the climate center

# Water's Edge Tax Haven and California's Budget Shortfall

## How Oil and Gas Majors Crafted a Tax Avoidance Policy Contributing to Ongoing Budget Woes

By The Climate Center

*Image Credit: Contains modified Copernicus Sentinel data 2020, Attribution, via Wikimedia Commons*

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# Endorsements

The Climate Center would like to thank the following organizations for endorsing this report's call to end fossil fuel subsidies like the Water's Edge tax loophole, which allows oil and gas corporations to dodge taxes while Californians shoulder the cost. Together, we stand for redirecting these resources toward clean energy, climate equity, and the needs of working families.

- 198 Methods
- 350 Bay Area Action
- 350 Humboldt
- 350 San Diego
- California Environmental Voters
- California Nurses for Environmental Health and Justice
- Center for Biological Diversity
- Climate Action California
- Climate Hawks Vote
- Climate Reality Project - Bay Area
- Climate Reality Project - CA State Coalition
- Climate Reality Project - Los Angeles
- Climate Reality Project - San Fernando Valley
- Coastal Lands Action Network
- Communities for a Better Environment
- Consumer Watchdog
- Defend Ballona Wetlands
- Elected Officials to Protect America
- Food & Water Watch
- Fossil Free California
- FracTracker Alliance
- GreenFaith
- Greenpeace USA
- Indivisible California Green Team
- Institute for Research on Labor and Employment, Climate and Society Center, UC Berkeley
- Oil and Gas Action Network
- Physicians for Social Responsibility – SF Bay Area
- Sacred Places Institute For Indigenous Peoples
- Sierra Club California
- Sunflower Alliance
- The Story of Stuff Project
- Third Act So Cal
- Voices for Progress
- Youth v. Oil – San Diego

# Introduction

California regularly faces a multibillion-dollar budget shortfall, with the legislature making cuts to vital climate and environmental initiatives, as well as other programs. A significant factor in the shortfall is a massive corporate tax avoidance policy known as the "Water's Edge election," which was pushed through largely by global oil and gas majors in the 1970s and 1980s. Getting rid of the Water's Edge election as applied to the oil and gas industry could yield over $100 million per year in new tax revenue and ensure continued funding for programs needed to equitably tackle the climate crisis.

"Water's Edge" enables multinational corporations to choose (or "elect") to avoid taxes from earnings they designate as beyond the "water's edge" of the borders of a state in which they operate. The taxation avoidance maneuver replaced "worldwide combined reporting," resulting in creative accounting and offshore tax havens that have cost California more than $4.3 billion in corporate tax revenue. Water's Edge is the state's largest source of tax avoidance by businesses, according to California Budget & Policy Center analysis.

The policy did not come about by happenstance. Instead, it is the product of years of litigation and lobbying by oil and gas majors like ExxonMobil, Chevron, and Shell Oil. Though those oil companies ended up winning the policy debate in the 1980s, documents obtained via archival resources described in this in-depth report show that a coalition of California watchdogs, unions, and government officials foresaw this moment of budgetary reckoning from the onset and, in some cases, directly called out the oil industry's role in fomenting it. For example, as Water's Edge came under discussion in 1978 within the California legislature, the State Controller called the proposal "a king-size loophole ... for the giant multinational corporations—specifically the big oil operators." Californians prevented implementation of Water's Edge for years in large part due to the constellation of forces who lined up in opposition against it, but its proponents finally succeeded in pushing it through in the state in 1986, as part of broader efforts to take the policy nationwide.

Decades later, with Water's Edge essentially subsidizing the oil and gas industry to the tune of what may be more than a hundred million dollars per year in California alone, demand is growing for legislative action to end these corporate polluters' ability to profit from the Water's Edge scheme.

California, which was at the cutting edge of both fending off and then adopting the Water's Edge policy from the beginning, now has an opportunity to build on recent tax reform momentum in other states and restore funds for vital social and environmental programs that have been on the budgetary chopping block. In short, by ending the oil and gas industry's access to the Water's Edge scheme, California can play a major leadership role in line with the state's broader status at the vanguard of climate policy.



As the California Budget & Policy Center put it in a 2023 analysis, "Increasing corporate tax revenues would provide more resources to support solutions to the most significant challenges facing Californians, such as unaffordable housing, child care, and health care costs." Subsidies for corporate polluters, such as oil and gas companies, have the added downside of fueling more pollution. The state's biggest polluters avoid paying taxes by hiding profits in offshore accounts via Water's Edge. It is time to end this tax break for oil and gas companies and use recouped funds to maintain investments in climate solutions and other programs in the public's interest.

# Executive Summary

***The Water's Edge tax policy enables multinational oil and gas corporations to avoid paying their fair share in taxes, and by contrast penalizes local businesses. It now deprives California of $4 billion in annual revenue across all industries, putting climate and social programs in peril.*** California's 2024 budget closed a $46 billion deficit with $16 billion in spending cuts, including $9 billion in cuts to climate and clean air programs. Closing the loophole as it applies to the oil and gas industry could put anywhere between $75 to $146 million per year back into the state's budget, according to analyses conducted by the California Franchise Tax Board and the Western States Petroleum Association.[1]

The California Budget & Policy Center pointed out, too, that the Water's Edge tax paradigm has put everyday social programs on thin ice. "As millions of people struggle with the high costs of living and recovery from the health and economic effects of the pandemic, corporate profits have surged to historic new highs in recent years," the group noted in a 2023 analysis. "However, corporations now pay just about half of what they did in the early 1980s in California taxes as a share of their income. ... Increasing corporate tax revenues would provide more resources to support solutions to the most significant challenges facing Californians, such as unaffordable housing, child care, and health care costs." Major climate and air pollution programs, too, could of course benefit from higher state tax revenues.

A 2020 analysis points out that, compared to tax benefits made available for those in the lowest income brackets, Water's Edge saves multinational corporations more money per year *combined* than the low- and middle-income tax deduction programs save lower income individuals.

1 This estimate on the higher end comes from taking statewide oil and gas economic output figures for 2017 tabulated in a study funded by the Western States Petroleum Association published by the Los Angeles County Economic Development Corporation's Institute for Applied Economics and using it as percentage of total state GDP for that year (economic outputs, when combined by sector, equal GDP). The study concluded that the California oil and gas industry was 3.4% of state GDP for 2017 and state tax data for the most recent 2024-2025 tax cycle has concluded that the Water's Edge tax will cost the state $3.3 billion during the 2025-2026 tax cycle and $3.5 billion for the 2026-2027 cycle, or $3.4 billion on average in the next two years. Thus, $3.4 billion was multiplied by .034 to reach the $115.6 million figure.

The lower end figure comes from an analysis conducted by the Legislative Services Bureau of the California Franchise Tax Board during the fourth quarter of 2024.


**ExxonMobil storage tank**

*Image Credit: JHVEPhoto - stock.adobe.com*

And Water's Edge is unfair to small and local businesses. Because local businesses do not have offshore accounts into which they can stash their profits, the Center on Budget and Policy Priorities has concluded that they bear a greater tax burden under the Water's Edge status quo than do multinationals. Water's Edge is the state's largest business source of tax avoidance, according to California Budget & Policy Center analysis.

***Historical documents show that oil majors spearheaded the creation of Water's Edge.*** Initially, in the 1970s and early 1980s, global oil and gas majors' attempts to pass Water's Edge policies in California failed year after year. Most state leaders and advocates saw proposals for what they were: massive giveaways to corporations at the expense of taxpayers and vital social programs. In 1983, the U.S. Supreme Court also upheld the state's authority to tax multinationals as single unitary companies. California's State Comptroller at the time hailed this anti-Water's Edge *Container Corp. v. Franchise Tax Board* decision as saving the state from "tumbling into bankruptcy." Container Corp., at the time, was a subsidiary of Mobil Oil — now folded into ExxonMobil.

