

OKLAHOMA TAX COMMISSION

TAX POLICY DIVISION
DAWN CASH, DIRECTOR
December 18, 2007

PHONE (405) 521-3133
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REDACTED LETTER RULING

Re: LR-07-207
[REDACTED] LLC

Dear [REDACTED]:

This letter ruling is in response to your letter ruling request dated October 15, 2007 wherein you posed a series of ruling requests relating to the Small Business Capital Formation Incentive Act (68 O.S. §2357.60 et seq.) and 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.

FACTS

1. [REDACTED], an Oklahoma limited liability company ("ABCD") is in the process of [REDACTED], Oklahoma. ABCD intends to finance the development through a combination of debt, equity, and tax increment financing provided by the [REDACTED]. A portion of the construction will be performed pursuant to a construction contract with an affiliated Oklahoma company named [REDACTED] (the "Contractor"). The Contractor needs funds to commence construction. ABCD intends to form an Oklahoma limited liability company named [REDACTED] (the "Fund") to raise capital from accredited investors for the purpose of making venture capital investments in "Oklahoma small business ventures" and, possibly, "Oklahoma rural small business ventures" (the "Venture Company" or "Venture Companies") as defined in the Business Incentive Acts. Investments will be made through a designated series of a yet to be determined "qualified small business capital company" (the "Capital Company"). The Fund's initial investment will be in Contractor. Neither the Fund nor the Capital Company will elect to be treated as corporations for Federal income tax purposes.

2. The Capital Company will qualify as a "qualified small business capital company" and also as a "qualified rural small business capital company" as defined in the Business Incentive Acts. It will be a "series" Oklahoma limited liability company with its principal place of business within Oklahoma, formed to provide the direct investment of equity and near-equity funds to companies qualified as "Oklahoma small business ventures" and "Oklahoma rural small business ventures" within the state. It 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 commitment. Contributions, commitments 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 any one Oklahoma rural small business venture).

3. Contractor is intended to qualify as an Oklahoma small business venture. It needs financial assistance in order to commence its business which includes provision of goods and services. It will contract with the Fund for construction of improvements on the land owned by ABCD. It will have within 180 days at least 50% of its employees located in Oklahoma. It will be engaged in a lawful business activity under an Industry Number qualifying in 68 O.S. § 2357.61(5)(c) specifically [REDACTED] and will qualify as a "small business" as defined by the federal Small Business Administration. This determination has aggregated the activities of ABCD and the Fund since they will be under common control. It expects to expend 50% of the proceeds received within 18 months as required by 68 O.S. § 2357.61(5)(e).

4. The Fund will be formed as a limited liability company under Oklahoma law. It will not elect to be treated as a corporation and intends to be a "pass through entity" as that term is used in 68 O.S. § 2357.62(G).

5. ABCD will contribute cash to the Fund in exchange for "Common Units" and will be the initial Member and Manager of the Fund. To raise additional capital, the Fund intends to issue its "Preferred Units" to Investors. Investors in the Preferred Units will also be admitted as Members of the Fund ("Preferred Unitholders").

6. The Fund will invest a portion of its capital in a series of the Capital Company's Preferred Units to be invested in Contractor. The balance, after deduction for expenses and reserves, will be directly invested in the Contractor pursuant to the direct investment provisions of the Business Incentive Acts. The direct investment in the Contractor will be under the same terms and conditions as the Capital Company's investment in the Contractor. 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 Contractor. The Fund's investment in the Contractor directly or through the Capital Company are intended to qualify as a "Qualified Investment" as defined in the Business Incentive Acts.

