager's role has been "reinvigorated" as the worldwide entrepreneur

Establishment of regional product managers as regional entrepreneur, in some cases in more than one region, would significantly diminish the worldwide entrepreneurship of the worldwide product manager

Another inconsistency is that the role of regional managers is different across product groups and/or regions, and vis-a-vis emerging market regional product managers [who appear to have greater autonomy]

Under GPNP the likelihood that a regional product manager will move appears greater than a worldwide product mgr; such moves shift income to another country, requiring accounting system changes, changes in royalties, potential taxes from transferring intangibles

Current language in examples of proposed US regulations states: where substantial operational responsibilities and decision making regularly exercised by domestic parent employees [Worldwide Product Mgrs employed by Cat Inc in the US], who are directing the activities of a principal's employees [regional product managers in CSARL], the principal [CSARL] does not meet the manufacturing exception [immediate US taxation of CSARL profits, including those arising from parts]...depending upon final language when regs released, could be PARAMOUNT IMPORTANCE

Absence of any worldwide product manager in Geneva and relocation of some regional managers have significantly weakened existing substance.

Finally, let us know when a draft of a white paper on the roles and responsibilities of the regional product manager is completed. The review of that document was agreed as to the next step in this process.

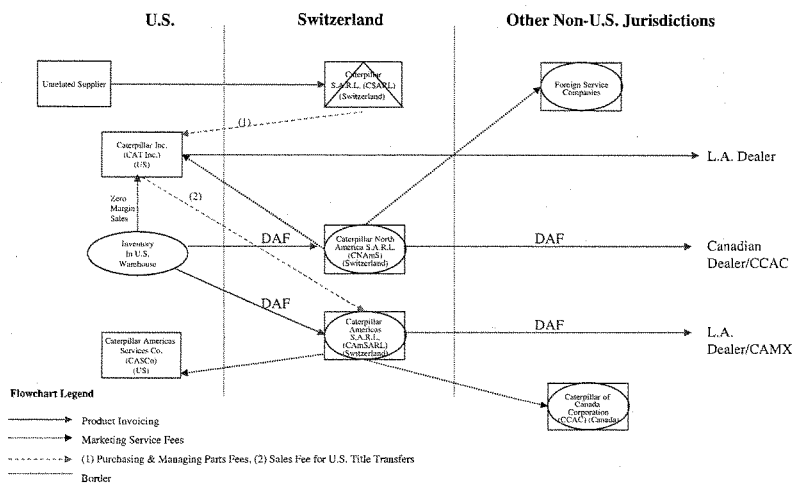
Thanks,

Rod Perkins
International Tax Manager (Europe Africa & Middle East)
Global Tax & Trade, Caterpillar Inc.
100 NE Adams, Peoria Illinois 61629-4230
E-mail: rperkins@cat.com
Telephone: (309) 675-4499
Mobile: [REDACTED]
Fax: (309) 675-6573

— = Redacted by the Permanent Subcommittee on Investigations

Inventory Tracking and Accounting Systems

Purchased Finished Parts: Present



Inventory Tracking and Accounting Systems

- ITAS (Commingled Inventory): physically commingled but discrete ownership of US-situated inventory.
- The physical inventory commingled into a single inventory stock, as long as the information systems (ie-ITAS) supporting the financial inventory records can confirm the ownership of that inventory stock belonging to CSARL and Cat Inc.
 - **Separate inventory ownership records** for Cat Inc. and CSARL must be available **at any point in time**.
- ITAS must not inadvertently represent the Commingled Inventory arrangement as a partnership / joint tenancy between CSARL and Cat Inc., or intercompany transactions as a sale or loan between CSARL and Cat Inc.
- Facilitates accurate characterization of unrelated-to-unrelated title flow.
- SAP Impact?

From: CN=Steven R. Williams/OU=US/OU=TLS/O=PwC
 To: CN=Christopher E Dunn/OU=US/OU=TLS/O=PwC@Americas-US
 Sent: 01/26/2006 10:17:10 AM EST
 CC: CN=Natalia Pryhoda/OU=US/OU=TLS/O=PwC@Americas-US
 Subject: Re: Fw: CSARL royalty rate

This document was not intended or written to be used, and it cannot be used, for the purpose of avoiding U.S. federal, state or local tax penalties.

this is good, I'll make a couple of changes and then will send it. Thank you.

How many companies are in the sample? and how many constitute the current IQ range?

thanks

This year, we really ought to think about a better way to distinguish the samples for the "aggregate" business from the "licensed" business. Right now it's the same set, just that the aggregate is adjusted for asset intensity.

Med IQ
 aggregate (adjusted) [REDACTED]
 licensed (unadjusted) [REDACTED]

note the adjustment decreases the data points (as expected) but by [REDACTED] for the median, and a whopping [REDACTED] for the IQ.

Steve

Steve Williams
 Transfer Pricing
 PricewaterhouseCoopers
 Washington, DC
 Tel 1-202-414-1458
 e-Fax 1-813-281-6601

Redacted by the Permanent
 Subcommittee on Investigations

Christopher E Dunn/US/TLS/PwC
 01/25/2006 08:34 PM
 (312) 238-2424
 Chicago

To: Steven R. Williams/US/TLS/PwC@Americas-US
 cc: Natalia Pryhoda/US/TLS/PwC@Americas-US
 Subject: [REDACTED]
 Re: Fw: CSARL royalty rate

Steve,

To address Tom's suggestions regarding audit risks for CSARL we have estimated the following:

1. In 2005 CSARL is estimated to have earned an Operating Margin [REDACTED] for its aggregated business. The 2001-2005 median Operating Margin of comparable companies [REDACTED]. As shown in the chart below, if CSARL's aggregated business profits were adjusted to the median this would result in an estimated \$146 million in additional taxable income in the US. At a 40% tax rate (assuming no Swiss tax reduction) this adjustment would amount to additional taxes of \$58 million.
2. Similarly, in 2005 CSARL is estimated to have earned an Operating Margin of [REDACTED] for its licensed business. The 2001-2005 median Operating Margin of comparable companies was [REDACTED]. If CSARL's licensed business profits were adjusted to the median this would result in an estimated \$290 million in additional taxable income in the US. At a 40% tax rate this adjustment would amount to additional taxes of \$116 million.
3. To assess the likelihood of CSARL's aggregated and licensed business' profitability being found to be outside of the arm's length range we analyzed the change in the comparable upper quartile that would occur if the most profitable companies were rejected as comparables. As shown below, the rejection of one comparable company would move CSARL's 2001-2005 licensed business OI/Sales above the interquartile range, while the rejection of three comparable companies would move CSARL's 2001-2005 aggregated business OI/Sales above the interquartile range.

Please let me know if there is any other information I can provide regarding risk estimates.

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00132905

1223

For reference, the file containing the tables presented above is attached:
[attachment "License Fee Risk Analysis 1-25-06.xls" deleted by Steven R.
Williams/US/TLS/PwC]

Regards,
Chris

Chris Dunn | Transfer Pricing | PricewaterhouseCoopers | (312.298.2424 | *:christopher.e.dunn@us.pwc.com

Steven R. Williams/US/TLS/PwC
01/24/2006 03:20 PM
Local: +1-202-414-1458
Intl: e-fax +1-813-281-6601
Washington, DC
US

To: Natalia Pryhoda/US/TLS/PwC@Americas-US, Christopher E
Dunn/US/TLS/PwC@Americas-US
Cc:
Subject:
Re: CSARL royalty rate

is this something you can spend max 4 hours on before Friday? TQ says it is
part of tax provision.

Steve

Steve Williams
Transfer Pricing
PricewaterhouseCoopers
Washington, DC
Tel: 1-202-414-1458
E-Fax: 1-813-281-6601
----- Forwarded by Steven R. Williams/US/TLS/PwC on 01/24/2006 04:19 PM -----

Thomas F. Quinn/US/TLS/PwC
01/24/2006 04:01 PM
312-298-2733
One North Wacker Drive Chicago IL 60606
US

To: Steven R. Williams/US/TLS/PwC

Cc:

Subject:
Re: CSARL royalty rate

This document was not intended or written to be used, and it cannot be used,
for the purpose of avoiding U.S. federal, state or local tax penalties.

Definitely tax provision. We have a code, as does Mark. Key is for a
reasonable amount of time - we are just "reviewing" with a high level of
materiality, not creating.

- Tom

Steven R. Williams/US/TLS/PwC
01/24/2006 02:52 PM
Local: +1-202-414-1458
Intl: e-fax +1-813-281-6601
Washington, DC
US

To: Thomas F. Quinn/US/TLS/PwC@Americas-US
Cc:

Subject:
Re: CSARL royalty rate

Cc:

given our new budgetary realities, is this something that NL or Rod P. is asking
us to do, or is it part of PwC's due diligence with regard to the tax
provision?

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00132906

Steve

Steve Williams
Transfer Pricing
PricewaterhouseCoopers
Washington, DC
Tel 1-202-414-1458
e-Fax 1-813-281-6601

Thomas F. Quinn/US/TLS/PwC
01/24/2006 03:46 PM
312-238-2733
One North Wacker Drive Chicago IL 60606
US

To
Steven R. Williams/US/TLS/PwC
cc
Garry Stone/US/TLS/PwC@Americas-US, Jim Bowers/US/TLS/PwC@Americas-US, Mark Dalbey/US/TLS/PwC@Americas-US, Natalia Pryhoda/US/TLS/PwC@Americas-US
Subject
Re: CSARL royalty rate

This document was not intended or written to be used, and it cannot be used, for the purpose of avoiding U.S. federal, state or local tax penalties.

