

Ingersoll Finds Escaping U.S. Tax No Penalty as Contracts Flow

By Zachary R. Mider
Bloomberg News

July 8, 2014 – American manufacturer Ingersoll-Rand Co. forged the tools that carved the Panama Canal and shaped Mount Rushmore. When it shifted its legal address to Bermuda in 2001 to reduce taxes, the maneuver sparked bipartisan outrage in Congress.

“These corporations have turned their back on their country,” Nevada Democrat Harry Reid fumed from the Senate floor, adding that his father, a hard-rock miner, had wielded an Ingersoll-Rand jackhammer. “There is no reason the U.S. government should reward tax runaways with lucrative government contracts.”

Over the next dozen years, Congress passed law after law to prohibit American companies that reincorporate overseas from doing business with the federal government.

Those laws haven’t worked. Benefiting from loopholes and a cooperative Obama administration, the companies avoid the ban on federal contracts as effectively as they avoid U.S. taxes.

Ingersoll-Rand continues to score federal work worth hundreds of millions of dollars, touting projects for the Army and Navy in sales brochures. The company’s strategies have even



This heat exchanger plant at Naval Air Station Oceana's Dam Neck Annex in Virginia Beach, Virginia was built by Trane, a subsidiary of Ingersoll-Rand Plc.
Photographer: Andrew Harrer/Bloomberg

included trying to piggyback on the eligibility of other companies, according to two former Ingersoll-Rand employees.

Ingersoll-Rand is one of more than a dozen large U.S. companies that have shifted their tax addresses offshore yet still earn federal business, a Bloomberg News investigation has found. In all, these companies are collecting more than \$1 billion a year from the government, even as their tax-avoidance techniques have deprived the Treasury of untold billions of dollars in revenue.

Policing Themselves

Regulators rely on the companies to police themselves for compliance with the prohibition.

At least three companies – Xoma Corp., Cooper Industries Plc and Foster Wheeler AG – have acknowledged they were subject to the ban and yet have said in a federal database that they're exempt.

Other firms that reincorporated overseas – a strategy known as “inversion” – qualify for contracts because they don't meet the law's narrow definition of an inverted company. Under the law, a U.S. company that shifts its address to a location abroad isn't eligible for federal contracts, unless it has substantial business in its new home or undergoes a major change in ownership. That means the prohibition doesn't apply, for example, to companies that got a new address through a takeover of a foreign competitor.

“These are bad actors. We should not be rewarding them,” said Representative Rosa DeLauro, a Connecticut Democrat who has led the push to keep contracts from the companies. “Let's give it to the companies that stay here, employ people here and pay their taxes here.”

Complex Law

Ingersoll-Rand, which now is run from North Carolina, continues to reap the benefits of a low-tax foreign address. The company says it works closely with government contracting officials to ensure compliance with a “complex area of the law.”

For several years, said spokeswoman Misty Zelent, Ingersoll-Rand avoided bidding on contracts that were off-limits to companies that shifted their tax address overseas. The company won other sales legally because they were awarded during periods when the prohibition had

temporarily lapsed, or that were grandfathered because of earlier contracts, she said. Ingersoll-Rand also warned shareholders and federal customers that it may be ineligible for contracts.

Recently, the company conducted an “exhaustive legal analysis” and concluded that it's not subject to the prohibition after all, Zelent said.

She declined to share the firm's reasoning or say whether the government endorsed this view, citing “competitive reasons.”

Corporate Stampede

Representatives for a half-dozen federal agencies said they followed the law in awarding projects to Ingersoll-Rand. Some of the agencies, including the U.S. Forest Service and the U.S. Mint, said they relied on the company's statements in a federal database that it wasn't banned.

The ranks of federal contractors with foreign addresses are likely to grow this year as a new stampede of companies escapes the U.S. tax system. Medtronic Inc., a Minnesota medical device maker with \$17 billion in annual sales, announced plans last month to become Irish. Four other American companies are in the process of reincorporating abroad, and Pfizer Inc., Monsanto Co. and Walgreen Co. also have flirted with the idea this year.

Without a change to the tax code, future inversions may cost the government \$19.5 billion in forgone revenue over the next decade, a congressional panel estimated this year. That doesn't count the billions avoided by the 36 U.S. companies that already have shifted their address overseas.

