

IOWA

Local Food Organizational Toolkit

STRUCTURE ■ MANAGEMENT ■ FINANCE

Part 2: Organizational structure



IOWA STATE UNIVERSITY
Extension and Outreach



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Introduction

The purpose of this toolkit is to lay out the business and financial elements of starting and coordinating a local foods organization in Iowa. The information in this toolkit is applicable to farmers markets, advocacy groups (Food Access and Health Work Group, Iowa Farmers Union), coalitions and multi-stakeholder groups (Regional Food Systems Working Group, Flavors of Northwest Iowa, Northeast Iowa Food and Fitness Initiative), food hubs, educational and civic groups, food policy councils, farmer cooperatives, and others.

This is **Part Two** of a toolkit which is divided into three parts: 1) Defining your organization's focus and leadership, 2) Organizational structure, and 3) Funding your local food organization. Although each section can be read independently, we strongly encourage you to review all three sections together. You will also find worksheets, references and examples to help you move each concept from idea to action.

Ongoing business or organizational management, food safety and health regulation, insurance, or marketing will not be covered in this toolkit. However, other resources on these topics are available at the Iowa State University Extension and Outreach Food Safety website <http://www.extension.iastate.edu/foodsafety/>, the Legal Guide For Direct Farm Marketing by the Drake Agricultural Law Center <http://directmarketersforum.org/the-legal-guide-for-direct-farm-marketing/>, and the Iowa Department of Inspections and Appeals Food and Consumer Safety Bureau <http://dia.iowa.gov/page3.html>.

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Legal Structure

Most local food organizations should operate as a legal business entity. This will allow the organization to:

1. Hold a bank account;
2. Enter contracts and rental agreements;
3. Apply for grants;
4. Clarify who is liable for the activities of the organization,
5. Purchase insurance to protect employees, board members, property owners and other interested parties in the case of a lawsuit.

If your organization is not operating as part of a legal entity, it cannot hold or spend funds, and it is difficult to offer legal protection for the people involved in organization management and planning.

Key Questions to Consider While Forming a Business or Organization:

1. **Will you form your own entity or become part of an existing entity?**
 - a. If you form your own entity, you will need to register your organization with the Iowa Secretary of State's office.
 - b. If you become part of an existing entity, a fiscal sponsor and usually another nonprofit, you will need a written and signed agreement with them. This usually is the easiest option for new nonprofit organizations.
2. **Where can you find advisors to help with your organizational formation?**
 - a. If you decide to form your own business or organization, a lawyer and a certified public accountant (CPA) are recommended.
3. **If you form your own entity, will you operate as a nonprofit, a for-profit, or a cooperative?**
 - a. Nonprofits are structured to receive grants and charitable funds with relative ease. However, all generated revenues must go back into the organization. Nonprofits require complicated maintenance paperwork and compliance with Internal Revenue Service (IRS) requirements.
 - b. For-profits are easy to start and allow owners to retain profits. However, they are not eligible to receive many grants.

- c. Cooperatives are a type of for-profit corporation owned and controlled by members who are users of the cooperative's services. Cooperatives return profits to members. They are sometimes eligible for grants.

4. What specific legal structure is most suitable?

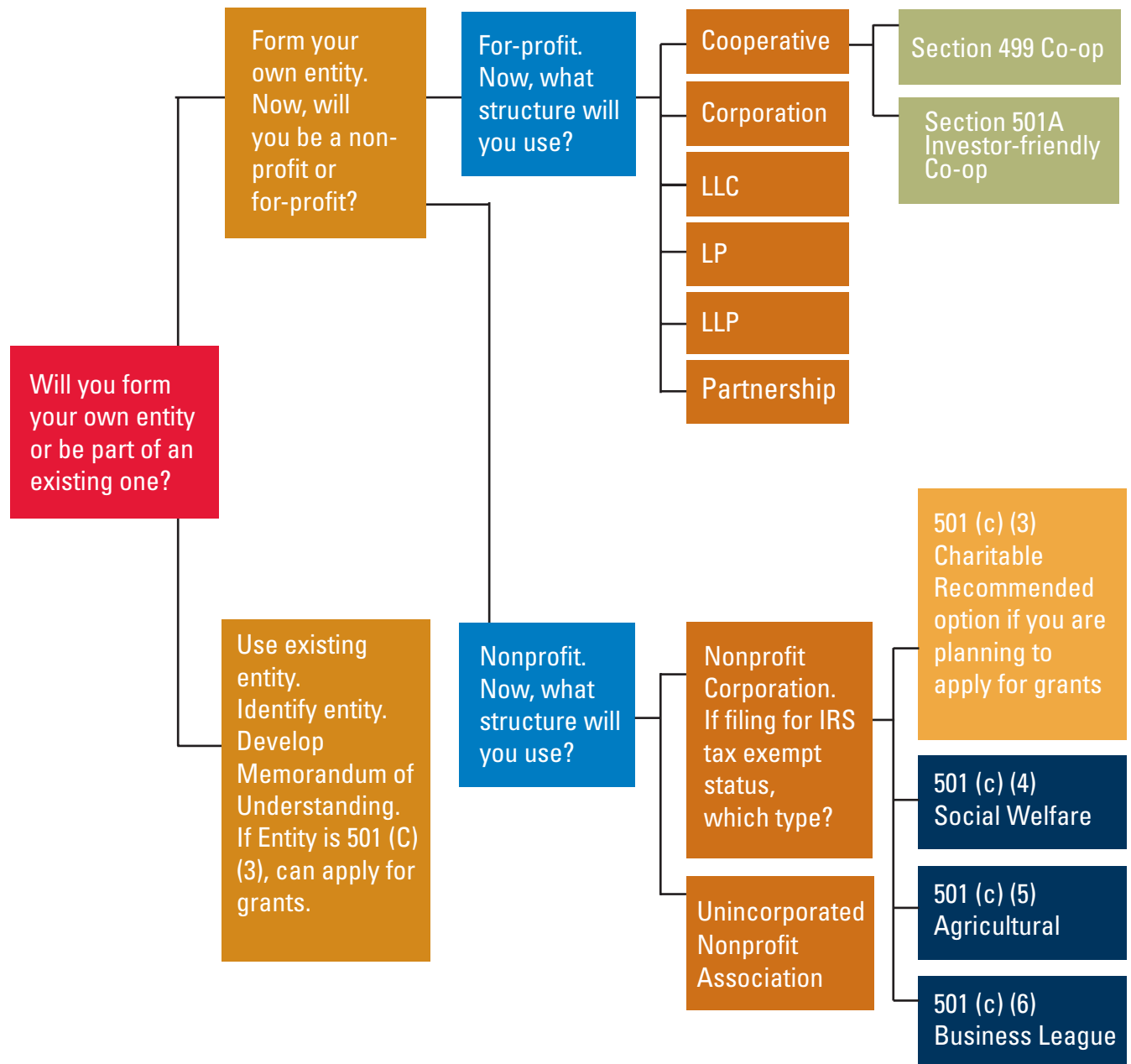
- a. Nonprofits must register in Iowa as a Nonprofit Corporation (recommended) or an Unincorporated Nonprofit Association. Nonprofits also must decide which IRS tax-exempt status to apply for: 501(c)(3) charitable nonprofit; 501(c)(4) social welfare; 501(c)(5) labor, agricultural or horticultural organization; or 501(c)(6) business league.
- b. For-profits in Iowa must register as a Profit Corporation, Partnership, Limited Liability Company (LLC), Limited Partnership, Limited Liability Partnership (LLP), or Sole Proprietorship.
- c. Cooperatives register in Iowa as a Section 499 Cooperative Association, which limits non-member investment, or a Section 501A Cooperative Association, which allows more non-member investment. They can also register as a 501 Cooperative Corporation, but we do not recommend this structure for most local food organizations.

