

CUBAN FOREIGN INVESTMENT LEGISLATION

Decree Law 50 of 1982 (“Decree Law 50”) was Cuba’s first foreign investment act authorizing the formation of international joint-ventures with foreign investors. In general, Decree Law 50 authorized the creation of joint venture companies and the execution of other international economic association contracts, both permitted under the present Foreign Investment Act, but did not authorize the creation of full foreign ownership companies. When the new Foreign Investment Act was adopted in 1995, existing foreign investment vehicles created under the authority of Decree Law 50 were brought under the application of the new Act, although the latter provides an express grandfathering provision in respect of all benefits granted to such foreign investment vehicles under the earlier legislation.

Foreign Investment Act of 1995

At present, the primary legal framework governing foreign investments in Cuba is set out in the Foreign Investment Act (Law 77 of 1995 on Foreign Investment). Detailed rules applicable to the operations of foreign investment vehicles are contained in generally applicable legislation dealing with matters such as tax, banking, environment, construction, labour, insurance and others, as well as in the Cuban Commercial Code and the Civil Code.

The Foreign Investment Act provides basic investment protection and other general rules relevant to foreign investors and sets out the principal legal structures for the implementation of investment projects in Cuba. In general, the Foreign Investment Act classifies foreign investments as *direct investments* or *indirect investments*. In the case of a direct investment, the foreign investor participates in the equity structure of the entity developing the project in question and actively participates in the management of operations. Conversely, in the case of indirect investments, the role of the foreign investor is generally limited to the provision of finance for a given investment project, without any participation in the management of the project. Under the Foreign Investment Act, all sectors of the Cuban economy are open to foreign investment, with the exception of health, education and the sector of the armed forces. The acquisition of ownership and other property rights over real estate (in accordance with current legislation) is expressly allowed by the Foreign Investment Act for residential, tourism and commercial projects.

The Foreign Investment Act provides the following main vehicles for foreign investment in Cuba:

- joint venture company;
- international economic association contract; and
- full foreign ownership company.

Joint venture companies and international economic association contracts are referred to in the Foreign Investment Act as “international economic associations”.

Investment Protection Provisions

The Foreign Investment Act provides that foreign investments in Cuba enjoy full protection and security and may not be expropriated, except for reasons of public utility or national interest, as declared by the Cuban Government in accordance with the Cuban constitution, current legislation and international mutual investment protection treaties executed by Cuba. In the event of expropriation, prior compensation based on the agreed commercial value of the assets and payable in a freely convertible currency must be paid. SwissCubanCham is not aware of any expropriation of foreign assets since 1982, the year of enactment of Decree Law 50, the predecessor of the Foreign Investment Act.

At any time, a foreign investor may sell or transfer to the Cuban Government or a third party, in whole or in part, its interest in a Cuban joint venture company or other international economic association, subject to agreement between the parties and prior approval of the Cuban Government. The proceeds of such sale or transfer must be paid in a freely convertible currency. The purchase price will be set, in the case of a joint venture company or an international economic association contract, by agreement between the parties, or, in the event that no agreement can be reached, by an organization with internationally recognized expertise and prestige in business valuations authorized by the Ministry of Finance and Prices to operate in Cuba. It is generally possible to establish in the corporate documents creating Cuban foreign investment vehicles rights of first refusal and similar rights regarding the sale or transfer of interests therein.

The Foreign Investment Act guarantees that net profits, dividends and the proceeds resulting from the expropriation, liquidation or sale of shares in a Cuban joint venture or full foreign ownership company or of investment assets may be freely repatriated abroad (free from taxes, withholdings and deductions) in a freely convertible currency. In the event of dispute over the amount payable to the foreign investor following any expropriation, sale, transfer or liquidation of investment assets, such dispute will be settled by an organization having internationally recognized expertise and prestige in business valuations that is authorized by the Ministry of Finance and Prices to operate in Cuba. To the best knowledge of SwissCubanCham, no such organization has been so authorized to date.

In addition, the Foreign Investment Act provides that foreign investments are protected against third party claims made in accordance with Cuban law and rulings of national courts. It should be noted that claims of US nationals resulting from expropriations that took place after 1959 and made pursuant to US law do not fall under this category.

Cuba has executed bilateral investment protection treaties with a number of countries. These treaties provide additional protections to investors of signatory countries.

Taxation

The Foreign Investment Act contains special tax rules and rates for foreign investment vehicles (see Part V entitled "Taxation"). The Ministry of Finance and Prices may generally grant exemptions in respect of all applicable taxes and customs duties. The granting of such exemptions will generally depend on the perceived benefits and size of the investment, the rate of recovery of capital, instructions given by the Executive Committee of the Council of Ministers regarding the priority sectors of the economy and the benefits that may result for the national economy.

