

September 25, 2019

Tax Update

Tax Incentives for Agriculture and Agro-Industries under the Incentives Code

On July 1st, 2019, the government of Puerto Rico enacted Act 60-2019, adopting the Puerto Rico Incentives Code (“Incentives Code”) and setting the new legal framework for many of Puerto Rico’s incentives programs. This Legal Update focuses on tax incentives available for agriculture and the agroindustry.

Agricultural and agroindustrial tax exemptions previously granted under Act 225-1995, known as the Puerto Rico Agricultural Tax Incentives Act (“Act 225”), and Act 73-2008, known as the Puerto Rico Economic Development Incentives Act (“Act 73”), are now afforded under Chapters 6 and 8 of Subtitle B of the Incentives Code. Through the enactment of the Incentives Code, Act 42-1971, also known as the “Agricultural Worker Annual Bonus Act”, Act 46-1989, also known as the “Agricultural Wage Subsidies Program Act”, and Act 26-2008, also known as the “Research and Development of Food and Agricultural Technology Program Act”, were repealed and most of their provisions are now part of the Incentives Code.

I. Bona Fide Farmer Eligible Activities

Pursuant to Section 1020.08 of the Incentives Code, a person or entity shall be considered a *bona fide* farmer for the year in which the tax incentives under said chapter are claimed, subject to: i) a certification from the Secretary of Agriculture confirming that the applicant’s activities qualify as an agro-industrial business pursuant to Section 2081.01 and further subject to ii) deriving 51% or more of its gross income from an agro-industrial business and 51% of the value of production and/or investment in an agro-industrial business, both as an operator, owner or lessee.

Section 2081.01(a) of the Incentives Code further provides that a business or individual, or both, may apply for tax exemption before the Secretary of the DDEC who, upon technical recommendation from the Secretary of Agriculture, shall issue a *bona fide* farmer grant of tax exemption (“*Bona Fide Farmer Grant*”) for the performance of any of the following:

1. Activities of the Puerto Rico Dairy Industry Corporation, known in Spanish as “Indulac”.
2. Agricultural or agroindustrial businesses dedicated to the operation or exploitation of one or more of the following businesses in Puerto Rico:
 - a. Farming or cultivation of land for the production of fruit and vegetables, spices for condiments, seeds, and all kinds of foods for human beings or animals, or raw materials for other industries.



For more information on this Legal Update, please contact:

Carlos E. Serrano

cserrano@reichardescalera.com
787.777.8815

Alba I. Joubert Pereira

ajoubert@reichardescalera.com
787.777.8825

Ernesto Zayas-García

ezayas@reichardescalera.com
787.777.8813

- b. Raising of animals for the production of meat, milk and eggs, among others, used for foods of human beings, or raw materials for other industries.
- c. Breeding of thoroughbred racehorses; breeding of “paso fino” horses and breeding of saddle horses.
- d. Agricultural or agroindustrial operations that buys raw material produced in Puerto Rico, as available.
- e. Manufacturing, elaboration, pasteurization and sterilization of milk and its agents, provided said milk is extracted from milking operations conducted in Puerto Rico.
- f. Operations engaged in the packing, crating or labeling of fresh agricultural produce that are part of the same agricultural business. The operations that are exclusively devoted to the packing, crating or labeling of agricultural produce do not constitute an agricultural business per se. However, operations exclusively devoted to these activities are eligible for a grant of industrial tax exemption under Chapter 6 of the Incentives Code for manufacture industries.
- g. Commercial marine fishing, mariculture, and aquaculture.
- h. Commercial production of ornamental flowers, plants, and grasses for the local and export market, without including the professional services of landscape designers.
- i. Cultivation of vegetables by hydroponic methods, the buildings and other equipment used for these purposes.
- j. Production of grains by bona fide farmer's associations to be consumed by livestock industries.
- k. Breeding of fighting cocks and for the production of spurs.
- l. Any other business that, with recommendation of eligibility from the Secretary of Agriculture, the Secretary of the DDEC, through Incentive Regulations and in consultation with the Secretary of Agriculture, considers an agricultural or agroindustrial business.

