THE NEW 2027 FEDERAL SCHOLARSHIP TAX CREDIT (AKA THE EDUCATION FREEDOM TAX CREDIT)

Frequently Asked Questions for Tax Professionals

ACE scholarships + Education Freedom Tax Credit

FSTC/EFTC FREQUENTLY ASKED QUESTIONS FOR TAX PROFESSIONALS

EFFECTIVE DATE

Contributions made on or after January 1, 2027.

STATUTE

26 U.S.C. §25F (enacted as Section 70411 of the One Big Beautiful Bill Act (OBBBA), signed July 4, 2025).

STATUS OF GUIDANCE

On October 1, 2026, Treasury and the IRS issued **proposed regulations (REG-117199-25)** covering the whole initiative, plus **temporary regulations (TD 10057)** that put the state election and Scholarship Granting Organization (SGO) reporting rules into effect now. Both were published in the Federal Register on October 2, 2026. Comments on the proposed regulations are due **December 1, 2026**, and a public hearing is scheduled for **December 15, 2026**.

These are still proposed rules. They could change before they are finalized. That said, Treasury has stated that taxpayers, SGOs, and states may rely on the proposed regulations for contributions made on or after January 1, 2027, as long as they follow them consistently and in their entirety. For planning purposes, treat them as the operating rules. Where an answer below rests on the proposed regulations, we say so. Where a question is still open, we say that too.

One more piece is still coming: separate guidance under §530 defining qualified education expenses and the term "school." Treasury has called that a high priority.



THE SHORT VERSION (READ THIS FIRST)

- 100% non-refundable federal income tax credit, capped at **$1,700 per individual taxpayer per year**.
- **Eligible married couples filing jointly can claim up to $3,400**, as long as each spouse makes their own qualified contribution of up to $1,700. This is the single biggest change from the earlier guidance.
- **Cash only.** Check, card, ACH, wire, money order, after-tax payroll deduction. No stock, no crypto, no in-kind property.
- **The client has to designate the gift as a "qualified contribution" at the time they make it.** No designation, no credit. The designation cannot be undone later.
- **Five-year carryforward** for unused credit.
- **No double-dipping** with the §170 charitable deduction on the same dollars.
- The contributor does **not** need to live in a participating state. Any U.S. citizen or resident can contribute to any SGO on the IRS SGO list.
- **No Social Security Number goes to the SGO.** The SGO issues a unique donor number, and the client reports it on **new Form 8525** with the 1040.

- Scholarships go to K-12 students who live in participating states and whose households earn up to 300% of area median gross income.
- First eligible contribution date: **January 1, 2027.** The credit first appears on the 2027 return, filed in 2028.
- **Tax professionals partnering with ACE Scholarships can earn a referral fee up to 3.5% of client contributions** (and sometimes even higher), **directed to the charity of their choice, or to the bottom line of their practice.**

TWO MORE THINGS TAX PROS SHOULD KNOW

This is the first time in U.S. history that a federal tax credit has been built around K-12 scholarships. The closest analog at the federal level is the dependent care credit. The state-level analog is the scholarship tax credit programs that have operated in roughly 20 states for over a decade. The proposed regulations borrow from both, and from the Section 8 housing rules for measuring household income.

Plan now, advise in 2027. No client can claim this credit until the 2027 return. But year-end 2026 conversations are the right time to introduce it, set expectations for cash only, explain the designation step, and, for married clients, make sure both spouses plan to contribute in their own names. The decision between the §25F credit and a §170 deduction is mostly arithmetic, and most clients will land on the credit.

THE CREDIT ITSELF

Where is this credit in the Code?

IRC §25F, added by OBBBA Section 70411(a)(1). Statute text: law.cornell.edu/uscode/text/26/25F. The proposed regulations would add §§1.25F-1 through 1.25F-5 to the income tax regulations.

What is the maximum credit amount?

$1,700 per individual taxpayer per year. The credit is 100% of qualified cash contributions to a listed SGO, after reduction for any state credit on the same dollars, up to that cap.

Is the $1,700 cap per spouse on a joint return, or per return?

