



Understanding the New Federal Tax Credit for K-12 Scholarship Donations

Client Advisories

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On July 4, 2025, President Trump signed the One Big Beautiful Bill Act (P.L. 119-21), which created a new permanent federal income tax credit under IRC § 25F for individual donors who make cash contributions to qualifying Scholarship Granting Organizations (“SGOs”) supporting K-12 students. The credit takes effect January 1, 2027, so for organizations in the education and scholarship space, there is much to do between now and then.

How the Credit Works

Individual taxpayers may claim a dollar-for-dollar federal income tax credit of up to \$1,700 per year for qualifying cash contributions to an eligible SGO. The credit is nonrefundable, meaning that it can reduce federal tax liability to zero, but will not generate a refund. Any unused amounts, however, may be carried forward for up to five years. Because the cap applies per taxpayer (not per return), married couples where both spouses have federal tax liability could each claim up to \$1,700.

The credit cannot be combined with a charitable deduction for the same contribution. There is also a coordination rule with state-level scholarship tax credits. If a donor claims a state credit for the same gift as, for example, is common for Pennsylvania donors using the EITC or OSTC programs, the federal credit is reduced dollar-for-dollar by the state benefit.

A companion provision, IRC § 139K, excludes from gross income any scholarship amounts received by students under a qualifying SGO program, providing favorable federal tax treatment on both ends of the transaction.

What Organizations Can Qualify

To qualify as an SGO, an organization must be recognized by the IRS as a Section 501(c)(3) public charity (private foundations are excluded) and must use at least 90% of its income to fund scholarships for eligible students. Treasury’s preliminary guidance under Notice 2025-70 interprets “income” broadly to include all organizational

revenue, not just scholarship-designated contributions. This interpretation has drawn pushback from practitioners and may be revised when formal regulations are issued. Multi-purpose nonprofits should pay close attention to this issue, as it may require housing SGO activities in a separate 501(c)(3) entity.

Scholarships are required to serve students at multiple schools (at least ten students, not all from the same institution) and to cover qualified K-12 education expenses such as tuition, fees, books, supplies, room and board, uniforms, transportation, academic tutoring, computer technology and internet access, and special needs services. They are limited to students whose household income does not exceed 300% of the area median gross income and to students and schools located within the SGO's state. Organizations are required to maintain separate accounts for qualifying contributions, follow priority rules that favor prior-year recipients and their siblings, and refrain from accepting donor-directed contributions earmarked for a specific student.

State Participation: The Threshold Requirement

The credit is only available to donors who contribute to an SGO that has been officially listed by a participating state. States must voluntarily elect to participate and submit a certified list of qualifying SGOs to the IRS. If a state does not act, no organizations based there will qualify, regardless of how well they otherwise meet the statutory requirements. As of the date of writing, roughly twenty states have formally opted in or signaled their intent to do so, though the landscape is shifting quickly.

Because states must affirmatively opt in, early activity at the state level is worth monitoring. Pennsylvania and New Jersey, two states where many of our clients operate, present different pictures. Pennsylvania has a well-developed scholarship tax credit infrastructure through its EITC and OSTC programs. It also has pending legislation (HB 1763) that would position the Commonwealth to participate. Participation still requires action by the Shapiro administration, but the groundwork is being laid. New Jersey has not yet indicated whether it will opt in, but we are monitoring that situation closely.

One practical note for donors: the credit follows the SGO's location, not the donor's state of residence. Thus, a Pennsylvania donor could claim the credit by giving to an SGO in a participating state, though scholarships from that organization would go to students in that other state. Pennsylvania families would only benefit directly if Pennsylvania itself participates.

What You Should be Doing Now

The most immediate question for any K-12 school, school network, or education-focused nonprofit is whether its existing entity can qualify as an SGO, or whether it needs a separate entity. Given the 90% income expenditure requirement and the prohibition on multi-purpose activities, many organizations will need a dedicated 501(c)(3) subsidiary or affiliate to house SGO functions. That entity needs to be in place and properly structured before your state submits its SGO list, so the clock is already ticking.

Beyond the structural considerations, organizations should begin building the compliance systems that SGO status requires. That means establishing separate accounts for qualified contributions, developing documented student eligibility procedures consistent with the income thresholds, adopting scholarship award policies that



follow the required priority rules, and implementing internal accounting controls that can demonstrate the 90% test is being met.

We also recommend that organizations begin thinking about donor communications now, even before state participation is confirmed. Donors who currently support your scholarship programs will have questions about how this credit changes their giving strategy, and the organizations best positioned to benefit will be the ones that can quickly and clearly communicate their SGO status and what it means for donors once state participation is known.

Finally, because formal Treasury regulations are still pending, we recommend against locking in final structural decisions until those regulations are released, unless the state timeline requires earlier action.

How We Can Help

We are advising nonprofit organizations on SGO qualification, entity structure, and scholarship policy compliance, and we continue to monitor state participation requirements. If you have questions about whether this program makes sense for your organization and what steps you should take, please reach out to **Noel Fleming** at nfleming@archerlaw.com or 267-422-9855, or **Kayci Petenko** at kpetenko@archerlaw.com or 267-422-9856.

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