Rented Mailboxes

The U.S. has the highest corporate income-tax rate in the developed world, 35 percent. Because the U.S. taxes profits based on the country of the company's legal incorporation, rather than of executives, factories or customers, switching to an address in a lower-tax nation can dramatically reduce a firm's tax bills. Before a tax-law change in 2004, this exercise involved little more than completing some paperwork and renting an office or a mailbox in Bermuda or the Cayman Islands.

That's how Ingersoll-Rand did it. The company was founded by Simon Ingersoll, a Connecticut farmer who invented a steam-powered rock drill in 1871. Its factories have made everything from golf carts to refrigerated boxcars.

Changing its address from New Jersey to Bermuda, an island in the Atlantic with no corporate income tax, was only Ingersoll-Rand's first step in cutting its U.S. tax bills. The company then loaned more than \$3 billion to itself, which had the effect of shifting reported profits from its main U.S. unit to Bermuda, according to records in U.S. Tax Court.

IRS Challenge

In part because of this loan, the company's effective tax rate dropped by half to about 16 percent in the years following its change in address. The Internal Revenue Service is challenging aspects of the loan arrangement, demanding \$774 million in additional taxes from 2002 through 2006, plus interest and penalties, Ingersoll-Rand said in securities filings. The company says the arrangements were proper and is defending them in Tax Court.

Ingersoll-Rand was one of several companies to take Bermuda addresses in the early 2000s, and by 2002 the trend caught lawmakers' attention. As Congress prepared legislation to set up the Homeland Security Department, DeLauro and others sought a clause prohibiting the new agency from doing business with inverted companies, arguing that their lower tax costs would give them an unfair advantage over domestic contractors.

Congressional Critics

As one of the biggest companies to go offshore, Ingersoll-Rand became a punching bag for Reid and the measure's other advocates. Charles Grassley, the top Republican on the Senate Finance Committee, described the company's move as "immoral" and called for an end to "fat government contracts" for such firms. Representative Richard Neal, a Massachusetts Democrat, called the company and another firm "financial traitors."

A version of the Homeland Security contract ban became law, but it was toothless. It applied only to the inverted companies themselves, not to any subsidiaries they might have. And it applied only to companies that had shifted overseas after November 2002, sparing all those that had already done so, including Ingersoll-Rand.

The ban had so little effect that when Homeland Security awarded its first big contract in 2004, it chose Accenture Ltd., the former consulting arm of the Arthur Andersen accounting firm. Although Accenture had Chicago roots and a Dallas CEO, it had incorporated in Bermuda in 2001. The contract was worth as much as \$10 billion.

Closing Loopholes

That summer, a group of Democrats pushed to tighten the law and revoke the Accenture contract. Eventually, Accenture kept the award, though the loopholes for subsidiaries and for pre-November 2002 inversions were closed.

In 2007, Congress extended the ban to all contracts funded by an annual government-wide appropriations bill. Similar one-year bans were approved in four of the following six years.

The law defines an “inverted” company so narrowly that it still doesn’t catch Accenture or Tyco International Ltd., another company that took a Bermuda address and was repeatedly cited by legislators as a target. Also exempt is Chicago Bridge & Iron NV, a Texas-run company with a Dutch address. All three companies, as well as Ingersoll-Rand, were included on a list of dozens of inverted companies published yesterday by Democrats on the House Ways and Means Committee, who said the names were furnished by the nonpartisan Congressional Research Service. Accenture got \$960 million from federal contracts in 2013, and Chicago Bridge had \$734 million, according to data compiled by Bloomberg.

Never U.S.-Based

All three companies say they’ve complied with the law. James McAvoy, a spokesman for Accenture, said the company isn’t inverted because it was never a U.S.-based organization. When it first separated from Chicago-based Arthur Andersen in 1989, it was set up as a network of separate partnerships around the world overseen by a Swiss entity. For that reason, the U.S. General Accounting Office concluded in 2002 that Accenture wasn’t inverted.

McAvoy said a 2012 legal analysis by the Homeland Security Department confirmed that Accenture isn’t covered by the ban.