"If/when we receive that analysis from Dave Poling, we'll confirm to Mark that the 7% would yield a result near the median, and therefore, if they had used 7%, it would likely Not be subject to any additional adjustment by IRS."

Agree. But, isn't the median only an issue if there is a result outside of the range? We need to assess the risk that there would be a result outside the range. This could occur from two (at least) situations:

1. The range is "different"
2. The operating income is "different"

- Tom

Steven R. Williams/US/TLS/PwC
01/24/2006 10:54 AM
Local: 41-202-414-1458
Intl: e-fax 41-813-281-6601
Washington, DC
US

To
Thomas F. Quinn/US/TLS/PwC
cc
Garry Stone/US/TLS/PwC@Americas-US, Jim Bowers/US/TLS/PwC@Americas-US, Mark Dalbey/US/TLS/PwC@Americas-US, Natalia Pryhoda/US/TLS/PwC@Americas-US
Subject
Re: CSARL royalty rate

I guess you're (Tom) catching up on your emails.

We discussed yesterday with Mark.

1. We are providing Mark with our judgment as of Q4 2005 that the existing 4% royalty gives a reasonable filing position for 2005 (excerpts from our Royalty benchmarking analysis)

2. Mark is requesting from Dave Poling their analysis of why they use 7% for their provision. We believe (based on discussions in prior years), that they use 7% since it puts CSARL's results closer to the median of the range (rather than the upper quartile). If/when we receive that analysis from Dave Poling, we'll confirm to Mark that the 7% would yield a result near the median, and therefore, if they had used 7%, it would likely Not be subject to any additional adjustment by IRS.

I'll suggest Natalia and Chris Dunn work on your other three ideas below (the 8 Risk questions).

As to the \$ effect of different royalty rates, and % profit splits, I recall that chart also, but it would probably be easier for Natalia/Chris to re-create that chart than for me to find it. Plus we need to do it on new data, not old data, anyway.

--Steve

Confidential Treatment Requested by PwC

PWC_PSI_CAT_00132907

Steve

Steve Williams
Transfer Pricing
PricewaterhouseCoopers
Washington, DC
Tel 1-202-414-1458
e-Fax 1-813-281-6601

Thomas F. Quinn/US/TLS/PwC
01/24/2006 11:42 AM
312-298-2733
One North Wacker Drive Chicago IL 60606
US

To
Steven R. Williams/US/TLS/PwC
cc
Garry Stone/US/TLS/PwC@Americas-US, Jim Bowers/US/TLS/PwC@Americas-US, Mark
Dalbey/US/TLS/PwC@Americas-US, Natalia Pryhoda/US/TLS/PwC@Americas-US
Subject
Re: CSARL royalty rate

This document was not intended or written to be used, and it cannot be used,
for the purpose of avoiding U.S. federal, state or local tax penalties.

Steve,

Step one for Mark is to request an analysis from Cat of the appropriateness of
the 7% actual rate for us to test. Theory is that we are supposed to audit
their work and judgement.

A couple of areas of reasonableness testing that you could assist in that would
be helpful to assess risk areas:

1. \$ Risk resulting from an actual operating result being measured by the IRS
as outside the range being adjusted to the median.
2. \$ Risk associated with the comparables set. An analysis of the comparables
creating the range and an understanding of whether a change in the
accept/reject could cause a swing in the range.
3. \$ Risk resulting from rejection of the aggregation theory. Disaggregated
royalty rate would be x%

I remember (or am hallucinating about) a chart that you prepared for Robin a
couple of years ago that analyzed the result of royalty rates from 4% to 9%
which showed the dollar amounts associated with each percentage point change as
well as the resulting profit splits. Do you recall?

- Tom

Steven R. Williams/US/TLS/PwC
01/23/2006 02:42 PM
Local: 41-202-414-1458
Intl: e-fax 41-813-281-6601
Washington, DC
US

To
Mark Dalbey/US/TLS/PwC@Americas-US
cc
Jim Bowers/US/TLS/PwC@Americas-US, Garry Stone/US/TLS/PwC@Americas-US, Natalia
Pryhoda/US/TLS/PwC@Americas-US, Thomas F. Quinn/US/TLS/PwC@Americas-US
Subject
Re: CSARL royalty rate

I have not seen, or prepared myself, any explanation of the 7% rate they use in
their provision. One may exist, I just haven't seen it.

(the actual rate was 4% in 2005, as I'm sure you know). We did a lot of work
in Q4 2005, to decide whether the 4% needed to be raised in 2006. We
recommended not to change it in 2006, but to raise it to 5% beginning in 2006.
We are putting together documentation now to support the sliding scale
provision from 2006-2010.

Based on year-end numbers of CSARL, we can easily prepare a 7% analysis-- i.e.,
demonstrate that at 7%, CSARL's profitability is sufficiently lower (than
actual) that the risk of an IRS adjustment beyond 7% is small. Is that what
you need?

Confidential Treatment Requested by PwC

PwC_PSI_CAT_00132908

Steve

Steve Williams
Transfer Pricing
PricewaterhouseCoopers
Washington, DC
Tel 1-202-414-1458
e-fax 1-813-281-6601

Mark Dalbey/US/TLS/PwC
01/23/2006 03:32 PM
phone (309) 680-3214 fax (813) 393-2834
Peoria, IL

To
Steven R. Williams/US/TLS/PwC@Americas-US
cc

Jim Bowers/US/TLS/PwC@Americas-US

Subject

Re: CSARL royalty rate

Steve:

We are attempting to acquire, for our Caterpillar audit/tax workpapers, support for the CSARL royalty rate of 7% for the booking of the tax provision. Would you have any spreadsheets, powerpoint presentations, or other support available to provide us which we could attach in our workpapers?

Thanks.

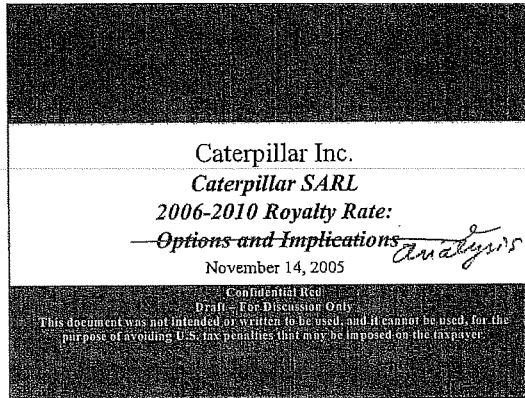


Table of Contents
<ul style="list-style-type: none"> ➤ Summary of Issues ➤ Current Situation: Profitability, Structure, and Coverage ➤ Future Scenarios: Status Quo, Broader Base, Class C Impact ➤ Caterpillar Profitability Projections ➤ Future Scenarios: Baseline and Growth ➤ Additional Testing Methods ➤ Which Royalty Rate is Best Supported?
<p>CONFIDENTIAL RED Draft - For Discussion Only</p> <p>2</p>

✓
may modify
need

Summary of Issues

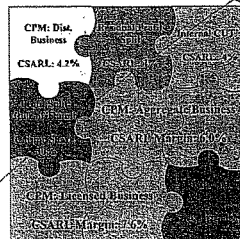
- In the past, CSARL's "bundled royalty" of 4% was supported by CPM, Profit Split and CUT methods
- Increasing profitability puts pressure on arm's length conclusion in post-2005 documentation
- Current "bundled royalty" agreement expires on 12/31/2005
to develop for 2006 - 2010
- Need a higher royalty rate starting 2006?

CONFIDENTIAL RED
Draft - For Discussion Only

*we still have
the same issue*

Current Situation: Support for 4% Royalty Rate: 2001-05

Actual
2001 - 2005



CONFIDENTIAL RED
Draft - For Discussion Only

NO

Page(s)
Redacted By The
Permanent Subcommittee
on Investigations

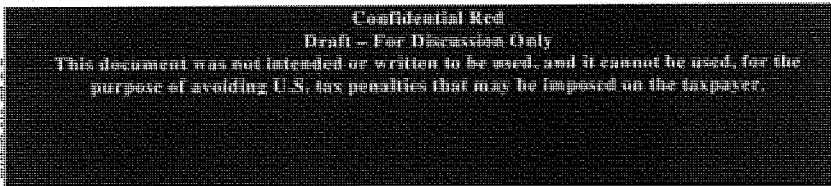
Confidential Treatment Requested by PWC



Caterpillar Inc.
Caterpillar SARL 2006-2010 Royalty Rate
Executive Summary

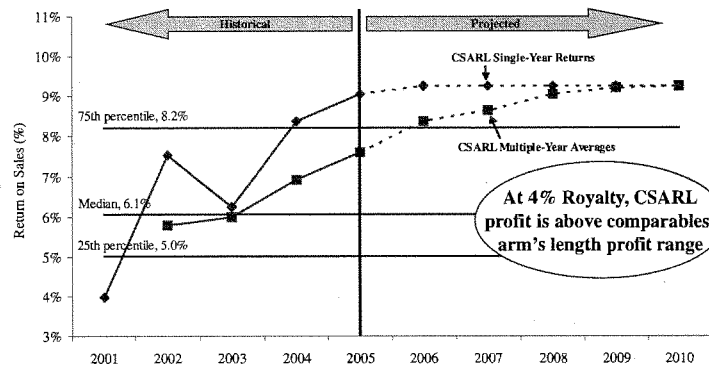
December 6, 2005

CONFIDENTIAL
DRAFT - FOR DISCUSSION ONLY
THIS DOCUMENT WAS NOT INTENDED OR WRITTEN TO BE USED, AND IT CANNOT BE USED, FOR THE
PURPOSE OF AVOIDING U.S. TAX PENALTIES THAT MAY BE IMPOSED ON THE TAXPAYER.