Per spouse. This is the headline change in the October 1, 2026 proposed regulations. Treasury and the IRS read "any taxpayer" in §25F(b)(1) to mean each individual, and a joint return has two taxpayers on it. So a married couple filing jointly can claim up to $3,400, **provided each spouse has made qualified contributions of up to $1,700.**

The practical point: one $3,400 check from a joint account, in one spouse's name, is the wrong move. Each spouse should make their own contribution and receive their own donor number from the SGO. Married filing separately, each spouse claims up to $1,700 on their own return.

Caveat: This is in the proposed regulations, which Treasury has said taxpayers may rely on for 2027 contributions. It is not yet in a final rule. We do not expect it to move, but we will update this FAQ if it does.

Is the credit refundable?

No. §25F is non-refundable. It can zero out federal tax liability, but it will not generate a refund larger than what was already withheld or paid.

Can unused credit be carried forward?

Yes. Up to five tax years. So a retiree with $1,200 in federal liability who contributes $1,700 in 2027 uses $1,200 in 2027 and carries the remaining $500 into 2028. As long as there is federal liability somewhere in the next five years, the credit is not lost.

Two details from the proposed regulations worth knowing. Carryforwards are used first-in, first-out, and they are used before the current year's credit. And while no single year's credit can exceed $1,700, stacked carryforwards can offset more than $1,700 of tax in a single year.

Does AMT block the credit?

No. The proposed regulations allow the §25F credit against the tax imposed by both §1 (regular tax) and §55(a) (AMT). The credit is limited to the client's tax liability under §26(a), reduced first by the nonrefundable personal credits that cannot be carried forward (the child tax credit, education credits, saver's credit, and so on). Anything left after those credits is available for §25F, and anything §25F cannot absorb carries forward.

Where will the credit be claimed on the return?

On **Form 8525, Federal Scholarship Tax Credit**, filed with the Form 1040. The client reports the unique donor number from each SGO they contributed to. If the donor number is missing, the IRS will presume no qualified contribution was made to that SGO. The client can rebut that with the SGO's written acknowledgment or other satisfactory evidence, but only within the response window of an IRS notice. Easier to get the number on the form the first time.

Can my client contribute to more than one SGO?

Yes. The $1,700 cap applies to the total across all SGOs, not per SGO. Each SGO issues its own donor number, so a client who gives to two SGOs will report two donor numbers on Form 8525.

Can a partnership or S corporation make the contribution?

No. The proposed regulations limit the credit to individuals contributing directly. A partner's or shareholder's share of an entity's gift to an SGO may still be a §170 charitable deduction passed through on the K-1, but it is not a qualified contribution for §25F. Clients who normally give through their business entity need to write a personal check for this one.

What if the SGO turns out not to qualify?

The proposed regulations give the client a reliance rule. If the organization was on the IRS SGO list (and not shown as removed) when the contribution was made, the client may rely on that listing. Reliance is lost only if the client knew the organization did not qualify, or had a hand in whatever got it removed. Check the IRS list before the client gives, and keep a dated copy in the file.

WHAT COUNTS AS A QUALIFIED CONTRIBUTION

Does the contribution have to be cash?

Yes. §25F(c)(3) defines a qualified contribution as a charitable contribution of cash to an SGO. The proposed regulations define cash as physical currency, check, money order, electronic transfer (including credit or debit card), after-tax payroll deduction, or a similar method, all in U.S. dollars.

What it does **not** include: appreciated stock, mutual funds, ETFs, real estate, cryptocurrency or any other digital asset, services, or any other property. An earlier draft of the bill (H.R. 833) allowed appreciated securities. That provision was stripped during reconciliation. If your client read an article from 2024 that suggested donating stock, that article is now wrong.

What is the "designation" requirement?

New in the proposed regulations, and easy to miss. A cash gift to an SGO is a qualified contribution only **to the extent the contributor designates it as one at the time of the contribution.** The SGO then deposits it into a segregated §25F account. Once designated, neither the contributor nor the SGO can revoke the designation.

In practice, SGOs will build this into their giving forms. Your job is to make sure the client checks the box. A gift that goes in as an ordinary donation cannot be converted to a qualified contribution after the fact.

Can a client give more than $1,700 and designate only part of it?

Yes. The proposed regulations include an example: a client gives $4,000 to an SGO and designates $1,700 as a qualified contribution. The $1,700 generates the federal credit. The other $2,300 can be a regular §170 charitable deduction if it otherwise qualifies. This also matters for state credit stacking, covered below.

