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# Facts in the Flood

**Education First's analysis of federal education policy under the Trump Administration**



## Understanding the Federal Scholarship Tax Credit (FSTC):

The newest federal education funding program

October 2026

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*Prepared by Dave Powell, Spencer Sherman and Jonathan Zabala of Education First*



# What is the Federal Scholarship Tax Credit (FSTC)?

# The FSTC is a new federal program that could provide billions to public and private schools

- **Created by the One Big Beautiful Bill Act (2025),** the Federal Scholarship Tax Credit (FSTC) allows taxpayers to get a tax credit of up to $1,700 for donating to a Scholarship Granting Organization (SGO).
- **These SGOs then award scholarships** to public and private school students to help pay for expenses such as tutoring and tuition.
- **In return, the taxpayer receives a dollar-for-dollar federal tax credit** equal to their contribution, up to $1,700.

## How Funding Moves in the FSTC






Source: U.S. Congress, 2025

# Governors decide whether to join the FSTC but have little say over how it runs

| | |
|---|---|
| **State opt-in** | **The governor (or an official designated by state law) must opt in each year.** For 2027, states must opt in by Jan. 1, 2027. The opt-in only takes effect once the state submits its SGO list by Feb. 15, 2027. Taxpayers in any state can donate, but only students living in opted-in states can receive scholarships. |
| **State authority** | **States must list every SGO that meets federal requirements and cannot add stricter requirements** such as limiting SGOs to certain students, schools or expenses. States can remove an SGO only for noncompliance and must provide due process. |
| **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 income limit varies significantly across the country: for example, it equates to over $616,000 for a family of four in San Jose, CA but is under $200,000 for rural counties in Kentucky. The law also requires SGOs to give priority to prior-year recipients and their siblings. |
| **Eligible uses** | **SGOs can grant scholarships for expenses related to attendance at a public, private or religious school**, as defined by the federal Coverdell education savings account rules. |
| **Budget** | **Program size depends on taxpayer contributions and state opt-in decisions.** The Urban Institute estimates the program could cost $2.7–6.1B per year. The U.S. Treasury estimates the program would cost $26B per year by 2030, which would exceed Title I ($18.4B). |



Sources: EducationCounsel, 2026; Urban Institute, 2025; U.S. Department of the Treasury, 2026; EdChoice, 2026

# SGOs carry most of the responsibility for who gets scholarships and how they are used

| | |
|---|---|
| **SGO requirements** | **SGOs must be 501(c)(3) public charities** (not private foundations), keep FSTC donations in a separate account, serve at least 10 students who don't all attend the same school and not earmark donations for specific students. SGOs may choose to focus on particular students, schools or expenses. |
| **90% spending rule** | **SGOs must spend at least 90% of their income on scholarships by the end of the following year**. By default this counts all income, but SGOs whose activities are at least 85% scholarship-granting only need to meet the test using their FSTC account. |
| **Verifying eligibility** | **SGOs can verify income with tax returns, W-2s or pay stubs. Students are automatically eligible if their household participates in SNAP, TANF, WIC, Section 8 or SSI, or if they are in foster care**. A separate safe harbor covers tutoring and special needs scholarships for students in low-income areas. |
| **Fraud prevention** | **Payments go directly to schools, verified vendors or digital wallets; families can only be reimbursed with receipts.** SGOs must submit annual financial and programmatic audits to each state, prevent duplicate awards and cannot award scholarships to insiders or those determining awards. |
| **Donors** | **Donors receive a federal tax credit of up to $1,700 per person** ($3,400 for married couples who each give), can give through payroll deduction and can carry unused credit forward five years. In states with their own tax-credit scholarship programs (e.g., IN, OH, GA, VA), the federal credit is reduced by any state credit claimed on the same donation. |



Sources: EducationCounsel, 2026; U.S. Department of the Treasury & IRS, Proposed Rule, 2026