However, the oil majors found a friendly audience with President Reagan's administration and an ally in U.S. Sen. Pete Wilson (R-CA), who would several years later become California Governor. Exxon leaders joined a 1984 working group overseen by the Reagan Treasury Department created to overturn the *Container Corp.* ruling via legislative means; this working group called for states to adopt Water's Edge paradigms. Shell funded multiple groups with the intent of undoing California's "unitary" tax law that had been upheld via *Container Corp.*, and with a goal of implementing Water's Edge instead. Exxon additionally funded a pro-Water's Edge interest group founded by the same firm still used by the oil industry in California today for lobbying and front group creation, Niesen Merksamer. Water's Edge legislation, SB 85, was eventually enacted in California in 1986. Water's Edge policies have passed in several other states, as well.

***From the start, prescient watchdogs and government leaders warned of the risks of Water's Edge.*** Throughout the late 1970s and into the 1980s, the California Tax Reform Association—a group funded by labor and public interest groups—cautioned against a Water's Edge regime, warning in 1978 that such a policy could create "wide-scale tax avoidance schemes which would be beyond the capacity of the state to control." In 1985, the California Department of Education further warned that passage of Water's Edge "will adversely affect ... critical needs facing education."

In 1979, Martin Huff—the executive officer of California tax-collection agency Franchise Tax Board—was essentially forced out by then Governor Jerry Brown due to Huff's outspoken opposition to Water's Edge, which Huff called "an outrageous swindle on every California taxpayer." In its 1986 analysis, the state's legislative services wing forecasted that the adoption of Water's Edge would lead to a major annual loss of General Fund revenue of up to $640 million by the 1988-1989 tax cycle ($1.6 billion today adjusted for inflation) due to reduced tax liabilities of corporations. The legislation was so controversial that California's then Governor, George Deukmejian, declined to sign it after passage, tacitly allowing it to become law in 1986 by simply refraining from a veto. He warned in a statement explaining why he did not sign it that its "cost will be borne to a significant extent by local business."

***Momentum is growing in multiple states to rein in corporations' ability to avoid taxes using Water's Edge, and California has the unique opportunity to achieve a win for both taxpayers and the climate by repealing Water's Edge as it applies to the oil and gas industry.*** Several states have recently made moves toward Water's Edge reform. Vermont's legislature has considered a Water's Edge repeal, and Minnesota's legislature has considered a bill that would authorize a study on the economic impact of moving away from Water's Edge. This year, too, New Mexico became the first state to start to peel back Water's Edge by passing tax reforms via HB 252. New Mexico's legislation is limited, though, and does not apply to U.S.-based corporations, such as Chevron and ExxonMobil. Interestingly, Alaska already has a law on the books prohibiting the oil industry's use of Water's Edge; the oil industry makes up about 75% of the state's revenues.

Recently, environmental, public interest, and tax justice groups have mobilized in California to oppose Water's Edge. We strongly recommend eliminating the Water's Edge election for oil and gas companies in California. By ending the industry's ability to utilize this tax loophole and by repealing other polluter giveaways, California legislators can help close the state's budget gap and maintain essential social and climate programs. It's time to begin to close the Pandora's Box that California opened in creating Water's Edge nearly four decades ago. The state has an opportunity to reaffirm its status as a climate leader by embracing the fight to end handouts to highly profitable fossil fuel corporations.

# Water's Edge Emerged Amid California Oil Industry Taxation Fight

The story of Water's Edge begins in the 1970s. Just a couple of years before the push for the policy began in California, it was preceded by a 1975 report published by the state's Republican attorney general, Evelle Younger, that argued for the elimination of three types of subsidies provided to oil and gas industry producers:

II. AN EXAMINATION OF STATE AND FEDERAL TAXATION POLICIES WHICH AFFECT THE PETROLEUM INDUSTRY

Recommendations:

1. Limit the foreign tax credit, so that American oil companies cannot write off royalties on foreign petroleum operations against their United States taxes.
2. Remove expensing of intangible drilling costs.
3. Abolish the percentage depletion allowance for oil.

*Image Credit: California Department of Justice, Office of the Attorney General*

According to the report, "The original intent of these tax subsidies was to establish a quid pro quo whereby the consumer got gasoline at a low price ... this is no longer the case. ...The consumer no longer buys gasoline at bargain prices. Inflation in fuel prices is running far ahead of cost of living inflation at the current time. ... Therefore, we take the stand that the tax subsidies no longer operate to keep down prices for the consumer. ... If a tax subsidy neither holds down prices nor increases exploration, it is not in the public's interest to maintain it."

Commenting on the report's findings, Younger stated that "a major bipartisan effort is necessary in order to revamp the taxation structure in the oil industry. For years, Congresses and national administrations of both parties have permitted these tax subsidies. They have cost the American taxpayers billions of dollars in lost revenue, while stifling competition in the oil industry."

Nearly 50 years later, however, those subsidies remain state law in California. Notably, two of the subsidies Younger recommended in the report for removal – expensing of intangible drilling costs and allowance of a percentage depletion for oil extraction – were eliminated in the finalized 2024-2025 state budget package. The state budget also eliminates the oil recovery costs credit, slated to return to the state an estimated total of $22 million in revenues.



These tax subsidies pale in comparison to the enormity of the Water's Edge policy enacted in 1986, however, allowing the oil industry and other sectors to evade billions in taxes. Water's Edge remains intact for the 2024-2025 budget cycle. The historical documents included in this report show how Water's Edge went from a series of widely opposed legislative proposals to California's law of the land, and that story starts with oil industry involvement.

During the period immediately following the Attorney General's report release, both a BP-owned oil refinery and a Long Beach oil terminal project that would have brought Alaskan oil to Texas via an Exxon pipeline were scuttled. Fossil fuel companies and other corporate interests pointed to the cancellation of these projects as evidence that California's tax system was too hard on multinationals.

Historical newspaper clippings show these companies had, in actuality, chosen to scratch the projects after failing to comply with the permitting process required by bread-and-butter environmental laws. The failure of these projects to get off the ground was not due to the state's tax policy, but that didn't prevent the industry from assigning blame. The projects' cancellation became political fodder used by oil and gas advocates to argue for undoing the state's "unitary" tax system and replacing it with a Water's Edge regime. As the name implies, unitary taxation treats companies as a single unit, taxing fairly based on the company's actual in-state taxable revenue as a percentage of its total global income. This is also known as Worldwide Combined Income Reporting.

Former California Democratic Lt. Gov. Mervyn Dymally proved among the most outspoken supporters of Water's Edge after the demise of the aforementioned oil projects. In 1977, he railed against the unitary tax system and also blamed it for the departure of the petrochemical company Dow Chemical from the state.

In the run-up to the 1978 election, Republican gubernatorial candidate and future Governor Pete Wilson also referenced Dow's departure in his push for a tax system more lenient for multinationals. Then Republican presidential candidate and former California Governor Ronald Reagan, too, mentioned this array of project cancellations when campaigning for President in 1979. That backdrop served as a pretext for a coming years-long legislative and lobbying push.

In 1978, despite counsel from the California Franchise Tax Board that it could cost the state more than $125 million per year in tax revenue (more than $598 million in today's economy), Governor Jerry Brown advocated for one of the state's first Water's Edge legislative proposals. Known as SB 1266, that bill was introduced in 1977 but failed to gain much momentum or attention at the time. In 1978, Brown pushed the related AB 2363, which would have repealed the state's unitary tax on multinational corporations as applied to foreign-based corporations.

While some oil companies would have benefited, some foreign-owned oil and energy companies, such as Shell Oil, would not have been eligible for Water's Edge under the legislation. Without full industry backing, the 1978 proposal also failed.

Also in 1978, Democrat Vic Fazio proposed AB 3415, the first piece of Water's Edge legislation that applied jointly to both domestic and foreign-based multinational corporations. Upon introducing it, Fazio called it "sound public policy" that "would signal to the business community that California has recognized the unfairness of its unitary tax policy as applied to multinational corporations." That bill, however, also failed to advance. With both bills dying, Brown said "These things take time."

The 1978 Water's Edge push likely faced its demise due in part to the fact that major corporations received a separate and significant win in California that year. The passage of ballot Proposition 13 amended the state constitution to severely limit the ability of the state to collect taxes on properties. After the measure's passage, Brown's spokeswoman said referring to Water's Edge, "Given the enormous favorable effect of Proposition 13 on the business community, it would seem that these matters are probably not of the highest priority at this point."

