

OCTOBER 5, 2026

What the New Federal Scholarship Tax Credit Regulations Mean for States, SGOs and School Districts

Although AASA continues to oppose policies that divert public resources toward private-school choice, we have actively engaged with the U.S. Department of Treasury throughout the Federal Scholarship Tax Credit (FSTC) implementation process to advocate for policies that reduce unnecessary barriers and provide public school-focused Scholarship Granting Organizations (SGOs) a fair opportunity to participate in states that choose to opt in. Several concerns raised by AASA are reflected in the [temporary](#) and [proposed](#) regulations for the new FSTC that were published on October 2.

The rules clarify the roles of states and SGOs, establish initial operating and reporting requirements, and confirm several implementation options relevant to public school districts. They do not, however, resolve every major question. Additional guidance on "qualified elementary or secondary education expenses" and the meaning of "school" is still expected by the end of the year.

BOTTOM LINE: The regulations create a workable path for public school-focused SGOs, but they also leave important questions unresolved. District leaders in states likely to participate should begin planning now, while leaders in undecided states should continue pressing state officials to opt out.

Program at a Glance

The FSTC allows individual taxpayers to receive a federal tax credit of up to \$1,700 each year for contributions to an approved SGO. "Married taxpayers filing jointly may each claim up to \$1,700 -- for a combined total of \$3,400 -- provided each spouse makes qualified contributions. SGOs use these contributions to fund scholarships for eligible students for qualified elementary or secondary education expenses connected to enrollment in a public, private or religious school.

Student eligibility is broad. Children residing in a participating state will qualify if their household income is below 300 percent of area median gross income (AMGI). Treasury estimates that approximately 96 percent of children in participating states could be eligible. By 2030, Treasury and the IRS estimate the program could attract more than 11 million taxpayers, generate nearly \$26 billion in annual contributions, and fund up to 2.2 million scholarships each year.

What States Must Do

Participation is voluntary and must be renewed annually. For 2027, a state must submit its election by 11:59 p.m. on January 1, 2027, and then confirm participation by submitting its approved SGO list to the IRS on or before February 15, 2027. A state is not officially participating until both steps are complete. Once opted in, states must:

- Review, certify and list all eligible SGOs. The regulations do not permit midyear additions to the state list, although states can add additional SGOs to their list up until the February 15, 2027, deadline.
- Allow an organization with a pending 501(c)(3) application filed before January 1, 2027, to appear on the list, provided the organization otherwise meets the applicable requirements.
- Apply generally applicable state requirements for charitable organizations, including transparency, accountability and fraud-prevention rules.
- Create applications, documentation and financial-reporting requirements that are reasonably tailored to the federal program and designed to prevent or detect fraud and abuse.

State discretion is limited once a state opts in. States may review SGOs and enforce applicable federal and generally applicable state requirements, but they may not narrow federally eligible categories of schools, students or expenses. An SGO, by contrast, may adopt a narrower programmatic mission. For example, a public school-focused SGO could serve only public school students or prioritize tutoring, special-needs services or other targeted educational supports. But a state cannot categorically exclude SGOs that do so (or that focus on other schools, students, or expenses, including private schools).

Core SGO Requirements

An SGO must be a 501(c)(3) nonprofit, appear on a participating state's approved list, award scholarships to at least 10 students attending at least two schools, maintain FSTC donations in a segregated account, control scholarship disbursements, and comply with federal and applicable state requirements.

Particularly important for SGOs is what's known as the 90 percent spending test. Treasury interprets the statutory requirement as applying to all an SGO's income, not only the FSTC contributions donated to it by taxpayers, unless the organization qualifies for the exception described below. For income received in one year, an SGO generally has through the end of the following year to make qualifying scholarship payments that can help meet the 90 percent threshold. Only actual payments for qualified scholarships count. An award, reservation, or commitment does not count as spent until the money is paid.

Treasury created a more favorable exception for organizations that primarily grant scholarships. If at least 85 percent of an organization's activities are scholarship-granting activities, the income subject to the 90 percent test is limited to donations in its FSTC account. When making this determination, the activities may include the costs of administering scholarships, such as related fundraising, governance, compliance, outreach and other supporting functions. Existing education foundations with multiple program areas should carefully assess whether they could meet this test. In some cases, a separate 501(c)(3) focused on scholarships may be the more workable structure. For more information on creating a separate 501(c)(3), see the [AASA/NAEF Toolkit](#).

