

Date of Hearing: March 3, 2025

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Avelino Valencia, Chair

AB 232 (Calderon) – As Introduced January 13, 2025

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

SUMMARY: Establishes a catastrophe savings account (CSA) for the purposes of covering certain emergency-related expenses. Provides, for taxable years 2025 through 2029, certain state tax benefits on CSA contributions and earnings.

Specifically, **this bill:**

1) Makes the following definitions:

- a) A CSA is a regular savings account or money market account established by a residential property insurance policyholder to cover the deductible for a policy that covers wildfire, flood, or earthquake for the policyholder's primary residence or by an individual to cover uninsured losses for the homeowner's primary residence from a wildfire, flood, or earthquake.
- b) Qualified catastrophe expenses are 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.

2) Authorizes a homeowner to establish a CSA for the purpose of covering the amount of insurance deductibles and other uninsured portions of risks of loss from wildfire, flood, or earthquake.

3) Allows CSA distributions to cover qualified catastrophe expenses and levies a penalty on a homeowner, to be determined by the Department of Financial Protection and Innovation (DFPI), who uses CSA funds for an uncovered purpose.

4) Provides, for taxable years 2025 through 2029, a state gross income exclusion for interest income earned by a CSA.

5) Provides, for taxable years 2025 through 2029, an income deduction for amounts contributed to a CSA. This deduction is capped as follows:

- a) For an individual whose homeowner's policy deductible (qualified deductible) is \$1,000 or less, the deduction is capped at \$2,000.
- b) For an individual whose qualified deductible is more than \$1,000, deduction is capped at the lesser of \$15,000 or twice the amount of the qualified deductible.
- c) For an individual who chooses not to obtain insurance on their primary residence, the deduction is capped at 250,000 but cannot exceed the value of the individual homeowner's primary residence.

- 6) Requires the Franchise Tax Board (FTB) to submit a report to the Legislature detailing the number of taxpayers allowed a CSA deduction.

EXISTING LAW:

Provides for two types of IRAs under federal law, to which state law automatically conforms: traditional IRAs and Roth IRAs. The total amount of qualified contributions to both are not generally deductible or excludible from income under federal or state law.

FISCAL EFFECT: Unknown. This bill is keyed Fiscal by Legislative Counsel.

COMMENTS:

- 1) Purpose.

According to the author:

Assembly bill 232 provides homeowners a proactive method to protect their homes by authorizing tax exempt savings accounts to be utilized for 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.

- 2) Background: Tax advantaged savings accounts.

Tax-advantaged savings accounts encourage certain behavior, such as setting aside money for college, retirement, or health expenses, in exchange for a tax benefit. At the federal level, tax-advantaged savings accounts are some of the largest benefits provided through the federal tax code. Examples include retirement accounts such as the 401(k) and the individual retirement account (IRA) as well as 529 college saving accounts or health savings accounts (HSAs).

Tax-advantaged savings accounts are offered by private sector actors such as investment managers, brokerage services, banks, or other types of financial services companies. These providers typically generate income from fees assessed on customers, though fee levels can vary significantly by company and product. In the case of banks and other depository institutions that take deposits, an additional benefit from accounts such as HSAs is the availability of stable deposits that banks rely on for their other activities.

The below table from the Congressional Research Service (CRS) highlights the different ways these accounts can work. Some accounts offer tax benefits based on contributions into the account, whereas others offer tax benefits on the growth and earnings of the account.¹ And some, like HSAs, offer a dual tax benefit for both contributions and growth.

¹ <https://crsreports.congress.gov/product/pdf/R/R47492>

Federal Tax Benefits of Selected Savings Accounts		
Account Type	Contributions	Growth
Taxable Accounts	Taxable	Taxable.
Traditional retirement accounts	Individual and employer contributions not taxable	Taxable
Roth retirement accounts	Taxable	Not taxable
529 plans	Taxable	Not taxable
Coverdell accounts	Taxable	Not taxable
ABLE accounts	Taxable	Not taxable
HSAs	Individual and employer contributions not taxable	Not taxable
Source: Congressional Research Service		

The above table highlights federal tax benefits only. States can conform to federal tax rules regarding these types of accounts, but may not necessarily do so. For example, California law conforms to federal law with regards to traditional retirement accounts, but not for HSAs. Thus, some accounts offer both federal and state tax benefits whereas others may only provide federal or state tax benefits.

