





January 9, 2024

Governor Gavin Newsom
 1021 O Street, Suite 9000
 Sacramento, CA 95814

Senate President pro Tempore Toni Atkins
 1021 O Street, Suite 8518
 Sacramento, CA 95814

Assembly Speaker Robert Rivas
 State Capitol, Room 219
 Sacramento, CA 95814

RE: Oil and Gas Industry Subsidies

Dear Governor Newsom, Senator Atkins, and Assemblymember Rivas,

We applaud your leadership and commitment to working with us and our colleagues to advance climate policies that position California as world-leading on climate action. In 2023, you held Big Oil accountable by enacting the first-of-its-kind price gouging penalty, and you launched a lawsuit against major players in the oil industry to hold them accountable for their deception

and role in exacerbating climate change. However, the oil and gas industry continues to receive California tax benefits, even as the state is moving away from fossil fuels.

Given the projected \$68 billion deficit for the upcoming fiscal year, the state must consider ending handouts to the oil industry, whose companies have profited enough off the backs of hard-working Californians. The state should not be subsidizing oil and gas, especially in light of the [new agreement from the United Nations Climate Change Conference \(COP28\)](#) to transition away from fossil fuels, coupled with California's ambitious climate target to reach [carbon neutrality by 2045](#). As you consider several funding shifts and cuts to California's climate commitment given the budget deficit, we urge you to put people over profits and continue to hold the oil and gas industry accountable.

The Department of Finance annually reports on tax expenditures.¹ We respectfully request that the Administration identify all current tax expenditures both specifically for the oil and gas industry and broader corporate tax expenditures that the oil and gas industry benefit from and utilize. We are requesting that you and the Legislature include language in the budget to remove these subsidies.

There are a number of broad tax credits that include many industries—including the oil and gas industry. Specifically, we suggest eliminating the following significant tax benefits enjoyed by the oil and gas industry using North American Industry Classification System (NAICS)² codes for the following corporation tax expenditures:

- Water's Edge Election (\$4.3 billion for all industries): Water's Edge Election is a tax expenditure that allows multinational corporations to compute the income attributable to California on the basis of a water's edge or domestic-only combined report, as opposed to a worldwide combined report. This allows a corporation to elect to compute its California tax by reference to only the income and factors of a limited number of entities.³
- Research and Development Credit (\$3.1 billion for all industries): Corporations are allowed a credit for research expenditures.

Allowing California's large oil and gas corporations the choice of a Water's Edge Election for purposes of being taxed sanctions offshore tax havens. In 2018, Dutch and International unions filed a complaint alleging that Chevron funneled billions through Dutch subsidiaries to tax haven countries. This suggests that Chevron benefits significantly from California's Water's Edge Election tax policy.⁴ Additionally, a 2015 U.S. Senate investigation found that Chevron had hidden \$31 billion in profit within companies based in 13 different offshore tax havens.⁵

¹ https://dof.ca.gov/wp-content/uploads/sites/352/Forecasting/Revenue_and_Taxation/TaxExpenditureReport.pdf

² <https://www.census.gov/naics/>

³ <https://dof.ca.gov/wp-content/uploads/sites/352/2023/10/2023-24TaxExpenditureReport.pdf>

⁴ <https://www.reuters.com/article/us-netherlands-tax-chevron/unions-accuse-chevron-of-massive-tax-avoidance-via-the-netherlands-idUSKCN1MJ1C3>

⁵ <https://www.budget.senate.gov/imo/media/doc/legalized-tax-fraud.pdf>

Furthermore, data from the Legislative Analyst's Office from 2001 shows that "chemical and allied products" was a top industry for receiving the Research and Development Credit, and that firms with over \$1 billion in revenue got about 63% of the value of the credits despite being only 7% of the number of recipients. This would suggest that the oil and gas industry has been a big recipient.⁶

We also suggest eliminating the following additional tax expenditures that currently benefit the oil and gas industry:

- Accelerated Depreciation of Research and Experimental Costs (\$90 million for all industries): Corporations are allowed the option to deduct research and experimental costs currently or amortized over a 60-month period.
- Combined Corporate and Personal Income tax: Percentage of Depletion of Mineral and Other Natural Resources (\$10 million)
- Combined Corporate and Personal Income tax: Intangible Drilling Cost Expensing (\$8 million)

Finally, we suggest restricting the following tax expenditure from benefitting the oil and gas industry:

- Sales tax: Exemption for Manufacturing and Research and Development Equipment (\$495 million for all industries)

Several states including Montana,⁷ New Hampshire⁸ and Minnesota⁹ have attempted to implement worldwide combined reporting on the issue of offshore tax havens and how to address them at the federal and state level. California can be the largest state to do so.

