

# I. Considerations in Starting a Farmers' Market



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## Introduction

Farmers' markets have blossomed during the past decade, more than doubling in number since 1994 according to the U.S. Department of Agriculture. It's not hard to see why. The prospect of buying local farm-fresh food straight from the producer on a sunny weekend afternoon has a simplicity and purity that is a welcome break from the world of mass production. On top of that, markets can serve as meaningful economic opportunities for communities and as catalysts for community redevelopment.

Starting a farmers' market involves more than just finding a vacant lot and opening the door to vendors. Without planning, here are some of the questions that will keep the board of a non-profit farmers' market association up at night. How can the community benefits of the market be maximized? Where should the market be located? What permits are needed? What happens if a vendor sells rotten food? Or someone trips and falls because a vendor didn't sweep in front of his stall? Or a vendor represents something as 'organic' that isn't? What are the requirements for collecting sales taxes, weighing food, accepting food stamps? But as any entrepreneur knows, careful planning is the key to success, even if the risks cannot be completely eliminated.

This manual is designed to give you an overview of the process and issues that you must consider when starting a non-profit farmers' market in your own community and, hopefully, to accelerate the time it takes you to get your farmers' market up-and-running. While some of the requirements may seem daunting, it is important to realize that the government agencies involved in the process want to help you succeed. Also, there are many other organizers around Texas who have successfully started and operated their markets. Because this manual cannot be all-encompassing and laws are always evolving, it is also important that you contact the various regulatory agencies to determine the application of the laws to your specific situation. In Annex J, we have included a list of contact information for many of the relevant agencies, as well as an Internet link to a page maintained by the Texas Department of Agriculture that will lead you to the websites for other farmers' markets located in Texas. Contacting the Texas Department of Agriculture and the organizers of other farmers' markets can be invaluable in helping to get your own market started. Of course, Texas C-BAR and its volunteers are always available to help you navigate the process.

Finally, we would appreciate any feedback you may have about this manual and would like to hear about your experiences as you go through the exciting process of creating a farmers' market in your own community.

## Why Form a Farmers' Market?

There are many different reasons for starting a market and numerous benefits that can be provided to the community. Because you are reading this manual, it is highly likely that you have already decided upon the reasons why a farmers' market may be good for your community. By exploring the rea-

sons that other farmers' markets have been started and the benefits other communities have experienced, you may find other reasons to support your creation of a farmers' market in your community. These factors can further impact how (and where) you organize and operate your market.

Primarily, farmers' markets offer an economic development tool in the community in which they are located. Depending on the types of products permitted to be sold, the markets offer a new customer base to farmers and a new business opportunity to craftsman, cooks, bakers and merchants.

According to one study, the economic development offered by farmers' markets occurs through the creation and capture of value:<sup>1</sup>

- Value is *created* by bringing food to the community that is fresher than food otherwise available.
- Value is *captured* by allowing farmers to sell directly to consumers in their community, thereby eliminating processing and transportation costs. As a result, consumers may pay about the same price for higher quality food purchased at a farmers' market than they would for lower quality food at a supermarket and the farmers' profit margins on items sold at the farmers' market will be higher than food sold by the farmer to processors. The additional profits will also stay in the community, furthering the positive economic impact generated by the farmers' market.

Many markets find it beneficial to enlist the support of local restaurants, and increasingly college food services providers, particularly during the formation of the market. Chefs generally prefer to use the freshest foods available and often are keen to purchase direct from farmers. The market and restaurant customers may even be able to cross-promote one another. The value created by buying local will benefit both the producers and the customers through a "multiplier" effect on local businesses. At a minimum, this approach should create an initial customer base and further help to create value within the community.

In addition, farmers' markets tend to become a social event in their community, providing customers with a chance to interact with each other and farmers and merchants to interact with their customers, an opportunity that usually does not exist for farmers. As a result, farmers and merchants have the opportunity to learn what their customers are looking for and to develop products to meet those needs.<sup>2</sup>

Some markets also list other goals among their purposes, including:

- environmental goals, such as promoting farming techniques that are environmentally sound or producing organic foods;
- social goals, such as increasing the availability of nutritious food for low income families; and
- educational goals, such as teaching children in the community about the source and nutritional value of their food or the benefits of locally grown food.

