Date of Hearing: April 21, 2025

ASSEMBLY COMMITTEE ON REVENUE AND TAXATION
Mike Gipson, Chair

AB 232 (Calderon) – As Amended April 11, 2025

Majority vote. Tax levy. Fiscal committee.

SUBJECT: Natural disasters: catastrophe savings accounts: personal income tax

SUMMARY: Allows, under the Personal Income Tax (PIT) Law, an above-the-line deduction for contributions to a "catastrophe savings account" by a "qualified taxpayer" and excludes any interest accruing to the account from gross income, as specified. Specifically, **this bill**:

1) Allows, for taxable years beginning on or after January 1, 2026, and before January 1, 2031, an above-the-line deduction equal to the amount contributed by a "qualified taxpayer" to a "catastrophe savings account", subject to the following annual limitations:

    a) For a "qualified taxpayer" whose primary residence is insured, $15,000; and,

    b) For a "qualified taxpayer" whose primary residence is not insured, $250,000.

2) Excludes from gross income, for taxable years beginning on or after January 1, 2026, and before January 1, 2031, any gains accruing during the taxable year to a "catastrophe savings account" whose beneficiary is a "qualified taxpayer".

3) Defines all of the following terms:

    a) "Catastrophe savings account" is a regular savings account or money market account with a financial institution that meets all of the following requirements:

        i) Is designated as a catastrophe savings account by the account holder;

        ii) Is established by a "qualified taxpayer", or by "qualified taxpayers" who are spouses, for the exclusive benefit of the "qualified taxpayer" establishing the account;

        iii) Is the only catastrophe savings account established by the "qualified taxpayer";

        iv) Is established by a residential property owner in this state for their primary residence; and,

        v) The written governing instrument creating the account provides for both of the following:

            1) All contributions to the account are required to be in cash; and,

            2) The account is established to pay for the qualified catastrophe expenses of a "qualified taxpayer" establishing the account.

b) "Qualified taxpayer" is an individual, or a married couple if filing a joint return, who owns a primary residence in California.

c) "Qualified catastrophe expenses" are either of the following:

i) Expenses paid or incurred due to damage to or loss of a homeowner's primary residence caused by a wildfire, flood, or earthquake that has been declared by the Governor to be an emergency, including a qualified deductible of a homeowners insurance policy; and,

ii) Expenses paid or incurred by a homeowner to incorporate property-level mitigation efforts, as provided in the California Department of Insurance (CDI) Safer from Wildfire regulations adopted under Title 10 of the California Code of Regulations (CCR), Section 2644.9(d)(1)(B), to their primary residence.

d) "Qualified deductible" is the deductible for the individual's homeowner's insurance policy for a homeowner's primary residence.

4) Provides for all of the following:

a) Any contributions in excess of the prescribed limits must be withdrawn and included in gross income in the year of the withdrawal;

b) Any interest that accrues to a catastrophe savings account after December 1, 2030, must be included as gross income; and,

c) Any distribution from a catastrophe savings account must be used to cover qualified catastrophe expenses.

5) Imposes a penalty of 2.5% of any amount improperly distributed from a catastrophe savings account to cover an expense other than a qualified catastrophe expense.

6) Finds and declares the following for the purposes of satisfying the requirements of Revenue and Taxation Code (R&TC) Section 41:

a) The specific goals, purposes, and objectives of this bill are to foster pre-event mitigation and postevent recovery from catastrophes by enabling taxpayers to accumulate funds that can be used to supplement insurance coverage and offset the costs of remediation and repair.

b) The performance indicators for the Legislature to use in determining if the deduction achieves its stated purpose include all of the following:

i) The number of taxpayers allowed a deduction;

ii) The average amount of the deduction allowed; and,

iii) The total amount of deductions allowed.

c) To measure whether this bill achieves its intended purpose, the Franchise Tax Board (FTB) shall submit a report to the Legislature no later than May 1, 2028, and annually thereafter, detailing the performance indicators listed above.

7) Sunsets the deduction and income exclusion's statutory provisions on December 1, 2031.

8) Takes immediate effect as a tax levy.

