www.coloradofiscal.org

COLORADO Fiscal Institute

FEDERAL TAX CREDIT SCHOLARSHIPS

What They Mean for Colorado's Education System

Policy Brief Highlight

The new federal tax credit scholarship program creates a parallel education funding structure in which private scholarship organizations control the distribution of publicly subsidized scholarship funds, raising questions about transparency, oversight, and alignment with Colorado's broader public education goals.

Prepared By:

Shana McClain, Research Manager

2026

TABLE OF CONTENTS

SECTION 1

Executive Summary

The federal government has established a new national tax credit scholarship program for elementary and secondary education (K-12), as part of H.R. 1 ("One Big Beautiful Bill Act"), that operates similarly to a school voucher system. The new program provides taxpayers with a dollar-for-dollar federal tax credit of up to $1,700 (or double for joint filers) for donations to Scholarship Granting Organizations (SGOs).

Because the program requires states to opt in, Colorado will need to determine whether and how the program will operate in the state. While the structure of the program is set at the federal level, there are some state decisions, particularly around participating schools and oversight, that will shape how it functions.

Key Takeaways for Colorado:

- **Private Control of Publicly Subsidized Funds:** SGOs, not states, decide who receives scholarships and how funds are distributed, even though the program is supported through federal tax credits subsidized by taxpayers. The public helps pay for the program, but private organizations receive full decision-making power over where the money goes.

- **Parallel Funding Structure:** Because the program operates through the federal tax code, it creates a separate funding stream with high potential to be donor-driven and lacks public oversight.

- **Implications for Public Schools:** If students shift into privately funded schools and programs, public schools may lose funding.

- **State Levers Still Matter:** While Colorado can't change the program's structure, it can influence how it functions locally by setting conditions for participating schools and shaping implementation.

SECTION 2:
The Federal Tax Credit Scholarship Program

The federal tax credit scholarship program, established under H.R. 1, creates a new process for funding education expenses through the federal tax system. While often described as a voucher program, it differs from traditional vouchers in how funds are raised and distributed.

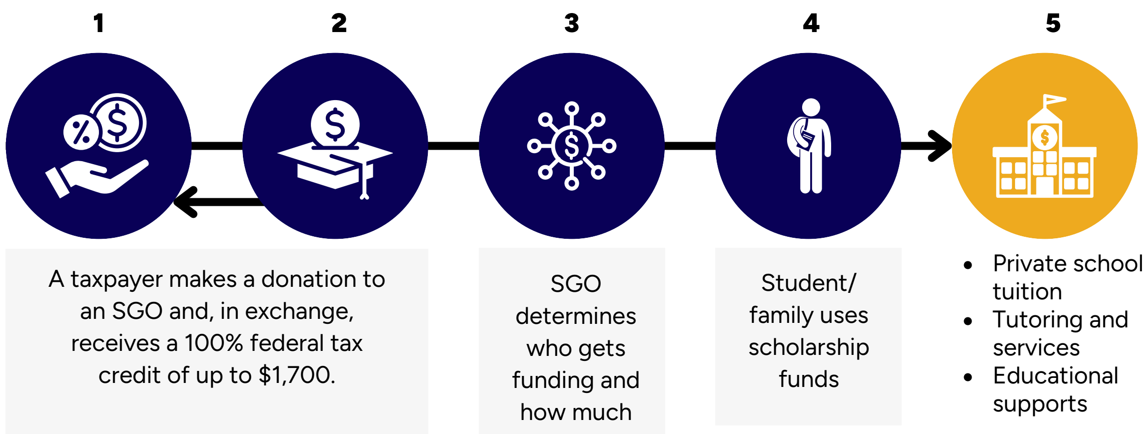
How the Program Works

The program operates through a multi-step process:

1. A taxpayer makes a donation to a qualified SGO.
2. The taxpayer receives a 100% federal tax credit (up to $1,700) for that donation.
3. The SGO pools donations and awards scholarships to eligible students.
4. Scholarship funds are used to pay for approved educational expenses.

SGOs must meet federal requirements, including distributing at least 90% of donations as scholarships, limiting administrative costs, providing scholarships to 10 or more students from at least two different schools, prioritizing prior-year scholarship students first, then siblings of students previously awarded scholarships, and verifying household income and family size within the statutory income threshold.

Figure 1. How the Federal Tax Credit Scholarship Program Works



Unlike traditional education funding, this program channels privately donated but federally subsidized funds through private organizations (SGOs) that control how funds are distributed

How Scholarships Can Be Used

Scholarships can only be used for a “qualified elementary or secondary education expense,” which applies to a range of education-related expenses, including:

- Private school tuition
- Tutoring and supplemental instruction
- Educational materials and services
- Therapies and specialized educational supports

Because scholarships aren’t limited to tuition, the program can be applied broadly to support several types of education settings. The types of expenses it covers are similar to those allowed under Coverdell Education Savings Accounts, which cover a broad range of education-related costs that also extend beyond tuition.