Confidential Treatment Requested by PAC

Licensed Business Profitability 2001-2005 and Future Projections



Projections based on baseline scenario (no increase in profit vis a vis comparables) – extending normalized 2005 results through 2010

PAC PSI CAT 0033121

Summary of Issues

➤ Historical Cycle 2001 – 2005

- CSARL's "bundled royalty" of 4% was supported by CPM, Profit Split and CUT methods
 - Aided by low profits in early years
- Increasing CSARL profitability in recent years ('04 & '05 single years above arm's length range)
- Current "bundled royalty" agreement expires on 12/31/2005
- Need a higher royalty rate starting 2006. At what rate?

➤ Next Cycle 2006 – 2010

- 4% rate not sustainable post-2005 (licensed business avg. profits above comparables' range)
 - Aggregate results (distribution + licensed) appear in range but still need to defend licensed business results
 - Need to increase royalty to 5% or 6%
 - Royalty should allow flexibility for expansion or downturn
 - Expand royalty base to allow gradual increase in the royalty rate
-

Recommendations – Beginning 2006

- Expand royalty base to include sales back to Cat Inc. – consistent with “bundling” theory and allows for more gradual increase in royalty rate
- Recommend step royalty based on CSARL Licensed Business annual sales

<u>Royalty*</u>	<u>If Sales are</u>
4%	less than \$6.5 Billion (9% decline vs '05 sales)
5%	between \$6.5 and \$9.0 Billion
6%	above \$9.0 Billion (26% growth vs '05 sales)

* Royalty rate applies to all sales, not incremental sales

- 5% projected rate in 2006-2008, 6% projected for 2009-2010

Page(s)
Redacted By The
Permanent Subcommittee
on Investigations

**Caterpillar Inc.
Caterpillar SARL
2006-2010 Royalty Rate:
Options and Implications**

November 14, 2005

**Confidential Red
Draft – For Discussion Only**

This document was not intended or written to be used, and it cannot be used, for the purpose of avoiding U.S. tax penalties that may be imposed on the taxpayer.

Summary of Issues

- In the past, CSARL's "bundled royalty" of 4% was supported by CPM, Profit Split and CUT methods
- Increasing profitability puts pressure on arm's length conclusion in post-2005 documentation
- Current "bundled royalty" agreement expires on 12/31/2005
- Need a higher royalty rate starting 2006?

Sales & Profit Projections 2006- 2010: CSARL Considerations

- Overall Cat growth forecast is dominated by large, higher-margin machines; services; large engines....not in CSARL licensed business portfolio.
- CSARL machines/parts split: parts have 80% of profit on 20% of sales.
- Machines: volatile/low margin; parts: stable/high margin.
- In the past, CSARL grew by adding profitable parts territories - what are the drivers of future growth?
 - Overall economic growth?
 - Class C turnaround, incl. sale of TH?
 - Improvement in EAME?
 - Brazil service based mfg?
 - Bring China and India into CSARL territory?

Historical Perspective on License Fees: Sources of 4% Bundled Royalty

Source of 4% Bundled Royalty

- Sept 1999: Parts License Fee Only:
 - 15% Purchased Finished, 7% Euro-Worked.
 - Confirmed with CPM: provided appropriate overall profit (4.6% estimated).
 - Confirmed with "other methods": provided appropriate margins on Machine Distribution profit (2%) and Parts profit (after royalty) of 18%. Compared to ratio of Dealer margins on Parts vs Machines of 8:1.
 - Confirmed with industry CUTs: replacement parts in auto industry.
- Beginning Jan 2001: Bundled License fee for Parts and Manufacturing
 - Selected 4% License fee on All Licensed Products.
 - Provided approximately same LF Income to Cat Inc as before:
 - CBSA/CFSA prime products: 3% on machines (5% on value added)
 - Class C products: hypothetical 1% for "background intangibles"
 - Parts: 15% PF, 7% worked
 - Less McFee paid to CBSA/CFSA
 - Confirmed by projected overall CSARL Licensing margin: 5-8%.
 - Confirmed by projected overall CSARL Licensing + Distribution margin: 4-6%.
 - Confirmed by CUT analysis: internal and external CUTs.
 - Confirmed by profit split.

CONFIDENTIAL RED
Draft - For Discussion Only

License Fees and CSARL Historical Territory Expansion

16. Cat Inc. pays a small license fee to CSARL under Class C – will increase in 2006 → higher CSARL operating profit in 2006
17. Actual license fee was not at 4% of licensed business sales in 2004 (actual license fee was at 3.0% of net sales, or 3.4% accounting for [REDACTED] retroactive adj.)
18. [REDACTED]
19. [REDACTED]
20. CSARL “bought” Asian and Australian businesses and has profits associated with those – Cat Inc. does not “deserve” additional remuneration, but entitled to bundled royalty (TQ)
21. “Library card” concept – royalty for “ability” to buy/sell profitable parts
22. Businesses in addition to parts transferred to CSARL with CofA restructuring
23. Current 4% royalty based on “weighted average” of 15% parts royalty and 3% machines royalty, however, CSARL added parts territories over last few years (only Class C machines to partially offset)
24. Adding new parts territories should have warranted a review of royalty rate?
25. In 2005, no territory changes, but Cat Brasil restructuring (higher Subpart F income to Cat Inc.)
26. Commensurate with income overrides agreement from US perspective – what from Swiss perspective?

Possible Options

27. Possible options to address high CSARL profitability through royalty change or adjustment:
 - o Increase royalty in 2005 (before agreement expires on 1/1/2006)
 - Amend current agreement (difficult to justify)
 - Terminate agreement and create new agreement (easier to justify; better “optics” under audit, what term?)
 - o Make a compensating adjustment (how would Swiss authorities react?)
28. Need to investigate why CSARL’s profits increased – and change compensation for specific high profit generating elements? (PdP)
29. Need to re-consider royalty on parts – if Cat Inc.’s contribution to parts business is small; what IP embedded in parts – dealer/marketing, logistics, some technology (PdP)

Recommendations:

1. Need a new agreement effective 1/1/2005 for a number of years
2. Need to develop methodology for new royalty rate calculation (old methodology used 15%/3% royalty on parts and prime product royalty, respectively; new methodology may be based on profit split)
3. Need to calculate new royalty rate
4. Check CSARL FY2005 Q1 results in the end of March to gauge FY2005 profitability
5. Check if CSARL 2004 results include FGW adjustment
6. Analyze relationship between CSARL volume and profits
7. [REDACTED]

John Hatch
11/06/98 10:19 AM

To: Charles Larson/TAL/Price Waterhouse
cc: Steven R. Williams/TAL/Price Waterhouse
Subject: CAT and COSA

1 file attached

Dear Chuck,

I wanted to bring you up to date on the work I've been doing regarding Cat's dealer network intangibles. Attached is a draft that tries to address the issue, but the major points are made below:

1. To recap, the primary issue is trying to attribute some of the high profits earned by CAT to COSA. To do so, we want to identify COSA's establishment and maintenance of the dealer network as a source of intangible value.
2. The high profit margins earned by CAT are in providing replacement parts for CAT machinery, while they earn only normal profits on machines. Though we initially discussed treating the parts market as a separate market, I think doing so may unnecessarily complicate the story. CAT undoubtedly faces very little competition in providing replacement parts for its own machines, but this is not a sufficient condition for earning high margins on parts. If more or better competition existed in the machinery market from competitors who produced replacement parts for their own machines, this would undoubtedly erode the high profits CAT earns on parts. The high profit margins indicate market power, but they indicate this power in the market for machines and subsequent replacement parts as a combined good.
3. In addition to the issues identified in item 2 above, if we were to deal with the parts market in isolation, we would then have to quantify the contribution of the "field population" to the high profits earned on parts, and then decide how this should be divided between CAT and COSA according to their contributions to machine sales. (This whole issue can be avoided if we say that the relative contributions of COSA are the same in both parts and machines.) I identify reasons for Cat's market power in providing parts for its own machinery, but again, I do not think this is the major point.
4. What customers in this market are most concerned with is obtaining a flow of machinery services, the cost of which depends upon the price of the machine, the price of subsequent replacement parts, the reliability of the machine, and the intensity of usage by the customer. CAT can achieve high profits in this market in three basic ways: the value of their trade name, product design and reliability advantages held by CAT, and cost advantages held by CAT over their competitors. (The value of the trade name is obviously going to be linked to the product design and reliability.)
5. Product design advantages (ease of use, versatility, comfort, appearance, and reliability) would traditionally be considered an intangible owned the manufacturer CAT. However, CAT makes the point that they rely heavily upon COSA to gain customer feedback through the dealer network. This contributes not only to improving the design of machines meant for certain applications, but also helps CAT to identify new, potentially profitable, products. The nuts and bolts advantages undoubtedly are attributable to CAT, but broader design ideas are less clearly allocated.
6. Traditional cost advantages can stem from COSA being able to deliver parts more cheaply and in a more timely manner than competitors, as well as from CAT being able to produce at lower costs. CAT says that it is much better than its competitors in keeping the field population of machines running with timely replacement of parts. It does not appear that CAT considers itself to be a lower cost manufacturer than its competitors.

7. A non-traditional cost advantage that exists for CAT may stem from its very smooth relationship with its dealers. The choice of methods to distribute product can vary across firms, and may greatly influence profitability. At one extreme, the manufacturer can gain complete control over dealers via vertical integration; at the other extreme, they may do nothing to control the efforts and pricing decisions of independent dealers. The trick is to achieve the most profitable trade-off between control and providing the proper profit incentives to dealers. COSA, through the establishment of these dealer relationships, can influence profitability in either direction. COSA, in comparison to competing firms, may be able to get the same level of effort from its dealers while they themselves expend less effort (i.e. bargaining and disputes). COSA may also achieve the same share of profits earned by the vertical structure (the profits to be split between the dealers and CAT). In addition, COSA, again in comparison to competing firms, may secure an equal or greater share of the profits to be split within their dealer relationships.

