

OKLAHOMA TAX COMMISSION

TAX POLICY DIVISION
DAWN CASH, DIRECTOR

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



April 15, 2008

[REDACTED]

Re: Our file number LR-08-043
[REDACTED]

Dear Mr. [REDACTED]

This letter ruling is in response to your letter ruling request dated February 13, 2008 wherein you posed a series of ruling requests relating to the Rural Venture Capital Formation Incentive Act (68 O.S. §2357.70 et seq.). Following a verbatim restatement of the facts as outlined in your letter, are the specific rulings requested and our responses thereto.

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 hard-equity contributions from [REDACTED] Management LLC, an Oklahoma limited liability company ("Management").

2. [REDACTED] (the "Venture") and Management will be for-profit subsidiaries of [REDACTED], Inc., a not-for-profit Oklahoma corporation organized and operated as a charitable organization under Section 501(c)(3) of the Internal Revenue Code of 1986 (the "Foundation"). The Foundation is an affiliate organization of [REDACTED], Inc, which is also a not-for-profit Oklahoma corporation organized and operated as a charitable organization under Section 501(c)(3) of the Internal Revenue Code of 1986 [REDACTED].

3. The Fund intends to issue two types of equity units, Common Units and Preferred Units. Management will be issued all of the Common Units in exchange for a capital contribution to the Fund of approximately \$4,000,000 to \$4,400,000. The Investors will be issued all of the Preferred Units in exchange for capital contributions to the Fund in the approximate aggregate total amount of \$790,000 to \$865,000. 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. As the owners of the Preferred Units in the Fund, the Investors will receive a preferred return (the "Preferred Return") from the Fund equal to: (i) State Credits earned by the Fund in the total amount of 180%, of the capital contributions made by the Investors; plus (ii) cash distributions from the Fund equal to a cumulative return on the investors' capital contributions of between five and ten percent (5% - 10%). As the owner of the Common Units, the Manager shall receive no distributions of cash, State Credits or other property from the Fund until the Preferred Return is paid in full to the Investors.

5. Following satisfaction of the Preferred Return, all remaining States Credits earned by the Fund, if any, shall be allocated to Management and all distributions of cash and other property from the Fund shall be allocated to the Members in accordance with their percentage ownership interest in the Fund,

6. The Fund intends to transfer 33.34% of the capital it raises (between approximately \$1,628,600 and \$1,790,000) to a "qualified rural small business capital company" as defined in Tit. 68 O.S. § 2357.72 (7) ("SBC") in return for 99.99% of all outstanding units of the SBC's Preferred Series [REDACTED] (the "SBC Equity Investment"). The Fund will use the remaining 66.66% of its investment capital (between approximately \$3,161,400 and \$3,474,900) to make the Side Equity Venture Investment as defined and as more particularly described in Paragraph 8 below.

7. The Venture intends to issue two types of equity units, "Alpha Units" and "Beta Units". The Alpha Units and Beta Units will be issued at a price of \$1,000 per unit and will share equally in all distributions of cash and property of the Venture. The owners of the Alpha Units 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.

8. The SBC shall use the proceeds of the SBC Equity Investment to make an equity investment in the Venture in return for 33.34% of the Beta Units (the "Direct Equity Venture Investment"). The Fund will use that portion of its investment capital not used to make the SBC Equity Investment to make a direct equity investment into the Venture in exchange for the remaining 66.66% of Beta Units (the "Side Equity Venture Investment"). The Direct Equity Venture Investment and the Side Equity Venture Investment are hereinafter collectively referred to as the "Beta Equity Venture Investments"

9. Management shall make an equity contribution to the Venture of between \$10,000 and \$100,000 in exchange for 100% of the Alpha Units. Thus, Management shall be in complete control of the business and affairs of the Venture.

10. The Venture shall be required to pay a one-time fee to the SBC of not more than 5% of the total amount of the Direct Equity Venture Investment to compensate the SBC for all compliance and reporting measures required to be taken under the RVCA for qualification as a "qualified rural small business capital company". The Venture will not be required to pay a similar fee to the Fund with respect to the Side Equity Venture Investment.

11. The Venture will maintain a principal place of business and conduct 100% of its operations within the city limits of [REDACTED] Oklahoma. The Venture has yet to be formed and has no current revenues or employees. The Venture will be formed as a [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 Beta Equity Venture Investments, at least 50% of its employees or assets located in Oklahoma. The Venture needs financial assistance in order to commence business and provide [REDACTED]. Furthermore, the Venture will expend, within 18 months after receipt of each such source of funding, at least 50% of the investment proceeds it receives from the Beta Equity Venture Investments for the acquisition of tangible assets, computer software, and required licenses to be used in the active conduct of the Venture's business.

12. The SBC shall satisfy all of the requirements set forth in Tit. 68 O.S. § 2357.72(8) for qualifications as a "qualified rural small business capital company" and will also comply with the provisions of Tit. 68 OS § 2357.74(A)(2) &. (4).

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

14. 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.

15. Contractual provisions shall be included in the Operating Agreements for the Venture which shall provide that the Beta Equity Venture investments shall not be transferred, withdrawn or otherwise returned within five years of the closing of the transaction contemplated hereunder.

16. Management will enter into contractual agreements (the "Option Agreements") with the Investors whereby Management will be entitled to purchase the Preferred Units of the Investors in the Fund, and the Investors will be entitled to sell their Preferred Units in the Fund to Management, any time following the later of: (i) January 1, 2009; or (ii) full payment of the Preferred Return to the Investors. 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 .1% and .5%, of the total purchase price originally paid by the Investor to the Fund for the ownership interests.

