ARIZONA STATE SENATE

Fifty-Fifth Legislature, Second Regular Session

AMENDED

FACT SHEET FOR H.B. 2204

~~technical correction; wage board; powers~~

~~(NOW: taxation; subtraction; virtual currency)~~

(NOW: taxation; virtual currency; non-fungible tokens)

Purpose

Effective January 1, 2023, prescribes the tax treatment of virtual currency and non-fungible token (NFT) gains and losses.

Background

Individual income tax is levied on Arizona residents' taxable income and uses a graduated rate structure, based on the taxpayer's income level. The tax base begins with Arizona gross income, which is equivalent to the taxpayer's federal adjusted gross income (AGI). Statute authorizes various amounts to be added or subtracted when computing an individual's Arizona AGI, which is further reduced by standard or itemized deductions to arrive at Arizona taxable income (A.R.S. §§ 43-1021 – 43-1023; and 43-1042).

The U.S. Internal Revenue Code (IRC) allows a deduction for any loss sustained during the taxable year that is not compensated for by insurance or otherwise. The deduction is limited to: 1) losses incurred in a trade or business; 2) losses incurred in any transaction entered into for profit not connected with a trade or business; and 3) losses of property not connected with a trade or business or a transaction entered into for profit, if the losses arise from theft or from fire, storm, shipwreck or other casualty. For TYs 2018 through 2025, an individual's personal casualty loss must be allowed as a deduction only to the extent that it is attributable to a federally declared disaster (26 U.S.C. § 165).

The Joint Legislative Budget Committee fiscal note for H.B. 2204, as introduced, estimates that removing the requirement for a casualty loss to be limited to a federally declared disaster would result in a reduction of individual income tax revenue of at least $500,000 annually. For the cryptocurrency provisions, the fiscal impact appears to be minimal in some circumstances and would likely represent foregone potential revenue in other cases (JLBC fiscal note).

Provisions

1. Establishes an individual income tax subtraction, to the extent not already excluded from Arizona gross income under the U.S. IRC, for the value of virtual currency and NFTs the taxpayer received through an airdrop, at the time of the airdrop.

2. Allows a taxpayer who included a gain or loss on the sale of virtual currency or an NFT in their Arizona gross income to subtract gas fees from the taxpayer's Arizona gross income, if in calculating the gain or loss the taxpayer did not include any gas fees paid on the purchase of the virtual currency or NFT or did not otherwise deduct the gas fees in determining their Arizona gross income.

3. Precludes the virtual currency and NFT subtraction from being interpreted as providing a subtraction for any appreciation in value that occurs from holding the currency after the initial receipt of the airdrop.

4. Defines *virtual currency* as a digital representation of value that functions as a medium of exchange, a unit of account and a store of value other than a representation of the U.S. dollar or a foreign currency.

5. Defines *NFT* as a non-fungible cryptographic asset on a blockchain that possesses unique identifiers or other metadata that distinguishes the asset from another token or asset in a manner that makes the asset irreplaceable and non-exchangeable for a similar token or asset.

6. Defines *gas fee* as a fee paid to the operator of a virtual network for the use of the network to facilitate the purchase, sale or exchange of virtual currency or an NFT.

7. Defines *airdrop* as the receipt of virtual currency through a means of distribution of virtual currency to the distributed ledger addresses of multiple taxpayers.

8. Defines *foreign currency.*

9. Makes conforming changes.

10. Becomes effective on January 1, 2023.

<u>Amendments Adopted by Committee of the Whole</u>

1. Limits the income tax deduction for personal casualty losses allowed by the U.S. IRC to losses related to virtual currency and NFTs.

2. Allows a taxpayer to deduct the amount of personal casualty losses related to virtual currency and NFTs in addition to, rather than in lieu of, the federally itemized deduction for personal casualty losses allowed by the U.S. IRC.

3. Allows a taxpayer who included a gain or loss on the sale of an NFT in their Arizona gross income to subtract gas fees from the taxpayer's Arizona gross income, as outlined.

4. Defines *NFT* as a non-fungible cryptographic asset on a blockchain that possesses unique identifiers or other metadata that distinguishes the asset from another token or asset in a manner that makes the asset irreplaceable and non-exchangeable for a similar token or asset.

5. Includes, in the definition of *gas fee,* the fee paid to the operator of a virtual network for the use of the network to facilitate the exchange of virtual currency or NFTs and the purchase or sale of NFTs.

6. Makes technical and conforming changes.

Amendments Adopted by Conference Committee

- Removes the deduction for the amount of personal casualty losses related to virtual currency and NFTs to the extent they are not deducted under section 165 of the U.S. IRC.

House Action

COM	2/15/22	DPA/SE	9-1-0-0
3rd Read	2/23/22		52-7-1

Senate Action

FIN	3/9/22	DP	6-3-1
3rd Read	6/20/22		22-4-4

Prepared by Senate Research
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MG/slp