

AN ANALYSIS OF DECREE-LAW NO. 171 ON PRIVATE HOME RENTALS

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The rental of rooms in private Cuban homes was not included among the original 1993 list of allowed self-employed occupations because such activity was *already legal* at the time under a previous 1988 law (General Housing Law No. 65, article 74). That law allowed Cubans to freely rent up to two rooms in their own homes tax free. Presumably because relatively few tourists were then visiting the island, the 1988 law failed to set specifications on renting to foreigners. Of course, like most other areas of self-employment, private rentals were already quite numerous throughout the island (especially in Havana and Varadero) when they finally came under state regulation in the summer of 1997. Also, like other “second economy” activities, private rentals originally began to expand as a strategic response to the economic crisis on the part of Cuban families. Moreover, prior to regulation, most Cubans who were renting rooms in their homes could make many times the average peso salary of a state employee as they were charging their foreign guests in dollars and not paying any taxes.

Another often overlooked, and quite ironic advantage the renters of private homes continue to benefit from in Cuba is the guarantees of the revolution in terms of housing and utilities. While there continues to be a severe shortage of inhabitable housing throughout the island, and while the existing stock of housing is in extremely poor condition, those lucky enough to own a solid home in a central location benefit from no mortgage payments and unimaginably low utility rates. Finally, much like the appearance of the famed *paladares*, the growth of private

rentals was a grass-roots response to the rapid growth of tourism as one of Cuba’s principal “exports,” a way for Cuban families to get a small piece of the tourism pie.

ADMINISTRATIVE OVERSIGHT AND GROWTH

Though private home rental is generally considered part of the “self-employed” sector in Cuba, for administrative and jurisdictional purposes rental activity is governed by the National Institute of Housing (INV) (and its Municipal branches), not by the Ministry of Labor and Social Security (MTSS), which oversees all other self-employment activities (except for private transport). Additionally, both the Ministry of Immigration and the National Office of Tributary Administration (ONAT) exercise oversight on private home rentals and have their own inspector corps that enforces immigration and tax laws, respectively. In practice, licensing and the enforcement of laws take place at the municipal level, partially explaining the fact that laws often change across municipalities. For example, fixed monthly tax (CFM) rates for rentals differ across the island, as do regulations concerning cohabitation by foreigners and nationals.

After they were first regulated in May 1997, licensed rentals began rather slowly as many potential entrepreneurs had a “wait-and-see” attitude, not wanting to go public with their intentions. Despite this initial reticence, the number of licensed “bed and breakfasts” had reached more than 8,000 island-wide by February 1999 (more than half of these being dollar

licenses with an estimate of a far larger number still renting without licenses). Moreover, new licenses were being added at a rate of 100-150 per month ("Private Rental" 1999). By May 1999, Mario Cabello, President of the National Housing Institute (INV), reported that numbers had reached 8,943 (Mas 1999), topping 11,000 by August 2000. Furthermore, officials expressed their concern about unfair competition, since there was a 5.3 percent decrease in hotel occupancy in Havana, despite a 15 percent increase in visitors to the city ("No official" 2000; "Tourists Stay" 2000).

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The 1997 legislation on Cuba's "bed and breakfasts" has been commonly misinterpreted as a further expansion of legal self-employment, allowing Cubans to practice yet another micro-enterprise activity. However, the new law actually had the effect of further *restricting and regulating* private home rentals, not legalizing them since the practice was already legal at the time. This remains true even though many pre-1997 renters themselves did not know whether what they were doing was legal. Even among those who did realize that renting rooms was legal, many understood it as an illegitimate activity, falling into what one renter called "la tierra de nadie" (no-man's land) (Henken 2001). The following quotation from Decree-Law No. 171, as published in *Granma* on May 16, 1997, gives a good idea of the attempt on the part of Cuban legislators to present the law as both an expansion of homeowner rights and as a way to aid in the "maintenance, repair, and construction of housing for the benefit of the population," both laudable goals given the dire straits of Cuba's housing stock:

Law Number 65, Article 74, of the General Housing Law (December 23, 1988) authorizes homeowners to conclude rental contracts for up to two rooms [...] at free market price *without obtaining any prior approval*. It has become necessary, within the current economic conjuncture, *to amplify and preserve previous rights of homeowners* so that they can rent more than two rooms [...] It is convenient, in order to guarantee an adequate exercise of these rights, to establish a registration procedure and with it achieve state control of this activity so as to avoid behavior outside the pur-

pose of this Decree-Law. The obligation of paying taxes on rental activity [will serve] as an additional source of revenue that will *help to finance the programs of maintenance, repair, and construction of housing for the benefit of the population* ("Decreto-Ley No. 171" 1997, emphasis added).