# Federal guidance limits states' authority, but key implementation questions remain

| Open Question | Why It Matters for Public Schools |
|---|---|
| **Which expenses qualify?** Treasury says guidance on eligible expenses is a high priority and expected by year-end. The proposed rules describe the Coverdell list as the "outer boundaries," which may signal a narrow reading. | Determines whether core public school uses (tutoring, extended day programs, transportation and dual enrollment) qualify. |
| **Can scholarships pay for existing services?** The proposed rules do not clearly address whether scholarships must fund new services or can cover services districts already provide. | Determines whether district-centered models, where scholarships cover existing district-run programs, are viable. |
| **Are pre-K students eligible?** The definition of "school" defers to state law but references K12, and the proposed rules do not resolve the conflict. | States that include pre-K in elementary education may be able to extend scholarships to pre-K students. |
| **How much oversight can states exercise?** States must certify SGO compliance but cannot add requirements beyond federal law. | States may be limited to surface-level review, with little ability to monitor quality or waste. |
| **What makes a vendor "verified"?** The rules do not define standards for vendors or for auditors under the low-income safe harbor. | Without standards, quality control for tutoring and other services falls to SGOs, districts and states. |

Treasury (not the U.S. Department of Education) oversees the FSTC. Its October 2026 proposed rules settled most program mechanics and will govern the program when it launches Jan. 1, 2027. Comments are due Dec. 1, 2026, with a public hearing Dec. 15, and final rules are unlikely to take effect before 2028.

# Even with relatively low contribution rates, the FSTC could become a major K12 education funding source

If 5% of eligible taxpayers* in the state gave the maximum donation ($1,700), it would be this many donors…

…which would provide this many students with a $1,500 scholarship…

…from this total amount raised.

For comparison, this is the amount of Title I dollars the state received in FY 2025.

| State | Number of Donors | Students Served | FSTC Funding | *For comparison:* Title I Funding |
|---|---|---|---|---|
| California | 590,967 | 669,762 | $1.00B | $2.27B |
| Texas | 404,161 | 458,049 | $687.1M | $1.81B |
| New York | 300,391 | 340,443 | $510.7M | $1.48B |
| Ohio | 173,412 | 196,533 | $294.8M | $650.5M |
| Georgia | 141,906 | 160,826 | $241.2M | $650.4M |
| Colorado | 97,597 | 110,609 | $165.9M | $229.0M |
| Mississippi | 33,023 | 37,426 | $56.1M | $177.6M |

*Taxpayers with a federal tax liability of at least $1,700. Sources: Bipartisan Policy Center FSTC Calculator; Congress.gov

# Federal law allows the scholarships to fund a variety of uses

| Eligible Expense | Illustrative Examples |
|---|---|
| ***Least flexible: "Required or provided by" a public, private or religious school*** | |
| **Transportation** | • Bus or transit passes for students to get to and from school<br>• Transportation to before-school, after-school or summer programs |
| **Supplementary services & extended day programs** | • Before- and after-school programs and summer learning programs run by the school<br>• Enrichment programs offered by the school (e.g., arts, music or STEM clubs) |
| ***Partially flexible: "Incurred in connection with enrollment or attendance" at a public, private or religious school*** | |
| **Tuition & fees** | • Tuition for full-day kindergarten in districts that charge for it<br>• Course, lab and activity fees; AP and IB exam fees |
| **Books & supplies** | • Required textbooks and workbooks or items on school supply lists |
| **Equipment** | • Musical instrument rental for school band or orchestra<br>• Graphing calculators and lab equipment required for courses |
| **Academic tutoring** | • High-dosage tutoring in reading or math |
| **Special needs services** | • Speech, occupational or physical therapy<br>• Assistive technology and additional supports for students with disabilities |
| ***Most flexible: "Used by the student and their family during school years"*** | |
| **Computer technology or equipment** | • Laptops or tablets for students<br>• Educational software and learning platform subscriptions |
| **Internet** | • Home internet service or mobile hotspots for students without reliable home access |



Note: Eligible expenses are based on those described for Coverdell Education Savings Accounts (26 U.S.C. § 530(b)(3)). Treasury has said it will publish further guidance on eligible expenses.