For example, the location of the market can be chosen to attract customers into areas of the city where, or on days when, they otherwise may not shop. This is especially true with respect to downtown markets. In this manner, the market may also serve as a catalyst to other businesses, especially restaurants and cafés located within the vicinity of the market.<sup>3</sup> The location will also influence the market's ability to accomplish environmental and educational goals that you may have.

While all of these factors should be considered, their importance to your market will also depend upon the type of market that is created, including the market rules adopted, the types of items sold and its hours of operation.

### Initial Considerations

The first question with which you may be struggling is whether you should form a farmers' market in the first place. You recognize that the success of farmers' markets involves careful planning and are willing to take the time and effort necessary to commit yourself to this challenging endeavor. Nevertheless, the ultimate success of the market will depend upon whether the community, as a whole, is receptive to the establishment and operation of a farmers' market.

As you work through this question, you may want to consider the following items:

- Have enough producers and vendors expressed a commitment to sell products at the market? Are the producers and vendors in a position to sell adequate quantities of products at the market at reasonable prices? Are these producers and vendors able to provide a variety of goods that will attract customers? You must keep in mind that the main driver of the market's viability is the ability of the producers to make a profit while providing quality goods at reasonable prices.
- Have you estimated the number of consumers that will go to the market? Is there a targeted socio-economic mix of potential consumers? Will this number (and their expected spending habits) support the market's operations?
- Who will be your competitors? Are there nearby farmers' markets? How do the quality and prices at local retail food stores compare?
- What financial support will be required? Will the government officials, philanthropists, commercial business people and the agricultural community provide the necessary financial support?
- Where would you like to locate the market and how will you lease, purchase or have donated the desired land?

While you may not yet have all the answers to these questions, we hope that this manual will help you think through these issues and guide you to other resources that allow you to make an informed decision as to whether a farmers' market is the best way to accomplish your goals.

## Getting Started

There are many “first steps” to be taken once you have decided to start a market – from obtaining necessary start-up funds to site selection to forming a non-profit corporation (and obtaining “tax exempt” status from the IRS and Texas). This manual attempts to highlight those areas and seeks to give you sufficient information to make some preliminary determinations and to be able to ask appropriate questions to government agencies and other market organizers. Many of these decisions, though, are dependent on each other. For example, where you locate the market may effect what types of products you permit to be sold at the market, while at the same time determining the interest of potential farmers and vendors in participating at your market may effect where you choose to locate the market. Similarly, the types of vendors may also impact the governance structure of your non-profit corporation. Again, early planning (including market research) can be invaluable. Nevertheless, creating some flexibility in your early planning will also help you to adapt your market better to your community as the market is organized and grows.

## Corporate Structure

One of the first questions for you will be to decide upon the structure of your market. While you could simply choose a place for your market and find vendors to fill it, without creating a separate entity, it likely will be better for you for legal and tax reasons to use a corporation or other structure that will be responsible for the market.

Many organizers of farmers' markets come to the task from an existing non-profit entity. Other markets are organized initially at a governmental level or by an economic development agency. For many, the question will be whether to have a new market operated under the auspices of one of those entities. The answer is that it depends.

Farmers' markets can carry more risks than groups typically undertake with other projects. Risks can include everything from the potential accidents and violence in a public space to the health concerns implicated by the selling of food products. Risks can be compounded by the complicated regulatory schemes that govern farmers' markets at the federal, state and local levels. Operating a market also could trigger tax consequences for a non-profit organization if not structured and operated correctly. While these risks should not deter you, they do mean that you should seek legal and tax advice before deciding how to establish and operate your market to minimize risk to your other undertakings.

In many cases, organizers have concluded that the goals of a market are best served by organizing the market as a separate standalone entity where growers are members in the market. In fact, there can be a number of advantages to operating a market using this type of structure in Texas and many other states.