Who is Eligible

1. Any taxpayer who donates to an approved SGO is eligible to claim a federal tax credit.
2. Students from families earning up to 300% of the area median income (AMI) are eligible for scholarships.

With the AMI having such a high threshold, most families would qualify for the scholarship, not just those with low incomes who typically face greater financial barriers. For example, in Boulder County, Colorado, 300% of the AMI for a family of four in 2025 is about $451,800, showing that eligibility extends well into upper-income households in many areas.

Timeline for Implementation

2025
Program enacted at the federal level when H.R. 1 passed on July 4, 2025

2026
States begin decisions on whether to opt in, as well as administrative setup.

2027
Scholarships become available to students.

Broad Eligibility ≠ Broad Access

Most families qualify based on the federal income threshold, but that doesn't mean they'll actually receive a scholarship. Being a recipient depends more on how SGOs choose to distribute the funds, who they prioritize, and how connected a student is to existing networks. In practice, access has less to do with eligibility rules and more to do with how the system operates and who's already part of it. This is especially true when SGOs are already tied to established school networks, where funds may flow toward students already connected to participating schools or donor networks.

Practical Limits to Implementation

There's also a practical side to it: Scholarships are easier to apply to large, standardized costs like private school tuition. Smaller or less centralized supports (e.g., tutoring, transportation, or specialized services), options most relevant for public school students, take more coordination and are more difficult to manage. In other words, many families may qualify on paper, but access to funding depends on how SGOs choose to distribute it and where the program is administratively easiest to use.

SECTION 3

How the Program Works in Practice

Who Controls Funding Decisions

At the center of the program are Scholarship Granting Organizations (SGOs), which receive donations to distribute scholarships to students. Although states must opt in and can set up certain conditions for participation, SGOs are responsible for determining (1) which students receive scholarships, (2) how much funding each student receives, and (3) how funds are prioritized and then distributed. Additionally, SGOs are required to spend at least 90% of funds on scholarships, leaving limited resources for administration, transparency, and oversight. Combined with the state's limited authority, this constrains how closely the program can be monitored in practice.

What the Law Allows vs. What the Program Structure Encourages

The program allows scholarships to be used for a range of education-related expenses, including private school tuition, tutoring, and specialized services. On paper, this creates flexibility across education settings. In practice, the structure of the program makes some uses much more likely than others. Private school tuition, for example, is a large, standardized expense. It's easier to administer, easier to verify, and already fits within existing scholarship models. Services like tutoring, transportation, and specialized educational supports vary in cost, are less consistent, and usually require more coordination to set up and manage. As a result, even though multiple uses are allowed, the program is more easily implemented around tuition-based models than around the smaller-scale, administratively heavy service-based models.

Access Depends on Networks and Participation

Eligibility alone doesn’t determine access; it depends on how SGOs operate and their connections to existing networks. In practice, SGOs are most likely to build around whatever is easiest and most cost-effective to work with, such as schools, systems, and providers that are already set up to handle this type of funding and distribution. That usually means creating partnerships with schools that already have the infrastructure to manage scholarships, relying on existing application and billing systems, and sticking with uses that are simpler to verify and process. This is especially important in a program where SGOs are required to spend at least 90% of funds on scholarships, while leaving relatively limited funding for administration.

As a result, SGOs are more likely to:

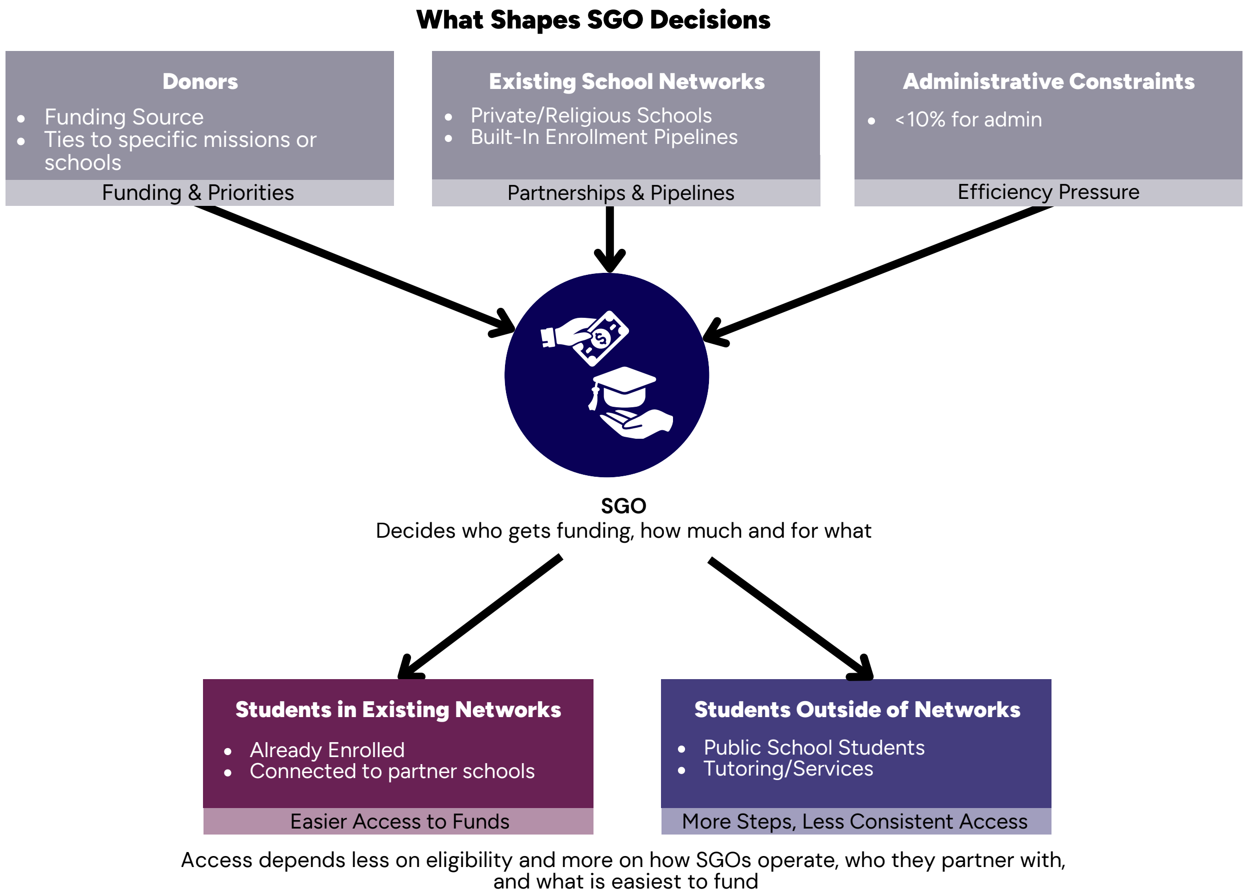
- build relationships with specific schools or providers;
- rely on existing administrative systems to distribute funds; and
- prioritize applications connected to established networks.

Essentially, this creates practical advantages for students who are already connected to participating schools or organizations. Students outside of those networks may face additional barriers to accessing funds, even if they meet eligibility requirements. And even when a student receives a scholarship, the award may not be enough to make attendance financially feasible, since scholarship amounts are determined by the SGO and may not cover the full cost of participation. This particular dynamic is consistent with other voucher and voucher-like programs, where partial awards can still leave families responsible for substantial remaining costs and typically benefit families who can already afford participation.

Eligibility alone doesn’t determine access; it depends on how SGOs operate and their connections to existing networks.

Regis Jesuit High School

Figure 2. How Scholarship Granting Organizations' (SGOs) Decisions Work in Practice



What States Can (and Can't) Influence

States play a role in whether and how the program operates locally, but their influence is narrow and will likely only operate through a single primary lever: they can set conditions on schools that choose to participate.

If Colorado opts in, it may be able to decide or set specific requirements schools must meet in order to accept scholarship funds. This could include participation standards, reporting requirements, or other conditions tied to receiving scholarship students. However, states do not have authority over the entities (SGOs) that control the flow of funds.

States cannot:

- determine who can establish or operate as an SGO, as long as federal requirements are met;
- direct how SGOs distribute funds, including which students receive scholarships or how much they receive;
- influence how SGOs prioritize applicants or structure their programs; or
- change core elements of the program, including eligibility thresholds or the federal tax credit structure.

This distinction is central to how the program functions, especially in practice compared to on paper. States can place conditions on schools that receive funds, but they can't control the organizations that decide where the money goes. Additionally, even when states attempt to place conditions, they likely will have to be done legislatively.

Vail Mountain School

How the program works in practice is shaped by who operates it, how easy it is to run, and where existing relationships can be leveraged.

