

California Wildfire Victims Get Major Tax Breaks Under New Law

By Robert W. Wood

Large numbers of fire victims in California have suffered losses. Some have recovered funds via insurance and from lawsuits, but many thousands of others are still waiting and hoping to recover. Everyone has to file annual tax returns, and some tax decisions may present themselves early, such as whether to claim a casualty loss on their taxes. But for many, the larger tax questions about how money from lawsuits and insurance is treated for tax purposes comes much later.

Fire victims are often surprised at the significant income tax consequences they encounter, both in the sheer complexity of the tax law and in the often surprising and seemingly unfair tax treatment they face on their proceeds. For fire victims in federally declared disasters, the skies parted in late 2024 with a blanket federal tax exemption for 2020 through 2025 litigation settlements. Yet even that tax relief provision includes puzzling qualifiers that exclude many people.

The federal law is also sunseting at year end, so unless it is extended by Congress, it will be of no help to the legions of fire victims who expect to eventually recover from defendants in 2026 and ensuing tax years. But what about California tax law? California passed a series of fire specific tax exclusion laws over the years, but they were spotty and omitted numerous fires and fire victims.

As more tax bills were introduced, on September 29, 2024, Governor Newsom vetoed two additional bills that would have granted additional state-level income tax exclusions to certain wildfires. Vetoing tax relief bills of this type seemed odd, but the Governor explained why he vetoed the bills. It was not because he disagreed with the idea that recoveries should be tax-free, but because he believed that a wildfire exclusion should be addressed more systematically as part of the annual budgeting process, not on a wildfire-by-wildfire basis.

Finally, in 2025, S.B. 132 was enacted to add a new section to the California tax code, Section 17138.7. This Section covers most types of California taxpayers, but C corporations are covered by a similar exclusion in Section 23409.2. The new exclusion has requirements, but unlike previous California exclusions for specifically named wildfires, this new California exclusion is broad. It applies to *all* qualifying wildfire recoveries received by a California taxpayer between January 1, 2021, and December 31, 2030.

Unfortunately, as originally enacted, to be excludable for California tax purposes, the qualifying recovery had to be received from a "settlement entity." The new law originally defined "settlement entity" to mean an entity "approved by a class action settlement administrator." On the surface, that omitted thousands of fire victims who received recoveries in standalone lawsuits against utilities.

If the payout was from a single defendant and not part of a class action, they would not be covered by the new California law. Fortunately, shortly after it was enacted, Section 17138.7 and the corresponding exclusion for C corporations in Section 23409.2 were amended to broaden their exclusion. The amendment removes the class action settlement administrator reference and covers amounts received in direct settlement with a defendant, via a settlement entity like the PG&E Fire Victim Trust, or via a class action settlement.

All should qualify if the other requirements in Section 17138.7 are met. Although the amendment to the "settlement entity" language broadened the exclusion, another revision to Sections 17138.7 and 23409.2 arguably narrowed it. That is, the original language to these sections seemed to include any wildfire as a qualifying wildfire for the purposes of the exclusion, without defining what would be considered a wildfire.

That is good news, but there are a couple of other changes to note. The amended language now requires that a qualifying wildfire be *either* a federally declared disaster that is the subject of a federal major disaster declaration or a federal emergency declaration *or* a wildfire that was the subject of a proclamation of a state of emergency by the California governor. A plain reading of this change shows a stricter definition than the previous undefined reference to all wildfires.

However, it is not clear how many major California wildfires will be affected by the revised language. Most of the largest recent California wildfires are the subject of a federal major disaster declaration or emergency declaration (or both). For the wildfires that did not qualify for federal major disaster declarations or emergency declarations, all of these that we have seen in our practice to date have been the subject of a Proclamation of a State of Emergency by the governor.

For example, some fires that should qualify for the California exclusion based on a California emergency declaration include the 2018 Holiday Fire, 2020 Mountain View Fire, and 2022 Mosquito Fire, despite their not having received either of the two required types of federal disaster declaration. Therefore, for most California wildfire victims, the clearer definition of a qualifying wildfire may not impact whether they qualify for the new exclusion, and instead, should make it much easier for them to qualify.

Turning to federal taxes, most of the attention may be on the federal exclusion for certain wildfire recoveries. Currently, the federal exclusion will expire at the end of 2025, unless it is extended. In contrast, the California exclusion will apply through the end of 2030 for most taxpayers. The California exclusion is also highly relevant for taxpayers who do not qualify for the federal exclusion. The California-specific

exclusion in the recently enacted—and then even more recently amended—Sections 17138.7 and 23409.2 provides important and welcome tax relief to California wildfire victims.

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