

Convertible Note Conversion

Once your Note converts, you will need to create transactions to reflect this, but first you need to create the Preferred Stock round into which the Note is converting {see Adding a Preferred Stock Round}.

Convertible note conversion is tricky because, for tax reasons, it is helpful to account for any interest you received as a separate transaction (interest received is taxable). To do so, create two separate transactions for (i) the conversion of the original principal and (ii) the Interest Paid in Stock. However, if simplicity is the goal, it is possible to create a single Note Conversion transaction and record all the shares received, including interest paid in stock - if you do this, we suggest using the memo field to indicate the amount of interest received for future reference when filing taxes.

Be advised: sometimes interest is paid in cash and is not paid in shares or ever turned into shares. If that is the case, it will be reported to the IRS separately and should be created as an Interest Paid in Cash transaction in Seraf, which will be reflected in your IRR calculation.

	Item	Where you can find it
<input type="checkbox"/>	Round of Investment	<ul style="list-style-type: none"> For this field you will want to select the convertible note round you created (you will enter the new preferred round the note is converting into later)
<input type="checkbox"/>	Date	<ul style="list-style-type: none"> The date the note converted, which should be the date the new preferred round of financing closed This date should be included in communications from the company
<input type="checkbox"/>	Number of Shares (* See comments below)	<ul style="list-style-type: none"> Your share count should be communicated to you by the company, but can also be found in the capitalization table or the stock certificate See introductory note above about whether to include interest earned in stock shares
<input type="checkbox"/>	New Round (You should have already created this Preferred Round on Seraf, so it should be right in the drop-down menu)	<ul style="list-style-type: none"> This is the new preferred round into which your note is converting You should receive correspondence giving you notice that your note is converting, the name of the new round, the date of conversion and the number of shares you are receiving
<input type="checkbox"/>	Share Certificate #	<ul style="list-style-type: none"> Share Certificate - each certificate has a unique number, often beginning with the letter of the round (for example, a Series A certificate number may be A-22) Check with company counsel - the round may not have certificates issued or even if it does, they may be held at the offices of company counsel for safe-keeping and they may need to tell you your certificate number or email you a scan of your certificate. It is a very good idea to keep a scan of your certificate on Seraf in case of problems down the road or for the benefit of your family and advisors.
<input type="checkbox"/>	1244 Qualified	<ul style="list-style-type: none"> As noted in the Help Center and Seraf Compass, if your investment part of the first \$1M invested in the company, you are eligible for very advantageous IRS Section 1244 tax treatment. Capitalization Table should indicate how much was invested in the round and any previous rounds Confirm with Company via email (where you can save a copy of the email as proof) Double-check with tax advisor
<input type="checkbox"/>	Memo Field	<ul style="list-style-type: none"> If you choose to create only one transaction, you should record here the number of shares you are receiving as interest for tax purposes

*** Comments re: Shares** - For tax purposes, it is important to differentiate how many shares you are receiving based on the conversion of the principal investment, and how many shares are being paid as interest because these categories may be taxed differently (speak to your advisor). Seraf recommends that you create separate transactions for each of these.

Typically companies communicate the total amount converting (principal plus interest) and the total number of shares received (based on principal plus interest). In order to create separate transactions, you will need to do some simple calculations to tease these amounts apart.

To start, calculate the discounted share price by either (i) multiplying the discount rate outlined in the Promissory Note by the share price of the new round of financing or (ii) take the aggregate amount of money converting (principal plus interest) and divide by the total number of shares received.

Next, calculate the amount of interest earned. If the correspondence about your conversion includes an amount greater than your original check size, the delta between those two numbers should be the interest amount - cross check it by doing an approximate calculation of what you think the interest should be based on the interest rate and mechanism in the note and the time elapsed.

Once you have the discounted share price and the amount of interest earned, you can quickly calculate the number of shares paid in interest, along with the number of shares converting from principal.

$$\text{Principal Shares} = \text{Principal Investment} / \text{Discounted Share Price}$$

$$\text{Interest Shares} = \text{Amount of Interest} / \text{Discounted Share Price}$$

or

$$\text{Interest Shares} = \text{Total Shares} - \text{Principal Shares}$$

To create transactions for deals where the interest is paid in cash, as noted above, you should be provided with a number of shares received in the correspondence relating to your conversion. Enter that as a Note Conversion and enter the cash as an Interest Paid in Cash transaction.