JLBC Staff Analysis of the Federal Budget Reconciliation Bill (H.R. 1) on Arizona State Budget

H.R. 1, otherwise known as the One Big Beautiful Bill, was signed into law on July 4, 2025. There are many provisions in this bill which may directly impact the Arizona state budget. On July 10, 2025, we published our initial analysis of H.R. 1 by focusing on the tax conformity impacts of the bill.

This July 17th version of this document expands our analysis to include the Supplemental Nutrition Assistance Program (SNAP). As our office continues analysis of the bill in its entirety, we will provide updates to this document addressing additional provisions. We anticipate the next update in several weeks will address H.R. 1's health provisions.

As displayed in Table 1, the combined conformity and SNAP provisions are currently projected to cost the state $381 million in FY 2026, $284 million in FY 2027 and $463 million in FY 2028. These estimates are subject to change as the federal government provides additional implementation guidance on various provisions of the bill.

<u>SNAP Provisions</u>

SNAP is a federal low-income food assistance program administered by the Arizona Department of Economic Security (DES). Prior to H.R. 1, the federal government paid 100% of the cost of SNAP benefits. The federal government and the state each paid 50% of the administrative costs of the program.

At least 2 provisions of H.R. 1 could have a substantial impact on state costs:

- Starting in FY 2027, the state share of administrative costs will increase from 50% to 75%. We project this provision will cost Arizona $33 million in FY 2027 and $44 million in FY 2028.
- Starting in FY 2028, a state will begin to pay a percentage of SNAP benefit costs if their error rate in administering the program is 6% or above. The FY 2028 payment will be based on the lower of the FY 2025 or FY 2026 error rate, each of which will be available about 12 months after the end of the fiscal year. The state's FY 2024 error rate was 8.8%. If Arizona's error rate stays at that level through FY 2026, the state would be responsible for 10% of the SNAP benefit cost. The cost would be $139 million in FY 2028 and would annualize to $185 million in FY 2029.

H.R. 1 also expands SNAP work requirements, which may increase DES's administrative costs. We will need information from DES before evaluating this potential impact.

The new SNAP administrative and benefit cost share provisions combined are projected to cost Arizona $33 million in FY 2027 and $183 million in FY 2028. Further detail on these provisions is included in Appendix B.

Federal Tax Provisions

The following description of the tax provisions as well as our dollar estimates remain the same as our original analysis on July 10th. We have, however, updated some of the descriptions in Appendix A for clarity.

The state of Arizona mostly conforms to federal tax law as Arizona tax returns use federal adjusted gross income as the starting point from which to calculate the amount of state individual and corporate income tax owed. To the extent that federal law changes would affect the calculation of federal adjusted gross income, Arizona tax revenue would potentially be affected by H.R. 1.

Our analysis of the federal tax provisions focuses on new policy changes contained in H.R. 1 (for example, deductions related to tip and overtime income). H.R. 1 also extended a significant number of federal tax law provisions which were previously scheduled to expire – those "extension provisions" are not projected to have a fiscal impact, as conforming to those items would continue existing policy at the state level.

Most of the federal tax law changes are effective for Tax Year 2025 income tax returns that would begin to be filed in the spring of 2026. Since Arizona does not automatically conform to federal tax law changes, the state would need to amend statute to reference H.R. 1 for the federal changes to apply to spring 2026 state income tax filing.

We estimate the FY 2026 state General Fund cost of conformity to be $381 million. A summary of the tax impacts appears on Page 3, while Appendix A provides more detail on individual provisions.

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Federal Impacts of H.R. 1 Provisions on Arizona General Fund Budget

