

OKLAHOMA TAX COMMISSION

TAX POLICY DIVISION
DAWN CASH, DIRECTOR



PHONE (405) 521-3133
FACSIMILE (405) 522-0063

November 24, 2009



Re: LR-09-180
[Redacted]

Dear [Redacted]:

This letter ruling is in response to your letter ruling request dated November 10, 2009 wherein you posed a series of ruling requests relating to the Oklahoma Small Business Capital Formation Incentive Act (68 O.S. §2357.61 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.

This is to request an opinion on the deemed market liquidity event under the Small and Rural Small Business Venture Capital Formation Incentive Act, 68 O.S. §§ 2357.61 and 2357.72 et seq ("Act"). [Redacted], an Oklahoma Small and Rural Small Business Capital Company ("Capital Company"), has previously received a favorable ruling from your office on its method of conducting business under the Act and for the benefit of motion picture production within the state in order to generate credits. Capital Company is currently anticipating several new film production ventures in Oklahoma which require additional considerations to expand upon the ruling of the initial letter issued to Capital Company.

Facts

In support of our request, we offer the following facts:

1. The Capital Formation Incentive Act states that investments made by a Capital Company into a Small or Rural Small Business Venture must remain invested for a five (5) year period or be subject to a recapture event. An

exception is made whereby an event deemed a "market-based liquidity" event will not have the result of triggering a recapture of the credits under the Act. The Act characterizes a market-based liquidity event, in relevant part, as the following:

(an Oklahoma small or rural small business venture)

A. sells all or substantially all of its assets to, or is acquired by share acquisition, share exchange, merger, consolidation or other similar transaction by another person or entity other than:

- (1) a person or entity controlled by a person that made a qualified investment in the qualified small business capital company that provided funds for use by the Oklahoma small or rural small business venture, or
- (2) a person or entity controlled by a person that made an investment in conjunction with a qualified investment made by the qualified small business capital company that provided funds for use by the Oklahoma small or rural small business venture, or

D. repays indebtedness from net income as determined in accordance with generally accepted accounting principles or proceeds of the sale of assets in the ordinary course of business.

For purposes of film production, the letter ruling issued to [REDACTED] in September of 2006 states that a sale, assignment, or license of the copyrights of the film, in this case the only assets of the film production entity, will qualify as a "market-based liquidity" event.

2. An Oklahoma film production entity is established for each film production venture qualifying as a small and rural small business venture. A film production entity will, immediately following completion of the production or creation of the film, seek to sell, assign, or license the copyrights in and to the film to a third party distributor. These transfers of the copyrights will continue for a period of 15 to 25 years if not sold outright. The transfers will, in most cases, be comprised of agreements between several third party distributors representing various territories around the world. By way of example, a film production entity may have agreements for licenses with entities from each of the following: Italy, Germany, France, Japan, UK, and North America to name a few. Therefore, a license may begin with multiple third party entities during production, with the licensee only able to take physical possession once the film has completed post production.

3. A film production entity has a shorter life than other business entities. The model for the motion picture industry is structured to make all sales of as many territories as possible within, typically, one to two years

following the completion of the film, thus leaving the film production entity with no assignable assets. In most cases, the rights in and to the third party distribution agreements are then transferred from the film production entity to a separate entity.

4. A typical film production entity will have equity investors seeking a repayment of and return on their investment upon the sale, assignment or license of the assets of the film production entity. This return is expected when payments for third party distribution agreements are actualized, typically as the payments are made to the film production entity upon delivery of the film to the third party distributor.

Supplemental Ruling Requested

The ruling requested is as follows:

1. The effect of a valid third party distribution agreement for the sale, assignment or license of the assets of any film production entity qualifying as a small or rural small business entity will count as a "market based liquidity event" under the Act.

The sale, assignment or license of all or substantially all of the assets of a film production entity, which qualifies as a small business venture or rural small business venture under the Act, qualifies as a "market-based liquidity event" pursuant to 68 O.S. §§ 2357.63B(2)(a) and 2357.74B(2)(a).

2. The occurrence of the market based liquidity event will allow for the return of investment capital to equity investors upon payment under any third party agreement as those agreements become payable without triggering a recapture event under the Act.

At any time, the Venture may pay the Investors a return on their investments as a result of profits generated by the investment. Upon the sale, assignment or license of all or substantially all of the assets of a film production entity, thus leaving the film production entity with no assignable assets, the return of the investment capital to equity investors will not trigger a recapture event under the Act.

This response applies only to the circumstances set out in the request dated November 10, 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

A handwritten signature in black ink, appearing to read "Dawn Elizabeth Cash". The signature is written in a cursive style with a large initial "D".

Dawn Elizabeth Cash, Director
Tax Policy & Research Division