7. The Operating Agreement of the Fund will provide that credits earned under the Business Incentive Acts will be allocated 100% to the Preferred Unitholders. Distributions will be made 100% to the Preferred Unitholders until the cash distributions and credits have been sufficient to provide to the Preferred Unitholders a return of their capital contributions plus a 20% annual return. Distributions will then be made 100% to the Common Unitholders until the cash distributions have been sufficient to provide the Common Unitholders a return of their capital contributions plus a 20% annual return. Thereafter distributions will be allocated pro-rata among all Members. After the distributions and credits to the Preferred Unitholders have provided a return of capital and a 20% annual return and after the Contractor has satisfied the investment of proceeds requirement of 68 O.S. §2357.63B(1), the Fund will have the option to redeem the Preferred Units at 1 % of the original capital contribution. The Fund will also indemnify Investors against any recapture of credits by reason of future transfer, withdrawal or return of investments by the Fund and the Capital Company in the

Contractor under 68 O.S. §2357.63B(2). Following redemption of the Preferred Units, the Fund may elect to be taxed as a C corporation or as an S corporation.

8. Capital Company and Fund investments in the Contractor will be in the form of "equity and near equity securities" as defined in the Business Incentive Acts. Specifically, it is expected that investments will be in the form of convertible subordinated debentures. The Contractor may be required to secure its securities issued to the Capital Company and the Fund with a security interest in its construction contracts, a mortgage on its constructed real estate improvements and a security interest in other assets. Likewise, the Contractor will be required to guarantee ABCD indebtedness and to pledge its assets to secure such guarantee.

9. 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. §2357.74A(F).

RULINGS REQUESTED:

Based upon the facts and representations set forth above and contingent upon Contractor meeting the employment and investment requirements of 68 O.S. § 2357.61(5):

1. The Contractor will qualify as an "Oklahoma small business venture" as defined in 68 O.S. § 2357.61(5).

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

- a) [REDACTED], LLC will have at least 50% of its assets or employees located within Oklahoma within 180 days;
- b) [REDACTED], LLC needs financial assistance to commence its business;
- c) [REDACTED], LLC is engaged in a lawful business activity under Division [REDACTED] of the Standard Industrial Classification Manual;
- d) [REDACTED], LLC qualifies as a small business as defined by the federal Small Business Administration; and
- e) [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 Capital Company will qualify as a "Qualified small business capital company" as defined in 68 O.S § 2357.61(7).

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 small business capital company" as defined in 68 Okla. Stat. §2357.61(7) if the following are met:

- a) *The Capital Company is a C corporation or a subchapter S corporation incorporated pursuant to the laws of Oklahoma, limited liability company or a registered business partnership;*
- 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 One Million Dollars (\$1,000,000.00); and*
- e) *The Capital Company has investment 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.*

3. The Fund will be entitled to the 20% tax credit described in 68 O.S. § 2357.62 resulting from its investment in the Capital Company to the extent of the Capital Company's investment in the Contractor.

The amount of the credit is 20% of the qualified investment in the Capital Company which is subsequently invested in the Contractor, provided all statutory requirements are met.

4. The Fund will also be entitled to the 20% tax credit described in 68 O.S. § 2357.62 resulting from its direct investment in the Contractor.

Yes, the Fund will be entitled to the 20% tax credit described in 68 O.S. § 2357.63 provided all statutory requirements are met.

5. The Metro Credits earned by the Fund may be allocated by it 100% to the Preferred Unitholders 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 a pass-through entity that are entitled to a credit under §§2357.62 and 2357.63 of Title 68 may receive an allocation of the credits from the pass-through entity, subject to the provisions of §2357.62(G) and §2357.63(E). If the members of the Fund are pass-through entities, the allocation of credits is subject to the provisions of §2357.62(G) and §2357.63(E).

6. Immediately upon the statutory requirements being met, i.e. investment into the Capital Company and investment by it into the Contractor or direct investment into the Contractor, the Metro Credits will pass through to the Investors and can be immediately used by them against any tax then due for the Member's current tax year as well as future tax years under the carry-forward provisions of the statute, including estimated income tax payments.

Shareholders, partners or members of pass-through entities that are entitled to a credit under §2357.62 and §2357.63 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.

This response applies only to the circumstances set out in your request dated October 15, 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.

Sincerely,

Oklahoma Tax Commission

A handwritten signature in black ink, appearing to read "Dawn Cash", written in a cursive style.

Dawn Cash, Director
Tax Policy & Research Division