

# Big, New, and Misunderstood: The Federal Scholarship Tax Credit could become one of the largest federal funding sources for career pathways in public schools

By [Spencer Sherman](#), Education First. April 2026. This is part of the [Pathways Policies that Work](#) series.

**Summary:** The new Federal Scholarship Tax Credit will go into effect in 2027. It has the potential to provide billions of dollars to public school career pathways programs—but only if state policymakers begin developing the right strategy and policy infrastructure now.

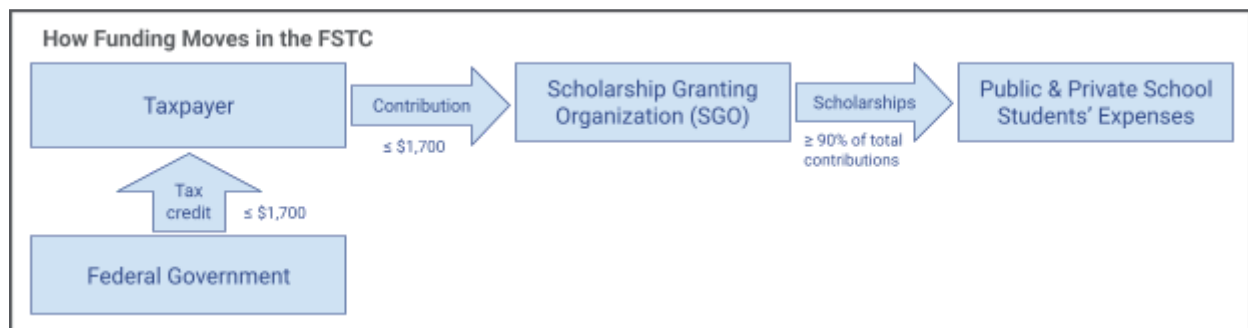
## Background

The One Big Beautiful Bill Act (OBBBA) of 2025 created a major new federal education program: the Federal Scholarship Tax Credit (FSTC).<sup>1</sup> The program reimburses taxpayers who contribute to nonprofit organizations, called scholarship granting organizations (SGOs), which, in turn, pay for certain education costs for students. The FSTC takes effect on January 1, 2027, and—as of this writing—the federal rules governing its use have not yet been finalized.

Although the program has generated the strongly partisan reactions that a private school voucher program would, the FSTC differs in important ways from typical voucher or education savings account (ESA) programs. One key feature is that it **explicitly permits SGOs to fund a wide variety of programs and services provided by public schools**. Therefore, **even opponents of private school voucher programs should understand the FSTC to make an informed decision**.

## How the Program Works

The program allows individual taxpayers to contribute up to \$1,700 per year to a state-certified SGO, which then awards those donations as “scholarships” for eligible education expenses. The federal government reimburses taxpayers up to the full value of their donation as an income tax credit. In essence, the program allows taxpayers to redirect part of their annual IRS tax payment to specific SGOs rather than the federal government.



<sup>1</sup> This program was not given a name in OBBBA, and different agencies use different names for it. This brief adopts the name used by the Internal Revenue Service, the agency that administers it under Section 25F of the Internal Revenue Code. The US Department of Education calls it the “Education Freedom Tax Credit.”

## Design Features

- **State opt-in:** States must opt in to the program each year. SGOs can accept contributions from taxpayers in any state, but only provide scholarships to students in participating states.
- **SGO requirements:** SGOs must be a 501(c)(3) nonprofit (not a private foundation); allocate at least 90% of donations to scholarships; serve at least 10 students from more than one school; and cannot earmark donations for specific students.
- **Budget:** The size of the program depends on the amount of taxpayer contributions and states' opt-in decisions. Estimates range from \$2.7-6.1B per year.<sup>2</sup> Even the low end of this range would make it **larger than Perkins (\$1.4B), WIOA Youth (\$0.9B), and Registered Apprenticeship grants (\$0.3B)**, but smaller than ESSA Title I (\$18.4B).<sup>3</sup>
- **Eligible students:** Students in public, private and religious schools are eligible. They must have a household income at or below 300% of the area median income. This limit is not stringent and, since it is a relative measure, increases for wealthier areas. For example, this limit equates to \$309,000 in New York County compared to ~\$127,000 in McDowell County, West Virginia.<sup>4</sup>
- **Eligible uses:** SGOs can grant scholarships for expenses related to attendance at a public, private or religious school, as defined by the [Coverdell education savings account](#) rules.

