FEDERAL SCHOLARSHIP TAX CREDIT COALITION

FSTC Coalition Guidance Document for Notice of Proposed Rulemaking (NPRM)

Overview

The U.S. Treasury Department released Temporary regulations that will govern the federal scholarship tax credit law for 2027 (**RIN 1545-BS17):** **https://public-inspection.federalregister.gov/2026-20264.pdf**

Treasury has also released a Notice of Proposed Rulemaking (NPRM) (**REG-117199-25] RIN 1545-BR97):** **https://public-inspection.federalregister.gov/2026-20277.pdf** for final rules that will be issued in 2028.

Treasury has publicly credited the FSTC Coalition letter and partner comments submitted in response to its November 2025 Request for Public Comment as especially helpful in drafting the Temporary Rules and NPRM. This document provides the FSTC Coalition Steering Committee's recommended comments on the issues where Treasury requested comment, plus other key rulemaking issues.

Before we submit the Coalition letter, we welcome your input on these recommendations and on any issues we may have missed. **We are also urging coalition partners to submit your own comments directly to Treasury on behalf of your organization. Aligned comments improve the odds of final rules that maximize participation by scholarship granting organizations (SGOs), taxpayers, and students.**

ACTION ITEM

- **Please contact us if you have questions, concerns, or suggested edits to the Coalition Draft Position.**
- **We encourage all coalition members to submit comments to the Treasury Department prior to December 1, 2026, midnight deadline.**
- Subject line for the comments should include a reference to REG-117199-25. Electronic submission can be done via the Federal eRulemaking Portal at www.regulations.gov. Type REG-117199-25 in the search field on the regulations.gov homepage to find this notice and submit comments.

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Issues For Which Treasury Is Seeking Comment

85% Safe Harbor

Proposed §1.25F–3(c)(2)–(3) would let an SGO apply the operational requirements only to its section 25F segregated account, rather than the income of the whole organization, if at least 85 percent of its activities are scholarship granting activities (counting administrative, fundraising, and other activities that support scholarship granting). Multistate SGOs must keep a separate segregated account for each covered State and meet the 85 percent test.

Treasury Department and the IRS request comments as to whether further guidance is needed regarding how an organization measures its scholarship granting activities, including whether the determination should be based on receipts, expenditures, staff time, program-service activity, or another administrable metric, as well as whether 85 percent is a reasonable threshold.

Recommendation:

- We believe the definition should count all costs of scholarship granting, including staff time as estimated by management, postsecondary and state K-12 scholarship programs, and fundraising. The only area that should not count would be the direct and staff costs of programs unrelated to scholarship granting. If the definition is this broad, it may present a workable threshold.

  However, we recommend a lower standard, such as 51%, for SGOs to take advantage of the 90% safe harbor. We would encourage coalition partners to give examples of existing SGOs that would benefit from this lower threshold.

Further Comment on SGOs

- We recommend that the host SGO should be explicitly allowed to shift up to 10 percent of the amount raised through the FSTC from the segregated account into its general fund. This has been common practice for state SGOs for many years, and it works well.

- Since Treasury admits that the statute doesn't provide a timeframe, we recommend that the 90 percent spending requirement be calculated on a rolling three-year average. This accommodates higher startup costs, multi-year scholarships, and the normal lag between year-end donations and scholarships disbursed the following school year.

Digital Wallet

Proposed §1.25F–1(a)(13) would define a "qualified digital wallet" as a third-party platform that manages section 25F scholarships by processing family purchase requests, tracking

approved expenses, and ensuring payments go only to qualified expenses (by pre-approving and paying vendors directly or requiring receipts).

Treasury Department and the IRS request comments on this definition of qualified digital wallet and whether additional safe harbors for verification that scholarships are spent on qualified elementary or secondary education expenses should be included in the final regulations.

Recommendation:

- We believe this definition of qualified digital wallet is sufficient and does not require additional safe harbors for verification.

501c3

The Treasury Department and the IRS note that section 25F(c)(5)(A) requires that an SGO must be a public charity under section 501(c)(3) (section 501(c)(3) public charity); therefore, scholarships provided by an SGO must further exempt purposes.

The Treasury Department and the IRS request comments on how section 501(c)(3) requirements interact with section 25F and whether any clarifications are needed in the final regulations.

Recommendation:

- We do not recommend any additional clarification, but we encourage coalition members to let us know if they identify any potential issue. We do want to reiterate that States cannot impose additional 501(c)(3) rules on SGOs.

