Submitted electronically via the Federal eRulemaking Portal (www.regulations.gov)
CC:PA:01:PR (REG–119986–25)
Room 5503
Internal Revenue Service
P.O. Box 7604, Ben Franklin Station
Washington, DC 20044

Re: Comments on Proposed Regulations Under Section 501(c)(3) – Racial Nondiscrimination in Private Schools (REG–119986–25; RIN 1545–BS05; 91 Fed. Reg. 56811 (September 4, 2026))

The National Association of Health and Educational Facilities Finance Authorities (NAHEFFA) submits the following comments on the proposed regulations published on September 4, 2026, that would add new section 1.501(c)(3)–2 (the "Proposed Regulations") to the Income Tax Regulations (the "Regulations"). If finalized as proposed, the rule would remove the tax-exempt status under Section 501(c)(3) of the Internal Revenue Code (the "Code") from any private school that adopts, maintains, or enforces any policy or practice that discriminates on the basis of race, color, or national or ethnic origin — regardless of the purpose of such discrimination, including remedial objectives.

The stakes are high: noncompliant schools could lose their federal income tax exemption, contributions to them could cease to qualify as deductible charitable contributions under Section 170, and outstanding tax-exempt qualified 501(c)(3) bonds that depend on the 501(c)(3) status of the school conduit borrower would become taxable with the loss of 501(c)(3) status. Future bonds could not be issued as tax-exempt. The proposal estimates that approximately 18,000 tax-exempt private schools and 750,000 students potentially eligible for identity-based scholarships may be affected.

NAHEFFA does not take a position on the basic policy and legal issues underlying the Proposed Regulations. Our comments are limited to the effect of the Proposed Regulations, as currently written, on tax-exempt bonds issued for the benefit of private schools. We urge the IRS to reconsider in detail and redraft the Proposed Regulations to avoid the potentially massive effects on millions of taxpayers, bondholders, students and schools if finalized regulations result in loss of tax-exempt status for many billions of dollars of outstanding and future bonds.

NAHEFFA is the national trade association for the state issuers of tax- exempt debt for the benefit of 501(c)(3) nonprofits, including thousands of colleges, universities, professional schools, k-12 schools, charter schools, and trade and vocational schools, large and small. As "conduit" issuers, our members pass through the tax exemption on the bonds and repayments are solely the responsibility of the borrowing institutions. But our members' state law mandates are to support the institutions' fiscal health through lower cost financing so they can continue their vital educational missions. This is what motivates these comments.

This is not an education-only issue. Such bond-financed projects inject billions of dollars into national and local economies each year, supporting employment and infrastructure as well as education. The Proposed Regulations jeopardize the feasibility and benefits of these projects.

There are many hundreds of billions of these bonds outstanding and billions of additional bonds issued every year, owned by millions of US investors (including institutional investors and retirement funds). If some of these bonds become taxable as a consequence of this proposal, then bondholders/taxpayers will be stuck paying tax on the interest on these bonds that were purchased at a lower tax-exempt rate. And many schools will not be able to successfully obtain taxable loans because their finances cannot support the higher taxable rates, especially in the current interest rate environment. Many bondholder funds cannot hold taxable bonds and will be forced to divest of those securities, further limiting the available financing options for private schools. Thus, NAHEFFA has a direct interest in the content, clarity, administrability, and timing of any rule that changes the conditions for maintaining a school's section 501(c)(3) status.

Qualified 501(c)(3) Bonds issued under section 145 of the Code require that borrowers—the educational institutions- of qualified 501(c)(3) bond proceeds maintain their status as organizations described in section 501(c)(3) of the Code for the entire term to maturity of the Bonds – typically 20 to 30 years after issuance. The Proposed Regulations add to the requirements that a private school must satisfy to maintain that status. Although the bond-specific rules themselves are unaffected, the consequences of the finalization of the Proposed Regulations for bondholders could be severe, even, without exaggeration, catastrophic. If a private school borrower ceases to be described in section 501(c)(3) of the Code, interest on its outstanding qualified 501(c)(3) bonds would become included in gross income, and the Proposed Regulations contain no grace period, grandfathering, or correction mechanism. Investors holding these bonds bear that risk even though they have no ability to monitor or control a school's scholarship, admissions, or other programs. We therefore request full economic analysis of these possible consequences of the proposed rule.

We request a full analysis of these potential effects:

Many private schools have financed campus facilities, dormitories, and other capital projects through tax-exempt "qualified 501(c)(3) bonds" issued under Section 145 of the Internal Revenue Code. The tax-exempt status of these bonds depends on the conduit borrower maintaining its Section 501(c)(3) status. If a school loses its tax-exempt status under the proposed rule, several significant consequences could follow:

- **Loss of tax-exempt status on bonds.** Bonds issued as "qualified 501(c)(3) bonds" would lose their tax-exempt status, causing bondholders to face federal income tax on interest payments going forward. This could trigger a market value decline and bondholder claims.
- **Covenant defaults, mandatory redemptions and acceleration.** Most tax-exempt bond indentures and loan agreements require the borrower to maintain its 501(c)(3) status as a continuing covenant. Loss of exempt status generally would constitute an event of default under these documents, potentially triggering mandatory redemption and acceleration of the outstanding principal balance or other remedies available to bondholders.
- **Interest rate adjustments.** Some bond documents provide for interest rate increases ("grossed-up" or "taxable" rates) if the bonds lose tax-exempt status, significantly increasing the financing costs of the projects and further stressing the operations of the borrowers.

We also ask for the following clarifications and at a minimum if the rule moves forward the following revisions.

