



**SCHOOL OF LAW**  
TEXAS A & M UNIVERSITY

Texas A&M University School of Law  
**Texas A&M Law Scholarship**

---

Faculty Scholarship

---

2012

# Choice of Entity Considerations for Charitable Organizations

Terri Lynn Helge

*Texas A&M University School of Law*, [thelge@law.tamu.edu](mailto:thelge@law.tamu.edu)

Follow this and additional works at: <https://scholarship.law.tamu.edu/facscholar>



Part of the [Business Organizations Law Commons](#), and the [Nonprofit Organizations Law Commons](#)

---

## Recommended Citation

Terri L. Helge, *Choice of Entity Considerations for Charitable Organizations*, 39 *Tex. Tax Law* 17 [1] (2012).

Available at: <https://scholarship.law.tamu.edu/facscholar/629>

This Article is brought to you for free and open access by Texas A&M Law Scholarship. It has been accepted for inclusion in Faculty Scholarship by an authorized administrator of Texas A&M Law Scholarship. For more information, please contact [aretteen@law.tamu.edu](mailto:aretteen@law.tamu.edu).



# THE TEXAS TAX LAWYER

Spring 2012  
Vol. 39, No. 3  
[www.texasbar.org](http://www.texasbar.org)



# Choice of Entity Considerations for Charitable Organizations

By: *Terri Lynn Helge*<sup>1</sup>

**I. Introduction.** This article discusses choice of entity issues related to the formation, operation and governance of nonprofit organizations, highlighting the distinctions between charitable organizations formed as charitable trusts and charitable organizations formed as nonprofit corporations. In determining the legal structure for a new nonprofit entity, considerations that need to be taken into account include: (1) ease/speed of formation; (2) limitation of liability for members and directors; (3) financial resources; (4) type and scale of activities to be conducted; (5) governance requirements; (6) capacity to own property and contract; (6) capacity to sue and be sued; (7) liabilities to third parties; (8) permanence of the organization; and (9) ease of dissolution.

## **II. Formation.**

A. Charitable Trust. The charitable trust is the oldest form of nonprofit entity. A charitable trust establishes fiduciary relationship with respect to property between the trustee and the charitable beneficiaries. Texas law defines a charitable trust as ~~a~~ charitable entity, a trust the stated purpose of which is to benefit a charitable entity, or an inter vivos or testamentary gift to a charitable entity.” TEX. PROP. CODE § 123.001(2). Assets contributed to a charitable trust are irrevocably dedicated to charitable purposes. A charitable trust is created by a settlor irrevocably transferring property to a person or entity as trustee with the intention of creating a trust, and is typically evidenced by a written trust agreement executed by the settlor and the initial trustee or a provision in the settlor’s duly probated will. Charitable trusts are governed by the Texas Trust Code which includes provisions specifically directed at charitable trusts. *See* TEX. PROP. CODE § 123.001 et seq. Additionally, a large body of common law applies to charitable trusts.

B. Nonprofit Corporation. The nonprofit corporation is the predominant form of charitable organization in the United States. A nonprofit corporation is defined as a corporation that is prohibited from distributing its income to its members, directors or officers in the form of dividends or otherwise. TEX. BUS. ORG. CODE § 22.001(5). Nonprofit corporations are governed by the Texas Business Organizations Code which includes provisions specifically directed at nonprofit corporations under the Nonprofit Corporation Law. *See* Tex. Bus. Org. Code § 22.001 et seq. Formation of a nonprofit corporation begins with filing a Certificate of Formation with the Secretary of State of Texas. The Certificate of Formation generally contains the name of the corporation, the purposes of the corporation, the names of the initial directors, the name and address of the registered agent, and restrictions on distributions of assets of the corporation upon its dissolution if it is a charitable corporation. The Certificate of Formation may also contain other provisions permitted by state law such as indemnification of

directors and officers and limitation of liability provisions for directors and officers. The nonprofit corporation is incorporated when the Secretary of State issues a Certificate of Filing evidencing that the Certificate of Formation has been accepted for filing. Next, Bylaws for the corporation must be drafted. Bylaws are the set of procedures or internal rules governing the corporation. Bylaws typically contain provisions regarding meetings of the members and directors, election of directors and officers, duties of directors and officers, and committees of directors, and other miscellaneous matters, such as fiscal year and procedures for amending the Bylaws. Finally, the initial directors must hold an organizational meeting at which the Bylaws are adopted, the officers are elected and a number of other organizational resolutions are adopted, such as authorizing depository accounts and filing for tax exemption.

