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# IRS Issues Proposed Regulations on Discrimination by Private Schools


**WRITTEN BY**

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**KEY POINTS**

- The IRS and Treasury published proposed regulations (REG-119986-25) on September 4, 2026, that would strip section 501(c)(3) tax-exempt status from private schools that discriminate on the basis of race, color, or national or ethnic origin.
- The nondiscrimination requirement covers admissions, scholarships and loans, athletic programs, and all other school-administered or school-supported programs, applying to K–12 schools, colleges, universities, and professional and trade schools.
- Private schools that lose exempt status face federal income tax on endowment returns, loss of donor deductibility for contributions, potential bondholder income inclusion on tax-exempt bonds, and possible grant clawbacks.
- The Proposed Regulations expressly preserve the right of private schools to maintain a religious mission and to select students on the basis of religious affiliation or membership.
- Written comments are due November 3, 2026; if finalized, the regulations apply to taxable years beginning after May 31, 2027.

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On September 4, 2026, the Internal Revenue Service (IRS) published in the *Federal Register* a Notice of Proposed Rulemaking (REG-119986-25, RIN 1545-BS05) (Notice). The Notice contains proposed regulations (Proposed Regulations) that would update existing regulations by adding a proposed Treasury Regulation Section 1.501(c)(3)-2.

*What Do the Proposed Regulations State*? Generally, the Proposed Regulations state that a nonprofit, private school (as described below, Private School) that is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code (Code) must satisfy an explicit nondiscrimination requirement to remain an exempt organization described in Section 501(c)(3) of the Code.

The Proposed Regulations define a Private School as any entity described in Code Section 501(c)(3) and classified as an educational organization in Code Section 170(b)(1)(A)(ii). That latter Section of the Code describes an educational organization as an entity that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students at the place where its regular educational activities are carried on.

The Proposed Regulations have broad applicability across the private education sector. Affected institutions include:

- Colleges and universities (including graduate and professional programs);
- Private primary and secondary schools (K–12); and
- Professional or trade schools.

The Proposed Regulations do not apply to public secondary schools or state universities.

The Proposed Regulations impose a "nondiscrimination requirement" on Private Schools. The nondiscrimination requirement states that a Private School is not operated exclusively for exempt purposes if it adopts, maintains, or enforces any policy or practice (including, but not limited to, a policy or practice described as serving remedial or diversity-related objectives) that discriminates on the basis of *race, color, or national or ethnic origin* in the administration of any educational policy, admissions policy, scholarship or loan program, athletic program, or other school-administered or school-supported program.

If a Private School does not satisfy the nondiscrimination requirement, that Private School will not be treated as an organization described in Code Section 501(c)(3) with respect to any taxable year beginning after May 31, 2027.

The Notice expressly states that the Proposed Regulations "…would not preclude a private school from maintaining a religious mission, curriculum, or program of observance, or from selecting students on the basis of religious affiliation or membership."

*Practical Implications of Loss of Exempt Status*. Several steps must occur before a Private School can lose its exempt status. First, generally the IRS must open an examination. Second, the IRS must determine that the Private School has violated the nondiscrimination requirement and determine to revoke the Private School's exempt status. Third, all rights of the Private School to challenge the IRS's determination, including internal IRS Appeals and appeals to the federal courts, must be exhausted with the IRS's determination being upheld. Then, the loss of exemption from federal income tax means that the Private School is subject to federal income tax, including tax on endowment returns that currently accumulate tax free. Importantly, contributions to a Private School that loses its exempt status would no longer be deductible by the donor. Further, if the Private School was the borrower of proceeds of a tax-exempt bond issue, the interest on that tax-exempt bond issue would become includible in the income of the holder thereof. In addition, if the Private School is the recipient of grants, the applicable grant agreements may require the return of the granted moneys.

*Procedural Status and Next Steps*. The Notice states that the IRS will receive written comments on the Proposed Regulations through November 3, 2026. The IRS must also hold a public hearing if requested. We presume numerous organizations will request a public hearing. Once those requests are received, the IRS will set a date for that hearing.

Private Schools that wish to participate in the rulemaking process should note the November 3, 2026, comment deadline. Comments provide an opportunity to raise concerns and propose modifications to the proposed rule before it is finalized.

*Implementation Timing*. Absent any delays in the procedural process described above, the Proposed Regulations will tentatively be effective for the tax year of an organization beginning after May 31, 2027. Thus, for example, if a Private School uses a June 30 tax year, its first tax year after May 31, 2027, would begin on July 1, 2027, and end on June 30, 2028. The tax return for that tax year would be due November 15, 2028.

*Court Proceedings*. Affected taxpayers can challenge all or certain portions of IRS regulations in federal court. While a challenge may not be ripe until final regulations are promulgated, the timing described above could be impacted by court proceedings.

*Disclosure Implications*. If a Private School is the borrower of proceeds of tax-exempt bonds or has other obligations subject to SEC disclosure rules, it should consider, in consultation with its bond and/or disclosure counsel, adding appropriate disclosure about the Proposed Regulations to its disclosure documents. The most immediate impact would be on transactions currently in the market or for which there remains an obligation to update a final official statement for a period following the end of the underwriting period.

*Conclusion*. The Proposed Regulations may have serious implications for Private Schools. The Troutman Pepper Locke Public Finance Group is closely monitoring developments related to the Proposed Regulations. Our team has extensive experience advising colleges, universities, and private secondary schools on tax-exempt financing, regulatory compliance, and public policy matters. If you would like assistance with your financial disclosures or with providing comments to the IRS, please contact your Troutman Pepper Locke lawyer.

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