STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Petrie-Norris	Sponsor:	Bill Number: AB 294
	Related Bills: See Legislative History	Introduced January 25, 2023

SUBJECT

Gross Income Exclusion for Fire or Natural Disaster Damage

SUMMARY

The bill, under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL), would provide a qualified taxpayer an exclusion from gross income for amounts received in settlement for a wildfire or natural disaster.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

Not applicable.

REASON FOR THE BILL

The reason for the bill is to prevent undue hardship for taxpayers who reside, or resided, in parts of California devastated by a wildfire or a natural disaster.

ANALYSIS

This bill under the PITL and CTL would provide an exclusion from gross income for any qualified amount received by a qualified taxpayer.

For purposes of the PITL and CTL, the following definitions would apply:

- "Qualified amount" means any amount received in settlement by a qualified taxpayer to replace property damaged or destroyed by fire or natural disaster.
- "Qualified taxpayer" means any of the following:
    - Any taxpayer that owns real property located in an area damaged by a wildfire or natural disaster who paid and incurred expenses and received amounts from a settlement arising out of or pursuant to the fire or natural disaster.

    - Any taxpayer that has a place of business within an area damaged by a wildfire or natural disaster who paid and incurred expenses and received amounts from a settlement arising out of or pursuant to the fire or natural disaster.
- "Settlement entity" means the entity making the settlement payment to a qualified taxpayer.

The bill provides additional criteria for a taxpayer to be considered a "qualified taxpayer" that is different under the PITL and CTL.

Under the PITL, a "qualified taxpayer" would also include any taxpayer that resides within an area damaged by a wildfire or natural disaster who paid and incurred expenses and received amounts from a settlement arising out of or pursuant to the fire or natural disaster.

The settlement entity would be required to provide, upon request by the Franchise Tax Board (FTB), documentation of the settlement payments in the form and manner requested by the FTB.

Effective/Operative Date

This bill would be effective January 1st of the year following enactment and operative for tax years on or after January 1, 2022.

Federal/State Law

Federal Law

Existing federal law, Internal Revenue Code (IRC) section 139, provides a general exclusion that gross income does not include any amount an individual receives as a qualified disaster payment. A qualified disaster payment means amounts paid to, or for the benefit of, an individual for several purposes, including to:

- Reimburse or pay reasonable and necessary personal, family, living, or funeral expenses the individual incurred because of a qualified disaster; or
- Reimburse or pay reasonable and necessary expenses the individual incurred for the repair or rehabilitation of a personal residence or repair or replacement of its contents, to the extent that the need for such repair, rehabilitation, or replacement is attributable to a qualified disaster.

For any federally declared disaster, an individual may exclude from income a valid disaster relief payment, which includes any amount the individual receives from the settlement award for a purpose listed above.

A qualified disaster includes any federally declared disaster, as defined in IRC section 165(i). A federally declared disaster is any disaster the President of the United States determines assistance from the federal government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act is warranted. (The Federal Emergency Management Agency's website, www.fema.gov, provides the listing of federally declared disasters.)

State Law

California generally conforms to IRC section 139, as described above, and specifically allows an exclusion from gross income for:

- Settlement payments received from the Fire Victims Trust, and
- Settlement payments received from Southern California Edison for claims relating to the 2017 Thomas Fire or the 2018 Woolsey Fire.

Implementation Considerations

The department has identified the following implementation consideration and is available to work with the author's office to resolve this and other considerations that may be identified.

This bill uses undefined terms, e.g., "settlement entity" and "natural disaster." The absence of definitions to clarify these terms could lead to confusion for taxpayers. For clarity, it is recommended that the bill be amended to define the terms and to be consistent with other Revenue and Taxation Code (RTC) exclusions.

This bill requires the settlement authority to provide documentation to the Franchise Tax Board on request. However, it is the individual taxpayer who will be excluding the income and who would be subject to audit on this issue. The author may wish to amend the bill to require the settlement authority to provide a statement to the taxpayer, who then can provide the documentation to the Franchise Tax Board on request.

Technical Considerations

For clarity and consistency, it is recommended that the phrase in Sections 17139(b)(2)(A), (B), (C) and 24309.4(b)(2)(A), (B), "…natural disaster who paid and incurred expenses and received amounts from a settlement arising out of or pursuant to the fire or natural disaster…" be replaced with:

> "…natural disaster who paid or incurred expenses, and received amounts from a settlement, arising out of or pursuant to the fire or natural disaster…"

Policy Considerations

This bill does not specify whether the wildfire, fire, or natural disaster must occur within California.

This bill does not provide a sunset date, which would generally allow periodic review of the effectiveness of the tax law change.

In addition, under RTC section 41, legislation that would create a new tax expenditure, which includes a credit, deduction, exclusion, exemption, or any other tax benefit as provided for by the state, is required to include specific goals, purposes, objectives, and performance measures to allow the Legislature to evaluate the effectiveness of the tax benefit. The author may wish to amend the bill to include these goals, purposes, objectives, and performance measures.

LEGISLATIVE HISTORY

AB 1249 (Gallagher, et al., Chapter 749, Statutes of 2022) provides an exclusion from gross income for amounts received in settlement under the order of the United States Bankruptcy Court for the Northern District of California dated June 20, 2020, case number 19-30088, docket number 8053.

SB 370 (McGuire, et al., 2023/2024) would allow an exclusion from gross income for amounts received in settlement for claims relating to the 2019 Kincade Fire and allow refunds of tax previously paid on those amounts. This bill is currently in the committee process.

SB 1246 (Stern, Chapter 841, Statutes of 2022) provides an exclusion from gross income for amounts received from Southern California Edison in settlement for claims relating to the 2017 Thomas Fire or the 2018 Woolsey Fire and allow refunds of tax previously paid on those amounts.

PROGRAM BACKGROUND

None noted.

FISCAL IMPACT

The department’s costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be identified.

ECONOMIC IMPACT

Revenue Estimate

This bill would allow a qualified taxpayer a gross income exclusion of qualified amounts received in settlement to replace property damaged or destroyed by fire or natural disaster. To calculate the revenue impact, the frequency of fire or natural disasters and the dollar amounts arising from settlement payouts from these disasters must be known. Because it is difficult to predict the frequency of these disasters and the settlement amounts paid to qualified taxpayers, the revenue impact is unknown.

However, it is assumed that for every $1 million in settlement income received to replace property damaged or destroyed by fire or natural disaster and applying an average tax rate of 5%, the estimated revenue loss would be approximately $50,000.

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

LEGISLATIVE CONTACT

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