

# OKLAHOMA TAX COMMISSION

TAX POLICY DIVISION  
DAWN CASH, DIRECTOR

PHONE (405) 521-3133  
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July 28, 2008

## REDACTED LETTER RULING

Re: Our file number LR-08-092

Dear

This letter ruling is in response to your letter ruling request dated July 18 and July 29, 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 dated July 18<sup>th</sup>, are the specific rulings requested and our responses thereto.

[REDACTED] (the "Venture") that desires confirmation of its qualification as an "Oklahoma rural small business venture" as defined in Tit. 68 O.S. § 2357.72(6). The Venture is a subsidiary of [REDACTED] intends to organize one or more Oklahoma limited liability companies (each a "Fund" and collectively, the "Funds"), for the purpose of making equity contributions into the Funds, and possibly allowing other investors to make such contributions, in each case for eventual investment by the Funds: (i) into 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 the Venture; or (ii) directly into the Venture. It is intended for all investment proceeds contributed to the Funds to qualify for the Oklahoma tax credits provided in the Rural Venture Capital Formation Incentive Act, Tit. 68 O.S. § 2357.71 et. seq. (the "RVCA" and the "State Credits" when referring to the tax credits generated).

### I. STATEMENT OF FACTS

1. The Funds will be Oklahoma limited liability companies and shall receive investment proceeds in a total aggregate amount not to exceed \$240 million. It is expected that the Funds will be comprised of between two (2) and three (3) separate entities.

2. [REDACTED] will make hard-equity contributions to the Funds in a total aggregate amount of between \$180 million and \$220 million.

3. One or more of the Funds may raise additional investment capital from accredited Oklahoma investors (the "Investors"). With respect to a Fund that receives capital investment

from Investors, [REDACTED] and the Investors shall collectively be referred to hereinafter as the "Members" of that Fund.

4. Each Fund will issue all of its common ownership units (the "Common Units") to [REDACTED] in exchange for [REDACTED] capital contribution to that Fund.

5. In the event a Fund raises additional investment capital from Investors, such Investors will be issued preferred ownership units of that Fund (the "Preferred Units") in exchange for the Investors' capital contributions to that Fund.

6. As the holder of all of the Common Units of the Funds, [REDACTED] shall act as the managing member of the Funds and shall have complete control over the business and affairs of the Funds.

7. In the event a Fund issues no Preferred Units to Investors, [REDACTED] shall be the only equity owner of that Fund. In such case, [REDACTED] will be allocated all of the State Credits earned by that Fund and will receive all distributions of cash and other property from that Fund.

8. If a Fund raises capital from Investors and issues Preferred Units to Investors, the Investors will be entitled to receive a preferred return (the "Preferred Return") from that Fund equal to: (i) State Credits earned by that Fund in the total amount of 180% of the capital contributions made by the Investors to that Fund (the "Preferred Credit Return"); plus (ii) cash distributions from that Fund equal to a one-time, cumulative return on the Investors' capital contributions of between ten and twenty percent (10%-20%) (the "Preferred Cash Return"). As the owner of the Common Units of that Fund, [REDACTED] shall receive no distributions of State Credits or cash from that Fund until that Fund has fully satisfied the Preferred Return to be paid to the Investors. Following satisfaction of the Preferred Return, all other State Credits earned by that Fund, if any, shall be allocated to [REDACTED] and all other distributions of cash and other property from that Fund, if any, shall be allocated to the Members in accordance with their percentage ownership interest in that Fund.

9. Each Fund will transfer 33.34% of the capital it raises to one or more entities which function as a "qualified rural small business capital company" as defined in Tit. 68 O.S. § 2357.72(7) (each an "SBC" and collectively the "SBCs") in return for at least 99.99% of all outstanding units of each of the SBC's preferred series of units designated for this matter (each an "SBC Equity Investment" and collectively the "SBC Equity Investments"). Each Fund will use the remaining 66.66% of its investment capital to make the Side Loans, as defined and as more particularly described in Paragraph 12 of this Section 1.

10. Each SBC will use 100% of the proceeds they receive in the form of an SBC Equity Investment to make a loan to the Venture (each an "SBC Loan" and collectively the "SBC Loans"). The SBC Loans shall have a maturity date of not less than five years and such loans shall be subordinated to all other indebtedness of the issuer (i.e., the Venture) that has been issued or is to be issued to a financial lending institution: Furthermore, the SBC Loans 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. Each SBC Loan shall constitute a contractual obligation owed by the Venture directly to the applicable SBC.

