OKLAHOMA TAX COMMISSION

TAX POLICY DIVISION
DAWN CASH, DIRECTOR

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April 28, 2010

[redacted]

Re: Our file number LR-10-058
[redacted]

Dear [redacted]:

This letter ruling is in response to your letter ruling request dated April 8, 2010 wherein you posed a series of ruling requests relating to the *Rural Venture Capital Formation Incentive Act* (68 O.S. §2357.71 et seq.). Following a verbatim restatement of the facts as outlined in your letter, are the specific rulings requested and our responses thereto.

Client, [redacted], is an Oklahoma series limited liability company, that anticipates meeting the requirements of a "qualified small business capital company" as defined in the Small Business Capital Formation Incentive Act, Tit. 68 O.S. § 2357.60 et. seq. and a "qualified rural small business capital company" as defined in the Rural Venture Capital Formation Incentive Act, Tit. 68 O.S. § 2357.71 et. seq. (collectively the "Business Incentive Acts") (the "Capital Company").

The Capital Company intends to organize another Oklahoma limited liability company, [redacted], as an Investment Fund (the "Fund") for the purpose of allowing investors and/or 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), which will in turn invest such funds into, [redacted] a limited liability company that anticipates meeting the requirements as an "Oklahoma rural small business venture" as defined in Tit. 68 O.S. § 2357.72(6) (the "Venture"); or (ii) directly into the Venture. It is intended for all investment proceeds contributed to the Fund to qualify for the Oklahoma tax credits provided for in the Rural Venture Capital Formation Incentive Act, Tit. 68 O.S. § 2357.71 et. seq.

STATEMENT OF FACTS:

1. The Venture is an Oklahoma limited liability company that that intends to build a new [redacted] County, Oklahoma. The Venture will acquire land, construct [redacted] and purchase specialized equipment [redacted]. The Venture needs financial assistance to construct the building, furnish equipment and to pay for working capital (the "Project"). The Venture's principle place of business will be located in [redacted], [redacted] County, Oklahoma. At least seventy-five percent (75%) of the Venture's gross annual revenues will be a result of activities conducted in areas of the state deemed to be nonmetropolitan areas. The Venture will have within 180 days at least 50% of its employees or assets located in Oklahoma. The Venture is owned by [redacted], a Delaware limited liability company (the "Owners"). The Venture needs financial assistance because neither the Venture nor the Owners have funds available for the Project

2. The Fund will be formed as a limited liability company under Oklahoma law. The Fund will raise capital for the purpose of making venture capital investments in the Venture which, as discussed below, is intended to qualify as an "Oklahoma rural small business venture" as defined in the Business Incentive Acts. Investments will be made through a designated series of the [redacted], an Oklahoma series limited liability company (the "Capital Company").

3. The Capital Company is a "series" Oklahoma limited liability company registered and qualified to do business in Oklahoma with its principle place of business within Oklahoma. The debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing with respect to a particular series shall be enforceable against the assets of such series only, and not against the assets of the limited liability company generally or any other series thereof. [redacted]., an Oklahoma corporation, owns 100% of the Common Units of the Capital Company. The purpose of the Capital Company is to qualify as a "qualified small business capital company" and/or a "qualified rural small business capital company" as defined in the Business Incentive Acts and to make "Qualified Investments" of "equity," "near equity" or "subordinated debt," in companies qualifying as "Oklahoma small business ventures" and "Oklahoma rural small business ventures" as defined in the Business Incentive Acts. For purposes of this letter, the terms "equity," "near equity" or "subordinated debt," shall have the same meanings as provided in the Business Incentive Acts.

4. The Capital Company will be capitalized with cash and contractual commitments to contribute funds on demand to the Capital Company with a substantial penalty for breach of the commitments. Contributions and investments will be separate for each series of the Capital Company. The combined amount of capitalization for all series will be a minimum of $1,000,000 or such greater amount as required to meet the requirements of 68 O.S. § 2357.61 (not more than twenty percent (20%) of the capitalization may be invested in any one Oklahoma small business venture) and 68 O.S. § 2357.72 (not more than twenty-five percent (25%) of the capitalization of the Capital Company be invested in anyone Oklahoma rural small business venture).

5. The Venture will be engaged in a lawful business activity under an Industry Number qualifying in 68 O.S. § 2357.72(6)(d) specifically Division [redacted], Major Group [redacted], Industry Group Number [redacted], Section [redacted] of the Standard Industrial Codes and will qualify as a "small business" as defined by the federal Small Business Administration.

