How Should the New Federal Scholarship Tax Credit Be Regulated?

Treasury Department rulemaking could make or break OBBBA's school choice provision

THE ONE BIG BEAUTIFUL BILL ACT that passed in July includes a landmark provision offering dollar-for-dollar tax credits to individual taxpayers who donate to Scholarship Granting Organizations (SGOs)—representing the first nationwide school-choice initiative. Yet the provision that emerged from congressional sausage-making is very different from what its drafters intended. Notably, it requires states to opt in to participating in the initiative, rather than mandating it from coast to coast. The final bill also no longer explicitly includes a strict prohibition on states imposing their own requirements on SGOs if those states choose to opt in.

Policy wonks expect the Department of the Treasury to issue regulations in advance of the initiative's launch in January 2027. We asked five school choice proponents to advise the treasury secretary on what those regulations should say.

Participating in the discussion are Jim Blew, cofounder of the Defense of Freedom Institute for Policy Studies; Jorge Elorza, CEO of Democrats for Education Reform; Robert Enlow, president and CEO of EdChoice; Robert Luebke, director of the Center for Effective Education at the John Locke Foundation; and Peter Murphy, senior adviser to the Invest in Education Coalition.

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Rulemaking Must Resolve Ambiguities in Federal School Choice Law—and Fast

by Jim Blew

Congress has given the U.S. Treasury Department responsibility for the success or failure of a mechanism that could generate scholarships for millions of K–12 students. Treasury's rules for the new federal scholarship tax credit will determine whether that mechanism works effectively to transform elementary and secondary education in America.

The new tax credit is a remarkable legislative achievement. Now embedded in the federal tax code—with no aggregate cap or expiration date—is a one-for-one, nonrefundable credit to encourage charitable donations to K–12 scholarship-granting organizations (SGOs). Students attending traditional public, public charter, private, and religious schools are all eligible for various types of scholarships.

Yet hasty, last-minute redrafting of key provisions created some ambiguities that only Treasury rulemaking can resolve. As a longtime advocate of school choice and education reform, I offer the following advice.

Act quickly. The credit isn't available until January 1, 2027, but for the measure to succeed in helping students, a lot needs to happen before then. If not expedited, the formal rulemaking process could take a year or more—not accounting for inevitable lawsuits from teachers unions trying to disrupt implementation. Governors need time to determine which SGOs will satisfy federal requirements, and the SGOs need time to design their scholarship programs and identify potential donors, scholarship recipients, and quality education providers. The sooner we have rules, the more likely it is that implementation will succeed.

Clear up confusion about the governors' roles. If a state voluntarily elects to allow its students to receive scholarships for 2027, the governor must provide the Treasury Department with a list of federally compliant SGOs. Governors will likely use their bully pulpits to highlight favored organizations, and some might narrowly elevate SGOs focused on, say, tutoring for public school students. That's allowed. But Treasury should not give governors additional authority to discriminate against other compliant SGOs by excluding them from their states' lists.

Further clarify the role of governors. In addition, governors should be prevented from adding requirements not found in the federal law, such as prohibiting SGOs from focusing on specific student groups or educational approaches. Similarly, new governors should not be allowed to remove an organization from a state's list unless that organization falls out of legal compliance; this stipulation would preempt the sudden disruption of a student's education due to politics.

Clarify ambiguous bill language. For example:

- One hastily drafted provision suggests that compliant SGOs on a governor's list must be "located in the State." Does this language exclude organizations registered to do business in the state but headquartered elsewhere? If so, that would prevent proven national SGOs from helping children across the country.
- Other provisions require that SGOs hold tax credited donations in a segregated account but mandate that 90 percent of the organization's income be spent on "qualified K–12 scholarships." Congress clearly did not intend to impose this 90 percent condition on all the income of or contributions to SGOs—many of which already manage state-based school choice programs that have different definitions for "qualified scholarships." Treasury should clarify that the 90 percent rule only applies to contributions through the federal scholarship tax credit.
- The bill makes scholarships available to all students eligible to enroll in a state's elementary and secondary schools below defined income levels, but it later refers to Coverdell Education Savings Accounts for its list of eligible education expenses. The reference to Coverdell should not be interpreted to further restrict student eligibility, or else in some states it could disqualify students in microschools and other innovative models from receiving scholarships, contrary to the congressional intent to encourage more innovation in K–12.