Can a client still donate appreciated stock to an SGO?

Yes, but the stock contribution will be a regular §170 charitable deduction, not a §25F credit. Many clients will be better off contributing $1,700 in cash to capture the credit and giving appreciated securities separately for the §170 treatment and capital gains avoidance.

Can a contributor take both the §25F credit and a §170 deduction on the same contribution?

No. §25F(e) is explicit: the credit and the charitable deduction cannot be claimed on the same dollars. The portion of a gift that is not used for the credit may still be deductible under §170.

For almost every client, the credit beats the deduction. A $1,700 deduction in the 24% bracket saves $408 in tax. A $1,700 credit saves $1,700. Take the credit.

What about contributions earmarked for a specific student?

Not allowed. §25F(d)(1)(E) bars SGOs from earmarking or setting aside contributions for any particular student. A contributor cannot direct funds to a specific student or family. What a contributor to a multistate SGO can do is direct which state's segregated account the money goes to.

What about the contributor's own children?

The proposed regulations are narrower here than many people assumed. An SGO cannot award a scholarship to a "disqualified person," and the regulations define that group as:

- Substantial contributors (more than $5,000 to the SGO's §25F account in the year, if that is also more than 2% of what the account received that year; a spouse's gifts count toward the threshold)
- Officers, directors, and trustees of the SGO
- Anyone who participates in selecting scholarship recipients, including committee members
- Family members of any of the above (spouses, ancestors, descendants, siblings, their descendants, and their spouses)

A parent who contributes $1,700, or a couple who contributes $3,400, is not a substantial contributor by that fact alone. So the parent is not automatically barred from having a child receive a scholarship from the same SGO, as long as the child qualifies on income, the SGO's normal priority and selection rules apply, and nothing is earmarked. Treasury also rejected a proposed exception for "blind" selection procedures, so an SGO board member or selection committee member cannot get around the rule by recusing. If your client sits on an SGO board, their kids are out at that SGO.



SUBSTANTIATION AND DOCUMENTATION

What documentation does the client need?

Under the proposed and temporary regulations, the substantiation system works like this:

1. The client makes a cash contribution to a listed SGO and designates it as a qualified contribution.
2. By **January 31** of the following year, the SGO sends the client a written acknowledgment showing the SGO's EIN, the total designated contributions for the calendar year, a **unique donor number**, and a statement about any goods or services provided. Electronic delivery is fine if the client consented.
3. By **February 28**, the SGO reports each donor number, name, address, and total to the IRS through the IRS SGO portal.
4. The client reports the donor number on **Form 8525** with the 1040.

The IRS matches the Form 8525 against the SGO's report. Think of it as 1099 matching for charitable gifts.

Does my client have to give the SGO their Social Security Number?

No. That is the whole point of the donor number. Treasury said directly that requiring TINs would burden donors, chill giving, and expose sensitive information for no good reason. The SGO generates the donor number under an IRS-prescribed format and the IRS does the matching on its end.

What records should the tax pro keep?

Treat substantiation like any §170 cash contribution, plus the §25F specifics. At minimum:

- Contributor name (and which spouse, for joint filers)
- Date and amount of each contribution
- SGO name and EIN
- Unique donor number from each SGO
- Confirmation that the gift was designated as a qualified contribution (the acknowledgment will show this)
- A statement that no goods or services were provided, or the value of any that were
- Any state credit claimed on the same contribution

Best practice: get the acknowledgment into the client file before the return is filed. Keep the records for the standard three-year window, longer if the carryforward is still live.

STACKING WITH STATE CREDITS

Can a contributor claim both the federal §25F credit and a state scholarship tax credit?

Yes, but not on the same dollars. The federal credit is worth a dollar for every dollar contributed. State credits are worth less. So you never want state credit dollars overlapping federal credit dollars.

The proposed regulations let the client avoid the overlap. The client designates $1,700 of the gift as the federal qualified contribution. Anything given beyond that is where the state credit comes from. The regs treat a state credit as coming out of the undesignated portion first, so the $1,700 federal credit stays whole.

The advice for the client is short: give $1,700 and designate it federal. Give more on top if you want the state credit too. A client who gives exactly $1,700 and claims a state credit on it gains nothing; the state credit just shifts dollars from the federal return to the state return.