8. The marketing literature talks about "partnering relationships" as a highly profitable manufacturer-dealer relationship. CAT's description of its own dealer network relationships matches up closely with the characteristics of partnering relationships identified in the literature. This literature makes it clear that this type of relationship cannot be established overnight, implying that competitor's who see the superiority of CAT's dealer relationship cannot simply switch their own to be similar. Just as past research efforts may have yielded patents that contribute to value today by precluding competitors from use of that knowledge, past investments in establishing the "partnering relationship" can yield abnormal profits into the future, as competitors need time to establish a similar relationship. The fact that the knowledge of what constitutes a "partnering relationship" is not proprietary to CAT makes no difference - they may have been (and appear to be) the only firm in their industry able to recognize the value of these relationships in the past.

9. Quantifying the contribution of a "partnering relationship" is, however, a much less straightforward task. I haven't been able to find any study that tries to do so systematically for a large set of companies, nor do I believe that such a study is possible. The importance of the dealer relationship, and the choice among various ways to work with dealers, varies according to the type of product, making this type of study unlikely.

10. To sum up, we can provide very convincing stories for the argument that COSA should retain some share of the high profits, but actually quantifying their share may be difficult to do with any precision.



Caterpill

Regards,

John

I. Caterpillar - Assessing the Contribution of the Dealer Network to Abnormal Profits

A. Introduction

Caterpillar Inc. ("Cat") sells both machinery and machinery parts to its affiliate COSA, located in Geneva, Switzerland. COSA has established and maintained relationships with independent dealers throughout Europe, who buy Cat products from COSA, and resell them to final customers.

In determining the appropriate transfer prices for sales of product from Cat to COSA, it is necessary to determine the contributions of each entity to excess profits earned on certain product lines. In particular, the vertical structure (CAT and COSA) earns abnormally high margins on their sales of parts, while earning only normal margins on machinery sales. Is this stat true?

Our first task is to account for the possible sources of abnormally high profits earned by the vertical structure. Since we observe these high profit margins on the sale of parts rather than machinery, one approach would explore the reasons CAT might have market power within the parts market. To the extent that we can determine the relative contributions to profits stemming from manufacturing and design intangibles owned by CAT, versus the dealer network intangibles owned by COSA, we can determine the appropriate transfer prices from CAT to COSA. accy to economic pt?

Though it would seem appropriate to concentrate upon the market for replacement parts only, this could make the analysis more cumbersome, because one major determinant of demand for CAT parts is the size of the existing field population of CAT machinery. Since machinery and replacement parts are obvious complementary goods, CAT is no doubt aware of the interdependency of demand that exists between the two, and prices for machinery and parts will reflect this awareness. This implies that some portion of the high profits earned on parts sales must be attributed to CAT and COSA purposely setting low machinery prices (and hence low profit margins on machinery sales).

If we choose to concentrate upon the parts market, we need to apportion some share of the profits from parts sales to the field population. This may be impossible to do. There are two ways to circumvent this problem. We can assume that the contributions made by intangibles owned by COSA are equal in both the parts and machines markets. In this case, we would divide the profits stemming from the field population between COSA and CAT in the same proportions that we'd divide the remainder of those profits. This makes quantifying that field population share irrelevant.¹

¹ In using this approach, it is important to note that COSA sells both machines and parts. If COSA sold only the parts (machines), and another European distributor sold the machines (parts), then it would be necessary to estimate the share of profits attributable to the field population. Otherwise, the transfer prices would not provide the machine distributor an arm's length return.

Alternatively, we can avoid the field population issue by viewing the machinery and subsequent parts purchases as a composite good. The question of attributing part of the high margin stemming from parts to the low margin the company is willing to accept for machinery is then immaterial. There is an excess profit, and the only question is how to attribute it to the different factors that account for it. This approach requires us to look at the contributions of COSA and CAT to the entire business, rather than trying to determine their contributions to a particular product line.

Section B gives a more detailed analysis of the market conditions faced by CAT. We give an explanation of their profit results in that section as well. The analysis should make clear the difficulties faced in trying to quantify a share of profits from parts sales attributable to the field population.

Section C presents the two alternative approaches to the problem discussed above. Each method rids us of the need to quantify the field population contribution to profits. The first approach concentrates entirely upon the parts market, and attempts to outline the possible ways that the manufacturing and distribution intangibles can account for the high profit margins. The second approach examines the markets for machinery and parts as one market. We outline the possible contributions of CAT and COSA intangibles to this market as well.

B. Explaining the Difference in Margins for Parts and Machinery

An understanding of the economics behind CAT and COSA's profit margin results will be helpful in ascertaining the appropriate transfer prices. We start with two basic facts that we are trying to explain: the two entities earn high margins on part sales, while only normal margins are earned on machinery sales.

The fact that CAT earns high margins on either product line suggests that they have some market power, which allows a firm to earn abnormal returns within a market. The ultimate goal of this analysis is to figure out COSA's contribution to that market power, but for now we simply seek to explain how CAT utilizes its market power through its pricing of machines and parts.

Though CAT and COSA price replacement parts well above costs (giving them their high margins), we cannot ignore the interdependence of demand that exists between CAT machinery and CAT replacement parts. The machinery and its replacement parts are complementary goods: if the price of one rises, the demand for the other will fall. This implies that there may be a strategic reason for CAT and COSA to charge low prices for machinery (relative to production costs).

Consumers in the market for CAT machinery are not myopic - they view their machinery purchase as an investment. That investment requires an immediate cost for the machine itself, as well as costs down the line for replacement parts. If I am considering a purchase

of a machine sold by both CAT and its competitor Komatsu, I will be concerned not only with the machine prices, but also with replacement part costs. I can gauge my expected usage, and therefore my expected future replacement part costs, and make the appropriate decision based upon differences in the prices set by CAT and Komatsu, and known differences in the durability of their machines.

It is more proper to view the two products offered by CAT, machinery and replacement parts, as one good, precisely because this is how consumers view them. The abnormally high profits earned on parts are more properly viewed as profits earned on the joint good. Any abnormal profits earned are a result of some market power for the joint good.

Flow of
machinery
services

This discussion suggests that it is the joint price faced by a consumer that matters. Given this, what explains the choice of a low price for machinery and a subsequent high price for the parts? The answer lies in the fact that CAT is trying to attract customers who differ in the planned intensity of use for the machines that they purchase. The need for replacement parts in the future is a function of the intensity of use, and the conditions of use, for a particular customer. This implies that the cost of the investment in the new equipment depends not only upon the prices of the machine and its replacement parts, but also upon the planned usage of the customer. We can see why CAT would choose their current pricing policy with a simple example. Assume that there are only two types of customers: low-use and high-use. Low-use customers will have much fewer replacement costs in the future than high-use customers. Therefore, in comparison to high use consumers, low-use demand will be more sensitive to increases in the price of the machinery than to increases in the price of replacement parts, since the machinery price represents a comparatively larger percentage of their total price. By keeping the machinery price low, CAT does not lose these low use customers.

When we view the machine and replacement parts offered by CAT as one package, it makes no sense to distinguish the relative contribution to excess profits made by the sales of machines. Any attempt to do so would be arbitrary. In our analysis, we should try to avoid having to make this type of estimation.²

² I can conceptualize only one way to be able to this accurately, but I do not think that it is possible given CAT's market position. Nevertheless, I will describe how one could proceed.

Assume that CAT faces competition in the parts market for one geographical region that requires them to price competitively, and earn only normal margins on parts sales. Then, any market power that they can exert will be only present in the machine market. In this case, they will raise the price of machines in that market in order to earn some excess profits (they are willing to lose low demand consumers since their only chance to make high margins is in their machine sales). By comparing profits in this geographical market to those in a market for which they face no competition in parts, we can get the percentage of profits that could justifiably be attributed to machinery. Here, we say that the appropriate margin to be earned on machine sales is what could be earned by machine sales if this were the only source of market power for the firm.

C. The Alternative Approaches

1. The Market for Replacement Parts

a. Avoiding The Field Population Issue

We only need to worry about the interdependence of the margins on parts and machines if these two product lines get unequal contributions to value from the dealer network intangibles (and, consequently, from design intangibles). If the distribution network is much more important in sales of parts than it is for sales of machines, then it is necessary to assess the importance of the field population to those high margins. That portion should be split between COSA and CAT in a manner that gives COSA a smaller proportion than they will earn for the remainder of those residual profits.

To illustrate this, suppose there are \$100 million in excess profits on sales of parts, and that we determine \$50 million of this is due to the field population. COSA's share of this \$50 million depends upon its relative contribution to machinery sales. Suppose that we determine that 33% of this \$50 million is properly attributed to the dealer network intangible, giving them \$16.7 million. The remaining \$50 million in excess profits from parts sales is divided up according to the relative contributions of COSA and CAT to parts sales. If COSA's role in parts sales is relatively more important than its role in machinery sales, it will get more than a third of this \$50 million.