Approval Procedures

Following the selection of an investment project and the conclusion of preliminary agreements (usually a letter of intent or a memorandum of understanding) with the Cuban counterpart and/or the relevant Cuban Ministry or Ministries responsible for the investment sector, the procedure for the establishment of a foreign investment vehicle will consist in 5 different stages:

- feasibility study and negotiation of main corporate documents;
- investment proposal to Ministry responsible for project sector;
- joint presentation of investment proposal to Ministry of Foreign Investment and Economic Collaboration by foreign investor and Ministry responsible for project sector;
- consultation with all relevant Government bodies;
- presentation of final investment proposal to Executive Committee of Council of Ministers for approval.

Under the Foreign Investment Act, the decision approving or denying the foreign investment must be rendered within 60 days counted from the date on which the investment proposal is accepted by the Ministry of Foreign Investment and Economic Collaboration. The approval of the Executive Committee of the Council of Ministers is given in the form of a resolution setting out, amongst others, the terms and conditions that will be applicable to the investment. In accordance with article 48 of the Foreign Investment Act, all entities incorporated under the Foreign Investment Act must, within 30 days following the decision mentioned above, be registered on the appropriate commercial register maintained by the Cuban Ministry of Justice.

Resolution of Disputes

The Foreign Investment Act gives to the parties complete freedom to designate in the corporate documents of the foreign investment vehicle any forum for the resolution of disputes arising within the context of their joint activities. In practice, most joint venture agreements and international economic association's contracts contain international arbitration clauses, including International Chamber of Commerce (ICC) and United Nations Commission on International Trade Law (UNCITRAL) arbitration. Cuba is a party to the New York Convention of 1958 on the Recognition and Enforcement of Foreign Arbitral Awards.

Other Provisions

Cuban foreign investment vehicles must generally denominate and carry out their operations entirely in a freely convertible foreign currency, although local payments are now largely made in Cuban Convertible Pesos (CUC). Only in highly exceptional circumstances will a foreign investment vehicle be permitted to make any payment in non-convertible Cuban Pesos (CUP). Foreign investment vehicles may open bank accounts in the Cuban banking system denominated in freely convertible foreign currencies and, with prior approval of the BCC, in Convertible Cuban Pesos (CUC). Such vehicles may only open bank accounts abroad with the prior approval of the BCC. Joint venture companies, full foreign ownership companies and foreign parties to international economic association contracts have the right, in accordance with applicable legislation, to import and export directly all goods necessary to carry out their approved activities.

Foreign investment vehicles must generally comply with applicable labour and social security legislation and must hire Cuban employees in preference to foreign nationals, with the exception of certain top supervisory, administrative and technical positions that may be filled by foreign temporary residents. Temporary residents employed by foreign investment vehicles are not subject to Cuban labour and social security legislation. In general, Cuban employees must be hired through a Cuban employment agency, with the result that foreign investment vehicles pay for employees in freely convertible foreign currency or Cuban Convertible Pesos (CUC) but such employees receive their salary in non-convertible Cuban Pesos (CUP). In certain circumstances, hard currency incentive funds may be established for the benefit of Cuban employees.

Although no maximum term is established in the Foreign Investment Act, joint venture companies are generally established for a term of 25 years. International economic association contracts generally are established for a term of 10 years or less. In all cases, the term of the foreign investment vehicle may be extended by agreement of the parties and with the approval of the Cuban Government for an additional period equal to the original term.

Cuban foreign investment vehicles must establish contingency reserves, charged to profits. Insurance must generally be contracted with insurance providers authorized by the Ministry of Finance and Prices to operate in the country, provided their coverage and premiums are competitive internationally. It should be noted that, to date, no foreign insurer has been so authorized and in practice, insurance coverage must be contracted with Cuban insurance providers.

Foreign investment vehicles may freely determine the accounting system that shall govern their activities, provided that Cuban financial reporting standards are complied with.

Commercial Code and other Legislation

To the extent that foreign investment vehicles take the form of an anonymous share company (S.A.), such vehicles are subject to the application of certain provisions of the Cuban Commercial Code. It should be noted that significant parts of the Commercial Code have been repealed by subsequent legislation. Other generally applicable legislation, such as the Cuban Civil Code, the Banking Act, the Environmental Protection Act, the Tax Act, the Procedures Act and others will also be applicable to the operations of foreign investment vehicles.

Intellectual Property

Cuba is a party to a number of international treaties and agreements dealing with the protection of intellectual property, including

- Agreement on Trade-Related Aspects of Intellectual Property Rights;
- World Intellectual Property Organization;
- Paris Convention;
- Lisbon Agreement; and
- Madrid Protocol.

