SENATE COMMITTEE ON REVENUE AND TAXATION
Senator Steven Glazer, Chair
2023 - 2024 Regular

Bill No:	SB 927	**Hearing Date:**	03/13/24
Author:	Dahle	**Tax Levy:**	Yes
Version:	1/12/24	**Fiscal:**	Yes
Consultant:	Grinnell		

INCOME TAXES: GROSS INCOME EXCLUSIONS: STATE OF EMERGENCY: NATURAL DISASTER SETTLEMENTS

Enacts Personal Income and Corporation Tax exclusions for amounts received in settlement by a taxpayer to replace property damaged or destroyed by a natural disaster declared a state of emergency by the Governor and the President.

Background

Tax expenditures. California law allows various income tax credits, deductions, exemptions, and exclusions. The Legislature enacts such tax incentives either to compensate taxpayers for incurring certain expenses, such as child adoption, or to influence certain behavior, such as charitable giving. The Legislature uses tax incentives to encourage taxpayers to do something that they would not otherwise do. The Department of Finance is required annually to publish a list of state tax expenditures, currently totaling around $87 billion per year.

Income. Existing federal and state laws provide that gross income includes all income from any source, including compensation for services, business income, gains from property, interest, dividends, rents, and royalties, unless specifically excluded. Existing federal and state laws provide that certain types of income are excluded from gross income, such as amounts received as a gift or inheritance, certain compensation for injuries and sickness, qualified scholarships, educational assistance programs, foster care payments, and interest received on certain state or federal obligations.

Treatment of settlement awards. Generally, federal and state law allows taxpayers to exclude income from settlements from gross income if the amount received resulted from a personal physical injury or physical sickness, unless its punitive damages. Additionally, payments received as a reimbursement of costs, such as those paid to rebuild a destroyed home, are excluded from gross income. However, amounts resulting from emotional distress are included when calculating gross income, unless the emotional distress is the result of physical injury or sickness. In some cases, federal and state law requires inclusion of attorney's fees resulting from a settlement in the calculation of gross income. To the extent that any settlement payment exceeds costs incurred or paid in connection with the event that caused the settlement, that income may be taxable.

California Fires. Over the last decade, California has experienced increased, intense, and record-breaking wildfires throughout the state. These fires have resulted in devastating loss of life and billions of dollars in damage to property and infrastructure. Fires attributed to power lines and electrical equipment comprise nine of the 20 most destructive fires in California history. According to Cal Fire, in 2022 alone there were over 7,490 incidents and over 362,000 million acres of scorched land. In 2021, wildfire destroyed 2.5 million acres. Public utilities have entered into settlements for many wildfire incidents where they were involved, where settlement entities such as the Fire Victim Trust make payments to those affected by the incident

Disaster tax relief. In recent years, the Legislature has enacted Personal Income and Corporation Tax exclusions when disaster victims receive settlement payments to replace property damaged or destroyed by specific wildfire events, including:

- AB 1249 (Gallagher, 2022) which applied to amounts received in settlement from the PG&E trust to fire victims by a qualified taxpayer from PG&E related to the 2015 Butte, 2017 North Bay, and 2018 Camp Fires.
- SB 1246 (Stern, 2022), which applied to amounts received in settlement from Southern California Edison related to the 2017 Thomas Fire and the 2018 Woolsey Fire.
- SB 131 (Committee on Budget & Fiscal Review, 2023) which applied to amounts received in settlements associated with either the 2019 Kincade Fire in the County of Sonoma, or the 2020 Zogg Fire in the Counties of Tehama and Shasta.

However, victims of future natural disasters who receive settlement payments may not be able to exclude them from taxable income for state purposes unless and until the Legislature enacts a bill. Additionally, some taxpayers may have received settle payments in connection with other natural disasters in the past where the Legislature has not enacted an exclusion specific to that disaster. The author wants to enact income exclusions that apply whenever a natural disaster declared a state of emergency by the President and the Governor gives rise to settlement payments to affected individuals and businesses.

Proposed Law

Senate Bill 927 enacts Personal Income and Corporation Tax exclusions for 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. The measure applies commencing in the 2023 taxable year. The bill requires taxpayers to provide documentation to the Franchise Tax Board (FTB) upon request.

State Revenue Impact

According to FTB, "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."

Comments

1. Purpose of the bill. In California, we have unfortunately witnessed the devastating impact of wildfires, storms, and floods, leaving our neighbors to face the daunting task of rebuilding their lives after these natural disasters. In the past, we have worked on legislation to ease the financial

burden of rebuilding homes. Last year, I had the privilege of authoring a bill that provided a tax exclusion for settlement payments related to the Zogg fire, and I'm proud to share that the Governor included this provision in the budget. However it's time to take a proactive approach to future disasters. Victims of natural disasters should not be further penalized for circumstances beyond their control. SB 927 ensures that the Legislature does not have to introduce a new bill every time a disaster strikes, providing a seamless process for affected taxpayers to rebuild their lives and communities."