# Public school families can use scholarships to cover services for students through a spectrum of approaches

SGOs and service providers, including school districts, can make choices about how the FSTC operates. Below are illustrative examples of how families might access tutoring services depending on how actively their local district partners with SGOs.

| Passive | Intermediate | Active |
|---|---|---|
| Families apply to an SGO for a scholarship. Services are provided by an independent provider. | The district acts as a broker, partnering with SGOs to secure scholarship applications and match families with SGOs funding needed services. | Scholarship applications are part of the district enrollment process. The district receives scholarships from partner SGOs for defined per-pupil costs. |
| *Example*: Families independently select tutoring for their students and identify providers that are funded by SGOs. | *Example:* The district encourages eligible students in need of tutoring to select from a menu of district-vetted providers, all of which are funded via a partner SGO. | *Example:* The district uses funds from its affiliated SGO to cover a district-operated after-school tutoring program aligned to the school's curriculum. |

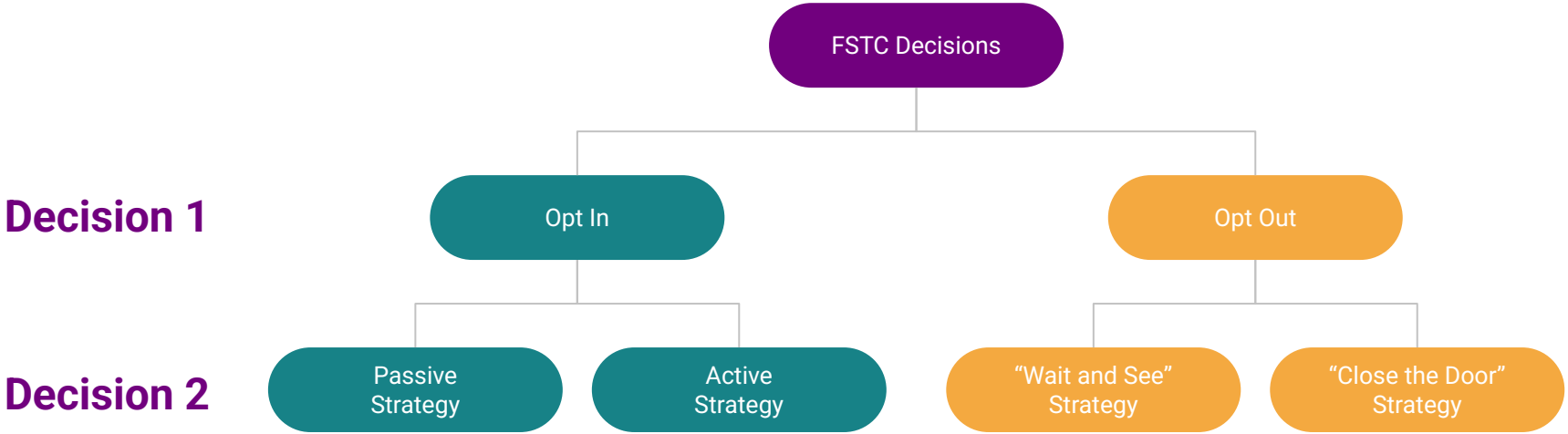


Adapted from ERS and Edunomics



# Using the FSTC to Support Public Schools

# States face two decisions: whether to opt in to the FSTC and which implementation strategy will achieve their goals



# Governors should weigh the benefits and risks to public schools when deciding whether to opt in

**Argument for Opting In**

- Potentially large funding source that can benefit public schools
- "Free money" from the federal government
- Opting in only determines if students in the state benefit; taxpayers can contribute regardless

**Argument for Opting Out**

- States have limited ability to regulate SGOs
- Benefits may flow primarily to more advantaged families and divert students to private and religious schools. This raises serious equity concerns.
- Opponents of the FSTC may fear that opting in makes the program more likely to become permanent

Increasingly, left-leaning state policymakers are making a **"lemonade argument":**

You may not support the FSTC, but, since it exists, you should make it advance your goals. Turn lemons into lemonade.

