Have Your Cake and Eat It Too: How Patagonia's Founder "Gave Away" The Company While Maintaining Control And Avoiding Millions In Taxes

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Have Your Cake and Eat It Too: How Patagonia's Founder "Gave Away" The Company While Maintaining Control And Avoiding Millions In Taxes

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On September 14th, 2022, Patagonia's 83-year-old founder Yvon Chouinard announced he and his family would be giving away their 100% ownership of the company, valued at around $3 billion dollars.[1] This environmentally-centered effort resulted in the Chouinard family being celebrated as one of the most charitable families in the country.[2] Amidst this praise, however, many have noticed that while the Chouinard's "gave away" the company, they received considerable value in return.

Giving Away The $3B Company

This "unusual but not unique"[3] dual-class transaction resulted in 98% of the Patagonia stock being gifted to Holdfast Collective, a non-profit with a mission of "fighting the environmental crisis and defending nature."[4] The other 2% of shares, consisting entirely of voting stock,[5] was moved to an entity titled Patagonia Purpose Trust ("Trust") "created to protect the company's values" of environmental preservation.[6] The Trust will have decision-making power over the company, and, unsurprisingly, the Chouinard family retains decision-making power over the Trust.[7]

If this structure seems confusing, that's because it is. Undoubtedly, easier alternatives would be to sell Patagonia or to take it public, each of which would provide the Chouinards with millions of dollars to contribute to their goal of environmental preservation.[8] What these options lack, however, is the driving force behind the current structure: control. Donating the non-voting shares to the §501(c)(4) and the voting shares to the Chouinard-controlled trust allows the family to continue to oversee important managerial decisions of the company, as members of the family will sit on the board of the Trust for the foreseeable future.[9]

The 501(c)(4)

2% of the Patagonia stock went to Patagonia Purpose Trust, a non-tax-exempt trust, so the Chouinards incurred $17.5 million in gift tax on this transfer.[10]

The other 98% of the stock is now owned by Holdfast Collective, a 501(c)(4) organization.[11] 501(c)(4) organizations receive favorable tax treatment thanks to a 2015 amendment to the tax code, allowing donations to such organizations to avoid capital gains tax, gift tax, and ultimately, estate tax.[12] Here's how it breaks down:

· If Mr. Chouinard had sold the stock, he would have realized estimated $700 million in capital gains tax based on the appreciation of the stock to around $3 billion (and as the company founder, we can assume he acquired it for significantly less).[13]

· If Mr. Chouinard had "given away" his stock to any other person or organization lacking the §501(c)(4) designation, he would have owed around $1.2 billion in gift tax on the transfer.[14]

· If Mr. Chouinard had retained his stock until death (a realistic outcome given that he is 83 years of age) the stock would've been subject to a 40% estate tax, resulting in more than $1 billion in tax liability.[15]

In strategically giving the stock to his §501(c)(4) organization, Chouinard and his family were able to avoid taxation under all three of these alternatives. Ultimately, he was able to give away highly appreciated stock to Holdfast Collective with no associated tax liability. To make matters worse, because Holdfast Collective is a non-profit, tax-exempt organization, it can turn around and sell the Patagonia stock tax-free as well.[16]

The purpose of providing favorable tax treatment to §501(c)(4) donations was to encourage donations to such organizations.[17] Unfortunately, it has had the practical effect of creating a loophole allowing Mr. Chouinard, and others,[18] to avoid a substantial tax liability that would otherwise be incurred.

Closing the Loophole

Donations to a §501(c)(4) organization is a perfectly legal method of tax avoidance,[19] and are becoming an increasingly popular method for avoiding substantial tax liability.[20]

Nonetheless, providing these benefits to some come at a cost to others: the deficit in tax revenue created by these transactions will likely have a trickle-down effect, creating "a higher tax burden for the rest of Americans."[21] Further, it allows certain individuals to opt-out of tax assessments that the rest of Americans are forced to participate in.[22]

So, how do we fix it? A start would be to repeal the 2015 amendment to the tax code that removed gift treatment for property §501(c)(4) organizations. Thus, in this case, Mr. Chouinard would've incurred gift tax liability for both transfers of stock.

Alternatively, the IRS could treat stock transfers to Holdfast Collective and other §501(c)(4) organizations as sales that give rise to the realization of capital gains.[23] Although drastic, this would prevent savvy tax avoiders such as Mr. Chouinard from realizing immense capital gains and avoiding recognition of those gains entirely.

The current lax treatment of §501(c)(4) organizations is intended to encourage philanthropic giving; however, it's costing billions of dollars in the process. Ultimately, its effectively saddling American taxpayers with the responsibility to subsidize these complex, albeit legal, tax avoidance schemes.

[1] David Gelles, *Billionaire No More: Patagonia Founder Gives Away the Company*, N.Y. Times (Sept. 14, 2022, 6:05 PM), https://www.nytimes.com/2022/09/14/climate/patagonia-climate-philanthropy-chouinard.html.