## How SGOs Can Fund Career Pathways

Eligible Expense	Career Pathways Examples
<b>Least flexible: "Required or provided by" a public, private or religious school</b>	
Transportation	<ul style="list-style-type: none"> <li>■ Work-based learning: transportation to employer or job training sites</li> <li>■ Dual enrollment: transportation to colleges for in-person course-taking</li> <li>■ Visits to colleges or employers for advising and career exploration</li> </ul>
Supplementary services & extended day programs	<ul style="list-style-type: none"> <li>■ Extended day programming, such as after-school CTE or dual enrollment</li> <li>■ School-contracted career advising or outside pathways-related services</li> </ul>
<b>Flexible: "Incurred in connection with enrollment or attendance" at a public, private or religious school</b>	
Tuition & fees	<ul style="list-style-type: none"> <li>■ Dual enrollment course fees and tuition</li> <li>■ Industry-recognized credential exam fees or CTE program fees</li> </ul>
Books & supplies	<ul style="list-style-type: none"> <li>■ Dual enrollment and CTE textbooks</li> <li>■ CTE materials and course supplies</li> </ul>
Equipment	<ul style="list-style-type: none"> <li>■ CTE equipment, materials and safety gear</li> </ul>
Academic tutoring	<ul style="list-style-type: none"> <li>■ High-impact tutoring on pathways-related academic coursework</li> </ul>
Special needs services	<ul style="list-style-type: none"> <li>■ Additional supports for students with disabilities</li> </ul>
<b>Most flexible: "Used by the student and their family during school years."</b>	
Computer technology or equipment	<ul style="list-style-type: none"> <li>■ Laptops or tablets for students</li> <li>■ Pathways-specific software programs or platform subscriptions (software must be education-related)</li> </ul>
Internet	<ul style="list-style-type: none"> <li>■ Subsidizing students' home internet for access to virtual programs</li> </ul>

<sup>2</sup> [Blagg](#) (2025)

<sup>3</sup> [ED](#) (2026); [Justia](#) (2026); [Collins](#) (2025); [Skinner & Sorenson](#) (2026)

<sup>4</sup> [HUD](#) (2025)

Crucially, **decisions about the use of funds are made by SGOs, not districts or states, and their use must be tied to specific students.** Major cost drivers for pathways programs, such as staff salaries, are therefore not eligible to be funded by SGOs. States and districts should think about SGOs as part of a broader braided funding strategy: see this series' [policy brief on braided funding](#) for more information.

## Recommendations for State Policymakers

### **Decision 1: Decide whether to opt in to the FSTC**

States need to decide whether to opt in to the FSTC before the program begins on January 1, 2027. As of April 2026, most Republican-led states have opted in, and most Democrat-led states are undecided.<sup>5</sup>

- **Arguments for opting in:** The FSTC gives students within their state access to an additional federal funding source for education—it is effectively free money for the state. The opt-in decision only determines whether students in that state can *benefit* from SGOs; taxpayers can *contribute* to out-of-state SGOs regardless. Therefore, opting in creates the opportunity to keep taxpayer donations in the state. The FSTC also expands school choice options for families, potentially allowing them to find the right school for their children and fostering healthy competition among schools.
- **Arguments against opting in:** SGOs could lead to large numbers of students leaving public schools to enroll in private and religious schools. This could shrink public school enrollment, leading to funding cuts and reduced services, which may further reduce enrollment. The FSTC may also disproportionately benefit more advantaged families, while eroding services for public schools in low-income or rural areas.<sup>6</sup>

