Federal Scholarship Tax Credit Program

Summary of Proposed Regulations by the U.S. Internal Revenue Service

On October 1, 2026, the IRS released proposed regulations and "temporary" regulations to implement the Federal Scholarship Tax Credit (FSTC) program that was enacted in 2025, codified in the Internal Revenue Code (IRC) as section 25F, and effective January 1, 2027. The regulations will comprise the following sections in Title 26 of the Code of Federal Regulations (CFR) section 1.25F, following the definitions in section 1.25F-1:

- Section 1.25F-2, Federal scholarship tax credit for qualified contributions
- Section 1.25F-3, Scholarship granting organizations
- Section 1.25F-4, Reporting and recordkeeping requirements for SGOs
- Section 1.25F-5, State election, state SGO list, and certification of SGOs

Section 1.25F-2, Federal scholarship tax credit for qualified contributions

Allowance of tax credit. The credit is against federal income tax liability for an individual who is a U.S. citizen or legal resident. The credit is equal to 100 percent of the qualified contribution made to a scholarship granting organization (SGO) that is listed by a "covered" state, i.e., which elects to participate in the program, and in which the SGO is authorized to conduct business. Partnerships and S-corporations are not authorized to make qualified contributions that obtain the credit.

Maximum annual credit and carryover. The maximum annual credit for an individual donor is $1,700 and applies to individual income tax liability after applying any other non-refundable credits. If tax liability is below the qualified contribution(s) for the year, the taxpayer may carry forward unused credit for up to five subsequent tax years. Married individuals filing joint tax returns can take combined credits of up to $3,400, with each spouse obtaining a donor number from the SGO(s).

Interaction with any state credits. Any state tax credit that applies to a qualified contribution thereby reduces the amount of donation for which the federal credit applies. A taxpayer also cannot take both this federal credit and an income tax deduction on the same qualified contribution of up to $1,700 but could take the deduction on the amount of a qualified contribution above this maximum.

Section 1.25F-3, Scholarship granting organizations (SGOs)

Organizational definition. SGOs must be tax-exempt organizations pursuant to IRC section 501(c)(3) and cannot be private foundations; and they must be listed on the IRS SGO list and be authorized by a covered state in which they are located, defined as authorized to conduct business, and listed by the state to receive qualified contributions.

Operational requirements. SGO operational requirements comprise the following:

- cannot co-mingle qualified contributions with other organizational income (a separate account for qualified contributions must be established for each covered state in which an SGO operates);
- must award ten or more scholarships to students who do not all attend the same school in each covered state in which an SGO operates;
- spend at least 90 percent of income on scholarships within the end of the tax year following the tax year during which the income was received;
- if at least 85 percent of the SGO is comprised of scholarship granting activities, a "safe harbor" is permitted to define "income" of the organization as qualified contributions to which the 90 percent spending threshold applies;
- scholarships cannot be given to children of "disqualified persons," i.e., SGO trustees, employees making award decisions, or substantial contributors of above $5,000 that constitutes two percent of the SGO's revenue;
- must prioritize scholarship awards to existing recipients and their siblings, with the exception if the SGO is focused on students in low-income census areas and awards them scholarships for tutoring or special needs services;
- must award scholarships from qualified contributions only for qualified elementary and secondary education expenses described in the Coverdell Savings Account program, codified in IRC section 530(b)(3)(A);
- cannot set aside contributions for a particular student; and
- must "facilitate" the prevention and detection of fraud and abuse of the program.

Eligible students. Students from households at or below 300 percent of the median area household income who are eligible to enroll in a public elementary or secondary school are eligible to receive a scholarship. SGOs can only award scholarships from qualified contributions to students who reside in the covered state in which the SGO is listed and operates, with two exceptions that apply to students who may reside in another state: dependents of U.S. military personnel and residents of Tribal Lands.

Qualified expenses. Qualified elementary and secondary education expenses for which a scholarship can finance are listed in the Coverdell Savings Account program in IRC section 530(b)(3)(A): tuition, fees, academic tutoring, supplies, books, and other equipment, special education services, extended day programs, transportation, computers, internet costs, uniforms, room and board. Forthcoming additional guidance will provide definition of these expenses; along with any context of how they can be used since this provision stipulates certain expenses must be used in connection with enrollment or attendance in a public, private or religious school, as defined by the respective state, and other goods must be provided by or required by the school in which the scholarship recipient attends.