Does §25F replace state-level scholarship tax credit programs?

No. State programs continue to operate under state law. In many states, the same organization will administer both. One caution: an organization that qualifies for a state credit is not automatically a federal SGO. It has to be on the state's §25F list and the IRS SGO list. Check before the client gives.

Will the federal credit reduce state tax benefits?

State by state. A state **deduction** for the contribution does not reduce the federal credit; only a state **credit** does. Whether a state conforms to §25F or adjusts its own program in response is a state-law question. Check your state's most recent guidance before filing.

STATE OPT-IN

Is the credit available to contributors in all 50 states?

Yes. §25F(a) allows the credit to "an individual who is a citizen or resident of the United States." There is no residency test for the contributor, and the proposed regulations say so plainly: a taxpayer in State X may contribute to an SGO in State Y as long as the SGO is on State Y's list.

What matters is the **SGO's** state. §25F(c)(3) requires the SGO to use the contribution for scholarships to eligible students "solely within the State in which the organization is listed," and §25F(g) requires that state to have elected in. So a client in New York can contribute to an SGO listed in Florida and claim the credit. The scholarship funds a Florida student. The New York client still gets the credit.

How does a state opt in?

The election is made by the governor, or by whoever state law designates to make federal tax elections for the state. It is good for one calendar year at a time and must be renewed annually. Under the temporary regulations, which are already in effect:

- **For 2027:** the state must have filed an advance election (Form 15714) by **January 1, 2027**, and must perfect it by submitting its SGO list through the IRS state portal by **February 15, 2027**.
- **For later years:** a state can file an advance election between January 2 and September 30 of the preceding year, or elect and submit its list together by 11:59 pm on January 1 of the credit year.
- A state cannot revoke an election once it is perfected. It can, in effect, opt out of a future year by not perfecting the next year's election.

The state has to certify that every SGO on its list meets the federal requirements, has reviewed each SGO's audit, and has due-process procedures for removing one. States may not impose operating rules on SGOs stricter than §25F itself, such as limiting the kinds of schools or expenses a scholarship can cover.

Which states have opted in for 2027?

Per the IRS as of September 14, 2026, the following 30 states had made an advance election for 2027: Alabama, Alaska, Arkansas, Colorado, Florida, Georgia, Idaho, Indiana, Iowa, Kansas, Kentucky, Louisiana, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, North Carolina, North Dakota, Ohio, Oklahoma, South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia, West Virginia, and Wyoming. Kansas, Kentucky, and North Carolina are new since our June version. The list can change until January 1. Current source: IRS FSTC page.

What if my client wants their dollars to stay local?

If the client's state has opted in and lists an SGO, the client can give to that SGO (or direct a multistate SGO like ACE to allocate the gift to that state's account). If the state has not opted in, the scholarships will fund students somewhere else. The strongest local move is to encourage state participation. Tax professionals who serve nonprofit and political clients are often well positioned to drive that conversation.



WHO GETS SCHOLARSHIPS AND WHAT THEY COVER

Who is eligible to receive a scholarship?

Three tests under the statute and proposed regulations:

- The student must **reside in the state** on whose list the SGO appears, as determined under state law. Where the student goes to school does not dictate eligibility. Exceptions: dependents of members of the armed forces, and dependents of individuals residing on Indian lands.
- The student must be **eligible to enroll in a public** elementary or secondary school. They do not have to be enrolled anywhere when the scholarship is awarded, and they may attend a public, private, or religious school.
- **Household income** for the prior calendar year cannot exceed **300% of area median gross income**, measured the way the Department of Housing and Urban Development (HUD) does for Section 8, adjusted for family size. The proposed regulations drop the non-cash items HUD counts (imputed return on home equity, housing allowances)

because they cannot be verified. Treasury estimates roughly 95% of U.S. children fall under the limit.

For shared-custody situations, the relevant household is the one where the student lives most of the year; if it is an even split, the higher-income household.

An SGO may set a lower income limit than the statute. ACE does, with a focus on lower-income families.

How will SGOs verify a family's income?

