4 Questions About the New Federal Tax Credit Scholarship

Taxpayers can donate to any approved organization, but to receive a scholarship students must live in a state that has opted in to the program.

By Emily Katz Sayag | November 4, 2025

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The federal budget reconciliation bill signed into law this summer includes a new, permanent federal education tax credit for donations to qualifying scholarship-granting organizations. States will decide whether to opt in to the program, which starts in 2027.

While the statutory text of the reconciliation bill establishes a framework for how the tax credit will work, there are many questions about how significant aspects of the program will be implemented. The Treasury Department plans to hammer out the details of the program in regulation but has yet to establish a timeline for doing so.

How will the program work?

The program allows individuals to receive a dollar-for-dollar tax credit for up to $1,700 per year for donations made to eligible scholarship-granting organizations, or SGOs. Those organizations will then provide scholarships to students and families, who in turn will choose how to spend the funds.

To be considered an eligible SGO, organizations must be registered as a nonprofit, provide scholarships to at least 10 students who do not all attend the same school and spend at least 90% of their revenue on scholarships, among other requirements.

SGOs are responsible for determining student eligibility. Students must be eligible to enroll in a public elementary or secondary school and have a household income that is no more than 300% of the area median income. The Urban Institute estimates that about 90% of households nationally would meet the income requirement.

SGOs must also prioritize awarding scholarships to students who received one during the previous year, as well as students who have siblings that received scholarships. The law prohibits SGOs from providing scholarships to their contributors and from earmarking scholarship funding for specific students.

The law provides no guidance as to how SGOs should determine the funds awarded to each student. This could be addressed in regulation or be left to the discretion of the SGOs.

How can scholarship funds be used?

Families who receive a scholarship can use the funds on a variety of educational expenses. The law's definition of "qualified elementary and secondary education expenses" is the same as that for Coverdell Education Saving Accounts, which help families save for education expenses from kindergarten through college. Under this definition, eligible expenses include tuition, fees, tutoring and other educational supports for students attending public and private schools.

Questions remain about whether families could use scholarships for all forms of schooling, such as homeschooling or microschools. This is not referenced in statute and could be determined in regulation.

What is the state role?

First, states must decide whether to opt in to the program. The law specifies that decision must be made by the governor or other individual, entity or agency designated under state law to make tax decisions on the state's behalf. At least three states so far—Illinois, North Carolina and Pennsylvania—have introduced legislation that would compel the state to participate in the program.

Participating states must provide the federal government with a list of their eligible SGOs. Additionally, states may have a role in program implementation and oversight, though it's likely the state role will be further addressed in regulations. The law specifically directs the secretary to develop regulations on "recordkeeping or information reporting" necessary for program administration.

State scholarship tax credit programs may also be affected by the new law. Specifically, an individual's federal credit will be reduced by the amount of any similar state tax credit received. Currently, 18 states have at least one tax credit scholarship, and only one has an individual credit limit below the federal limit of $1,700. Guidance from the Treasury Department likely will address how state programs interact with the federal tax credit.

Can states add criteria to determine which SGOs are eligible for qualifying donations?

This is perhaps the most significant question surrounding the program and is expected to be addressed in regulation. Education experts differ on how to interpret the law. Some, including Jim Blew of the Defense of Freedom Institute and Robert Enlow with EdChoice, favor a strict reading that would prevent states from adding to the federal requirements. Others, including Michael J. Petrilli with the Fordham Institute and Jon Valant of the Brookings Institution, argue the statute would allow states to develop additional criteria for qualifying SGOs.

For those interested in making their own interpretation, there are three key sections of the statute to parse in Section 70411 in the bill. Subsection (g) says that participating states must submit an annual list of the SGOs that meet the requirements in subsection (c)(5). Among the requirements in subsection (c)(5), the statute says that qualifying SGOs must be included on the state list in subsection (g) and meet all the requirements in subsection (d).

Subsection (d) lists about six requirements for SGOs to qualify for tax credit donations but includes no clause explicitly permitting a state to add requirements. However, the statute does not explicitly restrict states from adding their own criteria. Some argue that the dual requirement for qualifying SGOs to meet enumerated federal requirements and be included on a state's list allows room for states to craft their list of SGOs based on additional considerations.

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