Comments

of

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in response to

Notice 2025-70: Request for Comments on Individual Tax Credit for Qualified Contributions to Scholarship Granting Organizations

IRS-2025-0466

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EXECUTIVE SUMMARY

These comments address the administrative framework for the new tax credit scholarship created by the "One Big Beautiful Bill" under § 25F. While this tax credit goes beyond the role of the federal government and should not have been created, it is crucial that the implementation does not further overstep. The rules should not allow the federal government to set parameters around what kinds of schools scholarship-granting organizations (SGOs) can let parents pick based on such things as their enrollment policies or teachings. As the notice acknowledges, it is also important that all SGOs that meet the § 25F(c)(5) statutory requirements be allowed to participate, rather than states imposing further restrictions.

On the specific requests for comment in the notice, Treasury should:

1. Adopt a light-touch administrative model relying on self-certification and IRS audit authority rather than imposing burdensome verification requirements; and
2. Permit multi-state SGOs to allocate contributions among their listed states through organizational designation rather than requiring donor designation at the time of contribution;
3. Interpret statutory requirements in ways that enable efficient SGO operations while maintaining accountability through established tax enforcement mechanisms.

This approach would honor the statutory text, draw on proven federal tax administration precedents, align with existing state scholarship programs, and enable SGOs to operate effectively while ensuring compliance.

COMMENTS ON SECTION 3: STATE LISTS AND CERTIFICATIONS

A. Proposed State Certification Framework (Section 3.03)

Section 3.03 of Notice 2025-70 deals with "Contents of State certification," but the law calls for a state list, not state certification. The only certification required by the law is to certify that the person or entity submitting the list has the authority to do so.

> "(g) State List of Scholarship Granting Organizations.—
>
> "(1) List.—
>
> "(A) In general.—Not later than January 1 of each calendar year (or, with respect to the first calendar year for which this section applies, as early as practicable), a State that voluntarily elects to participate under this section shall provide to the Secretary a list of the scholarship granting organizations that meet the requirements described in subsection (c)(5) and are located in the State.
>
> "(B) Process.—The election under this paragraph shall be made by the Governor of the State or by such other individual, agency, or entity as is designated under State law to make such elections on behalf of the State with respect to Federal tax benefits.
>
> "(2) Certification.—Each list submitted under paragraph (1) shall include a certification that the individual, agency, or entity submitting such list on behalf of the State has the authority to perform this function.

Further, Section 3.03 outlines extensive state certification requirements, including that states must independently verify each SGO meets all § 25F(c)(5) requirements and that "reliance by a covered State on self-certifications by SGOs would not be sufficient." This approach is inconsistent with federal tax administration principles and unnecessarily burdensome.

1. No Statutory Basis for Heavy-Verification Model

Nothing in § 25F suggests Congress intended to impose an unusually burdensome compliance structure on SGOs. The statute directs states to provide lists of organizations "that meet the requirements" of § 25F(c)(5), but does not specify that states must conduct intensive upfront verification rather than relying on organizational attestations subject to audit. Considering scholarship grants are simple, contemporaneous transfers to families, rather than the complicated financing schemes involved with some programs, there is no rationale to imposing a burdensome compliance system.

2. Federal Tax Administration Relies on Self-Certification with Audit Enforcement

The federal tax system overwhelmingly depends on voluntary self-assessment paired with targeted IRS audits and penalties for misrepresentation, not upfront regulatory clearance. Programs vastly larger and more complex than § 25F operate successfully without pre-clearance of eligibility.

For starters, 501(c)(3) organizations are already governed under a system that relies on a robust self-reporting model. After receiving exempt status, charities self-assess their ongoing compliance with exempt purposes, operational tests, public charity requirements, and the prohibition on private inurement. The IRS does not continuously verify compliance; instead, it enforces the rules through periodic examinations, public disclosures, and the possibility of penalties or revocation. This framework successfully governs hundreds of thousands of nonprofits nationwide. Given that SGOs are themselves 501(c)(3) organizations, a similar light-touch, audit-based enforcement model is both appropriate and fully consistent with long-standing federal practice.

Other examples include:

- Qualified Opportunity Funds (QOFs) involve intermediary investment vehicles deploying billions in capital to designated opportunity zones. QOFs self-certify eligibility by filing Form 8996. The IRS does not pre-approve QOF status; instead, it audits compliance and imposes penalties for violations. This is directly analogous to SGOs.
- The Research and Development Credit involves tens of billions in annual claims. Taxpayers self-determine whether expenses qualify as R&D under § 41, with IRS examination and accuracy-related penalties as the enforcement mechanism.
- The Earned Income Tax Credit distributes over $60 billion annually through self-assessed eligibility and refundable credits, with audit and recapture as primary enforcement tools.

In each case, taxpayers or intermediaries attest to compliance, and the IRS enforces accuracy through selective audits, accuracy-related penalties under § 6662, and in serious cases, revocation or disallowance. This enforcement model works precisely because the risk of audit and consequences for noncompliance drive truthful reporting.