Alternatively, if the contribution of COSA to each business segment is the same, then we don't have to deal with this issue at all. We make the assumption that this is the case. By doing so, we can concentrate exclusively on the parts market to try to ascertain the comparative importance of COSA and CAT. If we were to do otherwise, we have two more tasks: identifying the value of the field population, and determining the proper split of that between the companies. Alternatively, we'd have to look at the total package, viewing parts and machinery as a composite good, and determine the overall contribution of each entity to the excess profits generated in the aggregate.

b. Sources of Value in the Parts Market

Ignoring the field population issue, how can we account for the high profit margins earned on parts sales? These high margins suggest that the firm does not face aggressive competition in the market for replacement parts for CAT vehicles. We can attribute the excess profits to this fact, but then the task becomes explaining why competitors can not reduce the margins earned by CAT. The answer lies in assessing advantages held by CAT that either bar the entry of competitors, or gives CAT a significant cost advantage over any entrant. By identifying potential advantages, we may provide some notion of the comparative importance of the distributor network and the CAT intangibles. This analysis is purely qualitative, and it may be difficult to verify or quantify some of the

reasons cited. However, the analysis does point out that the distributor network can make potentially large contributions to value.

We will first identify advantages held by CAT over competitors that stem from their manufacturing functions, rather than their distribution functions. First, CAT enjoys a timing advantage over potential competitors because of its machinery manufacturing. It should take other potential entrants some time to figure out what replacement parts can be made for a particular model. Frequent product line changes may imply that independent parts suppliers cannot enter the market in a timely fashion. The machinery itself lasts 10-20 years, and without actually buying the product or a replacement part (which may be carefully distributed), it may be difficult to know what to produce. Also, the manufacturing technology or the design of parts may be proprietary, making timely entry difficult if not impossible. Second, if there are economies of scale in production, CAT will have a natural cost advantage by virtue of the fact that they have already produced the original machinery parts.

What are the potential contributions of the distributor network? The distributor network can contribute to cost-efficiency in a number of ways. First, by having a worldwide network already established, CAT can increase its cost advantages due to economies of scale over competitors who lack such an extensive network. Unless the potential entrant already had a distributor network available in as many markets, the costs of establishing one would be a huge deterrent to entry. Even if they could build a plant that is as efficient as CAT, making the economies of scale irrelevant, this may still keep them out of the market.

Second, from the perspective of an end-user purchaser of machinery, the price paid for parts down the line is actually two-fold: there is the money price, and perhaps more significantly, there is the time price that represents the opportunity cost of down time due to inoperable machinery. The distribution network is capable of replacing any part within 48 hours for a machine anywhere in the world. Dealers now provide 80% of parts orders immediately upon request, and 99% are shipped within a day of being requested (contrast this to 2-7 days for car dealers that do not have a part in stock). If the distribution network is able to do this at a cost similar to what it would require other distributors seven days to perform, they are able to capture the value of their customer's time in their price.

Third, the dealers within the distribution network may purposely decide not to carry competitor replacement parts, which would mean any competitors would have to establish their own distribution chain, which would be very difficult. To the extent that COSA is successful in restraining distributors from carrying competitor product, it contributes to the excess profits.

Fourth, the dealer network may reduce transaction costs for several reasons, again providing excess profits. The dealers provide: advice on selection and application of product, financing, insurance, operator training, maintenance and repair, and help in deciding the most cost-efficient time to replace existing machinery. The distribution

network therefore allows customers one stop shopping, for which they will generally be willing to pay a premium equal to the reduction in their transaction costs.

2. Viewing Machines and Parts as One Market

For reasons already discussed, this approach would seem to be the more logical of the two, since it requires making no distinction between machines and replacement parts. However, we are ultimately looking for the approach that can give us some way to quantify the contribution of the dealer network to excess profits.

Manufacturing Intangibles

Within the construction equipment industry, economies of scale and scope may limit entry, providing all incumbents with profits in excess of those made in other, more competitive, industries. However, my presumption is that we are calculating the excess profits earned by CAT relative to the industry median. Since the industry median is the standard of comparison, we need only look for advantages that CAT might have over its current competitors (we can leave aside issues of barriers to entry for others).

Assume that CAT and its competitors make products that are perfect substitutes for each other. If this is the case, CAT can only make abnormal profits if they are a lower cost provider of machinery and replacement parts than their competitors. Where can they gain a cost advantage over their competitors? Since all of the firms in this market are quite large, economies of scale or scope on the manufacturing side are probably safely dismissed in looking for cost advantages held by CAT. Nonetheless, CAT may achieve greater cost efficiency in their production efforts through proprietary or secret manufacturing processes. To the extent that they do, this is entirely attributable to CAT, and it is independent of the distributor network. econ. rent

Another way that CAT can contribute to abnormally high profits is through the design of superior products. If their machines are more durable, more comfortable, or more versatile than competitor product lines, this will contribute to the excess profits. However, unlike the advantages cited for superior production processes that might lower CAT's costs, COSA and the dealer network may contribute to the design of better products through customer feedback that is essential to the design process. Expenses incurred in doing so should be weighted against other R&D done by CAT to determine the proper split of any excess profits attributable to better products.

Distribution Intangibles

How can the distributor network contribute to lowering the costs of machine and parts provision? As noted before, they may be instrumental in reducing the down time of customers when replacement parts are needed. If CAT can provide replacement parts faster than their competitors, they can extract the value of a customer's time in the price

of the product. As long as the extra costs incurred by the company in the quicker delivery do not exceed the money value placed on that time by the customer, this will generate excess profits for CAT and COSA.

The relationship between a company and its independent distributors is also very important to the profit margins earned. If the relationship is contentious, this may dissipate profits by increasing costs for both entities. COSA maintains the dealer network within Europe. A comparison of the dealer network established by COSA to the dealer networks established for CAT's competitors may reveal advantages held by CAT.

Another factor related to design intangibles is the timing of entry for new product lines in the market. Large profits can be made if the company has the ability to recognize a market for an entirely new product, and then to manufacture that product before any competitors do. Design of both the product and the process for manufacturing the product are likely to be done by CAT, but recognition of the market for a slightly different product will come initially at the dealer level. The advantage for CAT over its competitors is likely to lie in the recognition phase as much if not more than in the design and production phase.

D. CAT's Dealer Network

The CEO of Caterpillar, Donald V. Fites, provides a good overview of the relationship that Caterpillar maintains with its 186 independent dealers. He identifies this network as the primary reason for Caterpillar increasing their market share despite dire predictions made only a decade ago that Caterpillar would continuously lose market share to competitors such as Komatsu. At that time, Komatsu boasted cost advantages as large as 40 percent over Caterpillar in some product lines.

Cat's dealer network has a combined net worth of \$5 billion, which is 1.5 times Caterpillar's stock equity. The dealers employ 73,600 people, which is 19,000 more than CAT. Two-thirds of the 186 independent dealers operate outside of North America. The local dealers play a vital role in almost every aspect of CAT's business, including product design and delivery, service and field support, and management of replacement part inventories. The local dealers are long established members of their communities. The dealers serve CAT as sources of market information and intelligence, consultants, and problem solvers.

With a few rare exceptions, the dealers derive 90 percent or more of their revenues from selling or supporting CAT products, with many deriving all of their revenue from CAT products. In return for that commitment, CAT has shown a similar commitment to its dealers. From 1982-1984, CAT was losing \$1 million per day, but they did not let the dealers suffer the brunt of that recession, and as a consequence every CAT dealer survived even as competitor's dealerships were failing at a significant rate. When the economy bounced back, CAT enjoyed a stronger market presence through protection of the dealers.

Fites specifically mentions that competitors are slower in delivery and instillation of replacement parts, taking as much as four or five days to get a customer's machine properly repaired. As mentioned before, CAT boasts that it can replace any part within 48 hours, and replaces as much as 80 percent within twenty four hours.

CAT believes that its emphasis upon its dealer relationships sets them apart from competitors. He notes that for the Japanese competitors, and for Japanese businesses in general, distribution and after sales service are not considered to be as important as a manufacturer's relationships with its suppliers.

CAT and its dealers have made significant investments in their relationship, and CAT regards the mutual trust that exists between CAT and its dealers as being more important than mere contractual relationships. In fact, there is some support for this idea within the economics literature. A long-term relationship characterized by trust can reduce transaction costs by limiting the reliance upon legal contracts. That trust has enabled both parties to make significant investments that are specific to the relationship, and this in turn reduced the possibility of opportunistic behavior on the part of either party.

E. The Literature Concerning Vertical Relationships

The ability to quantify the contributions that can be made to profitability by a smooth running distribution system is limited. This fact is reflected in the literature, where almost all the work applicable to our problem tries to characterize the problems inherent in vertical relationships between unrelated parties, and analyze how companies fare in solving these problems.

Many firms vertically integrate into distribution rather than trying to effectively manage relationships with dealers. This structure presents the advantage of enabling the company to fully control the final customer price, as well as to engage in an efficient level of advertising. However, vertical integration can significantly increase governance costs for the firm, which can potentially outweigh the advantages stemming from greater control. If some of CAT's competitors have vertically integrated into distribution, this is one very important difference between them, and may be a potential source of CAT's excess industry profits.

When a manufacturer chooses to deal with independent dealers, their success will be largely dependent upon the nature and quality of that relationship. The manufacturer must make many decisions concerning its dealer network. Will dealerships be given exclusive territories? Will the dealer have discretion over the final product price? Will the dealer have discretion over their advertising and customer support services? How will the manufacturer aid the dealer in providing customer support? Settling these questions to the satisfaction of both parties can be very problematic, and can be continuing sources of conflict between a manufacturer and its dealers. To the extent that the two parties bicker in bargaining over the split of profits brought in by the vertical structure, they reduce the profits available to be split.

Recently, researches have shown an interest in what they call "partnering relationships" between manufacturers and their retailers. They point out the advantages of relationships of this type, though again, there is no attempt to systematically measure their contribution to profitability. Many of the characteristics they identify as indicative of a partnering relationship coincide perfectly with the relationship between CAT and their dealers.