How Scholarship Funds May Be Paid

The regulations identify four payment pathways:

- Direct payment to a school for a qualified expense charged by the school.
- Direct payment to a verified third-party provider for a qualified service or item.
- Reimbursement to a family after documentation of a qualified expense.
- Payment through a qualified digital wallet.

SGOs remain responsible for managing contributions and applications, verifying student and expense eligibility, making payments, using reasonable efforts to prevent fraud, arranging annual financial and programmatic audits, submitting audit results to the state and reporting required data. An SGO with total annual receipts exceeding \$500,000 must use an external independent professional or accredited body.

Student Eligibility and Verification

The rules provide three potential approaches for verifying students' eligibility. An SGO may review income documentation to verify that the student's family is under the [300% AMGI threshold](#) such as pay stubs, tax returns, IRS transcripts, W-2 forms and evidence of other household income. It may also use categorical eligibility when a member of the student's household currently participates in SNAP, TANF, WIC, Section 8 housing or SSI; students in foster care are also categorically eligible. The current rule does not list free or reduced-price meal eligibility, although the preamble suggests Treasury may consider this so long as it is

on the basis of an individual student's status (and not via a community eligibility this so long as. The current rule does not list free or reduced-price meal eligibility, although the preamble suggests Treasury may consider this approach, so long as it is on the basis of an individual student's status (and not via a schools' community eligibility).

A safe harbor created in the regulations may eliminate individual income verification when an SGO funds individual academic tutoring or special-needs services at qualifying schools in low-income areas. To qualify for this, the school must select students for the services based on their individual needs, and the tutoring or special-needs program must also satisfy the rule's additional conditions including quality and evaluation requirements. This option could be particularly relevant to public school-focused SGOs, but districts and SGOs should wait for complete legal and operational review before relying on the safe harbor.

Implications for School Districts

The regulations confirm that employees may contribute to an SGO through voluntary after-tax payroll deductions, allowing for FSTC donations incrementally throughout the year. An employee could separately elect to adjust federal income-tax withholding, potentially offsetting the contribution's effect on take-home pay, but that decision is distinct from authorizing the contribution and should reflect the employee's individual tax circumstances. A participating employer would deduct the employee-authorized amount, transfer it to the designated SGO, and maintain appropriate records. The SGO would attribute the contribution to the individual donor and provide the documentation and donor identification needed for the employee to claim the credit. An employee could separately adjust federal withholding, but that is distinct from authorizing the contribution itself.

The scholarship process may also be more streamlined than many education savings account models. The regulations do not require parents to separately direct each expenditure of their child's FSTC scholarship. A potential district workflow could include identifying eligible services and students, transmitting necessary information with appropriate consent and privacy protections, allowing the SGO to independently verify eligibility and assign scholarships, delivering the service, and invoicing the SGO. If the expense qualifies and the applicable payment and documentation requirements are satisfied, payment could flow directly to the school or an approved vendor for the scholarship.

Before moving forward, districts should address the following operational questions:

- Which student services align with the district's strategy and could qualify for scholarship support?
- What is the actual per-student cost, and what share would the scholarship cover?
- What agreements, data-sharing safeguards, family notices and consent processes are needed?
- How will the district document participation, service delivery, attendance, invoicing and receipt of funds?
- Can payroll systems support voluntary after-tax deductions and accurate remittance to an approved SGO?
- How will the district mitigate inequities in access, awareness, enrollment and service availability?

Recommended Next Steps for AASA Members

- If your state's decision remains open, continue advocating for the state to opt out and use resources from [NCPE](#) and other national partners to support that effort.
- If participation is likely, identify the state agency and process responsible for SGO approval, including deadlines that precede the federal February 15 list submission. Assess whether an existing education foundation can satisfy the SGO rules or whether a separate scholarship-focused nonprofit should be

considered. Begin internal conversations across leadership, legal, finance, payroll, student services, data privacy and communications teams.

- Avoid final program design decisions until Treasury issues additional guidance defining qualified expenses and schools.
- Let us know where you stand on the program by completing [this form](#).

Important caveat: The rules summarized above will govern the FSTC for 2027, while proposed provisions remain subject to public comment and change before Treasury finalizes them for 2028 and beyond. Public comments are due December 1, 2026. Treasury has also indicated that separate guidance addressing qualified expenses and the definition of schools is forthcoming. AASA will continue to analyze new guidance and provide members with updated implementation resources.