The proposed regulations give SGOs four routes:

- **Direct verification:** pay stubs, prior-year federal or state returns, IRS transcripts, W-2s, plus documentation of income not shown on those (child support, alimony).
- **Categorical eligibility:** an award letter dated within the last 12 months showing a household member is approved for SNAP, TANF, WIC, Section 8 housing, or SSI. School-wide free or reduced lunch eligibility does not count, because it is not determined household by household. Treasury asked for comments on adding state and tribal programs.
- **Low-income-area safe harbor:** students selected by their school for individual tutoring or special needs services, where the school is in a HUD qualified census tract or certifies that 80% of its students live in one. The SGO has to obtain a third-party audit to use this one.
- **Foster children:** treated as meeting the income test with no separate verification.

The SGO carries this burden. Nothing about a family's income crosses the contributor's desk or yours.

What educational expenses qualify?

§25F(c)(4) ties qualifying expenses to §530(b)(3)(A), the Coverdell education savings account (ESA) list. That includes:

- Tuition, uniforms, transportation, and other fees
- Books and supplies
- Academic tutoring
- Extended day programs
- Computer technology, equipment, or internet access
- Special needs services for a special needs student

Treasury has said separate §530 guidance defining qualified expenses and "school" is a high priority and will be issued as soon as possible. Homeschool and pre-K questions are expected to be addressed there.

How does the money get paid out?

This is new detail from the proposed regulations and it matters for fraud prevention. Tuition and fees charged by a school must be paid directly to the school. Other vendors can be paid directly if the SGO has verified them and they are not related to the student. Families can receive money only as reimbursements against receipts the SGO has checked. SGOs may also use a "qualified digital wallet," a third-party platform that pre-approves vendors, pays them directly, and tracks approved expenses. Every SGO must have procedures to stop two scholarships from paying for the same expense.

Is the scholarship taxable to the family?

No. New §139K, enacted alongside §25F, excludes SGO scholarships for qualified elementary or secondary education expenses from the gross income of the student and the student's family, for amounts received after December 31, 2026.

What types of schools qualify?

The proposed regulations use the §530(b)(3)(B) definition: any school providing elementary or secondary education (K-12) **as determined under state law**, which includes public, private, and religious schools. Whether a homeschool counts therefore depends on state law, and the coming §530 guidance is expected to say more.

How is this different from a voucher?

Vouchers move state-appropriated public funds. The §25F credit moves private dollars. The contributor gives cash, gets a credit against federal tax, and the SGO awards scholarships. No public school appropriation is touched.



SCHOLARSHIP GRANTING ORGANIZATIONS (SGOS)

What does an SGO have to do to qualify?

Under §25F(c)(5), §25F(d), and proposed §1.25F-3, an SGO must:

5. Be a 501(c)(3) public charity, not a private foundation
6. Be on the §25F list submitted by a participating state in which it is "located," and registered in the IRS SGO portal
7. Deposit every designated contribution into a segregated §25F account (one per state, for a multistate SGO) and keep a full set of books for it
8. Provide scholarships to 10 or more students who do not all attend the same school
9. Spend at least 90% of its income on scholarships for eligible students
10. Verify that scholarships pay only for qualified §530(b)(3)(A) expenses
11. Verify that recipients are eligible students who reside in the state
12. Prioritize prior-year recipients first, then their siblings
13. Not earmark contributions for any particular student
14. Not award scholarships to a disqualified person
15. Send donor acknowledgments, report to the IRS, certify annually, and undergo an annual audit

What does "located in" a state mean for the SGO?

An SGO is "located in" a state if it is authorized to do business there and complies with the state's generally applicable rules for charitable organizations (transparency, accountability, and fraud prevention). Physical headquarters in the state is not required. States may not add SGO-specific rules more restrictive than §25F.

Can an SGO operate in multiple states?

Yes. A multistate SGO must be on each participating state's list, maintain a separate §25F account for each state, meet the operational requirements separately for each account, and let contributors choose which state's account their gift goes to. At least 85% of a multistate SGO's activities must be scholarship granting (administrative, fundraising, and compliance work in support of scholarships counts toward that). Treasury asked for comments on how to measure the 85%.

How will the 90% spending requirement be measured?

Default rule: 90% of the organization's total gross receipts from all sources, cash method, unreduced by expenses.

Safe harbor: a single-state SGO whose activities are at least 85% scholarship granting, and every multistate SGO, measures the 90% against the income of the §25F segregated account (designated contributions plus earnings on them), state by state for multistate SGOs.