A couple of years later, during Brown's 1980 presidential bid, the California Legislature considered AB 525, a bill that would have applied Water's Edge to foreign-based corporations. AB 525 was eventually voted down at the 11th hour after a contentious debate over whether the Netherlands-based Shell Oil should uniquely receive a tax-free or low-tax experience in California.

That same year, Shell also testified before the Assembly Revenue and Taxation Committee against the unitary tax and de facto in favor of Water's Edge. The Council on State Taxation (COST) – which serves as an offshoot of the U.S. Chamber of Commerce that for decades has served as the center spoke of the business community's campaign for Water's Edge and against attempts to repeal it – also supported Water's Edge at that hearing, despite acknowledging it would cost states hundreds of millions of dollars annually. COST testified that much of this was attributed directly to losses from the oil industry, based on "a sample of audits of five oil companies and 12 other corporations for 1970 through 1975."

Today, ExxonMobil's Senior Tax Counsel John Paraskevas serves on COST's Board of Directors. Previous oil industry-affiliated Board of Directors members have included representatives from companies such as Chevron, Shell, Mobil Oil, Gulf Oil, BP, Texaco, Standard Oil, and Sun Oil. Both Chevron and ExxonMobil also self-disclose being dues-paying members of this influential lobbying group.



## Insiders, Outsiders Sound Alarm Regarding Water's Edge Fiscal Impact

Support for Water's Edge during this period was far from unanimous, even within Brown's own administration. Concerns raised prior to passage have increased resonance when viewed in light of the billions in dollars of climate and social programs that could go unfunded amid the state's budget shortfalls today.

Both the Franchise Tax Board and State Controller Ken Cory, each tasked with oversight of the state's tax system, opposed the tax loophole. Governor Brown also only supported Water's Edge upon reversing course on the issue amid pressure from major businesses. In a 1977 interview with The Sacramento Bee in which he announced his official opposition to the tax loophole, Cory cited concerns with "creative accounting" used by the oil industry that would only grow if the policy was put into play.

In announcing this opposition, Cory pointed to an example of how the oil industry was taking advantage of an accounting mechanism that resembles what is now legal today via the Water's Edge loophole. Cory noted one gas station had cited Saudi Arabian oil prices so high in its tax documents that on paper it appeared to have lost money and thus owed no income taxes. Richard Nevins, a former member of the California Board of Equalization, further reiterated in a 1988 interview that Chevron acted as the partnering company in the gasoline accounting arrangement with Saudi Aramco. The Franchise Tax Board later ruled that Chevron owed the state $4.9 million in taxes, but the company appealed and won.

In 1978, Cory also warned that implementing a Water's Edge policy could cause the creation of "a king-size loophole ... for the giant multinational corporations —- specifically the big oil operators who already are wringing us dry at the gas pump and want to escape paying a just share of taxes on their profits."

Public interest advocates, too, warned of the consequences of Water's Edge in a way that proved prescient. Throughout the late 1970s and into the 1980s, these watchdogs included the California Tax Reform Association, a group funded by labor and other groups to defend the unitary tax and push back against the prospect of Water's Edge. As early as 1978, a leader of the Association cautioned that legislation then on the table to create a Water's Edge tax regime could create "wide-scale tax avoidance schemes which would be beyond the capacity of the state to control."

The National Governors Association added its voice opposing Water's Edge in 1983, stating that such a policy would "deny the states the right to structure their tax systems within constitutional limits." The NGA added that "The states' right to fashion tax systems consistent with local needs is basic to the viability of our federal system."

Ultimately no legislation came to pass during Brown's first years of service as governor ending in 1982, despite yet another 1980 legislative attempt that was amended to favor Shell Oil. However, when Republican George Deukmejian took the Governor's seat thereafter, California once again found itself at the center of the tax debate pushed by oil multinationals.

In 1984, California attempted to pass a Water's Edge bill known as AB 2414, which failed amid concerns from stakeholders like the American Federation for Teachers about the impacts it could have on the state's budget. Tom Rankin, former Research Director of the California Labor Federation, told the *California AFL-CIO News* that if AB 2414 became law, it would put California in line with the "federal approach of decreasing corporate taxes and increasing the personal income tax burden." The outlet further reported that others shared Rankin's concerns stating, "It places a great risk on the state's economy and on California's schools and social services."

In a 1984 magazine published by the *California Regulatory Law Reporter*, a representative from the California Tax Reform Association warned that passage of AB 2414 "could cost the state $600 million in annual revenues." Adjusted for inflation, that amounts to $1.8 billion today. Another Tax Reform Association representative, Martin Huff – the former head of the Franchise Tax Board who was essentially forced out of his position by Jerry Brown and his allies due to his outspoken opposition to Water's Edge – called the policy akin to "attempted blackmail by the multinational corporations."

Page 10—S.F. EXAMINER Tues., Oct. 2, 1979

# Huff says he'll quit state tax job because of 'ruthless' Cory

By Nancy Day
Examiner Capitol Bureau

SACRAMENTO — Martin Huff says he plans to resign as executive officer of the state Franchise Tax Board because of what he called ruthless actions and assaults by Controller Ken Cory on the independence of the office Huff has held for 16 years.

Huff's comments came yesterday after Gov. Brown's office announced he had allowed to become law without his signature a bill that allows the Franchise Tax Board to fire its executive director without a difficult-to-obtain two-thirds vote of the state Senate. Previously the tax board, which administers the personal income and business and corporation taxes, had to have that Senate concurrence.

Cory, chairman of the three-member board, has been trying for years to get the authority for removing the director vested in the board instead of the Senate. In the closing hours of the 1979 legislative session — by amending a bill in conference committee — Cory got his wish.

Brown said the bill, [illegible], "moves in the direction of greater accountability. No high official should enjoy virtual lifetime tenure .... even though the present executive officer is doing a good job and has my full support."

Cory was not immediately available for comment. But Deputy Controller Walter Harvey said: "Everybody's trying to make this into a monster change. It's minor. And this isn't bulls---."

Harvey said Cory had no intention of trying to fire Huff, whose "honesty and integrity" have not been questioned.

John Jervis, Cory's press secretary, said the controller was disappointed about Huff's decision and hoped to persuade him to change his mind, although Jervis conceded the two did not talk very often.

At his press conference, Huff blasted Cory and Brown, noting that "one is running for governor, the other for president," and asked reporters to "draw your own conclusions" about the huge fund raising those quest-

MARTIN HUFF
He's lost his independence

ential.

"That special protection removed by the bill, which takes effect Jan. 1, has made my job infinitely easier," Huff said, "because it constrained those in power from asking for special favors and privileges that they knew would not be conferred."

"Without it," he said, "I predict that the administration of the income tax laws of this state will become highly politicized."

Huff, 56, said he had not yet decided on the timing of his departure from the $42,900-a-year post, although it will be "in the near future." He did not rule out running for public office, said he would work against Cory in his next electoral effort and might go to the people with an initiative to reform California's personal income tax laws.

"Since 19[illegible] I have become more and more disturbed at the increased complexity and obfuscation of the personal income tax law," Huff said. "The Legislature finds it difficult, if not impossible, to make hard decisions or to resist special interest lobbyists."

In addition to the furor over the substance of [illegible], critics were outraged that the measure did not go through the usual legislative process of hearings before various committees.

There was acrimonious debate on the floor of the Senate the last night of the session when Sen. Nicholas Petris, D-Oakland, an old friend of Huff's, brought the implications of the bill to the attention of his colleagues. But intensive lobbying by former legislator Cory and resentment of legislators over Huff's inquiries about taxing their daily expense money led to a favorable vote.

One issue over which Brown and Huff are at philosophical odds is the unitary method of computing taxes on multinational corporations. The state figures out the proportion of business conducted in California and taxes net corporate income by that fraction, bringing in about $800 million a year to the state treasury. Brown had favored the unitary concept earlier in his career, but in seeking to attract more business to the state has reversed his position.

Cory earlier favored the tax, too, and spokesmen said he still does, but last week he joined state Finance Director Mary Ann Graves, in a 2-1 Franchise Tax Board vote against staff recommendations. The two voted that Jacobs Co., which manufacturers chucks for electric drills, could be considered a separate company from its owner, Chicago Pneumatic, a decision lopping $12,300 from the company's $100,000 yearly tax bill. The third member, state Equalization Board Chairman William Bennett, strongly opposed the majority vote, siding with the staff and Huff that the unitary principle should be applied.

