ICNL INTERNATIONAL CENTER FOR NOT-FOR-PROFIT LAW

Evolving threats to the tax-exempt status of 501(c)(3) nonprofits

Briefer - April 2025

The tax-exempt status of 501(c)(3) nonprofits is facing new types of scrutiny. In the past year, Congressional committees have called on the IRS to investigate 501(c)(3) groups working on Palestinian rights, voting rights, and other issues, and revoke their tax-exempt status. Last fall, the House of Representatives passed a bill that would have granted broad discretion to the Treasury Secretary to suspend the tax-exempt status of nonprofits the Secretary deemed "terrorist supporting organizations." An Executive Order issued in March 2025 has raised concerns that the administration will seek to revoke particular groups' tax-exempt status based on an expansive definition of activities with an "illegal purpose." And in April 2025 President Trump called for the revocation of Harvard University's tax-exempt status for "pushing political, ideological, and terrorist inspired/supporting 'Sickness'" not in the "public interest."

501(c)(3) organizations must meet a number of requirements in order to qualify for tax exemption. They must (1) be organized and operated for an exempt purpose; (2) not engage in any amount of electioneering; (3) not engage in lobbying activity above a certain threshold; (4) not engage in private benefit or inurement.

Failure to meet these requirements can result in revocation of an organization's exempt status. This briefer focuses on three other avenues by which organizations may lose their 501(c)(3) tax exemption that have attracted significant recent attention:

- Illegal purpose or activities;
- Activity contrary to fundamental public policy; and
- Support for terrorism.

The briefer then discusses measures in place to prevent politicized investigations by the IRS and steps nonprofits can take to protect themselves.

Changes in enforcement or the law related to these grounds for revoking tax-exempt status can have ramifications for a broad range of nonprofits. As discussed further below, groups across the political spectrum have expressed alarm at the specter of the IRS applying politicized scrutiny of organizations during tax-ex-

This briefer focuses on three avenues by which 501(c)(3) nonprofits can lose their tax-exempt status:

(1) illegal purpose or activities;

(2) activity contrary to fundamental public policy; and

(3) support for terrorism.

It analyzes measures in place to prevent politicized investigations by the IRS and steps nonprofits can take to protect themselves.

empt determinations. Enforcement based on organizations' protected speech or associational interests would violate these groups' First Amendment rights as well as potentially legislative protections. Amidst rising concerns about politicized targeting, the IRS should approach revocation of tax-exempt status in a consistent, narrow, and nonpartisan manner that protects Americans' constitutional rights, as should the federal government in relation to designating nonprofits as supporters of terrorism.

Illegal Purpose or Activities

Under the illegality doctrine, which is a common law doctrine that derives from English charitable trust law, a 501(c)(3) organization can lose its tax-exempt status if its purpose is illegal or it is engaged in substantial illegal activity. The House Ways and Means Committee has written several letters to the IRS in the past year urging it to investigate whether certain nonprofits, particularly groups that express support for Palestinian rights, should lose their tax-exempt status for allegedly supporting illegal activities. The letters claimed that these organizations supported terrorist organizations or protests that have involved illegal activities such as property vandalization, assault, or trespass. Likewise, in 2021, the Ranking Member of the Senate Finance Committee urged the IRS to revoke the tax-exempt status of organizations that "played a role" in "inciting or committing" illegal acts on January 6th, citing groups that allegedly helped spread voter fraud claims or urged protesters to the U.S. Capitol. While the illegality doctrine has an important role in regulating nonprofits, the IRS has traditionally interpreted it in a narrow and proportionate manner. An expansive interpretation of illegal activities by the IRS raises the potential for abuse and infringement of First Amendment protected rights.

The IRS and courts have denied or revoked tax-exempt status from organizations with an illegal purpose. In an early application of this doctrine, the IRS in the 1970s found that an anti-war nonprofit did not qualify for 501(c)(3) tax-exempt status because it was formed to promote world peace through nonviolent, but often unlawful direct action where "demonstrators [were] urged to commit acts of civil disobedience." The IRS explained that "[t]he intentional nature of this encouragement preclude[d] the possibility that the organization might unfairly fail to qualify for exemption due to an isolated or inadvertent violation of a regulatory statute." As such, the IRS determined the group had "an illegal purpose." IRS General Counsel Memo 34631 later opined that demonstrations constitute a valid form of expression that is "affirmatively charitable," but emphasized that if illegal acts at a demonstration make up a substantial part of an organization's activities it would be ineligible for 501(c)(3) status.

