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CUBA'S NEW FOREIGN INVESTMENT LAW NUMBER 118: CAN TAX INCENTIVES BUY FOREIGN INVESTORS' TRUST AND BE JUSTIFIED IN INCREASING FDI?

Alyssa K. Ortiz*

I. INTRODUCTION

FOREIGN Direct Investment (FDI) is recognized as a crucial aspect of modern countries' economic development. An increasing amount of governments are incorporating a FDI policy into their law to attract investors and promote their land as an attractive place for capital.¹ The countries where FDI thrive are those that work toward creating a safe, convenient, and liberal investment structure and climate.² In an ever-competing international economy, incentives are key for attracting investors—second to primary determinants like market size, resource availability and access, and employment skills.³ Possibly the most common incentives are financially driven and deal specifically with tax rate reductions or exemptions for a particular sector of business or type of tax.⁴ Successful tax incentives to FDI should produce a win-win outcome—investors receive a financial break, while the host country's capital growth and intangible assets increase.⁵

Cuba, a country many understand to be in economic flux and in need of capital, has benefited from its utilization of an FDI regime. The most recent reform to its foreign investment policy, Law Number 118 (Law 118), is noted primarily for its charming tax reductions and exemptions. Cuba anticipates this law will increase FDI to about \$2.5 billion per year. However, in light of the insecurity Cuba has instilled in investors, the reality of this estimate is questionable.

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1. United Nations Conference on Trade and Development, Geneva, Switz., Nov. 6–8, 2002, *The Development Dimension of FDI: Policy and Rule-Making Perspectives*, 29, UNCTAD/ITE/I1A/2003/4 (2003) available at http://unctad.org/en/docs/iteiia20034_en.pdf.

2. *Id.*

3. *Id.*

4. *Id.* at 30.

5. Email interview with Cuban Attorney, (Nov. 8, 2014). Attorney did not want to be named.

This article conducts a brief history of the relationship between the Cuban government and foreign investors. It then lays out Law 118's changed tax provision as compared to Law 77 (Cuba's prior foreign investment law), analyzing the tax incentives' potential success to FDI increase, while keeping in mind the country's social and political structure. Finally, it sets forth a brief comparative analysis between what the law says on paper and what is evidenced in practice.

II. CUBA'S HISTORY WITH FOREIGN BUSINESS AND FOREIGN INVESTORS

*"A reputation once broken may possibly be repaired, but the world will always keep their eyes on the spot where the crack was."*⁶

—Joseph Hall

The weariness and mistrust causing many foreign investors' hesitation is far from unmerited. Foreign investors have been unexplainably arrested and their investments taken without indemnification. For instance, a septuagenarian Canadian auto executive was sentenced to fifteen years in prison for what the state claims to be corruption-related charges.⁷ The foreign company contends this allegation is unsupported and describes it as a fabrication by the Cuban government to confiscate the company's \$100 million in assets in Cuba.⁸ Governmental takings, such as this, have largely characterized Cuba's interaction with investors for the past half-century.

In the late 1950s and early 1960s, Cuba was under a time of change, all starting with and driven by the Revolution. Under Castro's regime, the government's economic and commerce power spread contagiously throughout the island. His unchecked and unbalanced power over every aspect of government opened the door to future decades of infamous tension and doubts in loyalty between Cuba and foreign investors across the world.⁹

In 1959, at the beginning of the Revolution, Cuba had no foreign investment law in place. Despite this, the United States, along with many other western nations, engaged in relatively amicable business relations with the island. But once the Revolution began, Cuba refused to acknowledge negotiations with the United States, and by 1963, it absolved all of the U.S. operations in Cuba.¹⁰ As a result, the United States ceased

6. *Joseph Hall Quotes*, BRAINY QUOTE, <http://www.brainyquote.com/quotes/quotes/j/josephhall126495.html> (last visited Nov. 9, 2014).

7. Michael Weissenstein, *Cuba gives prison term to Canadian executive*, SARASOTA HERALD TRIB., Sept. 28, 2014, at A16.

8. *Id.*

9. ERIC N. BAKLANOFF, *EXPROPRIATION OF U.S. INVESTMENTS IN CUBA, MEXICO, AND CHILE* 117 (1975).

10. JAIME SUCHLICKI ET AL., *CUBA, A COUNTRY STUDY* 68–70 (Rex A. Hudson, 4th ed. 2002), available at http://memory.loc.gov/frd/cs/pdf/CS_Cuba.pdf; see also COMM. ON FOREIGN AFFAIRS, 88TH CONG., *EXPROPRIATION OF AMERICAN-OWNED PROP. BY FOREIGN GOVERNMENTS IN THE TWENTIETH CENTURY* 16–19

importing sugar from Cuba and started its notorious embargo in October of that year.¹¹ The year 1961 hosted the Bay of Pigs and complete severance of U.S. diplomatic ties with Cuba.¹² By 1964, after observing Castro's disaffection with the United States, and experiencing expropriations themselves, Spain, France, other investing nations, and all nations of the Organization of American States (with the exception of Mexico) ended diplomatic and business relations with Cuba.¹³