California should end subsidies for the fossil fuel industry that continues to profit at the expense of Californians. Ongoing savings associated with excluding the oil and gas industry from utilizing these tax expenditures (after calculating the benefit to Proposition 98) should be utilized to fund climate programs that would otherwise be cut or delayed in the 2024-2025 Budget. The statutory changes can be contained within a trailer bill to evaluate and effectuate these changes. Attached please find draft language that would eliminate the oil and gas industry's use of the Water's Edge tax credit.

We look forward to working with you to ensure we can enact policy changes that safeguard our communities from the impacts of climate change.

⁶https://lao.ca.gov/2003/randd_credit/113003_research_development.html

⁷[http://laws.leg.mt.gov/legprd/law0210W\\$BSIV.ActionQuery?P_BILL_DFT_NO5=LC0891&Z_ACTION=Find&P_Sess=20171](http://laws.leg.mt.gov/legprd/law0210W$BSIV.ActionQuery?P_BILL_DFT_NO5=LC0891&Z_ACTION=Find&P_Sess=20171)
https://itep.sfo2.digitaloceanspaces.com/A_Simple_Fix_for_a_17_Billion_Loophole_USPIRGEF_ITEP_AppendixC.pdf

⁸ <https://legiscan.com/NH/text/HB121/2023>

⁹<https://www.cbpp.org/blog/minnesota-bill-marks-major-step-forward-in-preventing-multinational-corporations-from-shifting>

Sincerely,

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cc: Senator Nancy Skinner, Senate Budget Committee, Chair
Incoming Senate President pro Tempore Mike McGuire
Assemblymember Jesse Gabriel, Assembly Budget Committee, Chair
Joe Stephanshaw, Department of Finance, Director

ADDENDUM

DRAFT AMENDMENTS to REV and TAX CODE

ARTICLE 1.5. Water's-Edge Election [25110 - 25116]

(Article 1.5 added by Stats. 1986, Ch. 660, Sec. 6.)

25110.

(a) *Any corporation or business primarily engaged in those lines of business described in Codes 211120 , inclusive, of the North American Industry Classification System (NAICS published by the U.S. Census Bureau 2022 edition) shall be excluded from the provisions of this chapter.*

~~(a)~~(b) Notwithstanding Section 25101, a qualified taxpayer, as defined in paragraph (2) of subdivision (b), that is subject to the tax imposed under this part, may elect to determine its income derived from or attributable to sources within this state pursuant to a water's-edge election in accordance with the provisions of this part, as modified by this article. A taxpayer, that makes a water's-edge election on or after January 1, 2006, shall take into account that portion of its own income and apportionment factors and the income and apportionment factors of its affiliated entities to the extent provided below:

(1) The entire income and apportionment factors of any of the following corporations:

(A) Domestic international sales corporations, as described in Sections 991 to 994, inclusive, of the Internal Revenue Code and foreign sales corporations as described in Sections 921 to 927, inclusive, of the Internal Revenue Code.

(B) Any corporation (other than a bank), regardless of the place where it is incorporated if the average of its property, payroll, and sales factors within the United States is 20 percent or more.

(C) Corporations that are incorporated in the United States, excluding corporations making an election pursuant to Sections 931 to 936, inclusive, of the Internal Revenue Code.

(D) Export trade corporations, as described in Sections 970 to 972, inclusive, of the Internal Revenue Code.

(2) (A) With respect to a corporation that is not described in subparagraphs (A), (B), (C), and (D) of paragraph (1), as provided in either one or both of the following clauses:

(i) The income and apportionment factors of that corporation to the extent of its income derived from or attributable to sources within the United States and its factors assignable to a location within the United States in accordance with paragraph (3) of subdivision (b). Income of that corporation derived from or attributable to sources within the United States as determined by federal income tax laws shall be limited to, and determined from, the books of account maintained by the corporation with respect to its activities conducted within the United States.