5. What other paperwork is necessary?

- a. Checklists for nonprofits and for-profits are provided later in this publication. Refer to the decision tree for a simple overview of options for forming your organization.



DecisionTree: Choosing a Business Structure for your Local Food Organization



1. Will You Form Your Own Entity or be Part of an Existing Entity?

A local food organization can operate as an independent entity or under the umbrella of another organization. There are advantages and disadvantages to both options.

Using a fiscal sponsor or umbrella group

Some local food groups function as initiatives or subgroups of established organizations, especially in their early years. These often are “born” out of their host organizations, but sometimes are “adopted.” There are many benefits to these arrangements. An existing organization can provide needed structure, support and perhaps paid staff for a local food initiative that is just getting started. This relationship may be permanent or just a temporary step on the way to the group becoming its own entity.

If a group becomes affiliated with an established organization in order to receive grants or donations through that organization, the established organization is called a **fiscal sponsor**. The affiliated group becomes the **fiscal sponsee**. Most often, new groups utilize a fiscal sponsor that has IRS 501(c)(3) charitable status in order to apply for grants, because 501(c)(3) entities are eligible for most types of grant funding. (A for-profit local food organization also could be a subsidiary of an existing for-profit company, but that scenario is not covered here.) IRS rules state, “As an alternative to applying for [tax] exemption,

an organization may obtain many of the benefits of 501(c)(3) status by affiliating with an existing charity that acts as its agent. It is important to note that the existing charity must be given full control and authority over the program.” Fiscal sponsees must also conform to the IRS regulations on tax-exempt activities for 501(c)(3) charities. More information is in “Applying for 501(c)(3) Tax-Exempt Status, IRS Publication 4220. www.irs.gov/pub/irs-pdf/p4220.pdf.

The fiscal sponsor’s board of directors assumes legal and fiscal responsibility for how funds are spent by the sponsee, and the degree of control that the fiscal sponsor has over projects is determined by an agreement with the sponsee.

A local food organization might want to find a fiscal sponsor if:

1. It is a small or very new organization without the capacity to manage the accounting and reporting needed to properly administer grant funds.
2. It does not have the time and manpower to file its own business paperwork and IRS application for nonprofit status.
3. It needs to begin soliciting grants and donations or hiring employees immediately, before tax-exemption paperwork can be processed.
4. It is starting on a trial basis, and may or may not continue to exist in the future.



Pros and Cons of Using a Nonprofit Fiscal Sponsor

Pros	Cons
<ul style="list-style-type: none"> • Sponsor provides accounting services. • Sponsee can apply for grants without going through IRS nonprofit paperwork if sponsor is a 501(c)(3). • Sponsor's insurance policy may cover the sponsee. • Sponsor may be able to hire employees for the sponsee without the sponsee having its own workers' compensation and unemployment insurance. • Sponsor files all annual tax information. • Sponsor may provide experienced advice on grant writing and strategic planning. • Sponsor may "buy in" to the success of the sponsee and become more likely to offer help in other matters. 	<ul style="list-style-type: none"> • Sponsee leaders and staff may not have immediate access to accounting statements and financial information. • Sponsor may charge an administrative fee for managing funds. • Applying for grants may take longer because the sponsee must seek sponsor approval on proposals and ask for required documents. • Sponsor could challenge authority of the sponsee's leadership or try to influence its decisions. • Sponsor could suddenly go bankrupt, change leadership, or decide it no longer wants to be a fiscal sponsor.

Creating a written, signed agreement with your fiscal sponsor is strongly recommended, which will help avoid some of the cons listed above. Many templates are available on the Internet, but you should consult with your legal advisor in developing an agreement that works for you. North Sky Nonprofit Network has an editable template online.

<http://www.northskynonprofitnetwork.org>

The IRS recognizes six types of fiscal sponsorship arrangements: (1) direct project, (2) independent contractor project, (3) pre-approved grant relationship, (4) group exemption, (5) supporting organization, and (6) technical assistance. Before entering a fiscal sponsorship arrangement, sponsor and sponsee should agree on which type is most suitable. More detailed information is available at www.boardsource.org.

For a local food organization that already has its own leadership and volunteers, a pre-approved grant relationship might work well, while a group that is new and will be managed directly by an existing organization might operate as a direct project.

