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KANSAS FARMERS' MARKETS

# Organizational Structure of a Farmers' Market

## *Kansas State Registration, Non-Profit Status, & Tax Exemptions*

As farmers' markets continue to grow and evolve in Kansas, many markets are considering how to best structure their organization for liability, governance, and tax purposes. The organizational structure of a farmers' market impacts how federal, state, and local governments treat that market. This resource provides information on organizational considerations a Kansas farmers' market may want to evaluate, including:

- Participating in the Central Registration of Kansas Farmers' Markets;
- Applying for Non-Profit Status under Kansas law; and
- Seeking federal and state tax exemptions.

Navigating non-profit status and tax exemptions can be complicated because the rules and outcomes are extremely fact-specific to the organization. The information provided in this resource is merely an introduction to these areas and is not meant to provide in-depth information.



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## The Farmers' Market Promotion Act

### Central Registration of Kansas Farmers' Markets

In 2013, the Kansas Legislature enacted the Farmers' Market Promotion Act to encourage the development and growth of farmers' markets across Kansas.<sup>1</sup> Central to this legislation was the creation of a registry of the state's farmers' markets, which is maintained by the *From the Land of Kansas* agricultural trademark program within the Kansas Department of Agriculture. Participating in the central registration of Kansas farmers' markets connects markets with business and technical assistance, provides access to funding opportunities, and offers limited liability coverage for registered markets. A farmers' market operator can voluntarily register a market for free by submitting an application online at [From the Land of Kansas](#).

### Limited Liability Coverage

The Farmers' Market Promotion Act created limited liability coverage for all farmers' markets registered in the central registry. The Act declares all individuals at a registered farmers' market assume the risk of attending, buying, and selling goods at the market. Further, the Act provides liability protection for the farmers' market operator in the event of injury to a participant arising out of the operation of the farmers' market. While this limited liability coverage does not protect against all claims, the protection is attractive especially because farmers' markets have so many unique characteristics, such as the sale of food and goods, distinct vendors, indoor or outdoor vending, and temporary or seasonal operational practices. Participating with the central registry and capitalizing on the statutory advantages created by the Kansas Legislature may provide important protections and services to farmers' markets.

Email [farmersmarkets@kda.ks.gov](mailto:farmersmarkets@kda.ks.gov) with any questions or concerns about the central registration of Kansas farmers' markets or liability coverage.

## Non-Profit Status for Kansas Organizations

Kansas farmers' markets may be able to benefit from non-profit status under federal and Kansas law if the market meets certain legal requirements.<sup>2</sup> Federal and Kansas law may recognize charity or service organizations as non-profits if the organization uses its revenues to achieve the organization's charitable goals or mission (i.e., maintain the organization and serve the community) rather than distributing profits to owners of the organization.<sup>3</sup> Because non-profits do not have the same economic incentives as other

### Can a farmers' market make a profit, but still be a non-profit organization?

Yes! A non-profit organization may make a profit, and should use its financial gain to pay employees and management, as well as fund the operation of the organization. However, non-profits cannot use excess profit to benefit owners. Further, non-profit organizations do not have shareholders. Therefore, a non-profit does not have the same economic incentives motivating its actions as a for-profit corporation and can use its profits to further its mission.

### Can the vendors make a profit?

Yes, vendors are legally separate from the farmers' market (i.e., pay their own sales tax) and can make a profit. The farmers' market organization and its excess profits are the focus of the non-profit status. Therefore, if the vendors are required to submit a participation fee to the non-profit farmers' market, that market would not be able to distribute that profit for a private benefit.

corporations or organizations, non-profits may receive special tax status by the state and federal government and special treatment under the law.<sup>4</sup>

For pre-existing non-profits, some additional considerations may be needed. However, the focus of this resource is organizations yet to receive non-profit status.

### **What does it mean to have non-profit status under Kansas law?**

A non-profit organization is most easily defined by the restrictions on how the organization may distribute excess profits. Specifically, an organization that has received non-profit designation by the Kansas Secretary of State (KSOS) as required by Kansas law may not give financial gains to its members, directors, officers, or other individuals, and may be “mission-driven.”<sup>5</sup> Further, non-profit organizations in Kansas are often considered to have the “greater public” as the organization’s primary stakeholder. In comparison, for-profit corporations distribute excess profits to their shareholders and have legal obligations to seek profit on behalf of those shareholders.