3. State Scholarship Programs Use Light-Touch Models

State tax-credit scholarship programs—on which Congress modeled § 25F—do not rely on intensive ex ante review. States may:

- Confirm basic organizational qualifications (e.g., 501(c)(3) status, state registration).
- Require annual reporting of scholarship recipients and expenditures.
- Conduct risk-based or random audits of SGO compliance.
- Enforce violations through removal from approved lists or recapture of credits.

Many states have operated these programs for 15-20 years without the need for burdensome verification processes.

4. Recommended State Certification Requirements

Treasury should require states to verify only:

- Organizational eligibility. Each listed SGO:
    - Is currently tax-exempt under § 501(c)(3) and not a private foundation (verifiable through IRS).
    - Is registered or authorized to operate in the state if required by state law.
    - Has attested to compliance with § 25F(c)(5) requirements.
- Policies and procedures. The state has adopted policies and procedures to:
    - Receive and review SGO attestations.
    - Respond to complaints or evidence of noncompliance.
    - Notify the IRS of removals from the state list.
- Annual reporting. Each listed SGO has committed to provide annual reports to the state containing information necessary to verify ongoing compliance (number of scholarships, expenditure percentages, recipient eligibility verification procedures).

This framework enables states to fulfill their statutory role without imposing unwarranted administrative burdens, while preserving IRS audit authority as the primary enforcement mechanism.

B. Multi-State Organizations Should Have Organizational Flexibility to Allocate Contributions (Section 3.03(5))

Treasury's Proposed Approach: Section 3.03(5)(b) of Notice 2025-70 indicates Treasury anticipates requiring multistate organizations to require "donors to designate the State, on whose State list the organization is named, in which their qualified contribution is to be used."

Recommended Alternative: Treasury should instead permit multi-state SGOs to allocate contributions among their listed states through organizational designation, provided the SGO maintains clear, state-specific accounting.

1. The Statute Does Not Mandate Donor Designation

Section 25F(c)(3) requires that qualified contributions be used "to fund scholarships for eligible students solely within the State in which the organization is listed." For an SGO listed in multiple states, this

requirement is satisfied when each contribution is ultimately used in one of those listed states—a determination the SGO itself is best positioned to make. The statute contains no language requiring donors to make state-specific designations at the time of contribution.

While federal statutes typically use “the State” to refer to a single, specific state, § 25F operates differently: state governments merely list SGOs, and the statute does not assign states any role in allocating federal credits, approving scholarships, or administering capped funds. Because § 25F is not a geographic allocation program like Low-Income Housing Tax Credit or New Markets Tax Credit, “the State in which the organization is listed” need not refer to only one state. Treasury may reasonably interpret this phrase to include any state in which the SGO has been lawfully listed.

This approach is consistent with how federal programs treat multi-state intermediaries, such as Qualified Opportunity Funds and multi-state CDEs, which operate nationally but allocate activities to any jurisdiction where they are properly authorized. A multi-state SGO similarly satisfies the statutory condition so long as the scholarship funds are used within a state where the SGO is listed. Allowing SGOs to make this designation preserves administrative flexibility, respects state roles, and avoids needlessly fragmenting multi-state organizations into separate entities. Treasury can adopt this interpretation without contradicting statutory text or any federal precedent.

2. Organizational Designation Is Operationally Superior

Matching supply and demand. Requiring donor designation upfront creates significant operational challenges. Donation patterns are unlikely to align perfectly with scholarship demand across states. If an SGO receives $100,000 in donations designated for Texas but only $50,000 in scholarship applications from Texas families, while receiving $150,000 in applications from Florida families, the organization faces either:

- Stranded capital in Texas that cannot serve families in need, which could violate the requirement that 90 percent of income be used for scholarships, or
- Complex reallocation procedures requiring donor consent or IRS guidance on redesignation

SGO-level allocation allows organizations to deploy resources where families actually need scholarships, maximizing the statutory purpose of serving eligible students.

Fundraising efficiency. Donor designation adds friction to the contribution process. National fundraising campaigns—which are essential for SGO sustainability—would require donors to choose among states they may know little about. Many donors wish simply to support the organization’s mission broadly; forcing state designation would complicate the giving experience and may reduce participation.

Administrative burden. Donor designation requires SGOs to:

- Track each contribution’s state designation from receipt through deployment.
- Segregate accounting not just by state (which organizational designation also requires) but by donor-designated state.
- Develop procedures for handling contributions where donors fail to designate or designate incorrectly.

- Create systems for potential redesignation if demand doesn't match supply.

None of these burdens improve compliance outcomes, as discussed below.

