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A Primer on the OBBBA Federal Scholarship Tax Credit

Charting a Possible Path to Support Public School Students

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The One Big Beautiful Bill Act (OBBBA) establishes a significant new federal scholarship tax credit (FSTC). Beginning in 2027, taxpayers can receive a dollar-for-dollar federal tax credit up to $1,700 each year for contributions to Scholarship Granting Organizations (SGOs) in participating states that fund scholarships for eligible students to support qualified education expenses related to enrollment in a public (including charter), private, or religious school. Given that there are over 100 million federal taxpayers each year, it is possible that this could over time become the largest federal investment in elementary and secondary education (potentially surpassing Title I, which was funded at just over $18 billion in FY2026).

Overview of the FSTC

The FSTC established in OBBBA has very limited statutory language. Key program elements include:

- Each governor (or other state official designated under state law) must choose each year for the state to participate in the tax credit program and provide the U.S. Department of the Treasury (Treasury) with a list of eligible SGOs in the state to which taxpayers can donate and receive federal tax credit.
- SGOs are nonprofit organizations (excluding private foundations) that spend at least 90% of income on scholarships and provide scholarships for 10 or more eligible students who do not all attend the same school.
- Eligible students are members of a household with income less than 300% of the area median gross income[1] and are eligible to enroll in public elementary or secondary school in the state (though they need not be enrolled in public school).
- Scholarships can be provided for any amount but must be used only for eligible expenses, which are defined by reference to the existing federal Coverdell education savings account program that names the following as qualified education expenses:
    - tuition, fees, academic tutoring, special needs services, books, supplies, and other equipment in conjunction with enrollment or attendance at a public, private, or religious school,
    - room and board, uniforms, transportation, and supplementary items and services (including extended day programs) required or provided by the school in conjunction with enrollment or attendance, and
    - purchase of any computer technology or equipment or internet access and related services used during any of the years in school.

[1] Initial estimates are that more than 90% of elementary- and secondary-aged students would likely meet this household income requirement.

Framework for Action

Implementation of the FSTC could proceed down two possible pathways. The first is a significant but narrow pathway in which these new resources are used primarily to fund tuition for private and religious schools in a manner that greatly expands the movement toward privatization and use of public funds for religious education. This was the primary motivation behind the legislation and presents many risks that states[2] will need to consider carefully, including the possibility of accelerating privatization in ways that could divert students and resources from public schools.

However, the final legislation does not limit the FSTC to this narrow use. There is a second, broader potential pathway for implementation through which the FSTC is also used to significantly expand the ecosystem of education services and opportunities available to public school students to help best meet the needs, interests, and abilities of each student in a manner that could strengthen public schools. This range of services could potentially include, for example, tutoring, afterschool, summer learning, enrichment activities, supplemental special needs services, pre-kindergarten, workforce apprenticeships, college bridge programs, and more.

Without an intentional focus on optimizing the FSTC for public school students and these broader uses, scholarships narrowly focused on private and religious school tuition may become the default. The extent to which the FSTC maximizes supports and minimizes risks for public school students and public schools depends critically on actions in three overlapping areas, which together create a framework for immediate and sustained action. As discussed further below, each of these areas will play a critical role in informing whether states elect to participate in the FSTC and in guiding efforts in states that choose to participate:

1. **Federal Program Design**: Federal regulations and guidance forthcoming from Treasury must permit, to the maximum extent possible, the ability of states, SGOs, schools, providers, and donors to support scholarships that provide expanded educational services and opportunities for public school students. Treasury is expected to publish proposed regulations (which will govern the first year of the program) along with guidance in 2026 and final regulations in 2027.

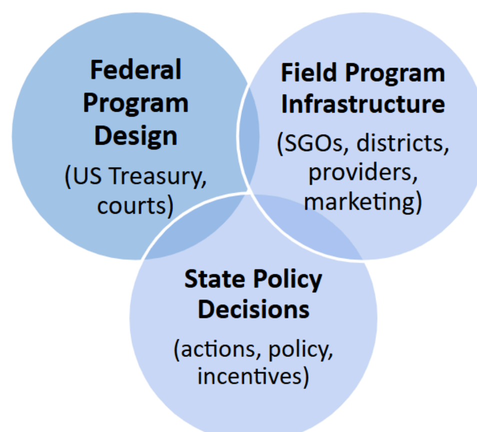

Figure 1: Framework for Action on Federal Scholarship Tax Credit

[2] Although the governor (or other state official designated under state law) is responsible for opting their state into the FSTC program each year or not, the term "state" here and throughout often refers to a broader set of leaders and actors in the state.

2. **State Policy Decisions**: States must closely consider the risks and benefits of participation in the FSTC – in this year and in out years – and, if they opt in, design policies, systems, and incentives that, to the fullest extent possible, enable the use of FSTC scholarships to support public school students, particularly students furthest from opportunity.

3. **Field Program Infrastructure**: Multiple stakeholders, such as state and local education leaders, philanthropy, and community organizations, must act in comprehensive and coordinated ways to build significant new infrastructure, including identifying and establishing SGOs, expanding high-quality service providers, building capacity in schools and districts to provide services directly and with partners, and launching communications campaigns to inform and direct potential donors.