**If you're not planning for how this will benefit public school students, you're effectively guaranteeing that it won't.**

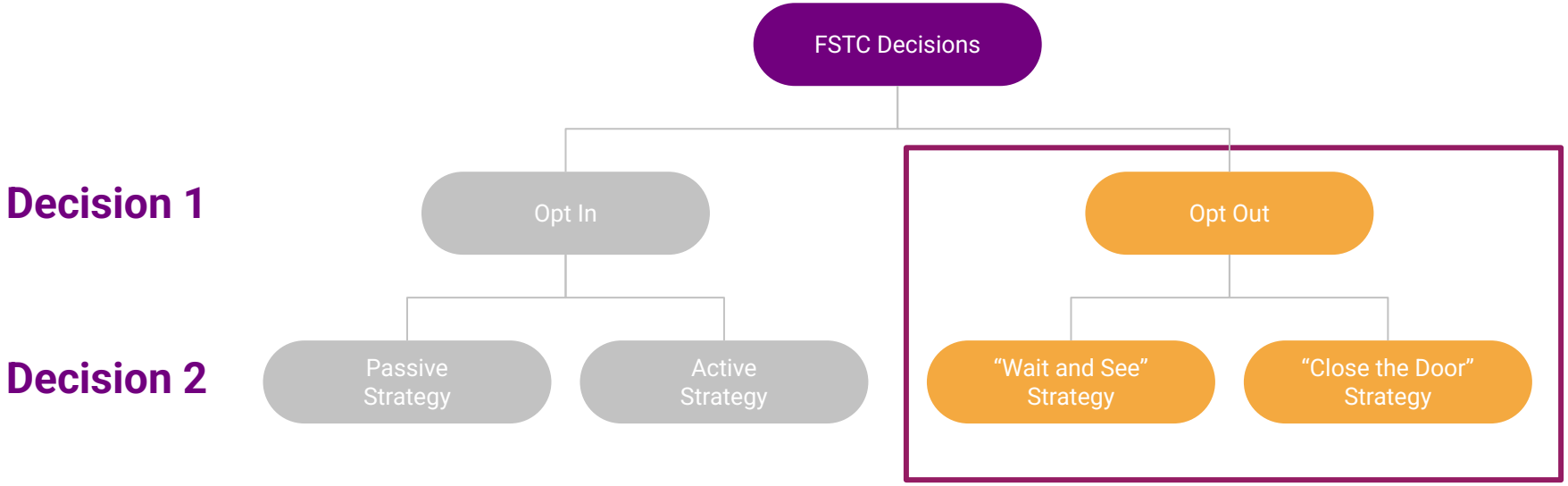
# All Republican-controlled states have opted in, while Democrat-controlled states are split

| | Democratic Trifecta States | Split Control States | Republican Trifecta States |
|---|---|---|---|
| **Opted In** | CO<br>NY<br>VA | AK<br>NC<br>NV<br>KS<br>KY | AL<br>AR<br>FL<br>GA<br>ID<br>IN<br>IA<br>LA<br>MS<br>MO<br>MT<br>NE<br>NH<br>ND<br>OH<br>OK<br>SC<br>SD<br>TN<br>TX<br>UT<br>WV<br>WY |
| **Undecided** | CA<br>CT<br>DE<br>HI<br>IL<br>ME<br>MD<br>MA<br>NJ<br>NM<br>RI<br>WA | AZ<br>MI<br>PA<br>VT | |
| **Opted Out** | OR | MN<br>WI | |

Status as of Oct. 26, 2026. "Trifecta" refers to a party controlling the governor's office and both state legislative chambers. There is no official mechanism for opting out, but the governors of the identified states above have publicly stated they will not opt in. At least 11 states have passed bills dictating participation and/or program requirements; in three states (KS, KY, NC), the legislature opted in by overriding a governor's veto.

Sources: Ed Week; IRS; Ballotpedia.

# States that opt out must decide how permanent to make their decision



# States that opt out can either bide their time or seek to prevent a future opt-in



### "Wait and See" Strategy

In the "Wait and See" Strategy, state leaders decline to opt in during the first year of the FSTC but keep the door open to participating in a future year. (Opting in is an annual decision.) Given the FSTC's new structure and uncertain impact, this strategy allows skeptical policymakers to watch how the policy plays out in other states before committing time, resources and political capital to implementing the FSTC.

