



The Public-Policy Doctrine Returns: DEI, Tax Exemption, and the New Fault Lines in Nonprofit Enforcement

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For more than forty years, *Bob Jones University v. United States* has stood for the proposition that qualification under § 501(c)(3) requires more than satisfying the literal categories in the statute. In *Bob Jones Univ. v. United States*, 461 U.S. 574, 585–96 (1983), the Court held that an educational institution that engages in racial discrimination is not a “charity” entitled to tax exempt status under Internal Revenue Code § 501(c)(3) since racial discrimination in education violates a “fundamental public policy.” On September 4, 2026, Treasury and the IRS proposed regulations that would deny § 501(c)(3) status to a private school that uses race, color, or national or ethnic origin in administering virtually any school policy or program. The proposal expressly reaches race-conscious measures adopted for remedial or diversity purposes. [Racial Nondiscrimination in Private Schools, 91 Fed. Reg. 56,811 \(Sept. 4, 2026\) \(proposed rule\) \(REG-119986-25\)](#).

At almost the same time, [Senators Ron Wyden and Raphael Warnock](#) asked Treasury and the IRS to respond to press reports that administration officials were considering heightened scrutiny, and possible revocation of exempt status, for particular left-leaning nonprofits. [Their September 2 letter](#) invokes statutory protections against political interference in IRS examinations and asks whether ideological criteria or the timing of the 2026 elections have affected enforcement decisions. Those allegations remain allegations; the letter is an oversight inquiry, not a finding that unlawful targeting occurred.

The two developments are legally distinct. (1) Treasury can promulgate generally applicable tax rules; and, (2) political officials cannot direct the IRS to audit a particular disfavored taxpayer. But together they highlight an emerging question for the nonprofit sector: how far can the federal government use tax exemption as an instrument of public policy, and what constrains that power when the underlying “public policy” is itself politically contested?



From *Bob Jones* to a New Nondiscrimination Rule

Section 501(c)(3) does not expressly say that a charitable organization must comply with “fundamental public policy.” The doctrine instead developed from the common-law meaning of charity.

In *Bob Jones*, the Supreme Court upheld the IRS’s revocation of exempt status for Bob Jones University and Goldsboro Christian Schools because their racially discriminatory practices conflicted with the nation’s fundamental public policy against racial discrimination in education. The Court reasoned that the statutory concept of charity incorporated the common-law requirement that an organization confers a public benefit and not be involved in activity that is contrary to fundamental public policy.

But an important qualification sometimes disappears from summaries of that case. The Court called public-policy determinations “sensitive matters” and stated that denial of charitable status should occur only when “there can be no doubt that the activity involved is contrary to a fundamental public policy.” *Id.* at 592 (highlight not in the original). The Court also expressly declined to decide whether an otherwise qualifying organization could lose exemption merely because some of its activities violated law or public policy.

That limiting language could become important if the proposed regulations are challenged.

The IRS’s historical rules for private schools also made a distinction that the new proposal would eliminate. [Rev. Proc. 75-50](#) generally requires racially nondiscriminatory policies, but it has long provided that certain preferences benefiting racial minority groups do not constitute prohibited discrimination when designed to establish or maintain a school’s nondiscriminatory policy. Similar language addresses scholarships and financial assistance. Rev. Proc. 75-50, 1975-2 C.B. 587, modified by Rev. Proc. 2019-22.

The proposed regulations would remove those provisions.



What the Proposed Regulation Actually Does

The operative language is unusually categorical. Proposed Treas. Reg. § 1.501(c)(3)-2 would provide that a private school is not operated exclusively for exempt purposes if it “adopts, maintains, or enforces any policy or practice” discriminating on the basis of race, color, or national or ethnic origin in an educational policy, admissions policy, scholarship or loan program, athletic program, or any other school-administered or school-supported program. It then adds that prohibited discrimination includes such discrimination “for any purpose.”