Partnering relationships enable a firm to gain many of the advantages of a firm that has integrated forward into distribution, while avoiding the expense and pitfalls of setting up an in-house distributor network. However, distributors will not commit to a partnering relationship unless they believe the manufacturers are similarly committed to them. A distributor's confidence in the commitment of the manufacturer increases if the distributor is granted an exclusive territory and the manufacturer makes investments in the relationship. The manufacturer's confidence in the commitment of the distributor is increased if the distributor grants product class exclusivity.³ These trust-building conditions amount to commitments that align the interests of the manufacturer and distributor by making them dependent upon each other. All of these trust-building conditions are met between CAT and its dealers.

In contrast to proprietary technology and product designs that can enhance the profitability of a firm, the characteristics of a partnering relationship are in no sense proprietary. However, it is not possible for CAT's competitors to develop these relationships tomorrow if they do not already have them established. Building a sense of commitment takes time, resources, and a willingness to reciprocate. These are investments that have already been made by CAT in the past, and their excess profits may be considered a return to that investment.

1. Difficulties in Quantifying the Effects of Different Vertical Structures

I searched for literature that might give some systematic empirical study of the effectiveness of different vertical relationship structures that exist between manufacturers and their distributors. I could find no study that measures the contribution of a particular vertical relationship between a manufacturer and a distributor.

The fruitlessness of the search is not totally unexpected, given the nature of the problem. The central problem is that the characteristics of a given vertical relationship cannot be captured by a proxy continuous variable. Vertical relationships are discrete in nature, and a firm can choose from any number of different options. The relative desirability of any one option hinges upon the degree of control that the manufacturer can exert over the retailer, and the split of the profits from the business between the two entities. Exerting greater control may secure a larger share of the profits for the manufacturer, but this may also reduce the aggregate profits available for division.

³ Eric Anderson and Barton Weitz, "The Use of Pledges to Build and Sustain Commitment in Distribution Channels" Working Paper – Marketing Science Institute Report Number 91-114.

The particular vertical structure that is established depends upon many factors. The nature of the product obviously influences vertical structure. The most appropriate vertical relationship can depend upon the life-cycle of the product, the type of advertising required for the product, the amount of after-sale service required for the product, and the amount of information that must be provided to the consumer before a sale is completed. In addition, the degree of uniformity across different geographical markets for the good will bear on the choice of vertical relationship: Local information becomes more valuable if the differences across markets are more pronounced, which implies that the dealer should be given more discretion. These factors can often be quantified in some way, and then used to estimate an equation that predicts the probability that a firm will choose a given type of vertical relationship. However, these same factors will affect profitability independently of their effects upon the choice of vertical structure, making it difficult to isolate the contribution of the vertical relationship to profits.

Though features inherent to the product and the markets for that product will certainly influence the vertical relationship chosen, it does not do so in a determinant way. Firms within the same industry may choose very different types of relationships with their dealers. Many firm-specific factors can influence their choice. A firm may have a product line related to its central product that differs in its fundamentals, and therefore influences their choice.

Some anecdotal evidence may be helpful in claiming that the dealer network established by COSA contributes to the profitability of Cat.

Engagement:	Caterpillar Inc. - 2011 Audit	Redacted by the Permanent Subcommittee on Investigations
Period End Date:	12/31/2011	
Audit Unit:	Cat Inc. HQ (Group 32)	
EGA Title:	Review intercompany transactions including company reorganizations and significant agreements	
Ref No:	32071-2775	

Review the Company's intercompany transactions including company reorganizations and significant agreements.

Results:

In 1Q 2011 the Company put into place a replacement long-term product supply agreement whereby CSARL made \$4 billion of advance payments for certain prime product up to 2 years in advance and received a discount for orders placed against this advance payment. After reviewing the agreement executed in 1Q, PwC discussed with management the potential tax impacts that could arise if the agreement were left in place for too long (i.e., if product was not sold to CSARL pursuant to the agreement quickly enough). In the 1Q 2011 quarter database, the engagement team documented our considerations of the prepayment within a significant matter. During 2Q 2011, the Company amended their agreement to include additional engine purchases under the agreement for which the engagement team updated our documentation on the arrangement within a significant matter in the 2Q 2011 database.

Tax engagement partner, Brian Sprick, prepared the following memo, [ASC 740-10 - Assessment of 2011 Prepayment Agreement Memo](#), which summarizes the technical considerations and work performed by the engagement team. For detailed testing performed by the engagement team, see below.

Further note, the engagement team had PwC Transfer Pricing specialist, Donald Jankowski, partner and Tim Fisher, sr. associate complete an assessment to the reasonableness of the discount rate provided to CSARL as a result of making the prepayment. Refer to [CSARL Prepayment Transfer Pricing Memo](#) for their memo and [CSARL Payment Discount Analysis](#) for the Company's calculations used to determine the 1.44% discount. No exceptions were noted.

At 4Q 2011, management confirmed that the \$4B advance payment made in February 2011 had been fully utilized against CSARL orders in November 2011. The engagement team also performed the following substantive testing to confirm the advance payment balance. The engagement team obtained the following schedule showing the orders placed against the prepayment from Mark Young, Sr. Tax Accountant, [CSARL Purchase Agreement Monthly Amortization](#). "Amortization" refers to the draw-down of the prepayment amount, which is based on the transfer of goods in accordance with the agreement. As shown in the file, the \$4B recognized in February 2011 was vouched by the engagement team. Further note that the ending general ledger balance [REDACTED] which was used by Cat Inc. for recording the prepaid asset) as of November 30, 2011 was zero as orders and invoices totalling \$4 billion for products that qualified under the prepayment agreement had been executed. The engagement team tested the amortization of the prepayment by performing the following.

The engagement team obtained the invoice details for the months of May, August and October and completed a tie out from the monthly amortization schedule linked above to the detail provided on an invoice level. The engagement team selected the month of May as invoices issued during this month would have been executed prior to the amendment (which was amended in June 1, 2011 - see [CSARL Prepayment Agreement January 1, 2011](#) and [CSARL Prepayment Amendment June 1, 2011](#) for the original and amended agreements). The months of August and October were selected given the invoices issued during these two months would have been executed subsequent to the amendment for which most of the transactions occurred, i.e., subsequent to the amendment. A total of three months is appropriate considering PwC Audit 5340.04 relating to accept-reject testing. As the engagement team is testing completeness, accept-reject testing is an appropriate testing method (see completed testing template at [Prepayment Testing Accept-Reject Template](#)). For each month, Steven M. Conde (SMC) reconciled the detail for completeness and verified that the models of the

— = Redacted by the Permanent Subcommittee on Investigations

machines and engines reducing the prepayment were the models specified under the prepayment agreement (Note that the machines per the agreement have a 3 digit code that matches up with the last three digits of the 5 digit code provided in the detail below. Per discussion with Sae Kitajima, CSARL Business Analyst II, the only engines not covered by the prepayment agreement are the [REDACTED] engines as noted in the detail below.). In completing the testing, SMC verified the completeness of the files by agreeing the drawdown summary (tab A, note, that within the following monthly tie outs, the tabs have been labelled to clearly show the details of each month's invoices qualifying for amortization of the prepayment) to the monthly drawdown entries (tab B), to the purchases summary by machine/engine type (tab C), to the pivot table summaries (tabs D) to the purchase report details (tabs E). For example, during August testing, the drawdown summary shows [REDACTED] purchases broken down into machines and engines. [REDACTED] can be traced back to the ledger entries which details the purchases into four CSARL sub-ledgers executing the purchases under the prepayment. [REDACTED] shows the breakdown of all qualifying machines and engines by subgroup, which, in total, ties back to [REDACTED]. The Pivot table summaries for each subgroup [REDACTED] of machines, while grouping engines together. SMC used the purchase agreement to note which purchases qualified for the drawdown of the prepayment, ensuring that non-qualifying purchases did not draw against the balance. From the pivot summaries, which include all purchases, SMC was able to agree the totals back to the purchase report details within tabs E, ensuring that all purchases were accounted for in the summaries. For the tie outs performed, refer to the following links.

[CSARL Prepayment - May Tie Out](#)
[CSARL Prepayment - August Tie Out](#)
[CSARL Prepayment - October Tie Out](#)

To further test the amortization of the prepayment, SMC performed non-statistical sampling and haphazardly selected 49 invoices across all CSARL ledgers for both qualifying machines and engines across the three months. For testing performed see [CSARL Prepayment Testing Template & Testing](#) [Note, the engagement team concluded it was appropriate to use consolidated PM in the referenced template, as the focus of this EGA is related to potential uncertainty in the prepayment arrangement and the engagement team tests uncertain tax positions from a consolidated perspective]. Note, no material exceptions were noted. As such the engagement team concludes that the Company has appropriately reduced the advance payment against qualifying orders such that the advance payment balance at 12/31/2011 is zero.

Based on the technical analysis memo above, the risks associated with the advance payment agreement are moot where the advance payment is recognized in taxable income during the year the payment is made. The engagement team takes comfort over the inclusion of income relating to the orders placed and invoices paid by CSARL through separate testing of revenue control 15.03.02¹, which is tested at all in scope SOX locations by the engagement team. Additional comfort is taken from the substantive testing performed on Cat Inc. revenue recognition which is documented separately in the Aura database. The combined controls and substantive testing provide sufficient audit evidence that appropriate revenue recognition has occurred. The engagement team also performed substantive testing of the Cat Inc. tax provision at [EGA Test current income tax provision and accrual - Consolidated US](#). The engagement team notes that there are no adjustments in the Cat Inc. tax provision relating to CSARL advance payments; therefore, the engagement team is comfortable that the advance payment has been included in the provision of taxable income.

