

Providing Real Opportunities for Growth to Rising Entrepreneurs for Sustained Success (the “PROGRESS Act”)

Summary

First Employee Credit

In general

The bill provides a credit against the income or payroll tax liability of a qualifying business entity equal to 25 percent of the qualified wages of the entity for an eligible taxable year. The amount of credit that may be claimed by a qualifying business entity is limited to \$10,000¹ in a single tax year, with a lifetime limit of \$40,000.

Qualifying business entity

A qualifying business entity is any entity² which is engaged in a trade or business, is majority³ owned by qualified active investors, and which complies with the reporting requirements described below. Rules are provided for the aggregation of entities that are treated as a single employer.⁴

A qualified active investor is any individual who (1) is a citizen or resident of the United States; (2) materially participates in the trade or business; (3) holds stock, or a capital or profits interest, in the entity; and (4) has average annual taxable income for the 3 prior taxable years of \$100,000⁵ or less (\$200,000 in the case of a joint filer or head of household⁶).⁷

Eligible taxable year

An eligible taxable year is any taxable year of a qualifying business entity beginning with the first taxable year in which the entity employed at least 1 full-time employee⁸ (or employees constituting a full-time equivalent employee⁹) and ending with the tax year in which the credit limitations are reached.

¹ Amounts are indexed for inflation.

² In the case of any entity with a single owner which is disregarded for tax purposes, the provision is applied in the same manner as if such entity were a corporation.

³ Defined as more than 50 percent of the stock (by vote and value) in a corporation or more than 50 percent of the capital or profits in any other entity.

⁴ Defined in secs. 52(a) and 52(b) or secs. 414(m) or 414(o).

⁵ Amounts are indexed for inflation.

⁶ Defined in sec. 2(b).

⁷ Rules are provided requiring the aggregation of taxable income of married individuals filing separately. The Secretary is granted authority to determine instances in which such aggregation is not appropriate.

⁸ Defined in sec. 4980H(c)(4).

⁹ Defined in sec. 4980H(c)(2)(E).

Qualified wages

Qualified wages are the total W-2 wages subject to wage withholding,¹⁰ elective deferrals,¹¹ and deferred compensation¹² paid by the qualifying business entity with respect to employment of its employees during the calendar year ending during the taxable year of the qualifying business entity.

Qualified wages do not include any amount that was not properly included in a return filed with the Social Security Administration on or before the 60th day after the due date (including extensions) for the return.

Qualified wages do not include wages paid to an individual that is a 5-percent owner¹³ of the qualifying business.

Application of credit against OASDI tax liability

An employer generally files quarterly employment tax returns showing its liability for The Federal Insurance Contributions Act (“FICA”) taxes with respect to its employees’ wages for the quarter, as well as the employee FICA taxes and income taxes withheld from the employees’ wages.

A business may elect for any taxable year to claim a certain amount of its first employee credit as a payroll tax credit against its employer OASDI liability, rather than against its income tax liability.

The payroll tax portion of the first employee credit is allowed as a credit against the business’s OASDI tax liability for the first calendar quarter beginning after the date on which the qualified small business files its income tax or information return for the taxable year.

The credit may not exceed the OASDI tax liability for a calendar quarter on the wages paid with respect to all employees of the qualified small business. If the payroll tax portion of the credit exceeds the qualified small business’s OASDI tax liability for a calendar quarter, the excess is allowed as a credit against the OASDI liability for the following calendar quarter.

Pass-through entities

If the qualifying business entity is a partnership, trust, S corporation, or other pass-through entity, the percentage and dollar limitations apply at the pass-through entity level.

Reporting requirements

A business entity must certify to the Secretary that the entity (1) is engaged in a trade or business and (2) meets the ownership requirements described above. A business entity must also provide to the Secretary the names, addresses, and taxpayer identification numbers of the entity’s qualified active investors and 5-percent owner-employees.

¹⁰ Defined in sec. 3401(a).

¹¹ Within the meaning of sec. 402(g)(3).

¹² Deferred compensation includes compensation deferred under section 457, as well as the amount of any designated Roth contributions (as defined in section 402A).

¹³ Defined in sec. 416(i)(1)(B)(i).

Coordination with existing provisions

The first employee credit is an employment credit and therefore no deduction is allowed for the portion of wages or salaries equal to the credit claimed.

Wages or salaries taken into account in determining the first employee credit are not considered in determination of the credit for increasing research activities,¹⁴ the Indian employment credit,¹⁵ or the empowerment zone employment credit.¹⁶

Other rules

The first employee credit is part of the general business credit¹⁷ and is creditable against the alternative minimum tax.¹⁸

The Secretary is granted broad authority to carry out the provision, including guidance to reduce reporting requirement burdens and to address the prevention of abuse.

Investor Credit

In general

The bill provides a credit against a taxpayer's income tax liability equal to 50% of the taxpayer's qualified investment in a qualifying business entity, limited to 10% in a single tax year. The credit is subject to dollar limitations of \$10,000¹⁹ in a single tax year, with a lifetime cap of \$50,000.

