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## **Charitable Trusts vs. Nonprofit Corporations**

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# Charitable Trusts vs. Nonprofit Corporations

**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 considering 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; (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 distributions of assets of the corporation upon its dissolution if it is a charitable corporation. 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 Secretary of State issues a Certificate of Filing evidencing that the Certificate of Formation have 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 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.