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Federal Tax Credit Scholarship Program Included in P.L. 119-21, the FY2025 Reconciliation Law

September 26, 2025

Congressional Research Service
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R48724

CRS REPORT
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Committees of Congress

Federal Tax Credit Scholarship Program Included in P.L. 119-21, the FY2025 Reconciliation Law

SUMMARY

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September 26, 2025

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On July 4, 2025, the FY2025 reconciliation act (P.L. 119-21), commonly referred to as the One Big Beautiful Bill Act, was signed into law. Among its provisions, the law created a federally funded tax credit scholarship program for elementary and secondary education that will be effective beginning on January 1, 2027.

Under the program, taxpayers will be eligible to receive a tax credit of up to $1,700 for the value of cash contributions to certain *scholarship granting organizations* (SGOs). These organizations, in turn, will be required to use these contributions to grant scholarships to students at private and public elementary and secondary schools located within their states.

Eligibility for scholarships will be limited to students whose family income is below 300% of their area median income. Recipients may only use the funds for qualified expenses, including

- tuition, fees, books, supplies, other equipment, academic tutoring, and special needs services for special needs beneficiaries that are incurred by the beneficiary in connection with enrollment or attendance as an elementary or secondary school student at a public, private, or religious school;
- room and board, uniforms, transportation, and supplementary items and services (including extended day programs) if these expenses are required or provided by a public, private, or religious school in connection with enrollment or attendance; and
- computer technology, equipment, or internet access and related services if used by the beneficiary and the beneficiary's family during any of the years the beneficiary is in elementary or secondary school.

Under the law, these scholarships will constitute tax-free income for the recipients and their families.

States (and the District of Columbia) may choose whether to recognize eligible SGOs within their jurisdictions. To qualify for the credit, a contribution must be made to a state-recognized SGO (which need not be located in the same state as the taxpayer), and the organization must only provide scholarships to students located within the state that recognized it. This effectively allows states to decide whether to make students who live within their borders eligible for the program. States are also responsible for ensuring that scholarship-granting organizations meet various requirements, including structuring themselves as 501(c)(3) nonprofits and spending at least 90% of revenue on qualifying scholarships. The SGOs must prioritize scholarships first for students who have received scholarships in previous years and then for siblings of such students, after which they may grant scholarships to other qualifying students.

Prior to the enactment of P.L. 119-21, no similar program existed at the federal level. Several states provide comparable state tax credits for contributions to scholarship granting organizations. The law specifies that the federal scholarship contribution tax credit is to be reduced by the value of any state tax credit awarded for the same contribution.

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Introduction

On July 4, 2025, the FY2025 reconciliation act (P.L. 119-21), commonly referred to as the One Big Beautiful Bill Act, was signed into law. The law includes a federally funded tax credit scholarship program for elementary and secondary education (hereinafter referred to as a *tax credit scholarship program*) that will take effect in calendar year 2027. Prior to the enactment of P.L. 119-21, no such program existed at the federal level.[1] The program will be administered by the Secretary of the Treasury (hereinafter referred to as the Secretary). Each of the 50 states and the District of Columbia (hereinafter referred to as states) will have the option of participating in the program. This report provides an overview of existing state-level tax credit scholarship programs and the newly created federal tax credit scholarship program.

Overview of State Tax Credit Scholarship Programs

Tax credit scholarship programs reduce corporate or individual tax lability for donations made to *scholarship granting organizations* (SGOs), certain nonprofit organizations that provide scholarships for elementary and secondary education. These scholarships may also be referred to as vouchers, but the provision of a tax credit in exchange for a donation to an SGO separates these programs from more traditional voucher programs, which are funded by a governmental entity (e.g., state government).

The federal tax credit scholarship program enacted in P.L. 119-21 is the first such program at the federal level. Several states, however, already operate tax credit scholarship programs. The first state-level tax credit scholarship program was enacted and launched in Arizona in 1997. As of August 2025, 22 tax credit scholarship programs were operating across 18 states.[2] **Table 1** provides examples of design elements included in various state tax credit scholarship programs.