### III. Governance Structure.

- A. Charitable Trusts. Charitable trusts are managed by trustees who have the legal authority to do all things necessary to administer the trust. Texas law does not require the trustees to have periodic meetings or to keep minutes of any meetings held by the trustee. Title to trust assets is held in the individual names of the trustees. Accordingly, conveyance of the assets of a charitable trust generally requires the signature of all trustees. Under Texas law, a charitable trust may be managed by a single trustee, including the settlor of the trust. When more than one trustee is serving, the decision of a majority of the trustees serving controls. *See* TEX. PROP. CODE § 113.085. If a dissenting trustee believes that the action approved by the majority of trustees would result in a serious breach of trust, then the dissenting trustee must exercise reasonable care to prevent a co-trustee from committing a serious breach of trust or compel a co-trustee to redress a serious breach of trust.; otherwise the dissenting trustee is jointly liable for the action taken by the majority of trustees. *See* TEX. PROP. CODE § 114.006.
- B. Nonprofit Corporations. Nonprofit corporations may be member organizations or non-member organizations. Typically, nonprofit corporations are managed by a board of directors (sometimes called the board of trustees). Texas law requires a minimum of three directors of a nonprofit corporation. TEX. BUS. ORG. CODE § 22.204(a). The approval of a majority of the directors present at a meeting at which a quorum is present generally is required to constitute the action of the board of directors. TEX. BUS. ORG. CODE § 22.214. The board of directors is ultimately responsible for the oversight of the nonprofit corporation. The board is the sole policy making authority of the corporation. The board of directors is required to have a minimum of one meeting annually and to keep minutes of all the meetings of the board. The board of directors elects the officers of the nonprofit corporation who are responsible for the day to day management of the corporation. *See* TEX. BUS. ORG. CODE § 22.232(b). If the nonprofit corporation has members, then the members typically elect the directors and have the authority to approve certain fundamental changes with respect to the organization, such as merger, dissolution, amendment to the Certificate of Formation or the Bylaws, or sale of substantially all of the corporation's assets. *See* TEX. BUS.

ORG. CODE § 22.164. In dealing with the membership, the board must act fairly. The board can curtail or abolish the members' rights, but the membership must have adequate notice, information and the right to vote upon such changes.

**IV. Fiduciary Duties of Directors and Trustees.** Regardless of the choice of form for the charity, all decision makers owe certain fiduciary duties to the organizations they serve. The fiduciary standards applicable to charitable directors and trustees include the duty of care, the duty of loyalty, and the duty of obedience. Additional standards may apply with respect to the investment of the charity's assets. These fiduciary standards vary somewhat depending on whether the charity is formed as a nonprofit corporation or a charitable trust. As a general observation, however, trustees of charitable trusts are normally held to stricter standards of fiduciary behavior than directors of nonprofit corporations. While some have argued for the higher trustee standard to apply to nonprofit directors, Texas law makes it clear that a director of a nonprofit corporation is not held to the fiduciary standards of a trustee of a charitable trust. *See* TEX. BUS. ORG. CODE § 22.223.

A. Duty of Care. All nonprofit managers are subject to a duty of care. At its most fundamental level, the duty of care requires a charity manager to act in good faith and with reasoned competence.

