Ostroff
ASSOCIATES

To: Lower Hudson Education Coalition
From: Ostroff Associates
Date: October 5, 2026
Re: Treasury and IRS proposed regulations on the Federal Scholarship Tax Credit (91 FR 62818, October 2, 2026)

Summary

On October 2, 2026, the Treasury Department and the IRS published proposed regulations implementing the new federal tax credit for donations to scholarship granting organizations, enacted as section 25F of the Internal Revenue Code in the 2025 One Big Beautiful Bill Act. The credit takes effect January 1, 2027. A companion set of temporary regulations (T.D. 10057), published the same day, puts the rules on state elections, state lists of scholarship organizations, and organization registration into force without waiting for public comment. Comments on the proposed regulations are due December 1, 2026.

For LHEC districts, the most consequential feature is how little room the rules leave for a state to shape the program. A state decides each year whether to participate, and if it does, it must list every organization that asks to be listed and meets the federal criteria. It may not limit the type of school scholarship recipients attend or the kinds of expenses scholarships cover. Governor Hochul has said she intends to opt New York in but would first review the federal rules for provisions that could harm the State's education system. These rules now supply most of what that review was waiting on, and the first filing deadline is January 1, 2027.

The rules also confirm that public school students are eligible and that tutoring, special needs services, and extended-day programs are among the permitted uses. How those uses would work in practice for public schools is left to separate guidance that has not yet been issued.

The rulemaking

The proposed regulations (REG-117199-25, RIN 1545-BR97) would add sections 1.25F-0 through 1.25F-5 to the income tax regulations. They follow Notice 2025-70, which solicited input in November 2025, and Revenue Procedure 2026-6, which set the 2026 procedure for state elections. The docket had already drawn nearly 9,900 comments as of this morning. A public hearing is scheduled for December 15, 2026.

The temporary regulations are narrower. They cover definitions, the state election, the state list, and organization registration and donor reporting, and they expire on October 1, 2029. Treasury invoked the good cause exception to notice and comment on the ground that states and organizations must act before January 1, 2027. The practical effect is that the state-role provisions described below are binding now, although they remain open to comment as part of the proposed rule.

How the credit works for donors

An individual who is a U.S. citizen or resident may claim a nonrefundable, dollar-for-dollar credit of up to $1,700 per year for cash contributions to a listed scholarship granting organization. Treasury reads the cap

as applying to each spouse, so a married couple filing jointly may claim up to $3,400 if each spouse contributes. Contributions made through partnerships or S corporations do not qualify. Unused credit carries forward for five years, and a contribution claimed for the credit cannot also be deducted as a charitable gift.

A donor may give to an organization listed in any participating state, regardless of where the donor lives. New York taxpayers will therefore be able to claim the credit in 2027 whether or not New York participates. If the State does not participate, their contributions would fund scholarships for students in other states.

Where a state offers its own credit for the same contribution, the federal credit is reduced by the state credit, but the reduction is taken from the full contribution before the $1,700 cap is applied. New York does not currently offer a state scholarship tax credit, so this rule has little immediate bearing here.

Donors must designate a gift as a qualified contribution when they make it. The organization issues each donor a unique donor number by January 31 of the following year, and the donor reports that number on new IRS Form 8525.

Which students qualify and what scholarships may cover

An eligible student must be eligible to enroll in a public elementary or secondary school and live in a household with income at or below 300 percent of area median gross income, measured using the Section 8 housing methodology with adjustments for family size. Treasury estimates that roughly 95 percent of children nationally fall under that threshold. The IRS expects to publish income limits by area and family size each year.

Organizations may verify income directly, through tax returns, pay stubs, and similar records, or categorically, by documenting that someone in the household is approved for SNAP, TANF, WIC, Section 8 housing, or SSI. School-wide free meal eligibility is expressly not accepted, because the statute requires a household-level determination. Foster children are deemed to meet the income test.

