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Nonprofit Corporations: Texas Practical Guidance

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Lexis Practice Advisor Texas Business & Commercial **Nonprofit Corporations**

by Jonathan Blum, Polsinelli PC

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Overview — Nonprofit Entities in Texas

Nonprofit corporations in the State of Texas are governed by the Texas Business Organizations Code (“TBOC”). The TBOC defines a nonprofit corporation as a corporation for which no part of the income is distributable to its members, directors, or officers. A nonprofit corporation may be formed for any lawful purpose, including those purposes not expressly prohibited by the TBOC. The purpose(s) of a Texas nonprofit entity may include one or more of the following: (1) serving charitable, benevolent, religious, eleemosynary, patriotic, civic, missionary, educational, scientific, social, fraternal, athletic, aesthetic, agricultural, and horticultural purposes; (2) operating or managing a professional, commercial, or trade association or labor union; (3) providing animal husbandry; or (4) operating on a nonprofit cooperative basis for the benefit of its members.

Nonprofit Corporation versus For-Profit Corporation

In contrast to for-profit corporations, a nonprofit corporation does not have shareholders or “owners.” Management of the nonprofit corporation may be vested in members or directors, but those members have no ownership interest in the organization. Where a for-profit corporation is focused on maximizing shareholder value, the nonprofit corporation is dedicated to furtherance of its mission or charitable purpose.

Nonprofit Corporation versus Nonprofit Unincorporated Association

Texas also recognizes nonprofit unincorporated associations in Chapter 252 of the TBOC. A nonprofit association is an unincorporated organization, other than one created by a trust, consisting of three or more members joined by mutual consent for a common, nonprofit purpose.

In many ways, a nonprofit association is very similar to a nonprofit corporation: it can sue and be sued, can acquire, hold, and transfer an estate or interest in real or personal property, and can be the beneficiary of trusts, contracts, or wills. The TBOC further provides that a nonprofit association is a legal entity separate from its members for the purposes of determining and enforcing rights, duties and liabilities in contract and tort. In other words, a person is not liable for a breach of a nonprofit association’s contracts or for its tortious acts or omissions merely because that person is a member or participates in management of the nonprofit association.

The benefits of a nonprofit association include it being informal and having only two discretionary TBOC filings: a statement of authority as to real property and an appointment of an agent authorized to receive service of process on behalf of the association. A nonprofit association may be an option if the organization is small, does not plan on receiving significant dollars, and has limited activity. The advantages of informality, however, almost disappear if the association goes through the process of applying for federal tax exemption as the process requires the association to provide certain formal organizing documents. Thus, the more common route in those circumstances is the formation of a nonprofit corporation.

Federal Tax Exemption

Nonprofit corporations that desire to be recognized as tax-exempt by the Internal Revenue Service ("IRS") are required to file documents with the IRS, as well as comply with annual filing requirements. Depending on the type of tax exemption sought, the documentation required may vary. To seek recognition of tax exemption as a charitable organization under Internal Revenue Code ("Code") Section 501(c)(3) (26 USCS § 501), the nonprofit corporation would need to file Form 1023 (<http://www.irs.gov/pub/irs-pdf/f1023.pdf>) (or the recently issued Form 1023-EZ, <http://www.irs.gov/uac/About-Form-1023EZ> for certain small organizations) with the IRS and comply with the annual reporting requirements under the appropriate version of IRS Form 990 (<http://www.irs.gov/pub/irs-pdf/f990.pdf>). To be tax-exempt under Section 501(c)(3) of the Code (26 USCS § 501), an organization must be organized and operated exclusively for one of the exempt purposes set forth in Section 501(c)(3) (26 USCS § 501), and none of its earnings may inure to any private shareholder or individual. In addition, it may not attempt to influence legislation as a substantial part of its activities and it may not participate in any campaign activity for or against political candidates. Assets of the organization must be permanently dedicated to an exempt purpose and, upon dissolution, the assets must be distributed for a charitable purpose.

The exempt purposes set forth in section 501(c)(3) (26 USCS § 501) are: charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, and preventing cruelty to children or animals. The term "charitable" is used in its generally accepted legal sense and includes relief of the poor, the distressed, or the underprivileged; advancement of religion; advancement of education or science; erecting or maintaining public buildings, monuments, or works; lessening the burdens of government; lessening neighborhood tensions; eliminating prejudice and discrimination; defending human and civil rights secured by law; and combating community deterioration and juvenile delinquency.

Licenses and Registrations

- Under Texas law, most charities or nonprofit organizations are not required to register with the State. Exceptions exist, however, for organizations that solicit for law enforcement, public safety or veterans' causes.
- Apply for tax exemption in Texas – See Publication 96-1045 from the Texas Comptroller of Public Accounts ("TCPA") (http://www.cpa.state.tx.us/taxinfo/taxpubs/tx96_1045.html). The Texas Tax Code provides tax exemptions for certain qualifying organizations for sales tax, hotel occupancy tax, franchise tax and property tax. Section 501(c)(3) Organizations can apply for exemptions using TCPA Form AP-204 (<http://www.window.state.tx.us/taxinfo/taxforms/ap-204.pdf>).
 - Sales tax – Section 501(c)(3) organizations are exempt from paying sales tax on purchases necessary to the organization's exempt function, but not exempt from collecting sales tax on most of their sales. See TCPA Publication 96-122 "Exempt Organizations, Sales and Purchases" for more information (http://www.window.state.tx.us/taxinfo/taxpubs/tx96_122.pdf).
 - Hotel Occupancy Tax – Section 501(c)(3) organizations are not exempt from paying hotel occupancy tax based only on their IRS status. A nonprofit charitable organization (as

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