OKLAHOMA TAX COMMISSION

TAX POLICY DIVISION
DAWN CASH, DIRECTOR

PHONE (405) 521-3133
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November 24, 2009

[redacted]

Re: LR-09-181
[redacted]

Dear [redacted]:

This letter ruling is in response to your letter ruling request dated October 14, 2009, wherein you posed a series of ruling requests relating to the Small Business Capital Formation Incentive Act (68 O.S. §2357.60 et seq.). Following a verbatim restatement of the facts as outlined in your letter, are the specific rulings requested and our responses thereto.

FACTS

For purposes of this letter, the terms "qualified small business capital company," "Oklahoma small business venture," "equity," "near-equity," and "subordinated debt" shall have the same meanings as are provided in the Act, as appropriate.

[redacted], (the "Fund") is a limited liability company formed under the laws of the State of Oklahoma on [redacted]. The purpose of the Fund is to raise equity capital from accredited investors and to aggregate such equity capital for investment in CAPITAL COMPANY [redacted], an Oklahoma limited liability company ("CAPITAL COMPANY"), and VENTURE [redacted]., an Oklahoma corporation ("VENTURE").

The Fund will issue 26,000 shares of Class A-1 Preferred Shares and 2,880 shares of Class A-2 Preferred Shares pursuant to the investment plan indicated on the attached flowchart.

CAPITAL COMPANY is an Oklahoma limited liability company with a principal place of business of Oklahoma City. CAPITAL COMPANY was organized primarily to provide the direct investment of equity and near-equity funds to companies within the state of Oklahoma. CAPITAL COMPANY secondarily may provide investments in companies in other geographical locations. CAPITAL COMPANY was organized on [redacted]. The "capitalization," as defined in the Act, of CAPITAL COMPANY is greater than $1,000,000. The investment into VENTURE at any time during calendar year 2009 will not be more than 20% of CAPITAL COMPANY's "capitalization," as defined in the Act.

VENTURE was incorporated on [redacted] to construct, own and operate a [redacted] in [redacted] Oklahoma ("[redacted]"). The owner of VENTURE is the [redacted] ("[redacted]"). OWNER currently owns the sole share of VENTURE Common Stock and will receive a total of 999 additional shares of Common Stock for contributions of land and other property upon the opening of the [redacted]. Through the [redacted], VENTURE will provide [redacted] and other services to the population of [redacted] and the surrounding communities. VENTURE will supplant the [redacted] historically provided directly by OWNER. VENTURE needs financial capital assistance in order to build and operate the [redacted] to provide the [redacted] and other services.

The amount of total capital to be raised by the Fund for investment in VENTURE is $28,880,000. The amount of equity investment into the Fund will be $28,880,000 for 26,000 shares of Preferred Class A-1 Shares and 2,880 shares of Preferred Class A-2 Shares. Holders of Preferred Class A-2 Shares will be allocated the Oklahoma Small Business Capital Formation Incentive Tax Credits, while holders of Preferred Class A-1 Shares will not.

The Fund's investment in CAPITAL COMPANY will take the form of equity capital. The $28,880,000 investment will be in the form of equity capital as a result of the Fund purchasing 26,000 Units of CAPITAL COMPANY Series A-1 and 2,880 Units of CAPITAL COMPANY Series A-2. The holders of the 2,880 Fund Class A-2 Shares, which will contribute $2,880,000 to the Fund, will be allocated the entire 20% small business capital formation credit of $5,776,000 ("Credits").

CAPITAL COMPANY will loan $26,000,000 in subordinated debt to VENTURE and will invest $2,880,000 into VENTURE 2009 6% Non-Voting Cumulative Convertible Preferred Stock. The debt will be subordinate to all other debt of VENTURE issued or to be issued to a financial lending institution as required by 68 O.S. § 2357.61(8). The debt will be "near equity" as defined in 68 O.S. § 2357.61(3) and required by 68 O.S. § 2357.63(B)(2) by being convertible dollar for dollar ($1 for $1) into VENTURE 2009 6% Non-Voting Cumulative Convertible Preferred Stock upon the exercise of a conversion election by CAPITAL COMPANY. Further, OWNER will be required to guarantee the CAPITAL COMPANY loan.

In addition, the investors and OWNER will grant to each other overlapping call and put options for the 2,880 Class A-2 Preferred Shares of the Fund owned by the investors at one dollar ($1.00) per Share plus an amount of Net Income allocable to the 6% cumulative Preferred Shares for the time of ownership. The options relating to the 2,880 Shares are exercisable anytime between fifteen (15) days after the closing of the loan and the first day of the fourth month following the closing date of the loan. Copies of the form of such agreements are also included.

Within one hundred eighty (180) days after the investment, VENTURE will have more than fifty percent (50%) of its assets and its employees located in Oklahoma. VENTURE will conduct activities resulting in at least seventy-five percent (75%) of its respective gross annual revenues from its principal place of business in [redacted], Oklahoma. VENTURE's business activities will be described in the Standard Industrial Classification Manual as Division [redacted]