EXISTING LAW:

1) Conforms generally to federal law, which provides that gross income includes all income from whatever source derived unless expressly excluded. (Internal Revenue Code (IRC) Section 61 and R&TC Section 17071.) Gross income includes compensation for services, business income, gain from selling property, interest, rents, royalties, dividends, and pensions.

2) Provides for various types of tax-advantaged savings accounts under federal law, including Individual Retirement Accounts (IRAs) and Qualified Tuition Programs (also known as 529 college savings plans), to which state law generally conforms. (IRC Sections 401, 457, 529 *et seq.* and R&TC Sections 17140.3 and 17501.5.)

3) Allows an above-the-line deduction for qualified IRA contributions to which state law conforms. (IRC Section 62(a) and R&TC Section 17072.)

4) Allows an itemized deduction equal to the amount of interest a taxpayer pays on a mortgage secured by their principal or secondary residence, subject to certain limitations. (IRC Section 163(h) and R&TC Section 17201.)

5) Requires any bill authorizing a new tax expenditure to contain all of the following:

a) Specific goals, purposes, and objectives that the tax expenditure will achieve;

b) Detailed performance indicators for the Legislature to use when measuring whether the tax expenditure meets the goals, purposes, and objectives stated in the bill; and,

c) Data collection requirements to enable the Legislature to determine whether the tax expenditure is meeting, failing to meet, or exceeding those specific goals, purposes, and objectives. The requirements shall include the specific data and baseline measurements to be collected and remitted in each year the expenditure is in effect, for the Legislature to measure the change in performance indicators, and the specific taxpayers, state agencies, or other entities required to collect and remit data. (R&TC Section 41.)

FISCAL EFFECT: The FTB estimates General Fund (GF) revenue losses of $15 million in fiscal year (FY) 2025-26, $60 million in FY 2026-27, and $110 million in FY 2027-28.

COMMENTS:

1) The author has provided the following statement in support of this bill:

> Assembly bill 232 provides homeowners a proactive method to protect their homes by authorizing tax exempt savings accounts to be utilized for home-hardening and disaster

recovery expenses. As these catastrophic events become more frequent, California must ensure homeowners are equipped with all available tools to plan for wildfire, flooding, and other extreme weather events. By allowing homeowners to set aside pre-tax dollars to cover disaster-related costs, this bill empowers Californians to take control of their financial preparedness and safeguard their futures.

2) In support of this bill, Insurance Commissioner Ricardo Lara notes, in part:

> Catastrophe savings accounts are a practical solution to help homeowners prepare for disaster-related expenses and reduce financial stress during emergencies. These accounts encourage proactive savings by offering tax deductions for contributions and exclusions for interest income, while simultaneously imposing penalties on misuse to ensure funds are used as intended. With wildfires continuing to pose a significant threat to all Californians, these accounts can help homeowners cover high deductibles or uninsured losses, enabling quicker recovery time and easing the strain on public disaster relief resources. Catastrophe savings accounts can also address gaps in preparedness for other risks, such as flood damage and earthquake losses. By encouraging individuals to save for their own recovery while maintaining traditional insurance these accounts work alongside existing coverage and promote a focus on preparedness without diminishing the importance of adequate insurance protection. Together, they create stronger financial security for Californians facing the growing threats of climate-intensified disasters.

3) Committee Staff Comments:

   a) *What is a "tax expenditure"*? Existing law provides various credits, deductions, exclusions, and exemptions for particular taxpayer groups. In the late 1960s, U.S. Treasury officials began arguing that these features of the tax law should be referred to as "expenditures" since they are generally enacted to accomplish some governmental purpose and there is a determinable cost associated with each (in the form of foregone revenues).