Corporations, associations, and trusts may legally become non-profit organizations if the work of the organization meets specific federal and/or state requirements of serving the greater public good.<sup>6</sup> To be incorporated as a non-profit, a Kansas farmers’ market must have some level of market governance or structure prior to filing for non-profit status.<sup>7</sup> Notably, most non-profits are incorporated. Further, the federal government does not determine whether an organization is a non-profit under state law, only a state can grant that status. In Kansas, an organization must apply for non-profit status and file the organization’s articles of incorporation and by-laws with the Kansas Secretary of State in order to be granted non-profit status.<sup>8</sup>

### **How to register for non-profit status in Kansas**

- 1 Choose board of directors and “name” for non-profit organization.
- 2 Prepare and file the articles of incorporation with Kansas Secretary of State (KSOS).
  - KSOS has created a standard form for an organization’s articles of incorporation.
  - Declare organization is not authorized to issue stock or have capital stock (K.S.A. 17-6002).
  - Declare conditions of membership (K.S.A. 17-6002).
  - If organization will seek federal tax exemption status under § 501(c)(3), articles of incorporation or by-laws must declare upon resolution, all assets will be distributed for an exempt purpose (i.e., to a public entity).
  - If organization will seek federal tax exemption status under § 501(c)(3), articles of incorporation or by-laws must limit the purposes of the organization to one or more of the exempt purposes under the law (i.e., charitable, educational, scientific) (I.R.C. 501).
- 3 Prepare by-laws.
  - Determine the rights and duties of the director, officers, and members.

### **What are the advantages and disadvantages of a farmers’ market becoming a non-profit in Kansas?**

There are several advantages to a farmers’ market becoming a non-profit in Kansas. First, a non-profit organization exists as a legal entity.<sup>9</sup> Non-profit organizations can enter into contracts, apply for grants and funding, and are afforded certain protections.<sup>10</sup> Further, non-profit status provides an additional layer of legitimacy (and even exclusive

eligibility in some cases), particularly when seeking grants, funding, or financial assistance. Finally, non-profit organizations are often eligible for special treatment by the local, state, and federal government or tax exemption (please see discussion below).<sup>11</sup>

At the same time, there may be disadvantages to a farmers' market becoming a non-profit in Kansas. Most obviously is the cost and time needed to prepare and file the required documents to the state. Further, in order for an organization to maintain its non-profit status and privileges, the state requires financial reporting. For example, the Kansas Secretary of State requires non-profits to submit an Annual Report.<sup>12</sup> Additionally, non-profits are subject to public scrutiny over its finances — meaning that the organization's finances must be made available to the public for inspection. Lastly, Kansas non-profits are subject to the specific Kansas laws and regulations that govern non-profit organizations.<sup>13</sup> Overall, the organization must determine its short and long term goals before deciding whether to seek non-profit status.

### **How do the articles of incorporation impact the operation of a farmers' market as a non-profit organization in Kansas?<sup>14</sup>**

Articles of incorporation that meet the minimum legal standards under Kansas law are an essential component of a farmers' market establishing non-profit status in Kansas. (These articles of incorporation are also needed if the market plans to file for federal tax-exempt status under Section 501(c)(3).<sup>15</sup>) The articles of incorporation must be filed with the Kansas Secretary of State to establish non-profit status. The articles of incorporation would generally protect the board of directors or an individual board member from liability for injuries or damages associated with the operation of the incorporated farmers' market, unless the board or individual board member knowingly engaged in wrongful misconduct that leads to the injury or damage thereby negating this legal protection.<sup>16</sup> The articles of incorporation do not protect the organization, itself,

from liability for injuries or damages caused by the operation of the farmers' market.

## **Tax Exemptions**

Non-profit status and tax exemptions are often spoken about at the same time. That is because many non-profit organizations are exempt from local, state, and federal taxation. However, an organization with non-profit status under state law does not automatically receive federal tax exemption. Therefore, if an organization is interested in becoming a non-profit and seeking tax exemptions, it should draft its articles of incorporation and by-laws in a manner that is consistent with the state and federal requirements. For example, an organization that is filing for non-profit status at the state-level should include the organization's mission and charitable purpose (discussed below) within its articles of incorporation and/or by-laws, which can also be later submitted to the Internal Revenue Service (IRS) as "evidence" that the organization should be exempted under Section 501(c)(3) of the Internal Revenue Code.