A third route bears directly on public schools. Where an organization funds individual academic tutoring or special needs services for students at a school located in a HUD qualified census tract, or at a school that certifies at least 80 percent of its students live in one, and the school itself selects the students based on academic or special need, those students are treated as income-eligible without verification. The organization must obtain an annual third-party audit covering provider qualifications, independent diagnosis of the student's need, and assessment of the services' effect on each student.

Students must reside in the state where the organization is listed, with exceptions for military dependents and dependents of individuals living on Indian lands. Residence controls, not the location of the school, so a New York scholarship could follow a New York resident to a school in Connecticut or New Jersey.

Permitted expenses are those in the Coverdell education savings account definition in section 530(b)(3)(A): tuition, fees, academic tutoring, special needs services, books, supplies and equipment in connection with enrollment or attendance at a public, private, or religious school; room and board, uniforms, transportation, and supplementary items and services such as extended-day programs required or provided by the school; and computer equipment and internet access. A school is whatever provides K-12 education as determined under state law. Treasury states that detailed guidance on qualified expenses will be issued separately under section 530 and describes it as a high priority, without giving a date.

Amounts charged by a school must be paid directly to the school, which must return any excess. Other vendors may be paid directly if vetted and unrelated to the recipient. Families may be reimbursed only

against receipts, and organizations may use third-party digital wallet platforms. Scholarships received are excluded from the family's gross income under new section 139K.

Requirements for scholarship granting organizations

An organization must be a section 501(c)(3) public charity, hold qualified contributions in a segregated account, award scholarships to at least ten students who do not all attend the same school, spend at least 90 percent of its income on scholarships, give priority to prior-year recipients and then their siblings, and refrain from earmarking contributions for particular students. It may not award scholarships to disqualified persons, a category that includes its officers and directors, anyone who takes part in selecting recipients, substantial contributors (more than $5,000 and more than 2 percent of the year's contributions), and their families.

Treasury reads the 90 percent requirement as applying to an organization's total gross receipts, but offers a safe harbor. A single-state organization whose activities are at least 85 percent scholarship granting may apply the federal requirements to its segregated account alone. Multistate organizations must meet the 85 percent test, keep a separate account for each state, and satisfy the requirements state by state. The 90 percent test may be met by the end of the year after the income is received. Treasury acknowledges that this structure may lead existing nonprofits to form new, dedicated entities.

Organizations must register through an IRS portal, report donor information to the IRS by February 28 each year, file annual certifications and operating data with their Form 990, and commission an annual financial and programmatic audit, a copy of which goes to each state that lists them. Organizations with receipts of $500,000 or less may use an independent committee rather than an outside auditor. Operating data to be reported include the number of applicants and awards, the range and average of award amounts, the number of schools attended, and aggregate spending by expense category.

An organization is considered located in a state if it is authorized to do business there and complies with the state's generally applicable charity laws. No physical presence is required. Treasury rejected requests for a headquarters test, which means national multistate organizations will be able to operate in any participating state.

The role of the State

The election is made by the Governor, or by another official or agency that state law designates to make elections on federal tax benefits. The rules do not call for state legislation. An election covers a single calendar year, must be made again each year, and cannot be revoked once completed for that year.

For 2027, a state must file an advance election on Form 15714 by January 1, 2027, and then perfect it by submitting its list of organizations by February 15, 2027. A state that misses the list deadline is treated as not having elected, and no organization in that state can qualify for the year. The list may be supplemented until the deadline, after which additions wait until the following year.

With its list, a state must certify that each organization is located in the state, maintains a segregated account, and satisfies the federal operating requirements, and that the State has reviewed each organization's audit report and annual certifications and investigated any failures. For organizations with no operating history, the State may rely on governing documents and written policies that expressly commit the organization to the federal requirements. A State must also certify that its own procedures are fairly administered, afford due process, and provide for prompt removal of noncompliant organizations.

