



Article
26 min read time

Basic Considerations for Choosing a Nonprofit Farm

Interested in forming a nonprofit organization for your farm? This guide will help you understand basic motivations and limitations so you can make an informed decision.

Table of Contents

Getting Started	2
Motivations for Forming Nonprofits	2
Limitations of Nonprofits	4
Barriers to Individual Wealth-Building	4
Farmer Pat's Retirement Plan	5
What might the board do?	5
Giving Up Control to Governance	6
Farmer Pat's Backstory	7
Difficult Crop Insurance Options	7
Whole Farm Revenue Protection & Micro Farm Crop Insurance Policies for Nonprofit Organizations	8
Noninsured Crop Disaster Assistance Program (NAP) and Nonprofit Organizations	9
Financing & Zoning Issues as a Nonprofit	10
How meaningful are these limitations to you?	11
Passing the IRS's four tests for 501(c)(3) tax status	11
Moving Forward	12

Getting Started

While many farms do good for their community by growing and selling food directly to consumers, other farms want to focus more on doing good than making sales. For farms with a specific focus on education, charitable programming, or scientific research, a nonprofit business model can enable access to grant funding and donations, among other benefits. However, deciding to form a nonprofit should be based on careful consideration, planning, and attention to legal details.

This guide will help you understand common motivations for forming a nonprofit as well as the associated legal limitations so you can decide whether or not you want to move forward with forming one for your farm.

Motivations for Forming Nonprofits

Many organizations and individuals are starting farm operations with social justice goals, including supporting BIPOC farmers, growing food for underserved communities, and upholding Indigenous traditions. Choosing a nonprofit or other social benefit structure comes with additional legal issues that often come as a surprise and can complicate the operation's viability. From managing a board of directors to complying with tax obligations and securing insurance, folks are in the best position for success if they know what they are getting into with a nonprofit farm.

Take a Moment: *Reflect on your motivations for exploring nonprofit organizations as a potential entity for your farm operation. What is driving this desire? What benefits do you expect to get as a nonprofit organization?*

Some common motivations are:

- Ability to have volunteers,
- Ability to apply for grants that require 501(c)(3) status and solicit donations that are tax-deductible,
- Not having to pay sales tax,
- Pursuing a social mission.

Analyzing motivations is important because you'll need clarity on what is most important to you to help decide if forming a nonprofit organization is the best method for achieving your organization's goals.

If the ability to apply for grants and solicit tax-deductible donations is your main motivation, it is important to consider the flip side of accessing tax-advantaged funding. The main drawback is the administration and recordkeeping involved in grant reporting and managing your tax-exempt status. To be really clear, *fighting for a social purpose is different work than that of managing and running an organization*. Nonprofits require both types of work. Starting a nonprofit requires sacrificing effort that might have gone toward supporting the mission to the bureaucratic requirements of nonprofit governance.

If there is a social purpose that you want to work on, there are many ways to do that without forming a new nonprofit organization! Options include:

- Partnering with existing nonprofit organizations that effectively run impactful projects
- Creating a for-profit business like a benefit corporation or a low-profit limited liability company (L3C) that also values social purposes
- Getting B Lab B Corp certification to demonstrate that your business upholds the triple bottom line for people, planet, and profits

To learn more about these options, check out our guide, *Exploring Social Purpose Business Structures*, for lots more information.

If your gut is leaning towards a nonprofit organization, let's explore some of the key factors to consider at the outset. With a clear-headed view of the limitations and obligations of a nonprofit, your vision can take greater shape.

Limitations of Nonprofits

Not to throw a wet blanket over anyone's good intentions, but forming a nonprofit does come with many potential barriers and complications. No one wants to sink effort into the process only to discover halfway through (or at the end) that the outcome simply won't help them achieve their vision. By exploring some of the key limitations of this business structure, we can help folks be efficient with their valuable time and energy.