(ii) The income and apportionment factors of that corporation that is a "controlled foreign corporation," as defined in Section 957 of the Internal Revenue Code, to the extent determined by multiplying the income and apportionment factors of that corporation without application of this subparagraph by a fraction not to exceed one, the numerator of which is the "Subpart F income" of that

corporation for that taxable year and the denominator of which is the “earnings and profits” of that corporation for that taxable year.

(B) For purposes of this paragraph, both of the following apply:

(i) “Subpart F income” means “Subpart F income” as defined in Section 952 of the Internal Revenue Code.

(ii) “Earnings and profits” means “earnings and profits” as described in Section 964 of the Internal Revenue Code.

(3) The income and apportionment factors of the corporations described in this subdivision shall be taken into account only to the extent that they would have been taken into account had no election under this section been made.

(4) The Franchise Tax Board shall prescribe regulations to coordinate implementation of subparagraph (A) of paragraph (2) to prevent multiple inclusion or exclusion of income and factors in situations where the same item of income is described in both clauses.

~~(b)~~ For purposes of this article and Section 24411, all of the following definitions apply:

(1) An “affiliated corporation” means a corporation that is a member of a commonly controlled group as defined in Section 25105.

(2) A “qualified taxpayer” means a corporation that does both of the following:

(A) Files with the state tax return, on which the water’s-edge election is made, a consent to the taking of depositions, at the time and place most reasonably convenient to all parties, from key domestic corporate individuals and to the acceptance of subpoenas duces tecum requiring reasonable production of documents to the Franchise Tax Board, as provided in Section 19504, by the State Board of Equalization, as provided in Section 5005 of Title 18 of the California Code of Regulations, or by the courts of this state, as provided in Chapter 2 (commencing with Section 1985) of Title 3 of Part 4 of, and Chapter 9 (commencing with Section 2025.010) of Title 4 of Part 4 of, the Code of Civil Procedure. The consent relates to issues of jurisdiction and service and does not waive any defenses that a taxpayer may otherwise have. The consent shall remain in effect as long as the water’s-edge election is in effect, and shall be limited to providing that information necessary to review or adjust income or deductions in a manner authorized by Section 482, 861, Subpart F of Part III of Subchapter N, or similar provisions, of the Internal Revenue Code, together with the regulations adopted pursuant to those provisions, and for the conduct of an investigation with respect to any unitary business in which the taxpayer may be involved.

(B) Agrees that, for purposes of this article, dividends received by any corporation whose income and apportionment factors are taken into account pursuant to subdivision (a) from either of the following are functionally related dividends and shall be presumed to be business income:

(i) A corporation of which more than 50 percent of the voting stock is owned, directly or indirectly, by members of the unitary group and which is engaged in the same general line of business.

(ii) Any corporation that is either a significant source of supply for the unitary business or a significant purchaser of the output of the unitary business, or that sells a significant part of its output or obtains a significant part of its raw materials or input from the unitary business. "Significant," as used in this subparagraph, means an amount of 15 percent or more of either input or output.

All other dividends shall be classified as business or nonbusiness income without regard to this subparagraph.

(3) The definitions and locations of property, payroll, and sales shall be determined under the laws and regulations that set forth the apportionment formulas used by the individual states to assign net income subject to taxes on, or measured by, net income in that state. If a state does not impose a tax on, or measured by, net income or does not have laws or regulations with respect to the assignment of property, payroll, and sales, the laws and regulations provided in Article 2 (commencing with Section 25120) shall apply.

Sales shall be considered to be made to a state only if the corporation making the sale may otherwise be subject to a tax on, or measured by, net income under the Constitution or laws of the United States, and shall not include sales made to a corporation whose income and apportionment factors are taken into account pursuant to subdivision (a) in determining the amount of income of the taxpayer derived from or attributable to sources within this state.

(4) "The United States" means the 50 states of the United States and the District of Columbia

~~(e)~~ All references in this part to income determined pursuant to Section 25101 shall also mean income determined pursuant to this section.