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IRS 501(c)(3) revocation based on racial nondiscrimination: Process and consequences

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What private schools should understand about how IRS revocation of 501(c)(3) status actually works—and the tax, donor, financing, and litigation risks that can follow.

What's the impact?

- On September 4, the US Department of the Treasury and Internal Revenue Service (IRS) issued proposed regulations addressing racial nondiscrimination by tax-exempt private schools and colleges, which, if finalized, would apply to taxable years beginning after May 31, 2027.
- IRS revocation of 501(c)(3) status generally follows an examination, proposed adverse determination, protest opportunity, appeals review, and final determination.
- Revocation can be retroactive, creating prior-year tax exposure and affecting donor deductions, tax-exempt bonds, employment taxes, and state taxes.

As discussed in our September 4, 2026, alert, the US Department of the Treasury and Internal Revenue Service (IRS) issued proposed regulations addressing racial nondiscrimination by tax-exempt private schools and colleges. The proposed regulations would provide that a private school that discriminates based on race, color, or national or ethnic origin in admissions, educational policies, scholarships or loans, athletics, or other school-administered or school-supported programs would not qualify for tax-exempt status under Section 501(c)(3) of the Internal Revenue Code (IRC).

Loss of exempt status is severe. It can affect the school's federal tax obligations, fundraising, financing, employment taxes, as well as state and local tax treatment. It also can create significant procedural and operational issues for an institution that wishes to challenge the IRS's determination.

But what is the process by which the IRS goes about actually revoking 501(c)(3) status? The framework for revocation is established by the IRC, Treasury regulations, IRS administrative procedures, and longstanding IRS guidance. In this alert, we review the process the IRS generally follows when questioning whether an organization continues to qualify for exemption or seeking to revoke Section 501(c)(3) status, which differs from the automatic revocation that occurs when an organization fails to file required annual returns or notices for three consecutive years.

Key takeaways

- Revocation of Section 501(c)(3) status is not automatic merely because the IRS identifies a compliance concern; it generally follows an examination, proposed adverse determination, opportunity to protest, IRS appeals review, and final adverse determination.
- The effective date of revocation can be retroactive, which may create tax, donor, financing, and reporting consequences for prior periods.
- Private schools should not focus only on written nondiscrimination policies. The IRS may also examine admissions, scholarships, athletics, extracurricular programs, board records, public statements, and actual institutional practices.
- A school that receives a proposed adverse determination should treat the administrative record as critical, as exhaustion of IRS remedies is generally required before seeking judicial review.
- Reinstatement of status is possible, but it generally requires corrective action and a new application, and retroactive reinstatement should not be assumed.

The revocation process: From examination to final determination

Step 1—Selection for examination. An IRS examination may be triggered by a variety of sources: a Form 990 review, a third-party complaint, state or federal agency referral, media reports, inconsistencies in required filings, or an internal IRS classification project. For private schools and colleges, compliance with racial nondiscrimination requirements—currently governed by Revenue Ruling 71-447 and Revenue Procedure 75-50, and in the future potentially by the proposed regulations—is a specific area of IRS enforcement focus.

Step 2—Examination and information gathering. Once an examination is opened, the IRS Exempt Organizations (EO) division will request the school's governing documents, admissions materials, nondiscrimination policy, scholarship and financial aid records, student and faculty demographic data, board minutes, catalogs, and evidence that the school published its nondiscrimination policy. The examining agent evaluates whether the organization continues to be "organized and operated exclusively for exempt purposes" within the meaning of Section 501(c)(3) and Treas. Reg. § 1.501(c)(3)-1. This stage can be particularly important because the IRS's inquiry may extend beyond the language of a written policy to how the school's programs are actually administered.

Step 3—Proposed adverse determination (30-day letter). If the examining agent concludes that revocation is warranted, the IRS issues a report of examination explaining the proposed revocation, the proposed effective date, factual findings, and legal basis. The school then receives what is commonly called a "30-day letter"—a proposed adverse determination letter giving the organization the right to file a written protest and request a conference with the IRS Independent Office of Appeals. The school's protest must state its disagreement, the relevant facts, and the legal arguments supporting its position.

Step 4—IRS appeals. If the school files a timely protest, the case is referred to the IRS Independent Office of Appeals, which conducts an independent review of the proposed revocation. Appeals consider the hazards of litigation, the factual record, applicable legal authorities, and potential grounds for resolution, including settlement or a closing agreement. Appeals may sustain the proposed revocation, modify the effective date, resolve the matter through a closing agreement, or return the case for further development.