Barriers to Individual Wealth-Building

Those of us motivated by making the world a better place sometimes center social purposes more than we do our own well-being and stability. For most folks, it is unsustainable to sacrifice for a cause to the detriment of our financial security and comfort. This is not to say that fulfilling and monetarily feasible careers do not exist in the nonprofit sector. They most certainly do, and many folks enjoy stable, inspiring careers in nonprofit organizations.

However, it is also true that, on the whole, the people who are able to enter the nonprofit sector most easily are those who already have some level of privilege and power. People who have safety nets do not have to worry as much about building up savings or making equity investments to protect their futures. People with less privilege are under more pressure to build wealth for themselves, their families, and future generations. No matter one's financial background, building wealth is a justified goal. In our capitalist society, financial security is required for all other types of security—health, safety, and well-being. No one can be faulted for prioritizing it. For this reason, people going into nonprofit organizations need to do so with open eyes.

One of the most impactful limitations of the nonprofit structure is what the IRS calls the rule against private inurement. **This means that the operations, assets, and resources of a nonprofit *cannot* be used for or paid out to a specific person, particularly an insider, like a founder or key employee.** In fact, the assets of a nonprofit at dissolution must be distributed to another nonprofit organization. Even

when the nonprofit ceases to exist, its earnings are not available for any one person associated with the organization!

The rule against private inurement is also associated with keeping salary levels reasonable for nonprofit employees. Charitable organizations can provide reasonable compensation to their employees. However, the IRS may scrutinize how those salaries are determined. Salaries *cannot* appear to be a mechanism for distributing profits to get around the private inurement rule. If salaries are high in a nonprofit as compared to other comparable positions, this may trigger an inquiry into the nonprofit's practices around private inurement. Nonprofit organizations have to disclose how they determine their salaries and the amount of compensation paid to employees on their tax returns. Violations of the rule against private inurement give the IRS the right to revoke an organization's tax-exempt status. They also have the power to impose a tax on the "improper" benefits received.

Farmer Pat's Retirement Plan

Farmer Pat has worked for 30 years for a nonprofit farm and does amazing work. However, Pat never made enough in wages to save for retirement, so as that time nears, she is getting concerned about how to fund her later years. In thinking about all she's done for the community, she starts to think of ways she could now help herself and how the community could step in for her in this time of need.

She prepares a proposal for the board of directors. She asks if the board would be willing to do any of the following:

- Give her some of the land with a small home on the property. She'd have a place to stay and the possibility of financing.
- Sell a portion of the land on the market and give her funds as a lifetime bonus.
- If none of the above, then simply hold a fundraiser and give her the money donated at the event.

What might the board do?

Unfortunately, even if the board agrees that Farmer Pat is more than deserving of these things, their hands will be tied. Any of these options would likely be considered private inurement and would thus be prohibited. Granting Farmer Pat any of these things will put the organization's tax-exempt status at risk.

A different but related rule governs private benefits: **the nonprofit cannot operate to benefit a specific person(s)**. This means a person cannot start a community garden nonprofit organization just so they can have a place for their own private garden. Neither can nonprofits host fundraisers for one single individual. These rules make sense. For example, we don't want organizations taking grant funds and donations only to use them to support a single individual. When donors give, they don't necessarily expect to fund someone's retirement. The result can be difficult, though, and can have a disproportionate impact on BIPOC farmers who want to pursue social purposes but also need to build wealth. When our culture has such a disproportionate wealth distribution (the Federal Reserve Board reports that white households have eight times the wealth of Black households and five times the wealth of Latinx ones), any barrier to wealth building should be viewed through a critical lens.

Giving Up Control to Governance

Choosing to form a nonprofit entity requires the founder to give up autonomy and agency as compared to the option of forming a for-profit entity. This has to do with the governance requirements of a nonprofit organization—how the entity is run and by whom.