      As the Department of Finance notes in its annual Tax Expenditure Report, there are several key differences between tax expenditures and direct expenditures. First, tax expenditures are typically reviewed less frequently than direct expenditures. Second, there is generally no control over the amount of revenue losses associated with any given tax expenditure. Finally, it should also be noted that, once enacted, it takes a two-thirds vote to rescind an existing tax expenditure absent a sunset date. This effectively results in a "one-way ratchet" whereby tax expenditures can be conferred by majority vote, but cannot be rescinded, irrespective of their efficacy or cost, without a supermajority vote.

   b) *Homeowners insurance in California*: Proposition 103, passed by California voters in November 1988, was intended to protect consumers from arbitrary insurance rates and practices, to encourage a competitive marketplace, and to ensure that insurance is fair, available, and affordable for all Californians. Proposition 103 instituted a regulatory system where the Insurance Commissioner must approve a rate applied for by an insurer before its use, known as the "prior approval" system, before an insurer can implement property and casualty insurance rates.

      In 2017 and 2018, California experienced two of the most destructive wildfire seasons in state history, which resulted in California insurers paying a record of $15.4 billion in losses in 2017 and $13.6 billion in 2018. After two straight years of insurers paying out $1.85 in losses for every $1 of premium earned, the California Department of Insurance approved 71 rate increase requests from 50 different companies in 2019. Damage resulting from winter storms in subsequent years has continued to strain the property insurance market, with several major insurers stopping issuance of new policies or exiting the state altogether.[1]

The 2025 fires in Los Angeles have further exacerbated the property insurance crisis in multiple ways. While damage totals are still being calculated, it is estimated the fires resulted in the destruction or damage of tens of billions of dollars in property. Claims for insured properties are still being filed and will likely also total in the tens of billions of dollars. Additionally, many properties that were damaged or destroyed were already insured by the California FAIR Plan, the state's insurer of last resort, potentially jeopardizing the Plan's future solvency.

c) *California FAIR Plan*: The FAIR Plan was established after the riots and brush fires of the 1960s and provides basic property insurance to consumers when coverage in the voluntary market is unavailable. Every property insurance company licensed in California becomes a FAIR Plan member as a condition of doing business in California. Roughly 44% of FAIR Plan policies cover properties in California's urban areas while the rest are in the wildland urban interface (WUI) and properties are eligible for coverage regardless of wildfire exposure. The FAIR Plan is not a state agency and not state- or taxpayer-funded; it is funded primarily through the policies it sells to customers.[2]

   As of February 11, 2025, the FAIR Plan reported that it had paid more than $914 million to policy holders, including advance payments, to cover claims related to the Palisades and Eaton fires. The massive destruction in Los Angeles prompted the FAIR Plan's Accounting and Governing subcommittees to each recommend an assessment of $1 billion – the first assessment on insurers in more than 30 years, according to Insurance Commissioner Ricardo Lara – to enable the FAIR Plan to access additional available layers of reinsurance and maintain operations.[3] Generally, assessments are based on an insurer's market share of dwelling and commercial policies from two years ago, which means that property insurance policyholders that are not customers of the FAIR Plan may see their insurance costs increase.

d) *What would this bill do?* AB 232 would create a new type of tax-advantaged savings account that residential property owners could use to pay for pre-disaster property-level

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[1] "Joint Informational Hearing: Wildfire Insurance: Risk, Resiliency & Recovery." Assembly Committee on Insurance and Select Committee on Wildfire Prevention. October 9, 2023. https://ains.assembly.ca.gov/sites/ains.assembly.ca.gov/files/10.9.23%20Final%20Committee%20background.pdf.
[2] "Oversight Hearing: The California FAIR Plan." Assembly Committee on Insurance. March 13, 2024. https://ains.assembly.ca.gov/system/files/2024-03/asm-ins-fair-plan-background-final_0.pdf.
[3] Jergler, Don. "California Approves FAIR Plan Request to Assess Insurers $1B for Wildfire Claims." Insurance Journal. February 11, 2025. https://www.insurancejournal.com/news/west/2025/02/11/811676.htm.

mitigation efforts for their primary residence and post-disaster losses that are not covered by insurance. Similar to the existing deduction for contributions to qualifying IRAs like a 401k, taxpayers would be allowed an above-the-line deduction equal to the amount they contributed to a catastrophe savings account in that taxable year. This "front-end" benefit allows taxpayers to reduce their adjusted gross income (AGI) while growing their savings. Taxpayers whose primary residence is insured would be able to deduct up to $15,000 annually in contributions while taxpayers whose primary residence is not insured would be able to deduct up to $250,000 annually. This bill also provides an income exclusion for the interest earned on amounts saved in a catastrophe savings account, meaning that taxpayers would be able to grow their savings tax-free by leveraging compounding interest.