Where an organization does not have an illegal purpose, but has engaged in illegal activities, the IRS has historically considered whether an organization's illegal activity is "substantial" enough to justify revoking its tax-exempt status. In doing so, the IRS evaluates both "quantitative" and "qualitative" factors. The IRS will weigh the time and attention an organization devotes to an illegal activity ("quantitative" considerations) and both the seriousness of the illegal activity and the extent to which it can be attributed to the organization ("qualitative" considerations). The IRS explains, for example, that "a great many violations of local pollution regulations relating to a sizable percentage of an organization's operations would be required to disqualify it from 501(c)(3) exemption. Yet, if only .01% of its activities were directed to robbing banks, it would not be exempt."

In March 2025, President Trump issued an executive order on public service loan forgive-

ness. The order declares that individuals employed by organizations "whose activities have a substantial illegal purpose" are ineligible for public service loan forgiveness. This is accurate, as far as it goes. However, as examples of this illegal purpose, the executive order calls out organizations that "aid or abet violations of . . . federal immigration law," "support[] terrorism," "engag[e] in a pattern of aiding and abetting illegal discrimination," and engage in a pattern of violating state tort laws including those against trespassing, public nuisance, and disorderly conduct, among others. While the order does not explicitly reference 501(c)(3) tax-exempt status, it indicates that the administration may push the IRS to aggressively reinterpret the illegality doctrine to use it to revoke the exempt status of organizations performing activities typically permitted by law. For example, a nonprofit that provides charitable assistance to undocumented immigrants could be accused of aiding and abetting violations of federal immigration law or a nonprofit that provides DEI trainings might be accused of engaging "in a pattern of aiding and abetting illegal discrimination."

The IRS should continue to narrowly interpret the illegality doctrine. Organizations that engage in substantial illegal activity or have an illegal purpose are ineligible for 501(c)(3) tax-exempt status. However, the IRS has made clear that minor or insubstantial violations of the law are not sufficient grounds for losing exempt status. The IRS also should not consider an organization to have an illegal purpose unless it intentionally promotes violation of the law and such promotion is not an isolated or minor incident, but part of its purpose. Without these guard rails, the IRS might, in many contexts, try to use the illegality doctrine to deny or revoke the 501(c)(3) status of organizations whose purpose or activities simply do not align with the current administration's priorities.

Contrary to Fundamental Public Policy

In addition to the prohibition on illegal purposes, 501(c)(3) organizations must serve a purpose that is not "contrary to public policy" – or what the Supreme Court has clarified is a purpose not "contrary to *fundamental* public policy". Although this common law standard has historically had very limited application, it has attracted new attention following President Trump's recent call to revoke Harvard's tax-exempt status for not serving a "public interest," as well as citations to the doctrine in recent letters from members of Congress and complaints by activist organizations to the IRS.

The IRS used this doctrine to argue in a ruling in 1971 that private schools that practiced racial discrimination should not qualify for tax-exempt status because such discrimination was "contrary to public policy". The IRS noted that while racial discrimination by private schools was not prohibited by federal law, decades of federal laws and court rulings demonstrated "well-settled" federal policy against it and under the common law that charities could not have a purpose that was "illegal *or contrary to public policy*." The Supreme Court broadly endorsed the IRS's approach in a 1983 decision upholding the revocation of 501(c)(3) status from Bob Jones University, which among other discriminatory policies prohibited interracial dating, and Goldsboro Christian Schools, which largely accepted only white students. While the schools' policies were not barred by federal law at the time, the Court found that they violated "fundamental public policy against racial discrimination in education," and thus the schools' were not entitled to tax exemption.