11. None of the SBCs shall own, directly or indirectly, any equity interest, voting or otherwise, in the Venture and none of the SBCs shall have any right whatsoever to elect any persons to any governing board of the Venture.

12. The net investment proceeds received by each Fund, less the amount of the SBC Equity Investments made by that Fund, shall be invested in the Venture through one or more subordinated loans to the Venture (each a "Side Loan" and collectively the "Side Loans"). Each Side Loan made by a Fund shall be made in conjunction with an SBC Loan which is attributable to (i.e., funded by) an SBC Equity Investment made by that Fund. The economic terms and conditions, including the interest rate charged and repayment obligations, of each Side Loan shall be identical to the economic terms and conditions of its paired SBC Loan for a period of at least five (5) years following issuance of such Side Loan. Furthermore, the dollar amount of each Side Loan shall be less than 200% of the dollar amount of its paired SBC Loan. With respect to each Side Loan, the Venture mayor may not be required to pay a one-time loan origination fee to the applicable Fund in an amount not greater than 5% of the dollar amount of such Side Loan. The Side Loans and the SBC Loans shall collectively be referred to hereinafter as the "Venture Loans".

13. The Venture will issue the subordinated debt instruments representing the Venture Loans within 30 days of the Venture's receipt of the funding to be provided by those loans.

14. The Venture maintains a principal place of business and conducts 100% of its operations within the city limits of [REDACTED]. Thus, all of Venture's revenues result from its business activities in [REDACTED].

15. The Venture is a for-profit entity and is predominately dedicated to the [REDACTED]. Therefore, the Venture is engaged in a business activity classified under Major Group Number [REDACTED] the Standard Industrial Classification Manual. For purposes of determining the Venture's qualification as a "small business" under the Table of Small Business Size Standards matched to the North American Industry Classification System Codes (the "NAICS"), the NAICS code for the Venture is [REDACTED].

16. The Venture has, and will have within 180 days after receipt of each of the Venture Loans, at least 50% of its employees or assets located in Oklahoma. In fact, all of the Venture's employees and all of the Venture's assets are and will be located in [REDACTED], [REDACTED].

17. The Venture needs financial assistance in order to expand its business and to ensure the future economic viability of its facility. More specifically, the Venture intends to [REDACTED]

18. It is projected that the Expansion Project will require capital expenditures of between \$180-\$240 million over a period consisting of approximately eighteen (18) months. Yet, due to its limited manufacturing capabilities, the Venture has struggled to maintain profitability over the past four years, with an approximate average annual net income (after taxes) for that period of merely [REDACTED] million in relation to average annual gross revenues for the same period of approximately \$[REDACTED] million. This low marginal profitability seriously compromises cash flow for

the Venture. The Venture is therefore unable to undertake the required capital expenditures for the Expansion Project without significant financial assistance.

19. 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 Venture Loans for the acquisition of tangible assets to be used in the active conduct of the Venture's business. In fact, it is projected that the Venture will use, at a minimum, 70% of the Venture Loans to directly pay for the cost of the acquisition and installation of equipment and the construction of real property improvements in connection with the Expansion Project. Any amount of the Venture Loans not so used (i.e., the remaining amount of up to 30%) shall be used by the Venture to satisfy its legitimate third-party operational expenditures and for working capital needs.

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

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

22. Each of the SBC and each of the Funds 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.

23. Provisions shall be included in the loan documentation for the Venture Loans indicating that none of the Venture Loans shall be transferred, withdrawn or otherwise returned within five (5) years of the closing of the Venture Loans.

24. In the event a Fund raises capital from Investors and issues Preferred Units to such Investors, [REDACTED] will enter into contractual agreements (the "Option Agreements") with the Investors whereby [REDACTED] will be entitled to purchase the Preferred Units of the Investors in that Fund, and the Investors will be entitled to sell their Preferred Units in that Fund to [REDACTED], at 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 Preferred Units of a Fund shall be equal to between .1 % and .5% of the total purchase price originally paid by the Investor to that Fund for the Preferred Units.

25. [REDACTED] owns 100% of the outstanding equity interests in the Venture. Therefore, [REDACTED] has 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.

