THE CIVIC FEDERATION

Understanding H.R. 1: How Federal Tax Code Changes Could Impact Illinois

As the State of Illinois budget season approaches, the Civic Federation continues its work on the State's fiscal outlook and potential budget issues likely to emerge in the next few months. In previous reports, we have considered the State's fiscal outlook as of mid-fall and explored how federal H.R. 1, signed into law on July 4, 2025, may affect the Supplemental Nutrition Assistance Program (SNAP). In this "explainer," we continue our focus on H.R. 1, particularly its tax code provisions. We describe selected changes and their impacts on Illinois, assess the State's responses to date, and briefly discuss other policy adjustments the state might consider going forward.

H.R. 1, the Budget Reconciliation Bill, passed by Congress last summer and signed into law on July 4, 2025, as P.L. 119-21, significantly revised federal individual and business income tax provisions. Illinois is among 26 states whose state income tax code "rolls with" changes in the federal Internal Revenue Code (IRC), meaning federal tax changes automatically affect state tax liabilities unless the state legislature intervenes to "decouple." While rolling conformity simplifies tax administration and compliance for taxpayers, especially those operating in multiple states, full conformity can expose a state to considerable and often unpredictable shifts in revenue.

Illinois faced an over $830 million revenue loss in the current 2026 fiscal year from all federal tax code changes included in last year's federal legislation, primarily due to changes to business taxation—most notably, expanded "expensing" provisions that allow corporations to immediately deduct the full cost of certain investments.

To mitigate these negative fiscal impacts, Illinois passed Senate Bill 1911, enacted into state law as Public Act (P.A.) 104-0453 in December 2025. This post highlights three specific provisions of Illinois's new law:

1) First, the State formally "decoupled" from provisions related to the expensing of investments in qualified production property, which is nonresidential real property used in the manufacturing, production, or refining of tangible personal property, saving the state an estimated $144 million in FY2026.
2) Second, the State essentially chose to conform with federal changes to treatment of international income earned by corporations with foreign subsidiaries: by tweaking its own legal definition of foreign income to align with the federal definition, the state protects an additional $90 million in tax revenues in FY2026.
3) Third, P.A. 104-0453 removed the sunset date of Illinois's pass-through entity tax "workaround", providing continued federal tax relief to individuals subject to the SALT (state and local tax) deduction cap.

These changes, combined with better-than-expected sales tax and individual income tax revenues received to date, will help the State close a projected $267 million budget gap in FY2026. The changes will also contribute modestly to closing a far larger projected $2.2 billion gap in FY2027—a gap which reflects essentially flat revenues due to slowing growth and continuing H.R. 1 impacts in the face of a $1.9 billion increase in expenditures.

Going forward, Illinois must weigh the administrative simplicity and economic incentives of tax code conformity against the need for local fiscal stability, making selective, strategic decisions on federal-state tax alignment in a world where federal-state relationships are undergoing significant change.