CUBA: ASSESSMENT OF THE NEW TAX LAW OF 2012

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As part of the reforms being carried out by the administration of President Raúl Castro, a new tax law, Law 113, was approved by the National Assembly in 2012, which became effective on January 1, 2013. The new law replaces the previous tax law, Law 73 of 1994.

Cuban tax policy is not a new topic at ASCE conferences. Gallagher proposed an agenda for tax reform for Cuba in 1999 as part of its economic transition to a modern economy. Costales, in commenting on Gallagher's paper, endorsed his tax reform proposals and proposed a set of simplifying principles to carry out tax reform in an economy in transition as well as proposing some additional taxes.[2] The author wrote in 2000 about the fiscal reforms in transition economies and the implications for Cuba.[3] Sánchez discussed taxation levels in Cuba in 2003.[4] Ritter has also written on the Cuban tax system in his excellent blog *The Cuban Economy*.[5] Many of the observations made in these contributions remain relevant today and this paper draws on them and on the recent tax policy literature to make an assessment of the new tax law.

The paper is organized as follows. The first section has a description of tax Law 73 of 1994 and compares the tax revenue generated during 2008–2012 in Cuba to those in Latin American and OECD countries. The second section describes the new tax regime proclaimed by Law 113 and the third evaluates Cuba's tax policy and individual taxes. The paper ends with concluding remarks.

RESULTS OF THE TAX LAW 73 OF 1994

Law 73 of 1994 included a corporate income tax and introduced a personal income tax, a social security contribution, and a tax on the utilization of the labor force. Law 73 also introduced a sales tax to replace the existing turnover tax. It maintained the existing excise taxes on tobacco and beverages, the services tax (imposed mostly on electricity supply and on state restaurants), and other taxes and duties (import duties, tolls imposed mainly on airport use by tourists, and document taxes).

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1. The paper has benefitted from comments and suggestions from Roger Betancourt, George Kopits, Emil Sunley, and Teresa Ter-Minassian.

2. Mark Gallagher, "Some Ideas for Taxation during Cuba's Transition" and René Costales, "Comments on Some Ideas for Taxation during Cuba's Transition," both in *Cuba in Transition—Volume 9* (Washington: Association for the Study of the Cuban Economy, 1999).

3. Lorenzo Pérez, "Fiscal Reforms in Transition Economies: Implications for Cuba," *Cuba in Transition—Volume 10* (Washington: Association for the Study of the Cuban Economy, 2000).

4. Nicolás Sánchez, "Taxation Levels in Cuba—And Other Topics of Rhetorical Interest," *Cuba in Transition—Volume 13* (Washington: Association for the Study of the Cuban Economy, 2003).

5. For example, see Ritter, "Micro-enterprise Tax Reform, 2010: The Right Direction but Still Onerous and Stultifying," *The Cuban Economy*, January 10, 2011.

Table 1 shows total tax revenue as a percentage of GDP for the 2008–2012 period. The table shows that Cuba has the highest tax burden in Latin America (the tax ratio for Cuba, at almost 41% of GDP, is twice the average tax ratio for Latin America in 2012) and also consistently higher than the average for OECD countries. Only Argentina and Brazil have tax ratios close to those of Cuba. This is not surprising given the size of the state in Cuba. A more relevant comparison to Cuba's tax burden could be the tax burden of Central and Eastern European countries at the time of the beginning of their transition from a centrally planned economy to a more market oriented system; in 1989, the average of tax revenue as a percent of GDP of Hungary, Poland, Bulgaria, and Romania was 47% of GDP, slightly higher than Cuba's.[6]

Table 1. Tax Revenues as Percentage of GDP

	2008	2009	2010	2011	2012
Argentina	30.8	31.5	33.5	34.7	37.3
Bolivia	20.5	22.7	20.7	24.2	26.0
Brasil	34.0	32.6	33.2	34.9	36.3
Chile	21.4	17.2	19.5	21.2	20.8
Colombia	18.8	18.6	18.0	18.8	19.6
Costa Rica	22.4	20.8	20.5	21.0	21.0
Dominican Republic	15.0	13.1	12.8	12.9	13.5
Ecuador	14.0	14.9	16.8	17.9	20.2
El Salvador	15.1	14.4	14.8	14.8	15.7
Guatemala	12.9	12.2	12.3	12.6	12.3
Honduras	18.9	17.1	17.3	16.9	17.5
Mexico	20.9	17.4	18.9	19.7	19.6
Nicaragua	17.3	17.4	18.3	19.1	19.5
Panama	16.9	17.4	18.1	18.1	18.5
Paraguay	14.6	16.1	16.5	17.0	17.6
Peru	18.2	16.3	17.4	17.8	18.1
Uruguay	26.1	27.1	27.0	27.3	26.3
Venezuela	14.1	14.3	11.4	12.9	13.7
Cuba	41.7	41.1	37.6	38.4	40.9
Unweighted average:					
Latin America, excluding Cuba	19.5	18.9	19.3	20.1	20.7
OECD[a]	34.5	33.6	33.8	34.1	…