Table 1. Examples of Design Elements Included in State Tax Credit Scholarship Programs

Design Element	Description	Examples
Eligible donors	States determine who is eligible to contribute to a scholarship granting organization (SGO) in exchange for a state tax credit.	Eligible donors generally include individuals, joint tax return filers, or corporations.
Tax credit available to donors	States determine the amount of tax credit that will be provided to a donor in exchange for their donation to an SGO.	In some states, the amount of a tax credit is capped at less than $1,000, while in other states there is no cap. The amount may also vary within the same state for individuals, joint tax return filers, and corporations.

[1] The only federally funded program that supports private school choice options is the DC Opportunity Scholarship Program (DC OSP). The DC OSP provides vouchers for students in the District of Columbia to attend private schools.

[2] According to EdChoice, a private school choice advocacy organization that tracks school choice programs at the state level, the following states were operating one or more tax-credit scholarship programs: Alabama, Arizona, Arkansas, Georgia, Indiana, Iowa, Kansas, Louisiana, Montana, Nevada, New Hampshire, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Carolina, South Dakota, and Virginia. For more information, see EdChoice, "Tax Credit Scholarships," 2025, https://www.edchoice.org/school-choice/tax-credit-scholarship/.

Design Element	Description	Examples
Restrictions on the tax credit available to donors	States may choose to provide a tax credit only for a portion of a donation to an SGO. They may also restrict the value of the tax credit to a certain percentage of the donor's tax liability.	States vary in the percentage of the contribution amount eligible for a tax credit, ranging from 50% to 100%. However, a donor might be limited to claiming a certain percentage of the donation (e.g., 100%) but only up to a certain percentage (e.g., 75%) of the donor's tax liability.
Cap on total amount of tax credits available	States may cap the total amount of tax credits awarded in a given year.	State caps range from under $2 million to $540 million in states with caps. Some states do not have a cap on the total amount of tax credits that can be awarded.
Maximum scholarship amount available to an eligible student	States establish a maximum scholarship amount that an SGO may award to an eligible student.	States may, for example, set a specific dollar amount for scholarships, tie scholarship amounts to a share of the state contribution to per-pupil revenue for public schools, vary the scholarship amount by the student's grade level or whether the student has disabilities, or link the scholarship value to the cost of the student's qualified expenses (e.g., tuition at a private school).
Student eligibility for a scholarship based on household or family income	States may limit scholarship eligibility based on a student's family household income.	Many states that limit student scholarship eligibility based on household income make this determination using the federal poverty level (e.g., family household income cannot exceed 250% of the federal poverty level for the number of people in the household).
Student eligibility for a scholarship based on prior public school attendance or other factors	States may limit scholarships to students who had previously attended a public school or to students with disabilities. States may also permit or require SGOs to prioritize certain students for scholarships.	Some states may require that a scholarship recipient has previously attended a public school and may further stipulate that the public school they attended met certain criteria. Some state tax credit scholarship programs only provide scholarships to students with disabilities. Other states make scholarships available to all students but may require or permit SGOs to prioritize certain students (e.g., low-income students).

