

# SB 1520

## Tax Subtraction – Settlement Received from Wildfire

Senate Committee on Finance and Revenue – Informational Meeting

2/21/2024 | LRO

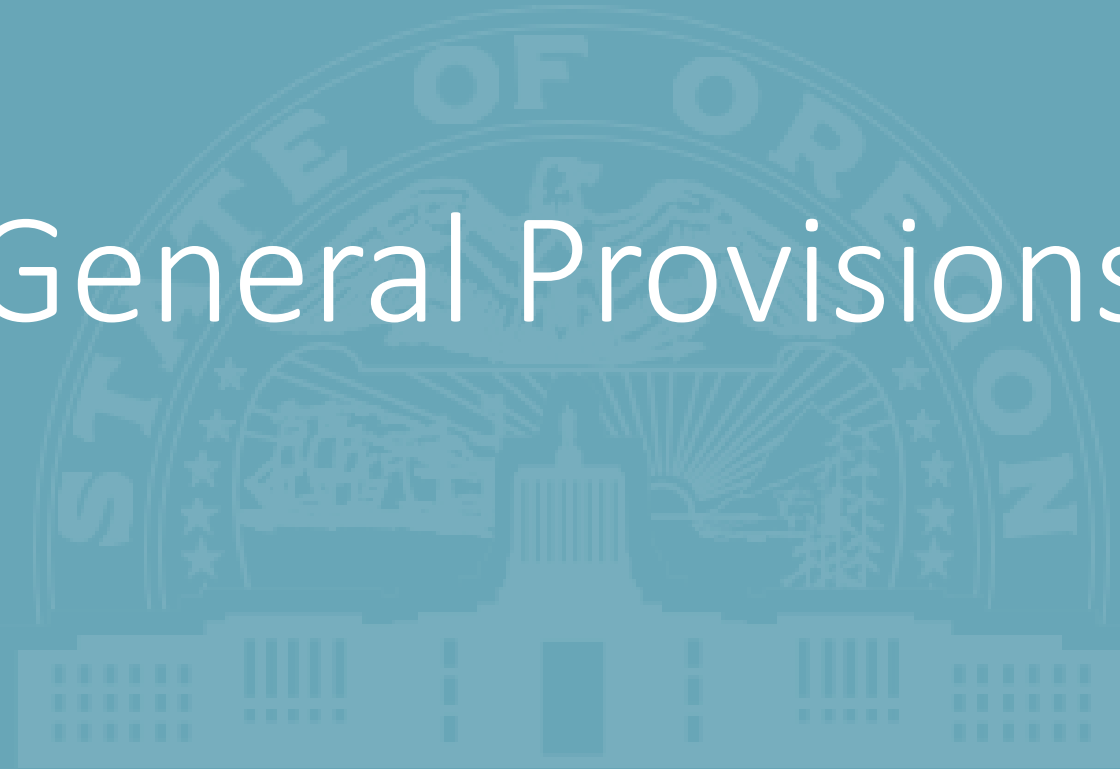


# Overview of Presentation

- Viewed in connection to one-pager
- Discuss tax treatment of payments from settlement / judgment
- Treatment of legal fees
- Federal legislation
- Simplified upshot



# General Provisions





# Qualified Disaster Relief Payment

- Federal law, IRC 139 – Oregon connected to provision
  - Excludes from income: any amount received by an individual as a qualified disaster relief payment (specific to federally declared disasters)
    - Payments to reimburse or pay reasonable & necessary personal, family, living, and funeral expenses
    - Payments to repair or rehabilitate personal resident or repair/replace its contents
  - Excludes payments compensated by insurance or otherwise





# Judgement / Settlement: Non-Taxable and Taxable

Non-Taxable	Taxable
<ul style="list-style-type: none"><li>• Personal physical injury or sickness</li><li>• Emotional distress or mental anguish, if attributable to personal physical injury or sickness</li></ul> <p data-bbox="445 1049 955 1092">If not otherwise deducted</p>	<ul style="list-style-type: none"><li>• Proceeds for emotional distress &amp; mental anguish (not attributable to physical injury)</li></ul>