### **Federal Income Tax**

*What does 501(c)(3) tax exemption under federal law mean?*

Federal law provides a tax exemption for charitable organizations that meet the requirements included in Section 501(c)(3) of the Internal Revenue Code. Section 501(c)(3) tax exemptions are the most common tax exemptions for non-profit organizations. Section 501(c)(3) tax exemptions are granted and governed by the IRS. If an organization is eligible under this section, that organization does not have to pay federal income taxes and is eligible to receive tax-deductible charitable contributions.<sup>17</sup> The federal Internal Revenue Code establishes a list of entities that are exempt from federal tax. Section 501(c)(3) exempts corporations organized and operated



for charitable, scientific, and educational purposes (among others) from having to pay federal taxes.

*Who is eligible for tax exemptions under § 501(c)(3)?*

The IRS requires that an organization be “organized” and “operated” “exclusively for exempt purposes.” Further, none of the organization’s profits may benefit a private interest (this requirement is the same as when an organization seeks to receive non-profit status at the state-level). Lastly, the organization may not be an “action organization” because a different set of rules apply to organizations that engage in political and legislative activities.<sup>18</sup>

Most commonly, organizations apply for § 501(c)(3) tax exemption as a charitable organization,<sup>19</sup> under one of the established “exempt purposes.” The test regarding whether an organization is “organized” and “operated” for a charitable purpose is whether the organization is providing a public benefit (rather than a private benefit).<sup>20</sup>

*Is my non-profit market eligible for tax exemption under § 501(c)(3)?*

Maybe! It is likely that a non-profit farmers’ market could argue it should be tax exempt under Section 501(c)(3) as an organization organized and operated for a charitable purpose because farmers’ markets provide a public benefit by establishing an economic marketplace for producers to sell their produce; offering consumers a source for local and quality produce and goods; and enhancing the community.<sup>21</sup>

When requesting federal tax exemption, it is important that the organization’s documents, such as the articles of incorporation, affirm that the organization is “organized and operated for a charitable purpose.” Therefore, in addition to including statements and documents supporting an exempt purpose, the organizing document must also limit an organization’s purposes to just the exempt purpose:

i.e., “Smallville’s Farmers’ Market is organized exclusively for charitable

purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code...

Lastly, within the organizing document, the organization should also declare that the organization's assets will be permanently dedicated to an exempt purpose in the case of dissolution:

i.e., "Upon dissolution of this organization, assets shall be distributed for one or more exempt purpose within the meaning of § 501(c)(3) of the Internal Revenue Code...or shall be distributed to the federal government, or to a state or local government, or for a public purpose."

*When do most organizations apply for exemption under § 501(c)(3)?*

Most organizations must file a Form 1023 ("Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code") before the 27th month after which that organization was incorporated or legally formed.<sup>22</sup> An organization that files its application before the "deadline" may be recognized as tax exempt from the date of incorporation or creation, if it meets the exemption requirements. Once an organization has applied, the IRS may seek additional information in order to make its determination.

*What are the advantages and disadvantages of applying for the 501(c)(3) tax exempt status?<sup>23</sup>*

First and foremost, those organizations that qualify for a federal tax exemption under § 501(c)(3) are able to take advantage of funds that would otherwise be paid as federal income tax. Further, this status may help efforts to receive grants or funding, as well as encourage other businesses or organizations to donate to the exempt organization because their donations will be tax deductible.<sup>24</sup> The disadvantages to applying for this exemption are that the application may be costly and time consuming for some organizations.<sup>25</sup> Further,

## How do you file to become tax exempt under federal law?

- 1 Establish farmers' market as a trust, corporation, or an association
- 2 Include appropriate provisions/statements in organizing document(s), i.e., articles of incorporation ([Sample IRS Draft](#))
- 3 Receive an Employer ID Number (EID)
- 4 Complete and sign the correct application forms ([Form 1023](#)) and pay required fee ([Form 8718](#))
- 5 Provide required financial information
- 6 Mail application to IRS

(See "Application Process," Internal Revenue Service, <http://www.irs.gov/Charities-&-Non-Profits/Application-Process>.)

those organizations granted the exemption will be required to keep records and final financial reports each year.<sup>26</sup> Lastly, exempt organizations will be limited in the type of political activity permitted.<sup>27</sup>

## Kansas Sales Tax

There are several types of Kansas state taxes that may be imposed on a farmers' market, but this fact sheet will just focus on the Kansas sales tax.