Remember the law's purpose. At its heart, the federal scholarship tax credit aims to improve K–12 education. Our system is failing to adequately educate about one-third of our children overall, and more than half in our low-income communities. This tax credit provision could help ill-educated children achieve their full potential, with positive consequences for families, communities, and our country.

The original premise of the K–12 scholarship tax credit was that it would encourage private, voluntary transactions between families (who want better schooling for their children) and donors (who want to support families in that quest). But the Senate parliamentarian would not clear the scholarship tax credit for inclusion in the budget bill until the Senate agreed to insert governors into the process—a presumption that the state, not the parent, is primarily responsible for a child's education.

To move the measure forward, the congressional majority reluctantly accepted the limited role for governors. After all, more than half of governors want to expand education freedom and are happy to nurture the relationship between donors and families. As for the other governors—who still seem to cling to the false hope that a standardized, highly unionized, government monopoly can someday successfully educate all our children—I am optimistic that they will not forever stand in the way of parents' aspirations and children's futures. If they do prevent children from accessing K–12 scholarships, I expect the voters will punish them, because school choice is wildly popular across all party affiliations, racial groups, and generations.

The new federal scholarship tax credit offers a historic opportunity to transform American education for the better. Treasury's rulemaking will determine whether that promise is fulfilled, and that means the agency must act with urgency, resolve ambiguities in favor of students, and safeguard this reform from political interference. Millions of children are depending on it.

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Passing the Law Was Just the Beginning

BY JORGE ELORZA

Anyone who works in advocacy knows that passing legislation is only the beginning of reform. The second step—rulemaking—is where laws are translated into practice and where the intent of a bill is either realized or restricted, depending on how agencies define the path forward.

This is especially true for the Educational Choice for Children Act (ECCA), which is included in the One Big Beautiful Bill Act. As the first nationwide private-school choice program, it is designed to expand opportunity, especially for students and families who have historically had the fewest education options. Treasury's rulemaking should honor that goal by ensuring consistency, fairness, and equity across participating states while preserving the flexibility needed for new approaches and school models to emerge.

Maintain a consistent standard for including scholarship-granting organizations. To ensure fairness and prevent political favoritism, Treasury should establish a uniform federal standard to determine which scholarship-granting organizations (SGOs) may participate. States should not be allowed to selectively recognize or exclude qualified organizations based on political considerations or other preferences.

This is not only a matter of legal consistency; it is also a matter of fairness. Many SGOs are deeply rooted in communities of color, immigrant neighborhoods, and under-resourced regions. These organizations are often best positioned to reach families who have been historically underserved by traditional education systems. Treasury must ensure that all qualified SGOs have an equal opportunity to participate.

Support equity through flexible program design. The new law gives SGOs discretion over which qualified expenses to fund, how to distribute scholarships, and what amounts to offer. That flexibility is not a loophole; it is a feature. It allows the program to reach students who are not well served by one-size-fits-all public school systems, including students with learning differences, students in rural communities, students from low-income households, and those still recovering from pandemic-related learning loss.

Treasury should not impose rigid programmatic requirements that limit the ability of SGOs to meet these diverse needs. Some organizations may focus on tutoring or afterschool care for public school students. Others may prioritize private-school tuition, transportation, early childhood programs, or dual enrollment. These differences reflect the unique priorities of different communities and should be supported, not restricted.

In addition, the law defines eligible students as those who come from households earning no more

than 300 percent of the area median income and who are eligible to enroll in public school. Treasury should allow SGOs within each state to tailor their programs to advance particular goals, such as prioritizing support for the most financially needy students. Once a state opts in, local SGOs should be empowered to respond to the needs of their communities, as long as these organizations adhere to the statutory mandate not to serve students from wealthy families.

Allow for flexibility and innovation. We are living through a moment of profound social, political, and cultural change. In times like these, education policy must make room for reinvention rather than retrenchment. The ECCA rulemaking process presents a rare opportunity to do just that.

Treasury should not narrowly define what counts as a legitimate learning environment and should instead preserve flexibility so that new forms, approaches, and models can emerge. Microschools, hybrid programs, community-led learning pods, and other innovations may not look like traditional schools, but they are meeting real needs for families today. Guardrails are important, but overly prescriptive rules risk reimposing the same bureaucracy and standardization that families are trying to escape.