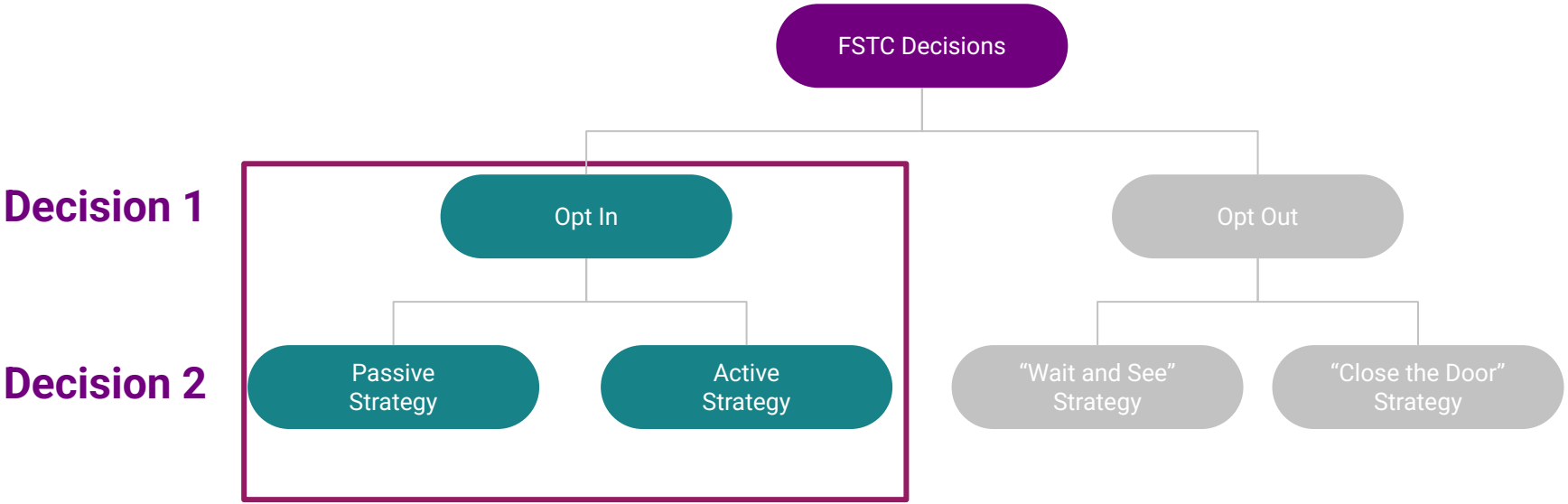


### "Close the Door" Strategy

In the "Close the Door" Strategy, state leaders not only opt out of the program, but they seek to prevent future state leaders from reversing this decision. This likely involves passing a state opt-out law. Strong opponents of the FSTC may choose this option, both for their own state and as a signal to federal policymakers who may revisit the FSTC's authorizing legislation in the future.

# States that opt in must decide how actively to steer FSTC dollars toward specific students, schools and services

States must list any qualifying SGO and cannot impose additional requirements on SGO eligibility, scholarship recipients or scholarship uses. However, states can still influence these decisions, even if they do not directly control them.



# With an active strategy, states can help drive FSTC funds to public schools, effective services and students in need



**Passive Strategy**

In a passive strategy, states let the market decide, relying on the choices of donors, SGOs, families and service providers to shape who gets scholarships and how they are used. The state focuses on its compliance role and preventing fraud and abuse.



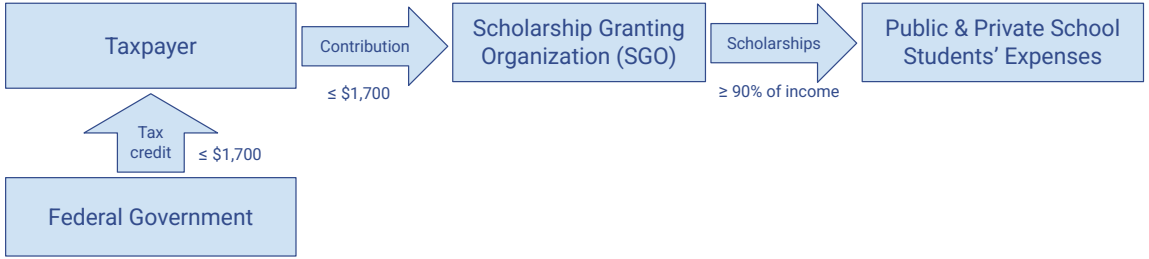
**Active Strategy**

In an active strategy, state leadership establishes a clear vision for how the FSTC can support state priorities and equitably serve public school students. It then uses its power to shape the choices of donors, SGOs, families and service providers to achieve this vision.

