

The Washington Report

Wealth Transfer Edition

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You Don't Have to be a Rock Climber to Leave a Lasting Legacy: Planning with Purpose Trusts

On September 30, 2018, the Sierra Club awarded its top award, the John Muir Award, to Yvon Chouinard, a “rock climber who has contributed more than \$90 million to grassroots environmental groups.”¹ In addition to being a rock climber, Yvon founded Patagonia, Inc., an outdoor clothing company, “for whom sustainability and responsible practices are core to the business.”² This recognition was overshadowed by two headlines in 2022: “Billionaire No More: Patagonia Founder Gives Away The Company”³ and “Patagonia founder’s big donation potentially saves him over \$1 billion in taxes – and experts say it shows how the wealthy are able to ‘entirely opt out of taxes.’”⁴ In 2023, Yvon was named one of the 100 most influential people in the world by Time magazine because “he and [his] family decided to give away the company to defend the planet and combat climate change last year.”⁵ (This did not make Yvon Time magazine’s Person of the Year in 2023 – that honor went to Taylor Swift.)⁶

In an open letter dated September 14, 2022,⁷ Yvon explains what led him to this drastic and impactful decision:

¹ <https://www.sierraclub.org/press-releases/2018/10/sierra-club-announces-2018-award-winners>, last visited March 5, 2025.

² *Id.*

³ <https://www.nytimes.com/2022/09/14/climate/patagonia-climate-philanthropy-chouinard.html>, last visited March 5, 2025.

⁴ <https://www.businessinsider.com/patagonia-big-climate-donation-saves-1-billion-in-taxes-yvon-chouinard2022-9#>, last visited March 5, 2025.

⁵ <https://time.com/collection/100-most-influential-people-2023/6269833/yvon-chouinard/>, last visited March 5, 2025.

⁶ <https://time.com/6343069/taylor-swift-history-person-of-the-year/>, last visited March 5, 2025.

⁷ <https://www.patagonia.com/ownership/>, last visited March 5, 2025.



While we're doing our best to address the environmental crisis, it's not enough. We needed to find a way to put more money into fighting the crisis while keeping the company's values intact.

One option was to sell Patagonia and donate all the money. But we couldn't be sure a new owner would maintain our values or keep our team of people around the world employed.

Another path was to take the company public. What a disaster that would have been. Even public companies with good intentions are under too much pressure to create short-term gain at the expense of long-term vitality and responsibility.

Truth be told, there were no good options available. So, we created our own.

Instead of "going public," you could say we're "going purpose." Instead of extracting value from nature and transforming it into wealth for investors, we'll use the wealth Patagonia creates to protect the source of all wealth.

Here's how it works: 100% of the company's voting stock transfers to the Patagonia Purpose Trust, created to protect the company's values; and 100% of the nonvoting stock had been given to the Holdfast Collective, a nonprofit dedicated to fighting the environmental crisis and defending nature. The funding will come from Patagonia: Each year, the money we make after reinvesting in the business will be distributed as a dividend to help fight the crisis.

For estate planning professionals who prefer a more technical version, this was not exactly a new creation. Other notable early adopters of using Section 501(c)(4) tax-exempt organizations are:

- Google Co-Founder Sergey Brin who created Catalyst4 and funded it with \$366 million of Tesla stock.⁸
- Koch Industries chairman and CEO Charles Koch who created Believe in People and funded it with \$4.3 billion of Koch Industries stock and CCKc4, which he funded with \$975 million of Koch Industries stock;⁹ and
- Tripp Lite chairman and CEO Barre Seid who created the Marble Freedom Trust with \$1.65 billion of Tripp Lite stock.¹⁰

What made this structure different from the others named above was Yvon's pairing of the purpose trust and a Section 501(c)(4) tax-exempt organization. He did this to keep Patagonia's values intact and preserve control. To accomplish this, he and wife and their two children conveyed all of the voting shares (2% of the total shares in Patagonia, Inc.) to a purpose trust called the Patagonia Purpose Trust and all of Patagonia's nonvoting shares to a Section 501(c)(4) tax-exempt organization called the Holdfast Collective.¹¹

⁸ <https://www.bloomberg.com/news/articles/2023-04-22/billionaire-brin-sold-tesla-near-its-peak-for-new-giving-vehicle>, last visited March 5, 2025.

⁹ <https://www.forbes.com/sites/mattdurot/2023/10/10/exclusive-charles-koch-koch-industries-has-given-more-than-5-billion-of-his-koch-industries-stock-to-two-nonprofits/>, last visited March 5, 2025.

¹⁰ <https://www.nytimes.com/2022/08/22/us/politics/republican-dark-money.html>, last visited March 5, 2025.

¹¹ <https://www.patagonia.com/ownership/>, last visited March 5, 2025.



