OKLAHOMA TAX COMMISSION

TAX POLICY AND RESEARCH DIVISION
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March 10, 2006

Re: Our file number LR 06-002

Dear

This is in response to your inquiry of December 15, 2005 wherein you requested a letter ruling on behalf of .) and regarding the application of Oklahoma Small Business Capital Formation Incentive Act (68 O.S. § 2357.60 et. seq.) and the Oklahoma Rural Venture Capital Formation Incentive Act (68 O.S. § 2357.71 et. seq.). Following are the facts as presented in your letter, the rulings requested and our responses thereto

FACTS:

an Oklahoma limited liability Company together with one or more individuals or entities, will form a "Capital Company". This will be an Oklahoma limited liability company tentatively called ' together with one or more individuals or entities, will also form a "Fund". This will be another Oklahoma limited liability company tentatively called or "Venture Funds".

The purpose of the Fund is to raise venture capital from private accredited "Investors" to be invested in qualified rural small business capital companies qualifying under 68 O.S. § 2357.72. The venture capital raised by the Fund may also be used for direct investments in Oklahoma rural small business ventures under 68 O.S. § 2357.74.

The Capital Company will be formed for the purpose of making qualifying investments in Oklahoma small business ventures under 68 O.S. §2357.61 and Oklahoma rural small business ventures as provided by 68 O.S. § 2357.72.

The Fund intents to raise approximately $30x of equity capital from Oklahoma accredited Investors and borrow $70x from accredited Investors and or "Financial Institutions".

The Fund and the Capital Company will not elect to be treated as a corporation for Federal income tax purposes. Therefore, they shall be treated as partnership for Federal and Oklahoma income tax purposes.

The Fund intends to transfer part or all of the its capital less operating and organizational expenses to the Capital Company in return for ownership units and subordinate debentures of the Capital Company.

The Fund intends to invest part or none of its capital in Oklahoma rural small business ventures and Oklahoma metropolitan small business ventures in equal or less amount as the Capital Company under the same terms and conditions as the Capital Company.

The Capital Company intends to qualify as a "qualified small business Capital Company" as defined in 68 O.S. § 2357.61, a part of Small Business Capital Formation Incentive Act, and also as a "qualified rural small business capital company" as defined in 68 O.S. § 2357.72, a part of the Rural Venture Capital Formative Incentive Act.

The Capital Company intends to invest its capital less operating and organizational expenses in qualifying Oklahoma rural small business ventures and Oklahoma metropolitan small business ventures as provided by the respective statutes (the "Ventures").

The Capital Company shall be incorporated pursuant to the laws of Oklahoma, limited liability company and shall:

a. provide the direct investment of equity and near-equity funds to companies within this state,
b. have its principal place of business located within this state,
c. have capitalization of not less than One Million Dollars ($1,000,000.00), and
d. have investment of not more than twenty percent (20%) of its capitalization in any one Oklahoma metropolitan small business venture and not more than twenty five percent (25%) of its capitalization in anyone Oklahoma rural small business venture

As a result of transactions outlined above, it is anticipated that the Fund will be entitled to a 30% tax credit on its investment in the Capital Company which in turn is used to fund qualifying rural small business ventures under 68 O.S. § 2357.73 and a 20% tax credit on its investment in the Capital company which in turn is used to fund other qualifying metropolitan small business ventures under 68 O.S. § 2357.62.

The Capital Company intends to notify the Fund immediately when investments are made in qualifying Ventures, and the Fund will then notify the Investors or their proportionate shares of the tax credit earned from such investment.

The Capital Company may also accept investments qualifying under the tax credit statutes from entities other than the Fund in which case the income and loss from Venture investments by the Capital Company shall be allocated to the parties supplying capital for each particular Venture investment.

RULINGS REQUESTED:

1. The Capital Company will qualify as a "qualified small business Capital Company" as defined in 68 O.S. § 2357.61, a part of Small Business Capital Formation Incentive Act, and also as a "qualified rural small business capital company" as defined in 68 O.S. § 2357.72, a part of the Rural Venture Capital Formative Incentive Act.

Yes, based on the facts outlined above, the "Capital Company" will qualify as a "qualified small business Capital Company" as defined in 68 O.S. § 2357.61, or as a "qualified rural small business capital company" as defined in 68 O.S. § 2357.72.

2. The 30% credit earned by the Fund on its investment in the Capital Company under 68 O.S. § 2357.73 and the 20% credit on its investment in the Capital Company under 68 O.S. § 2357.62 will pass through and be available to the Investors of the Fund in proportion to their investments in the Fund.

Generally, properly earned credits are able to offset Oklahoma tax liabilities of and may be allocated among members of the Fund. In the case of flow-through entities (LLC's, partnerships, and Sub S corporation), the credit is generally distributed to the appropriate

member, partner or shareholder. The Tax Commission has historically allowed the distributing entity to determine how the amounts of credits are distributed so long as the following two conditions are met. One, the amount distributed does not exceed the amount of available credit and two; distribution must be made to a member, shareholder or partner of the flow through entity that has generated the credit.

3. The credits will pass through to the Investors and be usable by the Investors against any tax of the Investor then due under the tax provisions of the statute, including estimated tax payments, immediately upon the statutory requirements being met, i.e. investment into Capital Company and investment by the Capital Company into qualifying venture or ventures.

The credits are available to be used to offset Oklahoma taxes when due, provided income tax year integrity is maintained. For example, an investment made in 2006 generates a credit that is available to offset tax year 2006 taxes and would not be available to pay 2005 income tax that may be due in 2006

This response applies only to the circumstances set out in your request of December 15, 2005 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, assuming that all pertinent facts have been accurately and completely stated, and that there has been no change in applicable law.

Please also be advised that the issuance of this ruling does not preclude the Oklahoma Tax Commission from conducting an audit or examination under 68 O.S. § 206 of and or any potential investors of either nd or any member of the aforementioned LLC's regarding the transactions outlined in this letter ruling. The Commission further reserves the right to issue any assessment, correction, or adjustment authorized under 68 O.S. § 221.

If I can be of further assistance, please feel free to call me at (405) 521-3133.

Sincerely,

FOR THE OKLAHOMA TAX COMMISSION

Michael C. Kaufmann
Tax Policy Analyst