Table 1

		A	B	C
		FY 2026	FY 2027	FY 2028
	Revenue Adjustments - Tax Conformity			
1	Establish Additional $6,000 Deduction for Seniors through 2028	(53.7)	(53.6)	(54.3)
2	Increase SALT Deduction from $10k to $40k through 2030	(79.7)	(67.3)	(70.7)
3	Reduce Income Tax on Tips through 2028	(23.6)	(17.9)	(18.8)
4	Reduce income Tax on Overtime through 2028	(76.5)	(59.8)	(53.6)
5	Establish Trump Accounts and Contribution Pilot Program - Minimal Estimated Impact	-	-	-
6	Establish Permanent Full Expensing for Certain Business Property	(31.8)	(20.8)	(15.2)
7	Restore Full Expensing of Domestic Research and Experimental Expenditures	(50.5)	(30.8)	(20.7)
8	Restore Higher Deducution on Business Interest	(9.8)	(9.3)	(8.5)
9	Increase Small Business Expensing Allowance from $1.25M to $2.5M	(10.0)	(8.4)	(7.0)
10	Create Special 100% Depreciation Allowance for Certain Non-Residential Production Property	(45.5)	(51.7)	(51.1)
11	Makes Opportunity Zone Program Permanent along with Other Changes to the Program	-	42.8	(8.1)
12	Require 0.5% Floor on Deduction of Itemized Charitable Deduction	-	16.9	17.3
13	All Other Provisions	(0.3)	8.9	10.3
14	**Subtotal - Revenue Adjustments - Tax Conformity**	**(381.4)**	**(250.9)**	**(280.4)**
15	**Spending Adjustments - SNAP**			
16	Increase State Share of SNAP Administrative Costs from 50% to 75%	-	32.7	44.2
17	Require State Cost Sharing of Benefits if Error Rate Is 6% or Higher	-		138.7
18	Expand Work Requirements	-	-	-
19	**Subtotal - Spending Adjustments - SNAP**	**-**	**32.7**	**182.9**
20	**Total - Federal Impacts of H.R. 1 on Arizona General Fund Budget**	**381.4**	**283.6**	**463.3**

Preliminary Detailed General Fund Revenue Estimates of State Income Tax Conformity to H.R. 1 [1/] [2/]

	Provision	Changes to Federal Law	Effective	$ Millions FY 2026	$ Millions FY 2027	$ Millions FY 2028
1)	Additional $6,000 Deduction for Seniors (which phases out for income above $75,000/$150,000)	Creates an additional standard deduction for taxpayers over 65 from 2025 through 2028. The deduction is equal to $6,000 per individual and phases out at a 6% rate for single taxpayers making above $75,000 and married taxpayers making above $150,000. This provision is frequently described as eliminating federal income taxes on Social Security benefits. HR 1 does not literally eliminate federal taxation of these benefits, but instead provides this additional deduction to offset the federal tax impact for most Social Security households. Arizona already exempts all Social Security benefits from state income taxes, but the state could still choose to conform to this higher deduction for taxpayers over 65. The senior deduction is available whether a taxpayer takes the standard deduction or itemizes their deductions. [IIT impact]	TY 2025 to TY 2028	($53.7)	($53.6)	($54.3)
2)	Limitation on Individual Deductions for Certain State and Local Taxes ("SALT Deduction")	Increases the cap for the SALT deduction from $10,000 to $40,000 for taxpayers making less than $500,000 in TY 2025. The deduction cap phases down at a 30% rate, from $40,000 to $10,000, for taxpayers making over $500,000. Increases this cap by 1% each year from TY 2026 through TY 2029. Beginning in TY 2030, the SALT deduction will be capped at $10,000. [IIT impact]	TY 2025 to TY 2029	($79.7)	($67.3)	($70.7)
3)	Reduce Taxation on Tips	Adds a deduction for qualified tips from 2025 through 2028. Includes a $25,000 limit on the amount of the deduction, and the deduction is generally limited to occupations that the Treasury Secretary certifies “customarily and regularly” received tips before 2025. The deduction phases out at a 10% rate for single taxpayers making more than $150,000 and married couples making more than $300,000. The tips deduction is available whether a taxpayer takes the standard deduction or itemizes their deductions. [IIT impact]	TY 2025 to TY 2028	($23.6)	($17.9)	($18.8)
4)	Reduce Taxation on Overtime	Adds a deduction for qualified overtime compensation from 2025 through 2028. There is a $12,500 limit on the amount of the deduction ($25,000 for married couples). The deduction applies to the extra compensation a taxpayer earns in overtime, not their entire compensation during overtime. (For example, an employee who earns $20/hour base pay and $30/hour as overtime pay, would be eligible for the deduction on the incremental $10/hour earned during overtime.) The deduction phases out at a 10% rate for single taxpayers making more than $150,000 and married couples making more than $300,000. The overtime deduction is available whether a taxpayer takes the standard deduction or itemizes their deductions. [IIT impact]	TY 2025 to TY 2028	($76.5)	($59.8)	($53.6)
5)	Trump Accounts and Contribution Pilot Program	Creates a new tax-advantaged savings account called a Trump Account. Accounts are available only for children under the age of 18 for whom a social security number has been issued. For US citizens born between January 1, 2025, and December 31, 2028, the federal government will contribute $1,000 per child to every eligible account. Parents, family members and employers may contribute up to $5,000 annually to a Trump Account, indexed for inflation. There is no tax liability on capital gains until funds are withdrawn from the account. Amounts from these accounts may not be distributed to beneficiaries until after they have reached age 18. Most of the federal cost is related to the $1,000 contribution by the federal government to the Trump Account. Since the federal government's contribution to the new accounts will not affect federal adjusted gross income, this provision is expected to have a minimal state-level impact. [IIT impact]	TY 2025 and after	-	-	-
6)	Full Expensing for Certain Business Property (100% Bonus Depreciation)	Establishes 100% bonus depreciation <u>permanently</u> for business investments in machinery, equipment, and other short-lived assets from Jan. 19, 2025, onward. (Under current law (TCJA), bonus depreciation is equal to 40% in 2025, 20% in 2026, and 0%, beginning in 2027.) [IIT impact; no CIT impact due to Arizona not conforming to this provision for corporations]	Property acquired after 1/19/2025	($31.8)	($20.8)	($15.2)
7)	Full Expensing of Domestic Research and Experimental Expenditures	Permanently restores full expensing for businesses’ domestic research and development (R&D) investments, retroactive from January 1, 2025 onwards. Since 2022, domestic R&D investments have had to be amortized (i.e., deductions spread out) over five years. Allows retroactivity to the beginning of 2022 (not just the beginning of 2025) for small businesses that meet an average annual gross receipts threshold of $31 million or less. [IIT & CIT impact]	TY 2025 and after (but retroactive to TY 2022 for small businesses)	($50.5)	($30.8)	($20.7)