Design Element	Description	Examples
Student testing	States may require scholarship recipients to participate in annual academic assessments.	States may require scholarship recipients to take the same statewide annual academic assessments that public school students are required to take or may require scholarship recipients to take different annual academic assessments.
Uses of scholarship funds	States determine how scholarship funds may be used by scholarship recipients.	States allow funds to be used for private school tuition. Some states may extend this to include other private school expenses, such as school fees. Some states permit funds to be used to pay for specific public school expenses, such as attending a public school outside of the school district in which the student resides.
SGO requirements	States may impose requirements on SGOs that want to participate in the tax credit scholarship program.	States may require SGOs to award a certain percentage (e.g., 95%) of the donations they receive as scholarships. States may also require SGOs to report on various aspects of their programs, verify student eligibility for scholarships, conduct annual financial audits, maintain reserve balances, serve students in more than one school, or give priority to certain students (e.g., returning students) in awarding scholarships.
Private school requirements	States may require private schools at which scholarships are used to meet various requirements.	States may require private schools to be accredited or hold state approval, or to follow federal or state nondiscrimination requirements. Private schools might also need to meet requirements in other areas such as school attendance (e.g., meeting compulsory attendance requirements), the school calendar (e.g., number of days of instruction), subjects taught, and teacher qualifications (e.g., bachelor's degree required), and staff background checks.

Source: Table prepared by CRS. Examples of design elements based, in part, on data available as of August 2025 from EdChoice, "Tax Credit Scholarships," 2025, https://www.edchoice.org/school-choice/tax-credit-scholarship/.

Federal Tax Credit Scholarship Program

P.L. 119-21 created a federal elementary and secondary school tax credit scholarship program financed with private donations that are, in turn, partly or fully funded via a tax credit. The program will operate through a new nonrefundable tax credit, codified as Internal Revenue Code (IRC) Section 25F. The program will allow individuals (but not corporations) to claim nonrefundable tax credits equal to the value of their qualifying contributions to private SGOs, subject to certain limits and restrictions.

Scholarship Contribution Tax Credit for Individuals

P.L. 119-21 created a nonrefundable tax credit (hereinafter the *scholarship contribution tax credit*) worth 100% of the value of a taxpayer's qualified contribution—up to $1,700 per year, regardless of filing status—to a qualified SGO starting in tax year 2027 (meaning taxpayers will receive the credit when filing taxes in 2028). Although this credit will not leave taxpayers who contribute to SGOs financially better off than if they had not donated, it could eliminate the cost of donating for taxpayers who claim the credit.

Because the credit is nonrefundable, taxpayers will be able to use it to reduce their individual income tax liability, but those whose credit exceeds their liability will not receive the difference as a refund. As a result, a taxpayer's individual income tax liability will function as an additional limit on the credit's value, reducing its value to taxpayers with low individual income tax liability (e.g., those with low incomes or those who earn most of their income through tax-exempt means). Taxpayers whose credits exceed their tax liabilities in the year of their contributions will be able to "carry forward" their unused credits for up to five additional years, claiming them against income tax liability in those years instead.

To qualify for the credit, a contribution must be given to an SGO that will use it to award scholarships to students located in the state in which the organization operates. SGOs will still be able to provide scholarships to students located in different states, but they may not use money from tax credit-supported contributions to do so.

Some additional rules aim to prevent taxpayers who contribute to scholarship granting organizations from "double dipping" on tax benefits. Taxpayers will not be allowed to claim both the scholarship contribution tax credit and the itemized deduction for charitable contributions for the same donation.[3] The value of the federal scholarship contribution tax credit will also be reduced (but not below $0) by the value of any state tax credit received for the same donation. These limitations aim to prevent taxpayers who make qualifying contributions from receiving tax benefits that exceed those contributions' value.

Additionally, qualified contributions must be made in cash. Earlier versions of the legislation that became P.L. 119-21 would have allowed donors to make qualified contributions of marketable securities, such as publicly traded stocks and bonds.[4] Doing so could have made contributing securities more valuable to taxpayers than selling them. The credit for a donation would have been worth a security's face value, whereas selling a security might have led a taxpayer to pay the capital gains tax on the sale, giving the taxpayer less after-tax spending power than if they had donated the security and claimed the credit. Limiting qualified contributions to only cash aims to prevent taxpayers from being better off after making a contribution than they would have been after selling a security.