That last phrase matters. Treasury states explicitly that remedial motives and diversity objectives do not change the analysis. In the preamble, it characterizes all race discrimination in education, “regardless of the intent behind or the legality of such discrimination,” as contrary to fundamental public policy. The rule therefore would do more than incorporate a prohibition against unlawful racial discrimination into § 501(c)(3): it would make Treasury’s conception of racial nondiscrimination an independent condition of tax exemption.

Treasury estimates that approximately 18,000 tax-exempt private elementary, secondary, and post-secondary schools and 750,000 attending students who may qualify for scholarships on the basis of race, ethnicity or national origin are within the potentially affected universe. The regulation, if finalized, would establish a qualification that could then support denial or revocation in of a private school’s exempt status.

The proposal covers organizations classified as educational organizations under § 170(b)(1)(A)(ii), private elementary and secondary schools, colleges, universities, professional schools, and trade schools. Governmental schools are excluded. See Proposed Treas. Reg. § 1.501(c)(3)-2(c).

It also contains important nuances. A religious school may continue to select students based on religious affiliation or membership, even where members of the religious community share ancestral characteristics, as long as the actual criterion is religion rather than race or ethnicity. And organizations remain free to pursue the elimination of prejudice and discrimination; they simply must do so without policies that discriminate on the basis of race, ethnicity or national origin.



If finalized as proposed, the regulations would apply to taxable years beginning after May 31, 2027. Comments are due November 3, 2026, and a telephonic public hearing is presently scheduled for December 2.

Does *Students for Fair Admissions* Get Treasury All the Way There?

Treasury's legal chain runs from *Brown v. Board of Education*, 347 U.S. 483 (1954), through *McCrary v. Runyon*, 427 U.S. 160 (1975), *Bob Jones*, and finally *Students for Fair Admissions, Inc. v. President & Fellows of Harvard College*, 600 U.S. 181, 206-31 (2023). In *Students for Fair Admissions* ("SFFA"), the Supreme Court invalidated the challenged race-conscious admissions systems at Harvard and the University of North Carolina.

But *SFFA* did not interpret § 501(c)(3). Nor did it hold that every race-conscious scholarship, grant, athletic program, or privately funded educational program violates federal law. Harvard was subject to Title VI because it received federal financial assistance; UNC was also subject to the Equal Protection Clause as a public university.

The proposed regulation utilizes *Bob Jones*: Treasury reasons that developments culminating in *SFFA* establish a broader fundamental national policy against all racial distinctions by private schools, including distinctions made for remedial purposes and even where the particular conduct is not independently unlawful.

That is likely to be a central legal battleground. There is considerable authority for the proposition that racial discrimination in education conflicts with fundamental public policy. There is considerably less precedent for the proposition that *Bob Jones* permits Treasury to transform every race-conscious educational benefit, including one intended to address disadvantage, into conduct inconsistent with charitable status.

The history cannot be ignored. The old Rev. Proc. 75-50 rules treated some minority-conscious measures as consistent with nondiscrimination; the new proposal treats the same kind of racial distinction as the very discrimination that disqualifies an organization. The question is therefore not whether *Bob Jones* remains good law. Absent congressional action to the contrary, it plainly does. The question is what counts as the fundamental public policy that *Bob Jones* requires the IRS to enforce.



The Issue Is Larger Than Schools

Race-conscious grantmaking has already faced litigation outside the university context. See, e.g., *American Alliance for Equal Rights v. Fearless Fund Management, LLC*, 103 F.4th 765 (11th Cir. 2024). And while proposed § 1.501(c)(3)-2 is expressly limited to “private schools,” nonprofits should not assume that the broader public-policy debate ends at the campus boundary.

The proposed rule's treatment of scholarship endowments illustrates the practical difficulty. Treasury acknowledges that schools may have gifts whose governing instruments expressly restrict eligibility by race and says institutions may need to work with donors or donors' heirs to revise those restrictions. For counsel, that can raise questions of donor consent, modification, variance, *cy pres*, state attorney-general jurisdiction, and applicable versions of the Uniform Prudent Management of Institution Funds Act, not merely federal tax compliance.