Preliminary Detailed General Fund Revenue Estimates of State Income Tax Conformity to H.R. 1 [1/ 2/]

				$ Millions	$ Millions	$ Millions
	Provision	**Changes to Federal Law**	**Effective**	**FY 2026**	**FY 2027**	**FY 2028**
8)	Modification of Limitation on Business Interest	Permanently restores a more generous interest deduction limit that was in place from 2018 through 2021 under TCJA, retroactive from January 1, 2025 onwards. The more generous interest deduction limit is based on earnings before interest, taxes, depreciation, and amortization (EBITDA) rather than earnings before interest and taxes (EBIT). The EBIT standard went into effect in 2022. [IIT & CIT impact]	TY 2025 and after	($9.8)	($9.3)	($8.5)
9)	Increased Dollar Limitations for Expensing of Certain Depreciable Business Assets (Small Business Expensing)	Permanently increases the Sec. 179 expensing allowance targeted at small businesses, from a maximum of $1.25 million to a maximum of $2.5 million in 2025. Raises the threshold at which the expensing allowance begins to phase out for Sec. 179 property, from $3.13 million to $4 million in 2025. Both amounts above are indexed for inflation after 2025. [IIT & CIT impact]	TY 2025 and after	($10.0)	($8.4)	($7.0)
10)	Special Depreciation Allowance for Qualified Production Property	Creates temporary, 100% depreciation for non-residential structures (i.e., real estate) that is placed in service in the U.S. before Jan. 1, 2031, for which construction begins between Jan. 19, 2025, and Jan. 1, 2029, and that is used for "qualified production activity." "Qualified production activity" includes manufacturing, refining, agricultural production, or chemical production. [IIT & CIT impact]	Property placed in service after date of enactment	($45.5)	($51.7)	($51.1)
11)	0.5 Percent Floor on Deduction of Contributions Made by Individuals	Sets a 0.5%-of-contribution floor on the itemized charitable deduction, so that the first 0.5% of charitable contributions are not eligible for the itemized deduction. (For example, a taxpayer donating $100,000 to charity, their first $500 would not be deductible.) [IIT impact]	TY 2026 and after		$16.9	$17.3
12)	Permanent Renewal and Enhancement of Opportunity Zones	Sunsets currently designated Opportunity Zones (OZ) on December 31, 2026 (rather than December 31, 2028, as provided under prior law). This earlier sunset will result in capital gains being paid in FY 2027. Establishes a new, permanent OZ program, with OZ designations every 10 years, beginning January 1, 2027. There are tax benefits associated with investments in the OZs. Also changes the definition of low-income community for the purpose of OZ designations. [IIT & CIT impact]	Taxable years beginning after date of enactment		$42.8	($8.1)
13)	Other Smaller Provisions		Various	($0.3)	$8.9	$10.3
	Total Conformity Cost/Revenue Loss			**($381.4)**	**($250.9)**	**($280.4)**

