Fiscal Note

BILL # HB 2204

TITLE: technical correction; wage board; powers NOW: taxation; subtraction; virtual currency

SPONSOR: Weninger

STATUS: House Engrossed

PREPARED BY: Nate Belcher

Description

HB 2204 would establish 2 new individual income tax subtractions. First, the bill would allow a taxpayer to subtract the value of cryptocurrency received by the taxpayer in an "airdrop" (a mass distribution of cryptocurrency for free to encourage its widespread usage). In addition, if a taxpayer reports a gain or loss related to the sale of cryptocurrency, the bill would authorize the taxpayer to subtract the amount of "gas fees" (transaction fees) associated with that cryptocurrency's purchase, unless those fees are already included in the cost basis for tax purposes.

The bill also changes the state's itemized deduction policy for personal casualty losses. Currently, Arizona taxpayers who elect to itemize deductions may deduct any personal casualty loss (not compensated for by insurance), but this deduction is limited based on Arizona's conformity to federal tax law. Among other restrictions, deducted losses must exceed 10% of adjusted gross income (AGI) and be attributable to a federally declared disaster. HB 2204 would: 1) Remove the requirement for any casualty loss deduction to be related to a federally declared disaster; and 2) Authorize a separate itemized deduction for 100% of virtual currency and non-fungible token (NFT) casualty losses (such as theft). A taxpayer could claim this deduction regardless of whether these casualty losses exceeded 10% of adjusted gross income.

The bill would take effect beginning in tax year 2023.

Estimated Impact

We estimate that HB 2204 would result in a reduction of IIT revenues by at least $(500,000) annually related to removing the requirement that a casualty loss be limited to a federally declared disaster. In terms of the cryptocurrency provisions, the impact appears to be minimal in some circumstances and would likely represent foregone potential revenue in other cases since we may already not be collecting income taxes on these monies.

Analysis

The first provision of HB 2204 allows a taxpayer to subtract the value of virtual currency received during an airdrop from the taxpayer's AGI. This subtraction is only allowed for the initial value of the virtual currency when received by the taxpayer and would not prohibit the state from taxing any subsequent capital gains that accrue from the virtual currency. Under a virtual currency airdrop, creators of a new virtual currency will distribute the currency to a large number of persons in order to encourage widespread usage. Given that an "airdropped" currency is typically in the initial stages of development, the net value received by any individual taxpayer is typically a small amount as measured in US dollars. Given this, we expect this provision to have a minimal fiscal impact.

The second provision of the bill allows a taxpayer, upon the sale of virtual currency, to subtract the value of "gas fees" incurred in the purchase of the virtual currency when calculating capital gains/losses for tax purposes. When calculating capital gains/losses on the sale of asset, taxpayers compare the final sale price of the asset to the cost basis. The cost basis for an asset is generally considered to be the initial purchase price along with any other adjustments allowed by statute. Under HB 2204, taxpayers would be allowed to adjust the cost basis of any virtual currency by the amount of gas

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fees paid during the initial purchase. When using virtual currency trading platforms, users are typically charged a transaction fee (known as a "gas fee") that ranges from 0.25% to 1%, depending on the size of the transaction. Given that the bill's gas fee provision would represent a minor percentage adjustment to the cost basis, we expect this provision to have a minimal fiscal impact.

HB 2204 would also make 2 changes to the state's itemized deduction policy for personal casualty losses:

- Remove the requirement for any casualty loss deduction to be related to a federally declared disaster. The federal Tax Cuts and Jobs Act (TCJA) of 2017 changed Section 165 of the Internal Revenue Code to require that any casualty loss itemized deduction must be attributable to a federally declared disaster. When Arizona elected to conform to this provision, JLBC Staff estimated this change would increase General Fund revenues by $500,000 annually based on nationwide data published by the Joint Committee on Taxation (JCT) in 2017. Given that publication date, we assume this JCT-sourced impact related to standard types of losses incurred by taxpayers and did not include any virtual currency or NFT losses. Given that HB 2204 would now permit the deduction of casualty losses <u>not</u> related to federally declared disasters, this $500,000 amount would be the corresponding annual General Fund revenue loss. Examples of this type of loss are uninsured property damage incurred from extreme weather events and accidents, or property loss from theft.
- Authorize a separate itemized deduction for casualty losses related to virtual currency and non-fungible tokens (NFTs) irrespective of any federal limitations, such as the federal requirement that deducted casualty losses must exceed 10% of adjusted gross income. Because this provision would relate specifically to virtual currency and NFT casualty losses, our analysis of this provision reviewed published data on these types of specific losses which almost exclusively occur as theft. Given the decentralized nature of these assets, however, there is limited formal data available on virtual currency theft and we were unable to find any reliable data on NFT theft. Due to this lack of data, we are unable to estimate the impact of this provision.

Local Government Impact

Beginning in FY 2024, incorporated cities and towns will receive 18% of individual and corporate income tax collections from 2 years prior from the Urban Revenue Sharing Fund (URSF) established by A.R.S. § 43-206. Therefore, based on the identified $(500,000) annual revenue impact, the bill would decrease overall URSF distributions to cities and towns by an estimated $(90,000) annually.

3/16/22