Household income verification. SGOs must verify the household income of every student applicant to confirm eligibility. Income cannot exceed 300 percent of the area median gross income, including wages, salaries, alimony and child support, but does not include imputed income from net assets and must factor in the number of people in the student's household for which commensurate income adjustments are applied. Exceptions to this verification requirement are for children in foster care and who reside in a qualified census tract where

students receive scholarships for tutoring or special needs services. Permissible verification methods include prior-year tax returns, W-2 statements, IRS transcripts, participation in the SNAP program, Temporary Assistance for Needy Families, Nutrition for Women, Infants and Children, Section 8 housing or Supplemental Security Income. An SGO also can impose a lower household income ceiling for student eligibility.

Section 1.25F-4, Reporting and recordkeeping requirements for SGOs

Registration with IRS. SGOs must register with the IRS using the forthcoming portal that will allow the organization to receive instructions for assigning a required number for every donor, have the SGO listed as eligible to receive qualified contributions, and to report contribution information to the IRS.

Reporting to donors. SGOs by January 31st of the year following the donation must provide donors with a written acknowledgement of their total amount of qualified contributions made to the organization.

Reporting to the IRS.

- By February 28th, SGOs must provide the IRS the names of donors with their unique donor number and the aggregate amount of qualified contributions they made during the immediate prior tax year.
- SGOs must submit to the IRS with their 990 Forms or by May 15th a certification of its compliance for the tax year immediately prior to the operational requirements, e.g., including preventing co-mingling of qualified contributions with other SGO funds, awarding scholarships to more than ten students, spent 90 percent of its income on scholarships, qualification for using any safe harbors, etc.
- SGOs also must provide the IRS with their 990 Forms or by May 15th data for the tax year immediately prior the number of scholarships awarded, the number of students applying and receiving scholarships, the highest, lowest and average dollar amount of scholarships, the number of schools at which the scholarship recipients were enrolled, the amount of the SGO's income, the percentage of the SGO's income spent on scholarships, and more.

Audits. SGOs must undergo financial and programmatic audits by a qualified independent third party and provide such audits to each covered state in which the SGO is listed by the state. Such audits must describe the SGO's procedures for soliciting student applications and selecting student recipients for awards, how such scholarships are paid, verification that scholarships paid for qualified expenses, how scholarship amounts were determined and verification the SGO was located in the state and met all operational requirements.

Section 1.25F-5, State election, state SGO list, and certification of SGOs

State participation. For a state to participate in the FSTC program, the governor is empowered to decide. In the alternative, a state law can designate another state official or entity. This voluntary state "election" begins with submitting IRS Form 15714 to the U.S. Treasury Department on or before January 1, 2027 for the 2027 tax year, followed by submission of a list of SGOs by February 15, 2027 that the state determines meet the requirements of the FSTC

program codified in IRC section 25F. For 2028 and annually for subsequent tax years, states must use the IRS portal to voluntarily make an "advanced election" at any point from January 2nd through September 30th of the year prior to the tax year for which the state participates in the program; followed by state submission of the SGO list from October 1st to through January 1st. In the alternative, an election and the SGO list may be submitted simultaneously from October 1st through January 1st for participation in the program for the following tax year.

SGO list. Submission of the SGO list by the state is deemed to "perfect" a state voluntary election to participate in the program. A failure by a state to perfect its election would prohibit an SGO from receiving qualified contributions. Participating states, upon submitting an SGO list through the IRS portal, must certify that the list includes every organization located in the state that is seeking inclusion on the list and is operating in accordance with the federal operational requirements for SGOs and applicable state statutory requirements for charitable organizations. A state cannot add otherwise qualified SGOs to the list passed the applicable deadline for the year in which the list applies.

SGO information. To be listed by a covered state, the state must certify that the SGOs are located in the state, that the state reviewed audits for each SGO, and the SGOs meet the federal operational requirements. SGOs that have not yet obtained tax-exempt status can still be listed, provided the state determines that its provisions, policies and procedures expressly adhere to the federal operational requirements and that the SGO has applied to the IRS for tax-exempt status, which, if granted, will be effective retroactively to January 1st of the year in which the SGO is listed.

SGO removals. A covered state can remove an SGO from the list upon determination that the SGO does not satisfy or is out of compliance with the applicable requirements; and such SGO must be afforded due process. State actions also are subject to federal review.

State restrictions. A state may not require SGOs to operate in a manner that is more restrictive than the federal requirements set forth in IRC section 25F such as by limiting the type of school that scholarship recipients may attend or the qualified expenses the SGO offers for scholarships. In addition, state requirements for SGOs to be listed must be "reasonably related" to satisfying applicable state laws for charitable corporations.