One of the principal benefits with this standalone structure is that the association may become a “certified farmers' market” and participate in federal food assistance such as the Farmers' Market Nutrition Program. Certified farmers' markets also enjoy certain promotional benefits provided by

the Texas Department of Agriculture and may be eligible for financial and other assistance from the U.S. Department of Agriculture through its Farmers' Market Promotion Program.

Finally, most farmers' markets are also established as "non-profit," or charitable, organizations. A non-profit organization is one that does not seek profit; rather, it seeks to serve a charitable or benevolent purpose. As a non-profit organization, your market would not be subject to income taxes and donations made to the market may be deductible as "charitable contributions" from the income taxes of the donor. Because of these benefits, it is highly likely that you should apply for your market to be granted non-profit status.

We will explore all of these concepts in greater detail below.

### **Choice of Entity**

When seeking legal and tax advice, you should expect the conversation with your advisors initially to focus on the type of entity that will be formed. The primary choices include a corporation, a limited liability company, an unincorporated association, a charitable trust and a cooperative marketing association.

One of the primary reasons for choosing to conduct business through an entity such as a corporation is to reduce the personal liability of the organizing persons. If properly structured and maintained, the entity itself, and not the directors, officers, employees or volunteers of the entity, are liable for the business. For example, if you choose to operate through a corporation, then generally the corporation alone will be liable for the debts of the business and for any problems, such as if a customer falls at the market site. If you choose to operate without an entity, then the organizers run the risk of being held personally liable for such debts or injuries.

The corporation is the entity with which you are likely most familiar. Many for-profit businesses are organized as corporations - even the local dry cleaner, hardware store or boutique, typically use this type of entity. The board of directors in a for-profit corporation govern the affairs of the corporation and have a duty to take actions that are in the best interests of the shareholders. The shareholders have the right to vote on certain major actions, including the election of the directors.

Similarly, non-profit corporations in Texas may be governed by board of directors, members, or combination of the two. Non-profit corporations do not have shareholders. Many non-profit corporations choose simply to have a board and permit the board to govern the company and to appoint the officers (such as the market manager) to handle day-to-day affairs. Other non-profit corporations also have members. Under Texas law, the members may serve a variety of roles, from choosing to have no board and allowing the corporation to be governed by the members, to permitting members to have control over certain issues (i.e. electing directors or voting on changes to market rules) or any other role that the organizers can envision.

In Texas, the limited liability company, or LLC, is extremely popular in the for-profit business world because of tax and corporate governance advantages. The tax advantages do not apply to charitable organizations. On the governance side and as compared to for-profit corporations, LLCs allow for a much more flexible governance structure and provide much greater flexibility with how to structure management of the entity than what is permitted in a for-profit corporation. Due to this flexibility, though, it is necessary to spell out the governance structure in great detail, a process that can be quite cumbersome for the organizers. Texas law, though, permits non-profit corporations to be governed by “members” or a “board of directors” and, accordingly, provides much of the flexibility offered by an LLC. In addition, Texas law does not provide clear guidance as to the applicability of the LLC regulations in a non-profit setting, increasing the requirement that all details be spelled out in the organizing documents of the LLC. As a result, few (if any) non-profit organizers in Texas elect to use the LLC as their entity.

An unincorporated non-profit association is created under Texas Law when three or more people jointly pursue a common, non-profit purpose. An unincorporated association is not subject to many of the strict, organization, reporting and registration requirements imposed upon nonprofit corporations. As a result, it is the easiest entity to form as it simply requires at least three people to act together for a common, non-profit purpose without even having any written documents. The major drawback to this option, however, is that many states do not view the unincorporated association as an entity, meaning that the persons acting together may have personal liability for the debts and other liabilities of the business when dealing with suppliers, vendors or other companies outside of Texas. Even in Texas, there is some ambiguity as to the liability of the members of a non-profit association. Accordingly, you are strongly cautioned to consult with your own legal counsel to discuss whether this form is appropriate for your farmers' market. In addition, you should also recognize that any actions that you take with others before formally creating your farmers' market could also create an unincorporated association and, as a result, unexpectedly expose yourself and your fellow organizers to liability.