3) Critiques of tax-advantaged savings accounts.

Evidence is mixed on the effectiveness of using tax policy to encourage household saving. For example, some research suggests that the non-tax features of these accounts, such as automatic enrollment, are more powerful in encouraging savings than the tax savings.²

Another criticism of tax-advantaged savings accounts is that higher-income households receive a greater benefit than lower-income households. Generally, these accounts allow participants to lower their taxable income through either deductions or income exclusions, which results in a more generous tax break for higher-income households at higher tax brackets. As a hypothetical, if someone with an annual taxable income of \$200,000 uses a tax-advantaged account to further reduce their taxable income by \$5,000, they would save \$1,600 on federal taxes. In contrast, someone with just \$40,000 in taxable income would save just \$600 on federal taxes even if they contributed the same amount into the account.

4) Early lessons from Los Angeles wildfires and similar disasters

The January 2025 Los Angeles wildfires destroyed more than 16,000 structures and has led to widespread hardship for victims and the surrounding communities. According to an analysis by the Los Angeles Times, real estate losses from the two largest fires – Palisades and Eaton – could exceed \$30 billion, and the fires caused the displacement of approximately 13,000 households.

The full scale of the harm caused by the Los Angeles fires are not yet fully known, but recent experiences from other recent fires suggest that homeowners will face significant unexpected costs in rebuilding. First, while displaced homeowners receive rent stipends, as a practical matter managing the process of rebuilding and living in a temporary location ends up being far more costly than expected. Second, households may be underinsured, meaning their insurance policy will not cover the full cost of rebuilding their destroyed home. According to studies of regions affected by fires, most homeowners do not have enough coverage to rebuild their house after a total loss, leading them to sell their property instead of rebuilding

² <https://crsreports.congress.gov/product/pdf/R/R47492>

their home.³ The incidence of underinsurance complicates our full understanding of what will happen next as homeowners consider their options, with many facing significant new costs well beyond their insurance policy deductible.

5) Emergency savings and household preparedness

The financial uncertainty faced by families who have lost their homes to a natural disaster is worsened by how unprepared many families are for unexpected emergencies. According to data from the Federal Reserve, as of 2023 just a little more than half (54%) of Americans have emergency savings that would sustain them for three months.⁴ A 2022 analysis by the Consumer Financial Protection Bureau, using a different data set than the Federal Reserve, found that a quarter of consumers have no emergency savings whatsoever.⁵ The CFPB also concludes that families with no emergency savings have greater financial constraints, such as poorer credit, higher debt levels and little access to credit (either because they have exhausted their credit limit or do not have a credit card). The CFPB concludes that savings alone cannot prepare families for sudden financial shocks:

Although a savings buffer can help consumers weather financial emergencies—from individual shocks like a sudden car repair or larger-scale shocks like a pandemic or natural disaster—this analysis also highlights that even consumers with some savings may struggle to meet financial obligations and goals. Savings is just one strategy. While consumers with even small amounts of savings are better able to weather financial shocks, our findings suggest it should be coupled with strategies that address other elements of a consumer’s financial condition: their credit health (e.g., credit scores), debt level, as well as their income.

One takeaway from CFPB’s analysis is that we should set appropriate expectations on how much a households can set aside for natural disaster-related expense. While financial education and literacy can play an important role in whether someone saves money for an emergency, generally the limiting factor is a lack of discretionary income to set aside. Given the choice between paying urgent bills and saving for an unknown future event, a rationale person would choose the former.

6) What does this bill do?

AB 232 creates a state-level CSA to help homeowners defray the expenses of a catastrophe such as a wildfire or earthquake through reduced state income taxes. These expenses include whatever deductible owed by the accountholder and any eligible uninsured amounts. Accountholders would receive dual state tax benefits from participating, similar to federal tax benefits offered through an HSA. Specifically, accountholders could deduct their contributions into the CSA from their income, thus lowering the amount of their income subject to California income tax. And, the passive interest earnings from the CSA also grow untaxed.