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[3] For more on the charitable giving deduction, see CRS Report R45922, *Tax Issues Relating to Charitable Contributions and Organizations*. Taxpayers who itemize their tax deductions have higher incomes, on average, than taxpayers who do not, although some lower-income taxpayers do itemize. While credits reduce income tax liability dollar for dollar, deductions reduce income subject to tax, meaning their value varies based on the tax rate the taxpayer would otherwise pay on the deducted amount.

[4] See, for example, H.R. 833 and S. 292.

The Joint Committee on Taxation estimated that the federal tax credit scholarship program will reduce federal revenues by roughly $26 billion from FY2025 to FY2034, with the costs primarily incurred from FY2028 onward.[5] Prior versions of the legislation that became P.L. 119-21 would have limited the total value of all scholarship contribution tax credits claimed in a given year by instituting an annual volume cap.[6] Under these proposals, the Secretary would have allocated the annual volume cap to individuals, primarily on a first-come, first-serve basis. This volume cap was not included in the enacted law.

State Role in the Tax Credit Scholarship Program

By January 1 of each calendar year, each state that voluntarily elects to participate in the tax credit scholarship program will be required to provide the Secretary with a list of the SGOs that meet the program requirements and are located in the state.[7] SGOs will be required to use donations for which federal tax credits were awarded to provide scholarships for eligible students within the state that recognized the SGOs for these purposes.

Governors (or other individuals, agencies, or entities specified in state law) are responsible for preparing lists of SGOs within their states and remitting the lists to the Secretary of the Treasury. Should a state choose to participate in the tax credit scholarship program, the list of SGOs submitted by the state must include a certification that the individual, agency, or entity submitting the list on behalf of the state is authorized to do so. The statutory language does not specify who must provide such certification.

Participation in the program is voluntary. States may elect not to participate, meaning they will not provide a list of qualifying SGOs to the Secretary. Residents of nonparticipating states will still be eligible to receive tax credits for contributions to SGOs in other states. However, an SGO will not be able to provide federal tax credit-supported scholarships to residents of states other than those in which the SGO is recognized, meaning families in nonparticipating states will not be eligible to receive such scholarships.

Student Scholarship Eligibility

The program will limit scholarship eligibility to students who are (1) members of a household with an income that is not greater than 300% of the area median gross income and (2) eligible to enroll in a public elementary or secondary school. Household income for the calendar year prior to the date of the scholarship application will be used in making the income determination. The terms "public school" or "private school" are not defined.[8] As discussed in the "Scholarship Granting Organization" section, the program will require SGOs to give priority in granting scholarships to eligible students who were awarded a scholarship the previous year and, after

[5] Joint Committee on Taxation (JCT), *Estimated Revenue Effects Relative To The Present Law Baseline Of The Tax Provisions In "Title VII – Finance" Of The Substitute Legislation As Passed By The Senate To Provide For Reconciliation Of The Fiscal Year 2025 Budget*, JCX-35-25, July 1, 2025, https://www.jct.gov/publications/2025/jcx-35-25/. JCT did not identify how it estimated the number of states that would participate in the program.

[6] See, for example, H.R. 833 and S. 292.

[7] For the first calendar year of the program (2027), the list must be submitted "as early as practicable."

[8] The Internal Revenue Code (IRC) does not include a general definition of a "public" or "private" school. Certain provisions may refer to definitions provided in other laws. For example, IRC §142(k)(4), pertaining to tax-exempt facility bonds, defines an "elementary or secondary school" by referring to the definition of such term in 20 U.S.C. §8801 (now repealed) as in effect when IRC §142(k)(2) took effect.

making these awards, to give priority to eligible students with a sibling who was awarded a scholarship from the same organization.