Based on the testing performed above, the management representations made and the inclusion of the prepaid funds in 2011 taxable income, the engagement team concludes that management has appropriately accounted for the transaction and no reserve is necessary for this tax position under ASC 740-10.

¹ Only valid shipments are processed for invoicing. Shipping documents (e.g., Bill of Lading- "BOL", packing slip, etc.) are compared against physical goods and sales order prior to shipment to ensure records reflect actual shipment, and shipping docs are signed by carrier indicating acceptance. Shipments are recorded into the sales / invoicing sub-system accurately and timely.

07/15/98 08:15 AM

Sent by: Simon Beaumont
 To: Christa Guarella/TAL/Price Waterhouse@Price Waterhouse-US
 cc:
 Subject: cat gpa ideas
 1 file attached

Forwarded by Simon Beaumont/TAL/Price Waterhouse on 07/15/98 08:14 AM

Steven R. Williams
 07/14/98 11:10 AM
 To: Jim McDonald/TAL/Price Waterhouse@Price Waterhouse-US, Thomas F. Quinn/TAL/Price Waterhouse@Price Waterhouse-US
 cc: Donna Siemaszko/TAL/Price Waterhouse@Price Waterhouse-US, Simon Beaumont/TAL/Price Waterhouse@Price Waterhouse-US
 Subject: cat gpa ideas
 1 file attached

attached and imported is first cut at three ideas. and a summary of them. Shall we use this format to catalog ideas? Pls add your comments, add new ideas, etc.

...
 steve

GPA Ide

CATERPILLAR GTOP
 ANALYZE PHASE
 GPA TOPICS

Summary (in approximate order of ease of implementation, easiest first)

1. COSA buys Parts (purchased finished) from Non-US sources for sale to Non-US destinations
- 1a. COSA purchases US-source Parts for Foreign Destination
2. COSA increases margin on parts, reduces margin on machines ✓
- ...
8. Boyd Critz's Super-Worldwide Parts Company (Swiss Co) (major changes in system!)

Number	1.
Description	COSA buys Parts (purchased finished) from Non-US sources for sale to N destinations

Legal Entity Effect	COSA takes place of Cat HE. COSA's parts resale margin (approx.15% gross, 7% net) non-Subpart F
Profit Center Effect	COSA pays spread back to P&SS for distribution. No change to PRM. No change to CO results. P&SS gets fee, equivalent to prior buy-resell gross margin
Additional Info Needed	Need Volume, PRM attributable to Foreign-Source, Foreign-Dest purchased-finished par territory, COSA-Sing territory. Consider if implement in CACO territory (pretty complex), or COFA territory (probably not Who performs purchasing functions, relationship with third-party supplier? Factory or P& Grimbergen? P&L, B/S of Cat HE entity. (Entity or branch)
Barriers—Tax	Does COSA need parts specialists to purchase? Can P&SS perform this function, or mu (Argument that nothing has changed, COSA gets its same margin as now, just through a mechanism)
Barriers— Mgmt	Minor—P&SS receives same margin as before. PRM stays same. COSA's margin (11% ROA on inventory) stays same. Systems work—suppliers invoice to COSA, not Cat Inc.
PPP, Tax Savings	Determine amount of parts at issue (For-source, For-dest, purchased finished). Determin COSA-Sing margin (gross, and net) Use COSA's 17.5% tax rate vs 35% US rate What is value of subpart F exclusion of this income? Is it enough to get out of the 70% r

Number	1a.
Description	COSA purchases US-source Parts for Foreign Destination
Legal Entity Effect	as above
Profit Center Effect	as above
Additional Info Needed	see above
Barriers—Tax	would COSA have a PE in US?
Barriers— Mgmt	see above
PPP, Tax Savings	as above, but add US-source, Foreign-destination can COSA claim FSC benefit on US-export parts? If not, offset the FSC benefit against tax rate

Page(s)
Redacted By The
Permanent Subcommittee
on Investigations

CATERPILLAR GTOP
ANALYZE PHASE
GPA TOPICS

Summary (in approximate order of ease of implementation, easiest first)

1. COSA buys Parts (purchased finished) from Non-US sources for sale to Non-US destinations
- 1a. COSA purchases US-source Parts for Foreign Destination
2. COSA increases margin on parts, reduces margin on machines.

...

8. Boyd Critz's Super-Worldwide Parts Company (Swiss Co) (major changes in system!)

Number	1.
Description	COSA buys Parts (purchased finished) from Non-US sources for sale to Non-US destinations
Legal Entity Effect	COSA takes place of Cat HE. COSA's parts resale margin (approx. 15% gross, 7% net) becomes non-Subpart F
Profit Center Effect	COSA pays spread back to P&SS for distribution. No change to PRM. No change to COSA's overall results. P&SS gets fee, equivalent to prior buy-resell gross margin
Additional Info Needed	<ul style="list-style-type: none"> ~Need Volume, PRM attributable to Foreign-Source, Foreign-Dest purchased-finished parts, sold in COSA territory, COSA-Sing territory. ~Consider if implement in CACO territory (pretty complex), or COFA territory (probably not) ~Who performs purchasing functions, relationship with third-party supplier? Factory or P&SS? Morton or Grimbergen? ~P&L, B/S of Cat HE entity. (Entity or branch)
Barriers—Tax	Does COSA need parts specialists to purchase? Can P&SS perform this function, or must COSA? (Argument that nothing has changed, COSA gets its same margin as now, just through a different mechanism)
Barriers—Mgmt	<ul style="list-style-type: none"> ~Minor—P&SS receives same margin as before. PRM stays same. COSA's margin (11% + whse fee + ROA on inventory) stays same. ~Systems work—suppliers invoice to COSA, not Cat Inc.
PPP, Tax Savings	<ul style="list-style-type: none"> ~Determine amount of parts at issue (For-source, For-dest, purchased finished). ~Determine COSA and COSA-Sing margin (gross, and net) ~Use COSA's 17.5% tax rate vs 35% US rate ~What is value of subpart F exclusion of this income? Is it enough to get out of the 70% rule?

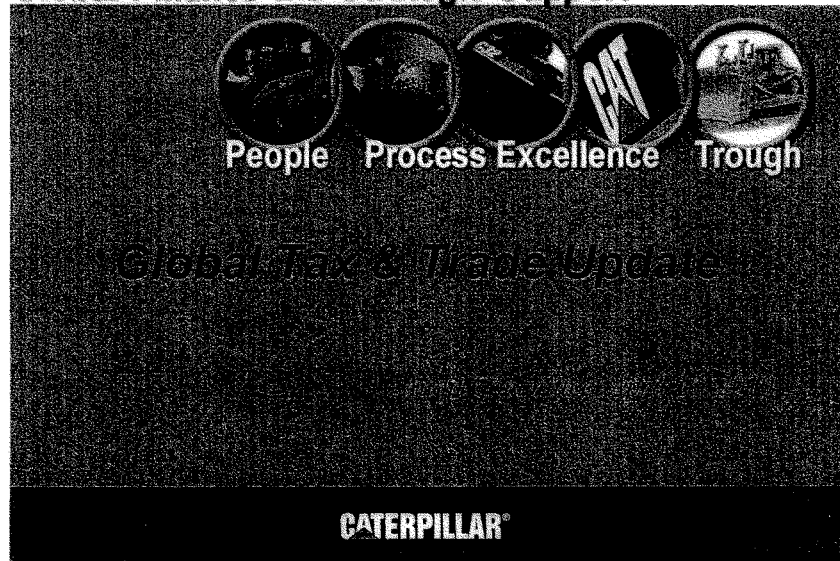
Number	1a.
Description	COSA purchases US-source Parts for Foreign Destination
Legal Entity Effect	as above
Profit Center Effect	as above
Additional Info Needed	see above
Barriers—Tax	would COSA have a PE in US?
Barriers—Mgmt	see above
PPP, Tax Savings	~as above, but add US-source, Foreign-destination

	Can COSA claim FSC benefit on US-export parts? If not, offset the FSC benefit against COSA's lower tax rate

**Redacted By The
Permanent Subcommittee
on Investigations**

Number	
Description	COSA earns share of Parts Residual Margin currently paid to (US and non-US) product profit centers
Legal Entity Effect	
Profit Center Effect	
Additional Info Needed	
Barriers—Tax	
Barriers—Mgmt	
PPP, Tax Savings	

Global Finance and Strategic Support

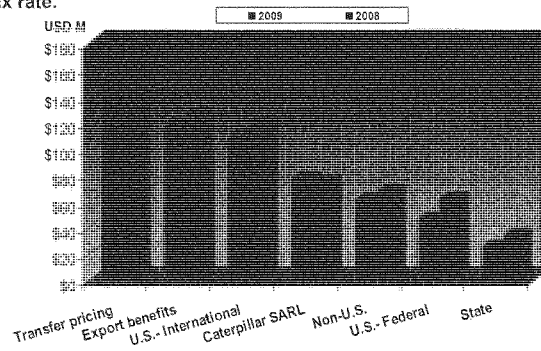


Confidential Treatment Requested by PwC

PwC_PSI_CAT_00006974

Issues - Tax Reserves

Total reserves of \$761 (\$803) million, \$593 (\$646) million of which are items depicted below that would permanently impact the effective tax rate.





Memo

To: / Location: Garry, Tom, Carl, Claude-Alain, Henry

From: / Location: PricewaterhouseCoopers Swiss tax team

Date: June 11, 2005

Subject: Morton

Dear all,

The purpose of this memo is to summarize the situation in connection with CSARL's ledger NW (Morton) activities as well as the methodologies chosen in the 2002 and 2003 tax returns to determine the profit allocated to NW.