These uncompensated takings were numerous, tolling to about 5,911 claims and amounting to about \$1.8 billion in lost assets in the United States alone.¹⁴ Other nations, including France, Canada, Switzerland, and Spanish nationals experienced similar expropriation—losses ranged from about \$100 million to \$350 million each.¹⁵

Although Cuba isolated itself from much of the West, it quickly adopted the Soviet Union as its benefactor. By 1978, and accumulating through the decade, Cuba's dependency on the Soviet Union teetered on the verge of excessive; 68 percent of its trade depended on the Soviet Union.¹⁶ The two countries shared a common bond that continued to disturb international relations—both leaders had a strong revolutionary goal in the Americas.¹⁷ This relationship led the Soviet Union to forgive massive Cuban debt accumulations equivalent to over one million U.S. dollars per day.¹⁸ But even with this financial grace, Cuba's economy was

(Comm. Print 1963) (Prepared by Ellen C. Collier) [hereinafter COMM. ON FOREIGN AFFAIRS], available at <http://www.devkrishan.com/resources/USExpropriationPolicy/0E-House-of-Rep-Report-on-Expropriation-of-US-business-19-Jul-1963.pdf> (explaining the Cuban government's sequential takings after the Revolution started). Land and buildings of United States citizen were being seized and occupied without court orders in various industries including banking, agrarian, oil, sugar, and nickel plants. COMM. ON FOREIGN AFFAIRS, *supra* note 10, at 16. Cuba passed a law in 1960 authorizing the nationalization of U.S. owned properties. *Id.* at 17. The United States, lead by President Eisenhower, protested this law as being discriminatory, arbitrary, and unjust. *Id.* By 1963, after Cuba had formed strong bonds with the Soviet Union and expropriations continued, the United States froze all assets in Cuba. *See id.* 17–19.

11. SUCHLICKI ET AL., *supra* note 10, at 68–70.
12. *JFK in History: The Bay of Pigs*, JOHN F. KENNEDY PRESIDENTIAL LIBR. AND MUSEUM <http://www.jfklibrary.org/JFK/JFK-in-History/The-Bay-of-Pigs.aspx> (last visited Nov. 7, 2014).
13. BAKLANOFF, *supra* note 9, at 119.
14. FOREIGN CLAIMS SETTLEMENT COMM'N OF THE U.S., SECTION II: FINAL REPORT OF THE CUBAN CLAIMS PROGRAM UNDER TITLE V OF THE INTERNATIONAL CLAIMS SETTLEMENT ACT OF 1949 412 (1972), available at <http://www.justice.gov/sites/default/files/fcsc/docs/final-report-cuba-1972.pdf>.
15. Michael W. Gordon, *The Settlement of Claims for Expropriated Foreign Private Property Between Cuba and Foreign Nations Other than the United States*, 5 LAW. AM. 457, 458–60 (1973).
16. *See* William Leogrande & Julie Thomas, *Cuba's Quest for Economic Independence*, 34 J. LATIN AM. STUDY, 325, 333 (2002). Because of its protection by the Soviet Union, Cuba was secure from catastrophic oil crisis in the 1970s. *Id.* This stability in cheap oil dissuaded Cuba to trade with other countries, diversify its exports, or develop its energy-efficient production; these weaknesses first become apparent in the 1990s when Soviet Union support fails. *Id.*
17. BAKLANOFF, *supra* note 9, at 122.
18. *See id.* at 120; *See generally* Leogrande & Thomas, *supra* note 16, at 342 (discussing Soviet Union aid accumulated to about 65 billion dollars between 1960 to 1990).

in need of further financial stimulation.¹⁹

This prompted the 1982 Cuban enactment of The Legislative Decree Number 50 on Economic Associations between Cuba and Foreign Entities (1982 Law), the purpose of which was to expand foreign relations and tourism.²⁰ The 1982 Law was Cuba's first foreign investment law. But about seven years later, the effectiveness of this decree proved to be unsustainable when the Soviet Union ended its monetary support to Cuba, throwing the island into a severe economic depression and on a desperate search for foreign investment to replace its lost support.²¹ In response to economic crisis, Cuba saw a budding resolution in another foreign investment structure.²² As a result, in 1995, Foreign Investment Law Number 77 (Law 77), a considerably liberal code, was presented to Cuba's National Assembly and passed.²³

