BUSINESS MATTERS

Equity Redemption Plans Can Provide Liquidity, Tax Relief

By Joe Leo

Due to recent reductions in profitability in the ethanol industry, now may be a perfect time for ethanol production companies to implement equity redemption plans. Equity redemption plans can provide important liquidity for investors and at the same time provide important tax relief for certain companies and an enhanced return for those that continue as owners. While equity redemption plans are typically considered when margins are favorable and companies are flush with cash, those are frequently the most difficult times to find willing sellers. However, when margins are less favorable, sellers may be more willing to consider a sale of their investment. In addition, due to less favorable commodities prices, many owners may welcome the ability to convert their ethanol plant investment into cash.

Ethanol production companies that have little or no debt can leverage the strength of their balance sheet in order to implement these equity redemption plans. For large-scale redemption programs, it may make sense to seek debt financing specifically tailored to this use. Further, for smaller redemption programs, ethanol production companies may be able to utilize existing lines of credit to implement a redemption program. Due to lower corn prices, many ethanol production companies are carrying large lines of credit that are not being used that could be tapped for equity redemptions.

Many ethanol production companies were capitalized through local equity drives spearheaded by local grain producers. These producers understood that ethanol would provide a market for their corn in addition to the other benefits provided by ethanol. Further, a significant number of these ethanol production companies were organized as limited liability companies to capture favorable tax treatment and have now fully depreciated their assets. Without generous accelerated depreciation deductions, these limited liability companies are allocating a significant amount of taxable income to their owners. On the heels of the record profits generated last year, owners are feeling the tax impact. At the same time, the age of the investors in these ethanol production companies continues to increase. Many of the investors who financed the ethanol production companies in the heart of their careers are now a decade older and considering retirement. Older owners are in many cases looking for a way to liquidate their investment but are finding a limited number of buyers in the market. While these two industry trends may seem unrelated, it is possible to marry the two in a way that presents a win-win for all involved through an equity redemption plan.

There is an important tax benefit to limited liability companies which may be able to treat a portion of the price paid to redeem the company's equity as a new asset that would allow additional depreciation for the company. For companies that have fully depreciated their assets, this can provide important tax relief to their owners, especially for larger-scale redemption plans.

In addition, some ethanol production companies that are SEC reporting companies could use redemption plans to terminate their Securities and Exchange Commission registrations. If this is your goal, companies would focus their redemption efforts on redeeming all of the ownership interests of a large number of small investors in order to meet applicable SEC thresholds for deregistration.

Structuring an equity redemption plan involves a number of legal and accounting considerations to be implemented successfully. Limited liability companies need to consider whether the equity redemption plan they implement will meet IRS rules related to publicly traded partnerships. For larger redemption plans, there may be SEC issues related to tender offers and insider trading regulations to consider. While these rules may limit your flexibility in implementing an equity redemption plan, with careful planning almost any program can be successfully pursued. If you think repurchasing equity may be something that could benefit your company, now may be the perfect time to start.

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