1. Charitable Trusts. To satisfy the duty of care, charitable trustees are required to exercise the care and skill that a person of ordinary prudence would exercise in dealing with their own affairs. *See* SCOTT, LAW OF TRUSTS § 174. More specifically, charitable trustees have a duty to make the assets of the trust productive while properly managing, supervising and safeguarding trust funds. *See* *InterFirst Bank Dallas v. Risser*, 739 S.W.2d 882, 900 (Tex. App.—Texarkana 1987, no writ). Charitable trustees must also administer the trust in good faith. *See* TEX. PROP. CODE § 113.051. Texas law does not define “good faith” in the context of fiduciaries. However, contrasting good faith with “bad faith” is illuminating – a fiduciary acts in bad faith when the fiduciary acts out of a motive of self-gain. *See* *Bohatch v. Butler & Binion*, 905 S.W.2d 597, 602 (Tex. App.—Houston [14<sup>th</sup> Dist.] 1995), *aff'd* 977 S.W. 2d 543 (Tex. 1998). One of the largest distinguishing factors between the duty of care for charitable trustees and the duty of care for nonprofit directors is that a charitable trustee is liable for simple negligence in the performance of the trustee's duties while a director of a nonprofit corporation generally is not.

2. Nonprofit Corporations. The duty of care requires a nonprofit director to discharge his responsibilities in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, and in a manner the director reasonably believes is in the best interests of the organization. *See* TEX. BUS. ORG. CODE § 22.221(a). The degree of skill required is that of the ordinary prudent person, that is, the basic directorial attributes of common sense, practical wisdom, and informed judgment. If a director has special expertise, such as accounting,

legal or investment expertise, then that director must exercise the degree of skill that a prudent person with similar expertise would exercise in the same or similar circumstances. The duty of care also requires that directors make decisions they reasonably believe to be in the best interests of the corporation. *See* TEX. BUS. ORG. CODE § 22.221. A director can fail to discharge the duty of care in two ways: by failing to supervise or by failing to make an informed decision. Adequate supervision means that the director actively participates in the charity's governance, such as by regularly attending board meetings, reviewing minutes and other materials disseminated to board members, meeting periodically with senior management, periodically reviewing the charity's financial statements and annual information returns (IRS Form 990), and asking questions of outside experts such as accountants and attorneys when appropriate. To make an informed decision, a director must be adequately informed about the material aspects of a proposed transaction before approving it. In discharging the duty of care, a director may rely in good faith on information, opinions, reports or statements concerning the corporation that was prepared or presented by officers, employees, a committee of the board of which the director is not a member, or outside professional advisors to the corporation (e.g., auditors, legal advisors, and investment advisors). *See* TEX. BUS. ORG. CODE § 3.102. The business judgment rule protects nonprofit directors by providing that directors will not be liable for harm to the corporation for the exercise of their judgment so long as they exercised care in the decision making process. Thus more than simple negligence on the part of the director is required to hold the director liable for a breach of the duty of care. The business judgment rule applies only in the absence of fraud, illegality or a disabling conflict of interest.

In summary, the duty of care relates to the decision-making process. If a nonprofit director acts in good faith and satisfies the requisite standard of care, a court generally will not review the action, even if it proves disastrous to the charity. Accordingly, compliance with the duty of care protects a nonprofit director from liability for decisions that, with the benefit of hindsight, turn out to be wrong.

- B. Investment Responsibility. Responsibilities with respect to the management of the charity's investment are a subsidiary of the duty of care. However, the Texas Uniform Prudent Investor Act (applicable to charitable trusts) and the Texas Uniform Prudent Management of Institutional Funds Act ("TUPMIFA") (applicable to nonprofit corporations and charitable trusts for which a charitable organization serves as trustee) contain specific provisions regarding the application of the duty of care in the management of a charity's investments. Therefore, the duties with respect to a charity's investments are discussed separately.

