

(S.B. 174)

(No. 8)

(Approved April 8, 1997)

AN ACT

To amend subsection (a), clause (v) of subsection (b) and clause (4) of subsection (k) of Section 3; Section 5; subsection (a) and add a second paragraph to subsection (b) of Section 10; and amend subsections (a) and (c), clause (3) and add a clause (4) to subsection (d); amend the second paragraph of subsection (e) and clause (1), and add clauses (5), (6) and (7) to subsection (f), and amend clause (1) of subsection (h) of Section 12 of Act No. 225 of December 1, 1995, as amended, known as the "Agricultural Tax Incentives Act of Puerto Rico," in order to temper its provisions to the realities of its fiscal impact and clarify definitions and correct technical errors and omissions.

STATEMENT OF MOTIVES

The Agricultural Tax Incentives Act of Puerto Rico, approved December 1, 1995, and amended by Act No. 35 of April 30, 1996, contains a number of provisions directed to stimulate the growth of agricultural activities in Puerto Rico. The purpose of this legislation is to grant additional tax incentives to the agricultural sector so that it may attempt to recover part of its share in the area of production and in the creation of jobs in the economy of the Island.

Our Government recognizes the importance of having a vigorous agricultural sector capable of successfully facing the challenges created by the technological breakthroughs and the effects of the global competition which become more evident every day. It is within this context that this sector of primary importance is being considered in the New Model for Economic Development promulgated in February 1994.

However, the strategy of granting tax incentives in order to foster investment or other economic activities must be based upon the real effect of economic growth generated by said fiscal policy measure. It must also take into consideration its effect upon the fiscal capability of the government on primary services, and the commitments to the people of Puerto Rico when it received its electoral mandate.

In this sense the abovesited Act No. 225, although possessed of great merits, must be reevaluated since its fiscal impact will hinder the natural growth of the tax base. In this manner, the growth rate of the General Fund revenues, which are the main source of income for the

Expenses Budget of the Central Government, shall be drastically diminished. This behavior shall noticeably affect the level of resources available to conduct the present work of the government.

Actually, the Department of the Treasury has received information indicating that there is more than \$180 million accrued in tax credits in income tax returns for taxable years 1996 and 1997, waiting to be claimed. All of these credits have accrued in only one (1) year since the implementation of this legislation. The level of this amount is of great concern when compared with the expected growth of the General Fund's income for fiscal year 1996-97. It is projected that for this year the government revenues will increase by some \$251 million, which means that these credits represent approximately 72 percent of the increase in the fiscal capacity of the government.

It is in view of this situation that the abovesited Act No. 225 must be amended in order to prevent the expansion of the fiscal capacity of the government from being adversely affected. Modification to the law must basically address the restructuring of the investment credits and the broadening of the concept of what an eligible investment in an agricultural business is considered to be.

These modifications, although limiting the investment tax credits in agricultural businesses, retain certain additional incentives for the agricultural sector that are sufficient to allow for its expansion, its substantial development, and to increase its competitiveness upon the arrival of the new century.

BE IT ENACTED BY THE LEGISLATURE OF PUERTO RICO:

Section 1.- Subsection (a), clause (v) of subsection (b) and clause (4) of subsection (k) of Section 3 of Act No. 225 of December 1, 1995, as amended, are hereby amended to read as follows:

"Section 3.- Definitions

For the purposes of this Act, the following terms and phrases shall have the meaning and scope stated below:

- (a) Bona fide farmers - The term 'bona fide farmer' shall mean every natural or juridical person who during the taxable year for which he/she claims the deductions, exemptions, or benefits provided by this Act, has a certificate in force issued by the Secretary of Agriculture upon consultation with the Secretary of the Treasury, which certifies that during said year he/she was engaged in the operation of an activity which qualifies as an

agricultural business as said term is defined in subsection (b), and derives fifty (50) percent or more of his/her gross income from the agricultural business as an operator, owner or lessee, as declared in his/her income tax return.