Nonprofit organizations are governed by a board of directors. The board is responsible to the community; their role is to see that public trust is upheld and nonprofit resources are well-stewarded. This is the nonprofit board's central legal obligation. Therefore, in a nonprofit, no single individual has control. Decision-making is spread out among high-level staff and the board. This creates a complicated power dynamic that doesn't need to be present in for-profit small business ownership models. In a small for-profit business, the founder can (and often does) have sole decision-making power. But for nonprofits, sole decision-making power will create complications adhering to tax-exempt rules and regulations. As soon as someone forms a nonprofit organization, the Board of Directors must also be formed and given powers of governance.

A founder who also wants to work at the nonprofit will need to make decisions about 1) whether they remain on the board, or 2) become an employee of the organization that then reports to the board of directors. Choosing the first option requires management of significant conflicts of interest that the IRS and donors may ask about. The second option requires giving up control over one's employment at the nonprofit.

Nonprofits are also funded by government or foundation grants. These funders have pre-set ideas about the work they would like to see done and sometimes strict requirements for adhering to their goals, budget guidelines, and reporting requirements. Often, seeking grants can feel like chasing money and can eventually lead to the nonprofit drifting from its original purpose in an effort to please funders.

Farmer Pat's Backstory

Pat started a nonprofit when she noticed a great opportunity to grow food for her community on a wonderful piece of land. Pat had already been collaborating with many community members who were willing to work together to build a nonprofit organization. Several volunteers were willing to serve on the nonprofit's board. The founding board members are all volunteers: four community members and Pat.

Pat continued to carry a significant amount of the workload and emerged as Farm Director. Pat was ready to quit her day job and become a full-time farm employee. After raising enough money, Pat goes on salary as a farm employee. However, Pat is also on the board of directors. The board of directors needs to approve Pat's pay rate and sign the check. This creates a conflict of interest. Pat decides to convert to a non-voting member of the board to resolve this conflict.

Now Pat is beholden to the board of directors. The board approves the strategic plan, Pat's salary, and any request for raises. The board oversees and evaluates the performance of the Farm Director. Basically, the board is Pat's boss.

Difficult Crop Insurance Options

Due to how nonprofit organizations file taxes, some limitations exist on how a nonprofit's farm products can be protected or grown. Applying for crop insurance, financing, or zoning exemptions can be complicated for the nonprofit organization.

Diversified producers operating a nonprofit organization may also sell farm products as part of their qualified purpose to earn some income for the organization. Nonprofit

organizations participating in commercial activity must follow IRS rules, so read about Test 2: Commerciality in our guide *Exploring Qualifications for a Nonprofit Farm* if you are considering going this route. However, organizations that do this may be interested in protecting their farm product income against potential farm-related pitfalls like crop failure. Traditionally, this income is protected by a crop insurance program.

Whole Farm Revenue Protection & Micro Farm Crop Insurance Policies for Nonprofit Organizations

Without considering whether the grower is organized as a nonprofit organization, there are two primary crop insurance programs that benefit diversified producers. Whole Farm Revenue Protection (WFRP) is especially valuable to diversified growers and those who receive premium prices through organic products, direct-to-consumer sales, or other premium markets. The other option is Micro Farm, which is explicitly designed for small farm or ranch operations. The unique aspect of Micro Farm is that producers can insure revenue from post-production operations. If you want to read more about either of these programs, refer to Farm Commons' guide, [Crop and Livestock Insurance Options for Diversified Operations](#).

WFRP and Micro Farm are revenue-based policies, meaning coverage is based on demonstrated past income via tax records. Typically, WFRP applicant farmers must provide five consecutive years of documentation of profits and losses from farming, documented on IRS Form 1040, Schedule F. Beginning farmers and ranchers are asked to give only three years' worth of tax forms but still require Schedule F documentation. The reliance on the Schedule F form to establish a farmer's insurable revenue can make it difficult, but not impossible, for nonprofit organizations to obtain WFRP or Micro Farm crop insurance policies.