Whereas most state tax credit scholarship programs that place income limits on student scholarship eligibility use some percentage of the federal poverty level to make this determination, the federal tax credit scholarship program will base income eligibility on 300% of the area median gross income. To make this determination, a household's annual income will need to be calculated. The statute does not define or specify "income" or "household" for these purposes. A household's annual household income will then be compared with the relevant area median gross income calculated by the U.S. Department of Housing and Urban Development (HUD) to determine the household's percentage of the area median gross income.[9]

Using area median gross income rather than the federal poverty level means the income levels at which students qualify for scholarships will depend on where they reside. For example, if the median gross income for an area is $60,000, a student in a household with an income of up to $180,000 will meet the income eligibility requirement. If the median gross income for an area is $100,000, a student in a household with a gross income of up to $300,000 will meet the income eligibility requirement.

In 2025, area median income ranges from a low of $32,900 in Oglala Lakota County in South Dakota to a high of $195,200 in Santa Clara County in California.[10] Unlike the poverty level, area median income does not vary based on the number of people in a household.[11]

Unlike most existing state programs, the program does not include any additional requirements related to a student's receipt of a scholarship, nor does it place any requirements on private schools that enroll scholarship recipients. Examples of state requirements include that only students previously enrolled in public schools are eligible to receive scholarships, that scholarship recipients participate in annual academic assessments, or that private schools enrolling scholarship recipients be accredited or conduct employee background checks.[12]

No program provisions will prevent a student from receiving a scholarship under the federal tax credit scholarship program and another student aid program (e.g., state tax credit scholarship program). The statutory language is silent regarding how scholarships available under the federal program shall interact with scholarships or other types of school choice aid available under existing state programs or the DC Opportunity Scholarship program (e.g., which funds are to be applied first to expenses).

Qualified Elementary or Secondary Education Expense

For program purposes, a qualified elementary or secondary education expense is any expense of an eligible student that is allowable under Title 26, Section 530(b)(3)(A), of the *U.S. Code*, which lists qualified elementary and secondary expenses that are allowable uses of funds under the

[9] For more information about the relevant area and these calculations, see Department of Housing and Urban Development (HUD), Office of Policy Development and Research, "Income Limits," https://www.huduser.gov/portal/datasets/il.html#faq_2025.

[10] HUD, Office of Policy Development and Research, "Income Limits: Data for section 8 Income Limits," 2025, https://www.huduser.gov/portal/datasets/il.html#data_2025.

[11] For more on the federal poverty level, see Department of Health and Human Services, Office of the Assistant Secretary for Planning and Education, "Poverty Guidelines," 2025, https://aspe.hhs.gov/topics/poverty-economic-mobility/poverty-guidelines.

[12] For example, the DC Opportunity Scholarship program (DC OSP), the only federally funded voucher program, requires voucher recipients to participate in assessments and places requirements on private schools that enroll students receiving vouchers, such as conducting employee background checks and obtaining accreditation.

existing federal Coverdell Education Savings Accounts program, often referred to simply as a Coverdell.[13] These uses of funds include expenses for

- tuition, fees, books, supplies, other equipment, academic tutoring, and special needs services for special needs beneficiaries[14] that are incurred by the beneficiary in connection with enrollment or attendance as an elementary or secondary school student at a public, private, or religious school;
- room and board, uniforms, transportation, and supplementary items and services (including extended day programs) if these expenses are required or provided by a public, private, or religious school in connection with enrollment or attendance; and
- computer technology, equipment, or internet access and related services if used by the beneficiary and the beneficiary's family during any of the years the beneficiary is in elementary or secondary school.[15]

Thus, scholarship recipients under the federal tax credit scholarship program will be able to use scholarships to support various aspects of their education at public, private, or religious elementary and secondary schools. Unlike many state tax credit scholarship programs, the uses of the scholarships provided under the federal tax credit scholarship program will not be limited to supporting enrollment or attendance at private schools.

Tax Treatment of Scholarships

In addition to creating the new tax credit, P.L. 119-21 also explicitly excludes scholarships provided under the tax credit program from federal income taxation, under a new Internal Revenue Code Section 139K. This exclusion will be effective for scholarships received in 2027 and thereafter.

