Business Insights: Cuba

Fox Rothschild LLP
ATTORNEYS AT LAW

A newsletter of the Cuba Practice Group of Fox Rothschild LLP

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Welcome

Fox Rothschild LLP is a national law firm with nearly 600 attorneys practicing in 19 offices coast to coast. Our lawyers provide a full range of legal services to public and private companies – from family-run businesses to multinational corporations – as well as to charitable, medical and educational institutions.

We provide strategic counsel to clients in more than 50 countries in a full spectrum of cross-border and international matters. Clients rely on our entrepreneurial guidance to help them navigate the vast terrain of the ever-changing international stage. We also provide advice on matters relating to Cuba.

We are pleased to present the inaugural issue of our newsletter, Business Insights: Cuba. In this and future editions, we will highlight relevant news – from a legal point of view – regarding Cuba and its relations with the United States. Topics may include licensing, trading, investing and economic news as well as the U.S. embargo in place under the Trading with the Enemy Act and the Foreign Assistance Act and other laws and regulations impacting economic relations between the two countries.

For more information on how Fox Rothschild can assist you in connection with business and legal matters in Cuba, please contact Raul J. Valdes-Fauli at 305.442.6542 or rvaldes-fauli@foxrothschild.com.

What Does the New Cuban Foreign Investment Act Mean?

Cuba adopted a new foreign investment law earlier this year that abolished duty free zones and industrial parks while expanding areas for investment. Under the new law, investment is allowed in all economic sectors, including utilities, administrative concessions, real estate (purchase, sale and leasing of houses and offices), hotel management and professional services. The law also provides for investments in stocks and other securities or bonds, public or private, that do not fit the definition of direct investment.

However, no foreign investment is authorized in the public health and education sectors or in any institution of the armed forces other than their system of enterprises. Likewise, foreign investment is not authorized if it will be detrimental to national defense and security, national resources or the environment.

Any foreign investment must be approved by an "authorization" issued, depending on its content and extent, by the Council of State, the Council of Ministers or another authority appointed by the latter. The authorization is granted upon the submission of business proposals to the Ministry of Foreign Trade and Foreign Investment (MINCEX), which relies on a Business Evaluation Commission, made up of representatives from eight ministries and the Central Bank of Cuba, to assess the proposals.

Every year, the state establishes a Portfolio of Foreign Investment Opportunities containing those

Key Changes in the New Law

- It cuts the tax on profits in half—from 30 percent to 15 percent for most industries—and eliminates the prior 25 percent tax on labor costs.
- It allows 100 percent foreign ownership, which, though previously legal, was never allowed in practice.
- Investors in joint ventures get an eight-year exemption from all taxes on profits.
- Investments in real estate can be in private housing.
- It offers new control measures to evaluate, inter alia, compliance with the legal provisions in force and the conditions approved for the establishment or implementation of every business. As the main entity in charge of controlling the investments, from both the financial and implementation viewpoints, MINCEX reviews all financial statements, balance sheets and annual results, all duly certified by independent entities.
- It provides for stricter environmental controls. The individuals or corporations responsible for environmental damages will be required to re-establish the previous environmental situation, repair the damage or pay the corresponding indemnification, as appropriate.
- It recognizes the intellectual property rights and technological innovation of the foreign investor.
- All the forms of investments are officially registered by a public instrument before a notary and inscribed in the Trade Register Office. The prior inscription requirement in the Cuba Chamber of Commerce has been rescinded.

Also in This Issue:

opportunities identified by the Cuban government entities. This portfolio responds to the state's priorities. MINCEX outlined provisions regarding the format and content of the documents for both the investments and proposals to be registered in the portfolio. It also publishes and promotes the investments proposed in the portfolio, albeit without excluding the possibility that potential investors will make further proposals.

Foreign investment must adopt one of the following three forms: joint venture, international economic association contract or totally foreign capital company. The international economic association contracts cover contracts for hotel, production or service management and contracts for the provision of professional services.

Guarantees

The guarantees for investors are similar to those stipulated in the previous law. They mostly refer to the validity of the authorizations for the whole period of time granted, albeit the foreign investor's assets may be expropriated for reasons of public utility or social interest, as declared by the Council of Ministers, contingent on indemnification based on the agreed commercial value of the assets.