Step 5—Final adverse determination letter. If the IRS sustains the revocation (either because the school did not protest or Appeals upheld the determination), it issues a final adverse determination letter, sometimes referred to as a "90-day letter." This letter formally revokes the school's exempt status, specifies the effective date of revocation, and generally starts the 90-day period for filing a Section 7428 declaratory judgment action if the organization seeks judicial review. It also informs the school that contributions are no longer deductible under Section 170 and that the school must begin filing federal income tax returns. Following revocation, the IRS prepares a Form 5666, EP/EO Information Report, which includes the effective date, a copy of the revocation letter, and other pertinent information for the Examination Division to follow up on the school's post-revocation tax obligations.

Step 6—Notification to state officials. Under IRC Section 6104(c), the IRS is authorized to notify appropriate state officials of both proposed and final revocations of 501(c)(3) status, which may enable state attorneys general, charity regulators, tax authorities, or other officials to evaluate whether corresponding action is warranted under state law.

A critical detail: the effective date can be retroactive. The revocation letter will specify an effective date that is not necessarily the date of the letter itself. Rather, it can be backdated, sometimes substantially.[1] Where the organization's own conduct is the basis for revocation—as would often be the case in a nondiscrimination matter—the risk of a retroactive effective date is heightened. In those circumstances, the IRS may determine that prospective-only treatment is not appropriate, particularly if the facts show intentional, serious, or continuing noncompliance.

There is no fixed statutory limit on how far back the IRS can reach. The IRS typically revokes for the years it has actually examined, treating the organization as a taxable entity for all years at issue and soliciting income tax returns for those years, though the general three-year statute of limitations on tax assessment under IRC § 6501 provides some backstop.[2]

Grounds and triggers: What conduct could prompt IRS action?

The legal foundation for the IRS's ability to deny or revoke Section 501(c)(3) status based on racial discrimination predates the proposed regulations. In *Bob Jones University v. United States*, the Supreme Court held that an organization that operates in a manner contrary to fundamental public policy (in that case, racially discriminatory educational policies) does not qualify for tax-exempt status under Section 501(c)(3).

The IRS currently implements that principle through Rev. Rul. 71-447 and Rev. Proc. 75-50. The proposed regulations would move the existing framework into regulatory text and expressly extend the prohibition to discrimination in admissions, educational policies, scholarships and loans, athletics, and other school-administered or school-supported programs.

For private schools and colleges, potential areas of IRS scrutiny could therefore include:

- Admissions policies or practices that use race, color, or national or ethnic origin as a criterion;
- Race- or ethnicity-restricted scholarships, grants, or loans;
- Athletic or extracurricular programs with race- or ethnicity-based eligibility criteria;
- Pipeline, mentoring, summer, or other school-supported programs that use race or ethnicity

[1] Under IRS procedures (Rev. Proc. 84-46; 26 C.F.R. § 601.201), a revocation will generally be prospective only if (i) there was no misstatement or omission of material facts, (ii) the facts subsequently developed are not materially different from those on which the ruling was based, (iii) there has been no change in applicable law, and (iv) the organization acted in good faith in reliance on the ruling or determination letter.

[2] For church-affiliated schools, IRC § 7611 imposes special limitations: tax may generally be assessed only for the three most recent taxable years before the examination notice date, extending to six years if the organization is found not to be exempt for any of those three years.

as an eligibility criterion;

- Inconsistencies between a school's stated nondiscrimination policy and its actual practices; and
- Documentation or public statements that suggest that race or ethnicity is being used as a criterion in a school-administered program.

As discussed in our prior alert, the proposed regulations would also eliminate certain existing provisions in Rev. Proc. 75-50 that permitted race-conscious policies designed to promote nondiscrimination.

Can a school recover its 501(c)(3) status after revocation?

Yes—but reinstatement is neither automatic nor guaranteed.

New application required. An organization whose 501(c)(3) status has been revoked may reapply for recognition of exemption by filing a new Form 1023 (Application for Recognition of Exemption Under Section 501(c)(3)). The school must disclose the prior revocation and demonstrate that it has corrected the noncompliance that led to the revocation.