Local nonprofit organizations that might be willing to act as fiscal sponsors:

- Churches
- Community colleges

- Local or state charities (anti-hunger organizations or food banks)
- Resource conservation & development councils
- Chambers of commerce—usually 501(c)(6) organizations
- Economic development authorities—inquire whether your local EDA is a 501(c)(3), 501(c)(4) or 501(c)(6)

If you are talking to potential fiscal sponsors, consider these items:

- Are they registered with the IRS as a 501(c)(3) charitable nonprofit? If you want to apply for grants, this is important.
- Are they enthusiastic about being a fiscal sponsor?
- Does your mission fit with the sponsor's organizational mission or goals?
- Do they care about your mission?
- Do they have a good bookkeeper and a reliable accounting system?
- Have they received grants in the past and managed them well?

- Do they have employees? If your group wants to hire an employee and provide benefits and workers' compensation, would that be an option through this organization?
- Are they likely to respect the existing leadership/structure/mission of your group or will they make changes? Would changes be a problem?
- Will they be able to give your group the attention it needs? Will they provide information quickly, work closely with you on grant submissions, and meet with your organizational leaders to discuss protocols?
- Will they charge an administrative fee (often ten percent) for managing your finances? If so, you must make sure that this is allowed in the grants you pursue.

Some great guidance on working with fiscal sponsors is available from the National Council of Nonprofits. <https://www.councilofnonprofits.org/tools-resources/fiscal-sponsorship-additional-resources>.

Registering your own entity

If you plan to operate as a **for-profit** entity, you cannot use a fiscal sponsor for business activities. You must register as your own business.

If you plan to operate as a **nonprofit**, registering your own business entity (as opposed to using a fiscal sponsor) may make sense if you:

- Strongly value your organization's ability to maintain its own leadership.
- Can recruit enough dedicated, skilled people for a board of directors who will monitor your organization's finances and take legal responsibility.
- Want to open a bank account and conduct business.
- Want to accept grants and charitable donations, and are willing to complete the IRS paperwork required.

More information about registering a new business entity will appear later in this publication.

2. Where Will You Find Key Advisors?

If you decide to form your own organization, we highly recommend finding trusted advisors or service providers in your community who have experience with business or nonprofit formation. There are a variety of resources for starting your nonprofit or for-profit entity.



1. **SCORE** is a nonprofit that provides assistance with incorporation and business startup through education and mentorship. Iowa locations include Des Moines, Ottumwa, Cedar Rapids, Cherokee, Dubuque, Muscatine, Sioux City, and Marshalltown. Find your local office here: <https://www.score.org>.
2. **Small Business Development Center** has resources for new businesses. <http://www.iowasbdc.org>.
3. **Iowa Institute for Cooperatives** offers help for new cooperatives. <http://www.iowainstitute.coop>.
4. **Brian Perry, ISU Extension and Outreach**, works with nonprofits in management, accounting and fundraising. bmperry@iastate.edu.
5. **Your county extension office** may have staff experienced in organizational startup and references for community resources.

A lawyer with business formation and/or nonprofit law experience is highly recommended. A good searchable list of lawyers is at <http://www.martindale.com/find-lawyers-and-law-firms.aspx>, or you can search the Iowa Bar Association roster. <http://www.iowabar.org>. Always ask for references from other nonprofits when seeking a lawyer. Some lawyers offer pro bono or discounted legal advice. However, someone providing free services may not always respond as quickly or diligently as someone who is being paid.

At some point, your organization or business will need a CPA to help you understand tax law, pay your taxes, and meet employer requirements. The Iowa Association of CPAs provides listings at www.iacpa.org/Resources/FindACPA.aspx. For nonprofits, ISU's Brian Perry recommends the following:

"Use [the Iowa Association of CPAs] as a starting point for identifying "local" CPA firms that want to work with nonprofits. Call nonprofits in your area similar to yours (staff size, board size, etc.) to see who they use. Draft a Request for Proposals (RFP) including the following information: who we are and what we do; number of employees; number on board and their responsibilities; income and expenses; number of checks that come in and number of payables cut; etc. List your board's expectations for any audits or financial review the CPA would conduct."

In addition to your advisors, the following general resources provide guidance for business and organizational formation:

Resources for business formation

IASourceLink is a government website set up to help businesses stay up to date on licensing and registration requirements via the Iowa Business License Information Center. <http://www.iasourcelink.com/resources/licensing>. Questions may be directed to Christine Cavil at Christine.Cavil@iowa.gov.

The Iowa Business Concierge can answer general business questions not related to licensing at 866.537.6052 or via their online request form at <http://www.iasourcelink.com/resources/business-concierge>.

Resources for nonprofit formation and management

The **Larned A. Waterman Iowa Nonprofit Resource Center** offers many resources including the publication "Iowa Principles and Practices for Charitable Nonprofit Excellence," at their website. <http://inrc.law.uiowa.edu>. "Start a Nonprofit" workshops are held regularly by the Waterman Center and cover the process of filing 501(c)(3) paperwork. Check their website for details. They also offer quarterly newsletters for nonprofits.

The **Nonprofit Management Academy** offered by Iowa State University Extension and Outreach offers training in nonprofit management, governance, fundraising, fiscal management, and leadership. The Academy is hosted by county Extension offices throughout the state with the assistance and input of local nonprofits. The Academy consists of ten full-day classes, one day per month, over a year. There is usually a fee for each class, and a certificate is available on completion of all classes. For more information, or to find out if an Academy could be hosted in your area, contact Brian Perry. bmperry@iastate.edu or visit <http://www.extension.iastate.edu/communities/npma>.

BoardSource has many useful resources including a brief but excellent overview on the entire process of starting a 501(c)(3) nonprofit, with answers to frequently asked questions, titled "101 Board Basics: Starting a Nonprofit- FAQs." Download it for free at their Learning Center & Store, under Community Resources. <http://www.boardsource.org>.