Kansas law declares all retail sales of goods, including food, are considered taxable unless specifically exempt.<sup>28</sup> This means that every sale item purchased by the farmers' market organization itself includes a sales tax. Likewise, individuals purchasing items from farmer's market vendors, must also pay a sales tax on those purchases. The current sales tax rate for Kansas is 6.15% (effective July 1, 2013). Notably, municipalities are also able to establish additional sales tax.<sup>29</sup>

## Will my Non-Profit Farmers' Market be eligible for Kansas's Tax Entity Exemption Certificates?

Probably not. The Kansas Legislature has established an exemption certificate which allows certain organizations to be exempt from paying sales tax when purchasing certain things, such as the exemption from retailers' sales tax of an item at the time of purchase.<sup>30</sup> While Kansas does

exempt several non-profit and 501(c)(3) exempt organizations, it does not grant exemption certificates to all non-profit organizations or all organizations that are exempt from federal income tax under Section 501(c)(3). Further, non-profit 501(c)(3) charities are not listed as organizations exempted by the Kansas Legislature. (See [Kansas Department of Revenue website](#) for more detailed information).

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## Endnotes

- <sup>1</sup> KAN. STAT. ANN. § 2-3801 et seq. (“Kansas Farmers’ Market promotion Act”).
- <sup>2</sup> See I.R.S., *Exemption Requirements — 501(c)(3) Organizations*, [http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Exemption-Requirements-Section-501\(c\)\(3\)-Organizations](http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Exemption-Requirements-Section-501(c)(3)-Organizations) (last visited May 27, 2014); see also Kansas Office of the Sec’y of State, *Charitable Organizations*, [http://www.kssos.org/business/business\\_charitable.html](http://www.kssos.org/business/business_charitable.html) (last visited May 27, 2014).
- <sup>3</sup> I.R.C. § 501(c) (“Exemption from tax on corporations, certain trusts, etc.”); KAN. STAT. ANN § 17-1760 (“Religious, Charitable, and Other Organizations; Definitions”).
- <sup>4</sup> See I.R.S., *Exemption Requirements — 501(c)(3) Organizations*, [http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Exemption-Requirements-Section-501\(c\)\(3\)-Organizations](http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Exemption-Requirements-Section-501(c)(3)-Organizations) (last visited May 27, 2014); Kansas Dep’t of Revenue, *Tax Entity Exemption Certificates*, <http://www.ksrevenue.org/pecentitylearnmore.html> (last visited May 27, 2014).
- <sup>5</sup> See Mod Nonprofit Corp Act § 26 (1964).
- <sup>6</sup> See I.R.S., *Application Process, Internal Revenue Service*, <http://www.irs.gov/Charities-&-Non-Profits/Application-Process> (last visited May 27, 2014) (“For the Internal Revenue Service (the IRS) to recognize an organization’s exemption, the organization must be organized as a trust, a corporation, or an association”).
- <sup>7</sup> See Mod. Corp. Checklist § 25:2 (“Procedures to organize not-for-profit corporation”).
- <sup>8</sup> KAN. STAT. ANN. § 17-1763 (“Definitions”). See also Kansas Office of the Sec’y of State, *Form CN 51-02*, (“Not-For-Profit Corporation Articles of Incorporation”), [http://www.kssos.org/forms/business\\_services/CN.pdf](http://www.kssos.org/forms/business_services/CN.pdf).