Source: OECD and the Office of National Statistics of Cuba.

a. Includes Chile and Mexico

The statistics for Cuba originate from the National Statistical Office—both the tax and the GDP statistics—while the information for the other countries is from the OECD or from Kopit's paper. It should be mentioned that the GDP figures for Cuba have to be used with caution because: (1) the GDP methodology Cuba uses does not strictly follow international practice, which may inflate the value of GDP in domestic currency; and (2) the use of arbitrary exchange rates to convert export earnings to Cuban pesos, which may underestimate both export earnings and nominal GDP in pesos. Cuba's tax revenues presented in Table 1 are also probably seriously underestimated because non-tax revenues, as classified in national statistics, are considerable in Cuba. Most of these revenues are the share of salaries of Cuban doctors and other professional working abroad under umbrella agreements with recipient governments such as the one with Venezuela. The portion of the salaries appropriated by the Cuban government is considerable and the "taking" of the salaries should be classified as personal income tax receipts. Non-tax revenues have declined somewhat as a share of GDP, but still amounted to about 18.5% of GDP in 2011–2012. Even if one assumes that only half of these revenues are personal income taxes, the tax ratio in Cuba rises to about 50% of GDP.

A sense of how Cuba's tax structure compares to Latin American countries and to the average of OECD countries can be seen in Table 2. The most important taxes for Cuba, in terms of shares of total taxes, are taxes on goods and services—almost 56% in 2012. This is close to the average of Latin American countries in 2012—51%, but considerably higher than in OECD countries, 33%. The shares of taxes on income and profits, social security contributions, and property (this last one nonexistent in Cuba before 2013) in 2012 are smaller than the average in Latin America and in OECD countries. For example, the share of taxes on income and profits in total taxes in OECD countries (at 34%) are twice as high as the

6. George Kopits, "Monetary and Fiscal Policy from Transition to EU Integration: A Comparative Assessment," Table 1, in Byung-Yeon Kim and Cheng Hoon Lim, eds. *Financial Sector Reforms in Transition Economies: Implications for North Korea* (Seoul: Seoul National University, 2009).

Table 2. Tax Revenue as a Percentage of Total Revenue: 2012

	Income & Profits	Social Security	Payroll	Property	Goods & Services	Other
Argentina	17.3	22.2	—	9.0	50.4	1.0
Bolivia	15.6	5.9	—	7.4	65.5	5.6
Brasil	21.7	25.2	2.4	6.0	44.1	0.7
Chile	39.7	5.2	—	4.2	50.7	0.2
Colombia	33.5	12.4	—	10.4	38.6	5.1
Costa Rica	18.7	29.7	4.3	1.7	44.6	0.9
Dominican Republic	24.5	0.4	5.1	6.0	64.0	0.0
Ecuador	19.5	27.9	—	—	51.9	0.7
El Salvador	31.8	10.8	—	0.5	56.9	—
Guatemala	27.8	12.5	—	1.2	56.8	1.8
Honduras	27.6	17.2	—	0.5	54.6	0.0
Mexico	27.3	14.5	1.5	1.5	54.1	1.1
Nicaragua	27.7	22.9	—	—	49.4	0.0
Panama	29.6	32.4	1.1	3.9	30.9	2.2
Paraguay	15.8	24.5	—	—	59.0	0.6
Peru	42.8	10.2	0.0	2.0	42.4	2.8
Uruguay	21.9	27.3	—	4.9	46.0	0.0
Venezuela	31.6	3.1	—	0.2	63.3	1.8
Cuba	15.6	10.5	14.1	—	55.8	3.9
Unweighted averages:						
Latin America except Cuba	26.4	16.9	0.8	3.3	51.3	1.4
OECD[a]	33.5	26.2	1.1	5.4	32.9	1.0

OECD and Cuba's Office of National Statistics

a. Includes Chile and Mexico

share of these taxes in Cuba (not adjusting the share of income and profit taxes in Cuba for some amount of Cuba's non-tax revenue as suggested above). Cuba makes up from the small share of taxes on income with the share contributed by the payroll tax, which at 14% is incredibly high compared to the share of about 1% in Latin America and the OECD countries. In fact, only five other Latin America countries taxed the wage bill in 2012, with the highest rate being in the Dominican Republic—5%. [7]

TAXES IMPOSED BY LAW 113 OF 2012

Law 113 of 2012 contains 19 taxes, three contributions and three tolls. The taxes include: a personal income tax, a corporate profit tax, a sales tax, and taxes on services, property, transportation, inheritances, and on the use of labor, as well as environmental taxes and import duties. The contributions include: two for social security and one to raise resources for local development. There are tolls on airport use and on outdoor advertisement signs and commercial advertisements. As discussed later, the 2014 Foreign Investment Law exempts some foreign investments of certain taxes.