3. Will You Operate as a Nonprofit, For-Profit or Cooperative?

Local food organizations can be structured in a variety of ways. Table 1 illustrates some key differences between being a tax-exempt nonprofit, a for-profit or a cooperative. It is important to note that all organizational structures, whether nonprofit or for-profit, must file annual reporting documents with the IRS.

More about nonprofits

Grants, fundraising, and not having to pay taxes are usually the chief reasons for becoming a nonprofit. Grants are available for many types of business entities, but a tax-exempt nonprofit is eligible to receive more kinds of grants than others.



Table 1

	Tax-exempt nonprofit	For-profit	Cooperative*
Earnings	No one receives profits; net income must go back into business operations. Organization staff can be paid pre-determined wages or salaries.	Owners can take profit from the business in addition to wages or salaries earned. If the business has investors, some profit may be distributed to them.	Allocates profits to members and sometimes to outside investors, depending on the cooperative's policies.
Governance	Democratically governed by a board of directors who promote and oversee the mission.	Governed by one or two people or by a board of directors, depending on structure.	Usually democratically governed by a board of directors comprised of voting (Class A) members and elected by other members.
Grants	May have the option to receive grants and tax-deductible donations, but first must file IRS tax exemption paperwork and comply with regular audits.	Cannot receive most types of grants (with some exceptions) and cannot accept tax-deductible donations.	Eligible for certain kinds of grants.
Other sources of capital	Eligible for loans. Cannot have investors because profits can't be distributed	Eligible for loans. Owners may contribute equity. Can accept investors.	Eligible for loans. Members may contribute equity. Can accept investors.
Taxation	Generally exempt from income tax and property tax. Exempt from paying sales tax in some situations.	Must pay all applicable business taxes including sales, property and income taxes. Details vary with type of business. For corporations, income is taxed at both the corporate and individual levels, except in the case of S corporations.	May be eligible for single taxation, meaning either the cooperative or the members, but not both, will pay income tax. Otherwise, taxed similarly to other for-profits.
Other considerations	Possibility of being grant and donation dependent.	Must make enough profit to survive.	Must make enough profit to survive, but members can provide equity and share the risk of losses.
Structures available in Iowa	Nonprofit corporation, Unincorporated Nonprofit Association	Corporation, LLC, LP, LLP, Partnership, Sole Proprietorship	Section 499 Cooperative Association, Section 501A Cooperative Association, Section 501 Cooperative Corporation

**Note: Cooperatives are a special type of for-profit corporation. See details later in this publication.*

In order to receive tax-exempt status, a nonprofit must file paperwork with the IRS. The IRS recognizes several types of tax-exempt nonprofit designations. The ones most likely to apply to local food organizations include:

- 501(c)(3) – Charitable
- 501(c)(4) – Social welfare
- 501(c)(5) – Labor, Horticultural or Agricultural
- 501(c)(6) – Business League

Details about the application process and requirements for each type of organization can be found in “Tax-Exempt Status for Your Organization,” IRS Publication 557. <http://www.irs.gov/Charities-&Non-Profits/Types-of-Tax-Exempt-Organizations>. A useful handout from the Farmers Market Coalition compares each designation from a farmers’ market perspective. <http://farmersmarketcoalition.org/wp-content/uploads/2013/10/Tax-Status-Handout.pdf>

For local food organizations, choosing the correct tax-exempt status can be confusing. It should be noted that while all four designations are exempt from paying most kinds of taxes, only 501(c)(3) charitable nonprofits can accept tax-deductible donations. This type of nonprofit is the type most commonly eligible for grants and therefore is the most sought-after IRS nonprofit status. However, depending on your organization’s mission and activities, one of the other tax-exempt statuses may be a better fit. Furthermore, filing paperwork for a 501(c)(3) involves a more lengthy and complicated process than the other tax-exempt designations, and IRS approval for 501(c)(3) nonprofits can take as long as sixteen months. These are some of the reasons why nonprofit-minded organizations might choose to use a fiscal sponsor, use a different tax-exempt status, or not apply for tax-exempt status at all.

Farmers markets illustrate the challenge of choosing and obtaining the right 501 designation for a local food organization. A recent national survey by the Farmers Market Coalition found that all four tax-exempt statuses are used by farmers markets across the country, but the 501(c)(3) structure is the most common choice.¹ However, in a ruling in 2008, the IRS determined that farmers markets are not eligible for 501(c)(3) status if their primary activity is to provide benefit to vendors. L. Leon Geyer, professor of agricultural law at Virginia Tech, explains:

“The regulations require an organization to show that it is not organized or operated for private interests in order to be exempt under section 501(c)(3) of the Code. When a group

of individuals associate to provide a service for themselves, they are serving a private interest. Where a farmers market’s primary activity is providing a location for members to sell goods and promotion of their sales activity, ninety percent of your funding comes from those same individuals, and all or most of the directors are vendors at the market and personally benefit from your operation, the market is not a tax exempt organization according to the IRS. These facts demonstrate that the market provides a substantial private benefit to the farmers’ market members.”²

However, some organizations that were created to host farmers markets since 2008 have been able to obtain 501(c)(3) status. This was most likely due to missions stating they would serve eligible purposes other than benefitting vendors; for example, they might have planned to offer public education, provide poverty relief, or combat community deterioration. In the “Farmers Market Guide to Nonprofit Incorporation,” Michael Siegel suggests giving your organization a name that does not have “Farmers Market” in it and trying to avoid the words “farmers market” on a 501(c)(3) application or incorporation paperwork.³ Siegel suggests that the organizational mission should focus on community services that the organization provides, such as:

- Generating interest in locally produced foods and producers.
- Providing information about local farm products and how to access and use them.
- Educating the public about how local food is grown and how it compares to other food.
- Providing growing advice, lessons, and tips.
- Preparing educational materials encouraging use of locally produced foods.
- Giving cooking, handling and purchasing lessons.

These insights could just as easily apply to a nonprofit food hub or any organization that serves farmers. The words “economic development” also can cause confusion because the IRS may think that you are operating a non-charitable business league or social welfare organization. The applicant may wish to avoid talking about economic development, and instead explain how its services will help meet the needs of the community or provide opportunities to underserved groups such as beginning farmers.

