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What We Know (So Far) About the Federal Tax Credit Scholarship Program

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Last year, Congress created a program that will give taxpayers a federal tax credit for donating to organizations that award scholarships for tuition or educational services at private or public K-12 schools. While the broad contours of the program were set in statute, many details are still being determined through a rulemaking process by the Treasury Department and Internal Revenue Service (IRS). Below, we address frequently asked questions about the program and examine the major “known unknowns” of the policy as we await the final regulations.

What is it?

The new tax credit scholarship program provides a nonrefundable, dollar-for-dollar federal tax credit of up to \$1,700 for individual contributions to qualifying scholarship-granting organizations (SGOs). The non-profit SGOs will use donated funds to award scholarships to K-12 students for eligible educational expenses at public or private schools.

When does it start?

The tax credit was established in the 2025 budget reconciliation law and will take effect January 1, 2027. Taxpayers will be able to claim the credit for donations made during the 2027 calendar year. Currently, the Treasury Department and IRS are working on regulations that will govern the implementation of the tax credit.

Who can receive the tax credit?

Any taxpayer can donate to a qualifying SGO, report the donation when filing taxes, and be eligible for a dollar-for-dollar tax credit. The maximum amount of the tax credit for a given tax year is \$1,700. The tax credit is nonrefundable—meaning it can lower a tax bill to \$0, but it cannot lead to a refund.

Individual donors to SGOs can qualify for the tax credit even if their state does not opt into the program, but their donation will go toward scholarships in participating states. While this is the first federal tax credit of this nature, many states already have tax credit scholarship programs in place. The law prevents taxpayers from receiving a double benefit from the same donation under both programs, so the federal tax credit will be reduced accordingly when a state tax credit is also claimed.

Which students can receive scholarships?

To be eligible for a scholarship, K-12 students must live in a state that has opted into the program. They can attend public or private schools, and their family income cannot exceed

300% of the median gross income for the area. This is a high threshold, and researchers at the Urban Institute estimate that 90% of US households have an income that could qualify.

What kinds of educational expenses qualify for scholarships?

Scholarship funds can go toward expenses allowed under Coverdell Education Savings Accounts (tax-advantaged accounts that can be used to save, invest, and pay for a child's education). These include:

- Tuition and fees
- Books and supplies
- Academic tutoring
- Services for students with special needs
- Computers, technology, and internet access
- Transportation
- Supplementary services, such as after-school enrichment programs and test preparation

What criteria do SGOs need to meet?

Eligible SGOs will be tax-exempt 501(c)(3) non-profit organizations that are included on the list submitted annually by participating states. They are required to:

- Maintain separate accounts for qualified scholarship contributions
- Provide scholarships to at least 10 students who do not all attend the same school
- Spend at least 90% of their income on scholarships for eligible students
- Provide scholarships only for qualified education expenses
- Award scholarships only to students whose families meet the income qualifications
- Give priority to students who received a scholarship during the previous year or who have a sibling who received a scholarship from the organization
- Not earmark or set aside scholarship contributions for a particular student or donor

What is the state role?

This is an opt-in program at the state level. States will voluntarily elect to participate in the program on an annual basis. The election can be made by the governor or by another entity

designated by state law.

To opt in, the state must submit a list of eligible SGOs operating within the state. By doing so, the state confirms that the listed organizations meet all criteria to participate in the program.

Will this divert money from public schools?

The program will not directly divert federal dollars from public schools, nor will it affect state or local tax revenues, which provide most funding for public K-12 education. Instead, it operates through a federal tax credit for private donations to non-profit organizations. Individual contributions are later credited back, reducing the donor's liability by up to \$1,700. Because the credit is funded through the federal tax system, states do not bear any cost. This design is distinct from traditional school voucher programs, which use government funds to pay private school tuition for students who leave public schools.

Critics note that tax credits reduce federal revenue and therefore could indirectly affect the total resources available for public education spending. In addition, if the program results in significant numbers of students leaving public schools, federal education funding tied to enrollment or poverty measures could decline over time.

However, unlike voucher programs that fund students only after they leave public schools, this policy can also support students who remain enrolled in them. Public school students can use scholarships for tutoring or other educational services, meaning the program may direct new additional resources to students who attend public schools. This creates different incentives, and the ultimate enrollment effects will depend on how states, donors, and families respond.

What could the scale of the program be?

The funding generated by the tax credit—and its subsequent reach for students—will be dependent on how many taxpayers participate. There is no federal budget cap for the program.

Analysis by Education Reform Now estimates that 47 million taxpayers owe more than \$1,700 in annual federal taxes. If 2% of them participated (aligned with the typical participation rate in state tax credit scholarship programs) and made the maximum donation for the tax credit, that could yield \$1.6 billion per year for the scholarship program. If 10% participated, that number could be closer to \$8 billion per year.