Prospective vs. retroactive reinstatement. Just as revocation can be retroactive (see above), the effective date of any new recognition of exemption upon reinstatement also depends on the facts and circumstances—and retroactive reinstatement is far from guaranteed. The IRS's general rule is that a revocation will be prospective where the organization acted in good faith, with no misstatement of material facts and no material change in operations. But the same logic cuts against retroactive reinstatement: where the revocation was based on intentional or serious noncompliance—such as maintaining racially discriminatory policies—the IRS is unlikely to grant retroactive reinstatement to the date of revocation. This means the school may face a gap period during which it was not exempt, and contributions made during that period may not be deductible. The school may also owe income and employment taxes for the gap period, with no ability to recoup those obligations through retroactive reinstatement.

Section 508(a) notice requirement. For organizations subject to the Section 508(a) notice requirement (which includes most private schools organized after October 9, 1969), there is an open question of whether a revoked organization must satisfy the Section 508(a) requirement anew in order to be treated as described in Section 501(c)(3) for periods subsequent to revocation. The safest course is to file a new Form 1023 and obtain a new favorable determination letter.

Consequences of revocation

The loss of 501(c)(3) status has cascading consequences that extend well beyond the school's own tax obligations.

Federal income tax liability. The school becomes a taxable entity and is required to file federal income tax returns for all years at issue. If the revocation is retroactive, the school may owe corporate income tax on net income for prior years.

Loss of donor deductibility and donor reliance. Contributions to an organization are deductible under IRC Section 170 only if made to a qualifying organization described in Section 170(c). Once a school's 501(c)(3) status is revoked, contributions to it are no longer deductible, and the IRS will publish an announcement to that effect.

Under Rev. Proc. 82-39, donors who are unaware of a revocation may generally continue to rely on the school's listing in the IRS's Tax-Exempt Organization Search (formerly Publication 78) for deductibility purposes, but only for contributions made on or before the date of the IRS's public announcement of the revocation. This reliance protection does not extend to donors who had knowledge that revocation was imminent, or who were in part responsible for, or aware of, the activities that gave rise to the revocation—for example, Board of Trustee members—and may, therefore, cause uncertainty for donors.

FICA and FUTA taxes. As the Supreme Court noted *in Bob Jones*, loss of 501(c)(3) status means that exemptions from FICA taxes (under IRC § 3121(b)(8)(B)) and FUTA taxes (under IRC § 3306(c)(8)) no longer apply, since those exemptions depend on Section 501(c)(3) status. Retroactive revocation may also affect employment-tax treatment, particularly where the school relied on tax rules available to Section 501(c)(3) organizations. Any potential FICA or FUTA exposure should be analyzed based on the school's workforce, prior reporting position, and the specific exemptions claimed.

Tax-exempt bond financing. Schools that have financed facilities with tax-exempt bonds under IRC Section 145 face significant exposure. Section 145 requires that all property provided by the net proceeds of qualified 501(c)(3) bonds be owned by an organization described in Section 501(c)(3) and exempt from tax under Section 501(a) (an "NFP Borrower") or a governmental unit. Loss of tax-exempt status by a NFP Borrower could result in the bonds ceasing to qualify as 501(c)(3) bonds, which could cause all of the interest on such bonds to be included in gross income for purposes of federal income taxation, retroactive to the date of issuance, if timely remedial action is not taken. Loss of the NFP Borrower's tax-exempt status could also trigger bond covenant defaults under the governing bond documents, all of which would have material adverse consequences on the financial condition of the NFP Borrower, and its ability to pay outstanding debt service.

State and local tax implications. Many state property-tax, sales-tax, and income-tax exemptions are tied to federal 501(c)(3) status. Revocation may trigger loss of state exemptions, reassessment of property taxes, and potential back-tax exposure. Under Section 6104(c), the IRS must notify appropriate state officials of revocations, which may prompt state-level enforcement actions.

Federal financial aid eligibility. For private colleges and universities participating in Title IV federal student aid programs, loss of 501(c)(3) status may affect the institution's nonprofit classification and its eligibility for continued participation in federal financial aid programs. This could trigger Department of Education review, recertification issues, and program-participation problems.

