The Transfer of Ownership in the 'Patagonia Case'

Tax Avoidance or a Step toward a Non-Extractive Economy?

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September 15th 2022 was a big day for the climate movement. The owner of Patagonia – a large multinational corporation producing wearables – transferred 98% of his shares (worth 3 billion dollars) to the newly established Holdfast Collective, a foundation aimed at fighting climate change. The right to Patagonia’s dividends was transferred with the shares. Such a step was not entirely surprising; the owner of Patagonia, Yvon Chouinard, has been a climate activist and nature lover all his life, devoting his company to producing wearables sustainably and durably throughout its existence. But what was surprising was the degree of his commitment – transferring *all* the company’s future profits, not to his children and grandchildren, but to a climate foundation. The climate movement has rightly rejoiced in response to this move. Are we at the dawn of a new type of capitalism, where profit is made to work for nature rather than against it?

It may be too soon to tell. Amongst the praise there are some more cautious, even critical voices. The legal structure that Yvon Chouinard has chosen is that of ‘steward ownership’ (which is, in fact, a movement of its own). To achieve this structure, 98% of Patagonia shares were donated to a newly created climate foundation (the Holdfast Collective). The other 2% – the ones with the voting rights – were transferred to a foundation for the governance of the business itself, The Patagonia Purpose Trust. The governing foundation is fully controlled by the Chouinard family. Importantly, the transfer of the voting shares to the Purpose Trust was the only transaction that Patagonia had to pay tax on. Under US law, the transfer of the other 98% to the Holdfast Collective was tax free, due to its classification as a ‘Social Welfare organization’.

Much of the criticism against Chouinard’s move focuses on the fact that no taxes were paid on the transfer to the Holdfast Collective. In this blogpost, we analyse both the legal framework and different considerations related to this tax-free transfer through a comparative lens. We conclude that Patagonia’s move, in its present form and at this particular juncture, can be embraced as a move toward non-extractive economy – depending however on some crucial aspects of the design of the governance arrangements of the Holdfast Collective that have not yet been disclosed. Importantly, we caution that every such assessment should be case specific, dependent both on the legal structuring as well as the broader political economic context. This blog post will be the first of two (the second will be focused on ‘steward ownership’) on what the Patagonia case can teach us about the transition to a more sustainable, ‘non-extractive’ economy.

Tax Exemptions in the US and Europe for Organisations with a Public or Social Purpose

In both the US and Europe, governments provide various tax benefits to not-for-profit organisations with a so-called 'public' or 'social' purpose. They do so because they consider that pursuing such public and/or social purposes is so valuable for society that the government alone should not be responsible for pursuing them. Usually, such charitable organisations are exempt from paying income, donation or gift taxes on income raised in relation to tax-exempt activities. Another important tax benefit related to not-for-profit organisations is the tax deductibility of donations to these organisations.

Sometimes, a distinction is made between a *public* or *social* purpose. In the US, Patagonia's home country, section 501(c)(3) of the Internal Revenue Code applies to so-called 'Charitable organisations', which must have one of the *public* purposes outlined in an exclusive list. Section 501(c)(4) is more flexible and applies to 'Social Welfare organisations', which 'must operate primarily to further the common good and general welfare of the people of the community' – a *social* purpose. Social welfare organisations can also use part of their money (up to 49%) to engage in political activities. Only donations to 501(c)(3) organisations are tax deductible, as these public purpose organisations are considered to contribute more to the common good than social purpose organisations. Similar categories exist in many European countries, like the Netherlands and Austria. Other countries, like France and Germany, have slightly different regimes.

The Rampant Abuse of Tax Relief Regimes

These tax relief regimes are beset by problems, often employed in many 'smart structures' to avoid paying tax. For example, families have made large tax-deductible donations to their own non-profit organisations to avoid paying any income taxes *at all*. They sometimes even keep the 'right to use' of gifted shares for themselves personally, allowing them to continue receiving dividends following the donation. Another way to extract resources from foundations is to make large 'expenditure' declarations by the board members. A famous foundation-owned enterprise, IKEA, has been previously accused of using their complicated corporate structure to avoid 1 billion in European income tax between 2009 and 2014.

The public and social purpose are often also very broadly interpreted by organisations, opening the door to all kinds of questionable uses of tax relief by 'philanthropic organisations' – including those promoting conversion therapy and female circumcision. In the US, an important issue is the possibility of the exemption under 501(c)(4) being used to fund political campaigns. Individuals can transfer shares tax-free to 501(c)(4) organisations and then use those dividends to further their own political preferences *without* needing to disclose where the money has come from ('dark money'). Interestingly, in Europe donations to political parties or campaigns are generally more accepted as they are considered to be in the public interest.