- Subject to authorization, the investors may sell or transfer stocks and shares in any investment or any form of contract.
- The foreign investors may transfer abroad the net profits or dividends derived from their investments, as well as the proceeds resulting from the liquidation or sale of shares, in convertible currency free from taxes, withholding or deductions.
- Foreign temporary residents who render services to a joint venture, the parties to an international economic association contract or a totally foreign capital company are entitled to transfer abroad 66 percent of their earned income.

Labor Force

The labor force needed by joint ventures and fully owned companies is selected and provided by a government employment agency, which charges a fee for such services and pays the employee's salary in Cuban pesos (CUP) while charging the investors in convertible currency (CUC). This salary is negotiated with the foreign investor on the basis of the minimum pay equivalent to the national average salary, which currently amounts to 456.00 CUP (1 CUC=25 CUP; 1 CUC=1 U.S.$).

No foreign investor can hire labor directly except for certain top management or technical positions to be held by nonpermanent residents. These positions are stated in the authorization. In these cases, the foreign investor must note the relevant labor regulations, as well as the rights and duties of the said employees, who must comply with the current immigration legislation.

The foreign investor may discharge the employees hired through the employment agency, but it is required to pay the agency the compensation amount established by the Ministry of Labor and Social Security.

An enterprise may establish, subsequent to the approval by MINCEX, an economic incentive fund, a cash incentive, for both the Cuban workers and the foreign employees who reside permanently in Cuba. Any contribution to the economic incentive fund must stem from the profits made by the enterprise.

All employees subject to international economic association contracts will be hired by the Cuban employment agency and must abide by the current Cuban legislation.

Special Taxation System

Joint ventures and national and foreign investors who are parties to an international economic association contract are subject to tax obligations and exemptions:

1) Foreign investors are exempt from payment of income taxes on net profits for business.
2) Exemption from payment of profits taxes during eight years following the establishment of the enterprise. This period may be extended by the Council of Ministers. Once the time is over, the tax shall be levied at 15 percent of the net profits. When natural resources (renewable or not) are used, the Council of Ministers may decide to raise the rate up to 50 percent. (The tax law provides for the payment of taxes for up to 35 percent of the profits.)
3) Exemption from payment of net profits taxes and other taxes authorized by the relevant authority for re-investment in the country.
4) Exemption from payment of wholesale and service taxes during the first year of operation of the investment. A 50 percent tax deduction, equivalent to two percent of the total wholesale of goods and 10 percent for services, will be levied in the following years.
5) Exemption from payment of taxes for the sales of goods and services in the case of contracts for hotel, production and service management and for the provision of professional services.
6) Exemption from payment of labor taxes. (The Tax Law provides for the payment of five to 15 percent of the total payroll.)
7) A 50 percent tax deduction during the period of return on investment for:
   - The use and exploitation of harbors. (This tax, which adds up to 0.25 USD per linear meter per day, is being levied only on the harbor of Havana.)
   - The use and exploitation of forest and wildlife resources. (The tax law provides for a scale of rates that fluctuates between 13.00 CUP and 45.50 CUP depending on the type of wood.)
   - The right to use inland waterways. (The tax rate depends on the budget law.)
   - Territorial contributions to local development, except in the cases

of contracts for hotel, production and service management and contracts for the provision of professional services. (The tax rate depends on the budget law.)

8) Exemption from paying customs taxes (tariffs) for the importation of equipment, machinery and other assets during the investment process, according to provisions established by the Ministry of Finance and Prices.

Totally foreign capital companies have an obligation to pay taxes for the duration of their contract, pursuant to the current legislation and without detriment to the fiscal benefits stipulated by the Ministry of Finance and Prices, provided it is in the interest of the country.

Resolution of Conflicts

Any conflict that may arise in the relations between partners of a joint venture, or between foreign and national investors who are party to an international economic association contract, or between partners in a totally foreign capital company established in the form of a nominal share corporation, must be resolved in accordance with the provisions stipulated in the corporate documents. The same rule applies when conflicts arise between one or more partners and the joint venture or the full foreign ownership company to which they belong.