A. 1995 CUBAN FOREIGN INVESTMENT ACT—LAW NUMBER 77, ITS
EFFECTIVENESS, AND EVENTS LEADING TO THE ENACTMENT
OF LAW 118

Effectuating September 6, 1995, Law 77 brought much-needed new hope for Cuba's economy after its 1982 foreign investment law proved insignificant when most needed. This new legislation created more definite guidelines for investors; something that the 1982 Law lacked. Accordingly, it was tactically aimed at enhancing the country's capital, markets, and technology by drawing in foreign investors.²⁴

Law 77 produced its desired spike in economic investment initially. The year immediately following its enactment, 1996, Cuba's FDI jumped from approximately \$5,400,000 to \$19,270,000.²⁵ In years following, there was a total of about 540 enterprises established in Cuba by merit of for-

19. See generally Leogrande & Thomas, *supra* note 16, at 327 – 33 (describing Cuba beginning to lose economic security and support from the Soviet Union).

20. Jose M. Diaz Mirabal, *Cuba: Legislative Decree on Economic Association Between Cuban and Foreign Entities*, 21 INT'L LEGAL MATERIALS 1106, 1107 (1982).

21. See Leogrande & Thomas, *supra* note 16, at 342 – 43 (describing the extent of Cuba's dependence on Soviet Union). When trade with Cuba nearly disappeared, Cuba lost its guaranteed market preference given by the Soviet Union; as a direct result, consumer good scarcity, rise in unemployment, and decreased quality of life occurred. *Id.* Cuba was confronted with the worst economic crisis since 1959. *Id.*

22. *Id.* at 344.

23. Jorge A. Vargas, *Cuba: Foreign Investment Act of 1995*, 35 INT'L LEGAL MATERIALS 331, 331 (1996).

24. See Ley de Inversión Extranjera Número 77 [LIEIX] [Foreign Investment Law], Gaceta Oficial [Official Gazette of the Republic of Cuba], 6 Septiembre de 1995, pmbi (Cuba) [hereinafter Law 77].

25. *Cuba – Foreign Direct Investment*, INDEXMUNDI, <http://www.indexmundi.com/facts/cuba/foreign-direct-investment> (last visited Apr. 27, 2015).

eign investors.²⁶ This number, however, began declining in 2002.²⁷ In 2003 the enterprises with foreign involvement numbered around 342.²⁸ Despite this decline in investors, a surprisingly steady 16.5 percent of Cuba's total revenue was acquired through projects with foreign investors.²⁹ During 2005, the FDI jumped from \$3,510,000 to \$15,600,000, and shockingly has only increased through the years.³⁰ In 2011 Cuba's FDI hit a record \$110,000,000.³¹ These numbers alone, however, do not reflect or support Cuba's need to adopt a new foreign investment policy. Therefore, brief mention of the social and political surroundings will help explain these times of economic growth.

The economic growth from 2005 to 2011 can be largely attributed to Cuba's relationship with Venezuela, which replaced tourism as the number one source of economic growth since 2004.³² Their primary agreement was that Cuba provides medical services in exchange for oil at indexed prices and long-term financing opportunities.³³ Venezuela put Cuba back on this relatively stable economic platform, allowing the island to nearly double its import capacity, initiate investments, and capitalize on its source of nickel.³⁴ However, similar to its prior relationship with the Soviet Union, Cuba's dependence on Venezuela may be dangerously excessive.³⁵ As of Spring 2014, Venezuela's economy began experiencing severe inflation and political stress. Although Cuba retains support from China, Russia, and North Korea, its economy depends substantially more on Venezuela.³⁶ Because Venezuela is the trunk of economic support to

26. OMAR EVERLENY PEREZ VILLANUEVA, *LA INVERSION EXTRANJERA DIRECTA EN CUBA: EVOLUCION Y PERSPECTIVAS* [FOREIGN DIRECT INVESTMENT IN CUBA: EVOLUTION AND PERSPECTIVES], 8 (2001). There are issues with Cuban economic statistics are widely recognized. Official reports are sporadic, there are multiple year gaps in data collected, official sources are not always in agreement, and the methodology behind data collection is unclear. *Id.*

27. *Number of Foreign Concerns Doing Business in Cuba Down for 2003*, CUBANET (Mar. 23, 2003), <http://www.cubanet.org/htdocs/CNews/y04/mar04/23e5.htm>.