If ECCA is to catalyze a more pluralistic, responsive, and equitable education system, policymakers must act with humility and place trust in the creativity of communities to shape what learning looks like next.

The Treasury Department's rulemaking decisions will determine whether ECCA fulfills its promise or falls short. If implemented thoughtfully, this program can expand opportunity, empower families, and foster innovation across the country.

By ensuring equitable opportunities to access the tax credits, protecting community-rooted organizations, and resisting arbitrary limitations, Treasury can help build an education system that is not only more accessible but also more adaptive to the needs of today's students and tomorrow's.

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Bases Are Loaded. Don't Get Caught Looking.

by Robert Enlow

On the *Education Exchange* podcast this summer, I told Paul Peterson that Congress swung for the fences on school choice in the One Big Beautiful Bill Act, but only hit a single. If we're not careful, that single could lead to the education equivalent of a rally-killing double play.

The final version of the act contains compromises that undermine the tax credit provision from the first pitch. The first and largest is the cap on individual taxpayer credits at $1,700. If we do some back-of-the-napkin math, assuming an average scholarship of $7,500, that means for every 1,000 scholarships, a scholarship-granting organization (SGO) would need 4,412 donors contributing $1,700 each. As someone who has done his fair share of fundraising, I know that the effort to identify, contact, follow up with, track, and do all the other administrative work for that many people will be enormous.

The second compromise made the program opt-in for states. For a program heralded as one that could bypass the special interests that have blocked school choice in dozens of states, especially blue states, it put the ball back firmly in their glove. The argument is that states won't want to turn down "free" federal money, but states do that for ideological reasons all the time. This also opens the program up to bureaucratic micromanaging, potentially allowing states to condition their participation on whether they can apply their preferred regulations.

So, what do we do now? Proponents claim these compromises can easily be fixed in the rulemaking process or in future reconciliation bills. That may be true, but as the old saying goes, when you are at bat and the bases are loaded, don't get caught looking.

The Treasury Department should establish three rules to ensure that doesn't happen.

Prohibit states from adding their own regulations or creating their own new rules for the program. Several blue states have demonstrated that they want more control over private and home schooling. New York's long-running desire to make private schools offer a "substantially equivalent" education led to a set of invasive regulations published in 2022 and a host of court and political battles since then. In Illinois, a bill to regulate homeschooling was beaten back by advocates this past legislative session.

If Treasury allows states to add their own regulations, the federal government could hand these governors and their functionaries a huge tool to exert influence over private schools. The carrot of millions of scholarship dollars could accomplish what the stick of regulations, court cases, and legislation could not.

Require governors to allow scholarships for education services across all school sectors, with no limit on which qualified SGOs can participate. States should not be permitted to allow scholarships for tutoring or supplemental education services for public school students unless they also allow scholarship support for private and charter school students. The bill uses the definition of "school" that is employed by the Coverdell Education Savings Accounts program, so it includes scholarships that provide support for public school students. School districts or nonprofits could create SGOs solely for public school students and could hoover up scholarship dollars. Given the massive administrative infrastructure of school districts, they are in prime position to accomplish this. There's not much to be done about that now. But as a fallback position, the Treasury Department can ensure that states don't *only* provide funding for public school students.

Additionally, I worry that Treasury could step in to create additional definitions of "school," which could effectively federalize what it means to be a private or home school. This is the main concern of many choice advocates on the right, and we should do everything we can to avoid that outcome.

Ringfence existing private-school choice programs. To assuage concerns of private schools and homeschoolers, state-level choice programs use specific language which makes it clear that these programs do not impose any new requirements or regulations on existing private schools or homeschooling families. Similar language would be helpful in federal regulations.

Private schools already have a confusing patchwork of regulations to comply with from local officials, state departments of education, and federal lawmakers. Private-school choice programs layer a new level of regulations on top of those, and this new federal choice program could layer even more on that.

The good news is that the game is not lost . . . yet. With smart, aggressive rulemaking and appropriate defense against those looking to distort the purpose of this program to suit their own ends, federal rulemakers can create a program that schools will want to participate in and that will not empower those who do not have students' or schools' best interest at heart. They're down in the count and facing an ace pitcher, but if a hobbled Kirk Gibson can hit a home run, so can they.