Timing: the 90% must be spent by the end of the taxable year following the year the income came in. Amounts count as spent when paid, so multi-year awards count in the year each payment goes out. A transfer to a qualified digital wallet counts as spent on the transfer date if the SGO gives up ownership of the funds.

What audit and oversight requirements will SGOs face?

Each SGO must commission an **annual independent financial and programmatic audit** and provide it to every state on whose list it appears. SGOs with $500,000 or less in total receipts can use a committee of independent persons unrelated to management, with the report signed under penalties of perjury.

Each SGO must also file an annual certification and operating report with the IRS (attached to the Form 990, or separately by the 15th day of the fifth month after year-end for organizations that do not file a 990), with a copy to each state. The report includes the number of applicants and awards, high, low, and average award, number of schools, expense categories, income, and the percentage spent on scholarships. The first reporting cycle runs in 2028 for 2027 activity.

The IRS can remove a noncompliant organization from the IRS SGO list, with Appeals rights. A state can remove one from its list through a process that provides due process. Removed organizations show on the IRS list in strike-through with the removal date, so contributions after that date are not qualified.

Is there an IRS portal for SGOs?

Yes, and registration is mandatory under the temporary regulations. An organization cannot generate donor numbers until it registers, and without donor numbers its contributors cannot claim the credit. The portal is also how SGOs report contributions to the IRS each February and how they consent to being published on the IRS SGO list. An SGO that does not consent to publication leaves its contributors without the reliance protection described above.

How is the program funded?

It is not funded by an appropriation. Contributors voluntarily give cash and claim a federal credit. Treasury bears the cost of the credit. No public school dollars are used

ACE SCHOLARSHIPS

Can ACE Scholarships receive contributions and award scholarships nationwide?

Yes. ACE Scholarships has been granting K-12 scholarships for more than 25 years and has delivered more than 121,000 scholarships and distributed more than $395 million in scholarships and education savings accounts. ACE is a 501(c)(3) public charity with a perfect four-star rating from Charity Navigator for 12 consecutive years, and is serving families across the country through the EFTC.

ACE is built to operate as a multistate SGO under the proposed regulations: a segregated §25F account for each participating state, contributor designation of the state account, household income verification, independent audits, and a SOC 2 Type II digital wallet for paying schools and vendors directly. The accounting and compliance systems the regulations require are already in place.

To direct a client to ACE, send them to acescholarships.org. Tax professionals can reach ACE's tax-pro team at taxpro@acescholarships.org or aceeftc.org/tax.

KEY DATES

- **October 1, 2026:** Proposed and temporary regulations issued
- **December 1, 2026:** Comment deadline on the proposed regulations; temporary regulations take effect
- **December 15, 2026:** Public hearing
- **January 1, 2027:** Credit goes live. Deadline for states' 2027 advance elections
- **February 15, 2027:** States submit their 2027 SGO lists
- **December 31, 2027:** Last day to contribute for a 2027 credit (calendar-year taxpayers)
- **January 31, 2028:** SGO acknowledgments and donor numbers due to contributors
- **February 28, 2028:** SGO contribution reports due to the IRS
- **April 15, 2028:** Clients claim the credit on Form 8525 with the 2027 return

SOURCES AND FURTHER READING

- 26 U.S.C. §25F (full statute text, Cornell LII)
- Proposed regulations, REG-117199-25 (Federal Register, October 2, 2026)
- Temporary regulations, TD 10057 (Federal Register, October 2, 2026)
- Submit comments: regulations.gov, docket REG-117199-25
- IRS: Federal Scholarship Tax Credit (FSTC)
- Notice 2025-70 (request for comments) and Rev. Proc. 2026-6 (2027 advance election procedure)
- Educational Choice for Children Act at ACE Scholarships
- ACE Scholarships

This FAQ reflects the statute as enacted and the proposed and temporary regulations issued October 1, 2026 (REG-117199-25 and TD 10057). The proposed regulations are not final and may change. ACE Scholarships will update this document when Treasury finalizes the regulations, when the §530 expense guidance is released, and when the IRS publishes Form 8525 and its instructions.

Last updated: October 20, 2026 (incorporating the October 1, 2026, proposed and temporary regulations)