Nonprofit organizations do not file IRS Form 1040 and, therefore, do not file Schedule F. Nonprofit organizations file Form 990, which doesn't have the same schedules as tax Form 1040. If a nonprofit were to file their Form 990 and later need a Schedule F to satisfy requirements for crop insurance, they would be in a tough spot. Tax-exempt entities can complete Substitute Schedule F tax forms to demonstrate revenue from the required five-year period. However, preparing the Substitute Schedule F Form requires

specifically formulated accounting and diligence, which may be overwhelming or beyond the skills of a typical nonprofit founder.

If no Schedule F is available, the USDA requires that the tax-exempt farm provide the tax forms they do file, along with supporting information:

1. **A farm plan.** The farm's production plan must be provided along with historical records to determine expected prices. If organic commodities are raised, organic certification must be provided.
2. **Marketing records.** If items are sold direct-to-consumer, marketing records can be used as documentation of those sales efforts.
3. **Other insurance coverage.** Summaries of coverage for any individual insurance policies the organization purchases.
4. **Inventory information.** Documentation of commodities, accounts receivable, or accounts payable, if available.

All of this comes before filling out the Substitute Schedule F Form itself. Essentially, the information on the nonprofit's Form 990 must be reformulated into the Substitute Schedule F Form.

Even if farm nonprofit organizations can provide all the required documentation and successfully fill out the Substitute Schedule F, the nonprofit would face a deeper problem. Filling out a Schedule F or a Substitute Schedule F requires tracking revenue and expenses from farming, just as a for-profit business would. However, earning a profit and operating as any other commercial business contradicts all a nonprofit stands for and could threaten the nonprofit's tax-exempt status. Read more about the Commerciality Doctrine below to better understand the commercial limitations of a nonprofit organization.

Noninsured Crop Disaster Assistance Program (NAP) and Nonprofit Organizations

A separate crop insurance policy, the Noninsured Crop Disaster Assistance Program (NAP), does not require a Schedule F to be filed to acquire coverage and can be helpful for diversified crop producers. However, NAP is limited in scope—it only covers crop losses when natural disaster events cause low yields, loss of inventory, or prevented planting.

NAP is not a revenue-based insurance policy; it is yield-based. Applicant farmers must provide documentation of the acreage, type, location, and intended use of the crops for which they seek coverage. They may also need to demonstrate that they can successfully grow the covered crop by meeting at least 50% of the county's expected yield. But, the upshot is that they will not need to demonstrate past revenue from farming as they would in the WFRP or Micro Farm insurance policies. Nonprofit farming organizations can purchase NAP policies for eligible crops to ward off the negative impacts of potential natural disasters causing crop loss.

Financing & Zoning Issues as a Nonprofit

Nonprofits are taxed differently than other entities, and they do not have owners. This can impact some financing programs as well as local rules that apply to or exempt farms from regulations.

For example, USDA's Farm Service Agency is well-known for the farm operating and land purchase loans they offer to farmers under their Direct Loan Program. However, one eligibility requirement for securing one of these loans is that any entity applying must be comprised of members who have an individual ownership interest in the entity and can assume personal liability for the loan. Nonprofit organizations do not have owners; the employees and board members of a nonprofit do not hold ownership interests in the nonprofit. For this reason, nonprofit organizations are ineligible for FSA loans.

Another consideration is local zoning rules that may require typical farm documentation, like a Schedule F, to verify the farm status of an organization. Farm status can, depending on the jurisdiction, lower one's taxes and exempt the farm from certain zoning regulations. The Schedule F may not be the *only* way to verify one's farm status with the municipality, but it is a common one. Some nonprofit farms have run into issues trying to establish farm status because of this barrier. Depending on what the nonprofit aims to do, this could be a consideration for your organization.