³ https://papers.ssrn.com/sol3/papers.cfm?abstract_id=5057551

⁴ <https://www.federalreserve.gov/consumerscommunities/sheddataviz/emergency-savings.html>

⁵ https://files.consumerfinance.gov/f/documents/cfpb_mem_emergency-savings-financial-security_report_2022-3.pdf

The CSA proposed by this bill is similar to program seen in a handful of other states. Three states — South Carolina, Mississippi and Alabama — have enacted state-level CSAs. There have also been federal efforts to pass similar legislation in Congress. Most recently, the Residential Emergency Asset Accumulation Deferred Taxation Yield (READY) Account Act would have established a similar tax-advantaged account with federal income tax benefits.⁶ Unlike the CSA established by AB 232, the READY Account Act contains more generous use of account funds, including on mitigation to prevent flood damage such as installing flood walls.

7) Policy considerations.

AB 232 proposes new type of savings account meant to help households defray the high costs associated with catastrophic events such as wildfires or earthquakes. Given the recency and severity of the Los Angeles fires, this proposal is timely and worth considering. However, the proposed CSA will be limited in its effectiveness absent a comparable federal law. And, the author may wish to consider additional ways to ensure that, if state funds are going to subsidize these costs, such funds are also directed to lower-income households. The author may wish to consider the following:

a) CSA participation is likely to be low.

The experiences of the other states with CSAs indicate that relatively few Californians will participate in a similar program. According to an analysis by Politico, in 2022 just 734 out of 2.1 million Alabama tax returns reported CSA deductions, and 258 out of 1.6 million Mississippi returns reported CSA deductions.⁷

One reason why CSAs in other states are failing to gain steam is that their state-only income tax benefits are fairly modest and may not be sufficient to attract participation. A Californian who participates in a CSA under AB 232 would not be able to deduct their account contributions from their federal taxes, and interest gained on the CSA balance would also be subject to federal tax.

Another reason CSAs are struggling to gain traction may just be human nature. People have a difficult time grasping the likelihood of a natural disaster and their actual financial risks, and other tax-advantaged savings accounts such as a retirement account may be a more appropriate use of their savings. After all, most households will need money in retirement, while far fewer households will need emergency funds for a natural disaster.

b) Those who participate in a CSA are less likely to need the tax benefit.

In addition to the likely low overall participation rate, those who do participate are likely to be higher income households with more discretionary income. AB 232's proposed CSA will struggle with the same internal contradiction as other tax-advantaged accounts (discussed in Comment #3): the tax benefits are most lucrative for higher-income households, and these households are more likely to already be setting funds aside for the

⁶ <https://www.rickscott.senate.gov/2024/10/sen-rick-scott-announces-ready-account-act-to-provide-tax-free-savings-accounts-for-disaster-mitigation-and-response>

⁷ <https://www.eenews.net/articles/states-offer-tax-free-disaster-savings-accounts-nobody-cares/>

account's intended purpose. In contrast, households without emergency savings, typically lower-income households with limited discretionary income, likely have a better, more urgent use of their money.

c) DFPI may not be the most appropriate department to administer CSA policy

AB 232 requires DFPI – California's state financial services regulator – to collect a penalty from a homeowner who misuses CSA funds. DFPI may not be the appropriate department for this role for a number of reasons. First, this bill contains limits on contributions based on the homeowner's insurance policy and deductible, and DFPI may not have adequate expertise in this area that would make them effective in identifying misuse. Second, other departments, such as the Franchise Tax Board (FTB), may have existing administrative processes to determine the appropriate use of tax-advantaged savings account distributions, which would allow them to more easily implement the bill's provisions.

REGISTERED SUPPORT / OPPOSITION:

Support

Insurance Commissioner Ricardo Lara / California Department of Insurance (Sponsor)
American Property Casualty Insurance Association
California Association of Realtors
Little Hoover Commission (org & Economy Comm.)

Opposition

None received.

Analysis Prepared by: Luke Reidenbach / B. & F. / (916) 319-3081