- (b) Agricultural business - The term agricultural business shall mean the operation or development of one or more of the following businesses:
 - (i) ...
 - (v) operations engaged in the packing, crating or labeling of fresh agricultural produce that are part of the same agricultural business; provided, that the operations that are exclusively devoted to the packing, crating or labeling of agricultural produce do not constitute an agricultural business per se.
 - (vi) ...
- (c) ...
- (k) Eligible investment means:
 - (1) ...
 - (4) the cash or the value of the land provided for the primary issue of stock or shares in an agricultural business engaged in said operations during a period of at least ten (10) consecutive years, shall constitute an eligible investment provided the funds obtained through said issue be used in their totality, solely and exclusively to:
 - (A) Establish and operate new agricultural businesses.- The term 'new agricultural business', means any agricultural business as defined in this Act, initiated or begun on or after the initial capitalization of said business. The funds used for the acquisition of an existing agricultural business shall not qualify as an eligible investment. However, the total purchase price of an existing agricultural business shall be considered as an eligible investment when, as part of said acquisition, the acquiring party contributes additional capital to the agricultural business in an amount of not less than two hundred (200) percent of the purchase price. The former provisions do not apply to the purchase or acquisition of an existing agricultural business by related persons. The term 'related person' shall be determined pursuant to the criteria established in Sections 1024(b) and 1028 of Act No. 120 of

October 31, 1994, as amended, known as the 'Puerto Rico Internal Revenue Code of 1994.'

The term 'eligible investment' shall not include an investment made with the cash derived from a loan secured by the agricultural business itself or by its assets.

- (B) Substantial renewal or expansion of existing agricultural businesses.- The funds contributed for the substantial renewal or expansion shall qualify as an eligible investment only if said renewal or expansion equals at least twenty-five (25) percent of: (i) the value of the land used in the existing agricultural business; or (ii) the book value of the real property used in the existing agricultural business, not including the land. The term 'eligible investment' shall not include an investment made with the cash derived from a loan secured by the agricultural business itself or by its assets.
- (C) Acquisition of machinery, equipment or working capital to be used during regular operations.- The funds contributed for the acquisition of machinery, equipment or working capital shall qualify as an eligible investment provided the machinery, equipment or working capital is used exclusively in the agricultural business. For these purposes, the acquisition of machinery or equipment previously used in an agricultural business in Puerto Rico shall not be considered as an eligible use of funds. Furthermore, the term 'working capital' does not include funds used for the establishment of reserves.

In those cases in which machinery and equipment, or an existing agricultural business which would have otherwise qualified as an eligible investment, are acquired, said acquisition shall not constitute an eligible investment if a purchase and sale contract with an agreement for the resale to the original seller is involved.

In case any of the contributions described in paragraphs (1) or (2) of this clause is carried out, said contribution shall be considered as an eligible investment only if said investment is made in the primary issue of stock or shares.

(1) ..."

Section 2.- Section 5 of Act No. 225 of December 1, 1995, as amended, is hereby amended to read as follows:

"Section 5.- Certification

The Secretary of Agriculture of Puerto Rico shall issue a certificate indicating that the 'bona fide' farmer is engaged in the development or operation of an activity which qualifies as an agricultural business. The Secretary of the Treasury shall determine whether the farmer, when rendering his/her income tax return, meets the requirement of the fifty (50) percent of the agricultural business income, in order to be deemed as a bona fide farmer."

Section 3.- Subsection (a) is hereby amended and a second paragraph is added to subsection (b) of Section 10 of Act No. 225 of December 1, 1995, as amended, to read as follows:

"Section 10.- Income Tax Exemption

(a) For the taxable years commencing on January 1, 1996, bona fide farmers are hereby exempted from the payment of income taxes on ninety (90) percent of their income derived directly from the agricultural business, provided that the 'bona fide' farmer has not availed him/herself of the provisions of Section 1023(s) of Act No. 120 of October 31, 1994, as amended, known as the 'Puerto Rico Internal Revenue Code of 1994.' This exemption does not extend to income from interest, dividends, bonuses or profits derived from the sale of assets, including those assets used in the agricultural business, or any other income derived from 'bona fide' agricultural businesses which is not derived directly from the agricultural activity.

(b) ...

The interest paid by a 'bona fide' farmer shall be exempted from the payment of taxes. In order to enjoy the exemption on said interest, the lender must grant the loan directly to the farmer. If the financing is granted to an intermediary who, in turn, lends or otherwise contributes the product of the financing to an agricultural business, the loan to the intermediary shall not constitute an eligible loan for the purposes of this exemption. The term 'intermediary' includes, but is not limited to, related persons pursuant to the criteria established in Sections 1024(b) and 1028 of Act No. 120 of October 31, 1994, as amended, known as the 'Puerto Rico Internal Revenue Code of 1994'.