THE PURPOSE TRUST

A purpose trust is a type of trust that does not exist to support a beneficiary but to support a cause. In this case, the cause is to maintain Patagonia, Inc.'s values for perpetuity.¹² This was probably done under Delaware law,¹³ which has eliminated the historical impediments to purpose trusts, namely: (i) the rule against perpetuities and (ii) the authority of the courts to reduce the amount in the trust if the "value of the trust property exceeds the amount required for the intended use."¹⁴ To be clear, this is not a Delaware Statutory Trust or a business trust, which still require beneficial owners.¹⁵ Most states allow for purpose trusts but California, Georgia, Louisiana, New York, Oklahoma, and Rhode Island do not. The states that allow them are all over the map geographically and philosophically with some retaining all or some of the historical impediments that Delaware eliminated.

To accomplish that cause, the trust agreement creating the purpose trust identifies the declared purpose, authorizes a personal to act as trustee, names a person to enforce the trust terms,¹⁶ and limits the use of the trust property to the cause for which the trust was created.¹⁷ In addition, a purpose trust often has a trust committee, which represents the stakeholder groups, and advises the trustee.¹⁸ Yvon and his family continue to play an advisory role,¹⁹ probably as members of a trust committee. As always in estate planning, careful planning is necessary to avoid claims under I.R.C. § 2036 that this is a retained interest.

In 2019, Oregon created stewardship trusts, which are purpose trusts specifically designed to hold and maintain for-profit businesses in perpetuity, in response to the founders of the Organically Grown Company.²⁰ The Organically Grown Company describes itself as "the nation's only trust owned and largest wholesale distributor dedicated to organic fresh produce, supporting farms big and small," is now owned by the Sustainable Food and Agriculture Perpetual Purpose Trust (SFAPPT).²¹ And other states are following suit, including Texas, which proposed a "commercial legacy trust" in 2023.²²

¹² *Id.* ("Put another way, Patagonia's purpose is: We're in business to save our home planet. The Patagonia Purpose Trust ensures the company's commitment to its purpose forever.")

¹³ 12 DE Code § 3556 (2024).

¹⁴ *Id.*

¹⁵ 12 DE Code § 3801(i) (2024).

¹⁶ This would typically be the settlor or the beneficiary of the trust or the state's Attorney General for a charitable trust but one must be named here as there is no beneficiary.

¹⁷ 12 DE Code § 3556 (2024).

¹⁸ "Patagonia, Purpose Trusts, and Employee-Centered Businesses" featuring ACTEC Fellow Professor Susan N. Gary, ACTEC Trust and Estate Talk (Podcast) Episode 52 (May 30, 2023).

¹⁹ <https://www.patagonia.com/ownership/>, last visited March 5, 2025 ("The Chouinard family will guide the Patagonia Purpose Trust, electing and overseeing its leadership. Family members will continue to sit on Patagonia's board, along with Kris Tompkins, Dan Emmett, Dr. Ayana Elizabeth Johnson, Charles Conn (chair of the board), and Ryan Gellert, our CEO. The family will also guide the philanthropic work performed by the Holdfast Collective.")

²⁰ Or. Rev. Stat. § 130.193 (2019) and Gary, Susan N. (2019) "The Need for a New Type of Purpose Trust, The Stewardship Trust," *ACTEC Law Journal*: Vol. 45: No. 1, Article 8, available at: <https://scholarlycommons.law.hofstra.edu/actecj/vol45/iss1/8>, last visited March 6, 2025.

²¹ <https://www.organicallygrown.com/about-ogc>, last visited March 6, 2025.

²² Phillips, Bryan A. (2023) "Purpose Trusts: An Opportunity for Tailored Planning and Governance or Beneficiaries? We Don't Need No Stinking Beneficiaries!"; available online at: https://ydklaw.com/wp-content/uploads/2025/01/13_Phillips-Purpose-Trusts-Article-TexasBar-version-with-BAP-Edits.pdf, last visited March 6, 2025.



When the voting shares were gifted to the Patagonia Purpose Trust, Yvon and his family incurred an estimated \$17.5 million in gift tax, which they could have avoided by giving all of their shares (voting and nonvoting) to the Holdfast Collective, but at the much higher cost of giving up control of Patagonia, Inc.²³

Although the focus thus far has been on using purpose trusts to hold and maintain for-profit businesses in perpetuity, purpose trusts can be created for any lawful purpose where there are no ascertainable beneficiaries, e.g., the care and maintenance of cemeteries and burial plots, the care of pets, and the preservation of historic homes and art collections. If an individual has a cause and wants to create a purpose trust, the individual can fund the trust with any type of asset, including a life insurance policy. As noted above, gifts to purpose trusts are subject to gift tax and care must be taken to ensure that such gifts are not brought back into the donor's gross estate at death.

If a life insurance policy is contributed, the policy proceeds will be included in the donor's gross estate if the donor retains any incidents of ownership.²⁴ Incidents of ownership "includes the power to change the beneficiary, to surrender or cancel the policy, to assign the policy, to revoke an assignment, to pledge the policy for a loan, or to obtain from the insurer a loan against the surrender value of the policy, etc."²⁵ In addition, if a donor contributes a life insurance policy to a purpose trust and dies within three years of the transfer, the policy proceeds will be included in the donor's gross estate.²⁶ This result can be avoided by contributing cash to the purpose trust and having the trustee of the trust purchase a new life insurance policy on the donor's life but that may not be possible if the donor is uninsurable. Another alternative is for the donor to sell an existing life insurance policy to the trust, which avoids the three-year rule described above,²⁷ but would be a taxable sale if the purpose trust is not treated as a grantor trust to the seller of the policy. And in all scenarios, one has to consider how to fund the life insurance premiums unless the policy is paid-up policy.