The final option, a charitable trust, is formed by a donor placing funds under the control of a trustee who is then charged with using the funds for a specified purpose. Due to the complexities of creating this type of entity, you should work closely with legal counsel to establish a trust if you believe that this type of entity would be the most appropriate for your situation.

As most organizers will choose to use the non-profit corporation, this manual does not further discuss the other entities.

### **Formation of the Non-Profit Corporation**

In order to actually create a non-profit corporation in Texas, you must file a Certificate of Formation with the Texas Secretary of State and pay the requisite filing fee. When filing, a duplicate copy of the Certificate of Formation should be provided in order that the Texas Secretary of State can return a file stamped copy to the organizer as further evidence of the filing, serving as a “birth certificate” for your company.

The Certificate of Formation sets forth some basic rules regarding the governance of the corporation. Additional rules are set forth in another document called the Bylaws. The board of directors of the non-profit corporation should also adopt some initial resolutions setting forth certain key items, such as the initial officers. Sample forms of a Certificate of Formation, Bylaws and initial resolutions have been included in this manual at Annexes G, H and I, respectively. These forms also include footnotes to highlight certain issues that you should specifically consider when forming your corporation.

Serious consideration should be given as to whether it is appropriate to have members at the outset of the market and, if so, what their role should be.<sup>4</sup> You should consider that there will be many decisions that must be made as the market is formed and begins operations. Some of those decisions may need to be revised. You should consider whether it will be more difficult to make the necessary adjustments to get the market running smoothly due to the involvement of the members. Should you choose not to have members (or to have members that have no governance role) initially, you could implement a membership structure, such as the one used by University Place Farmers' Market described below, once the market is operating. Adding members at a later date requires a simple amendment to the Certificate of Formation and the Bylaws of the corporation. This approach would allow you and your fellow organizers to focus on the initial issues and later engage the community giving vendors additional stake in the market, providing an additional source of revenue from sponsors and (hopefully) allowing you to share the workload with the members. For example, the University Place Farmers' Market in Washington elected to have a board and several levels of membership as described in their bylaws:

- Regular member: Must submit a completed membership application along with dues on or before the first meeting of the new market season. A regular member is eligible to vote at general meetings and may serve on the market's governing body and committees.
- Supporting members: These would be community members who would like to participate in the market as a non-vendor. Supporting members will pay an annual membership fee and may serve on the board of directors.
- Lifetime member: Regular and supporting members may amend their membership to lifetime status by paying a one time, non-refundable fee of \$250. The member/farm/family who holds the membership will no longer have to pay annual dues. Weekly stall rent will still apply.
- Youth member: Youth members (18 years or under) must submit an application to the market manager at least one week in advance of first market attended. The application must be signed by both the youth member and their legal guardian. The fee for a youth table will be 5% of their daily sales. Youth members must grow their own products or make their own crafts. Youth membership is a non-voting membership and youth members may not serve on the governing body.
- Sponsor: A business or other entity that wishes to support, financially or otherwise, the advancement of the market. This is a non-voting membership. Public recognition will be given to sponsors.<sup>5</sup>

## Tax-Exempt Status

Simply because your corporation is organized as a “non-profit corporation” does not make it a tax-exempt organization for federal and state tax purposes. Like individuals, corporations must pay federal income tax and, in Texas, the corporate franchise tax. The Texas franchise tax effectively is a state income tax on businesses. Organizations that are charitable in nature, however, can be exempt from these taxes if they follow the proper procedures to be declared “tax-exempt” by the relevant taxing authorities. In addition, donations made to certain tax-exempt organizations may be deducted by the donor from his or her income tax as a “charitable contribution.”