[2] *Id.*

[3]Julia Jacobo & Max Zahn, *Can A Clothing Company Save The Planet? Patagonia Wants to Find Out*, ABC News (Sept. 24, 2022, 10:20 AM), https://abcnews.go.com/Business/clothing-company-save-planet-patagonia-find/story?id=90265309 (https://abcnews.go.com/Business/clothing-company-save-planet-patagonia-find/story?id=90265309) (noting that similar structures exist at corporations like Facebook, Google, and the New York Times, where majority shareholders retain most of the control of the corporation).

[4] Yvon Chouinard, *Ownership*, Patagonia, https://www.patagonia.com/ownership (https://www.patagonia.com/ownership) (last visited Sept. 26, 2022) (explaining that all of the company's non-voting stock [98% of the total shares] went to Holdfast Collective, and providing that "nonvoting stock carries economic value but not decision-making authority).

[5] *Id.* (explaining that all of the company's voting stock [2% of total shares] went to Patagonia Purpose Trust, and providing that "voting stock has both economic value and decision-making authority); The Indicator From Planet Money, *Patagonia's Tax Break, Explained*, NPR (September 20, 2022), https://www.npr.org/transcripts/1124177696 (https://www.npr.org/transcripts/1124177696).

[6] Chouinard, *supra* note 4.

[7] Amanda Shendruk, *Patagonia Says It's Owned by the Earth Now. Here's What That Looks Like*, Quartz (Sept. 15, 2022), https://qz.com/patagonia-say-its-owned-by-the-earth-now-heres-what-th-1849539413 (https://qz.com/patagonia-say-its-owned-by-the-earth-now-heres-what-th-1849539413).

[8] Antony Currie, *Patagonia Lobs ESG Breakup Calls Back to the Wild*, Reuters (Sept. 16, 2022, 10:48 AM) https://www.reuters.com/breakingviews/patagonia-lobs-esg-breakup-calls-back-wild-2022-09-16/ (https://www.reuters.com/breakingviews/patagonia-lobs-esg-breakup-calls-back-wild-2022-09-16/) (noting that Chouinard could've "built a bigger war chest more quickly" by selling Patagonia); *see also* Chouinard, *supra* note 4 (explaining that Chouinard apparently did consider these alternatives, but felt there were "no good options available" to meet their goals of saving the environment).

[9] Gelles, *supra* note 1.

[10] Scott Nover, Patagonia's $3 Billion Corporate Gift Is Also a Convenient Way to Avoid Taxes, Yahoo (Sept. 16, 2022), https://www.yahoo.com/video/patagonia-3-billion-corporate-gift-154500444.html (https://www.yahoo.com/video/patagonia-3-billion-corporate-gift-154500444.html).

[11] Gelles, *supra* note 1.

[12] Consolidated Appropriations Act of 2016, Pub. L. No. 114-113 (2015).

[13] Devon Pendleton & Ben Steverman, *Patagonia Billionaire Who Gave Up Company Skirts $700 Million Tax Hit*, Bloomberg (Sept. 15, 2022, 3:10 PM), https://www.bloomberg.com/news/articles/2022-09-15/patagonia-billionaire-who-gave-up-company-skirts-700-million-tax-hit (https://www.bloomberg.com/news/articles/2022-09-15/patagonia-billionaire-who-gave-up-company-skirts-700-million-tax-hit).

[14] Jen Rose Smith, *How Patagonia Surfed Around Death and Taxes*, Sierra (Sept. 18, 2022), https://www.sierraclub.org/sierra/how-patagonia-surfed-around-death-and-taxes (https://www.sierraclub.org/sierra/how-patagonia-surfed-around-death-and-taxes); Nover, *supra* note 10.

[15] Gelles, *supra* note 1 (caveating their $1 billion estimate with the fact that the adult Chouinard children already own some indeterminate amount of Patagonia stock that would not be included in Mr. Chouinard's estate for the purposes of the estate tax calculation).

[16] 26 U.S.C. § 501.

[17] H.R. Rep. No. 114-64, at 5 (2022).

[18] Pendleton, *supra* note 13 (noting that in 2022, Barre Seid donated his electronics company to a §501(c)(4) organization, who then sold the company for $1.65 billion, avoiding capital gains tax and gift tax entirely); See also Justin Elliott (@JustinElliott), Twitter (Aug. 22, 2022, 5:42 PM), https://twitter.com/JustinElliott/status/1561831110086098944 (https://twitter.com/JustinElliott/status/1561831110086098944) (explaining that Seid, among other millionaires have taken advantage of the §501(c)(4) loophole to save millions in taxes).

[19] Nover, *supra* note 10 ("I don't think what [Chouinard and others] are doing is in any way tax evasion—it's legitimate tax avoidance.")

[20] Gelles, *supra* note 1.

[21] Pendleton, *supra* note 13.

[22] Gelles, *supra* note 1.

[23] *See generally* 26 U.S.C. § 1001 (prescribing the realization and recognition of gains on sales of appreciated property).

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