1. Charitable Trusts. A trustee has the duty to invest charitable funds as prudent investor would do in managing their own affairs, taking into account the purposes, terms, distribution requirements, and other circumstances of the trust. TEX. PROP. CODE § 117.004(a). In satisfying this standard, the trustee must exercise reasonable care, skill and caution. *Id.* Prudence is measured principally through the process by which investment strategies and tactics are developed, adopted, implemented and monitored. Actual performance of the investments is a secondary concern. Evaluation of a particular investment is determined in the context of the portfolio as a whole, not in isolation. TEX. PROP. CODE § 117.004(b). The trustee is allowed to consider overall return of the investment and not focus on traditional distinctions of income and principal. Diversification of investments is generally required unless the trustee reasonably determines that the purposes of the trust are better served without diversification due to special circumstances. TEX. PROP. CODE § 117.005. A trustee who has special skills or expertise, or is named trustee in reliance upon the trustee's representation that the trustee has special skills or expertise, has a duty to use those special skills or expertise. TEX. PROP. CODE § 117.004(f). Delegation of investment authority to an agent is permitted if exercise proper diligence in selecting agent, establishing criteria for agent, and periodically monitoring agent. See TEX. PROP. CODE § 117.011
  
2. Nonprofit Corporations. The Nonprofit Corporation Law does not provide for specific duties of directors with respect to the investment of the charity's assets. However, TUPMIFA prescribes specific standards regarding the investment of charitable funds held as "permanent endowment" – funds which the donor requires in writing to be held in perpetuity or for a specified period of time – by a nonprofit corporation. See TEX. PROP. CODE § 163.003. The TUPMIFA standard of investment provides "each person responsible for managing and investing an institutional fund shall manage and invest the fund in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances." TEX. PROP. CODE § 163.004(b). A person that has special skills or expertise, or is selected in reliance upon the person's representation that the person has special skills or expertise, has a duty to use those skills or that expertise in managing and investing institutional funds. TEX. PROP. CODE § 163.004(e)(6). In managing and investing an institutional fund, the following factors, if relevant, must be considered: general economic conditions; the possible effect of inflation or deflation; the expected tax consequences, if any, of investment decisions or strategies; the role that each investment or course of action plays within the overall investment portfolio of the fund; the expected total return from income and the appreciation of investments; other resources of the institution; the needs of the institution and the fund to make distributions and to preserve capital; and an asset's special relationship or special value, if any, to the charitable purposes of the institution. TEX. PROP. CODE §

163.004(e)(1). Management and investment decisions about an individual asset must be made not in isolation but rather in the context of the institutional fund's portfolio of investments as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the fund and to the institution. TEX. PROP. CODE § 163.004(e)(2). An institution is required to diversify the investments of an institutional fund unless the institution reasonably determines that, because of special circumstances, the purposes of the fund are better served without diversification. Tex. Prop. Code § 163.004(e)(4).

C. Duty of Loyalty. The duty of loyalty generally requires the charity manager to place the interests of the organization ahead of his own personal interests. Common forms of interested transactions that may pose duty of loyalty issues include: (1) use of the organizations property on a more favorable basis than available to outsiders; (2) usurpation of corporate opportunity; (3) use of material nonpublic organizational information or position; (4) insider advantages and corporate waste; and (5) competing with the organization. A breach of the duty of loyalty not only gives rise to a tort claim under state law, but may also implicate penalties under federal tax law such as the excess benefit transaction excise tax or the prohibited self-dealing excise tax.

1. Charitable Trusts. The duty of loyalty mandates that the trustee administer the trust property solely for the benefit of the beneficiaries. *See* TEX. PROP. CODE § 117.007. Under the trust standard of the duty of loyalty, the charitable trustee generally is prohibited from engaging in any act of self-dealing with the trust, no matter how fair or reasonable the transaction may be to the charity, unless the self-dealing was specifically authorized by the settlor in the trust instrument or the trustee made full disclosure of the transaction and obtained the consent of the trust beneficiaries. *See* TEX. PROP. CODE § 113.052; 113.053; 114.005. In the context of a charitable trust in which the beneficiaries are an unascertainable group of individuals, obtaining beneficiary consent for the proposed self-dealing transaction is not possible, and perhaps could be accomplished by receiving approval from the Texas Attorney General.