It is difficult to predict the impact of the FSTC on student outcomes, given its novelty and unique design. Research on vouchers and ESAs—the closest policy analogs to the FSTC—generally shows that benefits depend on the design, and it is thereby difficult to predict FSTC's impact before it is implemented.<sup>7</sup>

Therefore, **the decision about whether to opt in depends on the policy goals of state leaders.** While support for ESAs, vouchers and private school choice programs does not fall strictly along party lines, Republicans historically outsized support for such programs mean Republican-led states will likely see little downside to accepting the additional funding; but Democratic-led states may face a more difficult cost/benefit calculation.

States must make this decision annually. A likely outcome is that most Republican states participate in the program immediately, while most Democratic states take a “wait and see” approach, delaying a decision to future years when the program's impact becomes clearer. If the final federal rules (which have not yet been released, as of this writing) allow states to regulate SGOs and the schools receiving their funds more tightly, more Democratic-led states may opt in for the initial year.

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<sup>5</sup> [Stone](#) (2026)

<sup>6</sup> [Klinenberg, Valant & Zerbino](#) (2024)

<sup>7</sup> [Epple, Romano & Urquiola](#) (2017); [Roy, Schwartz & Gable](#) (2024); [ExcelinEd](#) (2023)

## ***Decision 2: If opting in, set up a policy ecosystem for SGOs to support evidence-based public school career pathways***

For the 28 states (and counting) that have opted into the FSTC, **policymakers can take actions now to maximize the benefit for career pathways programs serving public school students—potentially improving quality and expanding access for students.** Even states that are still weighing their decision will likely benefit from laying the groundwork for SGOs that support public schools.

Since SGOs themselves decide how to distribute their funds, states have relatively little direct control over SGOs after they opt in; and the [IRS's initial request for comments](#) on its rules suggested governors may have little ability to restrict the eligibility requirements for SGOs beyond the minimal requirements in OBBBA. States can, however, still shape the ecosystem of SGOs within their states. Depending on their policy goals, state policymakers should consider the following actions:

- **Support, incubate or create SGOs for public school career pathways**
  - + For many states, particularly ones without ESA or voucher programs, there are likely few (if any) existing SGOs that meet federal requirements and support public school career pathways. The FSTC will not benefit public school students without such organizations.
  - + **States or districts may therefore want to create their own affiliated SGOs.** State or district supporters can create a “public school SGO”: a 501(c)(3) designed to receive taxpayers’ FSTC contributions and direct them to public school students. These would be analogous to how Super PACs support political candidates: a separate funding vehicle created to receive additional donations, but used to advance shared goals.
  - + FSTC rules limit the types of organizations likely to serve as public school SGOs. States and districts are better-suited as incubators than individual schools, since scholarship recipients cannot all attend the same school. The requirement that SGOs pass on 90% of their contributions to students likely excludes many nonprofits focused on providing services. Private foundations are also ineligible to be SGOs.
  - + *Note: the Treasury Department’s SGO rules may impact states’ and districts’ process for creating their own SGOs. Policymakers can begin planning now, but should likely wait on forming new SGOs until the final rules are published.*
- **Encouraging taxpayers to donate to SGOs.**
  - + The complicated design of the FSTC may mean that few taxpayers fully understand how the program works. If states want taxpayers to contribute to specific SGOs, they should launch a communications campaign to that end. Employers could also set up programs to help employees contribute.
- **Align the FSTC with other state ESA or voucher programs.** States with preexisting ESA or voucher programs (such as [Arizona](#), [Indiana](#), [Ohio](#) and [Florida](#)) should seek ways to align or stack these existing programs with the FSTC. Taxpayers cannot “double dip” for both state and federal tax credits, but states may find efficiencies by using the same organizations to operate both state and federal programs. States should also update family-facing communication about the programs and, if possible, create a “single front door” for both programs.

To learn more, read the other briefs in this series: [Pathways Policies that Work: Practical Advice for Policymakers](#).