OKLAHOMA TAX COMMISSION

TAX POLICY AND RESEARCH DIVISION
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December 12, 2006

Re: Our file number LR 06-111; Income Tax - Oklahoma Capital Gain Deduction

Dear

This is in response to your inquiry of June 30, 2006, wherein you requested a ruling regarding whether the capital gain triggered in a certain transaction will qualify for the Oklahoma capital gain deduction under Okla. Stat. Ann. Tit. 68, § 2358 (F). Following is a restatement of the facts outlined in your letter, the question and ruling requested and our response thereto.

FACTS:

is a limited partnership organized under law and commercially domiciled in Oklahoma. has not elected to be treated as an association taxable as a corporation for federal income tax purposes, and is therefore treated as a partnership for federal and Oklahoma income tax purposes. was formed in April 2003 as a holding company and represents a joint venture between ("Management LLC"), several other pass-through entities (collectively referred to as "Investors") [1] and a number of individuals (collectively "Management")[2]. Management LLC owns a 0.014% general partner interest in and is itself owned by Investors. Management LLC has not elected to be treated as an association taxable as a corporation for federal income tax purposes, and is therefore treated as a partnership for federal and Oklahoma income tax purposes. Management owns approximately 6.11% of the limited partner interests of and the remaining 93.876% is owned by Investors.

In June 2003, acquired a 100% membership interest in , a limited liability company organized under law and commercially domiciled in Oklahoma. is a holding company that has

1 Generally the owners of these pass-through entities (i.e. Investors are individuals

2 For purposes of this ruling request, it is represented that Management and the individual owners of Investors have directly or indirectly owned their interests in MMH for an uninterrupted holding period of a t least two years prior to the "Deemed Sale" as defined below.

not elected to be treated as an association taxable as a corporation for federal income tax purposes, and is therefore treated as a division of for federal and Oklahoma income tax purposes.
Since 2003, has owned a 2% general partner interest in a multistate operating company, , a limited partnership organized under law in August 2000 and commercially domiciled in Oklahoma. has had its primary headquarters in Oklahoma since its formation.[3] is a publicly-traded partnership that meets the exception found in the Internal Revenue Code ("IRC") § 7704 (c) (1), and is therefore taxed as a partnership for both federal and Oklahoma income tax purposes. In June 2003, acquired a 52.6% limited partner interest in The remaining 45.4% limited partner interest was collectively owned by the general public (collectively referred to as "Public Unitholders"). has since sold off it limited partner interest in to the Public Unitholders. , Management LLC, and each have a calendar year end.

owns and operates a diversified portfolio of complementary energy-related assets, with a fairly significant amount of such assets located in Oklahoma. As a holding company, itself generally has no property or payroll. Historically, its revenue only included gains from the sale of its limited partner interests in . and have each been filing an Oklahoma partnership return (Form 514) since they were formed. The relevant legal entity structure before the Transaction Steps and Initial Offering (as defined below) is reflected in Attachment A.

In late 2005, Management and Investors began to explore the possibility of selling a portion of their limited partner interests in to the Public Unitholders ("Initial Offering"). In preparation for the Initial Offering, several new legal entities were formed in the following transaction steps ("Transaction Steps"):

1. Investors formed , a limited liability company organized under law and commercially domiciled in Oklahoma, with cash in exchange for all of the interest in in the same proportion of their ownership percentages in Management LLC. New has not elected to be treated as an association taxable as a corporation for federal income tax purposes, and is therefore treated as a partnership for federal and Oklahoma income tax purposes.

2. Investors and formed , a limited partnership organized under law and commercially domiciled in Oklahoma. has not elected to be

3 Accordingly, MMH has directly or indirectly owned the 2% general partner interest in MMP for an uninterrupted holding period of at least two years prior to the "Deemed Sale," as defined below.

treated as an association taxable as a corporation for federal income tax purposes, and is therefore treated as a partnership for federal and Oklahoma income tax purposes.

3. Investors contributed all of their membership interests in Management LLC to as a capital contribution.

4. Investors and Management contributed all of their limited partnership interests in to in exchange for limited partner interest in . Investors and Management have limited partner interests in that are identical to their limited partner interests in contributed all if its membership interest in Management LLC to exchange for a general partner interest in in exchange for a general partner interest in which is identical to the general partner interest that Management LLC has in.