The Cuban Court has jurisdiction over disputes arising from the following:

- Inactivity on the part of the top management of any form of foreign investment envisaged in the legislation or situations conducive to the dissolution or termination/liquidation of the investment.
- Relations between the partners to a joint venture or a totally foreign capital company or between national and foreign investors who are party to an international economic association contract who have been authorized to carry out activities involving the use of natural resources and public utilities and the execution of public works.
- Any dispute regarding the implementation of economic contracts that may arise within the context of the various forms of foreign investment envisaged in the legislation or between the said forms and Cuban legal entities or individuals.

Conclusion

Despite the initial success of the prior Law 77 of 1995 and the publicity obtained in the late 1990s, Cuba has not been able to secure foreign investment to the degree that the country needs and is capable of attracting when compared with other countries in the region and across the globe. The new Law 118 of 2014 redefines the legal framework and offers greater incentives to the foreign investors in a crucial moment where the Cuban government needs foreign investment to continue its economic growth and the foreign investors need the Cuban government to honor its pro-investment policies and promises. It is possible, therefore, to balance the rewards for both sides to ensure profitable ventures for all the players involved. However, there are still challenges such as uncertainty about the Cuban government's commitment to foreign investment, state control on the economic activities and on the operation of the enterprises and finally the inability of foreign investors to hire directly and to pay workers in convertible currency.

The Current State of Cuba's Offshore Oil Development

While Cuba produces some energy – principally heavy oil and associated natural gas – its domestic production does not meet its requirements for daily energy consumption. Once dependent on the Soviet Union for energy imports, Cuba now relies on Venezuela for oil to keep its economy afloat. According to experts, Cuba's arrangement with Venezuela is unsustainable over the long-term.

The U.S. Geological Survey estimates that offshore reserves in the North Cuba Basin could contain an additional five billion barrels of undiscovered technically recoverable crude oil. Cuba estimates its reserves in 20 billion barrels. However, all exploratory results have been a blow to Cuban hopes of finding oil. Some attempts came up dry or resulted in the discovery of a field devoid of commercial value.

Now, Cuba is asking for Russia's help with the support of President Putin. Russian companies Rosneft and Zarubezhneft signed an energy agreement with Cuba in May 2014 to explore offshore oil deposits. The drilling area north of Havana straddles the Gulf Stream, a powerful ocean current that rushes north to the Florida coast. Oceanographers warn that an oil slick caused by a major spill could reach Florida's beaches, reefs and marine sanctuaries in about a week.

Former U.S. Senator Bob Graham, who also served two terms as governor of Florida and co-chaired a presidential commission on the 2010 Deepwater Horizon oil spill in the Gulf of Mexico, met with Cuban officials in January 2014. Senator Graham and energy experts said the Russians have little experience with deep-water drilling and that the U.S. embargo of Cuba prohibits the use of American technology to prevent or respond to a spill.

A State Department spokesperson said U.S. officials "have expressed our concerns" to Cuba and its partners, but the United States can do nothing to stop drilling in Cuban waters. While

the embargo limits the use of American products, U.S. companies have been licensed to respond in case of a spill.

U.S. Embargo – Cuba Drilling

The embargo against Cuba denies access to Cuba of U.S. equipment for drilling and environmental protection. Exports and re-exports to Cuba of foreign made items incorporating, commingled with or drawn from controlled U.S. origin items exceeding 10 percent of U.S. components and technology – the so-called De Minimis Rule under Sections 734.4 and 736.2(b)(2) of Export Administration Regulations (EARs) – are prohibited by the Embargo.

Several experts have said that the only country that produces the necessary equipment is the United States. Therefore, Cuba would not have access to U.S. equipment unless the embargo is lifted or altered. At the very least, coordination between Cuba and the United States would be necessary to prevent any potential oil spill.

Members of Congress have presented several proposals to deny oil and gas leases and permits "to persons who engage in activities with the government of any foreign country that is subject to any sanction or an embargo" by the U.S. government.

Conclusion

A "safe" and "monitored" approach to Cuba's oil offshore development is in the national interest of the United States, which should work together with Cuba and use multilateral agreements with Mexico to facilitate oil exploration in the Gulf of Mexico.

President's Authority Under Federal Statutes and the Cuban Assets Control Regulations

Hillary Clinton's Petition To Lift the Embargo

In her new book, former Secretary of State Hillary Rodham Clinton says she pushed President Barack Obama to lift or ease the decades-long U.S. embargo on Cuba because it was no longer useful to American interests or promoting change on the communist island.

