

OKLAHOMA TAX COMMISSION

TAX POLICY DIVISION
DAWN CASH, DIRECTOR

PHONE (405) 521-3133
FACSIMILE (405) 522-0063

September 4, 2008

Re: Our file number LR-06-125

Second Tranche of Funding

Dear

This letter ruling is in response to your inquiry dated July 28, 2008 wherein you posed a series of ruling requests relating to the Rural Venture Capital Formation Incentive Act (68 Okla. Stat. §2357.70 et seq.). Following a restatement of the facts outlined in your letter, are the specific rulings requested and our responses thereto.

Our client, (the "Hospital"), is an Oklahoma limited liability company that previously received letter rulings from the Oklahoma Tax Commission dated November 16, 2006 and June 6, 2007 (collectively, the "Prior Rulings") with regard to a portion of the Hospital's funding that was made under the Rural Venture Capital Formation Incentive Act, Tit. 68 O.S. §2357.71 et. seq. (the "RVCA"). The transactions contemplated in the Prior Rulings with respect to closed on July 19, 2007 (the "2007 Closing") with total investment proceeds of . To date, or approximately one year following the 2007 Closing, nearly two-thirds of those investment proceeds have been expended by the Hospital on the acquisition of real property and on the construction of the Hospital's medical facility. The Hospital will expend most, if not all, of the investment proceeds remaining from the 2007 Closing on further construction of the medical facility, currently scheduled for completion in January 2009.

Although referenced in the Prior Rulings, the Hospital did not receive any funding through (the "Fund") as part of the 2007 Closing. The Hospital now intends to use the Fund to finance the Hospital's acquisition of the fixtures and medical equipment to be used in connection with the Hospital's business operations. More specifically, the Fund will be utilized for the purpose of allowing Oklahoma investors and lending institutions to make investments through the Fund into either (i) a "qualified rural small business capital company" as defined in Tit. 68 O.S. § 2357.72(8) (an "SBC"), which will in turn invest such funds into the Hospital, or (ii) directly into the Hospital. It is intended for the investments made in the Fund to qualify for the Oklahoma tax credits (the "Credits") provided in the RVCA.

Before raising capital from Oklahoma investors, the Hospital respectfully requests a letter ruling from the Oklahoma Tax Commission that the proposed investments by the Fund and the SBC

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qualify for the Credits. The Hospital requests that the Tax Policy and Research Division issue a letter ruling pursuant to Rule 710:1-3-73(e) that, under the specific facts indicated, the Oklahoma investors will be eligible to utilize the Credits upon their investment in the Fund and as more specifically set forth below.

Statement of Facts:

1. The Fund is an Oklahoma limited liability company. The purpose of the Fund is to raise investment capital from accredited Oklahoma investors (the "Investors") as well as to obtain loans (collectively, the "Bank Loans") from one or more lending institutions (collectively, the "Lender").
2. It is expected that the Bank Loans will consist of loans in the total aggregate amount of between and
3. The Fund intends to issue two types of equity units, Common Units and Preferred Units. The Investors will be issued all of the Preferred Units in exchange for capital contributions to the Fund in a total aggregate amount equal to approximately of the Bank Loans.
 an Oklahoma limited liability company ("Management"), will be issued all of the Common Units in exchange for a capital contribution to the Fund of not more than Management will be the managing member of the Fund. The Investors and Management shall be the only equity members of the Fund (collectively, the "Members").
4. The Operating Agreement for the Fund shall provide that all Credits generated by virtue of investments made in the Fund shall be allocated to the Members based on each Member's pro rata equity share of the Fund and that no Member's allocation of Credits shall exceed the Member's pro rata equity share of the Fund.
5. As the owner of the Preferred Units in the Fund, the Investors will receive 100% of all distributions of cash from the Fund until they have received a certain specified cash return (e.g., 10%) on the subscription amount paid for the Preferred Units (the "Preferred Cash Return").
6. As the owner of the Common Units, the Manager will receive its percentage allocation of the Credits as indicated in paragraph 4 above. However, the Manager shall receive no other distributions of cash from the Fund until the Preferred Cash Return is paid in full to the Investors.
7. After the Preferred Cash Return is paid, the holders of the Preferred Units and the Common Units will be entitled to distributions of cash and property from the Fund based on their percentage equity ownership in the Fund.
8. The Fund intends to transfer all or a portion of the investment proceeds it raises, less organizational expenses, to an SBC in return for at least 99.99% of all outstanding units of the SBC's Preferred Series (the "SBC Equity Investment").
9. The SBC will use the proceeds from the SBC Equity Investment to make a loan to the Hospital (the "SBC Loan"). The SBC Loan shall have a maturity date of not less than five years and such loan shall be subordinated to all other indebtedness of the issuer that has been issued or is to be issued to a financial lending institution. Furthermore, the SBC Loan shall not have a repayment schedule, or any right to repayment that would allow for a repayment schedule, that is faster than a level principal amortization over five years. The SBC Loan shall constitute a contractual obligation

owed by the Hospital directly to the SBC.