For federal income tax purposes, Step #4 described above is treated as a non-taxable liquidation of is treated as a division of since Management LLC is now also treated as a division of Since and Management LLC are all treated as divisions of for federal income tax purposes at this point, is now deemed to own the 2% general partner interest in

The Initial Offering subsequently occurred in February 2006 whereby approximately 35.1 percent of the limited of the limited partner interests in were issued to the Public Unitholders in exchange for cash. As a result, retained approximately 64.9 percent of the limited partner interest in and Management LLC retained its same 0.014 percent general partner interest in . In addition, the cash received by from Public Unitholders was distributed to

For federal income tax purposes, the cash contributed to by the Public Unitholders in return for an interest in is treated as a nontaxable partnership contribution under I.R.C. § 721, and again became a recognized partnership for federal income tax purposes (i.e. goes from being a division of for federal income tax purposes in late 2005 to a recognized partnership in February 2006 since it has more than one tax recognized partner following the Initial Offering).

As a result of the Initial Offering, is treated for federal income tax purposes as contributing approximately 64.9 percent of the 2% general partner interest in to in return for a 64.9 percent limited partner interest in . This contribution is nontaxable under I.R.C. § 721. In addition, under the disguised sale rules of I.R.C. § 707(a)(2)(B), is treated as selling approximately 35.1 percent of the 2% general partner interest in to in return for the cash which was distributed to it following the Initial Offering ("Deemed Sale"). The

Deemed Sale results in a capital gain, as defined in I.R.C. § 1222 (11), for l
that will be included on its federal Form 1065, as well as its Oklahoma Form 514. Management and the individual owners of Investors are expected to include their proportional share of such capital gain in their respective federal adjusted gross income, as well as their respective Oklahoma adjusted gross income when filing their Oklahoma individual income tax returns.

The resulting relevant legal entity structure after the Transaction Steps and Initial Offering is reflected in Attachment B.

QUESTION AND OTC RESPONSE:

Does the capital gain recognized by as a result of the Deemed Sale in the Initial Offering qualify for the Capital Gain Deduction found in Okla. Stat. Ann. tit. 68, § 2358 (F) for purposes of the 2006 individual income tax returns to be filed by Management and the individual owners of Investors?

In order to qualify for the Oklahoma Capital Gain Deduction found in Okla. Stat. Ann. tit. 68, § 2358 (F), the gain must qualify as a "net capital gain as defined in Section 1222 (11) of the Internal Revenue Code. Based on the facts outlined the capital gain recognized by appears to be a qualifying gain receiving capital treatment under in Okla. Stat. Ann. tit. 68, § 2358 (F).

Further, ownership interest in an Oklahoma partnership must have been held by an individual for at least two (2) uninterrupted years in order to qualify under Okla. Stat. Ann. tit. 68, § 2358 (F). For federal income tax purposes, it appears that Management and Investor's holding period in their limited partnership interest in will carryover to Management and Investors formed in 2003, which would indicate that Management and Investor's holding period is at least two years prior to the Initial Offering Deemed Sale, which occurred in February 2006.

Finally, the Oklahoma Capital Gain Deduction found in Okla. Stat. Ann. tit. 68, § 2358 (F) requires the qualifying gain to be the result of sale of the ownership interest in an Oklahoma company, Limited Liability Company, or partnership. In order to be an Oklahoma company, Limited Liability Company, or partnership, the entity must have had their primary headquarters in Oklahoma for at least three (3) years prior to the transaction which gave rise to the capital gain. The sale of the ownership interest of appears to be the sale of an Oklahoma partnership, since was organized in August of 2000 and has had its primary headquarters in Oklahoma since it formation.

Based on the facts outlined above, the capital gain recognized by as a result of the Deemed Sale in the Initial Offering does appear to qualify for the Capital Gain Deduction found in Okla. Stat. Ann. tit. 68, § 2358 (F) for purposes of the 2006 individual income tax returns to be filed by Management and the individual owners of Investors.

This response applies only to the circumstances set out in your request of June 30, 2006. Pursuant to Commission Rule 710:1-3-73(e), this Letter Ruling may be generally relied upon **only** by the entity to whom it is issued, assuming that all pertinent facts have been accurately and completely stated, and that there has been no change in applicable law.

If I can be of further assistance, please feel free to call me at (405) 521-3133.

Sincerely,

FOR THE OKLAHOMA TAX COMMISSION

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