

# Home Grown:

## *Legal Guide to Starting a Nonprofit Farmers' Market in Texas*

### 2009 Supplement

#### **Tax-Exempt Status**

Since the first edition of the *Home Grown* manual was published in 2006, there have been some legal developments that are relevant to process of applying for tax-exempt status for organizations operating farmers' markets. It seems that the IRS has been applying greater scrutiny to tax-exempt applications for farmers' markets due to concerns that some markets do not have valid tax-exempt purposes. This additional scrutiny should not discourage you from seeking to obtain tax-exempt status for your organization, but should cause you to prepare a complete application that anticipates (and addresses) some of these concerns.

Section 501(c)(3) of the Internal Revenue Code provides that "[c]orporations ... organized and operated exclusively for ... charitable, scientific, ... or educational purposes, ... no part of the net earnings of which inures to the benefit of any private shareholder or individual" are exempt from income taxation. In some instances of which we are aware, the IRS has expressed doubt that a farmers' market applying for tax exemption was actually organized for such a charitable purpose, determining instead that the market was a for-profit business existing to further the financial interests of its members.

In general, operating a market itself may not be a sufficient charitable purpose. This fact likely is not a major concern to many organizations seeking to create a farmers' market because their plans usually go beyond merely hosting a market and, instead, seek to benefit the community at large. Before applying for tax-exempt status, organizations are encouraged to review their structure and mission to ensure that they fall within the parameters for tax-exempt status and to ensure that their application properly showcases the charitable purposes for which it was formed.

When conducting this review, there are several factors of which the organization should be mindful:

- *Purpose* - Does the organization operate for an exclusively charitable purpose? Some examples of such a purpose include:
  - Lessening the burdens of government, such as by partnering with the local government to create a market to that is a cornerstone of local redevelopment efforts,
  - Advancing education, such as by sponsoring scholarships or having regular, free programs to educate persons about farming techniques and nutrition, but without an undue focus on such programs becoming a means to sell items offered at the market, and

- Promotion of social welfare, such as working to address some ailment in the locale in which the market will operate, including preserving the agricultural heritage of the community.
- *Membership* - Does the organization restrict its membership only to vendors? If so, the IRS may take the position that the organization does exist to benefit its vendors and, therefore, does not have a purpose that is “exclusively” charitable. As a result, you should consider:
  - Opening membership up to all persons who seek to join., which allows non-vendors to provide direct financial support to the organization’s efforts, and
  - Allowing all members to vote for directors, though additional votes could be given to vendors to provide additional control (or not - some organizations choose to let anyone with a true financial stake to have an equal voice in the governance).
- *Directors* - Are there too many restrictions on the requirements for directors? For example, if directors must be vendors, the organization may be making itself subject to a claim by the IRS that it is an organization existing to serve the purposes and interests of its members.
- *Name* - Does the name of the organization suggest that the purpose of the organization is solely to operate a farmers’ market? While the name should not matter to the tax-exempt application process, anecdotal evidence suggests that it could have some bearing. Given the number of applications that the IRS receives, the name of the organization may generate a pre-conceived notion about the purpose of the group.
  - For example, it may be preferable to use a name that is consistent with the overall purpose of the group, such as “Preserving Agriculture in [Your City]”, as opposed to a name focusing on the market, such as “[Your City]’s Farmers Market”. Of course, even if the name of the organization is broadly focused, the market itself could still be named however your organization should choose.

As you develop your organization, it is important to keep these principles in mind. There are many ways in an organization sponsoring a farmers’ market can demonstrate that it also serves a charitable purpose and is therefore entitled to tax-exempt status; however, it will require that the organization be committed to the community at large and not simply providing a place for farmers (and other merchants) to sell their goods. You are encouraged to discuss your plans with your attorney as early in the formation process as possible in order to identify whether your organization is likely to qualify as tax-exempt and to make any adjustments in advance that may help you to obtain tax-exempt status. As always, Texas C-BAR is also willing to provide assistance.