Other Non-Conformity Provisions: [3/]

14)	Increase of Standard Deduction ($750/$1,125/$1,500)	Adds $750 to the standard deduction for single taxpayers, $1,125 for head of households, and $1,500 for married couples in 2025, so that the standard deduction in 2025 is $15,750 for single filers, $23,625 for head of household filers, and $31,500 for married couples filing jointly. Continues to adjust the standard deduction for inflation after 2025. [IIT impact]	TY 2025 and after	($44.2)	($45.0)	($46.2)
15)	New Auto Loan Interest Deduction	Creates a new deduction for certain auto loan interest from 2025 through 2028. The deduction is limited to $10,000 overall and phases out at a 20% rate for single taxpayers making above $100,000 and married taxpayers making above $200,000. The deduction only applies to vehicles that are completed (i.e., assembled) in the U.S., and are new vehicles (not used). The auto loan deduction is available whether a taxpayer takes the standard deduction or itemizes their deductions. [IIT impact]	TY 2025 to TY 2028	($12.6)	($18.8)	($23.1)
16)	Permanent and Expanded Reinstatement of Partial Deduction for Charitable Contributions of Individuals Who Do Not Elect to Itemize	Creates a deduction for charitable contributions from 2026 onwards for those who do not itemize deductions, equal to $1,000 for single taxpayers and $2,000 for married couples. Arizona statute allows an individual who takes the standard deduction for state income tax purposes to increase their standard deduction by 33% (this percentage is adjusted for inflation annually) of their charitable contributions that otherwise would have been deductible if they had elected to itemize their tax return. Because this state deduction for non-itemizers is similar to the one provided under HR 1, there could be some interactions between the state and federal provisions that affect the scoring of the state conformity cost. For this reason, additional research and analysis may be needed. [IIT impact]	TY 2026 and after		($18.2)	($19.0)
	Total Cost - Non-Conformity Provisions			**($56.8)**	**($82.0)**	**($88.4)**

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1/ JLBC Staff estimate based on prorating the nationwide impact as projected by the congressional Joint Committee on Taxation (JCT) staff, which provides the official scoring of federal tax legislation.

2/ The state uses federal adjusted gross income as the starting point for Arizona income taxes. We currently lack definitive information on which provisions will be included in federal adjusted gross income. This chart's display reflects our preliminary analysis of the bill language relative to conformity provisions.

3/ These provisions are not likely to be included in federal adjusted gross income. The state may still consider whether to conform to the items. If the state chooses to conform to the non-conformity provisions, the total cost would increase to $(438) million in FY 2026, $(333) million in FY 2027, and $(369) million in FY 2028.