The Cuban Office of Industrial Property is the organization responsible for the protection of intellectual property rights in Cuba.

TAXATION IN CUBA

The general Cuban tax rules are set out in Law no.73 of 1994 on the Taxation System (the “Tax Act”), as well as in various tax resolutions issued by the Ministry of Finance and Prices (the “Ministry of Finance”) and other complementary legislation. The tax rules applicable to corporate income tax are set out mainly in the Tax Act and in Resolution 379 of 2003 on Corporate Tax issued by the Ministry of Finance (the “Corporate Tax Regulation”). In addition, the Foreign Investment Act contains particular tax rules applicable to the Cuban operations and activities of foreign investors.

The principal rules relating to personal income tax are laid out in the Tax Act and in Resolution 24 of 1995 on Personal Income Tax issued by the Ministry of Finance.

Decree-Law 169 of 1997 on Tax Norms and Procedures and the Cuban Criminal Code contain additional procedural and penal provisions.

In general, the Ministry of Finance is empowered to grant exemptions (total or partial) to foreign investors in respect of the payment of tax, including exemptions on the payment of corporate tax and personal income tax.

Corporate Tax

Cuban and foreign legal persons, whatever their form of organization or property regime, are subject to the payment of corporate tax (called a “profit tax – *impuesto sobre utilidades*”) in connection with their commercial, industrial, construction, financial, agricultural, fishing, service, mining or extraction or other business activities carried out in Cuba. In the case of Cuban legal persons (including Cuban joint venture companies and full foreign ownership companies); corporate tax is payable in respect of world-wide income. In the case of foreign legal persons that are party to an international economic association contract or that have a permanent establishment in Cuba, corporate tax is payable only in respect of Cuban source income attributable to such contract or permanent establishment.

A foreign legal person is normally subject to the payment of corporate tax in Cuba when it has a permanent establishment, a fixed place of business or some form of representation for the purpose of contracting on its behalf in the Republic of Cuba. The term “permanent establishment” is defined in the Tax Act as “any place of business where corporate, commercial, industrial or exploration/extraction of mineral resource activities are carried out, including branches and offices”. The Corporate Tax Regulation confirms further that a foreign legal person will be deemed to be carrying out business activities in Cuba at a permanent establishment when any place of business or work area of any nature is at that person's disposal in a continuous manner. A permanent establishment is also constituted by branches, offices, manufacturing and other facilities, warehouses, shops or other establishments, work sites, agencies or representatives authorized to contract on behalf of the foreign person, mines, oil and gas wells, agricultural/fishing/forestry or other natural resource installations, as well as the provision of corporate consulting or management services (for a continual period of at least 6 months within a single 12 month period).

In the case of the foreign investment vehicles provided under the Foreign Investment Act, corporate tax is payable on net taxable income at a rate of 30%. The Executive Committee of the Council of Ministers may determine that, in the case of renewable or non-renewable natural resources, the tax rate may be increased up to a maximum of 50%.

Net taxable income is calculated as the sum of all income earned during the fiscal year, minus deductible expenses, losses carried forward from previous periods and allowable reserves and provisions. For the purposes of calculating net taxable income, all receipts that increase the patrimony of the person in question, whether in cash, in kind, of valuable title or other, shall be counted as income. Where, as a result of the corporate form or other characteristics of a legal person, it is impossible to determine in an efficient manner satisfactory to the Ministry of Finance the net taxable income of such person, that person may be required to pay corporate tax on the basis of its gross income in accordance with rates established by the Ministry of Finance rather than on net income.

Corporate expenses are deductible if they are (i) necessary (a necessary expense is an expense that is proper to the activity or business in question, actually incurred, current, and that does not arise as a result of a fine or penalty), (ii) properly accounted for in accordance with Cuban Financial Reporting Standards established by the Ministry of Finance and by regulation, and (iii) duly justified by required documentation.

Assets may be depreciated and deducted in accordance with the rates fixed in the Corporate Tax Regulation. If it can be demonstrated that the depreciation of a particular asset should be carried out at a different rate, a request may be made to the Ministry of Finance for this purpose. In addition, in a section dealing with "other authorized adjustments", the Corporate Tax Regulation provides that, in the mining sector, persons subject to the payment of corporate tax may, if so authorized by the Executive Committee of the Council of Ministers, allocate a portion of profits, prior to the application of corporate tax, to the amortization of exploration and development costs characterized as recoverable expenses.

Proper accounting books and records must be maintained in accordance with Cuban Financial Reporting Standards, which [have been adopted from the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB)] are set out in Resolution no.235 issued by the Ministry of Finance in 2005.

The financial statements of any entity subject to taxation in Cuba must be audited annually by an auditor that is duly authorized by the Ministry of Finance.

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