STATE OF ILLINOIS
EXECUTIVE OFFICE OF THE GOVERNOR

GOVERNOR'S OFFICE OF MANAGEMENT AND BUDGET

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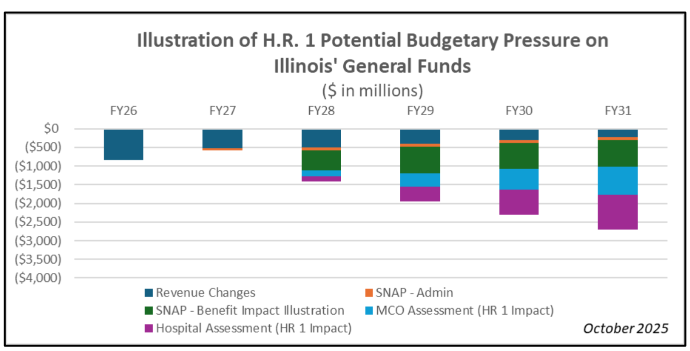
UPDATE TO THE OCTOBER 2025 ECONOMIC AND FISCAL POLICY REPORT: FEDERAL UPDATES

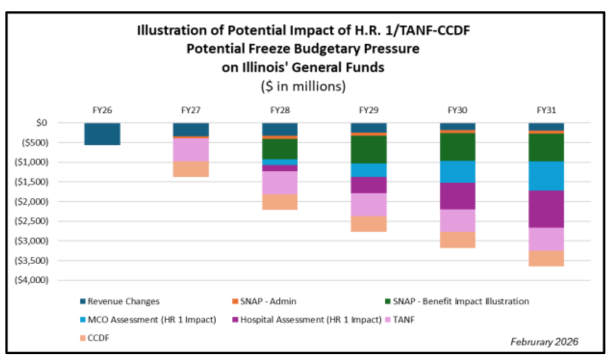
The following materials update information previously published in the 2025 Illinois Economic and Fiscal Policy Report to illustrate the potential magnitude of impacts to the Illinois budget resulting from changes in federal law and policy.

Over the last year, the federal government – primarily through the actions of the executive branch but also through changes driven by Congress – has attempted to alter the historical relationship between itself and state and local governments. This has included many actions that result in reduced federal funding for the states and changes in funding methodologies for many joint federal-state programs. Often the apparent federal objective is the reduction of the federal government's outlay of support, while expecting states to backfill with their own resources the gap or reduce services in programs that serve as a lifeline to some of the nation's most vulnerable populations.

State governments are facing many budgetary pressures, including inflation, increasing demands for state services as a result of economic conditions at the national level, necessary technology and cybersecurity updates, often required for compliance, to enable state programs and operations to be as efficient as possible, and infrastructure needs in response to evolving workforces and service delivery methods. These realities are concurrent with these potential reductions in federal support. Unlike the federal government, all states, including Illinois, are required to annually balance their budgets and have limited, if any, options to fill gaps left by these federal reductions.

ESTIMATED IMPACT OF H.R. 1 AND OTHER POTENTIAL FEDERAL CHANGES





Recently enacted provisions of federal House Resolution 1 (H.R. 1), now Public Law 119-21 (the Budget Reconciliation Bill), will impact the State's financial trajectory because of fundamental changes to decades-old federal programs and changes to the federal tax code that can impact Illinois' revenues. Additionally, in January 2026, the federal government threatened five states, including Illinois, with a freeze of federal funding that supports critical human services programs, including child care, by withholding payments from the Child Care Development Fund (CCDF), the Temporary Assistance to Needy Families (TANF) program, and the Social Services Block Grant (SSBG).[1] The attempted freeze on CCDF and TANF funding has been put on hold due to court action.

The above charts illustrate the estimated budgetary pressure in fiscal year 2026 and the next five fiscal years based on both the changes in H.R. 1 and the threatened freeze to CCDF and TANF (were that to occur). The charts compare the estimated impact from October 2025 to the potential current impact. While the future year projections in the previously published report illustrated many financial challenges coming to Illinois over the next few years due to H.R. 1 changes, threats to freeze CCDF and TANF funding would further reduce the state's annual federal funding and would significantly limit the State's ability to provide services to Illinoisans. Additionally, while there have been already budgetary challenges in fiscal year 2026 due to federal actions, with potentially more in fiscal year 2027, the scale of the impact is expected to continue to grow over the next few years.