In determining what constituted "fundamental public policy," the Court pointed to policy statements by all three branches of govern-

ment on racial discrimination: the Court's own jurisprudence, starting with their decision in *Brown v. Board of Education;* Congress's adoption of the Civil Rights Act of 1964 and "numerous enactments" thereafter; and executive orders and actions by the executive branch spanning at least three decades. Citing the common law standard of "charity," the Court noted that charitable exemptions are based on the theory that the "benefits resulting from promotion of the general welfare" outweigh lost tax revenue. The Court continued that to warrant exemption under 501(c)(3), an entity's purpose "must not be so at odds with the common community conscience as to undermine any public benefit that might otherwise be conferred."

Despite the Court's broad language in *Bob Jones*, it cautioned that a "declaration that a given institution is not 'charitable' should be made only where there can be no doubt that the activity involved is contrary to fundamental public policy." In practice, actual application of "fundamental public policy" grounds in 501(c)(3) determinations has been quite limited. In the more than five decades since formally recognizing the doctrine of "contrary to public policy," the IRS has invoked "public policy" argument almost exclusively in the context of racial discrimination in education. And the courts have not applied the doctrine in other types of cases. In the rare instances in which the IRS invoked "public policy" outside that context, the agency has relied on other grounds to withhold exempt status; "public policy" arguments merely provided additional support.

In defining "charitable," the IRS has not considered racial discrimination to include race-based affirmative action policies if their "purpose and effect is to promote the establishment and maintenance of that school's racially nondiscriminatory policy as to students." There is some concern that the administration may try to push the IRS to expand the definition of "contrary to fundamental public policy" and place greater reliance on this doctrine in status determinations. On his second day in office, President Trump issued an executive order that implied that many employers' race- and sex-based preferences may violate federal civil rights law, and ordered the Attorney General to identify private sector entities, including nonprofits, that engaged in "illegal DEI." In addition, the American Alliance for Equal Rights petitioned the IRS in April 2025 to investigate three foundations with scholarship and grant programs that are available only to racial minority applicants, claiming that programs that exclude white applicants "violate[d] established public policy." Without waiting for the IRS to potentially challenge its status, one of the foundations—the Gates Foundation—changed the criteria of their scholarship program to be race neutral.

Advocacy and other activities including protests over Palestinian rights have also triggered calls for applying the "fundamental public policy" doctrine to revoke tax status. In 2024, 16 U.S. Senators asked the IRS to examine the tax-exempt status of three nonprofits involved in pro-Palestine protests. Citing one group's alleged endorsement of Hamas's attack on Israel and calls to confront Zionism on U.S. college campuses, the Senators specifically emphasized that exempt status could be withheld on grounds that the organizations activities "contravened public policy," even though they were legal. Similarly, after the faculty at the City University of New York (CUNY) law school adopted a resolution supporting the Boycott, Divestment and Sanctions (BDS) movement in 2023, legal groups called on the IRS to investigate the law school's status, as its "pro-BDS and antisemitic stance is contrary to public policy."

In April 2025, amidst Harvard's rejection of demands by the Trump administration to change policies at the school, President Trump posted on social media: "Perhaps Harvard should lose its Tax Exempt Status and be Taxed

as a Political Entity if it keeps pushing political, ideological, and terrorist inspired/supporting 'Sickness?' Remember, Tax Exempt Status is totally contingent on acting in the PUBLIC INTEREST!" His comments came amidst reports that the IRS was considering revocation of the university's tax-exempt status.

While the "contrary to fundamental public policy" basis for revoking or denying tax-exempt status has had very limited scope and application in the past, these recent actions may signal new interest in its expansion. This raises the risk the doctrine could be abused to target nonprofits with which the government simply disagrees – whether it is a pro-choice or pro-life organization or a group supporting or opposing the death penalty. Such an action though would run counter to the Supreme Court's decision in Bob Jones University that stated that it can only be applied "where there can be no doubt that the activity involved is contrary to fundamental public policy." The historical narrow use of the doctrine would warn against its reliance in any context outside the issue in *Bob Jones University*, which involved the U.S.'s unique history with race, slavery, and discrimination. Expressing unpopular, minority, or even repugnant viewpoints is not contrary to public policy and, in fact, plays a vital role in U.S. democratic life and debate. As the Supreme Court stated in 2024 in National Rifle Association of America v. Vullo, "At the heart of the First Amendment's Free Speech Clause is the recognition that viewpoint discrimination is uniquely harmful to a free and democratic society."

