

# When Funding Walks

## How the Federal Tax Credits for Scholarships Act will affect local governments

BY ISABEL MU

**T**here is a lot of buzz around federal school choice, and the implications for state and local governments, public schools, and rural districts are worth examining. The Federal Tax Credits for Scholarships (FTCS) program, enacted in 2025 under the “One, Big, Beautiful Bill Act” (OBBBA) and slated to begin in the 2027 tax year, will allow individuals to claim a tax credit for contributions to qualifying scholarship-granting organizations (SGOs), providing a dollar-for-dollar reduction of up to \$1,700 for single filers and \$3,400 for married couples filing jointly.<sup>1</sup>

Public finance professionals need to be thinking about the fiscal strain, enrollment volatility, and funding diversion the act will lead to. This article will analyze the new federal tax credit scholarships as both an education policy and a tax policy. As school choice expands, superintendents, chief financial officers, city managers, and school board members should be asking:

- What fiscal and educational impacts will the FTCS program have on public school systems? How might benefits and tradeoffs vary across communities?

- To what extent will the FTCS program expand equitable access to educational opportunities in your district, and what unintended consequences may arise for public schools?
- How should governments and school districts prepare for both fiscal and enrollment impacts of the FTCS program?

SGOs will award the scholarships to K-12 students if their household income doesn't exceed 300 percent of the area median income (AMI), and the Urban Institute estimates that nearly 90 percent of the nation's households will qualify.<sup>2</sup> Families will be able to use scholarships for educational expenses, including tuition, curricular materials, books, online education materials, technology, uniforms, transportation, tutoring services, summer school, after-school activities, and standardized testing fees. This program marks the first time families will be allowed to spend federal dollars on private school tuition and costs outside the public school system.

What happens next is largely in the hands of states. Governors must formally notify the Internal Revenue Service if they intend to participate before SGOs can award tax-credit-backed

scholarships in specific states. As of April 2026, 28 states had opted in.

A federal program with participation from more than half of the states in the country will reshape enrollment patterns and revenue streams for public schools. High-income districts may be better positioned to take advantage of these opportunities, while low-income and rural communities may remain underserved.

### Fiscal implications for public schools

Superintendents, finance professionals, city managers, and school board members need to prepare for localized fiscal impacts. According to the Brookings Institution, the share of students in traditional public schools fell after the pandemic, coinciding with a spike in popularity of state choice programs.<sup>3</sup> Similarly, an analysis from the National Center for Research on Education Access and Choice (REACH), which compares states with universal voucher and ESA programs to non-choice states between 2021 and 2024, reveals that state-level choice programs have increased private school enrollment by 3 to 4 percent.<sup>4</sup> Declining public school enrollment and rising private school participation



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create three major concerns for public finance professionals.

**1. Enrollment shifts give rise to fiscal stress.** Public school revenue formulas depend on the number of students enrolled. As school choice accelerates an exit from the public school system, dollars will follow; costs, however, don't fall at the same rate. This mismatch creates structural deficits that districts must manage through staffing cuts, school consolidations, and program reductions.

**2. Declining enrollment often leads to school closures.** The Fort Bend Independent School District, the sixth

largest in the State of Texas, plans to consolidate seven elementary schools during the 2026 to 2027 school year. The district has a \$56 million budget shortfall after overestimating revenues by \$18 million and enrollment by 1,800 students. During the 2024 to 2025 school year, Fort Bend lost 8,600 students.<sup>5</sup>

Judson Independent School District plans to close three elementary schools and one middle school. District leaders and board members cite Texas's new voucher program as one of the factors contributing to unanticipated school closures.<sup>6</sup> Parents are exploring alternative learning options

for their kids through the Texas Education Freedom Accounts (TEFA) program. To put the scope of TEFA into context, the program will receive \$1 billion in funding over the first two years and provide \$10,474 per student, roughly 75 percent of what public students receive annually.<sup>7</sup>

**3. Allowing federal funds to follow students to new schools affects Title-I allocations.** When low-income students and students with disabilities pursue specialized learning options, federal funding streams for their home districts shrink. Schools that employ Title-I teachers, aides, and coordinators may be forced to reduce staff or services. The impact will be widespread, as roughly 95 percent of school districts nationwide are eligible for Title-I funding.<sup>8</sup>

There needs to be more collaboration between public schools and community partners. Instead of treating this phenomenon as a diversion of money from public institutions, districts can use federal funds to build on work already underway in local organizations. By shifting the cost of ancillary programming into external funding sources, districts can free up their own budgets to support additional services and staffing during the traditional school day.

### Equity considerations

The diversion of federal funds may raise equity concerns. While most parents, school leaders, and public finance officers are aware of the empowerment factor—that is, enabling rural students, underserved students, and students with disabilities to seek specialized options—the flip side of the narrative also warrants attention. Rural legislators from both sides of the aisle have expressed concerns about the impacts of school choice on their districts. What happens to students in underserved rural communities who can't afford private school, even after accounting for federal and state support?