The most recent U.S. companies seeking foreign addresses also qualify for exceptions to the contracting ban. For instance, Medtronic plans to reincorporate through a foreign takeover. A maker of pacemakers and defibrillators, Medtronic’s customers include the Veterans Affairs Department.

One of the few companies to face real consequences is McDermott International Inc., a Houston engineering firm that’s been incorporated in Panama since 1982. In 2010, citing the contracting ban, McDermott spun off a division that specializes in government contracts as a separate U.S. company.

Government Contracts

Even as Ingersoll-Rand reaped the tax benefits of its foreign address, it took steps to expand its U.S. government business. In December 2007, two weeks before the first government-wide contracting ban took effect, Ingersoll-Rand agreed to buy Trane Inc., a New Jersey maker of energy-efficient air conditioners and heating and ventilation gear.

Part of Trane’s sales came from retrofitting buildings – including government facilities – with new equipment to cut fuel and power costs. Combined with the legislation, the sale to Ingersoll-Rand was greeted with apprehension by Trane employees in the unit that served government customers, according to a former member of the unit who spoke on condition of anonymity. Since the prohibition applied to subsidiaries, would Trane be ineligible for

government contracts?

Instead, Ingersoll-Rand has championed Trane's work for the government and used it as a selling point. Marketing materials highlight how the unit is one of an elite group of contractors authorized by the Energy Department to bid on major federal retrofitting projects, including at military bases all over the country.

'Valued Customers'

"Trane counts among our valued customers nearly all major government departments and agencies," reads a pamphlet for the company's Federal Sector Team that's posted on the Energy Department's website. There's a photograph of a serviceman in white gloves, snapping a salute.

Since the company agreed to buy Trane in 2007, shares of Ingersoll-Rand have returned 79 percent, including dividends, through July 3, compared with a 56 percent return for the Standard & Poor's 500 Index.

As it pursued government business, Ingersoll-Rand gave different accounts of whether it was subject to the contracting ban. In 2008, it warned shareholders in a securities filing that the company's contracting work may be affected by the ban. The warning was repeated as recently as February. The company as recently as May included boilerplate language in its bids stating that it was restricted from receiving some government funds.

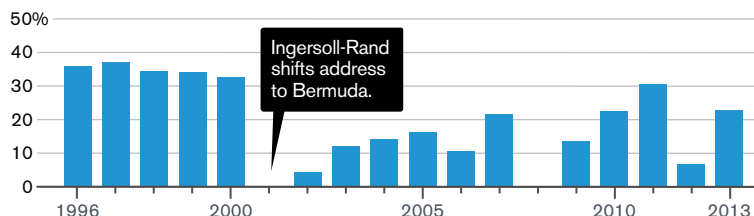
Cautious Statements

Ingersoll-Rand made those statements "out of an abundance of caution," because it wasn't sure until recently whether it was subject to the ban, spokeswoman Zelent said.

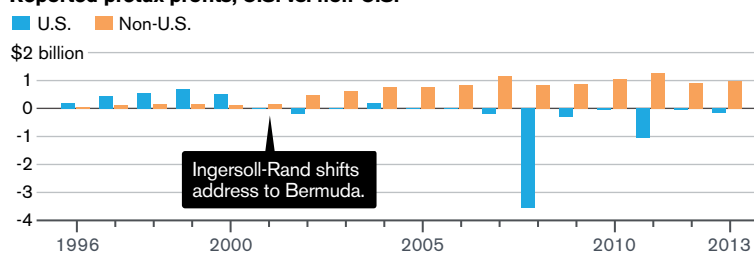
A Foreign Address Lowers Ingersoll-Rand's Tax Bills

After Ingersoll-Rand shifted its legal address to Bermuda in 2001, its effective tax rate dropped. Part of the reason: it started reporting that most of its profits were earned abroad. The company switched its address again, to Ireland, in 2009.

Ingersoll-Rand's effective tax rate



Reported pretax profits, U.S. vs. non-U.S.



Source: Ingersoll-Rand SEC Form 10-Ks

Meanwhile, in a federal contracting database known as the System for Award Management, Ingersoll-Rand was taking the position that it was exempt from the ban.