Support for Terrorism

Under U.S. law, it is a criminal offense to provide "material support" to a foreign terrorist organization or to engage in terrorism. In Holder v. Humanitarian Law Project (2010), the U.S. Supreme Court upheld a broad reading of the offense of "material support," which includes providing not just funding, but also "expert advice or assistance" to a foreign terrorist organization, even if that assistance is not intended to further a terrorist act. Since this activity is unlawful, nonprofits that support terrorism can have their tax-exempt status revoked for engaging in substantial illegal activity or having an illegal purpose.

After the terrorist attacks of September 11, 2001, a separate provision, 501(p), was added to the U.S. tax code. Under 501(p) if an organization is designated by the executive branch as supporting or engaging in terrorist activity its tax exemption is automatically and immediately suspended. Under 501(p), there is no review by the IRS of whether the organization supports terrorism, but rather the organization's tax-exempt status is automatically suspended if the executive makes this designation using one of multiple prescribed ways through other existing legislation or executive orders.

In practice, the federal government has used authority under Executive Order 13224 to designate nonprofits that then have their tax-exempt status suspended under 501(p). Amongst other measures, Executive Order 13224 allows the Secretary of Treasury in consultation with the Secretary of State and Attorney General to designate organizations or individuals if they "assist in, sponsor, or provide financial, material, or technological support for, or financial or other services to or in support of" terrorism or to other persons or entities designated under the executive order. Any individual or organization, including a nonprofit, that is designated under Executive Order 13224 as supporting or engaging in terrorism will have their assets blocked by the Office of Foreign Assets Control (OFAC). Under 501(p) of the tax code, the IRS will also automatically suspend their tax-exempt status – to date 9 organizations have had their tax-exempt status suspended in this manner. The designation process under Executive Order 13224 has been criticized for lack of clear knowledge or intent requirements on

the part of the organization being designated; opaque evidentiary standards; lack of an opportunity to challenge a potential designation; and inadequate redressal mechanisms after designation.

In the wake of Hamas's attack on Israel on October 7, 2023, Israel's invasion of Gaza, and subsequent protests in the U.S., a number of Members of Congress have called for nonprofits that they claim support or have connections to terrorism to lose their tax-exempt status. In 2024, Members of Congress introduced HR 6408 and, subsequently, HR 9495 to expand 501(p). Both bills passed the House, but neither the Senate. This proposed legislation would not have changed the current 501(p) designation process. Rather, it would have allowed for a new designation process of a nonprofit as a "terrorist supporting organization" through the sole authority of the Treasury Department if the nonprofit provided material support or resources to a foreign terrorist organization or another terrorist supporting organization. The proposed legislation led to widespread concern that the proposed process could be abused to curb free speech and target nonprofits disfavored by the government. Critics claimed it was unnecessary given preexisting avenues to revoke the exempt status of a nonprofit that supported terrorism; provided Treasury Department officials too much discretion to make the designation based on unclear criteria; and created a different – potentially stricter – standard for penalizing nonprofits that the government claimed supported terrorism than commercial enterprises or other entities that might be engaged in identical conduct.

Terrorism and support for terrorism is already illegal under U.S. law. Unless it can show that an organization violated criminal law related to terrorism – such as knowingly providing material support to a designated foreign terrorist organization – the government should not suspend an organization's tax-exempt status on grounds of supporting terrorism. In other words, there should not be a separate terrorism standard for tax-exempt organizations that is different from the criminal law standard as a broader standard is both confusing for nonprofits and susceptible to politicized misuse. Doing so would raise clear First Amendment and due process concerns.

Protecting Nonprofits from Politicized Enforcement

Concerns about the improper targeting of nonprofits is a bipartisan issue. While Democrats have recently voiced alarm about how legislation like HR 9495 could be selectively weaponized against parts of the nonprofit sector associated with liberal causes, Republicans have long expressed concern that the IRS has unfairly targeted nonprofits associated with conservatives, including pro-life organizations and Tea Party affiliated organizations. The latter helped lead to a bi-partisan Senate Report that found during the Obama administration the IRS had inappropriately selected for scrutiny the applications of Tea Party as well as some left-leaning organizations applying for tax-exempt status because of their names and policy positions rather than indications of potential political campaign contributions. During the Trump administration, the IRS later apologized and agreed to a settlement with some of the groups involved.

