What Treasury’s New Tax-Exempt Rules Mean for Private Schools

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On September 4, 2026, the Treasury Department and the IRS issued proposed regulations (Notice of Proposed Rulemaking, REG-119986-25) that would deny federal tax-exempt status to private schools that discriminate on the basis of race, color, or national or ethnic origin. These rules are proposed, not final — they remain subject to public comment and may change. Treasury estimates the rule could affect as many as 18,000 institutions, from grade schools to universities, professional schools, and trade schools, so the potential impact is worth understanding now.

The core principle isn’t new. More than forty years ago, the Supreme Court held that eligibility for exemption under section 501(c)(3) turns on common-law standards of charity, including that the institution serve a public purpose and not be contrary to established public policy, and that eradicating racial discrimination in education is a fundamental national public policy. *Bob Jones Univ. v. United States*, 461 U.S. 574(1983). The proposed rule builds on that logic against the backdrop of the Court’s 2023 decision holding that race-based college admissions violate the Equal Protection Clause, though that decision addressed admissions rather than tax exemption directly. *Students for Fair Admissions, Inc. v. President & Fellows of Harvard Coll.*, 600 U.S. 181(2023).

What changes. The rule reaches every corner of school operations — admissions, scholarships and loans, athletics, and any school-administered program. It also sweeps away older IRS guidance that tolerated certain racial preferences. Notably, rebranding a race-based preference as “diversity,” “equity,” or “inclusion” would not save it; Treasury has said the label doesn’t change the substance.

What’s preserved. Religious schools may keep their mission, curriculum, and observance, and may still select students by genuine religious affiliation. Schools may also continue helping disadvantaged students through race-neutral criteria — family income, geography, first-generation status, hardship, military-family status, or academic merit.

The timeline. The final rules would apply to taxable years beginning on or after May 31, 2027, giving institutions a window to review and revise their admissions, scholarship, and financial-aid policies.

The takeaway. Schools that rely on federal tax exemption should audit any policy or program that considers race and ethnic origin — even indirectly — well before the compliance date. Those that wait risk losing a benefit that underwrites much of how they operate.

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