A Message from the Controller's Council of Economic Advisors on Tax Reform

Tax policy is one of the most common concerns for California's policymakers. According to the California State Library, the Legislature considered 4,600 tax proposals in the past two decades—an average of about 245 per year. About half would have changed the personal income tax. Another one-third would have adjusted either the sales tax or the property tax. (See Appendix I on page 39 for the history of recent tax changes prepared by the State Library.)

Few proposals were intended to achieve comprehensive reform. For the most part, they were directed at a single tax or group of taxpayers. Sometimes the proposals merely adjusted tax rates. Major increases, though rare, were often designed to be temporary, while tax cuts were conditioned on the state's fiscal health.

It appears that fiscal necessity, rather than overarching policy considerations, prompted most recent major tax changes. In fact, during the nearly 40 years since California voters approved Proposition 13 to limit property tax rates, policymakers adopted incremental adjustments to each of the major taxes, but no comprehensive change to the state's tax structure. To be fair, comprehensive tax change is difficult. During the same 40-year period, the U.S. Congress focused on systemic reform just once, when it simplified the tax code, broadened the tax base, and eliminated many tax shelters in the 1986 Tax Reform Act.

Many believe the current tax system does not serve California as well as it might, and that a review of the entire structure is long overdue. Post-Proposition 13 revenues from the sales and use tax, the corporation tax, and the property tax have diminished. This has increased California's dependence on the personal income tax. The increasing volatility of the state's economy (and the stock market) has translated into greater unpredictability of state tax revenue, presenting challenges for budget forecasts.

Some call for the quick technical fix of reducing income tax on the wealthy to soften the impact of market throes on state revenues. Others contend we should take into account economic cycles by building greater cash reserves when the economy is growing to better weather the inevitable downturns. Like policymakers and California taxpayers, our Council has a range of sometimes contradictory opinions about the best course.

We thank State Controller Betty Yee and her staff for convening our Council and compiling contextual economic and fiscal information. Understanding tax policy changes cannot by itself address all our concerns about state finances. We must start a broader discussion about the tax structure as a necessary area of reform for improving fiscal management and encouraging economic vitality. We hope the following pages provide useful information to explore the implications of comprehensive change.

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