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Nonprofits Under Fire: How the IRS Can – and Cannot – Revoke Federal Tax-Exempt Status

On April 15, 2025, President Trump called for the revocation of Harvard University's 501(c)(3) tax-exempt status.[1] This comes as environmental groups are dealing with rampant rumors that the Trump administration may be moving – reportedly through an Executive Order to be issued on Earth Day (April 22) – to redefine the IRS' qualifications for 501(c)(3) tax-exempt status in a way that excludes conservation and climate nonprofits. All of this follows President Trump's March 7th Executive Order which ordered the U.S. Secretary of Education to propose regulations that exclude from the federal Public Service Loan Forgiveness program nonprofit organizations that the administration believes do not qualify for 501(c)(3) tax-exempt status due to having a "substantial illegal purpose," which it defines to include those that aid or abet violations of federal immigration laws, support terrorism, aid or abet illegal discrimination, or violate state tort laws (including those against trespassing, disorderly conduct, or public nuisance), among others. Finally, there were the complaints filed recently by Ed Blum's American Alliance for Equal Rights with the IRS asking the Service to audit and revoke the tax-exempt status of the Gates Foundation and two other 501(c)(3) foundations due to their race-restricted scholarship programs, as well as a recent editorial by a *Wall Street Journal* editor calling for the IRS to audit and revoke the exempt status of 501(c)(3) organizations that engage in "illegal" DEI (diversity, equity, and inclusion) activities as one of their principal purposes.

While these announcements have sent a wave of fear, apprehension, and alarm through wide swaths of the nonprofit sector, it is important to note that neither the President, the Justice Department, the Treasury Department, nor the

IRS have the ability to revoke the federal tax-exempt status of any entity through Executive Order or with the mere stroke of a pen.[2] There are well-established procedures for revoking federal tax exemption. As described below, those procedures require individual case-by-case IRS audits of each organization, with ample opportunity for the entity to defend itself, and including multiple routes of appeal. There simply is no lawful mechanism for the President, IRS, or others in the Trump administration to revoke the tax-exempt status of multiple nonprofits – or even a single nonprofit – without following this longstanding process.

Note that nonprofit organizations are generally organized and operated as both nonprofit *and* tax-exempt entities. "Nonprofit" status refers to incorporation status under state corporate law; "tax-exempt" status refers to federal income tax exemption under the Internal Revenue Code (IRC). Even if, following the IRS audit and appeal process (and any ensuing litigation), an organization's tax-exempt status is revoked, it still remains a nonprofit corporation (albeit a taxable one). Even post-revocation, the IRS has no authority to shut down a nonprofit, seize its assets, or otherwise take control of the organization.

If the IRS questions the federal tax-exempt status of a nonprofit organization, it can initiate an audit (technically called an "examination") of the organization, auditing one or more IRS Forms 990 that were filed by the entity; those are the tax years under examination and the IRS is effectively determining whether the Forms 990 at issue were accurate and reflected full compliance with the applicable tax laws. For 501(c)(3) tax-exempt organizations (which comprise the vast majority of all tax-exempt entities), there can be many bases for threats to their exempt status, including not meeting the "organizational" or "operational" tests, private inurement, impermissible private benefit, having a substantial non-exempt purpose, engaging in too much lobbying, engaging in prohibited political campaign activity, or having too much unrelated business income, among others.

The IRS conducts several types of audits of exempt organizations. The two most common are correspondence examinations and field examinations, the latter being much more invasive, involving one or more auditors on site reviewing information and documents and conducting interviews. Field exams generally take several months to conduct, at a minimum, and often much longer.

There are four potential outcomes of an IRS examination of an exempt organization: a no-change letter, no-change letter with written advisories, negotiated closing agreement, or proposed revocation of exempt status. The first three outcomes enable the organization to retain its tax-exempt status, but in the second or third options, with certain conditions and/or required changes.

If the IRS concludes an audit with a proposed revocation, the organization will have 30 days (or longer if an extension is negotiated) to "protest" the proposed ruling and avail itself of the IRS Appeals process. During the pendency of the IRS Appeal, the organization remains tax-exempt, and during the pendency of the audit and appeal process, the IRS is barred by law from disclosing anything publicly about the matter. Once the protest is filed, it will be assigned to an IRS Appeals Officer, and the organization (and/or its representative(s)) will have the opportunity to have an Appeals conference with the Appeals Officer to make its case for denying the proposed revocation or otherwise proposing a settlement. Note that the Appeals conference is an informal meeting between the organization's representatives and the Appeals Officer; the IRS agent who conducted the underlying examination does not participate in the conference. The Appeals Officer (with the approval of their manager) has broad authority to order the IRS examination division to issue a no-change letter or no-change letter with written advisories, to negotiate a settlement with the organization, or to finalize the revocation.[3]

If the IRS Appeals Officer decides to uphold the proposed revocation, the organization will be issued a final adverse determination letter, at which point the entity will have lost its federal tax exemption. The revocation will be published in the Federal Register. Following the receipt of the letter, the organization will have 90 days to petition the U.S. Tax Court, the U.S. Court of Federal Claims, or the U.S. District Court for the District of Columbia for a declaratory judgment as to its qualification for tax-exempt status.[4] Like other federal litigation, if unsuccessful at the lower court level, appeals by the nonprofit organization or the IRS to higher courts are permitted.

If, at the end of the process, the nonprofit loses its federal tax-exempt status, as stated above, it still remains a private nonprofit corporation, just a taxable one, required to file IRS Forms 1120 (the federal corporate tax return) annually and pay federal (and state, if applicable) corporate income tax on its net annual income. Of course, if the nonprofit makes the necessary conforming changes to its

organization or operations, it always has the option to prospectively re-apply to the IRS for recognition of its 501(c)(3) tax-exempt status. It also has the option to transfer its assets to an existing 501(c)(3) entity or to a newly created 501(c)(3) organization, following which it can then dissolve (once all outstanding liabilities have been satisfied).

[1] Note that federal law (26 U.S. Code Section 7217) prohibits senior officials of the executive branch, including the President, from requesting that the Internal Revenue Service (IRS) conduct or cease an audit or other investigation of any taxpayer (including tax-exempt entities); there is an exception for written requests by the Treasury Secretary to the IRS as a consequence of the implementation of a change in tax policy.

[2] Congress would seemingly have such authority, but, to date, such legislative action has not been publicly contemplated.

[3] Note that the IRC provides that a court may not issue a declaratory judgment unless the court determines that the organization (or individual) has exhausted their administrative remedies, including the IRS Appeals process.

[4] Note that if the court petition is filed prior to the issuance of the final adverse determination letter, the IRS is not permitted to revoke the organization's tax-exempt status during the pendency of the litigation.

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