Example*:* SGO A is established by a group of donors connected to three private schools, School X, School Y, and School Z. Rather than creating a new application and verification system, SGO A works directly with these schools. Families apply through the schools' existing enrollment process, the schools then verify income and eligibility information, and SGO A applies scholarship funds directly to the tuition bills.

Because these schools already have administrative staff, tuition structures, and enrollment pipelines and data in place, this model allows SGO A to distribute funds quickly and with minimal overhead. Over time, most of SGO A's funding flowed through these same three schools, since they are the easiest and most reliable partners to work with. At its most neutral, this can be considered administrative efficiency; however, in practice, it can reflect alignment with donor preferences, institutional affiliations, or shared values, for example, concentrating funding within a network of religious or mission-aligned schools.

Students outside this network, such as a public school student accessing tutoring or specialized services, would have to navigate a separate, less established process and may be less likely to receive funding or enough to cover the full cost. Because access is shaped by existing relationships and networks, eligibility alone isn't always enough, and students without those connections may be effectively excluded. This is especially relevant for students from lower-income families, rural areas, or historically underserved communities, who are less likely to have the same level of social capital to navigate or benefit from these networks.

SECTION 4

What This Means for Colorado

Budget and Fiscal Implications

Because the program creates a new funding stream that sits outside of Colorado's existing education finance system, it may have indirect fiscal effects. If it leads to shifts in enrollment or even just changes in how families access education, that can begin to affect how state dollars are distributed across school districts. Colorado's school finance formula is largely enrollment-driven, so even relatively small shifts in student populations can have downstream budget implications.

The scale of participation, the number of SGOs that would operate in Colorado, and how funds will ultimately be distributed will determine the magnitude of any fiscal effects, making impacts difficult to estimate in advance. This uncertainty is particularly challenging under TABOR because the state's revenue is capped and difficult to adjust downward once set, absent voter approval; therefore, Colorado has limited ability to respond if actual fiscal impacts differ from initial expectations.

Structural Risks and System-Level Implications

The program operates alongside Colorado's education system, but outside its direct control. Because of the role of SGOs, a structural gap is created between the state's role in managing its education system and its ability to influence how these new funds flow through it. This means that funding may not align with state priorities. For example, Colorado may prioritize equitable access to ensure geographic distribution or to direct resources to specific student needs; however, because SGOs control distribution, there is no mechanism to ensure that the state's priorities and outcomes are met. Instead, funding is more likely to follow existing networks, donor preferences, and uses that are easier to administer, like private school tuition.

As a result, this creates a mismatch between policy goals and program design. While the program is framed as broadly accessible and flexible, its structure does not guarantee that funds will reach the students or communities that the state would otherwise prioritize or even distribute equitably. Over time, this has the potential to lead to uneven participation, where some students and schools benefit more consistently than others.

Allowing SGOs to determine how funds are allocated creates a mismatch between the program's stated goal of broad accessibility and the state's ability to ensure equitable outcomes.