**For states that do opt in, we recommend an active strategy.**

# States can influence the flow of FSTC funding by providing guidance, building capacity and establishing protections

## FSTC Funding Flows




## State Levers to Influence FSTC Funding Flows

### GUIDE

Give specific direction that steers choices toward public schools and priorities

### BUILD

Create the infrastructure and expertise public schools need to participate

### PROTECT

Oversee compliance, quality and data to create transparency and accountability

Note: While the following slides focus on what states can do to influence public schools benefiting from the FSTC, other system levels and supporters can also influence the same actors at the same steps. These recommendations were informed by EducationCounsel, ERS, Edunomics and discussions with advocates and field leaders.

# States can steer donors to SGOs that award public school students scholarships for high-quality services

## *Stakeholder:* **Donors (taxpayers)**

### GUIDE

- Highlight SGOs vetted for alignment to state priorities, quality and service to public school students.
- Use public information campaigns to increase the number of taxpayers donating and encourage them to donate to SGOs supporting public school students.
- Provide ways for employees to automatically donate to public school SGOs. Offer after-tax automatic payroll deduction options to state employees and give other employers a model to follow.

### BUILD

- Give local partners, such as education foundations, fundraising toolkits to support securing donations for preferred SGOs.

### PROTECT

- Warn taxpayers that only IRS-listed SGOs generate the credit and give them a way to report suspected scams.

# States can help SGOs fund public school students to participate in activities aligned to state educational priorities

## *Stakeholder:* **Scholarship Granting Organizations**

### GUIDE

- Encourage SGOs to serve specific student populations or fund specific high-quality services that align with state priorities (e.g., high-dosage tutoring for lower-income students).
- Provide SGOs with guidance on evidence-based uses of scholarship funds and vetted provider lists.
- Connect potential SGOs, such as local education foundations, with national, state or regional partners establishing multistate SGOs, umbrella organizations or SGO networks.

### BUILD

- Partner with a nonprofit to establish a statewide SGO providing scholarships aligned to state priorities and underserved students.
- Recruit reputable partners to establish SGOs focused on priority students and services.
- Provide or fund technical assistance to prioritized SGOs to navigate legal requirements and access shared supports.
- Publish recommended practices and toolkits for SGOs, such as model district partnership agreements.

### PROTECT

- Set expectations for protecting families' data and help SGOs coordinate to prevent duplicate awards.
- Build processes to certify SGOs, review their annual audits and remove noncompliant SGOs with due process.
- Use audits and SGO reports to track who receives scholarships and what they pay for.
- Work with the attorney general to apply generally applicable state rules, such as charity laws, to SGOs. Update these laws if needed.

# States can help public school families access scholarships and can encourage districts to provide services with FSTC funds

## *Stakeholder:* Students, Schools and Service Providers

### GUIDE

- Use public information campaigns to make it easy for families to find, apply for and use scholarships for public school services. Provide family materials in the languages families speak.
- Help districts decide what role they will play in matching students with scholarship-funded services, from sharing provider lists to running services directly.
- Provide guidance to districts on what expenses are eligible.
- Shape what expenses may be eligible by revisiting state definitions the FSTC relies on, such as whether “elementary education” includes pre-K and which services schools must “require or provide.”

### BUILD

- Support districts in creating systems that automatically identify eligible students and build scholarship applications into district enrollment.
- Assist districts in setting up accounting systems to receive SGO payments and apply funds to eligible expenses.

### PROTECT

- Set quality expectations for providers and track whether scholarship-funded services improve student outcomes.
- Monitor whether scholarships draw students away from public schools and plan how state funding would respond if that occurred.
- Coordinate with the attorney general to prevent and prosecute billing fraud.

