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**FREQUENTLY ASKED QUESTIONS**
**Updated October 2026**

# Federal Scholarship Tax Credit FAQ

What Tennessee's public school advocates need to know before January 2027

**Tennessee has opted into a new federal tax credit that takes effect January 1, 2027.**
Public school students are eligible to benefit, but that will not happen on its own. It will take districts, education foundations, nonprofits, employers, and donors deciding to build a system of support for them. We have real concerns about how this program was designed and who it was built to serve, and we will be watching closely for who it actually reaches. Now that the program is moving forward, it is up to public school advocates to make sure these dollars benefit Tennessee's public school students. If we want that to happen, we have to organize for it. This edition reflects the proposed and temporary federal rules released October 1, 2026.

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## THE BASICS

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

Beginning January 1, 2027, an individual taxpayer can give up to $1,700 to an approved Scholarship Granting Organization and subtract that amount, dollar for dollar, from their federal tax bill. The credit is nonrefundable, so a taxpayer needs federal income tax liability to use it, and unused amounts carry forward for up to five years. Under Treasury's proposed rules, each spouse on a joint return is a separate taxpayer with their own $1,700 cap, so a married couple can claim up to $3,400 if each spouse makes their own contribution. Any amount that earns the credit cannot also be deducted as a charitable contribution.

### Is this Tennessee's voucher program?

**No.** Education Freedom Scholarships are Tennessee's state voucher program. The money comes out of the state budget and goes only to students attending private schools. The FSTC is a federal tax credit, administered through independent nonprofits, and it can pay for qualified expenses at

public, private, or religious schools. Both programs will be running at the same time.

### Has Tennessee decided to participate?

Yes. Governor Lee opted the state in, and the General Assembly passed a law designating the Department of Education (TDOE) to certify Tennessee's scholarship granting organizations (SGOs). TDOE has opened a question line at SGO.Questions@tn.gov. TDOE has not yet published how organizations will apply, but the federal rules now spell out what it must certify for each SGO: that it is located in Tennessee, keeps credit donations in a separate account, meets the federal operating rules, and has submitted its annual audit. The state must also give an SGO due process before removing it from the list. For 2027 only, Tennessee has until February 15, 2027 to submit its list. Opting in by January 1 is not enough – if the list is late, Tennessee will not participate in 2027. TDOE carries this oversight responsibility, and the cost, with little federal support.

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## WHO CONTROLS THE MONEY

### What is a Scholarship Granting Organization (SGO)?

A 501(c)(3) nonprofit (not a private foundation) that collects contributions and awards scholarships. To appear on Tennessee's list, an SGO must register with the IRS, keep credit donations in a separate account, spend at least 90% of its income on scholarships, serve at least ten students who do not all attend the same school, verify household income, and obtain an annual independent financial and programmatic audit. SGOs with $500,000 or less in annual receipts can use a committee of independent people instead of an outside auditor.

### Why do SGOs matter so much?

SGOs have significant control over how these dollars are used. Who receives a scholarship, how large it is, and what it pays for are all SGO decisions. Federal law is silent on program quality, student outcomes, and whether a school receiving scholarship money discriminates against students. Those judgments fall entirely to SGOs. Every SGO must give priority to last year's recipients, and then their siblings. The proposed rules give SGOs some room here. Priority matters most for tuition, so students can stay in the same school. For tutoring or special needs services, an SGO can prioritize by need instead. For SGOs that mostly pay tuition, early decisions will be close to permanent.

Some people cannot receive scholarships from an SGO: its officers and directors, anyone who helps select recipients, large donors (more than $5,000 and more than 2% of the year's credit donations), and their family members.

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### Who qualifies for a scholarship?