The Cuban tax system has its own peculiarities. Garcimartin, Pérez, and Pons note the control of economic activity by state corporations and the continuation of a centralized planning system in Cuba. The planning system regulates the amount of production, the available resources, the sales prices, and how the state enterprises interact which each other. These decisions determine, to a large extent, the level of sales and profits and hence the level of tax collections. [8]

7. If one were to classify Cuba's payroll tax receipts as part of personal income tax receipts, then the difference between Cuba's and the Latin America average would not be that large. However, the payroll tax in Cuba is not a mechanism to collect personal income tax. It is paid by the employers as a tax on employment and the salaried employees are currently exempted from paying the personal income tax.

8. Carlos Garcimartin, Omar Everleny Pérez, and Saira Pons, "Reforma Tributaria y Emprendimiento," in José Antonio Alonso and Pavel Vidal (eds.), *¿Quo Vadis, Cuba? La Incierta Senda de las Reformas* (Madrid: Los Libros de la Catarata, 2013), p. 164.

Direct Taxes: The Personal Income Tax and the Corporate Profit Tax

Law 113 calls for the personal income tax to be imposed on earnings of natural persons, including salaries, earnings of the self-employed, rental income, revenue from the sales of goods and real estate, and dividends. Remittances from abroad and pensions are exempted. The statutory marginal tax rates are very progressive and more so than they were in Law 73 (15% for incomes up to CUP 10,000 per year and rising for every additional earnings of CUP 10,000 up to 50% for earnings above CUP 50,000 per year).[9] The top marginal income tax rate is considerably higher than the average in Latin America of 27%.[10] Earnings of Cuban citizens and of foreigners who do not reside permanently in Cuba are subject only to a 15% personal income tax on their earnings in Cuba, and earnings of Cuban residents from labor contracts outside Cuba and of foreigners with permanent residency in Cuba are subject to a personal income tax of 4%. There is a minimum exemption of CUP 10,500 for the personal income tax. Self-employed workers are entitled to certain deductions in their income tax declarations (such as the minimum exemption of the law, rent payments of real estate and equipment made to state-owned companies, other taxes paid in the conduct of their businesses such as sales and services taxes, etc.). However, instead of allowing the self-employed to declare the cost of their inputs, the maximum amount deducted seems to have been set arbitrarily at between 10% and 40% of gross revenue, depending on the activity.[11]

A simplified tax regime was established for self-employed who carried out less complex economic activities, as determined by the Minister of Finance. The self-employed that pay taxes under this regime have to make monthly payments of sales and services taxes and of their personal income tax. These payments are equivalent to a license fee for the operation of the self-employed.[12] A list of self-employed activities that require the monthly payments has been issued in Resolution 21/2013; it is not clear how the required monthly amounts of payments were determined and how much of a burden they constitute. The highest monthly amount is for restaurants (*paladares*), set at CUP 700 or CUC 28.

For the time being, the personal income tax on salaries will not be levied given the extremely low salaries the State pays to most employees. Farmers who are renting land from the State are exempted from the payment of the personal income tax for two years from the time the land was occupied. The exemption is for four years for farmers who occupy land that needs to be cleared from undesirable vegetation (e.g., *marabú*). For purposes of this tax, once their exemptions expire, farmers will pay a minimum of 5% of their sales and an additional payment at the end of the year. The Cooperativas de Producción Agrícola (CPAs) and Unidades Básicas de Producción Cooperativa (UBPCs) will also pay a minimum of 5% of their revenues.

For workers of the Zona Especial de Desarrollo Mariel (ZEDM), Resolution No. 139 of 2014 of the Ministry of Finance and Prices established an income tax rate of 5%. However, Resolution 14 of the Ministry of Labor and Social Security established that these workers will be paid in CUPs at the rate of CUP 10=US$1. In addition, official statements have indicated that the workers will be paid 80% of the dollar salaries negotiated between the State Employment Agency and the foreign companies operating at ZEDM. In effect, the State Employment Agencies charge a permanent commission to the ZEDM em-

9. If one uses the CUP/CUC exchange rate called by the law (24:1) and used in the government's exchange houses, this means that the equivalent of annual earnings of slightly more than US$2,000 would be subject to a marginal tax rate of 50%. It should be mentioned, however, that Acuerdo Número VII of September 21 of 2012 of the Asamblea Nacional claims that the new tax law diminishes the marginal tax rates (between 3% and 7%) for the first three brackets for the self-employed. But the information available to the author on the 1994 law does not bear that the marginal tax rates of Law 113 are lower than those of the 1994 law.

