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Wildfire Recovery Tax Treatment Even With New Tax Exclusion Is Tricky



It was huge news in December 2024 when Congress [passed a tax law to many wildfire settlements tax free](#). The law expires at the end of 2025, and there's no sign of it being amended to cover 2026 and later recoveries. That's a worry for recent fires such as the LA fires of 2025. Litigation usually takes years to resolve. Yet fire victims usually have tax issues long before any lawsuit recovery. They include [whether and how to claim a casualty loss on their taxes](#), and how various categories of [insurance proceeds are taxed](#).

Which Fires, Does Yours Qualify?

The new federal law is a great benefit but among other limitations, it applies only for payments through the end of 2025. But what about California state taxes? As for California taxes, state law added temporary provisions to the California Revenue & Taxation Code that exclude from California income tax amounts received in connection with certain specific California wildfires (the Butte Fire (if the recovery is received from the Fire Victim Trust), the North Bay Fires (if the recovery is received from the Fire Victim Trust), the Thomas Fire, the Woolsey Fire, the Kincade Fire, and the Zogg Fire). Other fires were not covered, until now.

California's 2025 budget legislation expanded the California income tax exclusions that apply to certain wildfire recoveries received between January 1, 2021 and January 1, 2030. However, the new exclusion does have requirements that not all wildfire recoveries may satisfy. As noted, in the past, California passed state-level tax exclusions for recoveries related to *specific* wildfires. That often made the specific wildfire that affected your home or property controlling over whether you qualified to treat your wildfire recovery as tax free.

More Tax Relief

Then, on September 29, 2024, Governor Newsom vetoed two bills that would have granted state-level income tax exclusions to new wildfires. In his letter to the Legislature, Governor Newsom explained that he vetoed the bills, not because he disagreed with the idea that the recoveries should be tax-free for California tax purposes, 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 where it would be more difficult to incorporate the exclusions into California's budget balancing efforts.

That helps to explain why the new California wildfire exclusion was included in the recently enacted S.B. 132, which was one of the bills recently passed as part of a larger budget deal between the Governor and the state legislature. S.B. 132 adds a new section to the California tax code, Section 17138.7. The new exclusion applies to *all* wildfire recoveries received by a California taxpayer between January 1, 2021, and January 1, 2030, regardless of the specific wildfire involved.

What's a Settlement Entity?

However, there is one very notable requirement for the new exclusion. Under the new exclusion, the recovery must be received from a "settlement entity." The new law defines the term "settlement entity" to mean an entity "approved by a class action settlement administrator." This definition seems likely to have been intended to include the PG&E Fire Victim Trust. However, what about money you get from your insurance company? It seems unlikely that that kind of payment could be shoehorned into this defined term. The same for recoveries received in direct settlement with Southern California Edison or PG&E outside of a class action.

For taxpayers whose recoveries do not qualify for the new exclusion, the existing wildfire-by-wildfire exclusions remain in the California tax code, for at least a little while longer. Those exclusions are still *alternative* bases to claim a California tax exclusion for amounts received through 2026 or 2027, depending on the specific wildfire involved.

Does the new exclusion seem unduly narrow or formalistic, particularly for an exclusion that was presented as intending to expand the scope of wildfires that qualify for exclusion from California income tax? Yes, many fire victims are likely to think so. Of course, this is still a new law. It is possible that there may be guidance from the Franchise Tax Board about the application and requirements for claiming this exclusion.

Regarding federal taxes, [tax issues can hinge on federal disaster declarations](#), and even determining which [disaster declarations count can be nuanced](#).