Analysis of Tax Provisions of H.R. 1

H.R. 1 was enacted in July 2025, after the passage of Illinois' fiscal year 2026 budget package. In addition to a range of changes affecting federal support for federal-state government partnership programs, H.R. 1 also made several changes to federal tax code provisions, including extending several expiring provisions of the 2017 Tax Cuts and Jobs Act (TCJA) and modifying existing provisions of the U.S. tax code.

As outlined in detail in the Illinois Economic and Fiscal Policy Report[2] published in October 2025, a number of these changes are expected to negatively impact the State's General Funds revenue collections in fiscal year 2026 and beyond, particularly for taxes paid by businesses. Most states with income taxes link their tax codes to federal tax law in some way to streamline administration and filing of taxes at the federal and state levels. Illinois has an automatic or "rolling" conformity[3] to most of the business tax law changes in H.R. 1.

At the time of publication of the report in October 2025, DOR estimated that the changes in H.R. 1 would reduce fiscal year 2026 General Funds revenue collections by $830 million when compared to the revenue forecast at the time the fiscal year 2026 budget was passed. At that time, changes that benefited business taxpayers were estimated to account for approximately 95 percent of the estimated reduction in fiscal year 2026 revenues.

The General Assembly and Governor took action on two of the tax law changes that would have negatively impacted state revenues. Public Act 104-0453, effective December 12, 2025, included a decoupling from the 100 percent bonus depreciation for manufacturing structures and updated the reference to Net CFC

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[1] https://capitolnewsillinois.com/news/trump-freezes-10b-in-social-service-child-care-funding-for-illinois-4-other-blue-states/; See also: https://illinoisattorneygeneral.gov/news/story/attorney-general-raoul-files-lawsuit-to-stop-trump-administration-from-illegally-withholding-billions-in-essential-childcare-funding-for-families1.8.26

[2] https://budget.illinois.gov/content/dam/soi/en/web/budget/documents/economic-and-fiscal-policy-reports/Economic_and_Fiscal_Policy_Report_FY26_10.9.25.pdf