28. *Id.*; See generally Leogrande & Thomas, *supra* note 16, at 345 (describing various sector increases resulting from FDI).

29. Paolo Spadoni, *FOREIGN INVESTMENT IN CUBA: RECENT DEVELOPMENTS AND ROLE IN THE ECONOMY*, 173 (2002).

30. *Cuba – Foreign Direct Investment*, *supra* note 25.

31. *Id.*

32. *Cuba's Economy: Military*, GLOBALSECURITY, <http://www.globalsecurity.org/military/world/cuba/economy.htm> (last visited Apr. 27, 2015).

33. *Id.*

34. *Id.*

35. See *id.*

36. Patricia Rey Mallen, *China and Cuba Skip the Ideology, Let's Talk About Money*, INT'L BUS. TIMES (Apr. 24, 2014, 3:28 PM), <http://www.ibtimes.com/china-cuba-skip-ideology-lets-talk-about-money-1575560> (explaining that China historically has backed Cuba for access to Cuba's resources and similar political ideologies). In a close second to Venezuela, China is a major trading partner for Cuba. *Id.*; See also *Havana Thanks Russia for Writing off Cuba's Debts to USSR-Raul Castro*, SPUTNIK, (July 12, 2014, 14:04), http://sputniknews.com/voiceofrussia/news/2014_07_12/Havana-thanks-Russia-for-writing-off-Cubas-debts-to-USSR-Raul-Castro-0984/ (explaining Russia's continued relations with Cuba and that Russia just agreed to write off 90 percent of the debt Cuba owed from its prior relations with the Soviet Union); see also *Cuban relations with North Korea: The Cuban Connec-*

Cuba, any shaking of the trunk is inevitably going to threaten, damage, or destroy the branches. The severity of the inflation for Venezuela's economy is only a fraction of what Cuba's economy could expect to see if it loses support from Venezuela, which is not a far-fetched consideration.³⁷

Despite the late 2000s' profitable FDI increase from Law 77, the quality of Cuba's economy has drastically declined over the past five years due to bureaucratic obstacles, instability from Venezuela, and lack of credibility in the Cuban government.³⁸ As the island is still trying to recover from its economic pitfall during the Revolution and ward against possible Venezuelan diminishing support, it is in urgent need of foreign investment to revive its economy.³⁹ The government sees the potential for greater increase if it could accumulate a larger pool of investors. Cuba is anticipating a \$2-2.5 billion FDI increase, which will allow it to reach its goal of 7 percent growth per year.⁴⁰ Law 118 may symbolize a fresh start for Cuba to start winning back its credibility as a safe and financially profitable country for investors to establish investments. But because Law 118 has offered no additional legal securities or guarantees, the tax incentives must be enough to initially entice investors.⁴¹ If Cuba can secure the trust of weary investors through offering these financial incentives, its next hurdle is ensuring that the tax incentives can attract enough investment to make an FDI structure successful, and thus justified.

III. SIGNIFICANT TAXATION CHANGES IN CUBA FOREIGN INVESTMENT LAW NUMBER 118

Law 118's stated purpose is to institute a system of services, legal confidence, and assurance of protection to investors in an attempt to attract investors and increase FDI.⁴² It outlines Cuba's intention with foreign investment, noting that it is aimed at promoting diversification and expansion of export markets, advancing its technologies, obtaining external financing, creating new jobs, furthering the country's involvement in renewable energy and environmental sustainability, and much more.⁴³ Healthcare, education, and military ventures, like in Law 77, remain

tion, *ECONOMIST* (Dec. 15, 2013, 6:15) <http://www.economist.com/blogs/americas-view/2013/12/cuban-relations-north-korea> (explaining Cuba and North Korea work well together because they share a similar ideology).

37. Silvana Ordonez, *Cuba Could Be Venezuela's Biggest Loser*, NBC NEWS (Mar. 18, 2014, 4:42 PM), <http://www.nbcnews.com/storyline/venezuela-crisis/cuba-could-be-venezuelas-biggest-loser-n56101>.

38. Interview with Cuban Attorney, *supra* note 5.

39. *Id.*

40. Kelcey Hadden-Leggett, *Cuba Takes Another Step Forward to Join Global Economy*, PANORAMAS (Apr. 4, 2014), <http://www.panoramas.pitt.edu/content/cuba-takes-another-step-forward-join-global-economy>.