6. Neither the Fund nor the Capital Company shall own a direct voting interest in the Venture other than the Qualified Investments.

7. The Fund will not borrow funds for its capital The Fund will raise all of its capital from investors. The Fund intends to issue two types of securities: (a) Common Units; and (b) Preferred Units. The subscription price for the Common Units may be more or less per unit than the subscription price of the Preferred Units. The Fund may issue multiple classes of Preferred Units.

8. The Common Units will be purchased by [redacted], an Oklahoma limited liability company (the "Common Investor"). The Common Investor will be managed by the same manager of the Fund and the manager of the Capital Company. The Common Investor will be formed for the purpose of raising capital from financial lending institutions to invest in the Fund. The Common Investor will invest in the Fund in exchange for "Common Units" and will be the sole Common Unit holder.

9. The Common Investor may borrow all proceeds that it invests in the Fund from a commercial lending institution (the "Bank Loan"). It is expected that the Bank Loan may have a guaranty issued by USDA Rural Development (the "USDA Guaranties"). The terms of the Bank Loan will require a loan guarantee from the Common Investor, the Preferred Investors, and the Owners. The Bank Loan will also be conditional upon the Capital Company's willingness to make the Venture Loan to the Venture and will be cross collateralized with the Venture Loan.

10. To raise additional capital, the Fund intends to issue its Preferred Units to Preferred Investors. Investors in the Preferred Units will also be admitted as Members of the Fund ("Preferred Investors"). Prior to investing in the Fund, it is expected that certain of the Preferred Investors may borrow funds to purchase the units. Neither the Fund nor the Capital Company will be a borrower or guarantor of such borrowing.

11. The Fund will invest a portion of its capital in a series of the Capital Company's Preferred Units in return for 100% of all outstanding units of the Capital Company's Preferred Series X Units. The proceeds of the Fund's series investment in the Capital Company are to be invested by the Capital Company into the Venture. The balance, if any, of any proceeds in the Fund after deduction for expenses and reserves, will be directly invested (the "Direct Investment") in the Venture pursuant to the direct investment provisions of the Business Incentive Acts (68 O.S. § 2357.74). The Direct Investment in the Venture will be under the same terms and conditions as the Capital Company's investment in the Venture. The Direct Investment will be limited to the lesser of 200% of the Fund's investment in the Capital Company or 200% of the investment made by the Capital Company in the Venture. The Fund's investment in the Venture directly or through the Capital Company is intended to qualify as a "Qualified Investment" as defined in the Business Incentive Acts.

12. Capital Company and Fund investments in the Venture will be in the form of "equity and near equity securities" as defined in the Business Incentive Acts. Specifically, it is expected that the Capital Company will use the proceeds from the "Fund's Series Investment" to make a loan to the Venture in the form of subordinated notes. The "Venture Loan" or the "Qualified Investment" shall have a maturity date of not less than five years and the Venture 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 Venture 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 Venture Loan shall constitute a contractual obligation owed by the Venture directly to the Capital Company. The Venture will issue its "equity and near equity securities" in exchange for the "Qualified Investment" within thirty (30) days of the date as of which the investment occurs.

13. The funds from the Qualified Investment will be deposited by the Venture in its corporate accounts. The Venture may be required to secure its securities issued to the Capital Company and the Fund with a mortgage on real estate improvements and a security interest in other assets. The Qualified Investment will be used for the Project in a manner consistent with its operating agreement. The Venture will expend at least 50% of the proceeds received from the Qualified Investment within eighteen (18) months of the date of the Qualified 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, including but not limited to payroll, for the active conduct of the trade or business for which the determination of the small business qualification was made as required by 68 O.S. § 2357.72 (6) (e).

14. The Venture shall be required to pay a one-time program fee to the Capital Company of not more than 10% of the total Qualified Investment (the "Program Fee") to compensate the Capital Company for all compliance, reporting, accounting, and legal measures required to be taken under the Business Incentive Acts for qualification as a qualified small business capital company.