Rural districts can be hit hard because they face diseconomies of scale and

have small operating margins. The Center for American Progress argues that a scarcity of private schools in rural areas means that school choice will underserve rural students. For example, only 34 percent of rural families live within five miles of a private school, while that statistic rises to 92 percent for urban families. West Virginia's Hope Scholarship program contextualizes the challenges rural districts face. Average private school tuition in the state is 25 percent higher than the maximum ESA award amount, making private school accessible for some but out of reach for many.<sup>9</sup> When a small number of rural students leave their home districts, they take funding with them that could otherwise cover salaries, extracurriculars, or critical programs at public schools. Since benefits and tradeoffs vary across communities, local leaders must assess the ways resource constraints could impact equitable access to education.

Additionally, enrollment patterns in state choice programs suggest that a larger share of funds flows to higher-income areas. A report from the Brookings Institution reveals two key findings. First, programs that have no income limits in states like Arizona tend to see greater participation from affluent communities. Second, programs that use income-based sliding scales, in states such as North Carolina and Ohio, distribute funds more evenly across income groups. These findings indicate that universal programs may skew toward higher-income participation unless policymakers are intentional about broadening access.<sup>10</sup> In the context of the Federal Tax Credit Scholarship program, local leaders need to ask what specific safeguards can be implemented to tailor federal school choice to the needs of the community.

## Policy considerations

Federal school choice is arriving at a time of shrinking national student populations and diminished state revenues, driven by expiring pandemic-era aid, tax cuts during the 2021 to 2023 surplus years, stagnant employment figures, and

property tax relief. Cuts to Medicaid, SNAP, and means-tested programs add budgetary pressure by shifting costs to states. As legislators and budget analysts crunch out the numbers for future fiscal years, they face competing spending pressures at the same time revenue growth slows. These trends create less cushion for school districts to absorb enrollment-driven funding losses, especially for states using per-pupil funding formulas.

Furthermore, the impact of declining enrollment extends beyond operating budgets. Bond ratings will also be affected. Declining enrollment can trigger credit downgrades and raise borrowing costs for districts, since bond ratings are heavily dependent on enrollment stability. A district that receives more scrutiny from investors and rating agencies will see higher interest on both its new and refinanced debt.<sup>11</sup>

The convergence of budgetary pressures, legislative dynamics, and funding uncertainties during a phase of fiscal tightening creates an unpredictable environment for school districts. The FTCS program has the potential to benefit participants and expand alternative learning options to families for the first time, but its success will depend on implementation. The program is coming—it remains up to states, local governments, and school leaders to supplement federal directives with their own oversight mechanisms in order to ensure alignment with educational priorities.

## Next steps for governments and school districts

**Scenario planning.** Model enrollment losses at different levels (e.g., 1 percent, 3 percent, 5 percent) to assess impacts on operating budgets, staffing, facility master plans, capital plans, debt financing, and long-term financial obligations.

**Community engagement.** Engage families, educators, and community stakeholders to help them understand preferences for district planning efforts.

## Monitor program implementation.

This includes:

1. *Enrollment patterns.* With no limit on the size of scholarships SGOs may grant, tracking recipient demographics will help determine if benefits are equitably distributed.
2. *Provision of alternate programming.* Public schools, through their own staff or existing non-profit partners, should offer alternative programming that can take advantage of new federal dollars.
3. *Coordination challenges.* The program's success depends on a strong partnership between federal, state, and non-profit actors. Since the program is administered by the U.S. Department of the Treasury, state and local leaders have an obligation to align federal directives with educational priorities within their own communities.
4. *Regulatory framework.* The law leaves open questions about the extent to which states can shape tax credit scholarships. For example, whether a governor can limit scholarships to only tutoring and supplemental services rather than private school tuition will affect their decision to opt in. States should explore the flexibility and limitations of the FTCS program. ■

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<sup>1</sup> Federal Tax Credit Scholarship Program Included in P.L. 119-21, the FY2025 Reconciliation Law (CRS Report R48724), Washington, DC: Congressional Research Service, September 26, 2025.

<sup>2</sup> Kristin Blagg and Erica Blom, "Analyzing the Distribution of Benefits under the Educational Choice for Children Act," Urban Institute, May 8, 2025.

<sup>3</sup> Dylan Council, Sofoklis Goulas, and Faidra Monachou, "Declining Public School Enrollment," Brookings Institution, August 27, 2025.

<sup>4</sup> Douglas N. Harris and Gabriel Olivier, "The Effects of Universal School Vouchers on Private School Tuition and Enrollment: A National Analysis," REACH Center, September 11, 2025.

<sup>5</sup> Melissa Enaje, "Split Fort Bend ISD Board Votes to Close 7 Elementary Schools Despite Outcry from Parents," Houston Public Media, March 10, 2026.

<sup>6</sup> Public Schools Closure Tracker: Enrollment, K-12 Dive, 2026.

<sup>7</sup> Robin Berkley, Nina Rees, and Will Cullen, "An Overview of School Choice: Charters, Magnets, Educational Savings Accounts, and More," George W. Bush Presidential Center, March 17, 2026.

<sup>8</sup> Paige Shoemaker DeMio, "How the School Choice Agenda Harms Rural Students," Center for American Progress, May 15, 2025.

<sup>9</sup> Shoemaker DeMio, *ibid.*

<sup>10</sup> Jon Valant, "Universal School Choice Programs Mostly Benefit the Wealthy—Unless Policymakers Act to Prevent It," Brookings Institution, February 15, 2024.

<sup>11</sup> Alex Walters, "As Outlook Sours on K-12 Credits, Some Schools Will Fare Better," The Bond Buyer, March 27, 2024.