Nonprofits that don't file for tax-exempt status

According to the IRS, a nonprofit organization that meets the criteria for a 501(c)(3) charitable nonprofit, but receives no more than \$5,000 in gross receipts per year, can behave like a 501(c)(3) without formally applying to the IRS for that status. This applies to any organization structured as a nonprofit, including nonprofit corporations and unincorporated nonprofits. If the activities of the organization are fairly simple, or if the organization has a fiscal sponsor that can accept larger grants on its behalf, this may be an acceptable way to do business. Such an organization can form contracts, hold its own bank account, purchase insurance policies, accept small donations, and even manage larger grants through a fiscal sponsor, all without having formal tax-exempt status. However, if you are operating as a nonprofit and are receiving more than \$5,000 per year, you are required to file with the IRS for tax-exempt status.

More about for-profits

The most obvious reason to form a for-profit business is that owners are allowed to collect profits, which is appealing if you expect your operations to make a substantial amount of money. Owners of for-profits have a financial stake in their operations and are motivated to make them successful. Another reason for choosing for-profit status is the independence that accompanies efforts sustained without grants or donations. In some cases, especially when there is a possibility of direct competition with other area small businesses, a program may be viewed more favorably if it is structured as a for-profit. This eliminates the perception that the program has an unfair advantage over other businesses because of grants. Nonprofit farmers markets usually don't draw a lot of criticism from the business community for unfair competition, but more complex marketing models (such as nonprofit local food wholesale businesses) sometimes do.

For-profits may not have as many fundraising options as nonprofits, but they can apply for loans, solicit investors, and get help from agencies such as the Small Business Administration. For-profits often have to work harder than nonprofits to raise startup capital and maintain cash flow to pay their bills, but if the activities of the local food organization are profitable, the owners can enjoy the profits.

More about cooperatives

A cooperative is a type of for-profit corporation owned

by and operated for the benefit of those using its services. The following are unique characteristics of cooperatives:

- They are controlled primarily by their users, such as farmers or consumers, who join and become members.
- Realized profits are distributed to members at the end of the year.
 - Some of the profit must be returned to members on the basis of how much they used the cooperative, effectively reducing the cost of services. Such payments are called **patronage refunds**.
 - Some of the profit may be retained by the cooperative as member equity accounts, which are similar to stock owned by a shareholder. Members own the money in their equity accounts but the cooperative keeps and uses it. Cooperative policies determine when members can redeem their equity for cash.
 - If the cooperative incurs a loss, members risk losing the equity they've contributed.

There are limitations to the degree of control that outside investors (non-members) can have over cooperatives. This is meant to ensure that those who actually use the cooperative services maintain control of the business.

Current Iowa State Code allows for three different cooperative business structures:

- **Section 499 Cooperative Associations** are governed exclusively by their members via a "one member, one vote" system. If the cooperative has outside investors, they are not allowed to vote.
- **Section 501A "Investor Friendly" Cooperative Associations** are a hybrid of the cooperative and LLC business structures and considered by some to offer "the best of both worlds." They are allowed to give voting rights to investors if desired. This may make it easier to raise capital, but also may dilute member control.
- **Section 501 Cooperative Corporations** are a type of "new generation cooperative" structure designed for commodity processing facilities, making the structure an unlikely fit for most local food businesses.

These types of cooperatives are also considered to be for-profit corporations. Therefore, in addition to being governed by the state statutes for cooperatives, they are subject to the statutes for corporations.

Organizations may choose to structure themselves as cooperatives for a variety of reasons. Often, it is because an entire group of members want to have direct control over the activities of the organization, or because members wish to split the profits. Cooperatives are a popular structure for farmers who wish to market food or purchase inputs together, consumers who desire to share ownership of a retail store that supplies them with products, or mixed groups of people who want the same services for different reasons. Multi-stakeholder cooperatives, whose members might include farmers as well as customers, are becoming a popular structure because they enable people knowledgeable about supply and demand to be incorporated into the cooperative's decision-making. Examples of multi-stakeholder cooperatives include Iowa Food Cooperative and Iowa Valley Food Co-op, both of which aggregate products from multiple farmers to sell to consumers, and Fifth Season Cooperative in Wisconsin, which wholesales local food to volume buyers.

It also is possible for other types of entities to operate in ways similar to a cooperative without formally filing for a cooperative business structure. If strictly following cooperative principles, other types of for-profit entities can even file their federal taxes as cooperatives. Tax law, governance considerations, grant funding eligibility, financing and liability all influence the decision to incorporate as a cooperative or choose another business form. Consult a legal advisor for details.

While exploring options, it is highly recommended that prospective cooperatives consult a legal advisor who is familiar with securities law. Securities law includes requirements for businesses that have investors, and can protect a company's board of directors if the company is sued by its investors. Exemptions to security law exist for cooperatives. However, cooperatives should be aware of the law and how it works, since members hold equity and are similar to investors.

In Iowa, resources on cooperative formation include the Iowa Institute for Cooperatives. <http://www.iowainstitute.coop>. Keri Jacobs, Iowa State University Department of Economics, also serves as a resource for cooperatives, particularly for issues related to financing and capitalization. www.kerijacobs.net.

