OKLAHOMA TAX COMMISSION

TAX POLICY DIVISION
DAWN CASH, DIRECTOR

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June 3, 2009

Re: Our file number LR-09-027

Dear

This letter ruling is in response to your letter ruling request dated March 3, 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.

[redacted], is an Oklahoma series limited liability company that anticipates meeting the requirements of a "qualified small business capital company" as defined in Tit. 68 O.S. § 2357.61(7) (the "Capital Company"). The Capital Company intends to organize another Oklahoma limited liability company 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 small business capital company" as defined in Tit. 68 O.S. § 2357.61(7), which will in turn invest such funds into a "Oklahoma small business venture" as defined in Tit. 68 O.S. § 2357.61(5) (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 in the Small Business Capital Formation Incentive Act, Tit. 68 O.S. § 2357.60 et. seq. (the "Business Incentive Acts").

STATEMENT OF FACTS:

1. The Venture will be an Oklahoma limited liability company that [redacted] The Venture intends to expand its [redacted]

[redacted] (the "Project"). The Venture's office and principle place of business will be located in [redacted] The Venture will have within 180 days at least 50% of its employees or assets located in Oklahoma.

2. The Fund will raise capital from accredited investors, including the owner of the Venture and the family of the owner of the Venture, 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 OS. § 2357.61 (not more than twenty percent (20%) of the capitalization may be invested in any one Oklahoma small business venture) and 68 OS. § 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).

5. The Venture requires financial assistance in order to fund the Project. It currently has and will maintain within 180 days at least 50% of its employees and assets 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] of the Standard Industrial Codes and will qualify as a "small business" as defined by the federal Small Business Administration.

6. The Fund will be formed as a limited liability company under Oklahoma law. Both the Fund and the Capital Company will be managed by [redacted], an Oklahoma limited liability company (the "Manager"). Neither the Preferred Investors nor the Common Investors shall be entitled to manage the Fund or the Capital Company.

7. Neither the Fund nor the Capital Company shall own a direct voting interest in the Venture other than the Qualified Investments; however, the Owner of the Venture will own 100% of the Common Units of the Fund.

8. 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. § 2357.62(G).

9. 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 Fund may issue multiple classes of Preferred Units. The Common Investor will be issued Common Units.

10. The Common Investor will contribute cash to the Fund in exchange for "Common Units" and will be the sole Common Unit holder. 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 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. § 2357.63). 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. § 2357.61(5) (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 credits earned under the Business Incentive Acts will be allocated 100% to the Preferred Investors. Distributions will be made 100% to the Preferred Investors until the cash distributions and credits have been sufficient to provide the Preferred Investors a return of their capital contributions plus a 75% return. Distributions will then be made 100% to the Common Investors until the cash distributions have been sufficient to provide the Common Investors 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 Investors have provided a return of capital, a 75% return, and after the Venture has satisfied the investment of proceeds requirement of 68 O.S. § 2357.63B(A)(1), the Fund will have the option to redeem the Preferred Units at 1% of the original capital contribution. The Fund and the Capital Company will also indemnify Preferred Investors against any recapture of credits under 68 O.S. § 2357.63B (A) (3).

16. 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. § 2357.63 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. § 2357.63 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. Contractual commitments to contribute funds on demand to the Capital Company pursuant to a Capital Contribution Agreement attached hereto as Exhibit B will qualify as a contractual commitment to provide funds that is payable on demand and has substantial economic penalties for breach as described in 68 O.S. § 2357.61(2)(b).

Yes.

2. The Venture 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 the Venture meets the definition of an "Oklahoma small business venture" within the meaning of §2357.61(5) based on the following representations:

a) The Venture will have at least 50% of its assets or employees located within Oklahoma within 180 days;
b) The Venture needs financial assistance to acquire and/or construct and/or lease the nursing home facility;
c) The Venture is engaged in a lawful business activity under Division ▌ of the Standard Industrial Classification Manual;
d) The Venture qualifies as a small business as defined by the federal Small Business Administration; and
e) The 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. 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) provided 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.*

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

The [redacted] satisfies a legitimate business purpose of the Venture as defined in 68 O.S. § 2357.62(B).

5. 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 Venture and shall not be diminished by the Program Fee paid to the Capital Company.

Yes. The credit in 68 O.S. §§ 2357.62 and 2357.63 is for qualified investments which are actually invested in an Oklahoma small business venture and used in pursuit of a legitimate business purpose. Program 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 or for working capital" [Section 2357.61(5)(e)] and will not be included in the 50% expenditure requirement.

6. The Fund will also be entitled to the 20% tax credit described in 68 O.S. § 2357.63 resulting from its Direct Investment in the Contract.

Yes. A shareholder or partner of a qualified small business capital company that has made a qualified investment in an Oklahoma small business venture may make a direct investment in an Oklahoma small business venture to the extent allowable under the provisions of Section 2357.63 of Title 68.

7. The 20% tax credits earned by the Fund may be allocated by it 100% to the Preferred Investors 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 §§2357.62 and 2357.63 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 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.

8. 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 §2357.62 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 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, but not estimated income tax payments.

This response applies only to the circumstances set out in your request dated March 3, 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