SAM is a central registry for government contractors. Procurement officials can use SAM to check if a company is eligible to receive federal contracts or if it's on a list of firms that are prohibited – for instance, if they're deemed a national security risk. As early as 2011, company employees stated in filings that Ingersoll-Rand was "not an inverted domestic corporation."

For the most part, Ingersoll-Rand has been able to sidestep the question of whether it's inverted or not. Three different gaps in the laws have allowed the company to continue making big sales to government customers.

Military Supermarkets

First, Ingersoll-Rand could garner contracts that aren't funded by annual congressional

appropriations. In March 2010, an Ingersoll-Rand unit received a contract to maintain equipment at supermarkets on military bases from Texas to Hawaii. Funded by a 5 percent surcharge on purchases at the stores, the contract has already paid more than \$100 million, according to data compiled by Bloomberg.

Second, the company was awarded contracts during periods when the ban had temporarily expired. For example, a few months after Ingersoll-Rand completed the Trane acquisition, the Energy Department selected it as one of 16 contractors allowed to bid on large government retrofitting projects. Signed in December 2008, the contract authorizes Ingersoll-Rand to pursue up to \$5 billion in government work, over as much as 10 years.

Congress's first government-wide contracting ban had applied to the 2008 fiscal year, which ended in September 2008. Not until the following March did Congress restore the ban when it passed a funding bill for the 2009 fiscal year. By that time, officials at the Energy Department in Colorado had already signed Ingersoll-Rand's contract. The prohibition didn't apply retroactively.

Grandfathered In

Third, some contracts gave Ingersoll-Rand what spokeswoman Zelent calls a "grandfather clause," allowing the company to bid on new projects for decades without running afoul of the ban. The 2008 contract, and similar ones that Trane had won in earlier years, basically designate the company as an approved vendor that can compete on projects as they become available.

Thus Ingersoll-Rand has bid for and won 10

energy-savings projects since 2008, worth more than \$350 million in all, under the authority of Energy Department contracts signed years earlier.

The biggest of these was a \$124 million project at Naval Air Station Oceana in Virginia Beach, Virginia, the East Coast home of the Navy's fighter jets. The Trane unit was hired to replace an old steam plant with a more efficient heating system, and get paid back from the Navy's cost savings. It was Trane's third such project at the base.

Old Contract

Despite being awarded in August 2009, when the ban was technically in effect, the project came under the authority of an old Trane contract from 1999.

"The Navy had no legal basis for not considering Trane's proposal, which the Navy found to be the best value to the government," the Navy said in an e-mailed statement.

Later that year, service members from Oceana and Ingersoll-Rand officials traveled to a ceremony at the Ronald Reagan Building in Washington to accept a presidential award for their work on an earlier energy-savings project at the base. The company has used a photo of the Lucite trophy in its marketing material. The White House didn't respond to a request for comment.

Ingersoll-Rand tried other ways to get around the contracting ban, according to Jose Sanchez, a former senior engineer at the Trane unit that works on federal projects.

Joint Ventures

"In some cases, they do a joint venture with a company that's not inverted," said Sanchez, who

left Ingersoll-Rand in 2011 and now works in Texas for a competitor. “They’re able to process the application that way.” He declined to discuss specific transactions.

Ingersoll-Rand submitted just such a bid in 2010, according to the other former Trane employee. That year, company officials believed they were well positioned to win a bid on an energy- savings project at a Marine Corps base in Okinawa, Japan, yet were concerned the contracting ban might disqualify them, this person said. So they teamed up with Clark Energy Group LLC, a much smaller Virginia-based company, this person said.

Under the joint proposal, Clark would serve as the Navy’s prime contractor at the base in Okinawa and subcontract most of the work to Ingersoll-Rand, this person said.

In a statement, the Navy said the project was ultimately canceled “for reasons unrelated to any company’s status” as inverted, adding that “the Navy never formally accepted Clark’s proposal or its use of Trane as a subcontractor.” Clark confirmed its involvement in the bid and declined to answer specific questions.

‘Bidding Groups’

“The characterization that Ingersoll-Rand did anything improper is inaccurate,” said Zelent, the spokeswoman. She added that forming bidding groups on projects is common and “often encouraged by the acquiring governmental agency.”