2. Nonprofit Corporations. In general, nonprofit directors are subject to a less exacting standard with respect to the duty of loyalty than charitable trustees. To satisfy the duty of loyalty, a nonprofit director must act in the best interests of the corporation, but does not need to avoid personal gain at all costs.

a. Conflict of Interest Transactions and Self-Dealing. In the nonprofit corporate setting, a conflict-of-interest or self-dealing transaction is not flatly prohibited, but should be carefully scrutinized. The only exception is a blanket prohibition on loans to directors of a nonprofit corporation; any director who votes for or assents to the making of the loan is jointly liable for the amount of



the loan until it is repaid. *See* TEX. BUS. ORG. CODE § 22.225. Before engaging in a self-dealing or conflict-of-interest transaction with a charitable organization, the director should disclose all material facts relating to his personal interest in the transaction to the board of directors or a committee of the board comprised of disinterested directors, and a majority of disinterested directors or committee members should approve the transaction only after concluding that it is fair and reasonable to the charity. *See* TEX. BUS. ORG. CODE § 22.230. If this procedure is followed, then the transaction is not void or voidable solely because of the director's interest in the transaction. If the transaction occurred prior to obtaining approval from a majority of disinterested directors, then the transaction may be ratified by a majority of disinterested directors or a committee of the board comprised of disinterested directors provided the transaction is fair to the nonprofit corporation. *Id.*

- b. Corporate Opportunity. A nonprofit director is prohibited from usurping corporate opportunities for personal gain. *See* Int'l Bankers Life Ins. Co. v. Holloway, 368 S.W.2d 567, 577 (Tex. 1963). If the nonprofit director learns of an opportunity that is closely related to the operations of the charity the director serves, the director has an obligation to disclose the opportunity to the charity and allow the charity a chance to accept or reject the opportunity. If the charity rejects the opportunity, then the director is free to pursue the opportunity for herself. However, if the director fails to disclose the opportunity to the charity, then the director will be held liable for the harm caused to the charity unless the director can show that the opportunity was not in the same line of business as the charity's operations, that the charity abandoned the opportunity, or that the charity did not have the necessary financial resources to pursue the opportunity.

D. Duty of Obedience. The duty of obedience requires a director to adhere to the governing documents of the organization and to faithfully adhere to its mission, and to follow restrictions imposed by donors on contributions of charitable funds. Essentially, the duty of obedience requires directors and trustees to refrain from transactions and activities that are *ultra vires*.

1. Charitable Trusts. A charitable trustee has a duty to administer the trust in a manner faithful to the wishes of the settlor. *See* TEX. PROP. CODE § 113.051. If the trustee desires a modification to the administrative terms of the trust instrument, the trustee must generally seek court approval and show one of the following: (1) because of unforeseen circumstances, the proposed modification will further the purposes of the trust; (2) modification of administrative terms of the trust is necessary to prevent waste or avoid impairment of the trust's administration; (3) the proposed

modification is necessary to achieve the settlor's tax objectives; or (4) the proposed modification is not inconsistent with a material purpose of the trust, and all the beneficiaries consent to the proposed modification or termination. TEX. PROP. CODE § 112.054(a).

If the trustee desires to change the fundamental purposes of a charitable trust, then the trustee must seek court approval of the change through a *cy pres* proceeding. *Cy pres* is an equitable procedure that is used to reform a charitable trust to prevent the trust from failing. The theory of *cy pres* is that when a charitable purpose becomes impossible, inexpedient, or impracticable of fulfillment or is already accomplished, equity will permit the trustee to substitute another charitable object which reasonable approaches the designated purpose as closely as possible. In order to reform a charitable trust's fundamental purpose under *cy pres*, the trustee must show (i) a valid charitable trust exists; (ii) the settlor's specific charitable object is frustrated, necessitating *cy pres* reform to carry out the settlor's wishes; and (iii) the settlor's general charitable intent is not limited to the precise purpose identified in the trust instrument. *See Scott v. Sterrett*, 234 S.W.2d 917, 920-21 (Tex. Civ. App.—Dallas 1950, writ ref'd n.r.e.); *see also* RESTATEMENT (THIRD) OF TRUSTS § 67. In addition, the trustee must show that the proposed modification to the trust purpose is as near as possible to the settlor's original purpose. *See English v. Johnson*, 95 S.W. 558, 560-61 (Tex. Civ. App. 1906, writ ref'd). If the named charitable beneficiary of a trust ceases to exist or no longer qualifies as a charitable entity, a *cy pres* proceeding is not necessary to change the charitable beneficiary. Rather, the trustee is authorized to name a new charitable entity as the beneficiary of the trust. TEX. PROP. CODE § 113.026.