	Provision	Changes to Federal Law	Estimated Impact on Arizona	Effective	$ Millions FY 2026	$ Millions FY 2027	$ Millions FY 2028
1)	Administrative Cost Sharing	Increases the state's share of SNAP administrative costs from 50% to 75%. The federal share will decline from 50% to 25%.	We estimate that the 25% increase to the state share generates a cost of $44.2 million on an annual basis, but the cost would be $32.7 million in FY 2027 since the provision does not become effective until October 2026. This estimate is based on a federal Office of Management and Budget (OMB) report that shows Arizona spent $160.9 million in total on SNAP administration in FFY 2023. Our estimate assumes this amount grows at an annual rate of 2% based on Congressional Budget Office (CBO) projections of administrative cost increases within SNAP.	10/1/2026	$0.0	$32.7	$44.2
2)	Benefit Cost Sharing/ Error Rates	Adds a state matching requirement for SNAP benefits that is based on the state's payment error rate. States will be exempt if their error rate is below 6%. As the error rate increases above 6%, states are required to pay an increasing percentage of the SNAP benefit costs *(Please see table below.)* On a one-time basis, states with error rates above 13.3% are exempt from the benefit share provisions for up to 2 years after the regular October 2027 effective date. On an ongoing basis, a state's benefit share will be based on its error rate 3 years prior. In FFY 2028, the state will have the choice of using its FFY 2025 or FFY 2026 error rate. Error Rate — State Match 0%-5.99% — 0% 6%-7.99% — 5% 8%-9.99% — 10% 10% or more* — 15% *In FFY 2028 and FFY 2029, states above 13.3% will have no cost share.	The FY 2028 cost of this provision will depend on the state's error rate in FFY 2025 or FFY 2026. In the last 3 years, the state's error rate has been: • FFY 2022 = 11.4% • FFY 2023 = 11.4% • FFY 2024 = 8.8% We lack a reliable means of estimating the error rate for either FFY 2025 or FFY 2026, the two benchmarks for the FFY 2028 rate. As a result, our estimate is based on Arizona maintaining its current error rate of 8.8%. At that level, we estimate that the state cost will be $185.0 million on an annual basis, but the cost would be $138.7 million in FY 2028 since the provision does not become effective until October 2027. This estimate assumes that SNAP benefits in Arizona will equal $1.85 billion by FFY 2028. Our estimate assumes that in the absence of SNAP benefit and eligibility changes required by H.R. 1, SNAP benefit spending in Arizona would have grown to $2.14 billion by FFY 2028 based on national baseline growth estimates from CBO, or approximately 2% each year. However, we have reduced the $2.14 billion figure by (13.5)% to $1.85 billion to reflect other benefit and eligibility reductions included in H.R. 1. The (13.5)% assumption is based on CBO's scoring of these reductions relative to its baseline estimates.	10/1/2027	$0.0	$0.0	$138.7
3)	Modifications to SNAP Work Requirements	Under current law, non-disabled SNAP enrollees aged 16-59 are subject to a <u>general work requirement</u> that requires registration for work, accepting a job if offered, and, if already employed, not quitting a job or reducing work hours. In addition, able-bodied adults without dependents (ABAWDs) aged 18-54 are subject to an <u>additional work requirement</u> of a minimum of 20 hours per week of employment or participation in a state-administered work program. Individuals subject to the additional work requirement may only receive SNAP benefits for 3 months in a 36-month period unless they comply with the additional work requirement. H.R. 1 modifies the <u>additional work requirement</u> as follows: •Increases the minimum age required for an exemption from 55 to 65. •Includes adults with dependents if the dependents are aged 14 or older. •Adds exemption for American Indians •Removes exemption for homeless individuals, veterans, and former foster youth aged 24 or younger	We estimate that this provision may generate additional administrative costs within the Department of Economic Security (DES). We would need more information from the agency to determine what impact, if any, these changes would have on DES costs given this provision modifies an existing administrative function. We also estimate that this provision will reduce SNAP caseloads, which may serve to reduce the agency's administrative workload. H.R. 1 also limits the state from applying for waivers for the additional work requirement in select regions. Under current law, states are authorized to receive waivers of the applicability of the additional work requirement and associated 3-month time limit if the state determines, subject to USDA approval, that an area of the state "does not have a sufficient number of jobs to provide employment". Arizona's waiver approved by USDA through September 2025 waives the additional work requirement for A) residents of all counties except for Maricopa County and B) 16 tribal reservation areas. As a result, the additional work requirement is effectively only currently applicable in non-tribal areas of Maricopa County. H.R. 1 would only authorize waivers in jurisdictions with an unemployment rate of over 10%. For its current waiver, DES reported unemployment rates below 10% for all counties and for 12 of the 16 tribal areas. As a result, DES will likely need to reduce and/or modify its future waiver requests, which would subject more SNAP recipients to the additional work requirement and thereby increase SNAP administrative workload.	Date of Enactment (7/4/2025)	-	-	-

Total Cost - SNAP Provisions **$0.0** **$32.7** **$182.9**