3. No Compliance Advantage to Donor Designation

The IRS can audit SGO state-specific accounting just as effectively whether designation occurs at the donor level or organizational level. In fact, organizational accounting may be more reliable because:

- SGOs already face rigorous accounting requirements. Section 25F(c)(5)(B) requires SGOs to maintain separate accounts for qualified contributions. State reporting requirements and § 501(c)(3) compliance obligations create strong incentives for accurate recordkeeping. Adding donor designation simply moves the documentation burden earlier in the process without improving accuracy.
- IRS enforcement tools are identical. Whether an SGO misallocates donor-designated funds or organizationally allocated funds, the IRS has the same enforcement mechanisms, including examination authority under existing IRC provisions, accuracy-related penalties under § 6662, potential revocation of listing status for material misrepresentation, and disallowance of credits to donors.
- Self-interest ensures compliance. SGOs have strong incentives to maintain accurate state-specific accounting regardless of designation method, as errors could result in loss of listing status in one or more states, destroying the organization's ability to fundraise.

4. Proven Precedent: The New Markets Tax Credit Program

The New Markets Tax Credit (NMTC) program provides direct precedent for organizational-level geographic allocation. Under § 45D, Community Development Entities (CDEs) receive Qualified Equity Investments from taxpayers nationwide without investors designating specific projects or geographies. CDEs then exercise discretion to deploy capital within their approved service areas—which may be national, multi-state, state, or local—while maintaining rigorous accounting to demonstrate each Qualified Low-Income Community Investment is made in an eligible census tract.

The NMTC statute requires that "substantially all of such cash is used by the qualified community development entity to make qualified low-income community investments" in designated service areas (IRC § 45D(b)(1)(B)). This language parallels § 25F's requirement that contributions fund scholarships "solely within the State in which the organization is listed."

This structure has operated successfully for over two decades, showing that intermediary organizations can effectively aggregate capital nationally while maintaining geographic accountability. Multi-state CDEs routinely:

- Raise capital from investors in all 50 states.
- Maintain approved service areas covering multiple states or regions.
- Exercise discretion about where to deploy investments within those areas.
- Track each investment to specific eligible locations through organizational accounting.
- Face IRS audit and enforcement for misallocation.

If this model works for complex, multi-year real estate and business investments involving hundreds of millions of dollars, it can certainly work for scholarship grants.

5. Recommended Implementation

Treasury should provide that multi-state SGOs may allocate contributions among their listed states through organizational designation, provided:

- Separate accounting. The SGO must maintain one or more separate accounts for qualified contributions consistent with § 25F(c)(5)(B)'s prohibition on co-mingling.
- State-specific tracking. The SGO must track scholarships awarded by state to demonstrate that all funds allocated to a given state are used solely for scholarships to eligible students in that state.
- Reporting to IRS. The SGO must report state-specific financial information to the IRS to enable audit verification.
- Donor receipts need not specify state. Donors would receive substantiation of their qualified contribution to the SGO without requiring state designation, simplifying the contribution process.

6. Response to Section 4.02(1): Default Rule for Undesignated Contributions

Section 4.02(1) asks: "If a donor does not designate a particular State, what rules should apply?"

Under the organizational designation approach recommended above, this question becomes moot—donors would not be required to designate states. However, if Treasury nonetheless adopts a donor designation regime, the default rule should provide that contributions without donor designation are allocated by the SGO among its listed states based on scholarship demand and operational needs. This preserves organizational flexibility while providing clear guidance for the subset of donors who fail to designate.

C. Definition of "Located in the State" (Section 3.05)

Section 3.05 requests comments on how "located in the State" should be defined for purposes of § 25F(g)(1)(A).

Recommendation: An organization should be considered "located in the State" if it is either:

1. Incorporated or organized under the laws of that state, or
2. Authorized to conduct business or grant scholarships in that state under state law.

This approach:

- Accommodates multi-state organizations that may be incorporated in one state but authorized to operate in multiple states.
- Aligns with state scholarship programs, which typically allow out-of-state organizations to participate if properly registered.
- Focuses on operational authority rather than mere physical presence, consistent with the functional purpose of the statute.

CONCLUSION

The § 25F credit represents a federal overreach since the constitution does not authorize the federal government to advance school choice, even through tax breaks. To minimize the harm of federal involvement, Treasury's implementing regulations should ensure the federal government does not put limits on what types of schools SGOs can support. Beyond that, Treasury should use a light touch to enable the program to operate efficiently and effectively.

The recommendations in these comments—particularly not imposing a state certification framework that goes well beyond the statute, permitting multi-state SGOs to allocate contributions organizationally, and leveraging IRS audit authority as the primary enforcement mechanism—would:

- Honor the statutory text without imposing requirements Congress did not mandate.
- Draw on proven precedents from NMTC, QOFs, and other federal tax programs.
- Align with existing state scholarship programs that have operated successfully for decades.
- Enable efficient SGO operations that maximize resources available for scholarships.
- Maintain accountability through established IRS enforcement mechanisms.
- Minimize administrative burden on states, SGOs, and the IRS itself.

I appreciate Treasury's consideration of these comments and stand ready to provide additional information or clarification as needed.

Respectfully submitted,

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