Households at or below 300% of area median gross income. Treasury estimates about 95% of U.S. children live in households under that limit. The limit adjusts for household size, using the same method HUD uses for Section 8 housing, and the IRS will publish limits by area and family size each year.

| | ESTIMATED 300% AMGI LIMIT, BY HOUSEHOLD SIZE* | | | |
|---|---|---|---|---|
| COUNTY | TWO PERSON | THREE PERSON | FOUR PERSON | FIVE PERSON |
| Davidson County | **$278,700** | **$313,500** | **$348,300** | **$376,200** |
| Knox County | **$249,000** | **$280,200** | **$311,100** | **$336,000** |
| Hamilton County | **$234,000** | **$263,100** | **$292,200** | **$315,600** |
| Shelby County | **$222,600** | **$250,500** | **$278,100** | **$300,600** |
| Hardin County | **$187,200** | **$210,600** | **$234,000** | **$252,900** |
| * Estimated as six times HUD's FY2026 Section 8 very low-income limits. Official limits will come from the IRS. | | | | |

These figures are approximations until the IRS publishes official limits. A household is the student plus everyone living with them; with shared custody, it is the home where the student lives longest. Only cash income counts. SGOs can verify income with pay stubs or tax returns, or with a current approval letter showing someone in the household receives SNAP, TANF, WIC, Section 8, or SSI. Free or reduced-price meal eligibility does not count, whether individual or schoolwide. Foster children qualify automatically.

Nothing in the law requires an SGO to prioritize low-income students, students with disabilities, or English learners, and the proposed rules confirm states cannot add that requirement. Whether these dollars reach the students who need them most depends on how individual organizations choose to operate.

### Is there a limit on what one student can receive?

No. Donors are capped at $1,700. Scholarships are not, and Treasury cannot add a cap the statute does not contain. Nothing limits the number of SGOs a student can receive from, or the total across them. The proposed rules require each SGO to have systems to prevent and detect duplicate awards for the same expense. They also set how money moves: tuition and fees go directly to the school, other providers are paid directly only if vetted and unrelated to the student, and families are reimbursed only with receipts. Right now, though, no system lets one SGO see what another has awarded or check against Tennessee's voucher program, so overlapping awards for the same expense are still possible.

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## WHAT THIS COULD MEAN FOR PUBLIC SCHOOLS

### Can public school students really use this?

Yes. Section 25F borrows the expense definition used for Coverdell education savings accounts (a long-standing federal tax-advantaged account for K-12 and college costs). That definition covers

expenses at a public, private, or religious school. More than nine in ten Tennessee students attend public schools, so an SGO built to serve them starts with a broader base of potential donors than one funding private tuition. Scholarships from a Tennessee SGO must go to students who live in Tennessee, wherever they attend school, with exceptions for military and tribal-land families.

### How would the money actually reach a public school student?

Two paths. A district or school can partner with an SGO, identify students, and handle the paperwork. A family can also find an SGO and apply on their own. The family-initiated path depends on a parent knowing the program exists, finding an SGO, and completing the application without assistance.

The proposed rules also create a shortcut for high-poverty schools. If a school is in a HUD qualified census tract, or at least 80% of its students live in one, the school can select students for individual tutoring or special needs services based on need, with no household income paperwork. The SGO must then get an annual third-party audit confirming the school's eligibility, that students were selected on need, that providers were qualified, that need was diagnosed by an independent professional, and that services were of adequate quality and frequency.

For districts in high-poverty areas like Memphis-Shelby County Schools, this may be the most important piece of the rules, because it removes the income paperwork that would otherwise screen out the families least likely to finish it.

### Which organizations do the proposed rules favor as SGOs?

Organizations that do nothing but grant scholarships. If at least 85% of a group's work is granting scholarships of any kind, it can run the program through a separate fund and measure the 90% spending test against credit donations only. That most directly fits organizations historically built to pay private school tuition. Groups rooted in public school communities usually do more than one thing, so most fall below 85% and would need a separate nonprofit or a partner SGO. The easiest path goes to private tuition funds, and the hardest goes to the organizations closest to public school students. There is an opportunity for organizations to grant scholarships focused mainly on programs and fees for public school students, but most of those will likely be new organizations.