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For an Effective Scholarship Tax Credit, Feds Must Bend the Knee to States

by Robert Luebke

I am a long-time fan of school choice. It produces better student outcomes and propels improvements in systems resistant to reform. I am not a fan of scholarship tax credits. They undermine federalism, which gave rise to the school choice landscape. Scholarship tax credit programs tend to grow slowly, and they are accessed least by those who need them most.

Can school choice and tax credits be effectively wed in the federal scholarship tax credit legislation recently enacted by the Trump administration? In North Carolina, where I live, that prospect has produced both excitement—for the chance to turbocharge the choice movement—and apprehension. Dancing with federal bureaucracy risks overregulation and unraveling years of gains. The real question is: Can an admittedly imperfect vehicle, the scholarship tax credit, be improved to produce genuine gains for families and states? If federal regulations devolve power to the states and honor federalism, it's possible. Three recommendations may help get us there.

Give states maximum flexibility. Scholarship tax credits threaten other choice programs. North Carolina's largest school choice program, the Opportunity Scholarship, provides vouchers for private-school tuition to 80,000 students. Another program provides parents with Education Savings Accounts to help with the expenses of special needs students. Will federally sponsored scholarship tax credits expand these programs or compete with them? I believe regulators must underscore the primacy of state authority and provide the flexibility to administer existing programs. States must also be allowed to create a tax credit program for district and charter schools that assist students with tutoring, testing, or other services. This flexibility is only possible when regulations respect state authority to administer their programs. Without these actions, federal regulations continue to grow and school choice programs are undermined.

Empower states to add eligibility and accountability requirements. State officials charged with administering programs must have the authority to write the rules for the programs they operate. Does the state want a program focused on students from lower-income households or a universal program? States must also be able to decide accountability requirements, testing requirements, and metrics to assess academic progress for schools that enroll scholarship students. Minus this authority, federal regulators with less knowledge of the local landscape fill the gap.

Protect religious freedom and institutional autonomy. Approximately 70 percent of children enrolled in North Carolina's largest school choice program attend church-related schools. For this program to keep thriving, regulations must protect the principles of religious freedom and institutional autonomy. Religious freedom guarantees the rights of individuals to practice their religion. Institutional autonomy

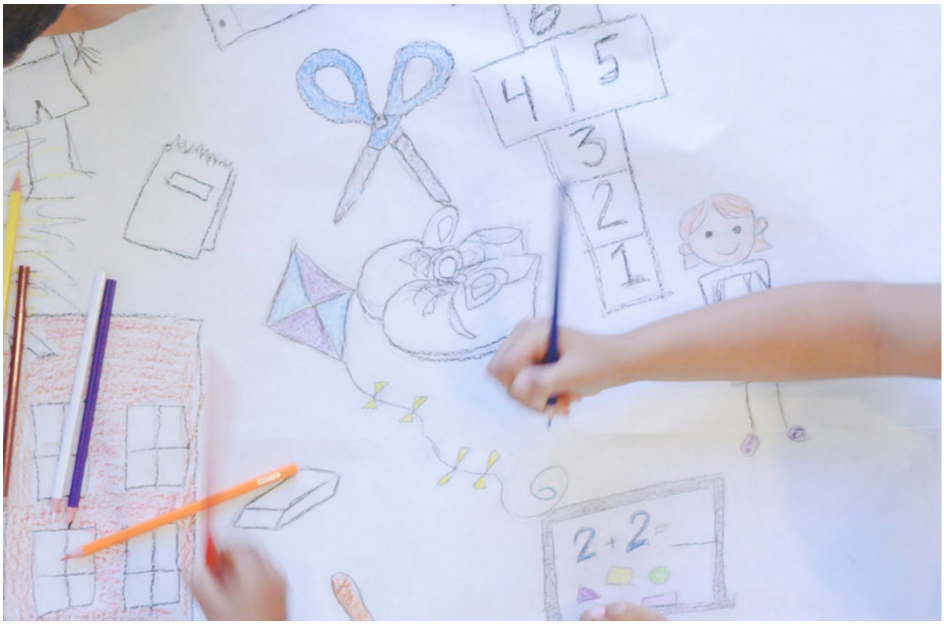
ensures that religious schools can administer schools in ways consistent with their values and mission. Federal regulations must honor both and keep schools free of federal entanglements. Without these protections, school choice becomes no choice.