Revisiting the non-profit/for-profit/cooperative decision—Key questions to ask:

As long as you follow applicable laws, it is possible to be creative about how you operate within each type of organizational structure. However, when deciding whether to be nonprofit or for-profit, here are some questions to consider:

1. **Can you make enough money from your core activities to fund those activities in the long run?** For-profits and cooperatives need to be profitable to stay in business. Generating profit is not a legal requirement, but if a business is losing money, the owner(s) of the business ultimately shoulder the responsibility. Nonprofits, on the other hand, may be eligible for a wide range of grants, donations, and sponsorships, which reduce the need for them to raise revenue through business activities alone. Like for-profits, nonprofits can generate revenue through product sales, fees and event tickets, although they must obey applicable laws. The key difference is that for-profit businesses ultimately rely on funds they generate, while nonprofits can always supplement their income with donated funds. If you're thinking about becoming a for-profit, it's very important to work out a budget and business plan to ensure the expected revenue from the business is sufficient to cover the expected operating expenses.
2. **Is your primary mission charitable or educational?** If your mission is to help or educate others, you are a good candidate to become a 501(c)(3) nonprofit, the designation most often eligible for grants and charitable funds. Organizations that exist primarily to do political advocacy, sell goods, or foster economic development have a hard time getting 501(c) nonprofit status. This includes trade associations and farmers markets, unless they also have a significant educational or charitable purpose. Such groups are eligible for nonprofit statuses other than 501(c)(3), but are eligible for fewer grants and cannot accept tax-deductible donations.
3. **How will you be received in your community?** Community perceptions of nonprofits can be positive. When community members recognize that you are providing services for the good of everyone, and not for personal gain, they may choose to support you.

However, nonprofits can also elicit a negative response, particularly in regard to competition. Nonprofits have an advantage over for-profits because they may be able to accept grants, allowing them to provide goods and services at a reduced price. There can be some very real ethical problems with nonprofits competing directly with local for-profit businesses by providing exactly the same goods or services to the same customer base at a reduced cost. There can also be challenges with perception. Consider this question: will local businesses think that you are trying to put them out of business, even if you are not?

If you are considering forming a nonprofit that will provide a service commonly provided by for-profits, such as producing or selling food, we recommend that you consider carefully. As a nonprofit, you might develop guiding principles or a code of conduct explaining the ethical justification for your activities. Why is producing or selling food important in this context? Who will you serve who would not be served otherwise? Who stands to benefit? Is it possible that your activities could have a negative impact on other businesses, and if that does happen, what will you do? How will the community have a voice in your decisions?

4. **Does your decision-making need to reflect democratic principles?** Nonprofits, cooperatives and for-profit corporations are all governed by boards of directors who have input into the strategies, policies, and key decisions of the organization. LLCs, LLPs, LPs, partnerships and sole proprietorships, on the other hand, may be governed by only one or two owners.

One of the oft-cited advantages of for-profits, particularly those without boards, is the ability to make quick decisions under changing conditions. However, the disadvantage of an organization that is not democratically controlled is that it risks losing the support of the community members it needs the most. For example, a farmer may be more hesitant to trust a for-profit LLC food hub than a marketing cooperative whose board is comprised of other farmers. A nonprofit set up to help farmers of color will have a hard time doing its job if people of color don't make up a majority of its board. Think about your own situation and whether your decision-making structure will affect your ability to do your work.

Table 2 lists common types of local food organizations, and how they tend to be structured. Knowing whether your organization will be a nonprofit, for-profit or cooperative will help you to choose a business structure.



Common structures for local food organizations

Table 2

Type of organization or business	501(c)(3) Non-profit	For-profit	Co-op	Why?
Farmers market	X	X	X	A farmers market that wants to apply for grants should consider nonprofit status. However, some markets generate enough revenue from vendor fees or sales commissions to operate as for-profit businesses. There are not many cooperatives whose sole purpose is to operate a tailgate-style farmers market, but for a farmers market that operates more like a retail store, it may make sense to be a cooperative.
Food hubs (local food distribution businesses)	X	X	X	Nationally, 47% of food hubs are for-profits, while 34% are nonprofits and 13% are cooperatives. ⁴ Food hubs that want to receive grants for startup and equipment may want to be non-profits. However, many successful hubs are for-profit corporations, LLCs, or cooperatives that charge a commission fee on local food sales. Food hubs interested in a democratic structure controlled by farmers and/or customers, or that want to return profits to members, should consider becoming cooperatives.
Local food marketing initiative or local food promotion coalition	X			Marketing activities are often eligible for grants. If the organization's main activity is to raise awareness about local food, but not to sell anything, it may be hard to generate revenue. In this case grants and donations may be necessary. Most regional marketing programs and Buy Fresh Buy Local chapters tend to use a nonprofit fiscal sponsor rather than establishing their own organization.
Urban farm or community-run farm	X	X	X	Some urban farms sustain themselves by selling their products to make a profit. Others exist primarily for educational or food access purposes and are often nonprofits.
Nutritional education or food access organization	X	X		Efforts to improve food access or food education for vulnerable populations would be considered charitable and eligible for grants. Some for-profits provide education or improve food access, but it's harder for them get grants. If you're thinking about becoming a for-profit, consider carefully whether the need to generate business revenue may reduce your ability to serve needy people.
Political advocacy organizations	X			These are typically nonprofits, but rarely are 501(c)(3) charitable nonprofits. Sometimes they are 501(c)(4) social welfare organizations (which can participate in election campaigns), 501(c)(5) agricultural organizations, such as Farm Bureau chapters, or 501(c)(6) business leagues such as chambers of commerce. For 501(c)(3) non-profits, political lobbying may take up to twenty percent of the organization's money or time, and they cannot participate in election campaigns. Check with the IRS for details.

4. Which Legal Structure Suits Us Best?

Basic characteristics of Iowa legal business structures.

Iowa Business Structures

Table 3

Type	Options for legal structures in Iowa	Eligible for IRS tax-exempt status?	Owners / board members protected from liability?	Who pays income tax on profits?
Cooperative	Cooperative Association (section 501A)	No*	Yes	The cooperative or the members
	Cooperative Association (section 499)	No†	Yes	The cooperative or the members
For-profit	Limited Liability Company	Rarely ‡	Yes	The owners
	Partnership	No	No	The owners
	Limited Liability Partnership	No	Protected only from liability for torts of other partners	The owners
	Limited Partnership	No	General Partners – No. Limited Partners – Yes.	The owners
	Profit Corporation	No	Yes	The business and/or the owners‡
	Sole proprietorship (NOT RECOMMENDED)	No	No	The owner
Nonprofit	Nonprofit Corporation	Yes	Yes	No one
	Unincorporated Nonprofit Association (NOT RECOMMENDED)	Yes	No	No one

*Cooperatives are generally subject to “single taxation.” Some or all income may be exempted from income tax at the cooperative level if criteria are met. In this case, income taxes must be paid by individual members who received profits.