In case the 'bona fide' agricultural business is disqualified as such, the interest generated by the debt instruments shall not be deemed eligible for the exemption provided in this paragraph.

The term 'financing' does not include the refinancing of a debt in the degree that the product is used to liquidate existing debts be they of the agricultural business or others. Therefore, the income tax exemption on the interest of bonds, notes and other debt instruments does not apply to said refinancing.

(c) ..."

Section 4.- Subsections (a) and (c), and clause (3) are hereby amended and a clause (4) is added to subsection (d); the second paragraph of subsection (e) and clause (1), are amended, and clauses (5), (6) and (7), are added to subsection (f), and clause (1) of subsection (h), is amended, of Section 12 of Act No. 225 of December 1, 1995, as amended, to read as follows:

"Section 12.- Tax Credit for Investments in Agricultural Businesses

(a) Subject to the provisions of subsection (c) of this Section, every investor, including a participant in a Fund, shall be entitled to an investment credit in eligible agricultural businesses equal to fifty (50) percent of his/her eligible investment or his/her investment in shares of a Securities Fund or Funds shares, to be claimed in two (2) installments: up to half of said credit, in the year in which the agricultural business obtained the necessary financing for its operation if financing was required; and the balance of said credit in the following year. Should an escrow account be established and it were dissolved for failure to obtain the needed financing to operate the agricultural business, the participants shall not be entitled to the credit. Every eligible investment made on or before the deadline for filing the income tax return as provided by Act No. 91 of June 29, 1954, as amended, known as the Income Tax Act of 1954, or by Act No. 120 of October 31, 1994, as amended, known as the Puerto Rico Internal Revenue Code of 1994, shall qualify for the tax credit provided in this Section in the taxable year for which the abovementioned return is being filed, provided that all requirements of this Section are met. Said investment credit may be applied against any tax determined by the investor or participant under Act No. 91 of June 29, 1954, as amended, known as the Income Tax Act of 1954, or under Subtitle A of Act No. 120 of October 31, 1994, as amended, known as the Puerto Rico Internal Revenue Code of 1994, including the minimum alternate tax applicable to corporations and partnerships and the alternate basic tax applicable to individuals. This credit shall not be used to pay off the taxes levied under any other Subtitle of Act No. 120 of October 31, 1994, as amended, known as the 'Puerto Rico Internal Revenue Code of 1994' or any other Act, including, but with being limited to, Act No. 8 of January 24, 1987, as amended, known as

the 'Tax Incentives Act of 1987', or to any other Act of a similar nature which substitutes or complements the latter.

The credit for investments in agricultural businesses allowed by this Section shall not apply nor be available in the event the participant acquires shares of a Securities Fund or Funds, in primary issue, to replace other shares of a Fund which the participant sold, exchanged, or otherwise transferred and with respect to which the participant shall not share in whole or in part, in the profit derived from said sale, exchange, or transfer.

The investor or participant must request an administrative decision from the Secretary of the Treasury before claiming the credit for investments in the agricultural business in order for him/her to determine whether the investment the agricultural business makes or intends to make qualifies for the investment tax credit.

In the case of an existing 'bona fide' agricultural business in operation as of the date of approval of this Act, the first half of the credit may be claimed in the year in which the eligible investment was made.

In case an existing agricultural business is acquired by contributing additional capital of at least two hundred (200) percent of the cost of said business, the investor shall be entitled to the credit granted in this subsection, provided said additional contribution is made within a period not greater than three (3) years from the date the new business is acquired. For such a purpose, the investor or participant must make not less than twenty-five (25) percent of the eligible investment during the 1st year of this period; not less than thirty-five (35) percent in the 2nd year, and the remainder, if any, in the 3rd year.

(b) ...

