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Fiscal Year (FY) 2026 Conference Committee Preview

Re-Evaluating FY 2026 Revenue Estimates

Last week, MTF published its first Conference Committee preview for the Fiscal Year (FY) 2026 budget, *Reconciling Revenue and Spending Differences Between the House and Senate Final Budgets*. That brief summarized the spending and policy proposals put forward by each branch, identified shared and unique priorities, and estimated the spending and resource gap that budget writers must solve in order to send a balanced budget to the Governor's desk.

Based on the budget bills that were passed by each branch, MTF estimated that policymakers face a non-surtax spending and resource gap ranging from $400 million to $770 million. Depending on the approach adopted to several revenue-generating initiatives, that is the amount of spending that would need to be cut from the House and Senate budgets to live within available resources.

MTF Preliminary Estimated Spending & Resource Gap (non-surtax)

	House	Senate
Total Proposed Spending	$59,627	$59,722
Shared Spending	$59,200	
Unique Spending	$437	$522
Est. Maximum Spending Level	**$60,159**	
Max/Min Revenues	**$59,761**	**$59,390**
Potential Spending & Resource Gap	**-$398**	**-$769**

$ in millions

However, while this estimate offers a preliminary understanding of the challenging decisions facing the Conference Committee, it does not reflect how spending decisions would be impacted by a re-evaluation or potential downgrade to FY 2026 revenue estimates.

In this second Conference Committee preview, MTF describes why changing economic trends and the negative impacts of federal action support a re-assessment of FY 2026 revenue expectations. The brief also emphasizes the importance of collaboration between the Healey administration, House, and Senate when adjusting revenue assumptions, reducing spending, and building a more sustainable state budget.

FY 2026 Original Revenue Assumptions

In January, budget leaders agreed to a $41.214 billion non-surtax consensus tax revenue estimate for FY 2026; reflecting an increase over expected FY 2025 collections of $907 million, or 2.25 percent. Tax collections were expected to be predominantly supported by moderate growth in income tax collections, particularly non-withheld income; offset by decreases in sales and corporate tax collections.

FY 2026 Consensus Revenue Estimate

	FY 2025 Benchmark	FY 2026 CR Agreement	$ Increase over FY 2025	% Increase over FY 2025
Non-Surtax Revenue	$40,307	$41,214	$907	2.25%
Surtax Spending Cap	$1,300	$1,950	$650	50.00%
Revenues Available for Budgeted Spending	**$41,607**	**$43,164**	**$1,557**	**3.7%**

$ in millions

This original estimate served as the revenue foundation for each of the FY 2026 budget proposals filed and passed by the Governor, House, and Senate; and despite calls to downgrade revenue expectations in the Spring, no adjustments were made during the budget development process.

In April, MTF maintained that while policymakers must consider all spending and revenue decisions within the context of increased economic uncertainties driven by federal action, there were several reasons why waiting until at least June to make any adjustments to the revenue benchmark was advisable.

- **FY 2025 revenue collections remained uncertain.** Through March, revenue collections were ahead of benchmark by $786 million and growth over FY 2025 exceeded seven percent. The majority of that growth was in the non-withheld income tax category and was driven by capital gains and income surtax collections. Both of those revenue sources are highly correlated to the performance of the stock market and are most likely to see the greatest losses as a result of certain federal actions or a downturn in the economy. A complete sense of FY 2025 revenue trends, and how they impact the resources available to support budgeted spending, will not be available until July.

- **The federal budget and legislative process was ongoing, and would have major implications for state finances.** Spending decisions in the pending reconciliation bill, the Federal Fiscal Year (FFY) 2026 budget, as well as other legislative vehicles, will have major implications for the state budget; particularly proposals to make significant cuts to Medicaid. In the Spring, no details were available about the specific policy proposals being advanced in Congress or their fiscal impacts on Massachusetts, and there was no certainty on the scope or timing of potential changes.

- **Broader economic trends would be better understood over time.** In the days immediately following the Trump administration's tariff announcement, the stock market plummeted and a surge in the sell-off of government-backed bonds prompted the administration to reverse course. This chaotic cycle of announcement and aftermath has continued to play out with each new federal action, and while the long-term economic outlook remains challenging to predict, it's clear that the state's fiscal picture looks different now than it did several months ago.

Re-Assessing Revenue Expectations

More information is now available pertaining to each of the factors listed above and the negative implications for the state budget are clear. It is imperative that the FY 2026 budget reflect the new economic environment and that revenue and spending decisions acknowledge the challenges ahead.

FY 2025 Revenue Collection Trends

Through May, the Commonwealth has collected $39.15 billion in tax revenue; $2.8 billion (7.8 percent) above collections in FY 2024 and $2 billion (5.5 percent) ahead of benchmark. However, as shown in the table below, almost the entirety of that growth and above benchmark performance has been driven by non-withheld income tax collections – predominantly related to the income surtax and capital gains.

