A Message from California State Controller Betty T. Yee

Taxes touch on almost every issue we face in California, from funding education to filling potholes. Tax policy deeply affects the state's interaction with local governments and shapes important perceptions about the business climate. In my public service career, I have grappled with many aspects of tax policy. As chief deputy director for budget with the California Department of Finance, I was responsible for developing the state's budget in a time of volatile revenue cycles. As a member of the State Board of Equalization, I see how the complexity of the tax code affects small businesses and other taxpayers. As the state's chief fiscal officer, I am responsible for managing cash flow with continued revenue volatility.

Designed during the Great Depression, California's tax structure is outdated, unfair, and unreliable. It reflects economic patterns and demographics of the past. Newer economic sectors escape tax obligations because the structure was created for an industrial manufacturing base. Upper-income earners pay a substantially higher rate on personal income—a progressivity that, depending on the analysis, either helps counter growing income inequality, distributes the tax burden too unevenly, or produces unpredictability with episodic cuts to vital programs. Further punctuating these flaws, Moody's Investor Services in May 2016 ranked California as the state least able to withstand a recession.

In 2015, I established a Council of Economic Advisors on Tax Reform to map the inadequacies of the state's tax system and focus on what it would take to implement truly comprehensive change. I convened experts with perspectives from academia, research institutes, business, and local government. I asked them to refrain from considering expenditure proposals ("spending side" reform) or reaching consensus on specific recommendations. As the work evolved, I realized it merited a broader audience.

The following framework incorporates the diverse and sometimes conflicting insights of my Council. Pulling together the puzzling patchwork of tax policy, we show that reform must go beyond discussion of rates. Whether Council members are concerned about the business climate, income disparity, or funding for infrastructure, housing, and transportation, most agree tax reform at its core must facilitate job creation and economic health. Further, the state-local relationship must be an integral part of comprehensive tax reform.

I am deeply grateful for the care and time that the Council members generously invested in this complex and occasionally frustrating effort. Many thanks to my staff and staff at the California State Library, California Board of Equalization, and California Franchise Tax Board for providing support; and to Deputy Controller John Decker for developing this framework.

Our broken tax system is a common conversation topic, yet comprehensive reform has been elusive and politically unpalatable. Resurgent revenues after the Great Recession have lulled many into complacency about the need to prepare for future economic downturns. However, look closely and the signals are there: California's economic outlook is dimming and operating deficits are at risk of growing. Even if the state could weather the next downturn with new revenue and budget cuts, fiscal imbalance will persist until we dig deep into structural changes.

As the state official responsible for paying California's bills each month, I know we can't afford not to consider a better way to plan ahead. I urge leaders in local government, economic development, the business community, education, and others to join me in pushing for tax reform that facilitates business development and growth, supports local and regional public services, and expands our state's capacity to take on the challenges of growing income disparity, lack of affordable housing, climate change, and more.

The time for comprehensive tax reform is now. No more kicking the can down the road.