Verification of Household Income

Proposed §1.25F–3(c)(6) would let SGOs verify household income directly, through categorical eligibility, or through two safe harbors (low-income-area tutoring and special needs; foster children), reducing the need to collect sensitive income information.

Treasury Department and the IRS request comments on other needs-based programs, such as State or Tribal programs, that also should be included in this categorical eligibility verification method.

Recommendation:

- The Coalition appreciates Treasury's consideration of family size in determining the area median gross income (AMI). This will allow more students to participate and recognizes that families with more children will have a greater struggle paying expensive educational costs like tuition.
- The low-income area safe harbor raises at least three concerns. First, in addition to using the poverty-based QCT metric, it adds DDAs, which are based on the cost of building low-income housing, not income. As a result, DDAs incorporate a much broader swath of census tracks, including some of America's wealthiest communities (where it is indeed expensive to build low-income housing). Second, there is no rationale for allowing some education providers for specific uses (schools providing academic tutoring or special needs services) to use this income-verification safe harbor, but to prohibit its use by other education providers such as independent afterschool providers for other allowable uses such as tuition and extended-day programs. The safe harbor should be extended to any service provider an SGO chooses to make available for any allowable use under the law. Finally, SGOs that choose this safe harbor are required to provide several certifications, many of which need to be clarified.

  Can the required audit be a supplement to the main annual financial and programmatic audit or must it be a stand-alone audit? Also, will the SGO selection process run afoul of the still unclarified provision prohibiting earmarking funds for students if teachers indicate which students are most in need? Finally, we believe SGOs should be allowed to define for themselves how they will select students based on academic or other needs, and whether their tutors are academically qualified.

State Certifications

Treasury Department and the IRS request comments on the certifications States would be required to make in accordance with proposed §1.25F– 5(d)(3), including any other certifications that should be required for a multistate SGO. Comments are also requested on whether any certification is disproportionately burdensome compared to the benefits to tax administration.

Recommendation:

- We appreciate Treasury clearly stating in the temporary rules that States may not impose additional burdens on SGOs beyond what is required in the federal statute. We also appreciate Treasury requiring any SGO that wants to participate in 25F to register

on the Treasury portal. We encourage Treasury to cross-reference SGOs that register in the federal portal with those submitted by Governors to ensure every SGO that wants to participate and attests compliance with the federal law is included on the State list.

- Consistent with the law's intent to make participation easy, State review of SGO governing documents and operational attestations in Year 1, followed by a financial and programmatic compliance audit beginning in Year 2, is sufficient and not disproportionately burdensome. However, if interested parties believe that states will impose additional regulation on SGOs through the process please advise us.

Other Key Rulemaking Issues

Married Couple Filing Jointly

- We appreciate Treasury's determination that married couples filing jointly can give $3,400. The statute and governing IRS precedent makes clear that the giving limitation applies per individual, allowing married couples filing jointly to give $3,400. Certain Members of Congress have challenged Treasury's interpretation (see here). It would be helpful to address some of their claims, such as in our comments below.

- Lawmakers included the phrase "any taxpayer," which would have been left out if the limit was only intended to apply per tax return, and there is no language within the FSTC supporting a different interpretation. IRS regulations generally recognize that a joint return consists of two taxpayers. For example, 26 CFR §1.6013-4(b) states, "Although there are two taxpayers on a joint return, there is only one taxable income." Tax court decisions have repeatedly confirmed that spouses on a joint return remain separate "taxpayers" absent express statutory merger. For example, *Dolan v. Commissioner* (1965) and *Anne Goyne Mitchell* (1969) treat each spouse independently for assessment and notice. *Rodney v. Commissioner* (1969) and *Moore v. United States* (1965) treat spouses filing jointly as separate taxpayers when it comes to criminal proceedings. If Congress had intended for the FSTC allowance to be denied to one of two taxpayers filing a joint return, such language would have been included in the FSTC, as is the usual practice for tax statutes that seek to treat joint filers as one taxpayer.

Section 530/ Coverdell Allowable Expenses

- Section 25F conditioned eligibility on being eligible to attend a public elementary or secondary school but doesn't define "school." Qualified expenses however are limited to those listed in Section 530(b)(3)A) which must be offered in connection with enrollment or attendance at a public, private, or religious school or in some

cases such as afterschool programming – required by or provided by the school. Treasury maintains that "school" when it appears in 530 (b) (3)(A) is defined by the state since that is how it is interpreted when "school" appears in 530 (b) (3)(B). Such an interpretation could prevent homeschool or micro-schools in states where they are not considered a private or religious school. It can also prevent any after school program that isn't considered provided by or required by the school.