LAWS AND REGULATIONS APPLICABLE TO DETERMINATION OF THE VENTURE AS A "SMALL BUSINESS".

17. The federal Small Business Act (the "Act") defines a "small business concern" as any business "that is independently owned and operated and which is not dominant in its field of operation." See Public Law 85-536, § 3(a)(1). The Act then provides that the Small Business Administration (the "SBA") may promulgate regulations further defining what constitutes a "small business" for purposes of the Act, as well as establish standards to accurately determine size limitations for a "small business" within different industries. Public Law 85-536, § 3(a)(2).

18. The SBA has issued regulations providing that a "small business" must: (a) be an operating business; (b) be organized for profit; (c) be located within the United States; and (d) satisfy the size requirement for a "small business" as established by the SBA. See 13 CFR Ch. 1 § 120.100. A for-profit subsidiary of non-profit business can be a "small business" for purposes of the Act so long as the other regulatory requirements for qualifying as a "small business" are satisfied. See 13 CFR Ch. 1 § 120.110.

19. As set forth in paragraph 11 of the above Section, the Venture will be an operating business organized for-profit and located in the United States. It is expected that the Venture will ultimately generate substantial fees and other income that may be unrelated to the core activities of the [REDACTED] and [REDACTED]. Thus, the [REDACTED] feels it is necessary to utilize a for-profit subsidiary to insulate and protect the [REDACTED] and [REDACTED] tax-exempt status. Furthermore, organization of the Venture as a for-profit subsidiary provides the [REDACTED] and [REDACTED] with greater flexibility in exploring otherwise unavailable sources of revenue and capital.

20. Any SBA size standards solely with respect to the Venture are inconsequential given that the Venture currently has no employees and no revenues. Thus, the issue open for determination as to the Venture's qualification as a "small business" is whether the revenues and/or employees of the [REDACTED] and [REDACTED] should be considered under the SBA affiliation rules. The regulations indicate that they should not. For purposes of determining qualification under the SBA size standards, a business shall not be considered affiliated with charitable trusts, foundations, endowments or similar organizations exempt from federal taxation under section 501 (c) of the Internal Revenue Code of 1986.

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 Venture will qualify as an "Oklahoma rural small business venture" under Tit. 68 OS § 2357.72(6).

It is the ruling of the Tax Policy Division that [REDACTED], LLC meets the definition of an "Oklahoma rural small business venture" within the meaning of §2357.72(6) based on the following representations:

- 1) [REDACTED], LLC will have at least 50% of its assets or employees located in Oklahoma within 180 days after a qualified investment is made;*
- 2) [REDACTED], LLC needs financial assistance in order to commence business and provide the facilities and services as described in the letter ruling request;*
- 3) At least seventy-five percent (75%) of [REDACTED], LLC's gross annual revenues will be a result of activities conducted in areas deemed to be non-metropolitan areas;*
- 4) [REDACTED], LLC is engaged in a lawful business activity under Division I of the Standard Industrial Classification Manual;*
- 5) [REDACTED], LLC qualifies as a small business as defined by the federal Small Business Administration; and*
- 6) [REDACTED], LLC will expend within eighteen (18) months after the date of the qualified investment at least 50% of the investment for the acquisition of tangible or intangible assets which are used in the active conduct of the trade or business.*

2. The SBC Equity Investment made by the Fund in the SBC followed by the Direct Equity Venture Investment in the Venture will qualify for the State Credits.

Based upon the facts and other assertions contained in your February 13th request and the attached exhibit, the SBC Equity Investment made by the Fund in the SBC followed by the Direct Equity Venture Investment in the Venture will qualify for the State Credits, provided all statutory requirements are met.

3. 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 Direct Equity Venture Investment and shall not be diminished by the 5%, SEC fees.

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. SBC fee, provided they are reasonable, qualify as 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.

4. The Side Equity Venture Investment made by the Fund in the Venture will qualify for the State Credits pursuant to Tit. 68 OS § 2357.74(B) and the calculation of the amount of State Credits attributable to the Side Equity Venture Investment shall be based on the amount of the Side Equity Venture Investment.

Yes, to the extent allowable under the provisions of Section 2357.74 of Title 68.

5. All of the State Credits attributable to the SBC Equity Investment and the Side Equity Venture Investment as described in paragraphs 2 through 4 of this section may be specially allocated to the Members as described in paragraphs 4 and 5 of the previous section.

The Tax Policy Division agrees that shareholders, partners or members of pass-through entities that are entitled to a credit under §§2357.73 and 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.

6. Upon completion of the Direct Equity Venture Investment and the Side Equity Venture Investment, the Members may immediately use the State Credits resulting from the Direct Equity Venture Investment and the Side Equity Venture Investment to offset various Oklahoma tax liability for the same year in which 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 a credit 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

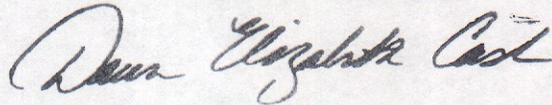
immediately be used to offset various Oklahoma tax liabilities for the same year in which the investment was made, including Oklahoma income taxes, bank privilege taxes and insurance company premium taxes when due.

This response applies only to the circumstances set out in your request dated March 3, 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

A handwritten signature in cursive script that reads "Dawn Elizabeth Cash".

Dawn Elizabeth Cash, Director
Tax Policy & Research Division