STATE OF CALIFORNIA
Franchise Tax Board

# Bill Analysis

Author: Dahle

Sponsor:

Bill Number: SB 927

Related Bills: See Legislative History

Introduced: January 12, 2024

## SUBJECT

Natural Disaster Settlements Gross Income Exclusion

## SUMMARY

The bill, under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL), would provide a taxpayer an exclusion from gross income for qualified amounts received in settlement to replace property damaged or destroyed in a natural disaster declared a state of emergency by the Governor and the President of the United States.

## RECOMMENDATION

No position.

## SUMMARY OF AMENDMENTS

Not applicable.

## REASON FOR THE BILL

The reason for this bill is to provide essential relief to taxpayers who have suffered property loss resulting from specific natural disasters.

## ANALYSIS

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

This bill, for purposes of the PITL and CTL, would define “qualified amount” as any amount received in settlement by a taxpayer to replace property damaged or destroyed by a natural disaster that was declared a state of emergency by both the Governor and the President of the United States.

This bill would include Revenue and Taxation Code (RTC) section 41 requirements that would provide that the measurement of effectiveness of the credit would be the number of taxpayers that excluded qualified amounts from gross income. On December 1, 2028, and every five years thereafter, the Franchise Tax Board (FTB) would be required to provide a written-report to the legislature that includes the number of taxpayers that excluded qualified amounts from gross income as a result of this exclusion.

*Effective/Operative Date*

As a tax levy, this bill would be effective immediately upon enactment and operative for taxable years beginning on or after January 1, 2023.

*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.

*State Law*

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

- Settlement payments received from the Fire Victims Trust.

- Settlement payments received from Southern California Edison for claims relating to the 2017 Thomas Fire or the 2018 Woolsey Fire.
- Settlement payments received from Pacific Gas and Electric Company or its subsidiary for claims in connection with the 2019 Kincade Fire or the 2020 Zogg Fire.

*Implementation Considerations*

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

The terms "amount received in settlement" and "settlement payments" are undefined. It is not clear whether these would include insurance payments, disaster related litigation settlement proceeds, federal or state disaster assistance payments, or amounts received with respect to previously deducted amounts, such as casualty losses deducted in one year where recovery amounts are received in the same or subsequent years or insurance settlements where a business entity has deducted insurance premiums.

This bill allows a specified exclusion, when among other requirements, there is a natural disaster that was declared "a state of emergency" by the President of the United States. Pursuant to the Robert T. Stafford Disaster Relief and Emergency Assistance Act (PL 100 – 707), the President of the United States may make a major disaster declaration or an emergency declaration. It isn't clear whether this bill would allow the specified exclusion when the President makes an emergency declaration or major disaster declaration.

This bill was introduced in the 2024 legislative session and would allow an exclusion from gross income for settlement payments received for taxable years beginning on or after January 1, 2023. If this bill were to be enacted this calendar year, the exclusion allowed by this bill would be considered retroactive to the specified operative date of January 1, 2023. The FTB has already developed the forms and instructions for the 2023 taxable year, and most taxpayers will have filed their 2023 returns by April of this year. Thus, the FTB may incur additional costs to develop additional tax forms and instructions in the short timeframe necessary to ensure the forms are available for taxpayers if this bill was to be enacted before the filing deadline. If this bill was enacted after the filing deadline, the FTB may incur additional costs to process amended returns claiming this exclusion. To alleviate these considerations, the author may wish to change the operative date to January 1, 2024.

*Technical Considerations*

None noted.

*Policy Considerations*

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

## LEGISLATIVE HISTORY

AB 294 (Petri-Norris, 2023/2024) would have provided a qualified taxpayer an exclusion from gross income for amounts received from a settlement entity for a wildfire. This bill did not pass out of the Assembly Appropriations Committee by the constitutional deadline.

SB 131 (Committee on Budget and Fiscal Review, Chapter 55, Statutes of 2023) among other things provided an exclusion from gross income for amounts received for settlement payments as a result of the 2019 Kincade Fire and 2020 Zogg fire.

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 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 FTB's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be determined.

## ECONOMIC IMPACT

*Revenue Estimate*

This bill would allow a taxpayer a gross income exclusion for amounts received in settlement to replace property damaged or destroyed by a natural disaster that was declared a state of emergency by both the Governor and the President of the United States. To determine the magnitude of the potential impact to the General Fund, both the frequency of state and federally declared natural disasters and the dollar amounts arising from settlement payouts must be known. Because it is difficult to predict the frequency of natural disasters and settlement amounts paid, the revenue impact to the General Fund is unknown.

However, using an average tax rate of 7 percent, it is assumed that for every $100 million in qualified settlement income received, the estimated revenue loss would be approximately $7,000,000.

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

## LEGAL IMPACT

None noted.

## APPOINTMENTS

None noted.

## SUPPORT/OPPOSITION

To be determined.

## ARGUMENTS

To be determined.

## LEGISLATIVE CONTACT

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