10. Garcimartin, Pérez and Pons, op.cit., p. 156.

11. Information provided by Ritter, *The Cuban Economy* blog (April 17, 2014).

12. Resolution No. 21/2013 of the Ministry of Finance and Prices, January 29, 2013.

ployees. The author's understanding of these complex regulations can be best illustrated with an example: Say the salary paid in US$ by the foreign company for a Cuban worker is US$ 1,000; $800 accrue to the worker except that the State takes off a huge part of the salary by using the 10 to 1 exchange rate to convert the dollar salary to pesos—CUP 8,000 which is equivalent to US$333 at the 24 to 1 rate. After the 5% tax, the worker is left with the equivalent of US$317, so that the deduction from the salary is equivalent to 68%, probably one of the highest personal income tax rates in the world.

Profits of juridical entities (corporations), Cuban and foreign, are subject to a profit tax.[13] These are mainly state-owned corporations that control most of the economic activity in the island. All profits are subject to the tax irrespective of where the profits are generated. The profit tax rate can be up to 35%.[14] The marginal tax rate can be raised to 50% if the economic activity involves the exploitation of a natural resource. Foreign companies which derive profits in Cuba without having a permanent establishment are subject only to a 4% rate.[15] This tax is probably collected on gross income as a withholding tax for services.

There are some special regimes for profit taxes for the mining sector (e.g., accelerated depreciation and deductions of exploration costs accepted by the Cuban authorities from their profits for purposes of the income tax), the agricultural sector, and for non-agricultural cooperatives (slightly lower marginal tax rates). In addition, the new Foreign Investment Law of 2014, Article 35, exempts from the personal income tax the earnings of foreigners who are partners in mixed enterprises or part of contracts of international economic associations in Cuba. The corporate profit tax was set at 15% for foreign investors, but it has been waived for 8 years, a period that can be extended. Moreover, the profit tax can be waived if the earnings are reinvested in Cuba and have been endorsed by the appropriate Cuban regulatory agency. In contrast, in the case of exploitation of natural resources, the marginal tax rate may be raised to 50%.

Indirect Taxes: Sales Tax and Special Taxes on Certain Products and Services

The sales tax proclaimed by Law 113 applies at the wholesale and retail level on the sales of goods for consumption or resale, imported or domestically-produced, and whether they are priced in CUPs or CUCs. A 2% tax is applied on wholesale transactions and a 10% tax on retail sales. For transactions in CUCs, they are converted to CUPs at the prevailing exchange rate at the moment the tax is calculated and collected in CUPs.

Article 140 of the Law establishes a special tax for the following products and services: alcoholic beverages (wines, liquors and beers); cigarettes and cigars; hydrocarbons; luxury items; electricity; and other products to be identified by the annual budget laws. For products which are commercialized at the wholesale level, the tax is a specific tax and for products and services sold at the retail level, it is an ad valorem rate. The author has not been able to find information on what are the current tax rates, which apparently are to be specified in the annual budget laws. Information is not provided regarding the rates in Law 113 or in its related regulations.

Article 146 establishes a 10% ad valorem tax on telephone services, communications, transmission of electricity, water, gas, sewage, transportation, restaurants, lodging, recreational activities, and other unspecified services. It is not clear whether in the case of electricity this tax is an additional one to the special tax on electricity.

13. Cuban corporations are mostly state-owned. In the past, there have been private *sociedades anónimas* which, according to ECLA, accounted by about one-third of the payments of corporate income tax in 1998 (Pérez 2000) but currently the government does not allow the creation of new *sociedades anónimas* and it is not clear how many of the old ones still exist.

14. The author has not been able to find an income tax table for corporations.

15. For a discussion of incentives given to foreign investors of the ZEDM, see Jorge Pérez-López, "Investment Incentives of the ZED Mariel: Will Foreign Investors Take the Bait?," in this volume of *Cuba in Transition*.

Property and Agricultural Land Taxes, Tax on Property Exchange and Inheritances, Document Tax, Taxes on Labor Utilization

Property taxes and on certain goods were created that are payable at the time of the acquisition of the property or goods. In addition, a 2% tax on dwellings and empty lots was introduced by Law 113. Proprietors who built dwellings themselves (without state support) are exempted for 5 years from the payment of this tax from the time the law goes into effect. A tax on agricultural land is also introduced with a specific tax per hectare depending on the category of the land. In the case the agricultural lands that are idle (not being utilized), there is an additional specific tax per hectare also depending on the category of the land (it is not clear whether this is an additional tax or a different one).