(c) **Maximum Amount of Credit.-** The maximum amount of credit for investments in agricultural businesses, for each business, which shall be available to the investors and the participants who made an eligible investment prior to April 8, 1997, shall be fifty (50) percent of the cash contributed through the Fund to the agricultural businesses by the investors or participants in exchange for stock or shares in said agricultural businesses. The maximum amount of the available credit shall be distributed among the investors and participants in the proportion they determine. The agricultural business shall give notice of the credit distribution to the Secretary of Agriculture, the Secretary of the Treasury, and its stockholders on or before the date provided by Act No. 91 of June 29, 1954, as amended, known as the Income Tax Act of

1954, or by Act No. 120 of October 31, 1994, as amended, known as the Puerto Rico Internal Revenue Code of 1994, as the case may be, in order to file its income tax return for its first year of operations, including any extension granted by the Secretary of the Treasury for the filing thereof. The eligible distribution shall be irrevocable and binding for the agricultural business, the investors, and the participants.

In the case of eligible investments made after April 8, 1997, the maximum amount of investment credits shall be as follows:

(1) If the total of the eligible investment does not exceed two (2) million dollars, the maximum amount of investment credits for each agricultural business which shall be available to the investors and the participants, shall be fifty (50) percent of the cash contributed to each agricultural business during the taxable year.

(2) In case the eligible investment exceeds two (2) million dollars, the investor or participant shall be entitled to the investment tax credit established in clause (1) plus the total amount of the credit corresponding to the cash included in said surplus for a limit of up to ten (10) percent of the total cost of the agricultural business, reduced by the two (2) million dollars. In no case shall the total amount of the credit for investments in agricultural business exceed five (5) million dollars per taxable year per each agricultural business.

The Secretary of the Treasury shall authorize the credits for investments claimed by the investors or the participants, as the case may be, for a limit of up to fifteen (15) million dollars per fiscal year. However, in those cases in which the Secretary of Agriculture and the Secretary of the Treasury evaluate the activities which an agricultural business intends to pursue and decide that the latter shall substantially contribute to the development of this economic sector, the Secretary of the Treasury may authorize the credits for investments in said business even when the credits for that particular year, have already been granted up to the limit of fifteen (15) million dollars authorized by this clause.

For this purpose, from the amount of fifteen (15) million dollars investment credits of five (5) million dollars for the investors or participants whose investments do not exceed one (1) million dollars, shall be reserved during the first six (6) months of the fiscal year. Should said reserved amount not be used in its totality during the aforementioned period, the latter shall be available to any investor or participant, regardless of the total amount of their investment.

(d) Base Adjustment and Credit Retrieve

(1) ...

(2) ...

(3) After the term of three (3) years from the date of the notice described in subsection (c) of this Section, the Secretary of Agriculture shall determine the total investment made by the agricultural business. In the case of investments made as of April 8, 1997, the investor or participant must make no less than twenty-five (25) percent of the eligible investment during the 1st year of this period; no less than thirty-five (35) percent in the 2nd year and the remainder, if any, in the 3rd year. In the event the investment credit in the agricultural business claimed by the investors exceeds the credit computed by the Secretary of Agriculture, based on the total investment made by the agricultural business in the activity, said excess shall be deemed as an indebted income tax to be paid by the investors in two (2) installments, the first of which shall be due on the first taxable year following the expiration date of the abovementioned three (3)-year period, and the second shall be due on the following taxable year.

(4) Should any 'bona fide' agricultural business cease to conduct operations as such prior to the expiration of the ten (10)-year period provided in Section 3(k)(4) of this Act, the investor or participant shall owe income taxes in an amount equal to the credit for investments in the agricultural business claimed by said investor or participant, multiplied by a fraction whose denominator shall be ten (10) and whose numerator shall be the balance of the ten (10)-year period required by this Act. The amount owed on account of the income tax shall be paid in two installments beginning on the first taxable year following the date in which the agricultural business ceased its activities.

(e) Credit for Losses -...

In the case of investment credit losses suffered with regard to investments made before April 8, 1997, the total amount of the credit for losses shall not exceed fifty (50) percent of the investment in the agricultural business. In the case of losses for investments attributed to investments made as of April 8, 1997, the amount of the credit for losses shall not exceed ten (10) percent of the total cost of the agricultural business. The investors and participants who claimed, or otherwise transferred investment credits in an agricultural business as a result of their eligible investment or their investment in the shares of a Fund, shall distribute among themselves the right to benefit from the credit using the mechanism provided in subsection (c) of this

Section. Once said distribution has been made, the provisions regarding the transfer or cession of credits provided in subsection (f) of this Section shall not apply. Any surplus of the credit thus granted on the taxes determined for the aforesaid five (5) taxable years shall not be claimed as a deduction or a credit, nor may it be carried back nor carried forward to another taxable year.

