Published on *The National Law Review* https://natlawreview.com

Wisconsin Business Tax Act 255 and Convertible…Equity

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Active angel and venture investors in Wisconsin are generally familiar with Act 255, a state law that provides a tax credit for investors in the equity of qualifying emerging technology businesses. In cases where an investment is made before a company receives Act 255 certification, the investment often takes the form of convertible debt: the Act 255 credits are triggered when the debt converts to equity, presumably after the company is appropriately certified.

While convertible debt is a wonderful vehicle for accessing the Act 255 tax credit in the above scenario, what about the situation where a company is Act 255 certified but the preferred investment vehicle is convertible debt for other reasons (most often, to avoid having to establish a valuation)? In this case, if the conversion to equity takes place in a tax year subsequent to the year of the investment, the investor does not get to claim the tax credit in the year of the investment itself, but rather in the later year when the debt converts to equity. Not good.

One way to avoid the delayed receipt of Act 255 tax credits in the above scenario is to make the initial investment in the form of convertible equity, rather than convertible debt. All of the important features of the convertible debt structure, including postponing the valuation discussion and the provision of a “sweetener” to the convertible security investors, are retained and the company will not have any debt on its balance sheet. Voila – the investment being in equity, the investors get the Act 255 credit (assuming, again, that the company has received Act 255 certification) as of the date of the investment.

National Law Review, Volume III, Number 138

Source URL:https://natlawreview.com/article/wisconsin-business-tax-act-255-and-convertible-equity