A tax on vehicles or means of transport pulled by animals has been established, with the actual rates set out in Annex II of the law depending on whether the means of transport are used to transport passengers or freight. Also the tax rates depend on the purpose of use, e.g., humanitarian, as in the case of ambulances. It is a fairly long list and the taxes are collected in CUPs, with the highest monthly charge being CUP 90. A tax on boats is also established by this law. The tax rates vary depending on whether the navigation is done at sea or in rivers. There are 14 possible categories.

A tax on exchanges of properties and on inheritances are introduced by the law. A 4% tax was introduced on the exchange of goods and real estate as well as when houses are bartered (*permutas*). Goods and property acquired in a divorce are taxed 1% of the value. The inheritance tax has a very low threshold level and the tax rates depend on who is inheriting and the value of the inheritance (e.g., for spouses or children of the deceased, the tax rate is 7% up CUP 50,000, and 25% for inheritances exceeding CUP 1,000,000; for other persons inheriting property, the rates could be as high as 65% for amounts exceeding CUP 1,000,000).

A tax schedule for the issuance of public documents for certifications, transactions and licenses is established in Annex 4 of the Law. Documents are validated with a stamp once the taxes are paid, and they are invalid without such stamp. Documents for the use of government entities are exempted. Documents requiring stamps range from civil transactions (marriages, birth certificates, driver licenses, registries of properties) to possession of weapons and commercial transactions. The stamp taxes are low, generally CUP 20 or less.

The tax on labor utilization is imposed as a percentage of the wage bill. In principle, domestic and foreign natural persons as well as corporations have to pay this tax. Diplomatic and international organizations are exempted from the tax and the 2014 Foreign Investment Law also exempts foreign investors from it. The base of the tax includes salaries and additional payments for special work conditions. The tax rate was set at 20% in 2013 and it is scheduled to decline five percentage points during the following four years to 5% by 2017. The tax is paid in the same currency that the wages are paid. There is a complex formula for determining the tax base. First, the law does not apply for the hiring of up to 5 workers. For the sixth to the tenth worker, it is considered that the salaries are the sum of the average salary of the province plus 50%. For the eleven to the fifteenth worker, the base is the equivalent of two average salaries of the province, and from the sixteenth worker on, the base is three average salaries of the province. It is not clear what happens for purposes of this tax if the enterprise can present different actual wage data.

Taxes on the Use and Exploitation of Natural Resources and on the Protection of the Environment

Taxes on the use and exploitation of natural resources and on the protection of the environment are innovations of Law 113. A tax on hotels, marinas, lodging, restaurants, and on the sales of goods and services are imposed on the beaches of Cayo Largo del Sur, Playas del Este of La Habana, Varadero, Cayo Las Brujas, Cayo Ensenachos, Cayo Santa María, Cayo Coco, Cayo Guillermo, and on the Región Turística de Holguín. The tax rates are supposed to be set in the annual state budgets taking into account tourist activities and the required investments to preserve and rehabilitate beaches. A tax on residue disposal is introduced to discourage these activities. At the beginning it will only apply to disposal activities that affect the bay of La Habana. The Ministry of Science, Technology and Environment working with the National Institute of Water Resources will issue certificates determining the amount of residues that might be disposed into the bay of La Habana and the taxes will reflect the seriousness of the problem presented by these activities. However, the law does not give any information on the potential levels of these taxes.

The tax on the use of bays is initially introduced for the bays of La Habana, Mariel, Matanzas, Cienfuegos and Santiago de Cuba. Specific taxes are set in Annex V of the Law, depending on the type of activities (e.g., transport of freight or passengers), on the wharfs, on ships (depending on horse power), and rights of ways that persons or enterprises may have in the bays. Taxes are lower for state enterprises than for private companies.

A tax on the exploitation of forestry resources and wildlife was also introduced by the Law. A tax is imposed on the production of wood products and non-wood products (e.g., resins, seeds) and on commercial hunting of wildlife. The activities of the Armed Forces are excluded from the tax. The base of the tax is the amount of wood produced or the number of hectares used for hunting. The specific taxes vary depending on the type of wood being exploited and where the hunt is carried out. The charges appear to be symbolic. A tax is imposed on the use of water captured through channels or other means for productive purposes or with the intention of providing a service. The tax rates are to be based on the volume of water captured and are to be stipulated in the annual budget laws. No information is provided in Law 113 on the level of the taxes.

Customs Duties

Law 113 notes that merchandise imported to Cuba by natural or juridical persons, Cuban or foreign, is subject to import duties. The Law does not establish the level of import duties which are set by the General Customs Department.

