Nonprofits & Tax-Exempt Organizations Alert
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Proposed Regulations Put Private-School Diversity—and Tax-Exempt Status—at Risk

The U.S. Department of the Treasury and the Internal Revenue Service released proposed regulations on Sept. 3 that could result in the revocation of tax-exempt status for private schools if they have race-conscious "educational, admissions, scholarship, athletic, or other policies … regardless of the intent or the legality" of those programs. The proposed regulations rely on the fundamental public policy doctrine while expanding the long-standing scope of that doctrine.

The proposed regulations

Under the proposed regulations, a private school would lose eligibility for Section 501(c)(3) tax-exempt status if it discriminates on the basis of race, color, or national or ethnic origin in its admissions, financial aid, educational policies, athletics or other school programs.

The proposed regulations would apply broadly to all private schools—including primary and secondary schools, colleges, universities and trade schools—with the caveat that schools maintaining a religious mission, curriculum or program do not violate the prohibition if they select students on the basis of religious affiliation or membership.

As described in the preamble of the proposed regulations, the prohibition on discrimination would apply "regardless of the intent behind or the legality of such discrimination," including remedial or diversity-related objectives. This is more limiting than the holdings in prior cases evaluating the Equal Protection Clause of the Fourteenth Amendment and Title VI of the Civil Rights Act of 1964, including the U.S. Supreme Court's 2023 decision in Students for *Fair Admissions, Inc. v. President & Fellows of Harvard College (SFFA).*

The preamble attempts to center the proposed regulations as one more part in the long history of the prohibition of racial discrimination in schools. It concludes that racial discrimination in education violates fundamental federal public policy and is incompatible with charitable tax exemption—citing the Equal Protection Clause of the Fourteenth Amendment, the Civil Rights Act of 1964, *Brown v. Board of Education, Green v. Connally*, Revenue Ruling 71-447, *Bob Jones University v. United States*, *SFFA* and "actions taken by the Executive Branch"—while going further than the *SFFA* case in its applicability.

How does this impact schools?

If finalized, the proposal could result in the revocation of 501(c)(3) tax-exempt status for schools. Treasury and the IRS estimate that these proposed regulations may affect "18,000 private elementary, secondary, and post-secondary schools" in the U.S. and the "750,000 students attending these schools who may qualify for scholarships on the basis of racial, ethnic, or national identity." The proposed regulations would broadly impact admissions, scholarships, educational programs and athletics, as well as other policies of private schools.

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For purposes of these proposed regulations, the term "private school" refers to entities classified as schools under Section 170(b)(1)(A)(ii) of the IRS Code. The proposed regulations would also supersede provisions of Revenue Procedure 75-50 that currently permit certain programs favoring racial minority groups when designed to promote a school's nondiscriminatory policy.

The preamble of the proposed regulations also discusses that private schools may need to work with donors in modifying race-conscious scholarship programs that are donor-restricted. This could raise issues with state enforcement since state charity regulators traditionally have jurisdiction over donor-restricted gifts.

What isn't impacted?

- **Organizations other than schools (defined under Section 170(b)(1)(A)(ii)).** The proposed regulations are narrowly tailored to apply to schools under Section 170(b)(1)(A)(ii) of the Code. While it discusses race-conscious scholarships when offered, administered or supported by a covered private school, it does not address such scholarships offered by tax-exempt organizations that are not classified as schools.
- **The ability to advance charitable purposes through the elimination of prejudice and discrimination.** The proposed regulations also do not address or modify the elimination of prejudice and discrimination as a charitable purpose under Section 501(c)(3) of the Code. In fact, the preamble acknowledges that "the proposed regulations would not disturb the continued ability of an organization (including a private school) to take actions or policies intended to eliminate prejudice and discrimination" consistent with existing tax guidance, provided those actions or policies do not discriminate on the basis of race, color or national or ethnic origin.
- **Private foundation tax guidance.** The proposed regulations do not affect the long-standing rules applicable to private foundations and their charitable and educational grantmaking programs.
- **Scholarship programs using "alternative criteria."** The proposed regulations provide that donors may "continue to donate to private schools using alternative criteria, such as income, geography, or first generation student status."

What's next?

The proposed regulations aren't effective yet. Taxpayers have until Nov. 3 to submit comments to Treasury and the IRS. If these regulations are finalized as currently written, we anticipate judicial challenges to them. We saw similar challenges to the new regulations pertaining to the Public Service Loan Forgiveness program, which also attempted to rely on the public policy doctrine. Those challenges resulted in the regulations being overturned.

We are standing by to help clients analyze these consequences, and we are happy to help draft comments to the IRS and Treasury in response.

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