FY 2025 Revenue Collections July – May

	FY 2025 YTD	FY 2024 v. FY 2025	Growth to Date v. FY 2024	FY 2025 YTD v. BM	Growth to Date v. BM
Withholding	$17,474	$1,120	6.8%	$385	2.3%
Non-Withholding	**$6,630**	**$1,430**	**27.5%**	**$1,990**	**42.9%**
Sales	$8,752	$215	2.5%	-$221	-2.5%
Corporate/Business	$3,811	-$144	-3.6%	-$349	-8.4%
Other	$2,482	$221	9.8%	$235	10.5%
Total	**$39,148**	**$2,843**	**7.8%**	**$2,040**	**5.5%**

$ in million

In May, the Department of Revenue (DOR) reported that through April, the state has collected $2.6 billion in revenues related to the surtax; already exceeding FY 2024 total surtax collections by $138 million. Additionally, capital gains tax collections in FY 2025 are estimated by MTF to reach at least $2.14 billion.

Tracking revenues related to the income surtax and capital gains is critical, because these resources are not entirely available to support general budgeted spending or balance the budget at the end of the fiscal year. As demonstrated by this table, when they are accounted for correctly, a $2 billion revenue surplus over benchmark quickly shrinks to an estimated $135 million tax revenue deficit.

MTF Estimated FY 2025 Tax Revenues Available for the Budget

FY 2025 Year to Date Collections	$39,149
June Benchmark	$4,499
FY 2025 Total Revenue Estimate	**$43,648**
Estimated Surtax Collections	($2,900)
Estimated Above Cap CG	($576)
FY 2025 Revenues Remaining for Budget	**$40,172**
Non-Surtax Benchmark	$40,307
Est. Tax Revenue Deficit	**($135)**

$ in millions

Based on tax revenue trends to date in FY 2025, it is possible to provide a preliminary update to the original FY 2026 revenue benchmark. Current trend data implies that non-surtax revenues may come in at least $600 million below the current benchmark of $41.2 billion, at $40.6 billion. It's important to note that this adjustment does not reflect potential economic impacts of tariff and trade policies, or the chance of a recession; accounting for these contingencies would likely result in a downgrade over $1 billion. However, this initial estimate provides policymakers with starting framework for assessing the impact of potential revenue declines. Depending on the category of tax collections that experiences the greatest loss, the budget impact of a revenue downgrade shifts significantly.

To demonstrate the impact that different types of revenue loss would have on the resources available for the budget, the table below presents a range of scenarios. In each scenario, total tax revenues for FY 2026 remain the same at $40.6 billion (a downgrade of ~$600 million from the current benchmark). However, the concentration of the revenue loss associated with capital gains taxes is increased from a 5 percent decline in capital gains collections to a 25 percent decrease.

MTF Estimated Budget Impact of FY 2026 Revenue Downgrade

	MTF Original Estimate	Scenario 1	Scenario 2	Scenario 3
	Capital Gains = $2,327	*5% Loss in Capital Gains*	*10% Loss in Capital Gains*	*25% Loss in Capital Gains*
Updated FY26 Revenue Estimate	**$40,626**	**$40,626**	**$40,626**	**$40,626**
Cap. Gains Transfer	*-$666*	*-$550*	*-$433*	*-$84*
Other Pre-Budget Transfers	*-$7,660*	*-$7,660*	*-$7,660*	*-$7,660*
Taxes Remaining for Budget	**$32,300**	**$32,416**	**$32,532**	**$32,882**
Original FY 2026 Taxes for Budget	**$32,897**	**$32,897**	**$32,897**	**$32,897**
Net Loss in Taxes for Budget	**-$597**	**-$481**	**-$365**	**-$15**

$ in millions

The more heavily concentrated revenue losses are in capital gains collections, the smaller the impact on the resources available to support budgeted spending. For example, if estimated capital gains collections decrease by 25 percent, from $2.3 billion to $1.7 billion, the net loss in tax revenues available to the budget decreases by only $15 million compared to what budget writers had available when building their FY 2026 budget proposals.

Impacts of Federal Action

In late May, the House of Representations advanced tax and spending legislation that included Medicaid cuts estimated by the Congressional Budget Office to reduce spending by more than $800 billion over the next ten years. There are more than 25 specific program reductions and revisions in the bill, but major provisions include:

- $279.8 billion in spending reductions related to the establishment of Medicaid work or engagement requirements.
- $237.9 billion in spending reductions related to Medicaid eligibility and enrollment changes.
- $196.4 billion in cuts as a result of changes to provider taxes and state directed payments.
- $101 billion in savings from Affordable Care Act exchanges.

As part of a series focused on the Impacts of Federal Action on Massachusetts, in the coming weeks MTF will be releasing a chartbook describing in detail the federal Medicaid proposals and their potential implications for Massachusetts. However, using population share as a rough guide, we can estimate that, under the House bill, Massachusetts could experience a loss of $16.3 billion in federal revenues over a ten-year period, largely driven by potential reductions in Medicaid enrollment.