### Can my district receive the money directly?

No. Scholarships go to students, not to institutions. A district that wants to participate has to form its own SGO or partner with one. An existing local education foundation has the nonprofit status, board, and donor relationships, but the proposed rules make it hard to use one as it is. Unless at least 85% of an organization's activities are scholarship-granting, the 90% spending test applies to all of its income, not just credit donations. Most education foundations also fund grants and programs, so many will need a separate affiliated nonprofit or a partnership with an existing SGO rather than a new fund.

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### Should we become an SGO?

That depends on which role you are after, and one organization can take on both. An SGO awards the scholarships and carries the compliance load: IRS registration and annual certification, the annual independent audit, the 90% spending test, and the priority rules for renewals and siblings. A provider delivers the tutoring, enrichment, or programming a scholarship pays for and carries none of that. Most organizations looking at this want the provider role.

Some providers are considering an SGO as a way to fund their own services. The statute does not prohibit it. An organization in that position is both deciding who receives a scholarship and receiving the payment. Separating those two functions supports accountability and transparency.

TDOE may include new SGOs whose tax-exempt status is still pending, but donors can count on the credit only after the IRS approves the SGO and adds it to the IRS list.

### What could scholarships pay for?

Tutoring, special needs services, books and supplies, extended-day programs, and technology including home internet are all named or clearly covered. Four high-value uses remain unconfirmed: summer school, pre-K, mental health supports, and AP or CTE fees. On pre-K, federal law defines school as K-12 "as determined under State law," and Tennessee law counts pre-K as elementary school for federal funding purposes, which leaves the door open for Tennessee and is worth exploring. Treasury says expense guidance is coming before the end of the year, and it calls the Coverdell list the "outer boundaries" of what qualifies, which suggests a narrow reading.

### Does a district have to charge a fee for a scholarship to cover it?

In most cases, yes. A scholarship reimburses an expense, so an expense has to exist. Scholarship dollars can only fund genuine additions, not what the state already requires a district to provide. That creates a temptation to attach a price tag to something a school currently offers free, and a risk that the new charge excludes the students the scholarship was meant to help. A district going this route should have a written plan for families who cannot pay and cannot easily document income, completed before the fee takes effect.

### How much money are we talking about?

Treasury recently projected SGOs will take in about $26 billion a year by 2030, more than Title I (about $18 billion) or IDEA (about $13 billion), the largest federal K-12 programs. That is roughly ten times Congress’s original estimate. The Joint Committee on Taxation scored the credit at $25.9 billion over ten years, about $2.6 billion in the first full year of claims, or roughly $50 million in Tennessee. If every eligible Tennessee taxpayer gave the maximum, the ceiling sits above $3 billion. Where Tennessee lands between $50 million and $3 billion depends almost entirely on how easy it is to give and how actively the opportunity gets promoted.

An SGO must spend at least 90% of its income on scholarships by the end of the following year. For most SGOs, that leaves at most 10% for administration, so covering a $90,000 program takes

about $100,000 in contributions. An SGO whose work is at least 85% scholarship-granting can measure the 90% against tax credit donations only and raise separate money for overhead.

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## MAKING THE FSTC WORK FOR PUBLIC SCHOOLS

### Why does it matter to move early?

The groundwork takes time, and the first year sets a pattern. Private schools have had years of technical assistance on how to work with scholarship organizations; public schools have had almost none. Because of the renewal priority, the students an SGO serves in 2027 keep a claim on its money in the years after.

The credit will fund private school tuition in Tennessee regardless. Whether it also funds tutoring, extended learning, technology, and career credentials for public school students depends on whether those options exist by the time donors start giving.

### What is the single biggest lever?

Payroll deduction. The credit costs the donor nothing in the end, but it asks someone to part with $1,700 and wait until they file to get it back. Employers can solve both problems. An employee elects a per-paycheck contribution to an SGO and files a new W-4 reducing federal withholding by the same amount, so take-home pay does not change. On a biweekly, twelve-month schedule, that is about $65 a paycheck. A district can offer this to its own employees and ask large local employers to do the same.