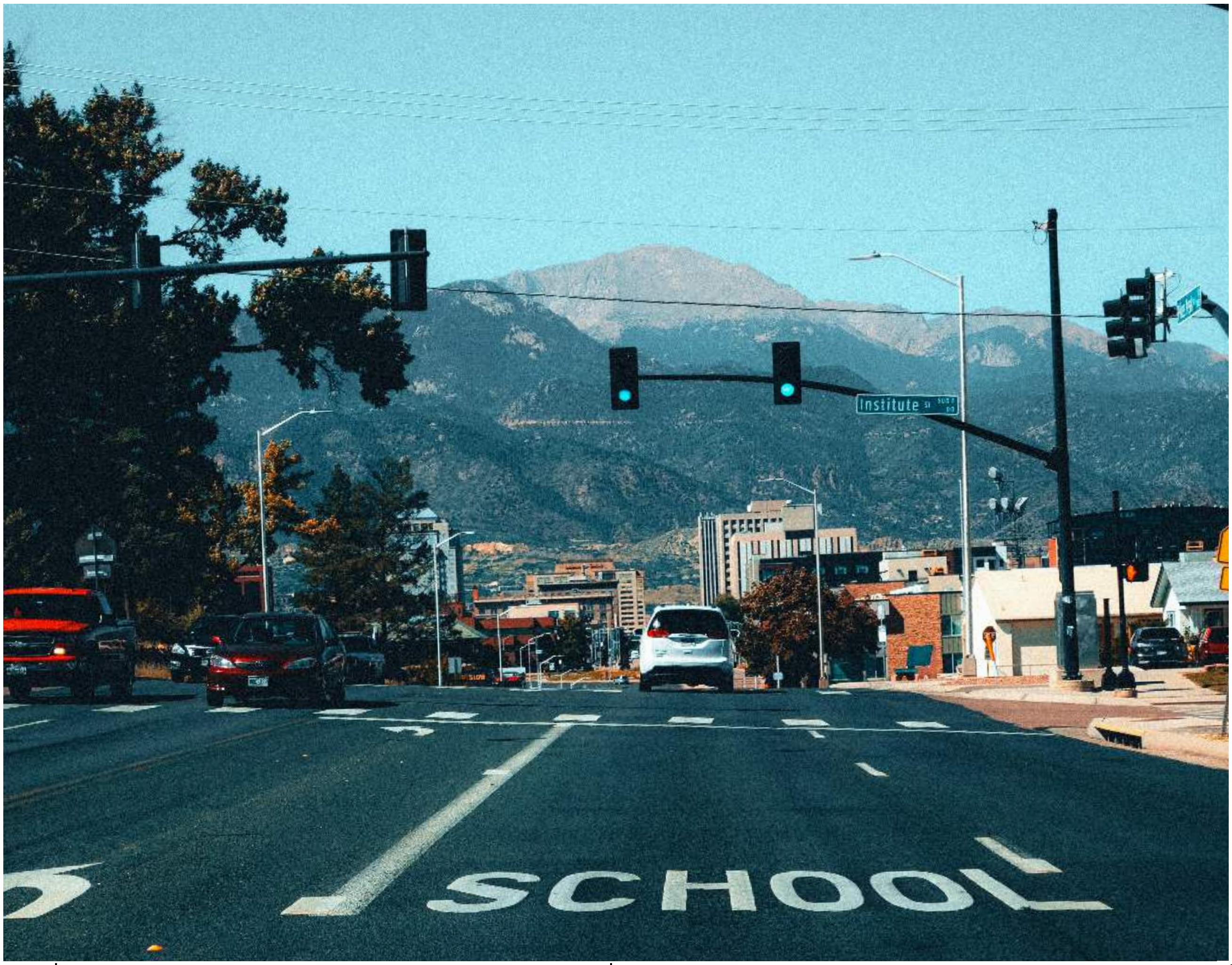
Colorado’s Current Policy Response (HB26-1292)

Given these structural limitations, Colorado lawmakers recently introduced House Bill 26-1292, which focuses on regulating schools that receive scholarship funds, rather than the SGOs that distribute them. The bill takes a targeted approach by establishing requirements for any “participating school” (defined as a school that enrolls a student whose education expenses are paid, in whole or in part, by an SGO).

At its core, the bill requires participating schools to:

1. Comply with nondiscrimination protections across a wide range of characteristics, including disability, race, gender identity, and socioeconomic status;
2. Follow federal and state laws related to students with disabilities (including IDEA, ADA, and Section 504); and
3. Avoid charging additional tuition and fees for students who require accommodations.

Schools that violate these requirements may face legal action and can have their eligibility to receive scholarship-funded students suspended by the State Board of Education for up to five years. In addition, if Colorado opts into the federal program, the state is required to include all SGOs that meet federal requirements on its official list submitted to the federal government.



The Colorado Springs School

HB 26-1292 is designed to place guardrails on the participating schools that receive scholarship students, but not to control how the program operates overall. The bill focuses on student protections, such as nondiscrimination and disability rights, and creates a way to hold participating schools accountable if those standards aren't met.

HB 26-1292 functions as an early test case of what states can realistically do in response to this new program, working through school-level requirements to shape outcomes at the margins rather than controlling or changing how the system actually operates.

Looking ahead, this approach is likely what policy will look like for a while. States can keep adding guardrails to better align the program with their priorities, even if they can't fully control how it functions. This could include setting expectations around student protections (like this bill), participation and education standards, or how scholarships are structured (that is, encouraging awards that are sufficient to make participation financially feasible, rather than leaving families with substantial remaining costs).

What Choices Still Matter for Colorado

For Colorado, the central challenge is not whether the program will exist; that ship has already sailed. The central challenge is how to respond to it. The state has a limited set of tools, primarily focused on setting conditions for participating schools, while the rest of the decisions about funding and access will continue to remain with SGOs.

This creates a policy environment defined by constraint. Colorado might be able to influence how the program shows up at the margins, but not how it actually operates or where the funding flows. Decisions at the state level will likely be less about fully advancing state priorities and more about managing risks, setting guardrails, and navigating tradeoffs. Colorado should be prepared for a more defensive posture in education policy as the program rolls out.

COLORADO
Fiscal Institute

Contact

Colorado Fiscal Institute
110 16th St. Mall, Suite 1410
Denver, CO 80202

www.coloradofiscal.org
info@coloradofiscal.org