Inside the Trane unit that catered to government customers, some employees now worried they were being too cautious in avoiding bids where inverted companies were off limits, according to the former Trane employee. Some said the company should just

start asserting that it wasn’t inverted after all, forcing the government to rebut the claim if it disagreed, this person said.

Advocates of this strategy were emboldened by the company’s decision to switch its legal domicile again in 2009 to Ireland from Bermuda, this person said. Although Ireland’s tax-friendly policies, like Bermuda’s, make it a magnet for U.S. companies looking to avoid taxes, it also has a network of treaties and a strong trading relationship with the U.S.

Zelent declined to say why the company recently decided that it’s not banned. It reached that conclusion after a federal rulemaking process that ended in 2011, she said.

Domicile Hopping

If companies could escape the contracting ban by hopping from one foreign domicile to another, it would “eviscerate” the law, said Willard Taylor, a retired corporate tax lawyer and adjunct professor at New York University School of Law.

Congress “would be very annoyed, I’m sure,” he said.

DeLauro says she’s working on a bill that would expand the definition in the contracting ban to apply to more companies, including most of those that inverted recently.

To bid on federal contracts, companies must attest in the SAM database that they aren’t subject to the ban. Three such companies have contradicted their SAM filings by acknowledging elsewhere that the ban did apply to them.

Xoma Contract

Xoma Corp., a California drugmaker, had a Bermuda address when it got contracts worth as

much as \$93 million from 2008 to 2011 to make an antitoxin for the deadly poison botulinum for the National Institute of Allergy and Infectious Diseases.

A Xoma employee submitted a form in the federal SAM database claiming that, as of July 2011, it wasn't inverted, the database shows. The form includes language acknowledging unspecified "penalties" if the information is inaccurate.

The statement was probably an "honest mistake," said spokeswoman Ashleigh Barreto. "The form that he's filling out was all these check, check, check boxes and he probably just checked the wrong box," she said. Both of the contracts were awarded lawfully because of other exceptions to the law, she said.

The institute said in a statement that it was unaware Xoma was inverted. The company switched back to a U.S. domicile in December 2011.

Pentagon Review

Cooper Industries Plc, a Texas-run firm that picked up a Bermuda address in 2002, said in a securities filing in 2009 that it somehow got \$8 million in federal contracts that probably should have been prohibited. It said it might face penalties from the Defense Department, which was reviewing the matter. That review continues six years later, according to Maureen Schumann, a department spokeswoman.

Nevertheless, Cooper continued to do work for the government. A SAM filing by an employee at a Cooper division in Sarasota, Florida, effective as of February 2012, stated that the company wasn't inverted after all.

Later that year, Cooper was sold for \$11.8

billion to Eaton Corp., a larger Ohio firm that coveted its offshore address. Thanks to the way the contracting ban is worded, the entire combined company, known as Eaton Corp. Plc and incorporated in Ireland, is now qualified to bid on government work, said spokesman Scott Schroeder. He declined to comment on Cooper's conflicting statements about whether it was inverted prior to the takeover.

Swiss Incorporation

Another inverted company that claimed not to be is Foster Wheeler AG, a former New Jersey firm now incorporated in low-tax Switzerland. Scott Lamb, the company's vice president for investor relations, said the division whose name appears on the filing hasn't worked for the government since 2006.

"We recognize that Foster Wheeler is classified as an inverted corporation," he said in an e-mail. "I cannot vouch for the authenticity of that document."

The U.S. General Services Administration, which oversees the SAM database, said in a statement that "submission of false representations or certifications is a very serious matter." It said penalties range from "monetary recoveries" to barring the contractor from future government work.

Ingersoll-Rand's quest for profit from making buildings more efficient dovetails with a priority of the Obama administration, which announced this year a raft of energy conservation initiatives. Among them was the expansion of the Energy Department's program for government buildings that's already worth more than \$500 million to Ingersoll-Rand, including its work for the Navy in Virginia.

The president announced the initiatives in May from the aisles of a Wal-Mart store in California equipped with solar panels. Ingersoll-Rand Chief Executive Officer Michael Lamach, 51, was an invited guest.

“Thanks to all the companies who are doing the great work,” Obama said as he stepped from the stage. “We appreciate your leadership.”

– *Editor: Daniel Golden, Stephen West*