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, a number of which may directly impact the Arizona state budget. As our office continues analysis of the bill in its entirety, we will provide updates to this document addressing additional provisions, including the bill's changes to the Supplemental Nutrition Assistance Program (SNAP) and Medicaid.

The estimates in this document are subject to change as the federal government provides additional implementation guidance on various provisions of the bill.

This July 10th version of the document solely contains our analysis of the federal tax provisions within H.R. 1.

Federal Tax Provisions

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 1, while Appendix A provides more detail on individual provisions.

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

		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	**Total - Revenue Adjustments - Tax Conformity**	**(381.4)**	**(250.9)**	**(280.4)**

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

				$ Millions	$ Millions	$ Millions
	JCT Description of Provisions:	**Changes to Federal Law**	**Effective**	**FY 2026**	**FY 2027**	**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. 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. Taxpayers may contribute up to $5,000 annually of after-tax dollars to a Trump Account, indexed for inflation. Amounts from these accounts may not be distributed to beneficiaries until after they have reached age 18. Most of the federal cost of the Trump Accounts 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 permanently 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)
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)

	JCT Description of Provisions:	Changes to Federal Law	Effective	$ Millions FY 2026	$ Millions FY 2027	$ Millions FY 2028
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: 2/

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. For state cost scoring purposes, additional research is needed to determine how this federal provision may interact with a similar provision provided for non-itemizers in state statute. [IIT impact]	TY 2026 and after		($18.2)	($19.0)
	Total Cost - Non-Conformity Provisions			**($56.8)**	**($82.0)**	**($88.4)**

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. The following 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.