The practical consequences of retroactive revocation. While a prospective revocation triggers income tax, employment tax, and donor deductibility consequences only from the effective date forward, a retroactive revocation can create back income tax liability for all retroactive years (plus interest and penalties), back FICA and FUTA liability for both employer and employee shares, retroactive disallowance of donor deductions (exposing donors to deficiency assessments), and potential retroactive taxability of interest on Section 145 tax-exempt bonds. For private schools and colleges facing nondiscrimination-based revocation, the risk of a retroactive effective date is elevated because the basis for revocation is the school's own conduct—precisely the scenario where the IRS's prospective-only protection does not apply.

Interim protections and litigation options

Schools facing revocation have several procedural protections and avenues for judicial review.

Declaratory judgment under IRC Section 7428. Section 7428 is the primary judicial remedy for challenging an IRS revocation of 501(c)(3) status. It provides that in a case of actual controversy involving a determination by the Secretary "with respect to the initial qualification or continuing qualification of an organization as an organization described in section 501(c)(3)," the US Tax Court, the US Court of Federal Claims, or the US District Court for the District of Columbia may issue a declaratory judgment. For purposes of Section 7428, "a determination with respect to a continuing qualification . . . includes any revocation of or other change in a qualification."

Exhaustion of administrative remedies required. A declaratory judgment will not issue unless the court determines that the organization has "exhausted administrative remedies available to it within the Internal Revenue Service." This means the school must pursue the 30-day letter protest and IRS Appeals conference before turning to the courts.

90-day filing deadline. If the IRS sends a final adverse determination by certified or registered mail, the organization must file its petition for declaratory judgment by the 91st day after the mailing. Missing this deadline can foreclose judicial review.

Protection for donors during litigation. IRC Section 7428(c) provides limited protection for contributions made during the pendency of a declaratory judgment proceeding. If a proceeding is timely initiated and the court ultimately determines the organization was not described in Section 170(c)(2), the organization is nonetheless treated as having been described in Section 170(c)(2) for the period from the date the revocation was published through the date the court first determined the organization was not so described. However, this protection is limited: for individuals, the aggregate of contributions during the protected period may not exceed $1,000 per donor (treating a married couple as one contributor), and the protection does not apply to any individual who was responsible, in whole or in part, for the activities that were the basis for the revocation.

No automatic stay. Filing a Section 7428 petition does not automatically stay the revocation or prevent the IRS from processing income tax returns and assessments. The school may seek injunctive or equitable relief in appropriate circumstances, but the Anti-Injunction Act (IRC § 7421) and tax-specific jurisdictional rules significantly constrain pre-enforcement remedies—as the Supreme Court made clear in *Bob Jones*, where the Court held that the university could not enjoin the IRS from revoking its tax-exempt status.

Alternative challenges. In addition to a Section 7428 declaratory judgment action, a revoked organization may challenge the IRS's determination through a deficiency proceeding or refund action for the years under examination.

What schools should do now

Private schools and colleges should consider taking the following steps before any IRS inquiry:

- Review admissions, scholarship, financial aid, athletic, extracurricular, mentoring, pipeline, and summer programs for eligibility criteria involving race, color, or national or ethnic origin.
- Confirm that published nondiscrimination policies are current, consistently stated, and actually followed in practice.
- Review board minutes, catalogs, websites, donor materials, scholarship descriptions, and public statements for consistency with the school's nondiscrimination policy.
- Preserve documentation showing how admissions, financial aid, scholarships, athletics, and school-supported programs are administered.
- Identify any programs that may require restructuring if the proposed regulations are finalized in their current form.
- Prepare an internal response protocol for IRS information document requests, including who will coordinate document collection, privilege review, and communications with the IRS.

Looking ahead

The proposed regulations, if finalized as proposed, would apply to taxable years beginning after May 31, 2027. Our September 4 alert (linked above) provides a useful starting point for institutions evaluating their current programs.

If finalized in their current form, the proposed regulations would make the consequences of race-based discrimination particularly significant for private schools by expressly connecting a broad range of school-administered and school-supported practices to continued eligibility for Section 501(c)(3) status. But the practical significance of the proposal extends beyond the substantive nondiscrimination standard.

For school leaders and boards, understanding the process is just as important as understanding the substantive rule. An IRS inquiry can quickly progress from information requests to examination, proposed revocation, appeals, final adverse determination, and litigation. At each stage, the school's documentation, governance record, public statements, and response strategy can materially affect the outcome. Schools should use the period before any final regulations become effective to assess programs, preserve records, and address inconsistencies between written policies and actual practices.

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