Key Issues and Decisions across the Framework for Action

1. Federal Program Design

Treasury is charged with developing regulations and guidance that will govern the FSTC program. Decisions made by Treasury (and potentially the courts) will significantly impact critical issues such as what services are eligible, which organizations can serve as SGOs, how much states can shape the program, and other key factors. Key Treasury implementation decisions include:

- What specific expenses count as "qualified expenses" and can be funded with scholarships (e.g., what can be included in "supplementary items and services"), and what relationship is required between a school and those expenses and service providers (i.e., what does it mean to be "required or provided by" the school)?
- What conditions can states set for SGOs, providers, and/or schools to define program requirements, like adherence to non-discrimination requirements, participation in state data or accountability systems, or prioritization of students in low-income households?
- Can states define "elementary or secondary school" in a manner that aligns with state law and includes opportunities such as pre-kindergarten?
- What qualifies as "income" for the 90% spending requirement for SGOs – all sources of revenue or just all FSTC donations to the SGO? How easy will the IRS make it for nonprofits to become SGOs and taxpayers to claim the tax credit?
- How can regulations enable sufficient data collection to ensure meaningful and ongoing monitoring of compliance with federal and state requirements and prevention of waste, fraud, and abuse?

In June, Treasury provided a preview of some of the policy decisions that it plans to include in forthcoming proposed regulations for the FSTC. This preview provides insights into key issues, such as state authority, the 90% of income rule, the definition of "school," student eligibility, and the prevention of fraud, waste, and abuse. However, this preview left many key questions unanswered, especially on eligible expenses, and raised additional questions for states, SGOs, providers, and families considering participating in the program.

Regarding its likely timeline, Treasury previewed that it plans to release temporary and proposed regulations this year, which will be operable for 2027, with final regulations expected before 2028. Federal regulations and guidance, however, are not fixed and could be changed, including by a new administration. Further, although congressional delegation in OBBBA likely provides Treasury some deference in its regulations, federal courts likely will have the final say on the best interpretation of the OBBBA statute, and Treasury's actions could be followed by litigation. Given all of this, the window to shape the federal guidelines is both immediate over the next year and ongoing.

2. State Policy Decisions

Each state will have to decide (each year) whether to participate in the FSTC program and what goals, guardrails, and incentives to build (to the extent allowable under federal law including as interpreted by Treasury). Each state, along with its advocates and stakeholders, will need to think through its theory of action regarding the FSTC and what state policies could help create a program that aligns with state priorities and maximizes the benefit to public school students. Additionally, states also have varying laws and systems for oversight of nonprofit organizations, which will likely extend to potential SGOs. Key issues for states to decide include:

- Should a state choose to participate in the FSTC program?
- How will a state approve, regulate, and/or monitor organizations that serve as SGOs, including through data collection and reporting, to prevent waste, fraud, and abuse?
- What existing state laws might apply to SGOs and what additional parameters would a state set for participating SGOs, to the maximum extent possible?
- How does the state define "elementary or secondary school" and what eligible services must be "required or provided by" schools?
- How can states incentivize SGO, donor, and service provider participation that supports public school students furthest from opportunity, including through immediate "easy button" mechanisms and continuous improvement over time?
- How might a state incentivize and support public school student participation in the program, including facilitating the identification of eligible students?

3. Field Program Infrastructure

Implementing the FSTC to benefit public school students will require building the capacity and infrastructure of SGOs, districts, public schools, and service providers (such as afterschool and summer school programs, tutoring organizations, workforce training programs, college access programs, pre-kindergartens, special needs services, and providers of technology). The focus will be on ensuring the development of a high-quality program that is ready to raise, accept, and make good use of donations; identify and screen eligible students; and vet and make payments to eligible providers for eligible services. This also includes capacity to communicate and encourage donations and participation to support public school students. Key issues to be decided include:

- How can nonprofit organizations that are well positioned to serve as SGOs for the benefit of public school students best be identified and/or established?
- How can the capacity of service providers be improved to interface with the public school system as needed, accept scholarships, and meet increased demand for services?
- How can the capacity of public schools and districts be strengthened to serve as not only service providers but also hubs that help connect students, service providers, and SGOs best be ensured?
- What infrastructure will be necessary to ensure donations are distributed only to eligible students for eligible expenses?
- How can communication and information campaigns be launched to sustainably raise scholarship donations to support public school students?

The FSTC presents both risks and opportunities for public education. For states that opt in, the opportunity to provide an ecosystem of supports for public school students could provide a meaningful upside to the FSTC. Education and youth development leaders, advocates, state and local policymakers, nonprofit organizations, and philanthropy will need to act quickly to make strategic policy decisions. They will also need to both strengthen existing and build new infrastructure and capacity to maximize the benefit for public school students.

DISCLAIMER: The information provided above does not serve as legal counsel and, given the pace of action, could be outdated quickly. If you have any suggestions or feedback please send it to info@educationcounsel.com.