II. Tax Exemption for Eligible Businesses

Farmers and agroindustrial businesses holding a *Bona Fide Farmer Grant* are afforded the following benefits pursuant to Sections 2082.02 through 2082.05 and Section 2085.01 of the Incentives Code:

- a. 90% income tax exemption on the income directly derived from the agricultural or agroindustrial business.
 - However, no exemption is afforded for distributions of dividends to shareholders or partners, and
 - No exemptions are provided on interest, dividends, royalties or gains derived from the sale of property.
- b. 100% income tax exemption on income derived by financial institutions from bonds, promissory notes, and other debt instruments issued by bona fide farmers.

- c. 100% tax exemption on property taxes; provided that the property is owned or leased by the bona fide farmer and placed in use 35% or more on the activities covered under the grant.
- d. 100% tax exemption on municipal license taxes on the activities covered under the grant.
- e. 100% exemption on excise taxes and on sales and use tax (“SUT”) on several articles including: machinery, equipment, parts, accessories, incubators, electricity generators, tractors and its implements, irrigation systems, structures, pesticides, herbicides, fertilizers, gas oil, diesel oil, among others, used in the agricultural or agroindustrial operations; provided that, for purposes of acquiring said articles exempt from SUT, the bona fide farmer shall show the seller its certificate of exempt purchases on every transaction.
- f. Total exemption on internal revenue stamps and registration fees on public deeds, private documents, and on the inscription of transactions before the Puerto Rico Property Registry.

III. Agroindustrial Manufacture Tax Incentives

Besides the *Bona Fide Farmer Grant*, Chapter 6 of Subtitle B of the Incentives Code provides grants of tax exemption for manufacture industries, as previously afforded under Act 73. Pursuant to Section 2061.01 of the Incentives Code, any business already established or in the process of establishing in Puerto Rico eligible industrial activities, shall be considered an eligible business for a grant of manufacture tax exemption (“Manufacturing Grant”). Specifically, any industrial unit established on a permanent basis for the production on a commercial scale of a manufactured product, which is now defined to include products transformed from raw materials, including plant or animal matter, into articles of commerce, shall be eligible for a Manufacture Grant.

Several agroindustrial activities are considered eligible for a Manufacturing Grant including:

1. Planting and vertically integrated cultivation with value added processes, such as the process of hydroponics;
2. Intensive cultivation of mollusks, crustaceans, fish or other aquatic organisms through the process of aquaculture;
3. The milk pasteurization process;
4. The agricultural biotechnology processes, provided that these operations are undertaken pursuant to standards and procedures approved by the Puerto Rico Department of Agriculture; and
5. Any other agroindustrial or agricultural operation, including those operations exclusively dedicated to the packaging, crating, preservation, classification or processing of agricultural produce.

The income derived from the manufacturing or industrial activities of an exempt agroindustrial business holding a Manufacturing Grant, shall be subject to;

- a. A 4% fixed income tax rate and the shareholders, partners, or members of the exempt business shall enjoy a 100% income tax exemption on distributions from E&P of said business.

- b. Royalties, fees, or payments for the rights the use of intangible property in Puerto Rico, related to the eligible activities, to any foreign person not engaged in trade or business in Puerto Rico, from sources within Puerto Rico, shall be subject to a 12% income tax withholding.
- c. As in the case of Act 73, the exempt business can alternatively enjoy a 8% fixed income tax rate and a 2% income tax withholding rate. Different than in the case of Act 73, an exempt business cannot opt to carry over lower rates enjoyed under grants issued pursuant to predecessor acts.
- d. Minimum tax provisions which continue to apply.

Municipal tax exemption under the Incentives Code generally provides:

- 1. 50% exemption on municipal license taxes (fixing the rates in effect at the time of executing the Manufacturing Grant). The Incentives Code also introduces an option to reduce the statute of limitations for an audit by foregoing the Municipal License Tax Act's 5% discount for prompt payment.
- 2. 75% exemption on property taxes (fixing the rates in effect at the time of executing the Manufacturing Grant)
- 3. 75% exemption on municipal construction taxes.