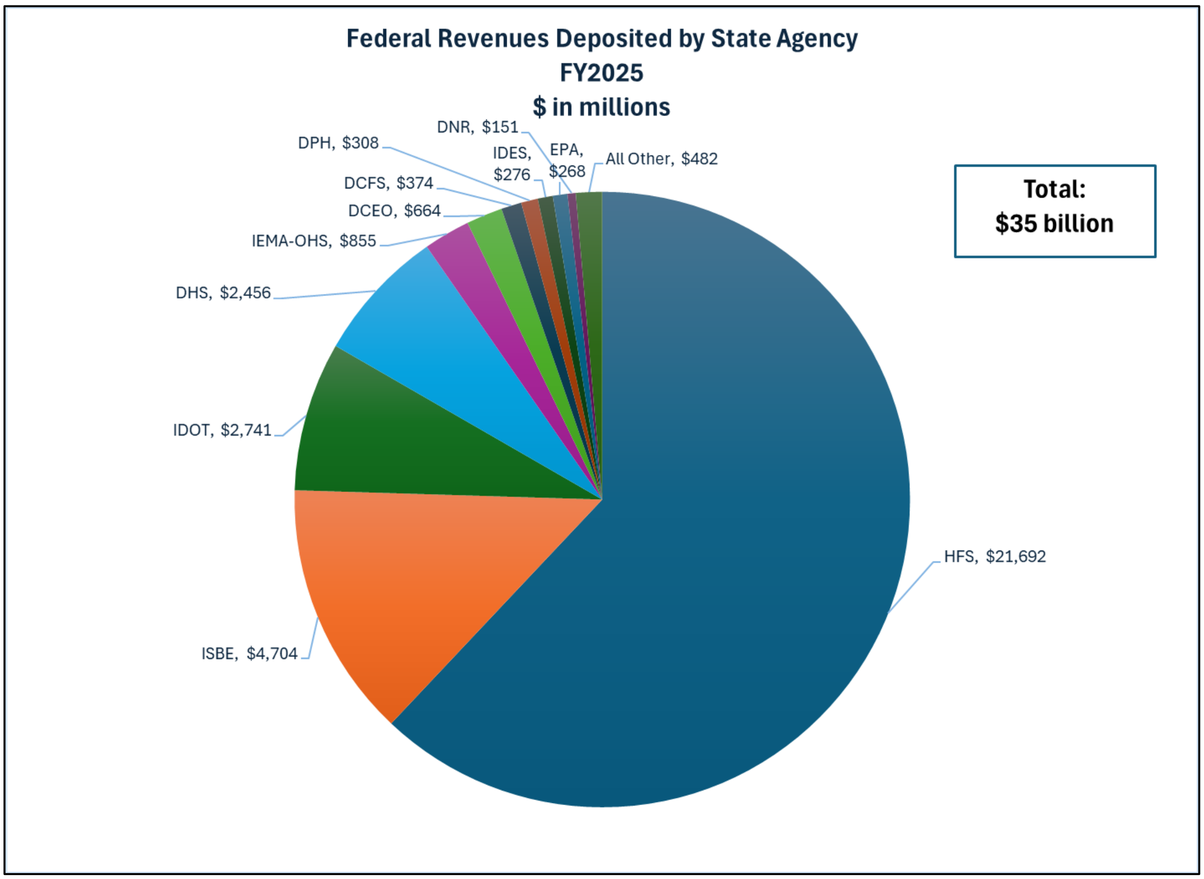
[3] States will link to a federal definition or federal base, in part to ease administrative burdens for taxpayers and to make enforcement of a state's tax laws easier for its Department of Revenue. Additionally, tax law structures may support certain goals through tax policy. However, states are linked to federal tax structures to a varying degree. Illinois generally links to Adjusted Gross Income (AGI), with some modifications.

Tested Income (NCTI) and the applicable sections of the Internal Revenue Code to reduce the H.R.1 impact by an estimated $243 million on the fiscal year 2026 General Funds budget. Because of the changes, the impact has been limited to an estimated $587 million in fiscal year 2026, and less in future years as much of the remaining impact was due to acceleration of certain tax benefits forward.

The timing of the impact of the revenue changes in H.R. 1 is expected to be a nearly double impact in fiscal year 2026 as many corporate taxpayers have likely reduced their September or December 2025 estimated payments or April 2026 final payments[4] to "catch up" on the 2025 tax changes while also reducing estimated payments through the spring of 2026 to reflect lower 2026 liabilities. Fiscal year to date, corporate income tax payments were below forecasted amounts, particularly in September and December, aligning with expectations, but the Department of Revenue will have an updated assessment of the impact of H.R. 1 on corporate income taxes with April 2026 payments.

Analysis of Certain Programmatic Changes in H.R. 1

Illinois, similar to all states, receives significant federal revenues each fiscal year, to carry out various governmental functions and public services. These federal funds are primarily allocated for purposes such as Medicaid and social services, K-12 and higher education, public health initiatives, infrastructure projects, and environmental projects.



4 Alternatively, there could be an unexpected increase in requests for tax refunds, which would manifest as an expenditure pressure rather than a shortfall of revenue.

Federal funds deposited into the General Funds are primarily reimbursements for Medicaid and Medicaid related program expenditures. Other federal revenues are deposited into various funds in the State Treasury. In fiscal year 2025, approximately $35 billion in federal revenues were deposited into the State Treasury across all funds, of which approximately $21 billion was drawn by the Department of Healthcare and Family Services for Medicaid and Medicaid-related program reimbursements.

The fiscal year 2026 budget framework estimated federal revenues of just under $4.2 billion for the General Funds. In recent years, federal revenues deposited into the State's General Funds have ranged from $3.8 billion to $4.7 billion.

