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Patagonia's Succession Plan Is A Blueprint For Biz Owners

By **Abosede Odunsi** (October 11, 2022)


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Yvon Chouinard, founder of the outdoor apparel retailer Patagonia Inc., recently announced that he donated the $3 billion company to fight climate change.

In so doing, he joins a growing list of business owners deploying their substantial earnings to effect social change. Just last year, for example, a little-known Chicago-based business owner, Barre Seid, donated his $1.65 billion manufacturing company, Tripp Lite, to an Internal Revenue Code Section 501(c)(4) nonprofit organization formed to advance conservative agendas.[1]

More than 10 years ago, Warren Buffett, Melinda French Gates and Bill Gates rolled out the Giving Pledge, a campaign created to make the world better by setting "a new standard of generosity among the ultra-wealthy."[2] Subscribers commit to donating their fortunes to charity during life or at death.[3]

Even amid this backdrop, Chouinard's decision to relinquish ownership of Patagonia in a hedge against climate change is unique. In the largest known corporate donation in history, the founder, his wife and their two children irrevocably transferred company ownership to two separate entities.

The voting stock was assigned to a purpose trust, for which the family reportedly paid $17.5 million in gift taxes. 100% of the nonvoting stock, representing 98% of the company value, was transferred to a nonprofit organization, Holdfast Collective. The nonprofit is funded by an annual dividend paid from the company earnings after reinvestment.

Going Purpose

In a statement published on the Patagonia website, Chouinard describes this innovative succession plan as "going purpose" instead of going public.[4] Faced with the prospect of either selling the company and donating the proceeds to charity or taking the company public, Chouinard, 83, rejected both options.

To Chouinard, an outright sale presented two obstacles: He could neither protect employees nor ensure new owners would uphold company values. The prospect of going public was equally unpalatable. Chouinard described an initial public offering as a disaster, citing pressures to create short-term gain at the expense of company values.[5]

Instead, he tasked a team of close advisers with designing a succession plan marrying environmental activism with goals to preserve company values.

Patagonia Purpose Trust

The Patagonia Purpose Trust owns 100% of the company's voting stock. Purpose trusts have existed for some time, most recognizably as pet trusts.

Defined in Section 409 of the Uniform Trust Code, purpose trusts are noncharitable and have no ascertainable beneficiaries.[6] The trust purpose is selected by the trustee. Essentially, purpose trusts are designed to benefit a specific purpose, whereas more commonly used revocable trusts benefit a particular person or group of people.[7]

A purpose trust will not necessarily qualify for a charitable deduction for income tax, gift tax or estate tax purposes. In Chouinard's case, the gift of voting stock to the purpose trust triggered gift tax. However, the tax only applied to the voting stock representing 2% of the company value.

Use of a purpose trust to hold closely held business interests — known as perpetual business purpose trusts — allows the Chouinard family to maintain control by carefully selecting individuals, including family members and possibly certain long-term employees or outside consultants, or advisory committees to manage the company.[8]

Alternatively, existing managers can run the company subject to trustee approval.[9] Enforcers and trust protectors also oversee business operations.[10]

Well-designed purpose trusts can effectively be for long-term business succession planning, providing benefits to a family over generations, avoiding repetitive estate taxes, successive control disputes, and virtually all of the other obstacles facing succession planning for a family business.[11]

Although perpetual business purpose trusts are uncommon in the U.S., Robert Bosch GmbH is an example of a purpose trust that has operated here successfully for decades.[12]

Holdfast Collective

All Patagonia nonvoting stock was transferred to the Holdfast Collective, a nonprofit organization dedicated to fighting the environmental crisis and defending nature.[13] It is estimated that the annual dividend paid to Holdfast will balloon to $100 million. As a nonprofit organized under Section 501(c)(4), Holdfast must promote social welfare. This requirement is accomplished by supporting the common good, civic betterment and general welfare of communities.

Unlike public charities and private foundations governed by Section 501(c)(3), Section 501(c)(4) organizations are permitted to engage in unlimited legislative and lobbying activities that achieve the organization's exempt purpose, in this case combating climate change.