26. [REDACTED], a [REDACTED] corporation publicly traded on the New York Stock Exchange under the symbol [REDACTED], beneficially owns 100% of the outstanding equity interests of [REDACTED].

27. [REDACTED] files a consolidated Oklahoma Corporation Income Tax Return (Form 512) on behalf of itself and a group of affiliated corporations, including the Venture.

28. In addition to the Venture, [REDACTED] indirectly owns a majority interest in and controls various other separate and distinct business entities with [REDACTED]

[REDACTED]

29. While the Venture has enjoyed only marginal profitability, and at times significant losses, in recent years (see Paragraphs 17 and 18 above of this Section I) and could in no way self-fund the Expansion Project, the much greater profitability of the other [REDACTED] has allowed [REDACTED] to amass sufficient cash reserves to fund the Expansion Project. More specifically, [REDACTED] will, either directly or through one of its wholly owned subsidiaries, make equity contributions to [REDACTED] in order to fund the entire amount of [REDACTED] equity contributions to the Funds, [REDACTED] will not engage in any borrowing and will receive no other sources of funding to facilitate its equity contributions to the Funds.

30. As of June 30, 2008, to [REDACTED]'s best knowledge no single person or entity beneficially owned more than 8% of the outstanding equity ownership interests of [REDACTED] and no person or entity holding an ownership interest in [REDACTED] has the ability to control the Board of Directors of [REDACTED].

## II. LAWS/REGULATIONS AND ANALYSIS APPLICABLE TO "SMALL BUSINESS" DETERMINATION

1. 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. See Public Law 85-536, § 3(a)(2).

2. The SBA has issued regulations providing that "a business concern eligible for assistance from SBA as a small business is a business entity organized for profit, with a place of business located in the United States, and which is operated primarily within the United States or which makes a significant contribution to the United States economy through payment of taxes or use of American products, materials or labor". See 13 CFR Ch. I § 121.105(a)(1). In addition, the SBA has established size standards to determine whether a business entity is small and, thus, eligible for the programs and preferences for small business concerns. See 13 CFR Ch. I § 121.101(a).

3. The SBA size standards are determined according to the total average number of employees and/or total annual receipts of a company for each of the various types of economic activity, or industries, represented in the NAICS codes. As discussed in Paragraph 15 of Section I above, the NAICS code for the Venture is [REDACTED]. The size standard for NAICS code [REDACTED] is not more than [REDACTED] employees of the company, including its affiliates, in order to qualify as a small business concern. The SBA size standards provide no limitation on annual receipts for companies under NAICS code [REDACTED].

4. Under the SBA affiliation rules, the number of employees and/or the annual receipts of "affiliates" must be included in determining whether a company meets the applicable SBA size standards. Concerns or entities are "affiliates" of each other when one controls or has

the power to control the other, or a third party or parties controls or has the power to control both. See 13 C.F.R. § 121.103. A person that owns, or has the power to control fifty percent (50%) or more of a concern's voting stock, or a block of voting stock which is large compared to other outstanding blocks of voting stock, controls or has the power to control the concern. See 13 C.F.R. § 121.103(c). If two or more persons each owns, controls or has the power to control less than fifty percent (50%) of the voting stock of a concern, with minority holdings that are equal or approximately equal in size but the aggregate of these minority holdings is large as compared with any other stock holding, each such person is deemed to be an affiliate of the concern. See 13 C.F.R. § 121.103(c).

5. In Geo-Seis Helicopters, Inc., Docket No. SIZ-94-3-23-32, the SBA determined that a publicly held corporation can qualify as a small business concern and can meet the requirement of being "independently owned and operated", provided the publicly traded corporation, including its affiliates, meet the applicable size standards designated in 13 C.F.R. Part 121. The SBA determined in Geo-Seis Helicopters that none of the regulations codified in 13 C.F.R. Part 121 "makes a distinction between a publicly traded corporation and a privately held corporation, nor do we". The SBA further determined in Geo-Seis Helicopters that whether an entity qualifies as a small business concern is based either on its average annual receipts or its number of employees, whichever is applicable, rather than on how its stock is sold. These "size standards seek to ensure that an entity meets a specific size standard is not dominant in its field of operation."

