OKLAHOMA TAX COMMISSION

TAX POLICY DIVISION
DAWN CASH, DIRECTOR

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June 7, 2007

REDACTED LETTER RULING

Re: Our file number LR-07-056

Dear

This letter ruling is in response to your inquiry dated May 29, 2007 wherein you posed a series of ruling requests relating to the Rural Venture Capital Formation Incentive Act (68 Okla. Stat. §2357.70 et seq.). Based upon the facts outlined in your two (2) letters, the Tax Policy and Research Division of the Oklahoma Tax Commission issues the following rulings:

Statement of Facts:

1. [redacted] (the "Fund") will be formed as 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 (each a "Loan" and collectively, the "Loans") from one or more lending institutions (collectively, the "Lender"). [redacted], an Oklahoma limited liability company ("Management"), shall be the non-member manager of the Fund.

2. The Investors will be issued 100% of all outstanding equity interests in the Fund and shall be entitled to distributions of all cash and property from the Fund. The Operating Agreement for the Fund shall provide that all State Credits and NMTC Credits generated by virtue of investment made in the Fund (collectively, the "Tax Credits") shall be allocated to each Investor based on that Investor's pro rata equity share of the Fund and that no Investor's allocation of Tax Credits shall exceed the Investor's pro rata equity share of the Fund.

3. The Loans to the Fund shall have a maturity date of not less than five years and shall be subordinated to all other indebtedness of the Fund that has been issued or is to be issued to a financial lending institution. Furthermore, the Loans 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.

4. The Fund intends to transfer all or a portion of the capital it raises, less organizational expenses, to a "qualified rural small business capital company" as defined in Tit. 68 O.S. § 2357.72(7) ("SBC") in return for 100% of all outstanding units of the SBC's Preferred Series X (the "SBC Equity Investment").

5. The SBC will use the proceeds from the SBC Equity Investment to make a loan to the Venture (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. More specifically, debt service payments under the SBC Loan during the first five years following issuance of the SBC Loan shall be either; (1) interest only, or (ii) interest plus no more than 15% principal repayment during such initial five year period. The SBC Loan shall constitute a contractual obligation owed by the Venture directly to the SBC.

6. Any net investment proceeds remaining in the Fund (i.e., from the Loans and from Investors less the amount of the SBC Equity Investment) shall be loaned directly to the Venture (the "Side Loan"). The principal economic terms and conditions, including the interest rate charged and repayment obligations, of the SBC Loan shall be identical to the terms and conditions of the Side 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 Venture directly to the Fund.

7. As part of the debt service obligations under the SBC Loan, the Venture shall be required to pay a one-time loan origination fee to the SBC of not more than 4% of the total amount of the SBC Loan. The debt service obligations of the Venture 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.

8. The Loans to the Fund will be directly 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 X; (iii) a pledge of Management's rights as the manager of the Fund; (iv) a guaranty in the maximum amount of 90% issued by the Bureau of Indian Affairs under the Indian Financing Act of 1974 (the "BIA Guaranty"); and (v) a guaranty from each Investor which is (y) limited in an amount equal to that Investor's equity share of the Fund multiplied by the total outstanding amount of the Loans, and (z) is subordinate to the BIA Guaranty.

9. The Side Loan and the SBC Loan (collectively, the "Subsequent Loans") will be collateralized by the Venture's assets, including its real estate, equipment and receivables. The Loans and the Subsequent Loans will be cross collateralized.

10. The Venture will be formed as an Oklahoma limited liability company. In exchange for a capital contribution made directly to the Venture, Management shall receive all outstanding ownership interests in the Venture and shall have the exclusive right to elect persons to the governing board of the Venture (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 Venture and to make all decisions for and on behalf of the Venture.

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

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

13. The Venture will maintain a principal place of business and conduct 100% of its operations within the city limits of [redacted], Oklahoma. The Venture will be formed as a [redacted]. More specifically, the Venture's business will include [redacted] Therefore, the Venture will be engaged in business activity classified under Major Group Number [redacted] of Division [redacted] of the Standard Industrial Classification Manual. The Venture will have, within 180 days after receipt of each of the Subsequent Loans, at least 50% of its employees or assets located in Oklahoma. The Venture shall qualify as a "small business" as defined by the federal Small Business Administration and the Venture needs financial assistance in order to commence business and provide the products and services as described above to the public. Furthermore, with respect to the Subsequent Loans, the Venture 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 Venture's business.

14. 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).

15. 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).

16. Each of the Venture, 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.

17. Contractual provisions shall be included in the applicable documents (i.e., the Operating Agreements for the Venture, the Certificate of Designation for the SBC's Preferred Series X, and the Loan Agreements for the Subsequent Loans) which shall provide that the SBC Equity Investment and the Subsequent Loans shall not be transferred, withdrawn or otherwise returned within five years of the closing of the transaction contemplated hereunder.

18. Management will enter into contractual agreements with the Investors whereby Management will be entitled to purchase the ownership interests of the Investors in the Fund at any time after expiration of the seven year compliance period under the NMTC Program.

Rulings Requested:

Based on these facts, the Venture 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 Venture will qualify for the State Credits.

Yes. When borrowed funds are used to make an investment in an Oklahoma small business venture or Oklahoma rural small business venture, the investment will qualify for the credits against tax provided in 68 O.S. §2357.63 and §2357.73 so long as the investors' guarantees of the loans are equal to the investors' pro rata equity share of the Fund.

2. The calculation of the amount of State 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 Venture as part of the SBC Loan, and shall not be diminished by the 4% loan origination fee subsequently paid to the SBC.

Yes. The credit in 68 O.S. § 2357.73 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 4% 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 Venture will qualify for the State Credits pursuant to Tit. 68 O.S. § 2357.74(B) and the calculation of the amount of State 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.

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

Yes. If a pass-through entity is entitled to a credit for funds borrowed by the pass-through entity to make a qualified investment, the pass-through entity may allocate such credit to one or more of the shareholders, partners or members of the pass-through entity but the allocation may not exceed such shareholder's partner's or member's pro-rata equity share of the pass-through entity.

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

Yes.

6. The Venture 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 [redacted] *meets the definition of an "Oklahoma rural small business venture" within the meaning of §2357.72(6) based on the following representations:*

a. [redacted] *will have at least 50% of its assets or employees located in Oklahoma within 180 days after a qualified investment is made;*

b. [redacted] *needs financial assistance in order to commence business and provide the products and services to the public;*

c. At least seventy-five percent (75%) of [redacted] *gross annual revenues will be a result of activities conducted in* [redacted]*,* [redacted] *County, in an area deemed to be a non-metropolitan area;*

d. [redacted] *is engaged in a lawful business activity under Division* [redacted] *of the Standard Industrial Classification Manual; and*

e. [redacted] *meets the definition of a small business by the federal Small Business Administration.*

This response applies only to the circumstances set out in your request dated May 29, 2007. 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.

If I can be of further assistance, please feel free to contact me.

Sincerely,

Lisa R. Haws
Tax Policy and Research