### What could employer participation add up to?

#### Shelby County Example

The twenty largest employers in Shelby County account for roughly 157,000 jobs, and about 47% of those are public sector: the school district, state and county government, the City, MLGW, and the universities. If 45% of those workers owe at least $1,700 in federal income tax, every one percent of participation across those twenty employers is about $1.2 million a year. Spouses can each give, so a two-earner household could contribute up to $3,400.

### Who can actually participate?

Any individual with at least $1,700 in federal income tax liability. That includes retirees, since leaving the workforce does not eliminate federal income tax liability, and Tennessee has a large pool of public retirees. It also includes grandparents, alumni, and community members with no children in school. Businesses cannot participate, including partnerships and S corporations, whose owners cannot claim the credit for the business's gift. The credit is available only to individual taxpayers, so a company cannot write a corporate check and claim it. An employer's value is as a channel to its workforce, not as a donor.

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### How does an individual donate and claim the credit?

Contributions begin January 1, 2027. Tennessee has no approved SGOs yet; for 2027 the state has until February 15 to submit its list, and the IRS will publish the approved SGOs on its website. Donors can rely on that IRS list as of the day they give, so it is safest to give once an SGO appears there.

A donor gives by cash, check, card, electronic transfer, or after-tax payroll deduction, not cryptocurrency, and must say at the time that the gift is meant for the credit. That choice cannot be undone. By January 31 the SGO sends an acknowledgment with a unique donor number, and the donor reports it on IRS Form 8525. Without that number, the IRS presumes the gift does not qualify. Donors do not give the SGO a Social Security number, and a donor does not have to live in Tennessee to give to a Tennessee SGO.

### How do we keep this from mirroring the inequities we already have?

The more locally an SGO raises money, the more closely its results will likely track existing wealth. Williamson County could be expected to out-raise Hardin County. SGOs, employers, and districts each have a role to play if we want this to reach students with the greatest need:

- SGOs can serve a region wider than a single affluent district, so better-resourced communities help fund scholarships elsewhere.
- Large statewide employers can offer their workforce an SGO focused on high-need students rather than defaulting to whatever is nearest.
- Districts can build the scholarship application into programs they already run, so families do not have to find it on their own.
- Districts with high-poverty schools can use the census-tract shortcut for tutoring and special needs services, which removes income paperwork for families.
- Tennessee must list every SGO that qualifies and cannot require any of them to serve public school or low-income students. The state can likely still highlight SGOs that do and encourage donors to give to them, if it chooses to.

### Can lower-income and rural communities raise this money?

Yes. Giving to an SGO does not take spare cash, it takes federal tax liability. A teacher earning $55,000 may have no room in the monthly budget and still owe several thousand dollars in federal income tax. The planning question is how many residents owe at least $1,700, and who in the community is trusted enough to ask them to contribute.

### What makes for well-designed implementation?

Four things are worth building in from the start:

- Put the money behind evidence-based practice. Research on tutoring, for instance, consistently finds that programs delivered during the school day outperform after-school ones. Scholarship dollars should follow what the evidence supports rather than what is easiest to stand up.
- Expect paperwork to act as a filter. Families have to verify income, and the families least aware of the program are the least likely to finish the process. A program that does not plan

for this will reach the most connected families first. Benefit approval letters and the census-tract shortcut can reduce this, and SGOs should use them.
- Treat this as supplemental money. A future Congress could end the credit, so anything built on it should be something a district could wind down without leaving a hole in its core budget.
- SGOs can pay tutors and other providers directly only if they are verified. Districts can help by sharing lists of trusted, evidence-based providers.

Donors, employers, districts, and community partners would all benefit from a shared set of criteria for evaluating SGOs and programs. Nothing like that exists yet.

