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## Wildfire Tax Payment Issues Can Hinge On Federal Disaster Declaration

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If your home or property is destroyed or damaged in a wildfire, you are likely to have surprisingly complex tax issues. If you recover money from insurance or a lawsuit – or if you claim a casualty loss on your taxes – you need to know some tax rules. Several key tax issues and benefits hinge on whether your fire was a “Federally declared disaster” for tax purposes.

## **Casualty Loss Tax Deduction and More**

Claiming a casualty loss on your taxes after a disaster can help you keep funds you would otherwise have to pay to pay in taxes. Casualty loss deductions are limited to the lesser of your adjusted tax basis in your damaged property, or the reduction in the fair market value of the property from the disaster. So even if you lost a very expensive home with a high fair market value, if you paid a small amount for it many years ago, your basis and therefore your tax deduction is small.

Since 2018, you can generally claim this deduction only if your loss was in a Federally declared disaster. This limitation is set to expire at the end of 2025, but the One Big Beautiful Bill Act in Congress would make this rule permanent. You can claim a casualty loss deduction in the tax year immediately before the year of the disaster. Thus, LA fire victims who lost homes in January 2025 can claim a casualty loss on their 2024 taxes, even though the loss did not occur during 2024. Claiming a casualty loss can make sense, and is a popular tax break for fire victims in disaster areas. You can read more [here, so you know the rules and potential downsides](#).

## **Involuntary Conversions**

### **Section 1033 Tax Deferral**

Section 1033 of the tax code is a key relief provision for victims of disasters. Generally, amounts received for damage to property, including property

insurance payments, are treated as sales proceeds for tax purposes. Whether you have gain is based on your tax basis in the property.

Section 1033 generally allows property owners to elect to *defer* paying tax on their casualty gain. Making the election allows you to reinvest insurance or litigation proceeds into the repair, reconstruction, or replacement of your damaged property within a prescribed time limits. The time to reinvest can be tricky and depends heavily on your facts.

### **1033 in Federal Disaster Areas**

What rules apply under Section 1033 depend on whether the involuntary conversion occurred in a Federally declared disaster. With a Federally declared disaster, you can:

1. Exclude from your income most insurance proceeds received for personal property damaged or destroyed in the disaster if that property was located at your primary residence;
2. Treat all other insurance proceeds for damage to your primary residence as a single asset to get the full benefit of your adjusted tax bases in all the affected property before any casualty gain is produced;
3. Treat the acquisition of any replacement property related to your principal residence as qualifying replacement property for any other property located at your principal residence;
4. Double the replacement period for damaged property under a Section 1033 election from two years to four years; and
5. Treat the acquisition of any property to be held for productive use in a trade or business as qualifying replacement property for any other damaged property that was held for productive use in a trade or business.

If you have casualty gain from a federally declared wildfire that damaged your principal residence for the *first* time in a given tax year, you have until four years from December 31 of that year to reinvest the proceeds under Section 1033. Any casualty gain you have in any subsequent tax year must be reinvested by the same deadline, which was based on the first year you had casualty gain.

Therefore, it is possible that some casualty gain may have *less than* four years to be reinvested under Section 1033, if casualty gain was *first* triggered in a previous tax year. This can create complications for taxpayers who receive insurance proceeds over several years. It can also create timing problems where a taxpayer receives insurance proceeds in one year, and a litigation recovery for the same fire several years later.

Indeed, it is possible that the Section 1033 replacement period may have already *ended* due to casualty gain created several years earlier. That is, the Section 1033 replacement period may have already ended when the taxpayer receives a litigation recovery for their fire. The timing is tricky, but if you can meet the timing, the property owner does not have to pay immediate tax on the casualty gain, and the gain can be deferred indefinitely until the property is later sold. The net effect of these rules is that a fire victim often will not owe any income tax on their insurance proceeds until the property is later sold.

Section 1033 is not the only tax code provision fire victims need to know, but it is usually the main way fire victims [that fire victims can rebuild without current tax](#).

### **Tax Exclusion For 2020 – 2025**

In December 2024, Congress enacted the Federal Disaster Tax Relief Act of 2023, providing an exclusion [in the tax law temporarily so many wildfire settlements are tax free](#) if received during 2020 through 2025. The exclusion

does not apply to all fire victims or all fires, it applies only to fires that were Federally declared disasters. For wildfires that are *not* Federally declared disasters, you must rely on Section 1033 and other provisions.

The new law applies only to payments to *individuals*, so partnerships, irrevocable trusts, and various other entities appear not to qualify. The only major carve-out of the exclusion is that an amount cannot be excluded if it compensates the taxpayer for a loss or expense that *has already been reimbursed by another source*, say through insurance. You can read more [here about how fire victims without a federal disaster declaration are taxed](#).