This exclusion is in addition to a preexisting income tax exclusion for certain qualified scholarship and fellowship income, codified as IRC Section 117. Under that preexisting exclusion, students and their families can exclude some scholarship, fellowship, and grant money from federal income taxation. Such excludable income may include income from need-based financial aid for one's education, as well as merit-based scholarships, among other sources. To qualify for this current-law exclusion, a scholarship or grant cannot exceed the value of tuition, fees, books, supplies, and equipment required for courses of instruction.[16] This exclusion applies to students at institutions of higher education as well as elementary and secondary school students.

The new Section 139K exclusion will apply to any amounts a family receives as part of an elementary and secondary school scholarship that is offered by a qualified SGO and used for qualifying expenses, regardless of whether they would have qualified for the preexisting Section 117 exclusion. For example, qualifying expenses for the scholarships will include certain test fees, tutoring services, and dual enrollment fees, which do not qualify for the Section 117

[13] For more information, see CRS Report R42809, *Tax-Preferred College Savings Plans: An Introduction to Coverdells*.

[14] Students for whom Coverdells are established and used are referred to as *beneficiaries*. In the context of the tax credit scholarship program, a beneficiary is an eligible student who has received a scholarship.

[15] This does not include expenses for computer software designed for sports, games, or hobbies unless the software is predominantly educational in nature.

[16] IRC §117. For more on this exclusion, see CRS Report R41967, *Higher Education Tax Benefits: Brief Overview and Budgetary Effects*.

exclusion. Additionally, the Section 117 exclusion is limited to expenses “required” for enrollment, while the scholarships provided under the tax credit scholarship program can be used for expenses “in connection with” enrollment or attendance at a school. The new exclusion ensures that families can exclude from taxable income all elementary and secondary school scholarships offered through the tax credit scholarship program.

Scholarship-Granting Organizations

Statutory language limits what institutions can be considered qualified SGOs. State governments that elect to participate in the tax credit scholarship program are required to verify that SGOs meet the requirements listed in statute.

To qualify, an SGO must be a 501(c)(3) nonprofit organization but may not be a private foundation. The program will also require SGOs to prevent comingling of assets used to finance scholarships with other assets, such as those used for administrative expenses. An SGO must also be included on the annual list of eligible SGOs submitted each applicable year by the state in which the SGO is located.

In addition, an SGO must spend at least 90% of its income on scholarships for eligible students. As a result of this requirement, it is likely that qualified SGOs will be either newly created nonprofits or institutions operating in states with existing tax credit scholarship programs that are able to meet the requirements for federal SGOs.

Other requirements that SGOs must meet include

- offering scholarships to at least 10 students who do not all attend the same school,
- not offering scholarships for nonqualified expenses,
- not “earmarking” or setting aside contributions for any particular student,
- verifying the income and family size of potential scholarship awardees and limiting scholarships to only those meeting the law’s requirements; and
- prohibiting “disqualified persons” (meaning those with certain personal or financial ties to the SGO) from receiving scholarships.

All SGOs are required to give priority in granting scholarships to eligible students who were awarded a scholarship the previous year. After making these awards, SGOs are required to give priority to eligible students with a sibling who was awarded a scholarship from the same organization. With respect to the second priority, neither bill specifies when an eligible student’s sibling must have received a scholarship (e.g., in the prior year or several years earlier).

Regulations and Guidance

P.L. 119-21 requires the Secretary to issue regulations and other guidance that he or she determines are necessary to carry out the purposes of the program. For example, if the Secretary determines it is necessary, he or she may issue regulations or other guidance regarding the enforcement of the requirements for SGOs to be eligible to participate in the program and the submission of the annual state lists of SGOs eligible to receive donations under the program. The Secretary may also issue regulations or other guidance related to recordkeeping or information reporting for purposes of administering the tax credit scholarship program, among other topics the Secretary determines necessary to carry out the purposes of the program.

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