Qualifying business entity

A qualifying business entity is any entity²⁰ which is engaged in a trade or business, is majority²¹ owned by qualified active investors, has at least 1 full-time²² or full-time equivalent employee,²³ and which complies with the reporting requirements described below. Rules are provided for the aggregation of entities that are treated as a single employer.²⁴

A qualified active investor is any individual who (1) is a citizen or resident of the United States; (2) materially participates in the trade or business; (3) holds stock, or a capital or profits interest, in the entity;

¹⁴ Sec. 41.

¹⁵ Sec. 45A.

¹⁶ Sec. 1396.

¹⁷ Sec. 38.

¹⁸ The first employee credit is a specified credit defined in sec. 38(c)(4)(B).

¹⁹ Amounts are indexed for inflation.

²⁰ In the case of any entity with a single owner which is disregarded for tax purposes, the provision is applied in the same manner as if such entity were a corporation.

²¹ Defined as more than 50 percent of the stock (by vote and value) in a corporation or more than 50 percent of the capital or profits in any other entity.

²² Defined in sec. 4980H(c)(4).

²³ Defined in sec. 4980H(c)(2)(E).

²⁴ Defined in secs. 52(a) and 52(b) or secs. 414(m) or 414(o).

and (4) has average annual taxable income for the 3 prior taxable years of \$100,000²⁵ or less (\$200,000 in the case of a joint filer or head of household²⁶).²⁷

Qualified investment

A qualified investment is: (1) any direct or indirect acquisition of stock, or a capital interest, in a qualifying business entity at its original issue solely in exchange for cash; and (2) any qualifying loan made to a qualifying business entity.

An investment made by a person related²⁸ to a qualified active investor or the qualifying business entity is not a qualified investment for purposes of the provision.

The amount of the qualified investment is determined each year for which a credit is claimed equal to the monthly average of the taxpayer's aggregate unadjusted basis and aggregate outstanding principal in the qualifying business entity.

If a taxpayer has or had more than 1 qualified investment in any qualifying business entity, all qualified investments are aggregated for purposes of applying the provision including in application of the dollar and percentage limitations described above.

Qualifying loan

A qualifying loan continues to be a qualified investment in the hands of the transferee for periods after the transfer. Rules are provided for the coordination of the percentage and dollar limitations between transferor and transferee.

The Secretary is granted authority to provide guidance for the calculation of the annual percentage rate of interest including rules for: (1) the calculation of the annual rate where there is a variable interest rate; (2) the recalculation of the annual rate where the terms of the loan are modified; (3) inclusion of lump sum payments, origination and application fees, closing fees, invoice fees, and any other loan fees.

Reduction in credit amount for certain qualifying loans

If the rate of interest on a qualifying loan exceeds the bank prime rate²⁹ as of the first day of the month in which the loan is entered into then the percentage limitations described above are reduced by the amount which bears the same ratio to such limitations as the number of full percentage points by which such rate of interest exceeds such bank prime rate bears to 25.³⁰

²⁵ Amounts are indexed for inflation.

²⁶ Defined in sec. 2(b).

²⁷ Rules are provided requiring the aggregation of taxable income of married individuals filing separately. The Secretary is granted authority to determine instances in which such aggregation is not appropriate.

²⁸ As defined in sec. 267(b) except applied by substituting '5 percent' for '50 percent.'

²⁹ The average predominant prime rate quoted by the commercial banks to large businesses, as determined by the Board of Governors of the Federal Reserve System.

³⁰ i.e. there is a 100 percent reduction in the credit at interest rates at or in excess of the prime rate plus 25 percent.

For example, a taxpayer makes a qualifying loan of \$100,000 to a qualifying business entity with an interest rate of 10%. Assume the prime rate on the first day of the month that the loan is entered into is 5%. Before consideration of the interest rate credit limitation, the taxpayer's annual investor credit with respect to the qualifying business entity would be \$10,000 (10% of \$100,000) and the taxpayer's lifetime credit would be \$50,000 (50% of \$100,000). Because the interest on the qualifying loan is in excess of the bank prime rate of 5%, the credit limitation is reduced by 20% $((10\% - 5\%)/25\%)$. Therefore, the taxpayer's annual credit is \$8,000 $(\$10,000 - 20\% * \$10,000)$. Similarly, the lifetime limit is reduced by 20% and the taxpayer's overall credit is limited to \$40,000 $(\$50,000 - 20\% * \$50,000)$.

Reporting requirements

A business entity must certify to investors and the Secretary that at the time of investment, the entity (1) is engaged in a trade or business; (2) meets the ownership requirements described above; and, (3) meets the employment requirements described above. A business entity must also provide to the Secretary the names, addresses, and taxpayer identification numbers of the entity's qualified active investors and the persons making the qualified investment.

Other rules

The investor credit is part of the general business credit³¹ and is creditable against the alternative minimum tax.³²

The Secretary is granted broad authority to carry out the provision.

³¹ Sec. 38.

³² The investor credit is a specified credit defined in sec. 38(c)(4)(B).