e) *What expenses qualify*? This bill creates two broad categories for qualifying catastrophe expenses. First, expenses paid or incurred due to damage to or loss of a homeowner's primary residence caused by a wildfire, flood, or earthquake that has been declared by the Governor to be an emergency, including a qualified deductible of a homeowners insurance policy, are considered qualified expenses.

Second, the types of pre-disaster property-level mitigation efforts that qualify as an eligible expense under this bill are outlined in CDI's Safer from Wildfire regulations and include both of the following:

- Measures addressing the immediate surroundings of the home, including the clearing of vegetation and debris from under decks and areas within 5 feet of the home, incorporating only noncombustible materials into improvements like fences, removing combustible structures, and compliance with state and local defensible space requirements; and,
- Building hardening measures, including the installation of a Class-A Fire Rated Roof, enclosed eaves, fire-resistant vents, multipane windows, and at least 6 inches of noncombustible vertical clearance at the bottom of the exterior surface of the home, measured from the ground up.

Additionally, similar to existing law governing IRAs and 529 accounts, this bill imposes a penalty of 2.5% on amounts withdrawn that are not used for qualified expenses.

f) *What happens when money is withdrawn*? As currently drafted, this bill does not explicitly provide an income exclusion when money in a catastrophe savings account are withdrawn, which is sometimes referred to as a "back-end" benefit. As such, amounts that are withdrawn, even if used for a qualifying expense, likely would be included in the taxpayer's AGI in the taxable year of withdrawal.

g) *Tax advantaged savings accounts*: As described above, both state and federal law provide for various types of tax-advantaged savings accounts that are intended to encourage saving for future expenses, such as retirement or pursuing higher education. Under these existing savings regimes, the tax benefit is provided either on the "front-end" in the form of a deduction, or on the "back-end" in the form of a gross income exclusion when disbursements are made for certain expenses. While there may be various trade-offs associated with each kind of account, taxpayers generally have to choose whether they pay taxes now or wait until later, but they cannot avoid their savings being subject to income taxes at some point.

There is only one type of tax-advantaged savings account recognized in federal law that offers the rare "triple benefit" of providing a deduction for contributions, tax-free growth on interest, and tax-free distributions: health savings accounts (HSAs). California law does not conform to the IRC provisions relating to HSAs and the Legislature has repeatedly rejected efforts that would have brought the state into full or partial conformity.

To benefit from an HSA, a taxpayer must be enrolled in a high-deductible health plan — meaning a deductible that is at least $3,000 for a family and that applies to virtually all services except preventive care — in order to save for out-of-pocket health expenses. HSAs have been criticized for encouraging enrollment in low-quality health plans, as well as for disproportionately benefitting wealthier taxpayers while providing no assistance to middle- and low-income taxpayers.[4] In fact, HSAs are seen by some financial planners as just another tool to save for retirement that can drastically reduce an individual's tax liability.[5]

h) *Evidence from other states*: Alabama, Mississippi, and South Carolina are the only other states that currently recognize catastrophe savings accounts and they are structured similarly to HSAs. Even with these generous tax benefits, very few taxpayers in these states are actually claiming the deductions associated with contributions to a catastrophe savings account. According to reporting by E&E News, in 2022, "just 0.02% of income tax returns in Mississippi and 0.03% of returns in Alabama claimed the deduction, according to state data, even as hurricanes and other storms pummel the Southeast year after year."[6]

One reason for the lack of uptake for these accounts in other states is likely due to the lack of a corresponding tax benefit in federal law. A state income tax benefit may not be enough of an incentive to motivate people to create an account, and they may not have disposable income on hand to fund it. The catastrophe savings account concept was first introduced in Congress in 2014 and most recently by Senator Rick Scott of Florida.[7]