Perhaps the greatest problem in the examined jurisdictions is the lack of supervision over these organisations. In the US, an investigation revealed that thousands of complaints about social welfare organizations breaking the rules – often the rule of spending less than 50% on political campaigning – have never been investigated or addressed by the IRS. In Europe, initiatives are coming up to improve the supervision on such organisations. This is especially true for tax regimes in countries such as the Netherlands, which are often used in smart tax avoidance structures.

How Should We Think About Tax Concerns in the Patagonia Case?

Patagonia moved shares with profit rights to a 501(c)(4) climate foundation. As such, the Chouinard's did not have to pay any taxes over this gift. By splitting the profit from the control rights and ensuring that the profits serve the mission of the organisation, Patagonia has created 'a steward ownership' structure. Both the Patagonia Purpose Trust and the Holdfast Collective seem to be created and controlled by the Chouinard family itself. The Holdfast Collective is set up as a (501)(c)(4) foundation, which means that it is a 'social welfare organisation' and can be (partly) organised or operated for the benefit of 'private interests.' Such a foundation thus can donate its funds not only to public causes, but also to political campaigns.

The decision to opt for (501)(c)(4) rather than (501)(c)(3) designation is an interesting one. On the one hand, this choice means that the Chouinard family cannot deduct this donation from their taxes, which can be interpreted as an attempt *not* to curtail tax payments beyond what is required by the public cause pursued. Moreover, there exists no dubious structure (such as those outlined above) in which the profit remains with the family. In fact, the entire ownership of the shares, including the profit rights, is transferred to the Holdfast Collective. However, the main issue that remains is that the 'public purpose' in this form of foundation is widely construed, which begs the question of whether it is desirable that any person or family can freely decide what happens with donated money that would otherwise have been transferred to the government in the form of taxes.

This 'democratic governance' concern could be somewhat alleviated via suitable governance arrangements of the Holdfast Collective itself. We do not know if others, except for the Chouinard family, are part of the board of the foundation. Indeed, if power was not entirely concentrated with the family, but genuinely shared with several other (ideally established) organisations with a similar purpose (such as Greenpeace or Friends of Earth), one could have more trust in the truly public nature of such purposes. This would be even more so if Patagonia's owners vested all the shares with an existing, established public purpose organisation.

But there are also more broader issues at stake, which concern all types of (corporate) philanthropy. When does redirecting tax revenues into socially valuable causes as chosen by private actors become a problem? If the idea behind such tax exemptions is that the government should not or cannot address all matters of public interest on its own, it makes sense to enable people to pursue such public interest

goals themselves. Moreover, we may hope that such charitable activities also have beneficial cultural effects, teaching those practicing them compassion, sharing and solidarity.

But is there a point when this rationale becomes unsustainable? A quantitative limit of some sort? If all companies forward their funds to charitable causes at once, without paying tax, how would we pay for social services, infrastructure, social benefits, political and judicial institutions – the things underpinning a (relatively) ordered and pleasant society? Nevertheless, even where the Chouinard family remains in the minority, we must ask whether it is socially desirable to enable similar initiatives?

Finding ourselves at a particular historical juncture – namely the major climate catastrophe around the corner – the 'special treatment' of funds invested into countering the most existential threat to humanity seems justifiable and even necessary. Yet do all 'public' and 'social' purposes, that currently qualify for tax relief in relevant legal regimes, justify vesting major power in a few rich individuals to 'short' society, which has enabled their success, of major tax income? We believe that the response to this question should be no. The degree of 'publicness' of such purposes should weigh in. The public interest of combating climate change deserves a different status than the public interest in fostering equestrianism. Any attempt, however, to rank the 'public' and 'social' causes will be highly sensitive, touching on some of the most strongly held values and dipping into raging political controversies. It will be also a particularly difficult task due to the growing polarisation across the world.

The public discussion on the purposes that can justify similar tax advantages is however still to start. The growing popularity and recognition of steward ownership will add an important set of reasons as to why to embark on it. Which tax regime should apply to steward ownership models? How can we make sure that the tax relief regime is not an incentive for creating steward ownership models, but a tool supporting the right kind of motivations? Importantly, under what governance, social conditions, and supervision, is this model acceptable? We take up these questions in the next blogpost on Patagonia and Steward Ownership.