"Since 1960, the United States had maintained an embargo against the island in hopes of squeezing Castro from power, but it only succeeded in giving him a foil to blame for Cuba's economic woes," she writes. She says her husband, former President Bill Clinton, tried to improve relations with Cuba in the 1990s, but the Castro government did not respond to the easing in some sanctions. Nonetheless, President Obama was determined to continue the effort, she writes.

"The steps that Obama took, including allowing more travel to the island and increasing the amount of money Cuban-Americans can send back to the island, have had a positive effect," she writes.

Presidential Authority

The President has certain legal authority to lift the embargo under the Trading With the Enemy Act (TWEA) and the Foreign Assistance Act (FAA). Under those statutes, the President could lift the embargo unilaterally, at any time and without any preconditions, and would not be required to consult Congress to do so. However, under the Cuban Democracy Act and the Helms-Burton Act, the President has to confirm that a "transition" government is in power in Cuba and the Cuban government has taken appropriate steps under international law standards to provide restitution or compensation to U.S. citizens whose property was confiscated by the Castro government. In addition to relaxing the embargo, the existing prohibitions against U.S. economic aid to Cuba would then be dropped.

Furthermore, the Helms-Burton Act directs the President to take steps to bring a democratic Cuba within the coverage of some U.S.-sponsored economic aid programs. The reach of that legislation, however, is incomplete and in some areas obsolete, and needs to be supplemented by specific legislation that covers the various aid programs in effect at the time the embargo is lifted, so that U.S. government agencies will be prepared to take expeditious action to admit Cuba into the programs.

Meanwhile, President Obama maintains broad authority and discretion to significantly ease specific provisions of the Cuba sanctions regime in support of particular U.S. foreign policy objectives recognized by Congress and supported by the Cuban-American community. The latest Cuba Poll, conducted by Florida International University's Cuba Research Center, indicates a majority, 52 percent, of all respondents oppose continuing the embargo. The poll also found:

- 58 percent support alternatives to the embargo in exchange for other policies that continue to exert pressure on the Cuban government for change;
- 68 percent favor diplomatic relations;
- 69 percent support lifting travel restrictions so that Americans can travel to Cuba; and
- 71 percent expressed support for continuing "people-to-people" travel and the contact that it makes possible, sending a high approval to President Obama's policies to Cuba.

President Obama could also take the following initiatives to further ease the embargo without further action by Congress using his licensing power granted by federal statutes and established by the Cuban Assets Control Regulations:

- Establishing "general licenses" for existing categories of travel to Cuba that are currently authorized only by specific licenses.
- Expanding non-family remittances to Cuba.
- Permitting microcredit programs to farmers and entrepreneurs through private companies and NGOs.
- Permitting family financing and investing in family-owned small and midsize companies, cooperatives and family residences in Cuba, but subject to the statutory conditions regarding "trafficking with confiscated property."
- Permitting payment for authorized transactions with Cuba (except sales of agricultural commodities or products) to be financed through letters of credit or other financing arrangements issued, confirmed or advised by U.S. financial institutions (but subject to statutory restrictions on the extension of credit for transactions involving "confiscated property").
- Creating a federal commission integrated by the Treasury and State Departments with the assistance of the Federal Claims Settlement Commission (FCSC) to negotiate with the Cuban government a settlement of the U.S. certified claims against the Republic of Cuba.
- Authorizing imports from Cuba of certain goods and services produced by private and non-state enterprises.
- Expanding the availability of existing license exceptions to cover additional categories of exports and easing conditions and limitations on the use of those exceptions.
- Increasing the frequency and dollar amount of gift parcels and family remittances.
- Granting general licenses to ferries and vessels to transport "licensed" passengers and for entry of vessels engaged in trade with Cuba.
- Authorizing travelers to use credit cards while in Cuba.
- Permitting Cuba's participation in the International Monetary Fund (IMF), World Bank and Inter-American Bank.

The President should also establish an advisory group to help identify the problems that will be posed by Cuba's transition to a free-market democratic society, develop a unified strategy to assist Cuba in resolving those problems, and draft the necessary implementing laws and regulations. Those interested in a smooth transition process should be represented and heavily involved in these efforts.

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For more information, please contact Raul J. Valdes-Fauli at 305.442.6542 or rvaldes-fauli@foxrothschild.com.