Congress has put in place measures that make it illegal for the President to direct the IRS to target nonprofits or others. One of the articles of impeachment against President Richard Nixon listed his attempts to have the IRS discriminatorily target perceived political opponents, including nonprofits, for audit or investigation. In the wake of Nixon's resignation, Congress enacted 26 USC 7217, which prohibits executive branch influence over taxpayer audits. Under the statute, it is unlawful for senior

members of the executive branch "to request, directly or indirectly, any officer or employee of the Internal Revenue Service to conduct or terminate an audit or other investigation of any particular taxpayer with respect to the tax liability of such taxpayer," unless they meet a set of limited exemptions. If any IRS officer or employee receives a request that falls under this law they must report it to the Treasury Inspector General for Tax Administration. Violation can lead to imprisonment of up to 5 years.

A vibrant and independent nonprofit sector is central to U.S. democracy. Tax-exemption should be enforced in a consistent and non-politicized manner that protects Americans' First Amendment and other constitutional rights. No administration should be able to weaponize the IRS to attack organizations with which it disagrees. As a DC district court judge found, "discrimination on the basis of political viewpoint in administering the United States tax code violates fundamental First Amendment rights."

Steps Nonprofits Can Take to Protect Themselves

Given these evolving threats to 501(c)(3) tax-exempt status, nonprofits can take a number of steps to help protect themselves. These include:

► **MONITORING**. Monitor developments in IRS enforcement of requirements for tax-exempt status as well as potential legislative or regulatory changes affecting tax-exempt requirements or the ability to carry out charitable purposes.

► **INTERNAL COMPLIANCE**. Ensure internal regulatory compliance. Amongst other requirements, a 501(c)(3) organization must be organized and operated for an exempt purpose. Organizations should also ensure they do not engage in unlawful activity, have an unlawful purpose, or provide material support to organizations or individuals designated as Specially Designated Nationals or improperly engage with other sanctioned nationals or blocked persons (maintained by OFAC).

Preparing for a potential government investigation. Prepare for a potential IRS or other government investigation or audit. Steps might include assessing risk for an enforcement action and taking steps to mitigate this risk, having a plan on how to respond to an enforcement action (including how to communicate with staff, funders, and the public), putting into place an appropriate document retention policy, and identifying legal counsel in advance.

► **UNDERSTANDING THE PROCESS**. The IRS determines if an organization has violated the illegality doctrine, conducts activities contrary to public purpose, or fails other requirements for tax exemption. The IRS maintains general information about audits and the appeals process for an adverse determination. During an audit and appeals process the organization will generally maintain its tax-exempt status. During an appeal of an adverse determination, contributions of up to $1,000 are deductible even if the nonprofit ultimately loses its exempt status (contributions over $1,000 are deductible if the organization succeeds in retaining its exempt status). Even if 501(c)(3) tax-exempt status is ultimately revoked an organization remains a nonprofit corporation, although a taxable one. The IRS does not have authority to shut down the organization or take control of its assets. On the other hand, it is not the IRS, but rather other parts of the Executive that can designate an organization as supporting a foreign terrorist organization and so automatically have its tax-exempt status suspended under 501(p) of the tax code. OFAC can freeze the assets of an organization designated as supporting terrorism. In that situation, appeal of such a designation is to a U.S. federal court.

► **RECOGNIZING RISK VERSUS NOISE.** Members of Congress, legal advocacy groups, and even the President have publicly claimed that specific nonprofits should have their tax-exempt status revoked for allegedly violating the illegality doctrine, engaging in activity contrary to fundamental public policy, or supporting terrorism. While there are legal risks nonprofits should be aware of, many assertions by political actors are simply that—assertions—and not necessarily backed by the law or made with legal authority. There are significant legal protections, including under the Constitution, against politicized or overbroad enforcement actions targeting nonprofits' tax-exempt status.

FOR MORE INFORMATION CONTACT

Elly Page (epage@icnl.org),

Lily Liu (lliu@icnl.org), or

Nick Robinson (nrobinson@icnl.org).