Improve requirements for opting in. States that elect to participate in the federal scholarship tax credit must present to the Treasury Department a list of scholarship-granting organizations that meet the requirements of the program. According to the legislation, the choice "shall be made by the Governor of the state or by such other individual, agency, or entity as designated under state law to make such elections." In the first week of August, the North Carolina General Assembly approved an opt-in bill. It was vetoed by Governor Josh Stein. Is legislation necessary to opt in, or can opting in be an executive action of the governor or state agency? Who decides?

Also confusing is the requirement that opting in occur annually. Doing so makes the program more sensitive to political winds. Yes, the annual option may make choice a possibility where it hasn't moved forward legislatively. That is good. However, a change in political parties may result in stop-and-start participation that would be disastrous for children and for the ability to raise funds.

One remedy might be to lengthen the participation period for states. Requiring the opt-in renewal every three, five, or seven years would encourage more stability and lessen the threat of lawsuits that would contribute to delays.

Scholarship tax credits offer the opportunity to significantly expand school choice. With that hope comes formidable threats of overregulation, dependence on the federal government, and an undermining of the system of federalism that helped to create school choice programs in 33 states. The recommendations discussed here, I believe, can counter these trends and put us on a more intelligent path forward, where federalism and school choice can help all children flourish.



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Nationwide School Choice a Major Breakthrough for Children—but There's a Catch

by Peter Murphy

In July 2025, President Trump signed into law the first federal school choice provisions that could benefit children in all 50 states. These provisions are contained in the Educational Choice for Children Act, which became part of the One Big Beautiful Bill Act. They create a federal tax credit to privately fund scholarships for use in K–12 education.

This new law requires governors to opt in to the program annually if they want their states to participate in this choice-expanding initiative. If a governor does decide to opt in, not later than January 1 of each year, they must submit to the U.S. Treasury Department a list of scholarship-granting organizations (SGOs) in the state that are qualified to participate.

In short, the law provides that governors decide whether to opt in and, if so, whether an SGO can be included, based on its compliance with this federal law. That's it. The governor's role is a *ministerial* function, not an arbitrary or open-ended determination.

The nation's governors have a moral obligation to sign their states up for this program. In 1963, Alabama Governor George Wallace stood in a doorway at the University of Alabama to symbolically oppose the enrollment of two Black students. If school choice is the civil rights issue of the 21st century, as many leaders and activists have averred, governors who refuse to opt in to the scholarship tax credit program would be metaphorically "standing in the schoolhouse door," becoming this century's version of Dixiecrat governors like Wallace. No need to sugarcoat it.

A governor who opts in must determine "the scholarship-granting organizations that meet the requirements" of this law. The process for making such determinations on the compliance of these organizations is not defined in the statute, and likely will be detailed in forthcoming Treasury regulations.

On this issue, note that there is no other basis under this school choice law by which a governor determines which organizations can participate, meaning that imposing additional conditions would exceed the scope of the governor's authority. A governor cannot tailor the list to their preferences to reflect a policy or political agenda. Either the organization qualifies under the federal law, or it does not, regardless of the entity's choice of schools, eligible services, or underlying philosophy.

If, however, a state law imposed additional requirements on SGOs, and such requirements were consistent with the federal statute, those actions would likely be acceptable. But if a state law imposed conditions that conflicted with federal law, the outcome is far less certain, and litigation would likely occur.

Governors of every state should be encouraged to opt in to the federal scholarship tax credit program

so their state's children can benefit from resulting scholarships for use in both public and private schools. Doing so would financially empower parents to access school or service options that best meet the education needs of their children and respect the family's values.

Expanding school choice in a state via these new federal provisions would increase private funding for education and be cost-free to the state's taxpayers. Since charitable donations would fund the scholarships for children attending public, charter, private, and religious schools, the resulting tax revenue loss would be incurred by the federal government, not individual state coffers. States that do not opt in will lose charitable contributions from donors who instead will fund children's scholarships in states that do opt in.

For governors who put the needs of children and families first, opting in to the new school choice program is a no-brainer. Every other consideration is secondary in importance or smacks of political bias.

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