The Fund believes that VENTURE qualifies as a small business as defined by the federal Small Business Administration ("SBA"). The SBA defines a "small business concern" as a business entity organized for profit, with a place of business located in the United States, which operates primarily within the United States and meets the size standard applicable for the NAICS code in which the business entity operates. The NAICS code for "[redacted]" is [redacted] with a size standard of $10,000,000 dollars in annual revenues. Whether or not a business entity meets the size standards described above is determined by reference to the entity's "annual receipts," which is defined as gross or total income, including cost of goods sold, of a company as reported on the company's federal income tax return and averaged over the latest three completed fiscal years. As a newly incorporated company, VENTURE will not have any historical annual receipts and will not have annual receipts at the time of the investment in excess of the applicable size standards listed above. OWNER's previous [redacted] activities, which VENTURE will supplant in [redacted], had an average gross income for the past three tax years (2006, 2007, and 2008) of approximately $[redacted]. OWNER's [redacted] activities have gross income for the current tax year, through June 30, 2009, of $[redacted]. When annualized, the current gross income is $[redacted], which is only slightly more than the size standard for the VENTURE NAICS code. When averaged with the gross income for 2007 ($[redacted]) and 2008 ($[redacted] the average is $[redacted], which is below the size standard for the VENTURE NAICS code. Further, VENTURE is an entity organized for profit with a business location in the United States and will operate primarily in the United States. Therefore, the Fund believes that VENTURE qualifies as a "small business" as defined by the SBA.

RULINGS REQUESTED

1. CAPITAL COMPANY meets the definition of a "qualified small business capital company" within the meaning of 68 O.S. 2357.61(7).

It is the ruling of the Tax Policy Division that CAPITAL COMPANY, as described in the letter ruling request, meets the definition of a "qualified small business capital company" as defined in 68 Okla. Stat. §2357.61(7) based on the following representations:

a) *CAPITAL COMPANY is a limited liability company;*
b) *CAPITAL COMPANY is organized to provide the direct investment of equity and near-equity funds to companies within this state;*
c) *The principal place of business of CAPITAL COMPANY is in the state of Oklahoma, specifically Oklahoma City;*
d) *The capitalization of CAPITAL COMPANY is not less than One Million Dollars ($1,000,000.00); and*
e) *CAPITAL COMPANY has investments of not more than twenty percent (20%) of its capitalization in any one company at any time during the calendar year of the capital company.*

2. VENTURE meets the definition of an "Oklahoma small business venture" within the meaning of 68 O.S. 2357.61(5).

Yes. It is the ruling of the Tax Policy Division that VENTURE meets the definition of an "Oklahoma small business venture" within the meaning of §2357.61(5) based on the following representations:

a) *VENTURE will have at least 50% of its assets or employees located within Oklahoma within 180 days;*
b) *VENTURE needs financial assistance to construct, own and operate a* [redacted]*;*
c) *VENTURE is engaged in a lawful business activity under Division* [redacted] *of the Standard Industrial Classification Manual;*
d) *VENTURE qualifies as a small business as defined by the federal Small Business Administration; and*
e) *VENTURE 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 or for working capital.*

3. CAPITAL COMPANY's loan to VENTURE will constitute "near-equity security" and "subordinated debt" as defined in 68 O.S. 2357.61(3) and (8) respectively.

Based upon the facts and other assertions contained in your October 14th request and the attached exhibits, CAPITAL COMPANY's loan to VENTURE will constitute "near-equity security" and "subordinated debt" as defined in 68 O.S. § 2357.61(3) and (8).

4. VENTURE's 2009 6% Non-Voting Cumulative Convertible Preferred Stock will constitute "equity" as defined in 68 O.S. 2357.61(3).

Based upon the facts and other assertions contained in your October 14th request and the attached exhibits, VENTURE's 2009 6% Non-Voting Cumulative Convertible Preferred Stock will constitute "equity" as defined in 68 O.S. § 2357.61(3).

5. The investment by the Fund in CAPITAL COMPANY will meet the definition of a "qualified investment" within the meaning of 68 O.S. 2357.61(6) and will qualify for the credit against tax provided in 68 O.S. 2357.62(B).

Based upon the facts and other assertions contained in your October 14th request and the attached exhibits, the investment by the Fund in CAPITAL COMPANY will meet the definition of a "qualified investment" provided, only the amount of the investment by the Fund in CAPITAL COMPANY which is subsequently invested in VENTURE will qualify for the Oklahoma Tax Credits described in 68 Okla. Stat. §2357.62.

6. The amount of the Credits under 68 O.S. 2357.62(B) is 20% of the funds invested by CAPITAL COMPANY in VENTURE.

Yes, the amount of the credit is 20% of the qualified investment in CAPITAL COMPANY which is subsequently invested in VENTURE.

7. The Credits resulting from the investments will be available to offset the Oklahoma tax liabilities, as defined in the Act, of the member(s) of the Fund and may be allocated among the members of the Fund, in accordance with the terms of the Fund's operating agreement.

The Tax Policy Division agrees that shareholders, partners or members of pass-through entities that are entitled to a credit pursuant to the Small Business Capital Formation Incentive Act may receive an allocation of the credits from the pass-through entity pursuant to the limitations provided in 68 O.S. §2357.62.

8. The Credits arising from the investments by the Fund will be immediately usable by the members of the Fund, or the ultimate taxpayers if the members are flow-through entities, against any tax liability then due from such investor under 68 O.S. 2355 (the "Oklahoma Income Tax"), 68 O.S. 2370 (the "Bank Privilege Tax") and 36 O.S. 624 and 628 (the "Insurance Premium Tax"), including estimated tax payments.

Shareholders, partners or members of pass-through entities that are entitled to a credit under §2357.62 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. The credit may also be used to offset estimated income taxes; however, if the credit exceeds the amount of taxes due, the amount of the claim not used may be carried forward to a future taxable year but may not be used to offset estimated tax liabilities to generate a refund of the credits.

This response applies only to the circumstances set out in your request dated October 14, 2009. 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

Dawn Elizabeth Cash, Director
Tax Policy & Research Division