The preamble to the regulation identifies income, geography, and similar race-neutral characteristics as possible alternatives to racial or ethnic criteria to determine scholarship eligibility. The proposed regulation does not give examples or create a categorical safe harbor for every facially neutral proxy.

At the Same Time: Who Decides Whom the IRS Examines?

A nonprofit does not acquire immunity from enforcement because its work is ideological or controversial. Rev. Rul. 75-384, Rev. Rul. 80-278, and *Bob Jones* demonstrated that unlawful activity or activity contrary to fundamental public policy can affect exemption. But legitimate enforcement of neutral tax standards is different from selecting a taxpayer because government officials dislike its viewpoint. The IRS's own procedures contemplate impartial examination selection and application of the laws governing exempt status.

The Wyden-Warnock letter raises this problem.

Based on press reports, the senators ask whether Treasury or White House officials have identified particular organizations for examination or revocation, whether ideological labels have been used in case selection, and whether officials sought to accelerate enforcement before the midterm elections



The letter points out that I.R.C. § 7217 makes it unlawful for specified senior Executive Branch officials to request, directly or indirectly, that the IRS conduct or terminate an audit or other investigation of a particular taxpayer concerning that taxpayer's tax liability. IRS employees receiving a prohibited request must report it to TIGTA; a willful violation carries criminal penalties. I.R.C. § 7217(a), (b), (d). The statute contains specific exceptions, including certain requests made in accordance with § 6103 and a written request from the Treasury Secretary resulting from implementation of a change in tax policy. I.R.C. § 7217(c). Section 6103 prohibits disclosure of tax return information and allows disclosure only in specified circumstances.

The letter further points out that auditing specific taxpayers is the IRS's responsibility, not Treasury's, and if Treasury officials have accessed taxpayer-specific return information, they may have violated. I.R.C. § 6103.

The senators ask Treasury and the IRS to provide ten categories of information about the Trump administration's use of national security directives to "weaponize the IRS against protected First Amendment speech" rather than targeting actual violence.

A New Era for the "Charitable" Standard?

The most consequential aspect of the proposed regulation may not be its treatment of any particular nonprofit DEI program. It may be the renewed importance of the *Bob Jones* public-policy doctrine itself.

Bob Jones gave the government meaningful authority to deny tax subsidies to conduct that unmistakably violated a fundamental national policy. But the Supreme Court simultaneously warned that the doctrine involves sensitive judgments and should be deployed only where the relevant public policy is genuinely fundamental and beyond doubt.

In 1983, the doctrine was applied against racial segregation.ⁱ In 2026, Treasury proposes to invoke the same doctrine against remedial or diversity-oriented racial preferences. Whether the statute permits that extension will likely generate significant litigation if the proposed regulation becomes final.

Meanwhile, the congressional inquiry into alleged targeting underscores the other side of the equation. The government has authority, and an obligation, to enforce § 501(c)(3). But the credibility of that system depends on a distinction that should



transcend administrations and political viewpoints: tax exemption may depend on what an organization does under the law; IRS scrutiny should not depend on whom political officials want investigated.ⁱⁱ

For nonprofit boards, lawyers, and CPAs, the practical lesson is not to predict which political view will prevail. It is to recognize that exemption itself is increasingly becoming a regulatory pressure point. Organizations are best positioned for that environment by ensuring that they know precisely what their programs do, what legal authority supports them, how donor restrictions constrain them, and whether any corrective actions may be appropriate, should they be faced with the need to defend their exempt status.

ⁱ On September 24, 2026, the Justice Department announced that it has ended over 50 of these half century-old desegregation cases in the United States. <https://www.justice.gov/opa/pr/justice-department-ends-over-50-half-century-old-desegregation-cases-throughout-united>.

ⁱⁱ See Treasury Inspector General for Tax Administration, *Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review* (May 14, 2013) (finding that IRS personnel used terms including “Tea Party” and “Patriots” to identify certain § 501(c)(4) applications for heightened scrutiny).

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