41. See Ley de Inversión Extranjera Número 118 [Foreign Investment Law Number 118], Gaceta Oficial de la Republic de Cuba [Official Gazette of the Republic of Cuba] 29 de Marzo de 2014 (Cuba) available at <http://www.cubadiplomatica.cu/LinkClick.aspx?fileticketdG-CVp5To%3D&tabid=21894>.

42. *Id.* art 1.1.

43. *Id.* art. 2, 3.

outside the eligible sectors for foreign investment.⁴⁴ These goals and regulations are almost identical to those of Law 77.⁴⁵

The discussion below of Law 118 will only address the labor, income, and profit tax provisions that vary significantly from Law 77, for these provisions are likely to be the most attractive to foreign investors, and accordingly, are the areas of interest for this article.

A. MONEY TALKS: THE SPECIAL TAX STRUCTURE

Compared to the other amended provisions in Law 118, the Cuban government most drastically altered its taxation structure, providing strong financial incentives to foreign investors. Out of the three general modalities of investment, only the joint venture and international economic association agreement entities are eligible for Law 118's tax incentives; fully foreign capital companies do not qualify.⁴⁶ Fully foreign companies are required to pay taxes in accordance with the current tax legislation and do not receive any exemption or discount benefit from this new law.⁴⁷

Law 118 reduces the *profits tax* to 15 percent of the net taxable profit and exempts the parties from paying the tax for eight years upon signing the agreement.⁴⁸ In addition, it totally eliminates a *labor tax* imposed for using the Cuban labor force, as well as *income tax*.⁴⁹ Although these

44. *Id.* art. 11.1.

45. Compare *id.* art. 1.1, with Vargas, *supra* note 23, at 344.

46. Ley de Inversión Extranjera Número 118 [Foreign Investment Law Number 118], Gaceta Oficial de la Republic de Cuba [Official Gazette of the Republic of Cuba] 29 de Marzo de 2014, art. 44 (Cuba), available at <http://www.cubadiplomatica.cu/LinkClick.aspx?fileticketdG-CVp5To%3D&tabid=21894>. Law 118, like Law 77, provides three different investment structures: 1) Joint Ventures, 2) International Economic Association Contracts, and 3) Totally Foreign Capital Companies. *Id.* art. 13.1. Joint ventures are defined as a "Cuban commercial company which adopts the form of a corporation with registered shares in which one or more national investors and one or more foreign investors participate as shareholders." *Id.* art. 2(h). An International Economic Association Agreement is "an agreement between one or more national investors and one or more foreign investors"; each party imparts its separate contributions, and each party retains ownership of these separate contributions. *Id.* art. 2(f), 15.1(d). A Totally Foreign Capital Company is wholly owned by foreign investors; it is fully funded by foreign capital, meaning it does not have a national investor. Foreign investors in this venture are allowed to enjoy all the benefits, rights, and obligations that accompany complete business ownership. *Id.* art. 16.1.

47. *Id.* art. 44.

48. *Id.* art. 36.1 – 36.2.

49. *Id.* art. 39; see generally Michael Weissenstein & Andrea Rodriguez, *Cuba Seeks Over \$8 billion in Foreign Investment*, ASSOCIATED PRESS (Nov. 3, 2014), <http://bigstory.ap.org/article/9b3318cce5e54331995fa807d7b117a3/cuba-seeks-over-8-billion-foreign-investment> (explaining that foreign executives are required to hire Cuban employees through the State's labor force agency). This allows the government to maintain control over its people by setting wages, managing employee placement, and handling employee complaints. In select ventures, after approval from the government, foreign investors are able to hire high-level employees directly. Investor's complain about this structure because it drastically limited their ability to select and promote their employees. Weissenstein & Rodriguez, *supra* note 49.

three tax breaks appear inconspicuously embedded in Law 118, they may amount to sizeable attractions and advance Cuba's FDI.

IV. ANALYSIS OF PROVISIONAL CHANGES FROM LAW 77 TO LAW 118

The varying provisions of Law 118 are an attempt by Castro to expand Cuba's foreign investment market that has long been limited by the country's political and economic platform refusing to release control, as well as its unfavorable reputation in the international perspective.⁵⁰ The changes from Law 50 to Law 77 illustrated a sizeable governmental effort to reduce its power over foreign investors with the first appearance of an express guarantee protecting against unwarranted and uncompensated government takings of foreign investments. While Law 118 includes this guarantee, there are no further amendments of security—the warranty provision from Law 77 to Law 118 reads verbatim the same.⁵¹