†LLCs may be charitable and can become 501(c)(3) tax-exempt nonprofits, but only if all members are 501(c)(3) organizations.

‡If the corporation chooses to file as an S Corporation, only its owners/shareholders are taxed. If it files as a C Corporation, both the business itself and the owners/shareholders are taxed.



The Drake University Agricultural Law Center has published an excellent guide to forming a producer marketing association which explains the difference between corporations, LPs, LLPs, LLCs and cooperatives from the perspective of a producer association. http://www.nationalaglawcenter.org/wp-content/uploads/assets/articles/obrien_producemarketing_book.pdf.

Corporations are the recommended structure for most organizations that plan to seek 501(c)(3) status. Author Joan Fritz writes, “Practically speaking, the group may want to seriously consider incorporating [if they plan to file for 501(c)(3) status] because the IRS will want to see certain documents even if not required by state law (for instance, organizing documents), and will also be checking for common governance issues such as compensation practices and conflict of interest procedures.” Read more at <http://nonprofit.about.com/od/faqsthebasics>.

Liability protection should be another important consideration when forming a new organization. Corporations often are favored as a business structure because of the liability protection they afford to board members as noted earlier. While a corporation can be sued, the individual board members and employees cannot be held personally liable as long as the board attempts to act responsibly, legally, and ethically. This means that the board members’ personal assets are protected in the case of a lawsuit or if the corporation goes into debt. The same is true for both nonprofit and for-profit corporations. By contrast, sole proprietorships and unincorporated associations offer few built-in protections for the personal assets of sole proprietors or association leadership if the business or organization is sued. For this reason, the Iowa Principles and Practices for Charitable Nonprofits Excellence states that “nonprofit corporation status under Iowa Code chapter 504 is often a preferable form for charitable nonprofits due to the limitation on liability of all those working for the charitable nonprofit corporation.”⁵

Regardless of whether your organization is a corporation, it’s still a good idea to purchase insurance to defray costs in the case of a lawsuit. Due to the expense of legal fees, even frivolous or unfounded lawsuits against an organization can be costly for the uninsured. Corporations should consider Directors and Operators or D&O insurance to protect board members, in addition to general liability insurance and other applicable policies such as product liability insurance.

Filing Organizational Paperwork

Once you have familiarized yourself with the information in this toolkit, consulted your legal advisors, and made a decision about how to proceed, you are ready to file your organizational paperwork.

General filings

The first step to creating a new business or organization is to file with the state. Although specific paperwork is different, the general process is similar, regardless of whether you are filing as a nonprofit, for-profit or cooperative.

Iowa Sourcelink is a state government website providing various resources for new businesses. The following checklist was adapted from their website www.iasourcelink.com.

Checklist for forming a new business or organization in Iowa:

1. Register your business entity with the state.
 - a. To find out if a business name is available, perform a database search under the Business Entities section on the Iowa Secretary of State’s website. <http://sos.iowa.gov>.
 - b. To register corporations, LPs, LLCs, nonprofits and trademarks, submit a completed set of Articles of Incorporation, containing all the information that the state code requires for your business type. See the requirements for each business type at Secretary of State Business Forms and Fees. <http://sos.iowa.gov/business/FormsAndFees.html>. Completed paperwork can be submitted via the Online Filings section of the website or mailed to: Secretary of State, Business Services Division, Lucas Building, First Floor, 321 E. 12th Street, Des Moines, Iowa 50319.
 - c. To register as a sole proprietor or simple partnership, contact your local county recorder, usually located at your county courthouse or county government building.
2. Post employee notices in the workplace as required by Iowa and federal law. <http://www.iowaworks.org/reqposters.htm>.
3. Check tax requirements with the Iowa Department of Revenue. <https://tax.iowa.gov>.

- a. If you are making taxable sales in Iowa, register for your Iowa Sales Tax permit. If you are wholesaling food, some customers may require a sales tax permit even if you are exempt from sales taxes.
- b. Check out these tax webinars to learn more about tax requirements: <http://www.iasourcelink.com/resources/business-webinars/iowa-tax-webinars>
4. Contact your local city clerk for any licenses or ordinances specific to the city in which your business is located.
5. Identify other state of Iowa license, permits and occupational licensing requirements at <http://www.iasourcelink.com/resources/licensing> or call the Business License Information Center 866-537-6052.
6. Check out fire and building code requirements online at Iowa Department of Public Safety, State Fire Marshal Division. <http://www.dps.state.ia.us/fm/index.shtml>.
7. For agriculture-related licenses, permits, and regulations visit the Iowa Department of Agriculture and Land Stewardship Regulatory Listings. <http://www.iowaagriculture.gov/departmentsForms.asp>.

New businesses and organizations, whether they are nonprofit or for-profit, should apply online for a Federal Employer Identification Number (EIN). <http://www.irs.gov/Businesses>. Use the IRS website to apply and avoid commercial look-alike sites. This is a short and simple process, but it requires having some important information on hand, and the information you supply should match what you submitted in your business registration application. Apply for the EIN after receiving verification of your business filings in the form or a certificate of incorporation from the state.

Additional procedures for nonprofits

Once a nonprofit has filed their Articles of Incorporation with the state and filled all requirements for nonprofit Articles of Incorporation, several additional actions must take place according to the Iowa Secretary of State's office.

1. **Receipt of a certificate of acknowledgement.** Upon filing the Articles of Incorporation with the Secretary of State, a certificate of acknowledgement will be issued to the nonprofit corporation.

2. **First organizational meeting.** After the certificate of acknowledgement is issued, an organizational meeting is held by the board of directors to adopt bylaws, elect officers, and carry out other business.
3. **Adoption of bylaws.** Iowa law requires the initial bylaws of a nonprofit corporation to be adopted by its board of directors. <http://sos.iowa.gov/nonprofits/MinCodeReq.html>.