In any proceeding involving a charitable trust, the Texas Attorney General must be given notice and the opportunity to intervene. TEX. PROP. CODE § 115.011. If proper notice is not given, then the judgment in the proceeding is voidable by the Texas Attorney General. TEX. PROP. CODE § 123.004.

2. Nonprofit Corporations. If the board of directors desires to alter the fundamental objectives of a nonprofit corporation, it must first amend its Certificate of Formation and Bylaws. Normally, these amendments can be made with only the approval of the board of directors. TEX. BUS. ORG. CODE §§ 22.102(c); 22.107. If the nonprofit corporation has voting members, then the members will also need to approve any amendments to the Certificate of Formation and Bylaws. TEX. BUS. ORG. CODE §§ 22.102(c); 22.105. However, court approval of the amendments generally is not required. The Texas Attorney General has the authority to supervise charitable organizations formed as nonprofit corporations and may intervene if the Texas Attorney General believes that the amendment of the charitable corporation's fundamental purposes is improper. Even if

the Texas Attorney General intervenes, generally courts are more lenient in allowing amendment of purposes to the Certificate of Formation of a nonprofit corporation that modification of the purposes of a charitable trust.

## V. **Liability of Directors and Trustees.**

- A. Limitation of Liability. Texas law allows for a nonprofit corporation to limit the liability of its directors to the organization or its members for monetary damages for an act or omission by the director in the person's capacity as a director by including appropriate provisions in its Certificate of Formation. *See* TEX. BUS. ORG. CODE § 7.001(b). However, the elimination or limitation of the liability of a director is not allowed to the extent the person is found liable under applicable law for: (1) a breach of the director's duty of loyalty; (2) an act or omission not in good faith that: (A) constitutes a breach of duty of the director to the organization; or (B) involves intentional misconduct or a knowing violation of law; (3) a transaction from which the director received an improper benefit, regardless of whether the benefit resulted from an action taken within the scope of the director's duties; or (4) an act or omission for which the liability of a director is expressly provided by an applicable statute. TEX. BUS. ORG. CODE § 7.001(c). Similarly, the Texas Trust Code allows the settlor of a charitable trust to exculpate the trustee from liability for breach of trust by including appropriate provisions in the trust instrument. Such exculpation from liability will not apply when the breach of trust was committed in bad faith, intentionally, or with reckless indifference to the interest of the beneficiary. TEX. PROP. CODE § 114.007 (a). Additionally, the trustee may not be relieved of liability for any profit derived by the trustee from a breach of trust. *Id.*
- B. Indemnification. Texas law allows for indemnification of directors of nonprofit corporations for costs and liabilities incurred in connection with a lawsuit filed against the director in her capacity as director of the nonprofit corporation. *See* TEX. BUS. ORG. CODE § 8.001 et seq. Such indemnification is provided by including appropriate provisions in the certificate or formation or bylaws of the nonprofit corporation. Both permissive and mandatory indemnification are authorized. Indemnification is not authorized, however, unless the director acted in good faith and reasonably believed that his conduct was in the best interests of the nonprofit corporation. TEX. BUS. ORG. CODE § 8.101. Furthermore, indemnification of a director who is found liable to the nonprofit corporation or is found liable because the director improperly received a personal benefit: (1) is limited to reasonable expenses actually incurred by the director in connection with the proceeding; (2) does not include a judgment, a penalty, a fine, and an excise or similar tax, including an excise tax assessed against the director with respect to an employee benefit plan; and (3) may not be made in relation to a proceeding in which the director has been found liable for: (A) willful or intentional misconduct in the performance of the director's duty to the nonprofit corporation; (B) breach of the director's duty of loyalty owed to the nonprofit corporation; or (C) an act or omission not committed in good faith that

constitutes a breach of a duty owed by the director to the nonprofit corporation. TEX. BUS. ORG. CODE § 8.102. The Texas Trust Code does not allow for similar indemnification of costs and liabilities of charitable trustees.