Social Security Contributions and Territorial Contributions for Local Development

Employers (natural or juridical) who have the legal authorization to hire employees who are subject to the general Social Security system make a contribution to this system based on a percentage of the value of remuneration to employees. Employees also pay a social security contribution. The contribution rates are to be determined in the annual budget laws of the State. As of 2010 (the most recent information available to the author), the combined employer-employee contributions were the equivalent of 25% of payroll, compared with a 5% contribution established by Law 73 of 1994. Under the new legislation, the self-employed are supposed to contribute 25% of a self-assessed monthly income ranging from CUP 350 to CUP 2,000 which will affect the subsequent level of pension benefits after they retire. Self-employed workers between 50–54 years old (women) and 55–59 years old (men) can only select a base pension of CUP 350 or CUP 500.

A contribution to support the sustainable development of municipalities is assessed on the revenues received by enterprises and cooperatives from the sales of goods or provision of services. The enterprises which already making a contribution for the restoration and preservation of localities identified as priorities for conservation do not have to make this contribution to promote sustainable development. The contribution rates are also to be defined by the annual budgets.

Road Tolls, Airport Tolls, and Tolls on Road Advertisements and Commercial Propaganda

Road tolls were established by Law 113 for the road Caibarién-Cayo Santa María, for the Cayo Coco road, and for the Matanzas-Varadero highway. The roads subject to will be revised annually by the Ministries of Transportation and Finance and Prices. State vehicles, funeral cars, ambulances, and fire trucks are exempted from paying the road tolls. In addition, vehicles involved in construction work are excluded. The maximum toll is CUP 3 for more than 50 kilometers for motorcycles, automobiles and station wagons, vans and trucks. Foreigners have to pay the tolls in CUCs.

An airport toll of CUC 25 was introduced for foreigners in arriving and departing international flights. Certain persons are allowed to make the payments in CUPs. The tolls on road advertisement are based on the size of the advertisement and on its location (rural, urban, tourist areas, etc.) The tolls range from CUP 15 to CUP 50 per square meter, depending on the locations where advertisements are displayed.

CUBA'S TAX POLICY UNDER LAW 113

Cuba's tax policy has not changed much with the adoption of Law 113. The same direct and indirect taxes are maintained but three types of new taxes—which are a good complement to the Cuban tax system—have been added, namely: environmental taxes, property taxes, and inheritance taxes. No information is yet available on tax revenues in 2013, but there is no reason to believe that the tax burden has changed very much because of the new Law. As noted earlier, the statutory tax burden in Cuba is very high and the tax regime is regressive[16] from an international and from a Latin American perspective given the relatively low share of income and profit taxes in total tax revenue.[17] In communist economies like Cuba, in assessing the net incidence of government policies on welfare, attention has to be given to spending policies in addition to tax policies because many government services are provided free of charge to the population. In Cuba, for many decades, education and health services have been provided free and a basket of consumer goods have been made available to consumers at subsidized prices. However, the quality and quantity of education and health services and the amount of consumer goods made available at subsidized prices have been declining steadily in recent years, suggesting that spending policies do not offset as much as in the past the regressive impact of Cuba's tax policy.[18]

In addition to its regressive nature, the effect of tax policy on incentives is negative. The high statutory tax rates of the personal income tax is not conducive to the promotion of private sector activities, which allegedly the government is trying to foster. It is true that many of the self-employed are subject to the simplified tax regime under which they make monthly payments set by the government. It is not possible to know, however, whether these monthly payments have been set at reasonable levels or whether they will prove to be too high. All in all, the risk is that private sector activities will be conducted in an underground environment because of the high tax rates, something that is not conducive to the growth of enterprises necessary for the attainment of economies of scale, investments in new technologies, or training of employees because of the fear of being closed down by the government at any time. Moreover, in discussing the effect on incentives of the Cuban tax system, the impact of the tax on labor utilization needs to be highlighted. Such a tax is a very strong disincentive to the creation of jobs in the private sector. and the Cuban government recognized the problem created by this tax by establishing, under Law 113, a program to reduce the rate of this tax from 20% of the wage bill in 2013 to 5% of the wage bill by 2017. But this is an absurd tax and it should be totally eliminated much more quickly to encourage the private sector to create more jobs.

The following paragraphs discuss some on the individual taxes of Law 113 and make suggestions to improve their efficiency and fairness.

16. Roger Betancourt has noted orally to the author that if a large share of indirect taxes on goods and services are paid by tourists, the argument that the Cuban tax system is regressive would be weakened. Unfortunately, the author does not have the necessary information to investigate this issue.

17. One can make this argument even if one takes into account of the confiscatory income taxes imposed on the professionals working abroad because these confiscatory taxes are imposed on a very small segment of the labor force.

18. There is anecdotal information that the quality of elementary and high school education has declined. The health sector is a good example of the decline in the quality and the availability of free services to the population. The lack of supplies and medicines and the shortages of doctors (because of the number of physicians working abroad) have drastically reduced the quality and quantity of medical services available to the Cuban population.