### Selecting the Type of Tax-Exempt Status to Pursue

In order to obtain tax-exempt status for your non-profit corporation at the federal level, your organization must file an application with the IRS demonstrating that it meets certain requirements. Once you have established your tax-exempt status at the federal level, it will be relatively easy for your corporation to obtain tax-exempt status in Texas.

The first step in the process is to determine the type of tax-exempt status for which you believe your organization will qualify. There are many different types of tax-exempt organizations. The types are defined in Section 501(c) of the Internal Revenue Code (or tax code).

You may have noticed references on materials from charities soliciting donations that they are “a 501(c)(3) nonprofit organization.” This reference is to the section of the tax code under which the organization has been declared tax-exempt. The exemption offered by Section 501(c)(3) is the most common exemption claimed by non-profits. Many farmers’ markets have also been declared tax-exempt under this section, while others have sought tax-exempt status as a “chamber of commerce/business league” under Section 501(c)(6). Notably, donations to Section 501(c)(6) organizations generally may *not* be deducted by the donor as a “charitable contribution.” To the extent that the Section 501(c)(6) benefits the donor, such as a local business donating (or paying dues) to its local chamber of commerce, the donation may be deducted as a business expense. While this deduction is beneficial to certain specific groups, it makes it difficult for Section 501(c)(6) organizations to raise money from the community at large. As such, it is likely to be of greater benefit to you to structure your market so that it can obtain Section 501(c)(3) status; accordingly, the remainder of the discussion will focus on the 501(c)(3) exemption.

In order to qualify for tax-exempt status under Section 501(c)(3) of the tax code as a charitable organization, “a non-profit organization must be *organized* and *operated* exclusively for one or more *exempt purposes*:

- *Organized*: A 501(c)(3) organization must be organized as a corporation, trust or unincorporated association. An organization’s organizing documents ([certificate of formation], trust documents, articles of association) must: limit its purpose to those described in section 501(c)(3) of the [tax code]; not expressly permit activities that do not further its exempt purposes, i.e., unrelated activities; and permanently dedicate its assets to exempt purposes.
- *Operated*: Because a substantial portion of an organization’s activities must further its exempt

purpose(s), certain other activities are prohibited or restricted including, but not limited to, the following activities. A 501(c)(3) organization:

- \* must absolutely refrain from participating in the political campaigns of candidates for local, state or federal office
  - \* must restrict its lobbying activities to an insubstantial part of its total activities
  - \* must ensure that its earnings do not inure to the benefit of any private shareholder or individual
  - \* must not operate for the benefit of private interests such as those of its founder, the founder's family, its shareholders or persons controlled by such interests
  - \* must not operate for the primary purpose of conducting a trade or business that is not related to its exempt purpose, such as a school's operation of a factory
  - \* may not have purposes or activities that are illegal or violate fundamental public policy.
- *Exempt Purpose:* To be tax exempt, an organization must have one or more exempt purposes, stated in its organizing document. Section 501(c)(3) of the [tax code] lists the following exempt purposes: charitable, educational, religious, scientific, literary, fostering national or international sports competition, preventing cruelty to children or animals and testing for public safety.”<sup>6</sup>

### **Sample Language:**

The mission of the \_\_\_\_ Farmers' Market is to provide children and adults in the \_\_\_\_ area with locally-grown foods and farm products. This will be accomplished by improving access to local, healthy, affordable food through a direct farm-to-consumer marketing venue that will serve diverse population. Other goals that the \_\_\_\_ Farmers' Market strives to achieve are increased education and support of \_\_\_\_ area agriculture. \_\_\_\_ Farmers' Market believes that small, local farms are essential to the local economy, and is committed to making economic and educational connections between \_\_\_\_ area residents and local farmers.

The sample Certificate of Formation included as Annex G to this manual contains provisions designed to comply with the tax code's requirements for Section 501(c)(3) status. Nevertheless, it will be important for you to properly explain your organization's purpose and method of operation in order to successfully obtain this status. Furthermore, if you do not believe that your organization would meet the above standards for Section 501(c)(3) status, as mentioned above, there are many other types of organizations under the tax code that may qualify as tax exempt. Your legal or tax advisors can help you to select the exemption that best meets your organization's goals. Further information is available at [www.texasbar.org](http://www.texasbar.org).