Implementation Needs Associated with H.R.1

The Department of Human Services (DHS) and the Department of Healthcare and Family Services (HFS) will need to implement operational and programmatic changes in response to H.R. 1. Additional federal mandates imposed by H.R. 1 require investment in additional staff and upgraded technology to manage the SNAP and Medicaid caseload and to ensure compliance with the new work requirements and complete eligibility redeterminations on the new six-month schedule for both SNAP and Medicaid. Combined, this is expected to cost the State over $100 million over the next two years to prepare for implementation.

Supplemental Nutrition Assistance Program

H.R. 1 makes several fundamental changes to the Supplemental Nutrition Assistance Program (SNAP) food assistance program beginning in fiscal year 2027.[5] Starting October 1, 2026, the federal government will shift a greater share of SNAP administrative costs—from 50 percent up to 75 percent—to states, which represents an estimated $80 million annual cost increase to Illinois. This will impact the State's General Funds budget trajectory by reducing federal revenues deposited annually while raising the State's contribution to maintain the same—or a higher—level of administrative support for the program.

Additionally, beginning October 1, 2027 (the start of Federal Fiscal Year (FFY) 2028), H.R. 1 establishes a new state cost-sharing requirement for SNAP benefits tied to each state's payment error rate (PER). This is a fundamental shift in the federal support for SNAP benefits as the states have previously only been involved to provide administrative support for this federal assistance program.

For the first year of state cost-sharing (FFY 2028), states will be able to choose between its PER for already completed FFY 2025 (10/1/24-9/30/25) or FFY 2026 (10/1/25-9/30/26). If Illinois were to fall into the 15 percent penalty bracket for any year, that would create a new $705 million annual liability on roughly $4.7 billion in benefits.

Other federal policy changes could lead to reduced program participation or benefits for hundreds of thousands of state residents. The graphs at the beginning of this report illustrates the impact of the potential cost share if the General Funds were required to cover a 15 percent state cost-share scenario.

Medicaid Impacts

H.R. 1 will also impact the State's Medicaid program by making changes to eligibility provisions and placing limitations on healthcare provider taxes (e.g. hospital and managed care organization taxes)[6] that Illinois

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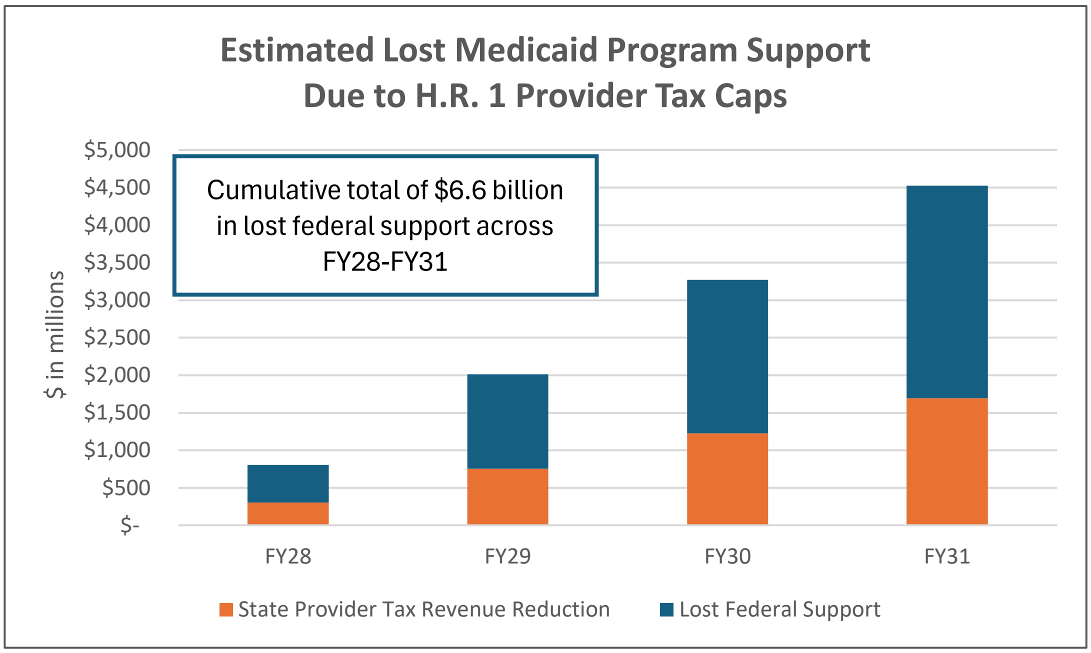
[5] Additional information on the potential impacts on SNAP and Medicaid are available on the Department of Human Services' website - https://www.dhs.state.il.us/?item=174038 and https://www.dhs.state.il.us/OneNetLibrary/27897/documents/SNAP/HHS%20Trump%20Budget%20Bill%20Briefing%20Deck_08012025_A11Y%20(1).pdf