Huff said yesterday the Chicago Pneumatic case had been overblown, but added it sets a bad precedent.

"Multinationals are more powerful than most governments," Huff said. "They even have a ring in the nose of the federal government .... The fact we've developed a method of substance to get at them drives the multinationals up the wall."

Bennett called [illegible] "part of the Brown administration's scheme to eliminate the unitary tax." He said the two-third vote provision for removing the board's executive officer established under Gov. Earl Warren has worked well through subsequent administrations because the system has been free from influence and control.

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*Image Credit: The San Francisco Examiner via Newspapers.com*

The Franchise Tax Board in the post-Huff days itself said much the same thing, noting in a 1984 legislative analysis that "Corporate taxpayers could, under the bill, manipulate tax results both through transfer prices and through changes in formal corporate structure."

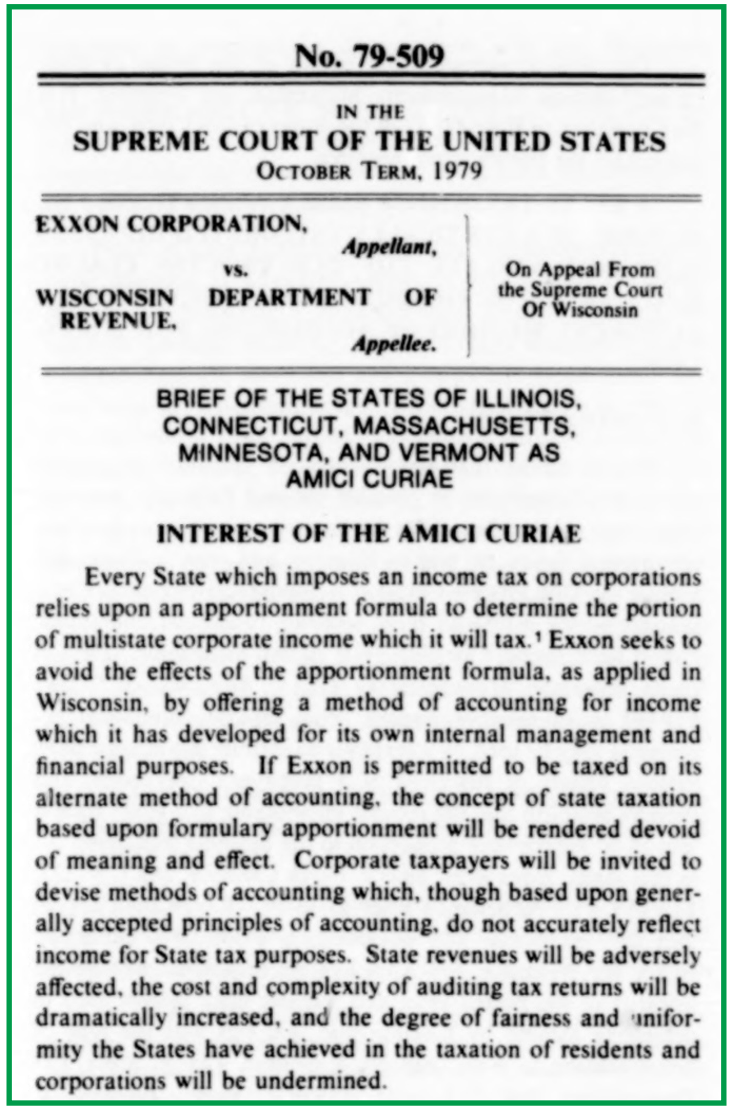
In 1985, the Board of Equalization member William Bennett added at a public forum that the state's taxpayers should "not mislead ourselves that this is anything but a giveaway." He further conveyed that the legislation under consideration "has almost an obscenity to it. ... Can California afford to give up $500 to $600 million a year? No, I don't think so. And once you give it away, you will never get it back."

Beyond public officials, unions, and public interest representatives, editorial boards of some of the state's largest newspapers came out against Water's Edge's legislation, too.

## Oil Majors Take to the Courts

Failing in the legislative realm, the oil industry next took its pressure tactics to the courts, leading to U.S. Supreme Court cases involving both Exxon and Mobil. Indeed, three different legal precedent-setting attempts to overturn unitary tax systems arose.

In 1980, Mobil lost a U.S. Supreme Court case against Vermont's taxation agency and its ability to impose a unitary tax. A few months later, the high court heard an Exxon case in which the oil company attempted implementation of a Water's Edge loophole in Wisconsin state policy. In a February 1980 amicus brief for that case, five state Attorneys General warned against the implications if the Court were to rule on behalf of Exxon based on the impacts it could have on state revenues. The Attorneys General wrote that if Exxon prevails in the case, "Corporate taxpayers will be invited to devise methods of accounting which ... do not accurately reflect income for State tax purposes."



No. 79-509

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1979

EXXON CORPORATION, *Appellant,*
vs.
WISCONSIN DEPARTMENT OF REVENUE, *Appellee.*

On Appeal From the Supreme Court Of Wisconsin

BRIEF OF THE STATES OF ILLINOIS, CONNECTICUT, MASSACHUSETTS, MINNESOTA, AND VERMONT AS AMICI CURIAE

INTEREST OF THE AMICI CURIAE

Every State which imposes an income tax on corporations relies upon an apportionment formula to determine the portion of multistate corporate income which it will tax.[1] Exxon seeks to avoid the effects of the apportionment formula, as applied in Wisconsin, by offering a method of accounting for income which it has developed for its own internal management and financial purposes. If Exxon is permitted to be taxed on its alternate method of accounting, the concept of state taxation based upon formulary apportionment will be rendered devoid of meaning and effect. Corporate taxpayers will be invited to devise methods of accounting which, though based upon generally accepted principles of accounting, do not accurately reflect income for State tax purposes. State revenues will be adversely affected, the cost and complexity of auditing tax returns will be dramatically increased, and the degree of fairness and uniformity the States have achieved in the taxation of residents and corporations will be undermined.

*Image Credit: U.S. Supreme Court*

They continued, “State revenues will be adversely affected, the cost and complexity of auditing tax returns will be dramatically increased, and the degree of fairness and uniformity the States have achieved in the taxation of residents and corporations will be undermined.”

*The New York Times* had reported several months earlier in September 1979 that Exxon had set up a global tax avoidance apparatus in which it had “systematically passed along artificially inflated price increases to customers in Canada and elsewhere.” The company, *The Times* further reported, “occasionally backdated agreements in order to pass along more costs, disguised increases in company profit margins and knowingly gave out inaccurate information to customers, [all] resulting in higher prices.” Exxon created offshore shell corporations to “launder” its profits “to avoid millions of dollars in taxes,” according to *The Times*. Bermuda was listed as one of the offshore tax havens Exxon utilized.

Exxon ultimately lost its U.S. Supreme Court case, too. A 1980 academic paper explained the impact of the *Exxon* and *Mobil* cases this way: “The Supreme Court emphatically reaffirmed the states’ broad power to tax multistate and multinational business.”

However, the oil industry was not deterred by its setback and continued to work the courts. In 1983, the Mobil subsidiary Container Corporation of America (Container Corp.) also lost in a landmark U.S. Supreme Court case against the California Franchise Tax Board, resulting in the legal precedent indicating that states have ultimate jurisdiction to set state tax policy. Documents show that California prevailed in the case by fending off briefs from the likes of oil companies such as Shell Oil, Gulf Oil (today Chevron) and Phillips Petroleum (today Phillips 66). Gulf Oil, in its amicus filing, explicitly made the case for an alternative Water’s Edge tax policy that would dismantle the unitary tax system.

Though not itself a plaintiff in the *Container Corp.* case, Exxon also played a key role as the first out of the gate to slam the ruling to the media, calling for “the need for federal legislation to prevent taxation by states.” Exxon issued that call to action even as California’s fiscal leaders responded that the Court’s decision saved the state from “tumbling into bankruptcy” or forcing it “to increase taxation of our own California-based small businesses and farmers.”