The FY 2026 state budget impact of the federal Medicaid proposals will be only a fraction of that total impact, as most of the proposed changes will not be implemented until FY 2027 or later. However, several changes proposed for the upcoming fiscal year could cost MassHealth close to $100 million.

In addition, these proposals will disrupt the state's entire healthcare system; leading to an increase in the state's uninsured population and increased demand on the Health Safety Net and other emergency services. These changes may have their largest effects after FY 2026, but policymakers need to begin to prepare for these changes now.

Other Factors and the Long-Term Economic Outlook

While policymakers will gain new insights from final FY 2025 revenue collections and the impacts of federal policy action will continue to crystalize, other factors impacting state budget resources and broader economic trends may remain more challenging to track.

In the near-term, state budget writers should remain aware that the US House reconciliation bill would eliminate the ability of states to use pass through entity tax structures to mitigate the impacts of the State and Local Tax (SALT) deduction cap. If the state's PTE tax were to go away, the state would have a financial exposure in the form of unclaimed personal income tax credits accumulated since FY 2022 related to the Pass-Through Entity (PTE) excise.[1] The timing for when credits will be claimed is unclear, but these refunds have the potential to diminish revenue collections in future fiscal years. If eligible taxpayers request their refunds at the same time that the state economy is contracting, the effects of a revenue loss would be multiplied. It is important to note that the minimum revenue downgrade of $600 million discussed earlier in this brief does not account for potential refunds associated with the PTE excise; if the PTE change were to go into effect immediately, it would increase the FY 2026 revenue loss.

But the greatest risk to the state's fiscal position continues to be the threat of a sustained economic downturn. If the national or state economy enters into a recession, the revenue losses experienced by the state would far outweigh the impacts of other federal policy changes, like those related to Medicaid.

During the Great Recession, Massachusetts tax collections fell by 12.5 percent between FY 2008 and FY 2009 and they remained flat through FY 2010. If a similar level of decline is applied to FY 2026 revenue expectations, the state could face a revenue loss of greater than $5 billion.

Building a More Sustainable State Budget

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[1] In 2021, in response to the $10K cap on federal state and local tax (SALT) deduction, Massachusetts enacted a new excise allowing certain types of businesses to pay income taxes at the entity-level and then claim a state tax deduction equal to 90 percent of the excise.

New details regarding FY 2025 revenue collections, the fiscal impacts of federal policy proposals, and greater insight into longer-term economic trends all underscore the importance of re-assessing revenue assumptions for FY 2026. And while the administration may be in a better position than the Legislature to make a revenue adjustment during the first quarter of the fiscal year, the House and Senate must work collaboratively with the administration to restrain spending growth and make spending decisions that reflect the reality of the state's fiscal position.

In March of 2020, at the onset of the COVID-19 pandemic and in the middle of the FY 2021 state budget development process, the administration and Legislature were suddenly faced with a potential revenue loss of billions of dollars. But instead of pushing forward with a budget process that would have resulted in draconian cuts to many state programs, the administration and Legislature made a joint decision to pause budget deliberations and reconvene economic experts. Throughout the spring and summer, policymakers monitored revenue trends, assessed new state needs, and coordinated the collection and distribution of federal resources. Ultimately, an FY 2021 budget was passed in December – six months after the start of the fiscal year – that maintained funding for core government programs and allowed the state to ably navigate through the pandemic.

While the situation facing budget writers in FY 2026 is unique, the same lessons of collaboration and developing a coordinated response apply. If the Conference report does not reflect an adjustment to FY 2026 revenue assumptions, policymakers should still aim to achieve several key goals:

- **Spending growth in the FY 2026 Conference Budget should remain below 6.4 percent.** The House and Senate final budgets both spend approximately $500 million less than Governor Healey's original proposal and increase spending over the FY 2025 GAA by $3.7 billion (6.4 percent). Despite the pressures that policymakers may feel to increase spending in the Conference budget to accommodate all shared and unique priorities between the two branches' proposals, spending growth should not exceed 6.4 percent.
- **One-time revenue solutions in the Conference Budget should not exceed $1.3 billion.** The Governor, House, and Senate all relied on at least $1.3 billion in one-time revenue solutions to support spending in FY 2026. The Conference budget should adhere to the same ceiling, which would represent a 33 percent increase in the amount of one-time resources used in the operating budget compared to FY 2025.
- **Policymakers should limit known deficiencies and prioritize funding for programs and services that are core to state government.** Before any adjustments are made to the revenue expectations for FY 2026, MTF estimates that budget writers could need to cut spending across the House and Senate budgets by as much as $770 million in order to live within available resources. As conferees are assessing those spending decisions, MTF urges policymakers to avoid known deficiencies and spending reductions to programs and services that are core to the work of state government. Namely, the FY 2026 budget signed into law should strive to fully fund MassHealth, K-12 education programs, and the annualization of ratified collective bargaining agreements.