[6] For more information see the National Association of Medicaid Directors' "How Medicaid Provider Taxes Work: An Explainer" (https://medicaiddirectors.org/resource/how-medicaid-provider-taxes-work-an-explainer/) and KFF's "5 Key Facts About Medicaid and Provider Taxes" (https://www.kff.org/medicaid/5-key-facts-about-medicaid-and-provider-taxes/)

and most other states use to support the Medicaid system. Most of the budgetary impact will begin in fiscal year 2028 as the maximum tax rate allowed for the hospital and MCO provider taxes will decrease from a current maximum of 6.0 percent of net patient revenues by 50 basis points a year until it reaches a maximum rate of 3.5 percent in fiscal year 2032.

These changes will reduce tax revenue generated while also reducing significantly the amount of federal funding that is annually provided to Illinois to support Medicaid. Absent any changes to H.R. 1's provisions, or additional state funding to backfill the federal cuts, the federal changes to the provider tax program will reduce federal Medicaid support in Illinois by approximately $2.8 billion annually by fiscal year 2031. The chart below illustrates the amounts by which Illinois' General Revenue Fund contribution to the Medicaid program would need to increase each year to draw in sufficient federal funds to replace the lost federal match. Such increases would create a State General Funds budget pressure of approximately $1.7 billion annually by fiscal year 2031.[7] By fiscal year 2031, Medicaid funding in Illinois will drop by $4.5 billion because of the provisions included in H.R. 1. It should be noted that these amounts show the impact of H.R. 1 only through fiscal year 2031. The total annual impact to the Medicaid program after full phase-in of the rate caps will be $6.1 billion by fiscal year 2033, $3.8 billion of which is lost federal support.



There were additional changes in H.R. 1 that are expected to impact the State's Medicaid program, including cost sharing for certain enrollees and mandatory work requirements for non-disabled Medicaid customers ages 19-64 without dependents under the age of 14. These changes would reduce the total liability of the State's Medicaid program but estimates of these impacts on the General Funds budget are not included in this review. Another change included in H.R.1 will require assessment tax parity between Medicaid MCOs and non-Medicaid MCOs. Currently, Medicaid MCOs pay a significantly higher tax rate than non-Medicaid MCOs. The impact of this required change to state revenues will depend upon how Illinois resolves the issue.

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[7] If the State was able to provide an estimated $1.7 billion into the Medicaid system, that would generate additional federal funding match which, jointly, could replace the $4.5 billion in lost funding. If the State does not replace any of the federal cuts, then the total impact would be $4.5 billion to the Medicaid program, including the reduction in provider tax payments back to the Medicaid system.

Other Federal Changes

Additionally, the federal government is changing its level of support for states, local governments, and community-based providers across various grant programs, including maternal health, emergency disaster and hazard preparedness, domestic violence prevention, HIV/AIDS prevention, substance abuse programs, violence prevention, climate change mitigation, renewable energy, mental health support, and agricultural support through actions by the executive branch and by Congress. The potential impact of these cuts generally is not reflected in the budgetary walkdown as impacted amounts either are spread across many different funds in the State Treasury outside of the General Funds or do not run through the State Treasury. However, canceled and reduced grants to entities in Illinois total several hundred million dollars, with significantly more potential cuts currently subject to litigation. **GOMB expects the State to have a very limited ability to replace lost federal funding for these specialized state grants and no funding to replace lost grants made directly to local governments and community organizations.**