To put this in context: Total federal tax revenue in Fiscal Year 2025 was \$5.23 trillion, with just over half coming from individual tax dollars. Total public spending on K-12 education is

about \$950 billion annually, with \$120 billion coming from the federal government. Private spending by parents and families on their children’s education and development amounts to over \$200 billion by some estimates.

How many states will opt in?

This remains a big question mark. Participating states must opt in before the program takes effect on January 1, 2027, but were allowed to make advance elections starting on January 1, 2026. As of March 2026, 29 governors have announced their intent to opt in.

The majority of those opting in are red states, many of which also have state-based tax credit scholarship programs. Two blue state governors—Josh Stein in North Carolina and Jared Polis in Colorado—have also expressed their intent to opt in. The Democratic governors of three other states (Hawaii, New Mexico, and Oregon) had initially indicated they would not participate but more recently clarified that they are awaiting further details on the program rules before deciding. The Kentucky legislature opted the state in, overruling a veto from Democratic governor Andy Beshear, and a handful of additional states have bills pending that would require participation. Some, including Illinois, have had state ballot measures on the program.

What has made the decision calculus more complicated than some expected for Democrats, who traditionally oppose school choice, is that the program design allows scholarship dollars to cover services for students in public schools, not only private school tuition. The debate has activated traditional public education advocates, including teachers’ unions, but it has also sparked pressure campaigns for blue state governors to remain open to the potential promise of the program. Non-profit foundations that support public school districts are one sector that has highlighted the opportunities the program creates to provide additional resources to public K-12 students at no cost to the state.

What do we still not know about how the program will function?

In late 2025, the Treasury Department and IRS solicited public input on the development of proposed rules for the tax credit and received over 4,200 comments. Several key outstanding questions are still to be determined through the rulemaking process. Among these “known unknowns” are two questions that could have significant implications on the parameters of the tax credit and the scope of participation by states and SGOs. One involves how a spending requirement for SGOs will be interpreted, which could influence the number of SGOs that seek to gain eligibility. Another relates to how much discretion states will have in approving SGOs, which could influence governors’ approach to their opt-in decisions.

How will the SGO spending requirement work? The law requires SGOs to spend at least 90% of their income on scholarships. In their comment request, the Treasury Department and IRS posed a question about whether “the income of the organization” is meant to refer to *all* the income of the SGO, or only to qualified scholarship contributions, which participating SGOs are required to keep in separate accounts. Interpreting “income” to mean the organization’s total income would pose major practical challenges for SGOs. Non-profits that offer programming beyond scholarships, receive unrelated grants, or have any investment income could find it hard to pass such an income test, even if they spend 100% of qualified contributions on scholarships. Pre-existing SGOs may not be able to gain eligibility without undergoing significant reorganization. This could disincentivize SGOs from seeking eligibility to participate or limit participation to newly constituted SGOs, which might slow uptake of the program.

Many commenters noted that since the legislation requires qualified donations for scholarships be held in separate accounts, Congress was cognizant that SGOs could have multiple funding streams, and so it is most probable that the intent was for the 90% income test to focus solely on scholarship contributions rather than all organizational income. Where Treasury and the IRS land on this definition will likely shape the ecosystem of SGOs participating in the program and the type of scholarship funding provided.

How much of a say will governors really have? The tax credit is an opt-in program, and the governor (or other designated state entity) must submit a list of eligible SGOs for participation on an annual basis. In their request for comments, the Treasury Department and IRS indicated that they expect to require participating states to include any SGO that meets the statutory criteria on their state list, with limited discretion given to the governor. This has raised questions about whether states will be able to place any restrictions on SGOs, such as prohibiting discrimination; enforcing program integrity safeguards against waste, fraud, and abuse; or developing additional criteria to shape the program in their state.

While legislative intent appears to have been to prevent states from making policy judgments about which SGOs are eligible, many commenters noted that states are still expected to verify SGO compliance with statutory requirements as part of the certification process, which implies an obligation to monitor risk and address credible concerns about abuse. For governors still considering whether to opt in, the level of SGO oversight that is ultimately entrusted to them in the regulations could be a factor in how they weigh the potential benefits of participation.

What happens next?

The Treasury Department and IRS are in the process of reviewing submitted comments and developing proposed rules for the tax credit. Once the Notice of Proposed Rulemaking (NPRM) is released, they will accept additional public comments, review them, and then issue final regulations. Given that the program is scheduled to take effect January 1, 2027, by which time participating states will need to establish their certification systems and submit their SGO lists, final rules are expected by late 2026.