A few months after the *Container Corp.* decision, Shell Vice President of Governmental Relations Jess Johnson wrote to the Reagan White House calling for a Water’s Edge policy program in lieu of the unitary system. Johnson claimed “the unitary system is impossible to administer with accuracy.” Shell’s efforts extended beyond government affairs and into the courts. At the end of 1983, leading to yet another industry loss, the U.S. Supreme Court denied a Shell appeal of the state’s unitary tax law. Shell wasn’t deterred, however, admitting in 1985 that it chose not to pay state taxes in California as a means of protesting the unitary tax law on the books.

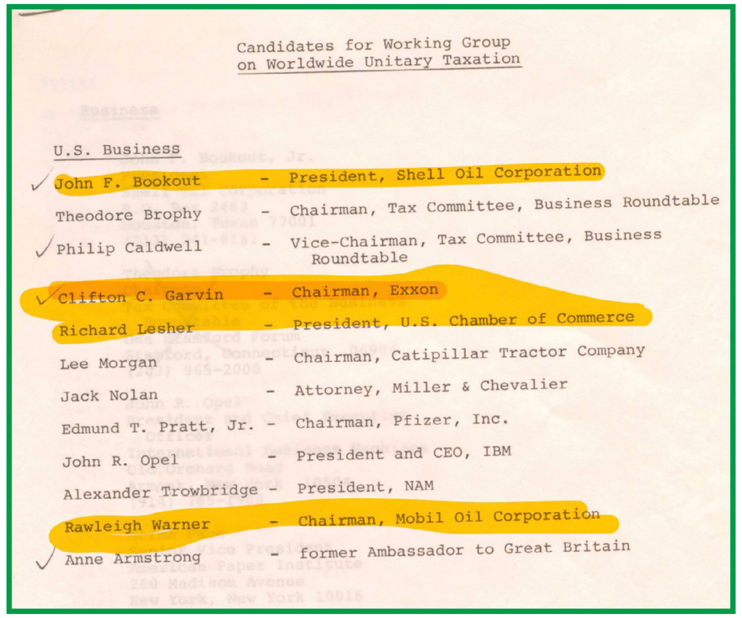


# Industry Finds an Ally in President Reagan’s Administration

*The Container Corp.* ruling and the failure of the Supreme Court to take Shell’s case appeared to be yet another triumph for public interest advocates – but it would end up serving as the beginning of the end of the unitary tax in California and beyond. The day after the late 1983 ruling, a new working group overseen by the Reagan Administration grappled with what to do about the unitary tax system at its first meeting.

Maintained under the auspices of the Reagan Administration Department of Treasury, the consortium calling itself the Worldwide Unitary Taxation Working Group included state officials and corporate leaders aiming to advance policy beneficial to multinational business interests and consistent with Water’s Edge proposals. In its own words, the Worldwide Unitary Taxation Working Group hoped to achieve results “conducive to harmonious international economic relations, while also respecting the fiscal rights and privileges of the individual states.”

Exxon was granted two different seats within the Working Group, while a Shell representative was also considered for a seat. Exxon and the Working Group stated their intentions not to pass a federal law to force states’ hands, which would run afoul of Reagan’s “new federalism” and states’ rights pledge. Instead, they vowed to come up with a legislative solution states would adopt themselves. The Reagan Administration itself from the start realized that pushing a federal version of Water’s Edge could come across as hypocritical, given its own posture on states’ rights, pointing to a “tradeoff between competing values and objectives” in a 1982 memorandum.



Candidates for Working Group
on Worldwide Unitary Taxation

U.S. Business

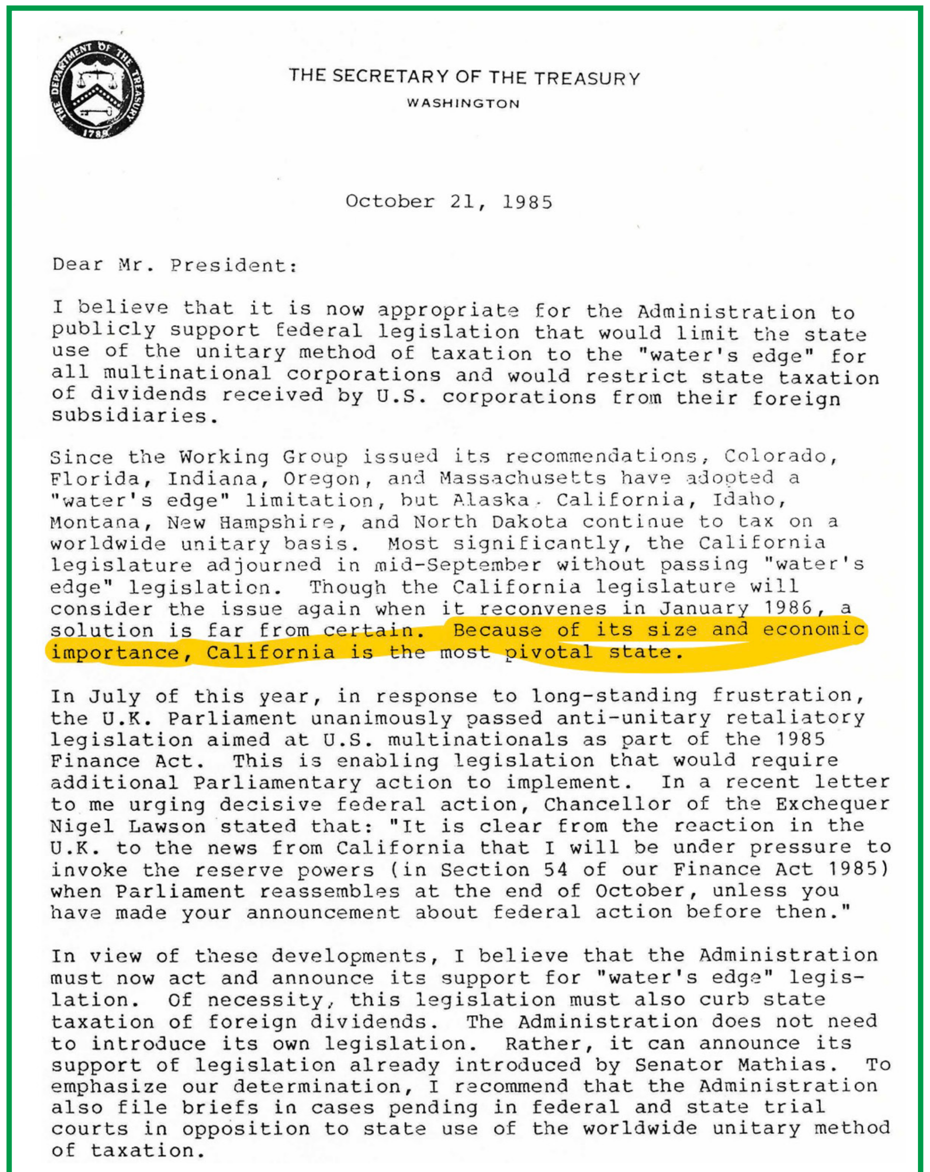
John F. Bookout - President, Shell Oil Corporation
Theodore Brophy - Chairman, Tax Committee, Business Roundtable
Philip Caldwell - Vice-Chairman, Tax Committee, Business Roundtable
Clifton C. Garvin - Chairman, Exxon
Richard Lesher - President, U.S. Chamber of Commerce
Lee Morgan - Chairman, Catipillar Tractor Company
Jack Nolan - Attorney, Miller & Chevalier
Edmund T. Pratt, Jr. - Chairman, Pfizer, Inc.
John R. Opel - President and CEO, IBM
Alexander Trowbridge - President, NAM
Rawleigh Warner - Chairman, Mobil Oil Corporation
Anne Armstrong - former Ambassador to Great Britain

***Image Credit:** Ronald Reagan Presidential Library*

“On the one hand, the administration is committed to a federal system in which states exercise sovereign fiscal powers within their own borders,” wrote John Chapoton, then the Assistant Secretary for Tax Policy for the U.S. Department of Treasury. “On the other hand, the administration has also frequently enunciated a commitment to a free and open world economy. It has argued for reducing barriers to international trade and capital flows.” In another memorandum, Chapoton dubbed the situation “a classic ‘no win’” for Reagan with “no way to satisfy all parties” because the “Administration will be vocally criticized for whatever decision it makes.

