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MTF Brief

January 12, 2026

Federal Tax Changes and the State Budget

As budget writers prepare for the Fiscal Year (FY) 2027 budget development process, they continue to closely monitor FY 2026 revenue collections and the myriad factors—stemming from both state and federal action—that impact the stability of the state budget. The task before the Administration, House and Senate is to develop a budget for the coming year that responds to the immediate and longer-term fiscal and economic challenges and opportunities that confront the state. One of the decision points before them is how to address potential revenue impacts stemming from federal tax policy changes made in the One Big Beautiful Bill Act (OB3).

This Brief provides an overview of the issue and a framework for any policy response. In doing so it provides a basic understanding of how federal conformity works in relation to the Massachusetts tax code and how critical it is to corporate tax simplicity, predictability and competitiveness. The Brief also explains that reliable estimates for the impacts of federal changes are challenging, as well as the dangers in hasty, uncoordinated action on conformity. It concludes with four principles that should be central to any tax conformity policy discussion.

When and How Do Federal Tax Changes Impact Massachusetts?

The interplay between federal and state tax policy is complicated, but several basic principles provide clarity to understanding that interplay. Massachusetts, like all states, sets forth in statute how its definition of taxable income – both personal and corporate – relates to the federal definition. The basic decision before states is if their definition of income will adhere to the federal definition on a rolling basis, meaning that the state will automatically adopt federal changes to the definition of taxable income, or on a static basis, in which the state adheres to the federal definition as of a specific date.

In Massachusetts, corporate taxable income conforms to the federal definition on a rolling basis, while the definition of taxable personal income uses static conformity and adheres to the federal Internal Revenue Code (IRC) in effect as of January 1, 2024. It is important to note that in both cases, there are exceptions to these conformity approaches, but the general

rule is that the state definition of corporate taxable income changes automatically when federal changes occur, whereas the state definition of personal taxable income does not.

It is also important to clarify that conformity does not apply to rates of taxation. Massachusetts establishes its own rates of taxation, both at the personal and corporate level, without regard for federal rates. Conformity only matters in determining the base of income that is subject to tax, including the deductions that can be made to taxable income.

Given Massachusetts' conformity approach, none of the OB3 tax changes that alter personal income – such as tax treatment of tips or the increased senior deduction – have any impact on personal income tax collections in Massachusetts. However, changes that affect how federal corporate income is defined will affect the definition of corporate income in Massachusetts.

Do All Federal Corporate Tax Changes Affect Massachusetts Tax Law?

While Massachusetts generally conforms to the IRC for corporate taxes, including trade or business expense deductions, there are exceptions. In a guidance issued in October of 2025, the state Department of Revenue (DOR) highlighted a number of OB3 tax changes and their assessment of the potential impact to Massachusetts taxes. Of the 29 corporate provisions, Massachusetts conformed in 23 instances but did not conform in 6 cases. Whether or not Massachusetts conforms is not always clear cut. This lack of clarity underlines the importance of a deliberate approach to any policy actions related to tax conformity: these policies are complicated and precipitate action leads to bad policy.

What is the Theory Behind Rolling Conformity?

Rolling conformity has three major benefits for Massachusetts and taxpayers:

- *Simplicity* – Corporate tax returns, at both the state and federal level are complicated, costly, and time-consuming to complete. Just as importantly, the consequences for errors are significant. Thousands of Massachusetts companies do business in all fifty states. The more differences between the Massachusetts and federal definitions of corporate income, the more complex the filing process and the greater the likelihood of error.
- *Predictability* – The ability for a tax filer to know what to expect is a major asset for any tax system. By maintaining rolling conformity with the federal code, businesses in Massachusetts can reliably plan around changes at the federal and state level at the same time.
- *Competitiveness* – Cost is a key factor in business competitiveness and a state's tax structure is a key component of cost. By aligning the Massachusetts definition of corporate income with the federal definition, Massachusetts ensures that it's

corporate tax system does not fall out of line with federal changes that will be adopted by most other states.

The competitive advantage of maintaining rolling conformity is particularly apparent in the case of OB3, when several changes relating to how businesses can deduct certain research and development or facility expenditures are designed to incentivize investment in the United States.

How Does the Department of Revenue Assess OB3 Conformity Impacts?

Accounting for the state fiscal impact of federal policy changes is always a tall task and it is especially challenging in the tax arena where the behavioral and economic effects of a change can far outweigh the revenue impacts of a tax policy adjustment assessed in a vacuum. Therefore, policymakers typically use analysis provided by DOR, which does not make assumptions on behavior, and weigh that analysis alongside an assessment of any broader economic impacts.

In September, DOR released its estimates for the impact of OB3 tax changes on tax collections in Massachusetts. The agency provided a nine-year outlook, focusing on the specific impacts of five corporate tax changes:

- *Research and experimental expense deductions* – increases allowable deductions in the year in which they occur;
- *Limitation of business interest in income* – allows businesses to deduct depreciation and amortization costs from business income;
- *Depreciable business asset expensing* – increases allowable deductions for depreciating business assets;
- *Qualified production property depreciation* – allows businesses to fully deduct the cost of new manufacturing facility production in the year in which the facility comes on line;
- *Expansion of opportunity zones* – makes permanent the opportunity zone tax benefit and expands investments that can qualify for the tax treatment.