Therefore, the government's expectation for success depends primarily on the tax incentives to Law 118. The presupposition to an successful FDI tax incentive is that the country ultimately benefits from the investment more than the investor.⁵² An FDI should seep into the expansion of the country's intangible resources, such as indirect technological advancements and expansion of workers' skills.⁵³ Thus, while these tax reductions and exemptions facially seem to benefit the investor more, a successful FDI is dependent on the offset of decreased governmental revenues from the incentive that flows into the utilization of intangible areas resulting in the increased tax revenues flowing from the investment.⁵⁴

The varying tax incentives from Law 77 to Law 118 need to not only be enough to subsidize investors' fear of expropriation, but, in order for it to be justified, they also must induce investors who will introduce and advance these intangible benefits in other sectors, not just increase capital flow. If this occurs, the government's decreased tax revenue from the tax deductions will be offset by the inadvertent intangible benefits flowing into other sectors. Below, the labor tax exemption, income tax exemption, and profit tax reduction incentives' probability for success in the Cuban ambiance are analyzed.

50. DR. OMAR EVERLENY PEREZ VILLANUEVA, CUBA: AN OVERVIEW OF FOREIGN DIRECT INVESTMENT 4 (2002), available at <http://carleton.ca/economics/wp-content/uploads/cep02-04.pdf>.

51. *Compare* Ley de Inversión Extranjera Número 118 [Foreign Investment Law Number 118], Gaceta Oficial de la Republic de Cuba [Official Gazette of the Republic of Cuba] 29 de Marzo de 2014, ch. III (Cuba) with Vargas, *supra* note 23, at 346.

52. United Nations Conference on Trade and Development, Geneva, Switz., July 2000, *Tax Incentives and Foreign Direct Investment* 14, UNCTAD/ITE/IPC/Misc.3, available at http://unctad.org/en/docs/iteipcmisc3_en.pdf.

53. *Id.*

54. *Id.*

A. LABOR FORCE TAX

As compared to Law 77, Law 118 eliminates the labor tax requirement entirely.⁵⁵ The old law set the tax at an 11 percent rate, with an additional 14 percent rate for Social Security contributions.⁵⁶ Combined, the tax for foreign investors to use the labor force was 25 percent.⁵⁷

The government revoking labor tax is beneficial for investors in agricultural or industrial ventures, which comprise about 36 percent of employment, but even more so for the tourism sector that employs about 63 percent of those employed.⁵⁸ Records from 2014 show Cuba's unemployment rate at a minuscule 3.2 percent, resulting in employment of about 8,110,000 citizens.⁵⁹ Cuba's tourism industry, multiplying its gross income eight-fold within the past decade, has grown into one of the most profitable and attractive investment areas in the country.⁶⁰

The island's thick culture, rooted in music, architecture, and art, provides a lens back in time for tourists.⁶¹ Since the Revolution began, the cars, buildings, and development seem to have stopped the country's time clock and preserved the beauty of what once was a glorious time.⁶² This is undoubtedly a significant allure for tourists. The country's tourism, however, spreads beyond its beaches and group tours through Havana; health tourism, eco-tourism, sports, and education contribute to the sector's success as well.⁶³ Needless to say, tourism accounts for a large majority of the country's labor force consumption and economic backing; it is a promising sector to see the labor tax incentive result in a successful FDI.⁶⁴

A successful tax incentive to FDI will require investments to initiate an overflow beyond the immediate capital from the hotel, agriculture or industrial investment and into the intangible benefits of employment, development of managerial skills, and contributing to technological, energy, and medical advancements.

For instance, in order for the tax incentive to be justified, a foreign investment venture in any branch of Cuba's tourism sector must expose its employees to managerial skills or expertise, which the employee will

55. Vargas, *supra* note 23, at 353 – 54.

56. *Id.*

57. *Id.*

58. Cuba: economy, GLOBALEDGE, <http://globaleedge.msu.edu/countries/cuba/economy> (last visited Apr. 27, 2015).

59. *Id.*; 2014 Index of Economic Freedom: Cuba, HERITAGE FOUND., <http://www.heritage.org/index/country/cuba> (last visited Apr. 25, 2015); Cuba Population 2014, WORLD POPULATION REV., <http://worldpopulationreview.com/countries/cuba-population/> (last updated Oct. 19, 2014).

60. Orinaldo Gutierrez Castillo & Nelida Gancedo Gaspar, *Tourism Development for the Cuban Economy*, REVISTA HARVARD REV. OF LATIN AM., <http://revista.drclas.harvard.edu/book/tourism-development-cuban-economy-english-version> (last updated 2014).