### **Public Charity or Private Foundation?**

The IRS further divides all tax-exempt organizations into one of two groups: public charities and private foundations. The difference between the two categories is the source of their funding. Public charities generally receive their funding from broad public support, the government or other publicly

supported organizations. Private foundations, in comparison, generally receive their funding from one or a few individuals. Different rules apply to each category, the principal purpose of which is to ensure that private foundations are not using their funds primarily to benefit their few donors for, in that case, the organization would not be considered a charity.

You will have to demonstrate to the IRS your sources of funds in order to support the basis for your request to be classified as a public charity or a private foundation. Many times, non-profit organizations are started with the financial backing of a few individuals with the ultimate goal of becoming broadly supported. If this situation applies to your organization, you may still seek to have your organization classified as a public charity and, assuming approval by the IRS, your organization will need to demonstrate at the end of a five year period that you have received sufficient public funds to sustain your classification. Even if you fall short of the requisite public support, you may still have your organization reclassified as a private foundation at the end of the period. It will be important, however, to work closely with your legal or tax advisors to ensure that you have taken the necessary steps to demonstrate your classification before the end of the five year period.

### **The Application Process**

To apply for Section 501(c)(3) tax-exempt status, you will need to obtain an employer ID number, or EIN, for your organization. An EIN is the equivalent of a Social Security number but for a corporation or other legal entity. You can obtain this number for no cost from the IRS. Information about the EIN can be found at the IRS web site (<http://www.irs.gov/businesses/small/>).

Once you have obtained the EIN, you must complete IRS Form 1023 in order to apply for Section 501(c)(3) tax-exempt status. The application should be submitted within 27 months of the formation of your organization. Once submitted, the IRS will review your application and, typically, ask you additional questions and request supplemental information. It typically takes between three months and one year for the IRS to complete its review and issue a determination.

During the period between the formation of your organization until the receipt of your IRS determination of your tax exempt status, your donors may deduct any contributions that they make to your organization as a "charitable contribution" with the understanding, however, that if some reason the IRS were to deny your request for tax exempt status, then they would have to amend their tax returns to remove those donations. Many people though are not willing to make donations to an organization until they know that it has received tax-exempt status. While many non-profit organizations do not seek broad solicitations for donations until after Section 501(c)(3) status has been received, other new organizations establish a fiscal sponsor agreement with nonprofit that has already received its Section 501(c)(3) status. For information about fiscal sponsors, go to the Texas C-BAR Legal Resource Library/Corporation & Corporate Structures/Pre-incorporation at [www.texasbar.org](http://www.texasbar.org).

## **Tax-exempt in Texas**

Obtaining tax-exempt status from the IRS is an important step, but not the only step that you will need in order to secure tax-exempt status for your organization. As mentioned above, you must also obtain tax-exempt status under the laws of Texas – and in any other state in which your organization operates.

Organizations that have obtained their Section 501(c)(3) status from the IRS, must file a Form AP-205 with the Texas Comptroller of Public Accounts. The form is available from the Texas Comptroller by visiting <http://www.window.state.tx.us/taxinfo/taxforms/ap-205.pdf> or contacting the Texas Comptroller at (800) 252-5555.

Once the Texas Comptroller has granted your organization tax-exempt status, your organization will be exempt from Texas sales and franchise taxes. Your organization may also qualify for exemptions from property taxes, but you will need to contact your local property tax authority to determine available exemptions and the exemption procedures.

### **After Tax-exempt Status Has Been Obtained**

Once your organization is tax-exempt, you will be required to file certain annual forms with the IRS, the Texas Comptroller and, potentially, local tax authorities. You should discuss these requirements with your legal and tax advisors. For more information, see Texas C-BAR's publication, "Nonprofit Legal Toolkit" at [www.texasbar.org](http://www.texasbar.org).