2. Revenue loss. Existing tax law provides various credits, deductions, exclusions, and exemptions for certain taxpayers. Since these items are enacted to accomplish some governmental purpose and determined to have a cost — in the form of foregone revenues — state law refers to them as "tax expenditures." This bill would create a new tax expenditure, costing the General Fund in foregone revenue. As a result, the state will have to reduce spending or increase taxes to match the foregone revenue.

3. Standardization. Between 1991 and 2009, the Legislature responded to natural disasters by enacting specific bills for each disaster that typically contained three parts:

- First, allowing taxpayers to claim excess disaster losses, where taxpayers can immediately file amended returns claiming losses attributable to the disaster, often generating a refund of previous taxes paid,
- Second, directing the assessor not to revoke a taxpayer's homeowners' exemption because their residence was temporarily damaged, destroyed, was being reconstructed by the owner, or was temporarily uninhabited as a result of restricted access, as a result of the disaster.
- Third, backfilling property tax revenue losses for local agencies resulting from the disaster.

Over time, the Legislature enacted general statutes to apply the first two parts whenever the Governor declared a disaster. SB 1494 (Committee on Revenue and Taxation, 2010) precluded assessors from revoking homeowners' exemptions for disaster-affected property upon a declaration of a state of emergency from the Governor. SB 35 (Wolk, 2015) allowed for disaster loss treatment for any loss sustained from a disaster in any city, county, or city and county in California that the Governor has proclaimed to be in a state of emergency through the 2023 taxable year; last year, the Legislature extended general disaster loss treatment another five years (SB 264, Niello). SB 927 continues the trend of the Legislature enacting general tax relief in the event of a future natural disaster declared a state of emergency by the Governor and the President, in this case for qualified taxpayers who receive settlement payments from those entities involved in the natural disaster.

4. No conformity. While following several precedents in state law, this bill creates an income exclusion not allowed for federal taxes unless and until Congress acts to enact a similar exclusion. As a result, taxpayers may have to include the same income for federal purposes that they would exclude for state purposes, which can create confusion for taxpayers. Currently pending in the United States Senate, HR 7024 would provide similar treatment for federal taxes as SB 927, but only for wildfires, not all natural disasters.

5. Related legislation. SB 1004 (Wilk) is similar to SB 927, with a few differences. SB 1004 would enact a similar exclusion when taxpayers receive settlement payments due to a wildfire.

SB 1004 applies retroactively to the 2020 taxable year, while SB 927 applies beginning in the 2023 taxable year. Additionally, SB 1102 (Nguyen) enacts a Personal Income and Corporation Tax exclusion for settlement amounts received by qualified taxpayers from defendants in settlement for claims relating to the October 2, 2021, oil spill off the coast of the County of Orange near the City of Huntington Beach. Lastly, SB 542 (Dahle) is currently pending in the Assembly Appropriations Committee, which would enact similar exclusions for qualified taxpayers receiving settlement payments from the 2021 Dixie Fire or the 2022 Mill Fire.

6. Section 41. Section 41 of the Revenue and Taxation Code requires any bill authorizing a new tax expenditure to contain, among other things, specific goals, purposes, and objectives that the tax expenditure will achieve a detailed performance indicators, along with data collection and reporting requirements (SB 1335, Leno, 2014). To satisfy these requirements, SB 927 states that its goal, purpose, and objective is to provide essential relief to individuals who have suffered injury, loss, inconvenience, and expenses resulting from natural disasters. The measure then directs FTB report to the Legislature regarding the number of taxpayers that excluded qualified amounts from gross income as a result of the exclusion by December 1, 2028, and every five years thereafter.

7. Sunset? SB 927 both excludes from taxable income amounts paid to those affected by natural disasters who received settlement payments in the 2023 taxable year or after where the Legislature has not enacted a bill, and provides that similar payments resulting from future natural disasters are not taxable either. However, a future Legislature may want to evaluate the bill's impacts. The Committee may wish to consider amending SB 927 to sunset its provisions after ten years.

8. Technicals. While SB 927's exclusions are similar to SB 1004 and other measures previously enacted by the Legislature, it does not contain the same definitions for "qualified taxpayer" and "settlement entity," as well as a requirement for any settlement entity to provide FTB or the qualified taxpayer with documentation of the settlement payments. The Committee may wish to consider adding those provisions to ensure consistency between SB 927 and these other measures.

Support and Opposition (3/8/24)

Support: None submitted.

Opposition: None submitted.

-- END --