10. Any net investment proceeds remaining in the Fund (i.e., from the Bank Loans plus the capital contributions of the Members less the amount of the SBC Equity Investment) shall be loaned directly to the Hospital (the "Side Loan"). The principal economic terms and conditions, including the interest rate charged and repayment obligations, of the Side Loan shall be identical to the terms and conditions of the SBC Loan for at least a period of five (5) years following issuance of the Side Loan. Furthermore, the dollar amount of the Side Loan shall be less than 200% of the SBC Equity Investment. The Side Loan shall constitute a contractual obligation owed by the Hospital directly to the Fund.

11. As part of the debt-service obligations under the SBC Loan, the Hospital shall be required to pay a one-time loan origination fee to the SBC of not more than 5% of the total amount of the SBC Loan. The debt service obligations of the Hospital to the Fund under the Side Loan may or may not include a similar loan origination fee calculated as a percentage of the total amount of the Side Loan. In the event such a fee is required under the Side Loan, the percentage used to calculate that fee will be equal to or less than the percentage used to calculate the loan origination fee under the SBC Loan.

12. The Bank Loans to the Fund will be collateralized by (i) all of the Fund's rights under the Side Loan; (ii) the Fund's pledge of all of its interest in the SBC's Preferred Series (iii) an unlimited and continuing guaranty from Management and an unlimited and continuing personal guaranty from each of the equity members of Management; (iv) a pledge of both Management's rights as the manager of the Fund and Management's ownership interest in the Hospital; and (v) an unlimited and continuing guaranty from each Investor effective at all times the Investor is a Member of the Fund and which is subordinate to the guaranty given by Management and the personal guaranties given by the equity members of Management.

13. The Side Loan and the SBC Loan (collectively, the "Hospital Loans") will be collateralized by the Hospital's fixtures and equipment.

14. The Bank Loans and the Hospital Loans will be cross-collateralized and subject to cross-default provisions.

15. The Hospital is an Oklahoma limited liability company. Management is the owner of all outstanding ownership interests in the Hospital and shall at all relevant times have the exclusive right to elect persons to the governing board of the Hospital (the "Board of Managers"). The Board of Managers shall have the exclusive powers and duties to manage and control all business and affairs of the Hospital and to make all decisions for and on behalf of the Hospital.

16. The SBC shall not own, directly or indirectly, any voting interest entitled to elect any person to the Board of Managers.

17. The Hospital will issue the subordinated debt instruments representing the Hospital Loans within 30 days of the Hospital's receipt of the funding to be provided by those loans.

18. The Hospital has its principal place of business and conducts 100% of its operations within the city limits of Oklahoma. The Hospital is a special purpose entity dedicated to the ownership and operation of a 48-bed acute care hospital and therefore, will be engaged in business

activity classified under Industry Group Number 8062 or 8069 appearing under Major Group Number 80 of Division I of the Standard Industrial Classification Manual. The Hospital will have, within 180 days after receipt of each of the Hospital Loans, at least 50% of its employees or assets located in Oklahoma. The Hospital shall qualify as a "small business" as defined by the federal Small Business Administration and the Hospital needs financial assistance in order to commence providing medical services to the public. Furthermore, with respect to the Hospital Loans, the Hospital will expend within 18 months after receipt of each such source of funding at least 50% of the respective funding for the acquisition of tangible or intangible assets to be used in the active conduct of the Hospital's business. The Hospital will use the proceeds of the Hospital Loans to purchase, and not lease, fixtures and equipment to be used in connection with the operations of the Hospital's business and for immediate working capital for the Hospital. The SBC shall satisfy all of the requirements set forth in Tit. 68 O.S. § 2357.72(8) for qualification as a "qualified rural small business capital company" and will also comply with the provisions of Tit. 68 O.S. § 2357.74A(A)(2) & (4).

19. Any offering materials involving the solicitation of any of the investments to be made in the Fund shall include the disclaimer set forth in Tit. 68 O.S. § 2357.74A(F).

20. Each of the Hospital, the SBC and the Fund will elect, or have already elected, to be classified as a "partnership" for federal and state income tax purposes and shall always be operated in a manner consistent with such classification.

21. Contractual provisions shall be included in the Loan Agreements for the Hospital Loans which shall provide that the Hospital Loans shall not be transferred, withdrawn or otherwise returned within five years of the closing of the transaction contemplated hereunder.

22. Management will enter into contractual agreements (the "Option Agreements") with the Investors whereby Management will be entitled to purchase the ownership interests of the Investors in the Fund, and the Investors will be entitled to sell their ownership interests in the Fund to Management, at a yet to be determined time following the first twelve-month anniversary of the closing of the transactions described in this letter. Under the Option Agreements, the purchase price to be paid to each Investor for that Investor's ownership interests in the Fund shall be equal to between 0.1% and 0.5% of the total purchase price originally paid by the Investor to the Fund for the ownership interests.

Rulings Requested:

Based on these facts, the Hospital respectfully requests a letter ruling from the Tax Policy and Research Division of the Oklahoma Tax Commission that

1. The SBC Equity Investment made by the Fund in the SBC followed by the SBC Loan to the Hospital will qualify for the Credits.