- The intent of the law was to allow families to choose the best school or education service for their child, including afterschool programs. We do not believe Treasury should limit families to choosing afterschool providers contracted by a "school." Treasury should make clear that: 1) parents must have control or agency over the scholarship funds, including the right to turn down the scholarship or not use it; 2) scholarships should not cover the cost of anything that a public school (traditional, charter, other) is funded to provide for free by state or federal law; and 3) qualified expenses chosen by the parent must not be subject to veto by a school.

Ease of Taxpayer Giving

- We urge Treasury to make the W-4 match the W-4P and clarify that donating to an SGO via an employer is similar to making regular charitable donations. It would also be helpful to employers and taxpayers if Treasury were to clarify what documentation is necessary when donating via payroll deductions, similar to the guidance for other charitable donations.

- We also encourage IRS to create a separate tax credit worksheet as part of the W-4, so that it's clearer the tax credit isn't contingent on having dependents.

Opting in for 2027 after January 1st

- The law implies in § 25F(g)(1)(A) that in 2027 states may opt in after January 1st if that is "as early as practicable." The February 15 deadline for submitting SGO lists should not be limited to states that previously made advance elections. Governors who miss the deadline should be able to opt in with an affidavit stating this was the earliest practicable date for them.

Taxpayer/Donor Eligible Contributions

- We ask Treasury to clarify that if a state, via state tax credit scholarship programs, provides a partial credit, a single donation can be made that is split with the 25F contribution.

- We agree that Treasury should not prevent SGOs from allowing donors to restrict the use of their funds to specific regions, school models, types of students, programs, and even a specific school. We also agree that if a donor contributes to a multi-state SGO, they must be allowed to designate a state but may instead designate their contributions without designating a state. We do not believe there should be any further restrictions on donor intent.

Definition of Disqualified Persons

- The best approach is for Treasury to disqualify major donors, defined as those giving $5,000 to an SGO, if such amount is more than 2 percent of the total contributions to the SGO. Using only the two percent cap would mean that if an SGO received fewer than 50 donations in a year, every donor who gave the maximum of $1,700 would have their child be disqualified. In practice, this would prevent small SGOs from opening and serving families locally, even if those SGOs are meeting all the other requirements of federal law.

- The law's language makes clear that Congress wanted to prevent self-dealing, conflicts of interest, and donors directing scholarships toward particular children. However, in limited and well-documented circumstances, an SGO board member's child should be allowed to receive an award if there is no conflict. This includes situations where scholarship applications are reviewed using blind or anonymized procedures—such as committee review without identifying information, randomized selection processes, or computer-based scoring.

- We strongly disagree with the addition of siblings and their descendants in the list of disqualified persons. In the IRS definition of a "member of the family," a member of the family includes any spouse, ancestors, children, grandchildren, great grand-children, and spouses of children, grandchildren, and great grandchildren. The IRS definition of "member of the family" does not include siblings and their descendants: https://www.irs.gov/charities-non-profits/charitable-organizations/member-of-the-family

Residency

- Treasury stated that SGOs must fund scholarships for "eligible students solely within the State in which the organization is listed;" however, the statute does not say that the student must be a resident. This matters for students in border regions, boarding and virtual schools, and military families. We appreciate the military-family safe harbor and believe the same interpretation should apply to all students. This would be most clearly aligned to the statute, which does not create a residency requirement. "Within a state"

should mean either residing or attending school within the state. Treasury wrote that their interpretation will have a minimal effect on the number of students receiving a scholarship and on student outcomes or economic growth.

We recommend that coalition partners address this issue and explain how common this situation is, and why a student from a state that opted in will have a difficult if not impossible time finding an SGO that will fund his or her education out of state.

Homeschools/Microschools

- Our best read of the law makes any student in an educational setting that satisfies the state's compulsory attendance laws satisfies 25F. We do not believe States should have to re-define "school" in their laws in order to ensure that homeschool and microschool students in any state that has opted in can participate.

  We believe if a student is regarded as receiving education in the state, regardless how or where that education is being received, this should be sufficient as acknowledgement that the child is being schooled. If a child is not regarded as truant from school, then the child is obviously regarded as attending a school.