SECTION 501(c)(4) TAX-EXEMPT ORGANIZATION

The simplest way to avoid gift and estate tax for individuals who have more than assets than they have applicable exclusion amount is to give the assets to charity. And when most people think of charities they think of 501(c)(3) tax-exempt organizations (both public charities and private foundations) because there are income tax deductions for donating to those organizations.²⁸ But when the income tax deduction is not as important as the ability to advocate, the 501(c)(4) tax-exempt organization can be a great way to be heard.

²³ Have Your Cake and Eat It Too: How Patagonia's Founder "Gave Away" The Company While Maintaining Control and Avoiding Millions in Taxes", 111 KY.L.J. ONLINE (October 6, 2022), available at: <https://www.kentuckylawjournal.org/blog/have-your-cake-and-eat-it-too-how-patagonias-founder-gave-away-the-company-while-maintaining-control-and-avoiding-millions-in-taxes>, last visited March 5, 2025, citing 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>.

²⁴ I.R.C. § 2042.

²⁵ Treas. Reg. § 20.2042-1(c)(2).

²⁶ I.R.C. § 2035.

²⁷ I.R.C. § 2035(d).

²⁸ I.R.C. § 170.



The 501(c)(4) tax-exempt organization must not operate for a profit, must operate exclusively for the promotion of the common good and general welfare, and none of its net earnings may inure to any private individual.²⁹ But it may engage in unlimited lobbying activity as long as those lobbying efforts relate to the organization's exempt purpose and promote the common good and do not result in private gain.³⁰ Of course, what is for the common good and general welfare is often in the eye of the beholder and not always clearly defined by the Internal Revenue Service. This trend towards using 501(c)(4) tax-exempt organizations was stimulated by two law changes in the last decade: (i) I.R.C. § 2501(a)(6) added by the Protecting Americans from Tax Hikes Act (PATH Act) of 2015 which confirmed that gift taxes do not apply to contributions to 501(c)(4), 501(c)(5), 501(c)(6) tax exempt organizations, and (ii) I.R.C. § 4943(g) added by the Bipartisan Budget Act of 2018 which created the "Newman's Own" exception to the private foundation excess business holdings rule permitting a business owner to make a charitable contribution of 100% of a business to a private foundation and keep it there intact.

As mentioned above, while the focus has been primarily on contributing stock, a donor can fund a 501(c)(4) tax-exempt organization with any type of asset, including a life insurance policy. Many of the same concerns identified above also apply to 501(c)(4) tax-exempt organizations with the notable exception that the contribution of a life insurance policy to a 501(c)(4) tax-exempt organization will not be subject to gift tax.

TAX SAVINGS

If Yvon had sold \$3 billion of stock, he would have owed as much as \$714 million in long term capital gains (assuming he had zero basis in the stock, the highest tax rate of 20% and the additional 3.8% net investment income tax).

If he gifted it to his children, he would have owed as much as \$1.2 billion in gift tax (assuming he has already used up his applicable exclusion amount³¹ and a tax rate of 40%). And his children would have received a carryover basis and holding period meaning they could have owed as much as \$714 million in long term capital gains if they sold the stock.

If he held the stock until he died, the stock would receive a step in basis which would eliminate the \$714 long term capital gains tax but result in \$1.2 billion in estate tax (assuming he has already used up his applicable exclusion amount and a tax rate of 40%).

Of course, the tax-exempt organization whether a 501(c)(3) or a 501(c)(4) can then sell the stock tax-free.

²⁹ I.R.C. § 501(c)(4)(A)-(B).

³⁰ See Treas. Reg. § 1.501(c)(4)-1(a)(2)(i); see also Treas. Reg. § 1.501(c)(3)-1(c)(3).

³¹ <https://www.irs.gov/newsroom/irs-releases-tax-inflation-adjustments-for-tax-year-2025>, last visited March 6, 2025, (The applicable exclusion amount in 2025 is \$13.99 million.)



CONCLUSION

When advising high net worth and ultra-high net worth clients on estate planning, it is common to counsel individuals with concentrated positions in their family businesses. Oftentimes, the identities of the individuals are intertwined with their businesses and the individuals struggle with business succession planning. It is difficult for the entrepreneurs to imagine their businesses under different management and their desire to maintain control can be a significant barrier to crucial planning. Deciding who should own the business, who should manage the business, and the right time to transition the business can be daunting.

The planning opportunities described above are not for everyone, but they are right for some clients, and it will only be through meaningful discussions with those clients with a focus on leaving a legacy that one will discover what the client truly wants. Too often, the discussion is limited to asset protection planning and tax reduction strategies and fails to focus on what the client really values.