61. *See id.*

62. *See id.*

63. *Id.*

64. Leogrande & Thomas, *supra* note 16, at 349.

presumably take to his next job, thus spreading the benefits of the initial investment. And because Cuba's tourism sector utilizes a large portion of the state's employees, and it is a thriving attraction for foreign investments, the labor tax exemption to FDI will likely be justified by this sort of spillover.

If the labor tax exemption incentive proves to effectively increase FDI, the resulting economical growth would offset the initial decreased tax revenue for the government. Although the Cuban government has agreed to take on the burden of supplying social security contributions,⁶⁵ the benefit should far outweigh the burden if these intangible skills, training, exposure to technological advancements, and new knowledge spread to other sectors and are not simply internalized at the point of immediate investment. For Cuba to see an offset of this incentive, it must approve investments with investors who will bring this sort of foreign expertise into Cuba.

B. INCOME TAX

Foreign investors are exempt from paying income taxes on net profits of their business under Law 118's Article 35.⁶⁶ This is a generous attraction for investors, allowing them to receive all their wage earnings and dividend returns that would otherwise be reduced by the tax.⁶⁷ It also illustrates that the government is willing to release its control and give investors more privacy concerning their investments and businesses. The government relieving itself of this power and focus on immediate return sheds a positive light, possibly revealing its intentions, desires, and efforts to make Law 118 successful for both itself and investors. This exemption also indicates the government's confidence in being able to compensate for the income tax exemption elsewhere, like through the intangible benefits a successful FDI regime generates. In combination with all other factors an investor considers when making his venture decisions, if the income tax exemption works as an enticement to bring investment into Cuba, the initial loss of income tax paid to the government will be far outweighed by a future increased economical boost, along with many of those intangible benefits that could be introduced to the country. If investors can overcome the insecurity of doing business in Cuba, the absence of income tax on foreign investors is likely to expedite and multiply investment in the country, and thus result, or at least raise the probability for FDI success.

65. John Pike, *Cuba's Economy*, GLOBAL SECURITY, <http://www.globalsecurity.org/military/world/cuba/economy.htm> (last visited Apr. 27, 2015).

66. Ley de Inversión Extranjera Número 118 [Foreign Investment Law Number 118], Gaceta Oficial de la Republic de Cuba [Official Gazette of the Republic of Cuba] 29 de Marzo de 2014, art. 35 (Cuba).

67. *Id.*

C. PROFITS TAX

The new law sets the profits tax of net profits at 15 percent, which is a 50 percent cut from Law 77.⁶⁸ In addition, Law 118 provides for an initial eight-year exemption period, a provision not present in the prior law.⁶⁹ Where the old and new merge is with respect to profits from the exploitation of renewable or nonrenewable natural resources.⁷⁰ The condition allows the Council of Ministers to raise the tax as it sees fit, to a cap of 50 percent.⁷¹

Law 118's profits tax decrease and eight-year exemption are unquestionably appetizing to foreign investors because a better return on investment results. But for those investors interested in sectors involving renewable or nonrenewable natural resources, the proviso put on profits tax is daunting. There should be great hesitation in the government's ability to tax up to 50 percent "as it sees fit," as this is an arbitrary and uncertain measuring method. The provision does not provide an explanation of how the increased rate will be decided. This unchanged ambiguity in Law 118 will likely not bode well for attracting certain investors.

As unflattering as this provision might be to attracting new investors in natural resource sectors, it is hardly unexpected. The need for any country to have a heavier hand in the exploitation of a natural resource is understood in order to maintain the proper environmental balance of taking and replenishment. Historically, in the late 1980s and into the early 1990s, Cuba was globally recognized for its sugar, tobacco, nickel, coffee, and citrus production.⁷² Now, due to a lack of management, inefficient methods, shortage of resources, and various other factors, many of these resources, with the exception of nickel, have drastically diminished.⁷³ As a reference point, Cuba now must import citrus to accommodate its tourism demand; its sugar production is declining from 1.6 million tons compared to a thriving 8 million tons just twenty-five years ago; and importers refuse to import tobacco after reporting reduced quality.⁷⁴ The country's need for managerial skills, organization, technological methods, and resources in this sector is precisely the sort of intangible benefit that a tax incentive to FDI should produce. Cuba has unequivocally recognized a flaw in how it governed natural and produced resources in the past and has drafted its recent foreign investment laws to not only protect against further depletion, but assist in reviving its resources.