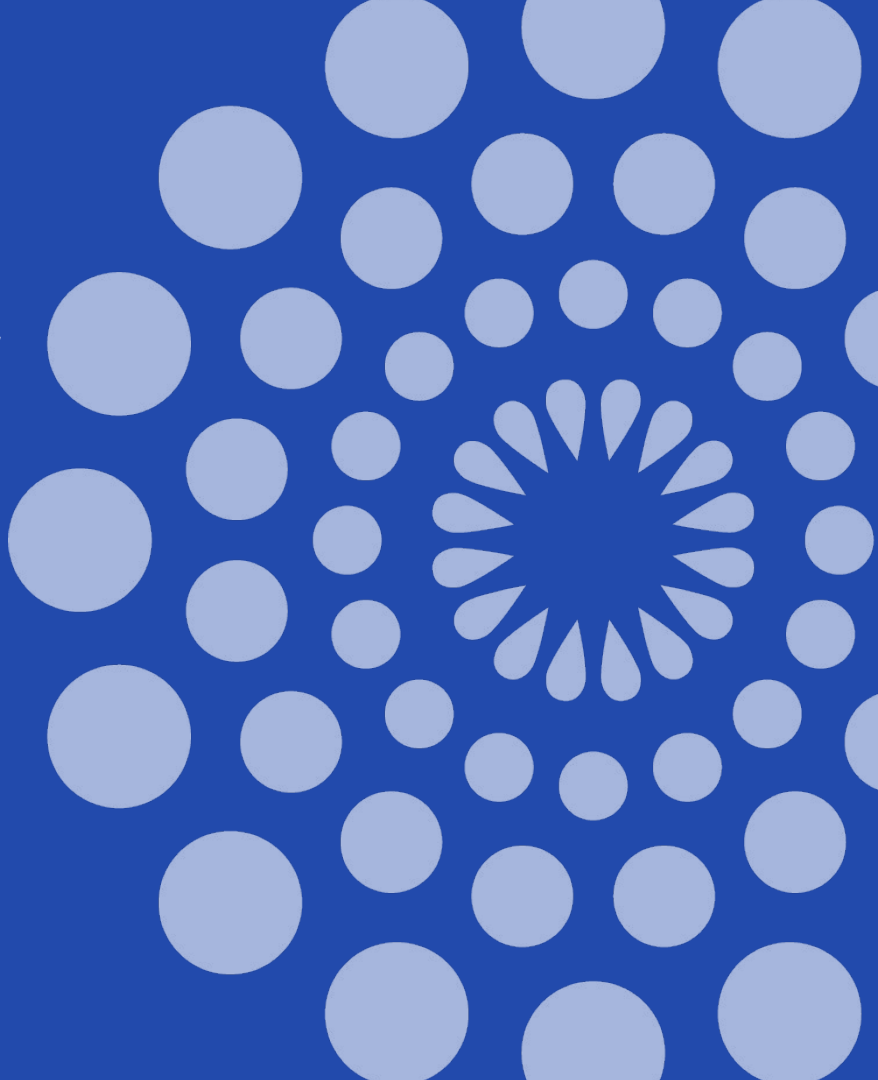
# For more information on federal education policy changes, visit our Facts in the Flood series page


**Contact Us**

Spencer Sherman, Principal Consultant, ssherman@education-first.com

Dave Powell, Senior Consultant, dpowell@education-first.com

Jonathan Zabala, Associate Consultant, jzabala@education-first.com

# Resources & Sources

## Resources

Bipartisan Policy Center: Funding Programs for Public School Students with the Federal Scholarship Tax Credit: An Interactive State Calculator

EdChoice: Updated Eligibility Income Limits for Scholarship Recipients for the New Federal Tax Credit for Scholarships

EducationCounsel: Implementing the Federal Scholarship Tax Credit to Maximize Supports for Public School Students: Considerations for State-Level Leaders

Edunomics: Can School Districts tap funding via the Education Freedom Tax Credits?

The School Superintendents Association (AASA) and Education Resource Strategies (ERS): Defining Your System's Approach to the New Federal Scholarship Tax Credit: Webinar Series

## Other Sources

Bridge Michigan · Chalkbeat Chicago · CRS R48724 · EducationCounsel · FutureEd Q&A with Deborah Gist · Holland & Knight, Aug. 2026 · IRS FSTC participating states · IRS Notice 2025-70 · MPR News on Walz · Rev. Proc. 2026-6 · Stand for Children Illinois · The 74 · Third Way · U.S. Department of the Treasury