Reagan himself also previously opposed a Water's Edge approach while Governor of California, stating in a 1973 letter, "One of the great strengths of the Federal-state system is the freedom of the states to act to meet their own particular needs. Interference by the Federal Government with the states' power to tax would be a major blow to such freedom."

There were additional concerns raised in August 1984, just a year after the *Container Corp.* ruling, by 15 different western Governors stating that undoing the unitary tax policy in states would undo "a state's right to impose a unitary tax." Ultimately, the Working Group officially recommended that states pass Water's Edge tax policy-enabling legislation. After making that explicit endorsement within the Working Group, the Reagan Administration's nuanced public-facing take on Water's Edge policy also ended as California failed to pass a bill during the 1985 legislative session. Viewing California as a key bellwether state in which to adopt Water's Edge, the Administration's support for state action grew increasingly explicit.



THE SECRETARY OF THE TREASURY
WASHINGTON

October 21, 1985

Dear Mr. President:

I believe that it is now appropriate for the Administration to publicly support federal legislation that would limit the state use of the unitary method of taxation to the "water's edge" for all multinational corporations and would restrict state taxation of dividends received by U.S. corporations from their foreign subsidiaries.

Since the Working Group issued its recommendations, Colorado, Florida, Indiana, Oregon, and Massachusetts have adopted a "water's edge" limitation, but Alaska. California, Idaho, Montana, New Hampshire, and North Dakota continue to tax on a worldwide unitary basis. Most significantly, the California legislature adjourned in mid-September without passing "water's edge" legislation. Though the California legislature will consider the issue again when it reconvenes in January 1986, a solution is far from certain. Because of its size and economic importance, California is the most pivotal state.

In July of this year, in response to long-standing frustration, the U.K. Parliament unanimously passed anti-unitary retaliatory legislation aimed at U.S. multinationals as part of the 1985 Finance Act. This is enabling legislation that would require additional Parliamentary action to implement. In a recent letter to me urging decisive federal action, Chancellor of the Exchequer Nigel Lawson stated that: "It is clear from the reaction in the U.K. to the news from California that I will be under pressure to invoke the reserve powers (in Section 54 of our Finance Act 1985) when Parliament reassembles at the end of October, unless you have made your announcement about federal action before then."

In view of these developments, I believe that the Administration must now act and announce its support for "water's edge" legislation. Of necessity, this legislation must also curb state taxation of foreign dividends. The Administration does not need to introduce its own legislation. Rather, it can announce its support of legislation already introduced by Senator Mathias. To emphasize our determination, I recommend that the Administration also file briefs in cases pending in federal and state trial courts in opposition to state use of the worldwide unitary method of taxation.

*Image Credit: Ronald Reagan Presidential Library*

After the 1985 California legislative session completed, Treasury Secretary James Baker — who had previously served as President Reagan's Chief of Staff — wrote a letter in late October calling for the Reagan Administration to take strong federal action to nix California's unitary tax system. The White House-led congressional legislative push may not happen, wrote Baker — but even the threat of it "would provide California with additional incentive to adopt suitable 'Water's Edge' legislation to avoid federally-imposed restrictions." Baker had assumed the role of Treasury Secretary in a swap with the previous U.S. Secretary of Treasury Donald Regan, who then became White House Chief of Staff. Donald Regan also served as the head of the Worldwide Unitary Taxation Working Group.



**President Ronald Reagan with James Baker (l) and Donald Regan (r)**

*Image Credit: National Archives; Reagan White House Photographs, 1/20/1981 - 1/20/1989*

Just weeks later, President Ronald Reagan issued a statement supporting repeal of the unitary tax nationwide, creating a new opening for Water's Edge. Congress never passed such federal legislation, but it would become a moot point when California and other states passed their own Water's Edge laws. One prominent critic — Kent Conrad, then head of the Multistate Tax Commission and later a Democratic U.S. Senator representing North Dakota — noted the irony in Reagan's change in policy positioning. Conrad told *The Wall Street Journal*, "Apparently the president's 'new federalism' is just rhetoric" and "they've gone back on everything they told us."

Just a month after President Reagan's statement, U.S. Senator Pete Wilson — who would later become California's Republican Governor — introduced federal legislation known as the Unitary Tax Repealer Act (S.1974). "It is my sincere hope that California and the other six states with unitary taxes will take remedial action without federal mandate," Wilson emphasized in a press release announcing the legislation's introduction. "But they are now on notice that a law to repeal the unitary tax [and pursue Water's Edge] has left the station, and, one way or another, the problem will be solved by the end of 1986."

The Reagan Treasury Department, meanwhile, used the existence of Wilson legislation to lobby California's Republican Party Chairman Bob Naylor for passage of a Water's Edge law. "The bill was drafted by the Treasury Department at the express direction of the President," a letter written to Naylor by the Reagan Treasury Department noted.

In another letter written just days later by Assistant Secretary of the Treasury for Tax Policy J. Roger Mentz to Assembly Republican Leader Pat Nolan, Mentz further alluded to the role the Wilson bill could play in forcing California's hand on Water's Edge. "[T]he fact that California continues to tax on a worldwide unitary basis presents serious problems to the Administration," wrote Mentz. "We hope that California, like other States, will be able to resolve this difficult problem by enacting legislation that is consistent with [S.1974]."

In light of this pressure from the Reagan Administration and Wilson, several states took action. In 1984, Oregon adopted a Water's Edge policy followed in 1985 by similar enactments in Colorado, Arizona, Idaho, Indiana, Montana, New Hampshire, North Dakota, and Utah. Minnesota would subsequently adopt a Water's Edge law in 1987.

## Oil Industry and Others' Lobbying Pushes Water's Edge Over the Line in California

Finally, about a decade after the oil industry's full court lobbying and legal push began in an effort to overhaul California's unitary tax, multinational corporations succeeded in their quest in 1986. News coverage at the time and scholarship produced since attributed the bill getting over the hill to two main factors: lobbying by Japanese technology interests, such as Sony Corporation and Fujitsu Limited, as well as pressure from the oil and gas interests that had been vocal on Water's Edge from the start.

A 1988 book titled Buying Into America: How Foreign Money Is Changing the Face of Our Nation, by the late former *New York Times* reporter and *Politico* and *The Hill* co-founder Martin Tolchin, notes that Fujitsu said it would not build disk drive plants in California unless Water's Edge became state law. When Oregon passed Water's Edge in 1985, the book notes, the company held a press conference to announce two plants would be located there "despite the fact that four of its subsidiaries were already located in California." The book went on to say that this "decision shattered Californians," and that other companies followed similar paths as Fujitsu by investing in Oregon and Washington (which also had a Water's Edge law on the books) instead of California.

"Aligned against [multinational corporate interests], the tax experts from the state's Franchise Tax Board and their allies faded into political insignificance," Tolchin explains. "Years from now, when analysts assess the impact of unitary repeal, they might look back and wonder how and why [California] gave away so much for so little." Buying Into America and *The New York Times* article upon which the book chapter touching upon Water's Edge is based also note that campaign contributions likely played a major role in getting the bill across the finish line, with 53 different legislators receiving contributions from Japanese companies.

For the oil industry's part, its massive lobbying effort continued in close coordination with California Governor George Deukmejian. Though the industry's legislative efforts in California had failed in 1984 and 1985, help from the Reagan White House boosted the push in 1986.

Shell, beyond its own lobbying efforts at the time, had funded a group called the California Unitary Coalition led by Governor Brown's former finance director Richard Silberman. Shell also helped fund a group called the Organization for Fair Taxation of International Investments. Exxon, for its part, had funded another group favoring Water's Edge known as the California Business Council. That group, incorporated in 1984 by legal and lobbying firm Nielsen Merksamer, serves today as an important legal and administrative hub for influence efforts by Chevron, the Western States Petroleum Association, and their myriad front groups. According to an archived list, the group's fossil fuel industry members in 1984 included Dow Chemical, Exxon, Mobil, Phillips Petroleum (today Phillips 66), Shell, Sun Oil Company (today Sunoco), and Texaco.