The issue with this income tax provision is not that the government can increase the rate for renewable and non-renewable resource investors, it is the ambiguity of how the rate will be set. Further, any sophisticated

68. *Id.* art. 36.1.

69. *Id.* art. 36.2

70. *Id.* art. 36.4.

71. *Id.*

72. Ron Frost, Comment, *Cuba's Changing Foreign Investment Climate: Castro's Attempt to Lure Foreign Investors*, 9 TRANSNAT'L LAW. 295, 323 - 24 (1996).

73. Pike, *supra* note 65.

74. *Id.*

businessman should know, considering Cuba's history and socialist regime, where there is an ambiguity in an agreement, the government will prevail. This uncertainty leaves a negative taste in an investor's mouth because he is unsure whether the tax will be fairly assessed. Cuba may be asking certain investors to trust in its good-faith dealings prematurely.

V. ON PAPER VS. IN PRACTICE

As stated, Cuba's largest hurdle to overcome is its reputation of taking successful investments and imprisoning foreign executives without valid cause. Because of Cuba's communist structure, the government has the ability to compel investors to relinquish what may, from other countries' standards, be legally owed by the investor. Although recent expropriations do not amount to the severity of those recorded in the early 1960s, Cuba's behavior toward investors has been far from a clean slate. The country's investment law appears attractive on paper, but what happens in practice illustrates inconsistencies.

On paper, Law 118 (along with Law 77) portrays security and the sense of a changed Cuban business government. But in practice, doing business in Cuba remains a risky endeavor. For instance, a British foreign investor, head of the Coral Capital branch in Havana, was detained abruptly in the early morning hours for questioning.⁷⁵ His company owned one of the most exclusive hotels in partnership with the state.⁷⁶ For months, the office remained closed and was declared a crime scene.⁷⁷ This past June, the investors were found guilty of minor charges and released with more than a year served in prison, but never again saw the millions of dollars seized by the government.⁷⁸

Undoubtedly, the government has an explanation for these occurrences. The state defends that its mission, and one of its most resistant difficulties, is to reduce the corruption that runs rampant.⁷⁹ Regardless of its unsupported reasoning, Cuba continues to use corruption as an excuse to exile or imprison investors. Within recent years, the government banned more than 150 businesspeople and dozens of small South American and European businesses.⁸⁰

Although there may be more to some of these stories than has been made known to the public, it is, at a minimum, a prime example of the lack of transparency and trust the Cuban government portrays to its current and potential foreign investors.

75. *Business in Cuba: A Risky Venture*, *ECONOMIST* (Nov. 12, 2011), <http://www.economist.com/node/21538202>.

76. *Id.*

77. *Id.*

78. *Cuba's Past Raises Skepticism about New Foreign Investment*, *REUTERS* (Mar. 31, 2014), <http://www.reuters.com/article/2014/03/31/us-cuba-investment-idUSBREA2U0PX20140331>.

79. Weissenstein, *supra* note 7.

80. *Id.*

It may be a more realistic consideration that these tax incentives will only produce a successful FDI if Cuba evidences an affirmative attempt to mend its unfavorable image in the global economy. However, Cuba's willingness to reach this bar appears questionable. In reality, Cuba has not only failed to affirmatively provide evidence of reassuring efforts, but it has swung in the opposite direction by displaying evidence of recent disparaging treatment.

VI. CONCLUSION

Perhaps some of the changes in Law 118 will be enough to satisfy hesitations of some investors, and Cuba will meet its anticipated growth as a direct result of Law 118's tax incentives to FDI. But the more likely result of these amendments will be moderate. On their own, the incentives to investors would likely be outweighed by introducing the country to advanced managerial skills and technological methods through investments in the tourism sector. But the government's continued heavy hand in successful investments will hamper its potential for securing credibility. Additionally, Venezuela's economic crisis may force Cuba to rely on other foreign investors or depend more heavily on China or Russia in order to prevent the country from an economical crash. If Cuba chooses the latter, the imprisonment and takings will most likely not subside. If Cuba decides to deviate from its historical tendency of excessive dependence on select countries, investors may see a turn for the better in Cuba's treatment and respect for the investments.

Regardless of its reasoning, Cuba cannot expect to substitute guarantees of legal security and protection from expropriation with enticements of tax breaks without evidence contrary to its harsh history of mistrust. Unfortunately for Cuba, its recent negative publicity creates an even stronger precedent of distrust that will inhibit the remarkable potential the island has for foreign ventures. These financial incentives could help sway potential investors, but the Cuban government's current unwillingness to liberalize its economic and political structure will have a restraining effect on its potential for great success with foreign investment.

Updates