(f) Cession of Credit

(1) After the date of notice of the distribution of the credit for investments in agricultural businesses provided in subsection (c) of this Section, the credit provided in this Section may be ceded, sold or otherwise transferred in whole or in part, to any other person by an investor or a participant.

(2) ...

(5) The tax credit for investments granted by this Act may be transferred, exchanged or sold only once. Said transfer, sale or exchange shall be that one made by the investor or the participant to any other person. A transfer, exchange or sale to a related person constitutes a transfer for the purposes of said limitation. The term 'related person' shall be determined pursuant to the criteria established in Sections 1024(b) and 1028 of Act No. 120 of October 31, 1994, as amended, known as the 'Puerto Rico Internal Revenue Code of 1994.'

(6) When the investment tax credit granted by this Act is transferred, exchanged or sold, the difference between the total amount of the credit and the amount paid for said credit shall not be considered as income for the purchaser of the credit.

A person who acquires a tax credit for investments in one of the activities described in subsection (k) of Section 3 of this Act from an investor or a participant, shall not be subject to the retrieval provisions of subsection (d)(3) of this Section.

(7) An investment in an agricultural business which, in itself, does not constitute an eligible investment does not confer upon the investor or the participant the right to claim, transfer, sell or exchange the investment tax credit described in subsection (a) of this Section. Should a taxpayer claim a credit for investments in an agricultural business against his/her tax liability, and it is subsequently determined that the latter was not valid because on the basis of the nature of the investment, said credit could not have been generated thereby, the insufficiency in the payment of the tax shall be governed by the provisions of Subtitle F of Act No. 120 of October 31, 1994, as amended, known as the Puerto Rico Internal

Revenue Code of 1994, and not by the provisions of subsection (d)(3) of this Section regarding the retrieval of the tax credit.

(g) ...

(h) ...

(1) Any Capital Investment Fund created under Act No. 3 of October 6, 1987, as amended, known as the 'Puerto Rico Capital Investment Fund Act of 1996,' or under any other law of a similar nature that replaces or complements the latter, which is an investor or participant in agricultural business projects shall be subject to all the provisions of this Section, except that:

(i) for investments made before April 8, 1997, it have shall the right to an agricultural business investment credit equal to only twenty-five (25) percent of its eligible investment or its investment in stock of the Fund, instead of the fifty (50) percent referred to in subsection (a) of this Section. The total credit of twenty-five (25) percent of its investment can be claimed in the year in which the business obtained the necessary capital to develop the agricultural activity; provided that for investments made as of April 8, 1997, the credit shall be equal to ten (10) percent of the total cost of the agricultural business instead of fifty (50) percent granted by subsection (a) of this Section;

(ii) for the purposes of the limitation imposed in subsection (c) of this Section, to the effect that the total credit for agricultural business investments shall not exceed fifty (50) percent of the cash contributed by the investors or the participants, or fifty (50) percent of the cash contributed up to two (2) million dollars plus the excess of two (2) million dollars of the cash contributed up to the limit of ten (10) percent of the total cost of the agricultural business, as the case may be, the computation shall be made as if the capital investment funds created under Act No. 3 of October 6, 1987, as amended, known as the 'Puerto Rico Capital Investment Funds Act of 1996,' or under any other act of a similar nature that replaces or complements the latter, had claimed the fifty (50) percent of their eligible investment;

(iii) the Capital Investment Funds created under Act No. 3 of October 6, 1987, as amended, known as the 'Puerto Rico Capital Investment Funds Act of 1996,' or under

any other act of a similar nature that replaces or complements the latter, shall not be entitled to the credit for losses provided in subsection (e) of this Section.

(2) ..."

Section 5.- This Act shall take effect immediately after its approval, except that the Secretary of the Treasury shall attend to the petitions for administrative determinations filed with the Department of the Treasury to April 8, 1997, pursuant to the legal provisions in effect at the time said petitions were filed.