Revell Communications handled public relations efforts for the California Business Council, according to a report obtained from the UCLA Library Special Collections archives titled "Unitary Tax Primer," which was published in February 1985. The report made the case for a Water's Edge policy, pointing to the conclusions made by the Reagan Administration Working Group. In another tie to Reagan, Revell Communications is the namesake of Dennis C. Revell – President Reagan's son-in-law. Revell had made headlines when he had reportedly traded access to tickets to the 1984 presidential Inaugural Address to his clients in exchange for billable hours. Revell opened up his firm in 1984 just two months before the Worldwide Unitary Taxation Working Group's August release of its final report.

The proponents of Water's Edge, like the oil and gas industry, "hammered away at the issue for so long that eventually [their narrative] was accepted almost universally" as "the only version of the truth," the book Buying Into America concluded. Assemblyman Tom Hayden – then married to actress and well known climate activist Jane Fonda – put it more bluntly, bemoaning that California had "mentally been colonized." Finally succumbing to this combination of factors, in 1986 the California Legislature passed SB 85, and Water's Edge became California law.

**Dennis Revell on the far left with President Reagan fourth from righ**

*Image Credit : Remembering Reagan by Peter Hannaford (1994) via The Internet Archive*

# Immediate Reactions to Passage

Before the Water's Edge bill became law in 1986, the Franchise Tax Board called on Governor Deukmejian to veto the bill in legislative analysis, writing: "This bill will alter a method of corporate income apportionment which has been used by California for 50 years, which is fair, easily administrable and which has been approved by the State and Federal Supreme Courts."

Perhaps emblematic of just how controversial Water's Edge was at the time, Deukmejian himself did not even sign the bill, instead simply leaving it unsigned for passage while not overtly vetoing it either. He wrote in a letter to legislators that the bill, as it stood, would create a "cost [that] will be borne to a significant extent by local business." Deukmejian added that "I am also concerned that the election fee reduction provisions benefit corporations new to California disproportionately over those corporations which have already made substantial investments in this state.

VETO MESSAGE

I am returning SB 85 unsigned.

Although I have supported amendment of the worldwide combination method of apportioning the income of a unitary business, the provisions of this bill do not address the concerns I have expressed as to the appropriateness of coupling revision of the worldwide unitary method with unrelated federal provisions currently being considered as part of the federal tax reform package and this cost will be borne to a significant extent by local business. I am also concerned that the election fee reduction provisions benefit corporations new to California disproportionately over those corporations which have already made substantial investments in this state.

*Image Credit: California State Archives*

But the Governor was sending mixed messages: he contrastingly stated in a press release after the Legislature sent the bill to his desk that its passage "will send a clear signal to all that California intends to continue to be the job-creating capital of the world."

SB 85 passed despite opposition from public school employee unions, SEIU, the public employees union, religious leaders, the Department of Education, and the Association Of California School Administrators. The Department of Education had warned in a 1985 letter that passage of Water's Edge "will adversely affect the momentum for educational reform and our efforts to address the critical needs facing education, i.e., an increasing student population, teacher shortages, class-size, and a projected need for school construction." Assemblyman Tom Hayden called the tax shelter passage a form of "voodoo economics" and "snake oil."



Further, legislative analysis published on SB 85 concluded, "There would be a major annual loss of General Fund revenue due to reduced tax liabilities of corporations which make the water's edge election," pointing to losses of up to $640 million (an inflation-adjusted $1.6 billion today) by the 1988-1989 tax cycle, "and increasing amounts thereafter."

The global oil majors, for their part, continued to beat the drum in support of Water's Edge even after it became California law. At a September 1986 hearing, a senior Exxon official testified in favor of creating a national Water's edge law, signifying it was not satisfied with a bounty of states changing their policies alone.

"[W]e feel compelled to turn again to Congress and urge that you favorably consider federal legislation which permits each state to tax income reasonably attributable to operations within its borders but prohibits taxation of income generated elsewhere," Exxon's testimony reads. "We continue to believe that the best approach is simply to exclude all income from sources outside the United States."

To date, Exxon and its corporate allies in favor of federal Water's Edge legislation have not been successful in that endeavor.

# Water's Edge Reform Today

Though Water's Edge laws remain on the books in California and several other states nearly 40 years later, reform efforts to amend or repeal Water's edge have grown.

New Mexico passed Water's Edge tax reforms within HB 252 during the 2024 legislative session, becoming the first state to peel back part of its Water's Edge policy. Section 37 of HB 252, signed into law by Governor Michelle Lujan Grisham in March 2024, enables New Mexico to end the Water's Edge tax loophole as applied to "corporations organized or incorporated outside the United States or its possessions or territories that have less than twenty percent of their property, payroll and sales sourced to locations within the United States." It passed despite opposition from COST, the industry group whose membership base includes ExxonMobil and Chevron.

However, HB 252 does not apply to U.S.-based corporations, such as Chevron or ExxonMobil that may have larger percentages of operations outside the U.S., but maintain their headquarters within the U.S. A fiscal impact report published by the New Mexico Legislative Finance Committee concludes that this tax amendment will allow the state to reclaim a mere $1 million per year in revenue for the General Fund between 2026 and 2028 by only taxing non-U.S. based companies.

In 2024, Vermont considered a Water's Edge repeal too, an effort that also came under heavy opposition by COST. Last year, Minnesota also considered legislation to authorize the state to do a study on the economic impact of moving away from a Water's Edge tax regime. Tennessee, for its part,

[considered](#) getting rid of Water's Edge during the 2024 legislative session. None of those bills passed in 2024, but they signal a growing nationwide clamoring to halt tax giveaways to large corporations.

In recent years there were additional attempts to repeal or amend Water's Edge policies in New Hampshire in 2023, as well in Montana in 2019 and Florida in 2022. However, COST opposition in those states, too, appears to have proven instrumental in ensuring that these attempts failed.

The major oil-producing state of Alaska, by contrast, already has a law on the books prohibiting the oil industry's use of Water's Edge. The oil and gas industry makes up about 75% of the state's tax income collections, and a November 2023 report by the Institute on Taxation and Economic Policy has concluded that Alaska Department of Revenue data shows that in 2023, "every dollar of corporate income tax revenue paid by this sector came from companies with at least one foreign subsidiary," meaning having Water's Edge in effect would have cost the state millions in budgetary revenues.

For its part, California has taken steps in recent months that could lead to unwinding Water's Edge, showing an already existing appetite and momentum to build upon.

In 2024, the legislature passed SB 167, which chips away at blanket use of the Water's Edge election by prohibiting companies from removing dividend income generated via foreign subsidiaries as an accounting line under their state taxes owed under Water's Edge. The California Taxpayers Association – with a board that includes representatives from oil companies such as Chevron, Aera Energy, Marathon Petroleum, and Koch Industries – has filed a state lawsuit challenging SB 167's constitutionality, and that case remains open.

Tax reform groups, both in California and nationally, have in recent years begun calling for the elimination of the Water's Edge election, as well.



