SENATE COMMITTEE ON APPROPRIATIONS
Senator Anna Caballero, Chair
2023 - 2024 Regular Session

SB 927 (Dahle) - Income taxes: gross income exclusions: state of emergency: natural disaster settlements

Version: March 14, 2024
Urgency: No
Hearing Date: April 8, 2024
Policy Vote: REV. & TAX. 6 - 0
Mandate: No
Consultant: Robert Ingenito

Bill Summary: SB 927 would enact personal income and corporation tax exclusions for amounts received in settlement by a taxpayer to replace property damaged or destroyed by a natural disaster, as specified.

Fiscal Impact: The Franchise Tax Board (FTB) estimates that for every $100 million in qualified settlement income received, the General Fund revenue loss would be approximately $7 million. FTB's costs to implement the bill have yet to be identified.

Background: Tax expenditure programs (TEPs) are special tax provisions that reduce the amount of revenues the "basic" tax system would otherwise generate in order to provide (1) benefits to certain groups of taxpayers, and/or (2) incentives to encourage certain types of behavior and activities, such as charitable giving. Specifically, current law provides for, among other things, various income and corporation tax credits and deductions, as well as exemptions from the sales and use tax. The Department of Finance is required to publish a list of TEPs (currently totaling several hundred), which currently exceed $87 billion annually.

Federal and state law generally allows taxpayers to exclude income from settlements from gross income if the amount received resulted from a personal physical injury or physical sickness. 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.

The California Department of Forestry and Fire Protection indicates that in 2022, there were over 7,490 incidents and over 362,000 acres of scorched land. The previous year, wildfires destroyed 2.5 million acres statewide. Public utilities have subsequently entered into monetary settlements for many wildfire incidents where they were involved.

The Legislature has, in recent years, 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 pertained to amounts received by a qualified taxpayer in settlement from Pacific Gas & Electric related to the 2015 Butte, 2017 North Bay, and 2018 Camp Fires.

- SB 1246 (Stern, 2022), which applied to pertained received by a qualified taxpayer 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 pertained to amounts received in settlements by a qualified taxpayer associated with either the 2019 Kincade Fire in Sonoma County, or the 2020 Zogg Fire in Tehama and Shasta Counties.

However, victims of future natural disasters who receive settlement payments may not be able to exclude them from taxable income for state purposes absent legislation. 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.

Proposed Law: This bill would, for taxable years 2023 through 2032, enact 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.

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.

- SB 1004 (Wilk) would, effective taxable year 2020, enact a similar exclusion when taxpayers receive settlement payments due to a wildfire. The bill is currently pending in this Committee.

- SB 1102 (Nguyen) would enact 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. The bill is currently pending in the Senate Committee on Revenue and Taxation.

- SB 542 (Dahle) would enact similar exclusions for qualified taxpayers receiving settlement payments from the 2021 Dixie Fire or the 2022 Mill Fire. The bill is currently pending in the Assembly Appropriations Committee.

Staff Comments: FTB notes that, to determine the magnitude of the bill's potential revenue loss, 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, FTB indicates that 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 million.

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