To receive your nonprofit tax-exempt status you will need to file with the IRS. Forms and guidance for this process are available at <http://www.irs.gov/Charities-&Non-Profits>. These forms are to be submitted to the IRS after filing with the state:

- If you choose to file for a 501(c)(4), (c)(5) or (c)(6) designation, complete the Application for Recognition of Exemption Under Section 501(a), IRS Form 1024.
- If you choose to file for a 501(c)(3) designation, complete the Application for Recognition of Exemption Under Section 501(c)(3), IRS Form 1023, and submit a set of attachments which includes Articles of Incorporation, organizational bylaws, and information about your board of directors and your fundraising plans, all of which must comply with IRS requirements for 501(c)(3) status. This must be done within 27 months after you file your business formation paperwork with the state. Make sure that you have approved bylaws and an organizational management structure in place prior to filing. In 2014, the IRS launched an abbreviated version of the form. The Streamlined Application for Recognition of Exemption Under Section 501(c)(3), Form 1023-EZ, is intended for small organizations with gross annual receipts of less than \$50,000 and assets of less than \$250,000, to make it easier for small community organizations to obtain charitable nonprofit status.

The online legal encyclopedia at www.Nolo.com states, "once you have your federal IRS tax exemption, you are automatically exempt from Iowa income tax, however you may still be subject to other state sales, use, and property taxes."⁶ The Iowa Department of Revenue website offers information regarding other state tax exemptions for nonprofits. <https://tax.iowa.gov/iowa-tax-issues-nonprofit-entities>. When questions about taxes arise, it is always best to consult a tax advisor, your state Department of Revenue or the IRS.

in policy documents or rules documents that are easier to modify.

[Grantspace.org](http://grantspace.org) suggests that organizational bylaws should define:

- The size of the board and how it will function.
- Roles and duties of directors and officers.
- Rules and procedures for holding meetings, electing directors, and appointing officers.
- Conflict of interest policies and procedures.
- How grant monies will be distributed.
- Other essential corporate governance matters.

Following is a more detailed example outlining bylaws is provided by the Farmers Market Federation of New York:⁷ <http://farmersmarketcoalition.org/resource/guide-to-developing-a-community-farmers-market>.

The easiest way to create bylaws is to start with a set of bylaws from an organization similar to yours and modify them to suit your needs. First, make sure that the model organization's bylaws are a good fit with your planned organization. If your organization does nothing but run a farmers market, then rely on bylaws from another similarly structured farmers market. If your organization is in charge of a whole range of local food-related activities, you should borrow bylaws from that type of organization. If you are planning to use a corporate structure and file for tax-exempt nonprofit status, look for bylaws from an organization that has structured itself the same way.

Sample bylaws are listed here. <http://grantspace.org/tools/knowledge-base/Nonprofit-Management/Establishment/nonprofit-bylaws>.

Examples of bylaws from Iowa local food organizations:

- Dubuque Food Co-op Bylaws: <http://static1.squarespace.com/static/520d3d88e4b021ed6a2e2a1c/t/528640c2e4b035638f9dcae4/1384530114183/dfc+bylaws.pdf>.
- Iowa Food System Council Bylaws: http://www.jhsph.edu/research/centers-and-institutes/johns-hopkins-center-for-a-livable-future/pdf/projects/FPN/Ordinances_Model_Policies/IFSA.Bylaws.Adopted083110.pdf.

Keep in mind that if you plan to file for tax-exempt nonprofit status, you may need to write or amend your bylaws to include certain pieces of language that are required for tax-exempt nonprofits. Consult the IRS or a legal advisor for more guidance on this topic.

Once a nonprofit has been established, it must put policies and procedures in place to govern how it handles finances, employees, and more. In Iowa, the publication "Iowa Principles and Practices for Charitable Nonprofit Excellence" is a good resource on best practices for organizational policies. Get it at the Larned A. Waterman Iowa Nonprofit Resource Center website. <http://inrc.law.uiowa.edu>.

Elements of Nonprofit Corporate By-laws

1. Organizational Name
2. Nonprofit purpose/goals of the organization
3. Membership
 - a) Definition
 - b) Rights and responsibilities
4. Board of directors
 - a) Eligibility
 - b) Terms
 - c) Rights and responsibilities
5. Officers
 - a) Define positions
 - b) Duties
6. Committees
 - a) Standing
 - b) Ad hoc
7. Operations of the organization
8. Amendments
 - a) Procedure
9. Termination of organization
10. Maintaining nonprofit continuity

Setting Up a Governance Structure

Bylaws

Nonprofit corporations, for-profit corporations, cooperatives, associations and various other types of entities are required to have bylaws. Bylaws define the legal structure of the organization for governance and decision making processes. Unlike the Articles of Incorporation, bylaws do not need to be filed with the Iowa Secretary of State, but they act as an organization's internal operating manual. For some organizations, bylaws can be difficult to legally amend, so if there are aspects of your governance that may change often over time, it is best to address those items

Membership

If your organization intends to have members, it is important to consider the rights, responsibilities, and decision-making roles that your members will have. Decide on membership qualifications and how members will participate. For example, will your members be exclusively producers, or will you also allow customers or other stakeholders to join? What decision-making role will they have once they join? Will they elect a board of directors to make decisions, participate directly in decision-making, or simply gain the right to receive services? What will be the cost of membership? These questions relate closely to your organizational structure and bylaws, so while you are choosing a structure, you should think about how you want to involve members.

Members should be required to fill out an application when joining the organization and when renewing their membership. The application should include basic contact information, farm information (if applicable), and an agreement to abide by organization rules. Use this opportunity to ask members about their interest in specific volunteer opportunities. Members should be made aware of their rights, responsibilities, rules, and bylaws when they join and when they renew their annual membership.

A simple annotated sample of bylaws for a nonprofit *without members* can be found here: <http://www.minnesotanonprofits.org/nonprofit-resources/start-a-nonprofit/samplebylawswoutmembers.pdf>.

A simple annotated sample of bylaws for a nonprofit *with members* can be found here: <http://www.minnesotanonprofits.org/nonprofit-resources/start-a-nonprofit/samplebylawswithmembers.pdf>.

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