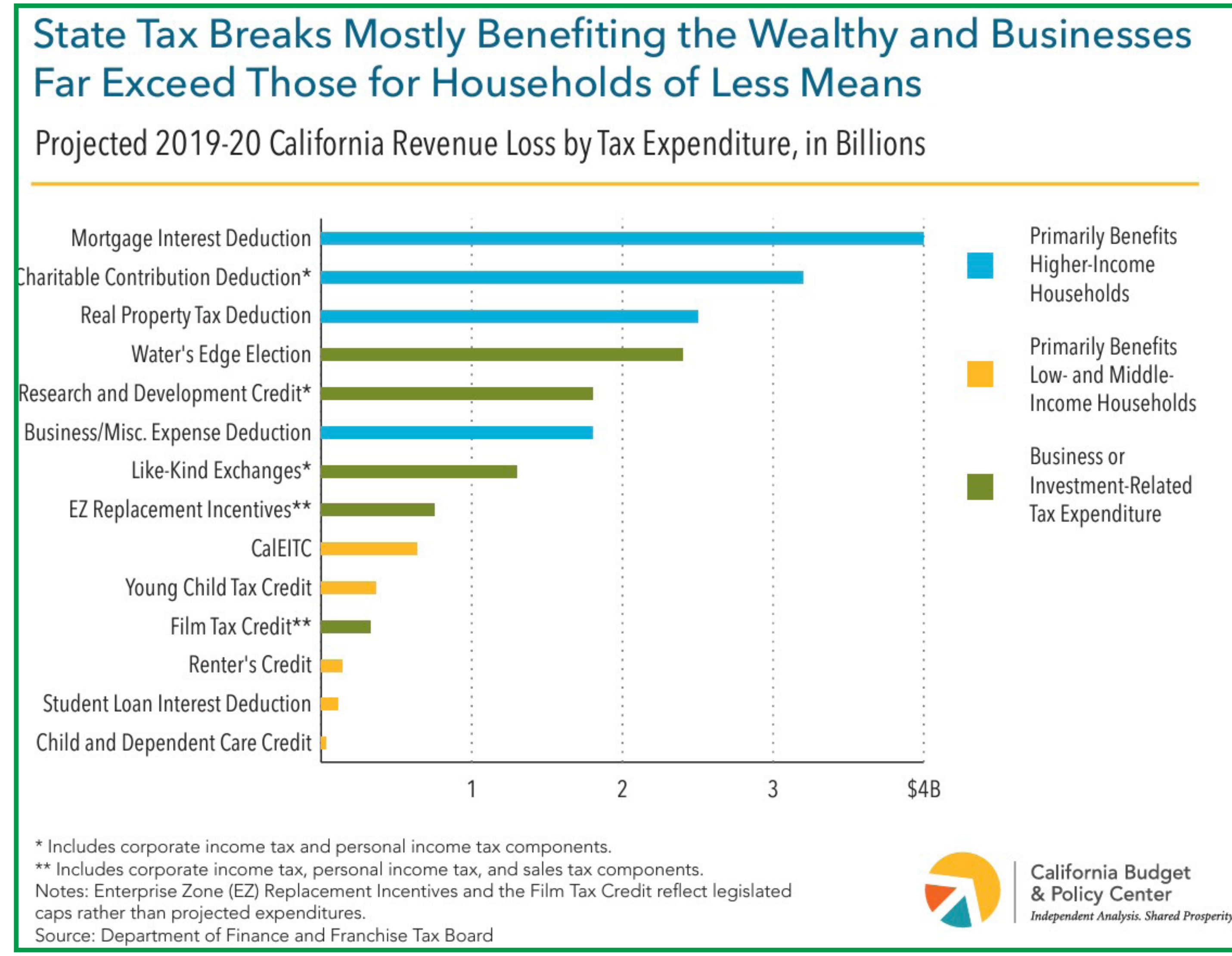



***Image Credit:*** *California Budget & Policy Center*

One such call to action came within a 2020 analysis published by the California Budget & Policy Center, which points out that Water's Edge saves multinational corporations more money per year than is spent on all tax deductions accessible to lower-income individuals combined.The national tax justice advocacy group Center for Budget and Policy Priorities has called on states nationwide to nullify Water's Edge because it would "remove an unfair advantage of multinational corporations, which have the resources and ability to set up operations in foreign tax havens..." The Institute on Taxation and Economic Policy (ITEP) concluded in a 2019 report that, by setting the Water's Edge tax policy aside, states across the country could recoup over $17 billion in tax revenues.

"Every person and every corporation in America benefits from government services—from schools to paved roads to courts and public health," ITEP wrote. "When it comes to paying the tab, we need to make sure the rules are applied evenly and fairly, but even though all of America's corporations use government services, some avoid paying taxes for them by moving their profits into offshore havens—a scheme that is not available to smaller competitors."

# Conclusion

Multinational corporations, including but not limited to those in the oil and gas industry, are avoiding massive tax payments, depriving states like California of huge amounts of revenue that could be used for schools, public works, climate programs, and other investments in the public interest. Ending the Water's Edge regime as it applies to California's oil and gas industry could potentially put approximately $146 million per year back into the state's budget

This ability to offshore profits and avoid taxes is no small matter. A 2015 U.S. Senate special investigation found that Chevron reported $31 billion in profits – untaxed – through subsidiaries in 13 different tax haven countries. In 2018 and 2019 Shell earned more than $3 billion and escaped tax obligations by reporting profits as being from Shell affiliate companies located abroad in Bermuda and the Bahamas. Also in 2018, international unions filed a complaint to the Organisation for Economic Co-operation and Development alleging that Chevron funneled billions to tax haven countries through Dutch subsidiaries.

A June 2024 report by the Center on Budget and Policy Priorities further concluded that 76 Fortune 100 companies "have at least one subsidiary in one or more of nine major foreign tax havens," according to a review of their most recent U.S. Securities and Exchange Commission (SEC) filings. That includes four for Chevron, five for Phillips 66, one for Marathon Petroleum, nine for Valero Energy, 18 for ConocoPhillips, and eight for ExxonMobil – all companies with oil and gas drilling, refining, and/or gas station operations in California. Further, CBPP pointed out that this is likely an undercount, citing a 2020 business paper published in the *Journal of Accounting Research* comparing subsidiaries in SEC filings to confidential IRS filings, which "found that while most companies complied with the SEC rules, underreporting was more likely when the subsidiaries were located in tax havens, particularly when the companies were covered extensively in the media."

It is time for California to eliminate this tax avoidance system as it applies to the oil and gas industry. This mode of tax venue shopping runs in conflict with California's climate and environmental justice goals. It makes no sense to subsidize pollution at the expense of the health and well-being of our communities.

Inspired by a growing number of other states working to end giveaways to oil and gas corporations as well as those working to repeal or amend their Water's Edge policies, advocates in California must take a leadership role in forging a future free of costly tax avoidance schemes that enrich corporate polluters. Such schemes are incongruous with balanced state budgets and unfair to state residents.

We strongly recommend eliminating the Water's Edge election for oil and gas companies in California. It is time to put hard-working families ahead of oil and gas company profits by ensuring the deficit is not balanced on their backs. California played a bellwether role in first considering, then staving off, and ultimately becoming a Water's Edge adopter. Some 40 years later, the state has lost billions of dollars in tax revenue. It's time to reverse course.



# Further Reading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Davis, Carl; Gardner, Matthew; "Far From Radical: State Corporate Income Taxes Already Often Look Beyond the Water's Edge"; Institute on Taxation and Economic Policy; Nov. 7, 2023

Kitson, Kayla; "Three Ways State Policymakers Can Raise Revenues to Advance California's Priorities"; California Budget & Policy Center; March 2023

Shanske, Darien; "How the States Can Tax Shifted Corporate Profits: An Application of Strategic Conformity"; *Southern California Law Review*; Aug. 27, 2020

Fort, Bruce; "Anatomy of a Domestic Tax Shelter"; *Multistate Tax Commission*; May 17, 2021

Phillips, Richard; "A Simple Fix for a $17 Billion Loophole: How States Can Reclaim Revenue Lost to Tax Havens"; Institute on Taxation and Economic Policy, U.S. Public Interest Research Group, Et Al; January 2019

Shanske, Darien; "White Paper on Eliminating the Water's Edge Election and Moving to Mandatory Worldwide Combined Reporting"; Aug. 2, 2018

Houghton, Kendall; Hogroian, Ferdinand; Et Al; "Unitary/Combined Filings: Old Concept, New Focus"; *State Tax Notes*; Aug. 9, 2004

Segal, Mark; "The Unitary Tax Reconsidered"; *Journal of Applied Business Research*; 2004


*Additional documents on the Worldwide Unitary Taxation Working Group, not yet obtained, are available through the Public Papers of President Ronald Reagan.*

# Methodology

Research was conducted by reviewing sources including:

- Newspapers.com's historical newspapers archive
- Archive.org's government, books, and U.S. Supreme Court archives
- Google Books
- Nexis News
- The Ronald Reagan Presidential Papers
- The Hoover Institution Library & Archives
- California State Archives
- Public Records Act request submitted to the California Secretary of State's Office
- Special Collections of the Sheridan Libraries at John's Hopkins University
- Department of Special Collections at Stanford University
- San Jose State University Special Collections & Archives
- Carl Albert Congressional Research and Studies Center at the University of Oklahoma
- The University of Kentucky Special Collections Research Center
- UCLA Library Special Collections
- The San Diego County Library Interlibrary Loan program

the climate center