- <sup>9</sup> See I.R.S., *Application Process*, <http://www.irs.gov/Charities-&-Non-Profits/Application-Process> (last visited May 27, 2014) (“For the Internal Revenue Service (the IRS) to recognize an organization’s exemption, the organization must be organized as a trust, a corporation, or an association”). Specific legal protections are created for an organization (and sometimes its board of directions) when the organization becomes organized as a trust, corporation, or association.
- <sup>10</sup> *Id.*
- <sup>11</sup> For example, the State of Kansas has declared several types of charitable organizations exempt from paying specific state taxes. See Kansas Dep’t of Revenue, *Tax Entity Exemption Certificates*, <http://www.ksrevenue.org/pecenti-tylearnmore.html>. (last visited May 27, 2014).
- <sup>12</sup> KAN. STAT. ANN. § 17-1764 (“Registration of charitable organizations”); Kansas Office of the Sec’y of State, *Form NP 50* (“Not-for-Profit Corporation Annual Report Instructions”), [https://www.kssos.org/forms/business\\_services/NP.pdf](https://www.kssos.org/forms/business_services/NP.pdf).
- <sup>13</sup> KAN. STAT. ANN. § 17-7504 (“Not-for-profit corporations; annual report; annual report fee”); 17-1760 (“Definitions”); 17-1761 (“Registration of charitable organizations”).  
KAN. ADMIN. REGS. § 81-4-4 (“Registration requirements for not-for-profit issuers”); 92-19-67 (“Sales by corporations, businesses, organizations, and associations organized not-for-profit”).
- <sup>14</sup> KAN. STAT. ANN. § 17-1763 (“Definitions”). See also Kansas Office of the Sec’y of State, *Form CN 51-02*, (“Not-For-Profit Corporation Articles of Incorporation”), [http://www.kssos.org/forms/business\\_services/CN.pdf](http://www.kssos.org/forms/business_services/CN.pdf).
- <sup>15</sup> See I.R.S., *Applying for 501(c)(3) Tax-Exempt Status*, <http://www.irs.gov/pub/irs-pdf/p4220.pdf>.
- <sup>16</sup> 8 Fletcher Cyc. Corp. § 3737 (explaining “Under the Revised Model Business Corporation Act, corporate existence begins when the articles of incorporation are filed. Without such organization, the corporation as such can do no corporate act, can receive no corporate property, and can incur no corporate liability, regardless of the rules governing corporate liability on preorganization contracts after organization under the doctrines of ratification or estoppel, or the rules governing the individual liability of directors, incorporators or promoters on such preorganization contracts.”)
- <sup>17</sup> See I.R.S., *Applying for 501(c)(3) Tax-Exempt Status*, <http://www.irs.gov/pub/irs-pdf/p4220.pdf>.
- <sup>18</sup> See I.R.S., *Political and Lobbying Activities*, <http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Political-and-Lobbying-Activities> (last visited May 27, 2014).
- <sup>19</sup> Charitable organization means “any person who engages in the activity of soliciting funds or donations for, or purported to be for, any fraternal, benevolent, social, educational, alumni, historical, humane, public health or other charitable purpose. Charitable organization does not include political parties, political candidates or committees formed in support of political candidates or political parties.” KAN. STAT. ANN. 17-1760 (“Religious, Charitable, and Other Organizations; Definitions”).
- <sup>20</sup> *Northern California Cent. Services, Inc. v. U.S.*, Ct.Cl.1979, 591 F.2d 620, 219 Ct.Cl. 60.
- <sup>21</sup> Similar language utilized by “The Constitution” and “By-Laws” for the Glen Falls Farmers’ Market Association.
- <sup>22</sup> I.R.S., *Applying for 501(c)(3) Tax Exempt Status*, <http://www.irs.gov/pub/irs-pdf/p4220.pdf>.
- <sup>23</sup> See generally, I.R.S., *Tax Information for Charitable Organizations*, <http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations> (last visited May 25, 2014).
- <sup>24</sup> I.R.S., *Organizations Eligible to Receive Tax-Deductible Charitable Contributions*, <http://www.irs.gov/Charities-&-Non-Profits/Organizations-Eligible-to-Receive-Tax-Deductible-Charitable-Contributions> (last visited May 27, 2014).
- <sup>25</sup> See generally, I.R.S., *Life Cycle of a Public Charity/Private Foundation*, <http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Life-Cycle-of-a-Public-Charity-Private-Foundation> (last visited May 27, 2014).
- <sup>26</sup> I.R.S., *Exempt Organizations — Required Filings*, <http://www.irs.gov/Charities-&-Non-Profits/Exempt-Organizations---Required-Filings> (last visited May 27, 2014).
- <sup>27</sup> I.R.S., *The Restriction of Political Campaign Intervention by Section 501(c)(3) Tax-Exempt Organizations*, [http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/The-Restriction-of-Political-Campaign-Intervention-by-Section-501\(c\)\(3\)-Tax-Exempt-Organizations](http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/The-Restriction-of-Political-Campaign-Intervention-by-Section-501(c)(3)-Tax-Exempt-Organizations) (last visited May 27, 2014).
- <sup>28</sup> KAN. STAT. ANN. § 79-3603 (“Retailers’ sales tax imposed; rate”); 79-3606 (“Exempt sales”).
- <sup>29</sup> KAN. STAT. ANN. § 12-187 (“Countywide and city retailers’ sales taxes; procedures for imposition; election required; rate; use of revenue; validation of certain elections; continuation in effect of certain taxes; authority to imposition; statement of purpose”).
- <sup>30</sup> See Kansas Dep’t of Revenue, Pub KS-1520 (Rev. 12/12), available at <http://www.ksrevenue.org/pdf/pub1520.pdf> (“Kansas Exemption Certifications”).