

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.

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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. Whether a married couple filing jointly can claim \$1,700 or \$3,400 is unresolved. The statute allows the credit to "an individual" and caps it at \$1,700 "to any taxpayer," and both readings have support in that language. Treasury will settle it in the regulations.

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. The department has not published how organizations will apply or how it will evaluate them, and that process waits on the federal rules. States are expected to collect and review each SGO's annual audit, so TDOE will carry the oversight responsibility (and the cost) with little federal support.

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 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.

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 also renew last year's recipients, and then their siblings, before serving anyone new, so the students an organization serves in its first year have a durable claim on its money. Early decisions are close to permanent.

Who qualifies for a scholarship?

Households at or below 300% of area median gross income. Nationally that covers an estimated 85 to 90 percent of children. The threshold does not adjust for household size, because area median income is a single figure per area.

300% OF AREA MEDIAN GROSS INCOME	ELIGIBILITY CEILING
Davidson County	\$348,300
Knox County	\$311,100
Hamilton County	\$292,200
Shelby County	\$278,100
Hardin County	\$191,400

The statute ties eligibility to area median gross income as that term is used in section 42, the Low-Income Housing Tax Credit. HUD publishes more than one income-limit series and they produce different numbers for the same county. The figures above come from HUD's published area median income and should be treated as close approximations until Treasury confirms which series applies. Nothing in the law requires an SGO to prioritize low-income students, students with disabilities, or English learners, and Treasury has signaled that 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. Treasury has said states should prevent duplicate awards for the same expense and floated a family certification as one method, but no system exists for one SGO to check what another has awarded. Treasury is also considering safeguards against misuse of scholarship funds.

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.

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.

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. For most districts, an existing local education foundation is the most realistic vehicle, because it already has the nonprofit status, a board, and donor relationships.

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: the IRS listing, 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.

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. Treasury has said the detailed expense guidance is a separate workstream that follows the main regulations.

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?

Estimates vary widely. Congress's Joint Committee on Taxation scored the credit at \$25.9 billion over ten years, roughly \$2.6 billion in the first full year of claims (FY 2028), which works out to about \$50 million in Tennessee. A smaller figure of about \$500 million is sometimes cited for the first year. That number covers federal FY 2027, which captures only a few months of adjusted withholding before anyone files a return claiming the credit. If every eligible Tennessee taxpayer gave the maximum, the ceiling sits above \$3 billion. Where Tennessee lands between those two numbers depends almost entirely on how easy it is to give and how actively the opportunity gets promoted.

An SGO may keep up to 10% of what it raises for administration. Whatever it keeps is the gap between what comes in and what reaches students, so covering a \$90,000 program takes up to \$100,000 in contributions.

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.

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. 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.

How does an individual donate and claim the credit?

Contributions begin January 1, 2027. Tennessee has no approved SGOs yet, because TDOE cannot certify organizations until the federal rules are published. The state must submit its list to the IRS before January 1, 2027. Once a list exists, a taxpayer selects an SGO from it and contributes directly or through an employer payroll deduction. The SGO provides a written acknowledgment that includes a unique donor number generated through an IRS-specified method. The taxpayer reports that number on their federal return, and the credit reduces their tax liability by the amount contributed, up to \$1,700. Donors do not give the SGO a Social Security number, and a donor does not have to live in Tennessee to contribute 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.

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?

Three 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.
- 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.

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.

WHAT HAPPENS NEXT

Are the rules final?

No. Treasury and the IRS are expected to issue proposed regulations in fall 2026. States, organizations, and taxpayers will be able to rely on those proposed rules for tax year 2027. Separate guidance defining eligible expenses will follow later, and final regulations are expected in spring 2027.

What is still unresolved?

Several questions remain open, and some answers are expected from Treasury:

- Whether joint filers can claim \$1,700 or \$3,400.
- How "household" and "income" are defined, and which HUD income limit series sets the 300% ceiling.
- Which additional public school expenses qualify.
- How duplicate awards will be prevented, both for families holding a state voucher and a federal scholarship and for students receiving from more than one SGO.
- What safeguards will apply against misuse of scholarship funds.

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 the rules are published. 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, the formal lever available before the regulations are final.

How do we stay informed when the rules are released?

Stand for Children Tennessee, working with EdTrust Tennessee, will hold a session after the proposed regulations are published, 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. To receive notice of the next one, contact us using the information below.

KEY TERMS

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. One figure per area, with no adjustment for household size.

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 when the proposed regulations are released. Questions and corrections are welcome at tninfo@stand.org.

Current as of September 2026. Details may change when the proposed regulations and separate expense guidance are released. Income figures from HUD FY2026 data.