Two provisions define the limits of state discretion. First, a State must certify that its list includes every organization located in the State that seeks inclusion and meets the federal definition. Second, under section 1.25F-5T(e)(2), a State "may not require SGOs to operate in a manner that is more restrictive than the requirements set forth in section 25F(c)(5), such as by limiting the type of school that scholarship recipients may attend or the types of qualified elementary or secondary education expenses for which scholarship funds may be used." A State must apply its generally applicable charity laws and may impose application, documentation, and financial reporting requirements reasonably tailored to confirming federal compliance. If the IRS finds a pattern of irregularities, it may direct a State to change its procedures.

An individual organization remains free to narrow its own mission, for example by serving only lower-income students or funding only particular services. The State cannot require it to do so.

Where New York stands

Governor Hochul stated in May that she intends to opt in. Her office said at the time that it would review the federal details for "poison pills that could harm New York's education system," and as recently as late September described the credit as having the potential to benefit public and private school students "without diverting resources from public schools or state and local budgets." Press reports through mid-September indicated that no formal election had been filed. NYSUT, the UFT, and the AFT have urged the Governor to opt out, while a coalition of anti-poverty organizations and charter school leaders, along with Catholic and Jewish school advocates, has pressed her to complete the election. According to the IRS, 30 states have opted in.

The administration projects that by 2030 the program will involve 600 to 700 scholarship organizations, more than 11 million contributing taxpayers, nearly $26 billion in annual contributions, and as many as 2.2 million scholarships a year.

Considerations for LHEC districts

The rules settle the question of whether New York could opt in on its own terms. It cannot direct scholarships toward public school students, confine them to tutoring or similar supplemental services, or condition participation by private schools on admissions, nondiscrimination, or accountability standards beyond what federal law and general charity law already require. Press analysis of the rules has emphasized the same point. The choice before the Governor is therefore participation in the program as federally designed, renewed or declined each year.

The program draws on federal tax expenditures rather than state or local appropriations, so participation would not directly reduce school aid or district budgets. Indirect effects would depend on how many families use scholarships to leave district schools and how enrollment changes flow through state aid formulas over time. Those effects are not addressed in the rule and are difficult to estimate before organizations begin operating in New York.

Conversely, public school students would be eligible for scholarships covering tutoring, special needs services, and extended-day programs, and the qualified census tract safe harbor is built around services delivered at schools that select the students.

However, several practical questions remain open. The rule does not explain how a public school that charges no tuition would bill for such services, and the forthcoming section 530 guidance is where that should be resolved. A district-affiliated education foundation would face the ten-student, multiple-school,

anti-earmarking, and 85 percent tests, which in most cases would point toward a separate entity. Districts that want to use the census tract route would need to make certifications and support the organization's annual audit. And because the rule does not accept school-wide meal eligibility and New York now provides school meals universally, meal program records will not serve as income documentation.

If the State participates, districts should also expect requests from scholarship organizations and families for enrollment, residency, and service documentation, and should anticipate that the annual operating data organizations file with the IRS and the State will become the main public source of information on how the program is working locally.

Key dates

Date	Action
December 1, 2026	Written comments on the proposed regulations due (regulations.gov, docket IRS-2026-1354, REG-117199-25). Requests to speak at the hearing and topic outlines are due the same day.
December 10, 2026	Requests to attend the public hearing due by 5 p.m. ET.
December 15, 2026	IRS public hearing, 10 a.m. ET (cancelled if no outlines are received).
January 1, 2027	Deadline for a State to file its advance election for calendar year 2027 on Form 15714. The credit becomes available for contributions made on or after this date.
February 15, 2027	Deadline for a State that filed an advance election to perfect it by submitting its 2027 list of scholarship granting organizations. Organizations cannot be added to the 2027 list after this date.
January 2 to September 30, 2027	Advance election window for calendar year 2028. A State may alternatively elect during October through December 2027 or on January 1, 2028.