

To 501c3 or Not to 501c3? Applying for Federal Tax Exempt Status

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In Washington State, most farmers markets are incorporated as nonprofits or are projects of nonprofits organizations. Of those, most also have federal tax exempt status from the Internal Revenue Service (IRS) and earned a 501(c) designation. If your farmers market is incorporated with the State of Washington only considering applying for 501(c) tax exempt status with the IRS, there are many questions to consider as part of this process. It is a complex process, especially if your market has already been operating for a number of years. Fortunately, there are some very good resources to help you understand the implications of doing this and help you through this process.

Tax Exempt Status Options

There are multiple 501c tax exempt statuses available to nonprofit -- 26 different types in all. When evaluating whether to apply for tax exempt status or not, market leaders need to decide which 501c status makes the most sense. Farmers Markets generally have the best fit with four options: 501c3, 501c4, 501c5, or 501c6.

501(c)3: Charitable	This is the only option that allows for donations to be tax deductible. Markets must be providing educational activities, serving the public good, or “lessening the burdens of government” (i.e. making it easier for government to fulfill its public policy objectives such as improving health outcomes with food access programs operated by the market).
501(c)4: Social Welfare	This category works well when markets are intended to beautify a community to help revitalize a neighborhood business district.
501(c)5: Agricultural	Markets organized to promote and educate about farm products and are focused on farmers.
501(c)6: Business League or trade associations	Markets organized to offer vendor education and promote vendors or members.

Does it make sense to even apply?

The Farmers Market Coalition (FMC) has prepared an overview about applying for 501(c)3 or another tax exempt status. This should be read prior to making a decision as to whether this is right for your market organization.

<https://farmersmarketcoalition.org/501c3/>

Does the market's mission fit the tax exempt requirements?

Although there are benefits to being applying for tax exempt status as a nonprofit, there are also costs. For example, to take full advantage of the tax exempt status, you will have to demonstrate to the IRS that the market organization has a strong education and service mission with regular programs and activities. They need to see evidence that your market is more than a location for vendors to show up and sell each week.

How is the market organized?

How a market is organized can influence which tax exempt status makes the most sense. If the market is a vendor membership organization and prioritizes sales to vendors, it may make more sense to submit an application for the 501(c)6 status.

The most notable reason markets apply for the 501(c)3 tax exempt status is to be eligible to receive tax deductible charitable contributions. This opens up funding opportunities from private foundations, individuals or grantors that require the recipient to be a 501(c)3. There are other good reasons to do this: favorable IRS tax treatment so that most revenue the market receives as part of its normal programming is not taxed and general community recognition that the market is serving a valued public benefit rather than just benefiting specific individuals. On the other side, the organization is subject to more public scrutiny; tax forms are expected to be sent to the Secretary of State for posting on its website for review by potential donors. Funders and donors may have special reporting requirements. The IRS tax Form 990 requires income and expenses to be categorized differently than for regular businesses, so there is a learning curve to do this correctly. This can impact the market's bookkeeping and accounting systems.

Is the board and market leaders willing to commit to the process?

Making the decision to apply for recognition by the IRS as a nonprofit with tax exempt status is a time consuming and complicated process that will require many dedicated hours by a market champion to coordinate the effort and ensure the application is completed. It will require support from the Board of Directors, and most likely, legal assistance.

Does our market need to be a 501(c)3 to have a sponsorship program?

No! Any market can have a sponsorship program. Some businesses will only sponsor 501(c)3s but others are happy to support your market. If you provide publicity for the

sponsor, such as name and logo on a banner or on your website or poster, a sponsor can claim their donation as a marketing expense.

Can our market just be recognized as a nonprofit in the state of Washington?

Among farmers markets in Washington that are nonprofits, 44% are incorporated in the state of Washington only. This status is *not* recognized by the IRS and does not offer any federal tax benefits. Regardless of whether your market is a 501(c) or not, it will generally be taxed like any other business. The market will need to pay business and occupation (B&O) taxes on eligible revenues, sales tax from selling taxable items (like market merchandise) and sales tax on goods and services the market purchases (like office supplies). The Department of Revenue has helpful resources on its website: dor.wa.gov/content/doingbusiness/business/types/industry/NonProfit/default.aspx.

Applying for Federal Nonprofit Status

If we decide to apply, what do we need to do? The application (Form 1023) is 29 pages and includes numerous schedules and attachments. In Washington State, farmers markets (and the WSFMA) have needed to use the services of an attorney to submit a successful application. Prior to starting the application, gather all the necessary materials.

- **Articles of Incorporation and By-laws.** The IRS looks to these two documents to ensure that your market organization's mission and organizational structure meet the requirements for tax exempt status. If not, they must be amended and approved by the Board of Directors, and filed with the Secretary of State, prior to submitting the Form 1023. Although this sounds daunting, this is common and many markets (including the WSFMA) have had to go through this process.

The IRS wants to see that your market is organized and operated for religious, charitable, scientific, public safety, literary or educational purposes. The IRS also wants to make sure the Articles stipulate that upon dissolution, the organization's assets will be distributed to worthy organizations, not to benefit the board, officers, or members.

- **Conflict of Interest Policy.** The IRS requires all 501(c)3 organizations to have a Conflict of Interest policy that each board member must sign every year. This is to ensure that individual board members and officers are not receiving special treatment or financial benefit from their role in the organization. The WSFMA has a sample conflict of interest policy available.
- **Financial Statements and budgets.** The Form 1023 requires several years of financials and pro forma budgets to show how the funds have been, and are projected, to be spent.

- **Filing fee.** If your market's gross revenues (not vendor sales) are greater than \$10,000, the cost is \$850 (smaller organizations pay \$400).
- **Documentation** of the market's activities that demonstrate how they fulfill the expectations of tax exempt status. This can include flyers, newsletters, educational materials you create for various activities such as cooking demos, kids educational activities, or food access programs.

In addition, although not required, farmers markets in Washington State and around the country (including the WSFMA) usually need the services of an attorney to file a successful application. Fortunately in Washington, we have WayFind Legal, a nonprofit that can help you find an attorney who will offer pro bono services to prepare the application (<http://wayfindlegal.org/>). Your market will need to complete an application to WayFind to request this service and pay a nominal fee (currently \$100). Your market can save time and effort by finding an attorney at the beginning of the process. Any market that wants to apply for tax exempt status is eligible to apply to WayFind.

The best time to apply for 501(c) status is when first opening the market. However, a market can apply at any time. (The WSFMA submitted its application after operating for 36 years!) The IRS recommends applying within the first 15 months of operation. After that time, you will need to submit additional justification explaining why the market did not apply in a timely manner and why it should now be considered for review.

Good Resources

Wayfind Legal: <http://wayfindlegal.org/> This nonprofit improves the quality of life in Washington communities by providing access to free business legal services for nonprofits and microenterprises.

Form 1023 Application: <https://www.irs.gov/charities-non-profits/application-for-recognition-of-exemption>

Farmers Market Coalition: <https://farmersmarketcoalition.org/501c3/> This FAQ is an excellent resource that provides more detail about applying for tax exempt status.

“IRS Denies Farmers Market Tax-Exempt Status.” This is a good article that identifies the likely reasons behind the 2015 IRS denial of a farmers market application for tax exempt status. <http://perlmanandperlman.com/blog/index.php/irs-denies-farmers-market-tax-exempt-status/>.

“Farmers Market Guide to Non-Profit Incorporation” from the NY Federation of Farmers Markets. This is a detailed document about applying for the various types of tax exempt status. <http://nyfarmersmarket.com/wp-content/uploads/2014/08/Incorporation.pdf>