15. The Operating Agreement of the Fund will provide that all state tax credits earned under the Business Incentive Acts will be allocated pro rata among the Preferred Investors and the Common Investor. Cash distributions will be made 100% to the Preferred Investors until the cash distributions have been sufficient to provide to the Preferred Investors a Five percent (5%) dividend. Cash distributions will then be made 100% to the Common Investor until the cash distributions have been sufficient to provide the Common Investor a return of its capital contribution plus a 20% annual return. Thereafter distributions will be allocated pro-rata among all Members. After the cash distributions to the Preferred Investors have provided a 5% dividend, all tax credits have been properly allocated to the Preferred Investors and the Common Investor, and after the Venture has satisfied the investment of proceeds requirement of 68 O.S. § 2357.74B (A)(I), the Fund will have the option to redeem the Preferred Units at 0.5% of their original capital contribution.

16. The Fund will be formed as a limited liability company under Oklahoma law. The Fund, the Common Investor, and the Capital Company will be managed by [redacted],

an Oklahoma limited liability company (the "Manager"). Neither the Preferred Investors nor the Common Investor shall be entitled to manage the Fund or the Capital Company.

17. Neither the Fund nor the Capital Company will elect to be treated as corporations for Federal income tax purposes and will therefore be classified as a "partnership" for federal and state income tax purposes and shall always be operated in a manner consistent with such classification. Both the Fund and the Capital Company intend to be a "pass through entity" as that term is used in 68 O.S. § 2357.73 (g).

18. Offering materials involving the solicitation of any of the investments to be made in the Fund shall include the disclaimer set forth in 68 O.S. § 2357.74 A (F). Contractual provisions shall be included in relevant documents which shall provide that the Qualified Investment shall not be transferred, withdrawn or otherwise returned within five years of the closing of the transaction contemplated hereunder. The Capital Company will comply with the requirements set forth in 68 O.S. § 2357.74 A (A)(2), (4) & (5).

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 Venture will qualify as an "Oklahoma rural small business venture" as defined in 68 O.S. § 2357.72(6).

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 construct the building, furnish equipment and pay for working capital as described in the letter ruling request;*

c. [redacted] *will qualify as a small business as defined by the federal Small Business Administration;*

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

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

f. [redacted] *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.*

2. The Capital Company will qualify as a "Qualified rural small business capital company" as defined in 68 O.S. § 2357.72(8).

It is the ruling of the Tax Policy Division that the Capital Company described in the letter ruling request meets the definition of a "qualified rural small business capital company" as defined in 68 Okla. Stat. §2357.72(8) provided the following are met:

a. *The Capital Company is an Oklahoma limited liability company;*
b. *The 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 the Capital Company is in the state of Oklahoma;*
d. *The capitalization of the Capital Company is not less than Five Hundred Thousand Dollars ($500,000.00); and*
e. *The Capital Company has investment of not more than twenty-five percent (25%) of its capitalization in any one company at any time during the calendar year of the Capital Company.*

3. The use of the proceeds of the Qualified Investment for the Project is a legitimate business purpose of the Venture as defined in 68 O.S. § 2357.73 (b).

Yes. The [redacted] *satisfies a legitimate business purpose of the Venture as required under 68 Okla. Stat. §2357.73(B).*

4. The Fund will be entitled to the 30% tax credit described in 68 O.S. § 2357.73 resulting from its investment in the Capital Company to the extent of the Capital Company's investment in the Venture and shall not be diminished by the Program Fee paid to the Capital Company.

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. Program fees, provided they are reasonable, are a legitimate expense of the venture. However, this expense is not a "qualified investment for the acquisition of tangible or intangible assets or for working capital" [Section 2357.72(6)(f)] and will not be included in the 50% expenditure requirement.

5. The Fund will also be entitled to the 30% tax credit described in 68 O.S. § 2357.74 resulting from its Direct Investment in the Venture.

Yes. A shareholder or partner of a qualified rural small business capital company that has made a qualified investment in an Oklahoma rural small business venture may make a direct investment in an Oklahoma rural small business venture to the extent allowable under the provisions of Section 2357.74 of Title 68.

6. The 30% tax credits earned by the Fund may be allocated by the Fund pro rata among the Preferred Investors and the Common Investor which parties will be entitled to claim their pro rata share of the credits.

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 provided the legal obligation to repay any borrowed funds must be unlimited and continuing, and must be equal to or greater than the member's pro rata equity share of the pass-through entity and the allocation may not exceed the member's pro-rata equity share of the pass-through entity.

7. Immediately upon the statutory requirements being met, i.e. investment into the Capital Company and investment by it into the Venture or direct investment into the Venture, the credits will pass through to the Preferred Investors and can be immediately used by them against any tax then due for the Preferred Investor's current tax year as well as future tax years under the carry forward provisions of the statute.

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 liability 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 April 8, 2010. 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