Holdfast can inform the public about climate issues or even participate in political campaigns.[14] Use of Section 501(c)(4) is, therefore, a well-designed solution for Chouinard's climate advocacy goals.

Notably, Chouinard avoids capital gains taxes for over 50 years of appreciation in the company, an estimated $700 million tax savings. Owing to the Protecting Americans from Tax Hikes Act of 2015, the transfer of nonvoting stock to Holdfast is also exempt from federal gift tax.

Planning Opportunities for Business Owners

Chouinard has said that "Truth be told, there were no good options available. So we created our own."

While not every business owner is interested in giving away their company, Chouinard's quote captures the magic of succession planning — the ability to customize solutions. Every business owner has the power to design a plan for the future of their company, no matter the size or annual revenue. The following is a list of considerations for business owners when developing a succession plan.

Assemble a Team of Trusted Advisers

Putting together a team of family, friends, accountants, financial advisers and attorneys to brainstorm ideas early in the process is critical. The Chouinard family reportedly had discussed the company's future for decades. Once the founder's children elected not to assume control of the company, planning discussions expanded to include a small group of advisers several years ago.

The takeaway: It is never too early to assemble and begin discussions about the future with your trusted team.

Identify Goals and Desired Impact

The Chouinard family explored a range of options for Patagonia's future. However, its clearly articulated goals to protect the planet and company employees guided the planning process and ultimately dictated the solution. Similarly, business owners planning for the future must identify their goals. Thinking through the following questions is a good starting point:

- Will the business continue to exist? If so, will it remain in the family, be managed by employees or other key people?
- If preserving the company for employees and other stakeholders is a major priority, would an employee stock ownership plan provide part of the solution?
- Does the owner aspire to sell? If so, is an outright sale or piecemeal approach preferred?
- Is the owner interested in partnering with private equity investors?
- Is the owner comfortable deferring to another person's opinions about the company's future and operations?
- What role, if any, should charity play in the process? What impact or legacy does the owner wish to leave?

- How much money, if any, does the owner expect to pocket at the end of the process?

Clearly identifying goals and grappling with these questions will serve business owners well in developing next steps for their companies.

Taxes

Tax considerations play a significant role in succession planning. Closely held companies present myriad valuation and tax issues, all of which require extensive planning to minimize income, capital gains, gift and estate taxes.

Conclusion

Many of the headlines swirling about Patagonia over the past several weeks focus on the company's financial value.

At its core, Patagonia is the story of a family whose clearly articulated goals and values guided its decisions about the company's future. It also highlights the lasting impact company owners can make not just in business, but on society.

With careful planning, all business owners have the ability to chart the future of their company and, if they so desire, leave behind an enduring legacy.

Abosede Odunsi is a partner at Freeborn & Peters LLP.

[1] Andrew Perez, Andy Knoll and Justin Elliott, How a Secretive Billionaire Handed His Fortune to the Architect of the Right-Wing Takeover of the Courts. Co-published by The Lever and ProPublica. August 22, 2022.

[2] See http://www.givingpledge.org
[3] Id.

[4] See Yvon Chouinard's open letter at http://www.patagonia.com/ownership

[5] Id.

[6] Uniform Trust Code § 409 (1).

[7] Alexander A. Bove Jr., The Ultimate Business Succession Plan, Estate Planning Journal, Oct. 2021 at 37.

[8] Alexander A. Bove, Jr. and Melissa Langa, The Perpetual Business Purpose Trust: The Business Planning Vehicle for the Future, Starting Now. 47 ACTEC L.J. 7 (2001).

[9] Id.

[10] Id.

[11] Alexander A. Bove Jr., "The Ultimate Business Succession Plan." Estate Planning Journal, Oct. 2021. Page 36.

[12] Id. at p. 39.

[13] See http://www.patagonia.com/ownership

[14] Patagonia is an example of the considerable influence organizations (including non-profits) bring to bear in the political process after the 2010 U.S. Supreme Court case, Citizens United v. FEC, where the Court extended First Amendment protections to corporations.