Department of Revenue Analysis of Corporate Conformity Impacts (FY 2026-FY 2030)

	FY 2026	FY 2027	FY 2028	FY 2029	FY 2030
Research and Experimental	-\$288	-\$87	-\$56	-\$33	-\$16
Modification of Business Interest	-\$52	-\$25	-\$23	-\$21	-\$21
Depreciable Asset Expensing	-\$25	-\$17	-\$14	-\$12	-\$10
Qualified Production Properties	-\$98	-\$131	-\$134	-\$118	-\$82
Opportunity Zones	\$0	-\$18	-\$33	-\$32	-\$20
Corporate Conformity Impact	-\$463	-\$278	-\$260	-\$216	-\$149

In total, DOR estimated that these changes will reduce corporate tax collections by \$463 million in FY 2026 and \$278 million in FY 2027. By FY 2030 the impact would be less than \$150 million.

The DOR estimates were generated using congressional Joint Committee on Taxation projections of the revenue impact on federal collections, and are by definition rough estimates that may not take into account how specific provisions relate to the makeup of the state's business sector.

How Do Economic Experts Estimate the Impacts of Corporate Conformity?

The FY 2027 Consensus Revenue Hearing offered policymakers the first opportunity to hear from local economic experts on how they believe federal tax changes will affect state tax revenue collections. As detailed in MTF's analysis of the hearing, each projection accounted for potential tax revenue losses related to federal changes. While five out of six projections assume the state will fall short of the FY 2026 non-surtax revenue benchmark, most assumed a small shortfall (less than one percent) or above benchmark revenue growth. In FY 2027, projections were more bullish, with all forecasts projecting growth of at least 2.1 percent, and three of the projections forecasting non-surtax growth of 3.5 percent or greater.

Based on the projections presented at the hearing, Administration, House and Senate budget makers are likely to build their FY 2027 revenue estimate on an unchanged FY 2026 base. Should the current FY 2026 revenue benchmark remain in place, it would imply that any negative impact from corporate conformity will be offset by better than expected revenue growth in other areas.

What are the Policy Options for Mitigating Revenue Impacts of Conformity?

During an economic roundtable convened in October and at the Consensus Revenue Hearing, budget writers made clear that they needed to assess the potential impact of federal tax changes. Even if the Administration chooses to recertify the FY 2026 revenue

benchmark as part of the Consensus Revenue Agreement, it is possible that policy proposals to change current conformity status are put forward.

Generally, there are two tacks when it comes to decoupling: permanently eliminating state conformity with a specific federal change or delaying adoption of a federal change at the state level.

Permanent decoupling eliminates any revenue loss from a federal change, but it does so at considerable cost to the simplicity and predictability goals of the corporate tax code described above. The more exceptions Massachusetts makes with its rolling conformity the more complexity it adds for filers and the greater the likelihood of compliance problems.

Permanent decoupling is particularly problematic from the standpoint of tax competitiveness. The changes that impact Massachusetts are generally designed to incentivize business investment by providing greater tax benefits in the initial year of an expenditure or when a facility is completed. For Massachusetts to proactively eliminate those benefits at the state level would immediately create a competitive disadvantage with the two dozen or so other states with rolling conformity and undercut the competitiveness progress made with the 2023 tax bill.

Another policy option would be to delay conformity. The tax provisions in OB3 are effective for tax year 2025, creating a significant FY 2026 impact. Delaying state conformity to tax year 2026 would push that fiscal impact into FY 2027 and beyond and provide a better opportunity to build any implications into next year's budget.

One of the challenges with rolling conformity is that it can disrupt fiscal planning by making the state subject to immediate revenue changes based on policies made outside of the state. However, creating different timelines for state and federal implementation adds complexity to the system.

What Principles Should Guide OB3 Tax Policy Considerations?

As policymakers assess tax conformity options they should ensure that they adhere to four principals of action:

1. **Tax Code Competitiveness** – The state made a major improvement to corporate tax competitiveness in 2023 with the passage of single sales factor apportionment. Adhering to federal corporate changes, especially related to the expensing and treatment of business interest, is important for maintaining the state's progress on business taxes as we relate to other states.
2. **Taxpayer Simplicity and Predictability** – As noted above, one of the primary benefits of corporate tax conformity is to ease compliance hurdles. At the same time, tax

policy predictability is something that large entities rely on for planning purposes. Maintaining alignment with the federal corporate code is central to both simplicity and reliability. The more places the Massachusetts code departs from the federal, the fewer the benefits of conformity and the more likely compliance difficulties arise.

3. **Responsive Revenue Modeling** – The Department of Revenue’s estimates for OB3 impacts are an important tool for policymakers, but they are designed to provide a rough directional guide and should be weighed against actual collection experience and mitigating economic factors. In some cases – for example, the impact of the qualified production property changes – the scope of the change in Massachusetts may not be as large as in other states. Therefore, policymakers should not simply apply DOR estimates as a reality to work against.
4. **Manage Volatility** – The major challenge with federal corporate tax changes is that they provide state policymakers with little ability to plan around short-term impacts and this can create real disruption within a fiscal year. Directionally, this can be seen in the DOR estimates which show the largest fiscal impact in FY 2026 – the current fiscal year. Policies that can smooth an FY 2026 impact while maintaining federal conformity can ease near-term budget disruption with fewer negative tax policy implications.

Bottom Line

Massachusetts’ conformity to the federal corporate tax code is a strength for tax competitiveness and for tax filers. OB3 made changes to the code in ways that will affect collections in Massachusetts, though the extent of that impact is hard to assess and could be offset by other collection factors. As budget writers begin the FY 2027 budget development process, it makes sense to look at potential conformity impacts and examine options to smooth short-term revenue impacts. However, it is critical that policy proposals do not sacrifice tax competitiveness, simplicity and predictability for questionable revenue gains.