For example, you may want to eventually build a barn or some farm worker housing. In most counties, farms can do this without having to apply for all the permits that another business or a resident would. Typically, the farm needs to demonstrate its farm status in order to receive or defend the exemptions (i.e., if a neighbor complains about the construction). You'll need to research your local zoning rules to determine if nonprofit farming organizations can apply for and receive any zoning exemptions you are counting on for the operation.

How meaningful are these limitations to you?

Let's pause to reflect. There are aspects of tax-exempt nonprofits that might conflict with an organization's goals or vision:

- Some founders may value ownership of their endeavor and feel resistant to handing power over to a nonprofit board of directors.
- Others might be reliant on the profits and assets of the business to be available to them as part of an exit plan, whether at retirement or earlier.
- Some founders may not have the tolerance for bureaucracy, political skills, or desire to navigate local zoning and financing complications around a nonprofit.

Do any of these sound like you? If so, a nonprofit might not fulfill your vision. If these factors feel insignificant or seem like something you can overcome, a nonprofit may be a good fit.

But wait, there's more. Before going too far down the path of creating a nonprofit, let's make sure we can pass the IRS's tests.

Passing the IRS's four tests for 501(c)(3) tax status

The ability to accept tax-deductible donations and be eligible for many foundation and governmental grants is reserved for organizations that qualify under the 501(c)(3) section of the tax code. Getting this tax status requires completing a long IRS form, Form 1023, which is estimated to take 100 hours to complete. The form must show how the entity is meeting the obligations of a 501(c)(3) organization. We can summarize the main things the IRS will be looking for in four tests, described briefly below:

1. **Test 1: Qualifying purpose.** Every nonprofit must have a purpose that qualifies it as a 501(c)(3) organization. The allowable purposes include religious, charitable, scientific, public safety testing, literary, educational, national or amateur sports competition, or preventing cruelty to children or animals. Every nonprofit's mission must align with one or more of these qualifying purposes.
2. **Test 2: Commerciality test.** Nonprofits cannot be overly commercial. To be clear, nonprofits can engage in commercial activity but within a limited scope.
3. **Test 3: No private inurement.** Nonprofits may not use their assets and resources to benefit any specific individual person or people. The IRS will be looking at how the organization is structured to determine if private inurement is potentially present.
4. **Test 4: Public support test.** Generally, this test focuses on identifying where the organization gets its money. If revenue is mainly from the government or the public as a whole, the organization meets the test.

Much more information is provided in the *Exploring Qualifications for a Nonprofit Farm* guide. At this stage, though, we're offering these tests to help readers get an idea of whether they want to pursue a nonprofit farm. If you feel like these tests won't be a big issue for you to meet, a nonprofit just might be the right choice!

Moving Forward

Now that you understand the basic limitations and qualifications for 501(c)(3) status, it's time to decide how you want to move forward.

- **Feeling good about forming a nonprofit entity for your farm?**
 - *Are you curious about those four tests? Looking for more information on what's required for achieving tax-exempt status? Then read *Exploring Qualifications for a Nonprofit Farm**
 - *Looking for information about seeking a fiscal sponsorship instead? Check out that chapter in *Exploring Qualifications for a Nonprofit Farm* for more.*
 - *Feeling ready to dive right into forming your own nonprofit? We have information on the first step, forming a state-level nonprofit corporation, in our *Exploring Qualifications for a Nonprofit Farm* for more.*

- **Looking for an alternative? Consider exploring for-profit social benefit options, such as benefit corporations, B Corp certification, and L3Cs.** We have information that will help assess whether one of those options may be the right fit for your goals. Read *Exploring Social Purpose Business Structures* for much more information.

Farm Commons' mission is to empower communities to resolve their own legal vulnerabilities, within an ecosystem of support.

Find legal workshops, timely resources, and a community for farmers, ranchers, and their service providers online at farmcommons.org.

 @farmcommons

 @farm.common

 /FarmCommons

 /farm-commons