Our memo is based on various documentations at our disposal (e-mails and documents from Caterpillar tax team, Lenz & Staehelin, PricewaterhouseCoopers Romandie and PricewaterhouseCoopers US). We would appreciate if you could provide us with your comments.

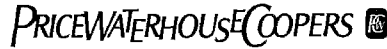
1 Commercial and fiscal year 2002

1.1 Approach regarding the NW's permanent establishment

With the new reorganizations in Latin America and North America, and the introduction of "virtual bins", a new inventory tracking system, CSARL held from 2002 inventory in the US, throughout 14 different distribution centres, but primarily in Miami and Morton (NW).

The effect of "virtual bins" is that it allows inventory physically located in the US to be viewed in total (for group inventory management purposes), but different parties can own the inventory. Thus, CSARL owns inventory in the US and can use that inventory to fulfil both customer and marketing entity requirements outside the US, any sales transacted in the US continue to be fulfilled by Cat Inc.

Thus, all of the CSARL inventory in the US is held and destined for export (CSARL does not sell parts in the US, and all parts destined for the US transfer to Cat Inc. via the flash title process). Previously, CSARL did not hold inventory in the US, and all parts sales destined for North America and Latin America were immediately transferred to Cat Inc. via a flash title system at zero margin. Since 2002, CSARL sells parts to CAMSARL and CNamSARL. The only flash title transactions remaining are for parts destined for sale in the US.



Due to important time pressure, the whole situation in connection with the PE was not reviewed in detail and it was concluded that starting on August 1st, 2002 (date of introduction of "virtual bins"), CSARL has a PE in the US under the Swiss/US income tax treaty as interpreted under Swiss rules because, amongst other things, NW has a physical presence in the US, negotiates and signs contracts in the US through agency, and effects sales in the US through agency. However, based on special US tax rules, CSARL is not required to pay US tax on these activities.

In 2003, it was decided to perform a functional analysis which purpose would be to determine the exact function of that PE in order that the PE accounts then reflect an arm's length remuneration for the performance of these functions and to show what part of NW's income could be objectively allocated to the PE.

1.2 Approach chosen in the 2002 tax return

For Swiss income tax purposes and on the 2002 CSARL Swiss tax return, it was decided to use the guidance under Circular Letter No 8, International Tax Allocation of Principal company, to govern the allocation of NW's income from August 1st 2002 to November 30, 2002. Under the Circular, 30% percent of NW's profit is deemed to be derived from production and was allocated to Switzerland. The remaining 70% were characterized as trading profits and was allocated 50/50 between Switzerland and the US PE. Hence, 35% of NW's income was allocated to the US PE.

2 Commercial year and fiscal year 2003

2.1 Approach regarding the NW's permanent establishment

In 2004, there were various discussions regarding the existence or not of the NW's PE, in particular regarding the US protective disclosure on the CSARL's US federal tax return that indicates that CSARL does not have a PE in the US under article 5 of the treaty.

It was also discussed how to prepare the CSARL international tax allocation in connection with NW's activities and how to show what part of NW's income should be **objectively** allocated to the PE. Indeed, the best solution would be, as it is the case for the Singapore's ledger, that CSARL allocates the NW's income according to the direct method, that is to say as if NW would be a separate, unrelated and distinct enterprise engaged in the same or similar activities under the same or similar circumstances. It was therefore decided to create a hypothetical P&L for NW's activities as if it was an independent unrelated company.

To strengthen the existence of a PE in NW, we have been informed in 2004 that there are [REDACTED] annual parts business connected with Americas markets for CSARL. There are no employees in CSARL that support this market. The principal support process for these parts sales exists in the US. Cat Inc. creates the purchasing strategy for the parts, manages their logistics and sets pricing under services agreements with CSARL. CASCO manages the markets providing market strategy, creates dealer programs, contracts with the dealers, executes pricing, warranty policy and dealer support. A services agreement has been signed between CamSarl and

— = Redacted by the Permanent
Subcommittee on Investigations

(2)



— = Redacted by the Permanent Subcommittee on Investigations

Casco and an agreement concluded between CSARL and Cat Inc. covers Cat Inc.'s support of the parts business of CSARL. This covers the services of several hundred employees located principally at the Morton Illinois facility who run the parts business on behalf of CSARL. This agreement results in the single largest service fee paid by CSARL – [REDACTED]. Based on this information, it was decided that there are sufficiently elements to argue that CSARL has a PE in Morton.

2.2 Approach in the 2003 tax return

For Swiss income tax purposes and on the 2003 CSARL Swiss tax return, it was decided to create a hypothetical P&L for the NW activities and allocate NW's income 2003 according to the guidance defined under Circular Letter No 8. Under the Circular, 30% percent of NW's profit deriving from Morton's activities has been allocated to Geneva as Swiss entrepreneur to respect it as the head office with the IP rights and to remunerate the entrepreneur for all other risks that it undertakes. The remaining 70% were allocated based on proportionate costs that incurred in performing the activities carried out in Morton to reflect the transfer pricing. Thus, [REDACTED] of NW's income was attributed to Geneva based on the calculation.

3 Commercial year and fiscal year 2004

To further strengthen the permanent establishment in the US for CSARL's purchased finished parts business, two options were envisaged for the presentation of the hypothetical P&L for the Morton activities.

1. Options 1: the 1st option was to have the income allocation based on the methodology used in 2003, with the addition that at November 2004 month end, ledger 36 (Geneva) and ledger Morton, respectively, would book a credit and a debit on their COGS line entry. Thus, the income allocation would be reflected on the trial balance of each ledger.
2. Option 2: the 2nd option was to formulate a transfer pricing arrangement between ledger 36 and ledger Morton. The transfer pricing results would be reflected in COGS of the two ledgers, and the results would be similar as option 1. Ledger 36 and ledger 86 (Singapore) currently use transfer pricing method to reflect transactions between them, and option 2 would mirror that process.

We still have the followings questions :

Which option has been selected ?

(3)



What kind of work has been performed in order to sustain the allocation ?

How this option has been documented

Which adjustment has been performed in the books ?

We are looking forward to your comments and remain at your entire disposal
should you need any further information.

Kind regards,

PricewaterhouseCoopers Swiss tax team

(4)

Product Management Alignment Recommendation

Recommendation
Programs & Goals

1) Implement Global Parts Management organization in Geneva

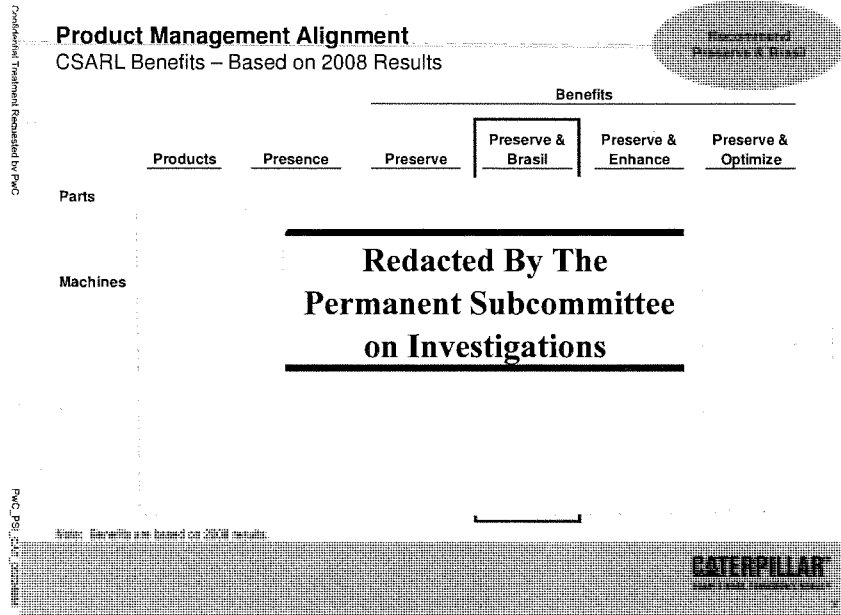
- Executes entrepreneurial responsibilities
- Must support all MBDs
- Staff likely drawn from Industry and Solutions & Product Support orgs

2) Locate Regional Product Managers in Geneva

- Substantial contribution to MWL, MTTT/L, HEX and MG manufacturing
- Global Product Managers provide oversight role

3) Support organizations provide added entrepreneurial substance

- Global Purchasing
- Industry Groups
- Solutions & Product Support



Product Management Alignment

Enhance & Optimize

Deferral due to
reference to
optics

1) Requires relocation of WW Product Managers

- PMs that have sole manufacturing source in U.S.
- Entrepreneur must not be located at manufacturing source

2) Inefficient, ineffective product management

- Distance to manufacturing, product development, business partners, customers
- Requirement of eleven days in Geneva too restrictive

3) While technically appropriate, creates optics concerns

- Taxation in CSARL with minimal business substance

4) Election not required in 2009

- Election may be deferred
- Revisit in conjunction with GPNP execution

Product Management Alignment

Product Management Alignment

CSARL Benefits – Based on 2009 ATS

Forecasted
profits do not
warrant longevity
of execution

		Benefits					
		<u>Products</u>	<u>Presence</u>	<u>Preserve</u>	<u>Preserve & Brasil</u>	<u>Preserve & Enhance</u>	<u>Preserve & Optimize</u>
Parts							
Machines							

Redacted By The

**Redacted By The
Permanent Subcommittee
on Investigations**

PWC, PSL, Intel, JPMorgan

* - Preserve & Optimize represents RFM responsibilities for EMEA, Americas and Asia Pac
Footnotes can be seen on corresponding slide deck.

CATERPILLAR
SINCE 1906, CATERPILLAR'S WORLD