Table 3. Main Taxes as a Percentage of GDP

	Income &s profits	Social Security	Payroll	Property	Goods & Services	Other
Argentina	6.5	8.3	0	3.3	18.8	0.4
Bolivia	4	1.5	0	1.9	17	1.5
Brasil	7.6	8.8	0.8	2.1	15.4	0.2
Chile	8.3	1.1	0	0.9	10.6	0
Colombia	6.6	2.4	0	2	7.6	1
Costa Rica	3.9	6.2	0.9	0.4	9.4	0.2
Dominican Republic	3.3	0.1	0.7	0.8	8.6	0
Ecuador	3.9	5.7	0	0	10.5	0.1
El Salvador	5	1.7	0	0.1	8.9	0
Guatemala	3.4	1.5	0	0.1	7	0.2
Honduras	4.8	3	0	0.1	9.6	0
Mexico	5.4	2.9	0.3	0.3	10.7	0.2
Nicaragua	5.4	4.4	0	0	9.6	0
Panama	5.5	6	0.2	0.7	5.7	0.4
Paraguay	2.7	4.1	0	n.a.	9.9	0.1
Peru	7.7	1.8	0	0.4	7.7	0.5
Uruguay	5.7	7.2	0	1.3	12.1	0
Venezuela	4.3	0.4	0	0	8.7	0.2
Cuba	6.4	4.3	5.8	0	22.8	1.6
Unweighted averages:						
Latin America	5.2	3.9	0.2	0.8	10.4	0.3
OECD	11.4	9.1	0.4	1.8	11	0.4

OECD statistics and Office of National Statistics of Cuba.

Personal Income Tax

The personal income tax should be one of the pillars of a modern tax system, but as contemplated in Law 113, this tax does not play such a role in Cuba. Data for Cuba prior to 2013 showed that in terms of GDP, tax revenues for the personal income tax and corporate income tax, although similar to the levels in Latin America, was about half of the average level for OECD countries (Table 3). In Latin America, income tax collections have been limited by the fact that a large share of the population has been excluded from the income tax (tax payers who make less than 1.4 times the average income per capita are excluded, and only those who have 6.5 times the average income per capita are subject to the maximum tax rate); the number of deductions; favorable treatment to capital income which are practically excluded in many countries; and tax evasion.[19] In the case of Cuba, notwithstanding the high marginal tax rates of the personal income tax, relatively little revenue has been raised by this tax. Law 113 has exempted the salaried workers for the time being and a simplified tax regime has been introduced for the self-employed.

In Cuba's circumstances, one way to make the personal income tax play a more important and useful role would be to have a zero rate income threshold high enough so that a significant amount of people are exempted, thus facilitating the actual introduction of such a tax in Cuba (salaried employees would start being subject to the tax). Right now, a person earning as little as the equivalent of under US$500 a year would be subject to a 15% tax on income in excess of exemptions. Fewer rates and few exemptions would also simplify the system and facilitate tax administration.[20] The number of tax rates could be reduced to two or three—from the current five rates—limiting the highest rate to a more reasonable level, like 25%. The tax base for the self-employed should be net revenue, with the actual input costs deducted

19. Ana Corbacho,Vicente Fretes Cibils and Eduardo Lora (editors), *Recaudar no basta: Los impuestos como instrumento de desarrollo* (Washington: Banco Interamericano de Desarrollo, 2012).

20. These recommendations follow suggestions by Gallagher (op.cit) and Corbacho el al. (op.cit).

to arrive at a realistic taxable income base. [21] Micro-management of the tax rates through the use of special exchange rates for labor income in certain locations (such as in Mariel economic zone) is unfair and complicates tax administration. Capital income of persons (which could grow over time) should be taxed as a single rate to facilitate retention schemes, reduce tax evasion and reduce the possibilities of fiscal arbitrage.[22] All in all, more moderate income tax rates with a wider tax base would produce more revenue and be a more equitable and efficient system, while at the same time simplifying tax administration.