### What are the biggest risks?

We are watching five potential scenarios:
- The money mostly ends up subsidizing private school tuition.
- SGOs serving public school students arrive late, after donors have already committed to private school SGOs.
- Districts add fees that price out the families they meant to help.
- SGOs form without real financial and privacy safeguards.
- Congress trims other education programs as this one grows.

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## WHAT HAPPENS NEXT

### Are the rules final?

No. Treasury and the IRS released proposed and temporary regulations on October 1, 2026. The temporary rules, covering how states approve SGOs and how SGOs register and report donations, are in effect now. The proposed rules cover nearly everything else. They are open for comment until December 1, 2026, with a public hearing December 15, but Treasury says taxpayers, SGOs, and states can rely on them for 2027. Final rules are not expected before 2028. Separate guidance defining eligible expenses will follow.

### What is still unresolved?

Several questions remain open, and some answers are expected from Treasury:
- Which additional public school expenses qualify, including pre-K, summer school, mental health supports, and AP or CTE fees.
- How duplicate awards will be prevented across SGOs and between the federal credit and Tennessee's voucher program.
- How an organization proves 85% of its activities are scholarship-granting, and whether education foundations can participate without forming a new nonprofit.
- What the final rules change after public comment.

Other questions will be answered in Tennessee:
- How Tennessee will approve SGOs.

- Where the line falls between an additive service and one a district already owes its students.

### What should organizations do right now?

Learn and plan, without committing. No organization should sign a contract or restructure a program before expense guidance and TDOE's application process are out. Districts and education foundations can identify additive, high-impact student needs and talk to potential SGO partners. Providers can identify who they would work with. Employers can ask their payroll company what offering a deduction would require. Everyone can file public comments on the proposed rules by December 1, 2026 at regulations.gov, referencing REG-117199-25.

### How do we stay informed?

Stand for Children Tennessee, working with EdTrust Tennessee, will hold a session on the proposed regulations October 29, covering what changed, what remains open, and what Tennessee organizations should do next. We held a first session in September 2026, ahead of the rules. A recording of the first session is available online.

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## KEY TERMS

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| **Section 25F** | The provision of the Internal Revenue Code that creates the credit. The IRS calls it the Federal Scholarship Tax Credit. Treasury and the U.S. Department of Education call it the Education Freedom Tax Credit. |
| **SGO** | Scholarship Granting Organization, the nonprofit that collects contributions and awards scholarships. |
| **Provider** | An organization that delivers a service a scholarship pays for. Fewer obligations than an SGO, and the right answer for most groups. |
| **Additive support** | A service beyond what a public school is already required to provide. Scholarships can only pay for additions. |
| **Payroll deduction** | An employer option letting employees contribute automatically and adjust withholding so take-home pay does not change. The main driver of participation. |
| **300% AMGI** | The household income ceiling for eligibility. Set by area and adjusted for household size; the IRS will publish the limits each year. |
| **Qualified contribution** | A cash gift to an SGO that the donor designates for the credit at the time of giving. |
| **Categorical eligibility** | Proving income eligibility with a current approval letter for SNAP, TANF, WIC, Section 8, or SSI. |

| | |
|---|---|
| **Disqualified person** | Someone who cannot receive an SGO's scholarships: its officers, directors, selection committee members, large donors, and their families. |
| **Qualified digital wallet** | A third-party payment platform that approves vendors and pays them directly, which SGOs can use to verify spending. |

## ABOUT THIS DOCUMENT

Stand for Children Tennessee organizes parents, educators, and community members around policy that serves Tennessee students. We are tracking the federal scholarship tax credit through implementation and will update this document as more information and details become available. Questions and corrections are welcome at tninfo@stand.org.

Current as of October 2026. Reflects proposed regulations (REG-117199-25) and temporary regulations (TD 10057) released October 1, 2026. Expense guidance is still pending. Income figures estimated from HUD FY2026 data.