## **VI. Modification and Termination.**

- A. Charitable Trust. In general, modification or termination of a charitable trust requires court approval. *See* TEX. PROP. CODE § 112.054. Additionally, in any proceeding involving a charitable trust, proper notice must be given the Texas Attorney General and the Texas Attorney General may choose to intervene in the proceeding. *See* TEX. PROP. CODE § 123.002; 123.003. Modification of the purpose of a charitable trust requires the application of *cy pres*. *Cy pres* is an equitable procedure that is used to reform a charitable trust to prevent the trust from failing. The theory of *cy pres* is that when a charitable purpose becomes impossible, inexpedient, or impracticable of fulfillment or already accomplished, equity will permit the trustee to substitute another charitable object which reasonable approaches the designated purpose as closely as possible. If the trustee instead seeks modification of an administrative provision of a charitable trust, then the more permissive doctrine of deviation will apply. The doctrine of deviation allows the court to alter the administrative or distributive provisions of a charitable trust when (1) because of unforeseen circumstances, the proposed modification will further the purposes of the trust; (2) modification of administrative terms of the trust is necessary to prevent waste or avoid impairment of the trust's administration; (3) the proposed modification is necessary to achieve the settlor's tax objectives; or (4) the proposed modification is not inconsistent with a material purpose of the trust, and all the beneficiaries consent to the proposed modification or termination. TEX. PROP. CODE § 112.054(a).
- B. Nonprofit Corporations. Generally, the purposes of a nonprofit corporation or other governance provisions may be changed by the board of directors approving an amendment to the relevant provisions in the nonprofit corporation's governing documents. TEX. BUS. ORG. CODE §§ 22.102(c); 22.107. If the nonprofit corporation has voting members, then member approval is also required. TEX. BUS. ORG. CODE §§ 22.102(c); 22.105. However, court approval is generally not required. If a nonprofit corporation receives an unrestricted gift, then the donation may be used for any of the corporation's enumerated purposes. If the gift is restricted for a specific purpose, then the nonprofit corporation must use it for that purpose or apply to the court to vary the use of the funds under the doctrine of *cy pres*. In such case, proper notice to the Texas Attorney General must be provided, and the Texas Attorney General may elect to intervene in the proceeding. *See* TEX. PROP. CODE § 123.002; 123.003.

## **VII. Other Considerations.**

- A. Public Disclosure of Information. In general, the public has a right to inspect all records, books and reports of financial activity of a nonprofit corporation for the

preceding three fiscal years at the corporation's principal office. *See* TEX. BUS. ORG. CODE § 22.353. Several important exemptions apply to this requirement, and generally only non-church charitable nonprofit corporations that solicit funds from the general public are subject to this requirement. *See* TEX. BUS. ORG. CODE § 22.355. In contrast, charitable trusts do not have an obligation to disclose its books and records to the general public other than the disclosure of its Form 990 or Form 990-PF in accordance with federal tax law.

- B. Unrelated Business Income. If a charity has a significant amount of unrelated business taxable income, it will likely pay more tax if it is formed as a charitable trust than a nonprofit corporation. The tax rates that are applied to unrelated business taxable income are the rates that normally apply to the underlying form of entity. Thus, charitable trusts are subject to the trust tax rates, which currently reach the maximum rate of 35% when net taxable income exceeds \$11,650. In contrast, nonprofit corporations are subject to the corporate tax rates, which currently do not reach the rate of 35% until net taxable income exceeds \$10 million.
- C. Change of Domicile. A relatively new provision in the Texas Trust Code prohibits a Texas charitable trust which benefits one or more charitable entities from transferring the administration of the trust to another state unless the trustee receives both court approval and approval from the Texas Attorney General. *See* TEX. PROP. CODE § 113.029. If a Texas nonprofit corporation desired to change its domicile, no approval is necessary by the court or the Texas Attorney General.

---

<sup>1</sup> Terri Lynn Helge is a [Professor of Law at Texas Wesleyan University School of Law](#)