Additionally, an exempt business holding a Manufacturing Grant shall enjoy:

- a. 100% exemption on fuels used by the exempt business to generate electric and thermal energy.
- b. 100% exemption of use and consumption taxes on articles to be used by the exempt business for its eligible activities.

See also our Legal Update of September 3, 2019 on *Tax Incentives for Manufacturing under the Incentives Code* for additional information and for an overview on the availability of credits for research and development activities.

IV. Wage Subsidy and Annual Bonus

Subtitle D of the Incentives Code provides for agricultural wage subsidies and annual bonuses for agricultural workers. Section 4010.01 of the Incentives Code establishes a guaranteed wage of not less than \$5.25 for agricultural workers. Agricultural employers shall be responsible for the payment of wages to their agricultural workers and the Department of Agriculture shall remit the wage subsidies to the agricultural employer as provided under regulations yet to be issued. The Secretary of the DDEC, in consultation with the Secretary of Agriculture, will establish through the Incentives Regulations or through special regulations delegated to the Secretary of Agriculture, the criteria for determination of agricultural workers eligible for said subsidy taking into consideration the criteria already established under the Incentives Code. The Secretary of Agriculture shall in turn establish the wage subsidy, using as a base the unit of production or cultivated area, or any other base determined by regulations taking into consideration the nature of the agricultural business and its marketing systems, but which shall never be less than \$2.72 per certified work hour.

Agricultural employers shall file reports with the Secretary of Agriculture, as provided under regulations and within the period established therein, for the computation of data upon which the wage subsidies that the Government commits to pay back to agricultural employers for the additional costs incurred for the compliance with the provisions of Section 4010.01 of the Incentives Code.

Section 4010.02 of the Incentives Code provides for the payment of an annual bonus to agricultural workers by the Department of Agriculture. The annual bonus shall be for an amount not less than \$165 or 4% of the annual income of the agricultural worker, whichever is higher, up to a maximum of \$235. The annual bonus shall be paid to agricultural workers engaged in agricultural labor in Puerto Rico for not less than 200 hours within a 12-month period, beginning July 1st and ending June 30th of each year. The payment of the annual bonus is further subject to the agricultural employer's filing of reports required by the Secretary of Agriculture pursuant to regulations, in order to establish the eligibility of the agricultural workers.

V. Agricultural Research and Innovation

Section 2084.01 of the Incentives Code imposes on the Department of Agriculture the responsibility of promoting highly technological agriculture, as well as the development of research plans, and of fostering the increase in production and exportation of agricultural produce. Accordingly, the Incentives Code imposes on the Secretary of Agriculture the responsibility to identify priority areas for investigation and to file formal petitions to the DDEC for the funding of agricultural research through the Economic Incentives Fund created under Section 5010.01 of the Incentives Code.

VI. Current Bona Fide Farmer Tax Exemptions and New Grant Applications

According to Section 6060.03 of the Incentives Code, farmers, agricultural and agro-industrial businesses holding a bona fide farmer certificate, grant, or certificate of compliance, shall continue to enjoy the exemption benefits, rights, and obligations issued under Act 225 until the expiration of said certificate and, until a new grant is issued under the Incentives Code, all provisions under Act 225 shall apply to the *bona fide* farmer as if said act were not repealed.

All new Bona Fide Farmers Grants of tax exemption, however, will be subject to the provisions and application process established of the Incentives Code, which shall be filed with the DDEC instead of the Department of Agriculture, subject to the provisions of Subtitle F of the Incentives Code. Act 72-1962, known as the "Puerto Rico Dairy Industry Tax Exemption Act", and Act 54-1971, also known as the "Commercial Flowers and Ornamental Plants Production Tax Exemption Act" were also amended by Act 60-2019 in order to provide that the tax exemptions under such acts may be claimed for years commenced before January 1, 2020.

This communication is for information purposes only and does not constitute legal advice. This communication may be based on authorities that are subject to change and is not a substitute for professional advice or services. You should consult a qualified professional advisor before taking any action based on the information herein. This communication does not create an attorney-client relationship between Reichard & Escalera and the recipient.

[Unsubscribe.](#)