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[4] Lukens, Gideon. "Expanding Health Savings Accounts Would Boost Tax Shelters, Not Access to Care." Center on Budget and Policy Priorities. June 22, 2023. https://www.cbpp.org/research/health/expanding-health-savings-accounts-would-boost-tax-shelters-not-access-to-care.
[5] Adams, Riley. "What is an HSA? The Ultimate Tax Shelter to Save Money." Young and the Invested. January 13, 2025. https://youngandtheinvested.com/what-is-hsa/.
[6] Ellfeldt, Avery. "States offer tax-free disaster savings accounts. Nobody cares." E&E News by Politico. August 6, 2024. https://www.eenews.net/articles/states-offer-tax-free-disaster-savings-accounts-nobody-cares/.
[7] "Proposal to allow disaster savings accounts gains traction." ABA Banking Journal. November 25, 2024. https://bankingjournal.aba.com/2024/11/proposal-to-allow-disaster-savings-accounts-gains-traction/.

For more information about the impact of recent disasters on the residential property insurance market and the California FAIR Plan, please refer to the Assembly Committee on Insurance's recent Oversight Hearings.

i) *Committee's tax expenditure policy*: Both R&TC Section 41 and Committee policy require any tax expenditure bill to outline specific goals, purposes, and objectives that the tax expenditure will achieve, along with detailed performance indicators for the Legislature to use when measuring whether the tax expenditure meets those stated goals, purposes, and objectives. A tax expenditure bill will not be eligible for a Committee vote unless it has complied with these requirements.

   In its current form, this bill states that the deduction is designed to foster pre-event mitigation and postevent recovery from catastrophes by enabling taxpayers to accumulate funds that can be used to supplement insurance coverage and offset the costs of remediation and repair. In addition, this bill provides that the deduction's effectiveness shall be measured by the number of taxpayers claiming the deduction, the average amount of deductions allowed, and the total amounts deducted.

   In addition to the R&TC Section 41 requirements, this Committee's policy also requires that all tax expenditure proposals contain an appropriate sunset provision to be eligible for a vote. According to this policy, an "appropriate sunset provision" means five years, except in the case of a tax expenditure measure providing relief to California veterans, in which case "appropriate sunset provision" means ten years. This bill, as currently drafted, complies with the Committee's policy on sunset dates.

j) *Implementation considerations*:

   i) *Lack of federal conformity*: As described above, this bill proposes a deduction and income exclusion that have no counterpart in the Federal tax code. In general, state conformity with federal law promotes greater simplicity and eases administration of complex tax laws. This bill would bring California further out of conformity with federal law as the deduction created by this bill could not be claimed on a Federal return. In the absence of similar federal treatment, taxpayers may need to keep separate accounting for state and federal tax purposes.

   ii) *Penalties and improper distributions*: As currently drafted, this bill would allow an income exclusion on interest earned on contributions made in excess of the stated limits, as well as an income exclusion for interest earned on funds from the catastrophe savings account are used for non-qualified expenses. The author may wish to consider amending the bill to disallow these tax benefits when a taxpayer does not comply with limitations established by this bill.

k) *Related legislation*:

   i) AB 1354 (Wallis) would allow a credit for amounts paid in residential property insurance premiums, as specified. AB 1354 is currently pending in this Committee.

   ii) AB 389 (Wallis) would allow a credit of up to $400 per year and $2,000 cumulatively for specified home hardening measures. AB 389 is currently pending on this

Committee's Suspense File.

l) *Prior legislation*: AB 1865 (Jim Patterson), of the 2023-24 Legislative Session, would have established homeownership savings accounts and provided gross income exclusions for investment gains accruing to the accounts and the withdrawal of funds for the purchase of a residential property, as specified. AB 1865 was held on the Assembly Appropriation Committee's Suspense File.

REGISTERED SUPPORT / OPPOSITION:

Support

California Apartment Association
California Association of Realtors
California Bankers Association
California Building Industry Association
Insurance Commissioner Ricardo Lara / California Department of Insurance
Little Hoover Commission
Personal Insurance Federation of California

Opposition

None on file

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