# Property Damage Compensation

Key Term: Adjusted basis in property

- Adjusted basis= Purchase price + cost of subsequent improvements – depreciation (business/rental property)
- If settlement amount **less** than adjusted basis
  - Amount is not taxable, basis in property reduced by amount of settlement
- If settlement amount **greater** than adjusted basis
  - Amount in excess of adjusted basis is income





# Example – Property Damage Compensatory Payment

Settlement Exceeds Basis	
Adjusted basis	\$100,000
Value at time of disaster	\$300,000
Settlement	\$300,000
Excess amount	\$200,000
Capital gain income	<b>\$200,000</b>





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## Replace the Property

- Treated as an **involuntary conversion**
- Tax is deferred on gain of property until replacement property is sold, basis unchanged
- Replacement period, typically 2 to 4 years
- Gain deferred cannot exceed the Fair Market Value of the replacement property







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## Exclusion of gain for primary residence

- May qualify to exclude \$250K (S) \$500K (J) of capital gain of primary home





# Compensatory & Punitive Damages

- “Origin of the claim”
- Compensatory damages for taxable sources of income (e.g. wages) are taxable
- Punitive Damages
  - OR Dept. of Justice becomes judgment creditor, receives portion of punitive damages
    - 60% for deposit in Criminal Injuries Compensation Account
    - 10% for deposit in State Court Facilities & Security Account
  - Attorney fees limited to 20% of overall punitive damages awarded
  - Individual taxed on entire 30% of award



# Legal Fees





# Legal Fees

- Generally, legal fees are not deductible and entire settlement is reported as income, including dollars paid to attorney (aligned with settlement source)
- If the settlement award is non-taxable, legal fees are not taxable (personal physical injury & illness)
- Potential to capitalize if recovery is for capital asset
- Class action, legal fees not taxable when paid on their behalf (where no express contractual liability exists)





# Legal Fees Continued

- **Certain Miscellaneous Deductions**
  - Itemized deduction
  - Allowed deduction of legal fees
  - Only deduct amount exceeding 2% of AGI
  - Phase limit on itemized deduction, AMT (federal)
- **Federal Tax Cuts and Jobs Act of 2017 (TCJA)**
  - Eliminated certain misc. deduction for tax years 2018 through 2025



# Federal Legislation



HR 7024 – Tax Relief for American Families and Workers Act of 2024

Sec. 403 – Exclusion from gross income for compensation for losses or damages resulting from certain wildfires



# Federal HR 7024

- Pending federal legislation, passed house chamber 1/31/2024
- Oregon connected to changes via rolling reconnect
- Excludes from income
  - “Qualified wildfire relief payment”
    - Any amount received by or on behalf of an individual as compensation for losses, expenses, or damages...incurred as a result of a qualified disaster (federally declared disaster)
    - Not compensated for by insurance or otherwise
    - Denial of double benefit
    - Applies to payments received during taxable years 2020 through 2025
    - Applicable to any forest or range fire declared federal disaster after 12/31/2014





# Upshot

Economic Damages	Non-Economic Damages	Punitive Damages
<ul style="list-style-type: none"><li>• Non-taxable or potentially taxable depending on actions following award (attributable to physical injury, involuntary conversion, replacement of property, etc.)</li></ul>	<ul style="list-style-type: none"><li>• Generally taxable</li></ul>	<ul style="list-style-type: none"><li>• 70% to Oregon for deposit in Criminal Injuries Compensation Acct. (60%), and State Court Security &amp; Facilities Acct. (10%)</li><li>• Remaining 30% is taxable</li></ul>
<p><b>Legal Fees:</b> Generally not tax deductible in tax years 2018 through 2025, some exception for class-action &amp; award amounts due to physical injury/sickness</p>		
<p><b>Federal proposed legislation:</b> Exclusion from income (economic &amp; non-economic), specific to federally declared disasters</p>		





# Legislative Revenue Office

<https://www.oregonlegislature.gov/lro>

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