6. As set forth above, the Venture will be an operating business organized for profit and located in the United States.

7. As set forth above, the Venture currently has [REDACTED] employees and will add between [REDACTED] employees as part of the expansion project. However, [REDACTED] beneficially owns 100% of the Venture. Thus, under the SBA affiliation rules, [REDACTED] is an affiliate of the Venture and the total number of employees of [REDACTED] and the [REDACTED] must be considered when determining the Venture's qualification under the SBA size standards. The total current number of employees of [REDACTED] and the [REDACTED] is 871, which is less than the [REDACTED] employee size standard applicable to the Venture.

8. The Geo-Seis Helicopters case clearly indicates that [REDACTED]'s status as a publicly traded corporation does not disqualify the Venture as a "small business" under the Act. In addition, no entity or concern that fails to qualify as a "small business" owns more than 50% of [REDACTED] or has the power to control the business or affairs of [REDACTED]. In fact, no single shareholder of [REDACTED] held more than 8% of [REDACTED] as of June 30, 2008.

### III. 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" under Tit. 68 O.S. § 2357.72(6) and more specifically, the determination of the Venture's qualifications under the requirements for an "Oklahoma rural small business venture" as set forth in § 2357.72(6) (other than § 2357.72(6)(e) by virtue of the SBA affiliation rules) is limited to consideration of the Venture itself and does not include consideration of [REDACTED] [REDACTED] or the other [REDACTED] separate and distinct from the Venture.

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:

- 1) [REDACTED] will have at least 50% of its assets or employees located in Oklahoma within 180 days after a qualified investment is made;
- 2) [REDACTED] needs financial assistance in order [REDACTED]
- 3) At least seventy-five percent (75%) of [REDACTED]'s gross annual revenues will be a result of activities conducted in areas deemed to be non-metropolitan areas;
- 4) [REDACTED] is engaged in a lawful business activity under Division [REDACTED] of the Standard Industrial Classification Manual;
- 5) [REDACTED] qualifies as a small business as defined by the federal Small Business Administration; and
- 6) [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.

2. An SBC Equity Investment in an SBC followed by the SBC's use of that SBC Equity Investment to make an SBC Loan to the Venture will qualify for the State Credits.

*Based upon the facts and other assertions contained in your July 18<sup>th</sup> and July 29<sup>th</sup> requests and the attached exhibits, the SBC Equity Investment made by the Fund in the SBC followed by the SBC loan to 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 an SBC Equity Investment in an SBC shall be based on the total amount of that SBC Equity Investment that is subsequently used by the SBC to make an SBC Loan to the Venture, and shall not be diminished by the 5% loan origination fees with respect to that SBC Loan.

*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. Loan origination fees, 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. A Side Loan made to the Venture will qualify for the State Credits pursuant to Tit. 68 O.S. § 2357.74(B) and the calculation of the amount of State Credits attributable to the Side Loans shall be based on the total aggregate amount of the Side Loan.

*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.*

5. In the event a Fund issues no Preferred Units to Investors, all of the State Credits attributable to Venture Loans funded by that Fund either through Side Loans or SBC Equity Investments may be allocated to [REDACTED] as the owner of the Common Units, as more

particularly described in Paragraph 7 of Section 1.

*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. In the event a Fund issues Preferred Units to Investors, the State Credits attributable to the Venture Loans funded by that Fund either through Side Loans or SBC Equity Investments may be specially allocated to the Members as described in Paragraph 8 of Section 1.

*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.*

7. Upon completion of a Venture Loan, the Members of the Fund that funded that Venture Loan either directly as a Side Loan or indirectly through an SBC Equity Investment may immediately use the State Credits resulting from such Venture Loan to offset various Oklahoma tax liabilities for the same year in which such Venture Loan is made, including Oklahoma personal income taxes, Oklahoma corporate income taxes (determined on a consolidated basis or otherwise), estimated personal or corporate income taxes, bank privilege taxes and insurance company premium taxes when due.

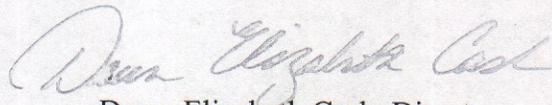
*Shareholders, partners or members of pass-through entities that are entitled to a credit under §§2357.73 and 2357.74 of Title 68 may receive an allocation of the credits from the pass-through entity. Once allocated to the shareholders, partners or members, the credits may immediately be used to offset 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 requests dated July 18 and July 29, 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, reading "Dawn Elizabeth Cash". The signature is written in dark ink and is positioned above the printed name and title.

Dawn Elizabeth Cash, Director  
Tax Policy & Research Division