A. Prospective application and protection of outstanding bonds. We request that the final regulations, or the preamble to them, confirm that a failure to satisfy section 1.501(c)(3) of the Proposed Regulations is intended to operate only prospectively, and that such a failure in a taxable year beginning after May 31, 2027 (or after any other date on which the rule in the Proposed Regulations is finalized) will not, by itself, cause interest on bonds issued before that failure (or before the applicability date) to be treated as included in gross income for any period before the date the organization ceases to be described in section 501(c)(3). Alternatively, we request that bonds issued before the date final regulations are published be grandfathered from the consequences of a failure under the Proposed Regulations, for a reasonable transition period of at least 12 months after the date final regulations are published.

B. Remedial action or correction mechanism. We request that Treasury and the IRS provide a remedial action or correction procedure that would allow a private school that discovers a noncompliant policy or practice to cure the failure within a reasonable period (for example, by discontinuing or modifying the policy or practice) without loss of section 501(c)(3) status and without adverse consequences to outstanding bonds. Such a procedure could be modeled on the remedial action rules in section 1.141–12 of the Regulations, the correction approach under section 501(r) of the Code and section 1.501(r)–2 of the Regulations, or a dedicated closing agreement or voluntary compliance program comparable to that currently in place to cure certain types of noncompliance affecting tax-exempt bonds. Given the breadth of the phrase "other school-administered or school-supported program," in the Proposed Regulations inadvertent or isolated failures are likely, and an all-or-nothing loss of exemption is a disproportionate result for both the institution and its bondholders.

C. *De minimis Exception.* We request that any final regulations provide that an organization's tax-exempt status not cease due to isolated, inadvertent, or de minimis practices or policies relative to the organization's overall programs if corrected promptly. IRS should not seek to treat interest on bonds as taxable while a good-faith correction is pending.

No financings can occur unless borrower's counsel conducts diligence and delivers an opinion that the borrower is an organization described in section 501(c)(3) of the Code and is not operated in a manner that would adversely affect that status. The Proposed Regulations significantly affect the practical ability to undertake that critical analysis due to their broad, standardless formulation, which is not accompanied by examples. Any final regulation should provide guidance on the following questions:

1. *Scope of covered programs and "for any purpose."* We request examples illustrating what constitutes an "other school-administered or school-supported program," and whether the rule reaches, for example, affinity events and observances, student organizations, faculty and staff matters, third-party scholarships or programs that a school merely publicizes or hosts, and activities of affiliated or related organizations (including separately incorporated foundations and obligated group members). We ask for clarification on treatment of such events that are open to all participants and do not exclude anyone.

2. *How loss of status operates.* Section1.501(c)(3)–2(a) of the Proposed Regulations provides that a noncompliant private school is not described in section 501(c)(3) of the Code "with respect to any taxable year" described in paragraph (d). We request confirmation that loss of status is determined on a year-by-year basis and applies only to the taxable year or years in which the failure occurs; such status is automatically restored once the failure is corrected; and loss of status takes effect only upon a revocation by the IRS and only after the exhaustion of administrative remedies and, if so, as of what date.

3. *Religiously based and other permitted criteria.* The preamble states that the Proposed Regulations would not preclude selection on the basis of religious affiliation or the use of criteria such as income, geography, or first-generation status. We request that these statements be incorporated into the regulatory text, together with guidance on whether or when a facially neutral criterion that might correlate with race would be treated as discriminatory.

It is critical that IRS and Treasury fully evaluate the economic and social consequences of this proposed action, particularly on entirely innocent students, taxpayers and bondholders who may suffer as the school's financial stability corrodes if bonds become taxable. We believe several conclusions in the preamble appear to understate the effect of the Proposed Regulations.

First, the preamble assumes that postsecondary schools have already conformed their admissions, scholarship and loan programs. But the United States Supreme Court decision addressed admissions and did not reach every scholarship, program, or activity covered by the Proposed Regulations, and private primary and secondary schools were not directly subject to it.

Second, the preamble characterizes the burden of restricted endowments as limited because such funds represent no more than 16 percent of scholarship dollars. That figure does not account for the legal cost, time, and uncertainty of modifying donor restrictions and even the impossibility under state law of making requisite changes.

Third, the preamble assumes that schools can shift to alternative criteria at low cost and that effects on athletic and other programs will be insignificant, without data supporting those assumptions.

Finally, as noted, the preamble does not address the potential effect on bondholders and taxpayers on the cost of capital for private schools, or on the municipal market. Notably, this will include fully compliant institutions which still may pay market penalties because of the effect of market loss of appetite for what may be considered riskier investments.

We request that Treasury and the IRS revisit these conclusions, including the certification under the Regulatory Flexibility Act, in light of these considerations.

As noted above, Treasury and the IRS expect that the Proposed Regulations will apply to taxable years beginning after May 31, 2027. For a school with a fiscal year beginning June 1 or July 1, that date could fall only a few days or weeks after final regulations are published. That period is grossly insufficient for schools to review all of their programs, obtain donor consents or court approvals, and amend policies, and for counsel to update diligence procedures. We therefore request that the applicability date be deferred to taxable years beginning at least 24 months after publication of final regulations, and that the transition relief requested above be adopted.

NAHEFFA appreciates the opportunity to comment on the Proposed Regulations and would welcome the opportunity to discuss these comments with Treasury and IRS personnel. Please contact Charles Samuels, NAHEFFA General Counsel, casamuels@mintz.com, 202-255-6696, with any questions.

Respectfully submitted,

Charles Samuels