Corporate Income Tax

It is appropriate for Cuba to have a corporate income tax as a means of taxing the profits of foreign investors given that tax laws of some countries—like those of the United States—treat overseas investment in a "tax neutral "manner (that is, corporations are credited the income tax payments made abroad in settling their income tax obligations at home) and not taxing profits would be a windfall to foreign governments.[23] This tax would also become more important as, hopefully, Cuba allows private corporations. Cuba has established, however, a complex corporate income tax system with generous tax incentives for foreign investors. Consideration should be given to making the system simpler with one corporate tax rate which should not exceed the top marginal tax on personal income and the avoidance of generous incentives to some sectors.[24]

Sales Taxes

Sales taxes raise more than half of Cuba's total tax revenues. Law 113 applies sales taxes at the wholesale and retail levels, which is an improvement over the old turnover taxes that had larger negative cascading effects. However, the medium term policy aim ought to be to move to a value added tax (VAT), which is a more neutral tax in terms of its impact on resource allocation decisions. Unlike the sales tax, the VAT taxes imports and allows registered VAT payers to credit VAT paid on purchases against VAT charged on sales, eliminating tax cascading. The VAT has self-contained enforcement mechanisms and can be a major revenue raiser. The various sales tax regimes could be consolidated into the VAT. Ideally one rate would be applied throughout the country with as few exemptions as possible. To ease its introduction, a relatively high minimum firm size could be established for the first few years of transition, with a special regime for small firms.[25] Consideration could be given to mitigate the regressive impact of the VAT by granting tax credits for low income sectors of the population or direct compensation payments using mechanisms like income-tested transfer mechanisms such "Oportunidades" in Mexico or "Bolsa Familia" in Brazil.[26] The VAT could be complemented with a limited number of special (excise) taxes on goods whose consumption the government wants to discourage, such as alcohol, tobacco and fuel. In the short term, if the introduction of a VAT proofs too difficult from an administrative perspective, a uniform turnover tax on goods and services on a broad base at a low rate could be introduced while the administrative capacity is built up.

Social Security Contributions

A full discussion of social security contributions goes beyond the topic of this paper. An analysis of the adequacy of the rates has to be done in the context of

21. Ritter, op.cit., 2014, pointed out that under the system prior to Law 113, an erroneous tax base was being used because of the use of an arbitrary proportion of total revenues dictated by the government as deductions instead of the actual input costs.

22. Corbacho et al, op cit.

23. This is not an issue for foreign investors from Canada, the UK, and Japan, as these countries have moved to the territorial system, imposing taxes only on income sourced in the country.

24. Chapter 8 of Corbacho et al, op.cit, discusses how corporate tax revenues in Latin America have risen at the same time that the corporate tax rates were reduced. In addition, Chapter 8 discusses the limited payoffs of corporate income tax incentives in Latin America.

25. Gallagher, op.cit.

26. This possibility has been raised by the staff of the Inter-American Development Bank (IADB). See "Para donde va el IVA," *IDEA*, Vol. 29, September-December, 2012. *IDEA* is a publication of the Research Department of the IADB.

an analysis of Cuba's pension schemes, which are in dire financial conditions with the aging of the population and the projections of a decline in population size.

Taxes on the Use and Exploitation of Natural Resources and the Protection of the Environment

These new taxes are welcome. The maintenance of Cuba's mostly pristine environment has been facilitated by the level of underdevelopment. As the economy grows and, in particular with the expansion of the tourism sector, care has to be taken to make sure that those who are exploiting natural resources or whose activities could damage the environment help defray the costs associated with their activities. Compared to other Caribbean countries, even with these initiatives, Cuba seems to be behind the curve. Several Caribbean countries are already addressing environmental problems other than water-related (e.g., air quality, degradation of wet lands, and deterioration of coastal ecosystems).

Law 113 has a special income tax regime for companies in the mining sector, as discussed above. Presumably, in addition to this regime, Cuba enters into royalty contracts with companies exploiting domestic mineral resources. Royalties can be an important revenue source and an instrument to avoid the over-exploitation of mineral resources. Cuba's royalty contracts could benefit from more transparency. Intergenerational equity depends on a good design of the taxes applied to exhaustible resources.

CONCLUDING REMARKS

A number of concluding remarks are warranted:

- Much remains to be done to establish a tax system in Cuba that reduces the tax burden while generating sufficient revenue to finance adequately the basic functions of a modern state, makes the tax system more equitable, and promotes economic efficiency.
- The reform of the tax system would need to be accompanied by a comprehensive reform of government subsidies and tax expenditures with the aim of increasing efficiency and reducing the share of resources managed by the State and state-owned companies so as to permit a reduction of the tax burden.
- It is imperative that for the economy to grow, the appropriate incentives be provided and that the existing strong bias against the development of the private sector (e.g., high statutory income tax rates, taxes on employment) be eliminated.
- Tax policy has to be transparent, stable, and free of arbitrary measures (like limiting income tax deductions for input costs). Tax rates which are set every year in the annual budget laws do not provide a stable environment for economic agents, whether they are in the public or private sector.
- Micromanagement of tax policy of the type of the income tax treatment for Mariel workers needs to cease.
- Finally, if the actual tax liabilities are subject to a large variety of exemptions or various favorable regimes beyond the reach of the administrative machinery, such practices unnecessarily complicate tax administration and could be a source of special privileges and corruption. For these reasons, they should also be avoided.