It is the ruling of the Tax Policy Division that the SBC Equity Investment made by the Fund in the SBC followed by the SBC Loan to the Hospital will qualify for the Oklahoma Tax Credits described in 68 Okla. Stat. §2357.73 so long as SBC meets the definition of a qualified rural small business capital company. Section 2357.72 defines a qualified rural small business capital company as a corporation, limited liability company or partnership which meets the following criteria:

- a. *The corporation, limited liability company or partnership is organized to provide the direct investment of equity and near-equity funds to companies within this state as outlined in its organizational instrument, bylaws, articles of incorporation or other agreement responsible for the governance of the capital company;*
- b. *The principal place of business of the corporation, limited liability company or partnership is located within this state;*
- c. *The capitalization of the corporation, limited liability company or partnership is not less than Five Hundred Thousand Dollars (\$500,000.00); and*
- d. *The corporation, limited liability company or partnership has investment of not more than twenty-five (25%) of its capitalization in any one company at any time during the calendar year of the corporation, limited liability company or partnership.*

2. The calculation of the amount of Credits attributable to the SBC Equity Investment shall be based on the amount of the SBC Equity Investment that is subsequently invested by the SBC in the Hospital as part of the SBC Loan, and shall not be diminished by the 5% loan origination fee subsequently paid to the SBC.

Yes. The credit in 68 O.S. §§ 2357.73 or 2357.74 is for qualified investments which are actually invested in an Oklahoma rural small business venture and used in pursuit of a legitimate business purpose. The 5% loan origination fee is reasonable and a legitimate expense of the venture. However, this expense is not a "qualified investment for the acquisition of tangible or intangible assets" [Section 2357.72(6)(f)] and will not be included in the 50% expenditure requirement.

3. The Side Loan made directly by the Fund to the Hospital will qualify for the Credits pursuant to Tit. 68 O.S. § 2357.74(B) and the calculation of the amount of Credits attributable to the Side Loan shall be based on the amount of the Side Loan, and shall not be diminished by any loan origination fees described herein which are subsequently paid to the Fund.

Yes (see number 2 above) provided the statutory requirements of 68 O.S. § 2357.74(B) are met.

4. All of the Credits attributable to the SBC Equity Investment and the Side Loan as described in Paragraphs 1-3 above will pass through to the Members.

The Tax Policy Division agrees that shareholders, partners or members of pass-through entities that are entitled to a credit under §§2357.73 or 2357.74 of Title 68 may receive an allocation of the credits from the pass-through entity. The credit may be claimed for funds borrowed by the pass-through entity only if the member to whom the credit is allocated has a legal obligation to repay the borrowed funds equal to or greater than that member's pro rata equity share of the Fund and the allocation may not exceed the member's pro-rata equity share of the Fund.

5. Upon issuance and funding of both the Side Loan and the SBC Loan, the Members may immediately use the Credits resulting from the Side Loan and the SBC Loan to offset various Oklahoma tax liability for the same year in which the such loans are made, including Oklahoma income taxes, estimated income taxes, bank privilege taxes and insurance company premium taxes when due.

Shareholders, partners or members of pass-through entities that are entitled to credits under §§2357.73 and 2357.74 of Title 68 may receive an allocation of the credits from the pass-through entity. Once allocated to the shareholders, partners or members, the credits may immediately be

used to offset various Oklahoma tax liabilities for the same year in which the investment was made, including Oklahoma income taxes, bank privilege taxes and insurance company premium taxes when due.

6. The Hospital will qualify as an "Oklahoma rural small business venture" under Tit. 68 O.S. § 2357.72(6).

Yes. It is the ruling of the Tax Policy Division that _____ meets the definition of an "Oklahoma rural small business venture" within the meaning of §2357.72(6) based on the following representation:

- a. _____ will have within 180 days after a qualified investment is made at least 50% of its assets or employees located within Oklahoma;*
- b. _____ needs financial assistance in order to commence providing medical services to the public.*
- c. At least seventy-five percent (75%) of _____ gross annual revenues will be a result of activities conducted in _____ in an area deemed to be a non-metropolitan area.*
- d. _____ is engaged in a lawful business activity under Division I of the Standard Industrial Classification Manual;*
- e. _____ meets the definition of a small business by the federal Small Business Administration;*
- f. _____ will expend within 18 months after the date of the qualify investment at least 50% of the proceeds of the qualified investment for the acquisition of tangible or intangible assets which will be used in the active conduct of the Hospital's business.*

Subsequent audits would be needed to ensure that the investments are expended as required and the Hospital qualified as a "small business" with the Small Business Administration at the time of the investment.

This response applies only to the circumstances set out in your request dated July 28, 2008. 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 and its investors, assuming that all pertinent facts have been accurately and completely stated, and that there has been no change in applicable law.

Please be advised that the issuance of this ruling does not preclude the Oklahoma Tax Commission from conducting an audit or examination under 68 Okla. Stat. §206 of any report or return claiming a credit for the transactions outlined in this letter ruling. The Commission reserves the right to issue any assessment, correction, or adjustment authorized under 68 Okla. Stat. §221.

Sincerely,

Oklahoma Tax Commission



Dawn Elizabeth Cash, Director
Tax Policy & Research Division