Apart from the point that homeowner rights are effectively reduced and eroded, rather than "amplified and preserved" by the new law, a number of other details of the entire text of the law, as well as subsequent clarifications published in *Granma* over the following months call for commentary and analysis.

First, there is no recognition of any contradiction between the statement that owners previously had had the right to rent "up to two rooms [...] without obtaining any prior approval" and the statement that their rights are now being expanded by the imposition of a tax regime and registration procedure. Moreover, stating that the law is being changed primarily so that owners rent more rooms is absurd, given the fact that the subsequent tax procedure, established just a week later on May 23, greatly discourages renters from declaring more than just one room.

Second, the stipulation (not quoted above) that the new legislation will help "provide rental facilities for Cubans, helping to solve housing problems," would seem to go hand-in-hand with the statement that tax revenue will be dedicated to the improvement of the existing housing stock. However, it does not seem logical that a new tax on existing rental activity would encourage more rental property to open up for Cubans, unless the peso tax rate were much more favorable than that in place for dollar rentals to foreigners. In fact, Ritter (2000) has demonstrated that just the opposite is true. The effect of charging Cubans a tax (in pesos) for renting in pesos to other Cubans actually makes such activity more costly, pressuring those Cubans to rent to foreigners instead. Furthermore, Ritter has shown that the supposedly progressive tax scale, along with the fixed monthly tax quota (CFM), actually discriminates against small-scale peso operations. This is the case, first since raising the initial monthly capital for the fixed quota (CFM) is much more difficult for smaller peso

operations, and second since the peso scale rises quite rapidly to where the operator pays a tax rate of 50 percent if his or her earnings exceed 60,000 pesos a year (the equivalent of just \$3,000). Meanwhile, the tax rate for earnings of \$3,000 (if one were to rent to foreigners) is just 12 percent (Ritter 2000: 150-151).

REGISTRATION

The actual procedure for becoming registered, reporting rental activity and income, and paying (monthly and yearly) taxes has been an area of great confusion for most homeowners. This is due partly to the lack of a culture and tradition of tax payment in Cuba. However, when Spanish bureaucratic traditions are mixed with the “iron cage” of socialist bureaucracy,¹ it is not difficult to understand why many homeowners have become frustrated with the web of bureaucratic steps required, first to register a “bed and breakfast,” and then to keep it running smoothly. In one sense, the entry of Cubans into private rental is considerably wider than that in place for other self-employed activities. Any homeowner, professional or not, retired or not, is allowed to obtain a license. However, one important restriction is that neither the homeowner nor any other member of the household can engage in other self-employed activities, including private transportation and food service. Though in practice it is fairly common to find licensed renters and/or their fellow household members engaging in other (underground) activities such as food service and taxi transport, this stipulation makes such activities illegal.

In order to begin renting, one must first have one’s home inspected and measured. Then, recommendation letters are usually required from three neighbors attesting to the potential renters’ qualifications. If approved, the applicant must then report to the local branch of the Municipal Housing Institute and pay the \$100 registration fee (100 pesos for rental to Cubans). At the time of registration, the potential renter will be provided with a rental registration booklet in which each new arrival must be recorded. Each time

a new guest arrives, the owner must have that person sign the booklet, which is then to be taken into the local Housing and Immigration offices so that the whereabouts of each foreigner not staying in a hotel can be known. The law also stipulates that anyone renting to Cubans must be sure that they abide by the Internal Housing and Migration Law (Declaration No. 217, issued on April 22, 1997). Finally, the law reiterates that though taxes will vary by zone, all renters will be required to pay an additional annual personal income tax.

PROHIBITIONS, FINES, AND OTHER LEGAL ACTIONS

Decree-Law No. 171 also puts in place a long and detailed list of prohibitions regulating rental activity along with the concomitant fines for each violation, independent of other possible legal ramifications (including the confiscation of one’s home). Violations include not bringing in one’s registration booklet or not having it up to date, renting without a license, renting in unauthorized zones, and renting for business purposes (fines range between 200-800 pesos, or dollars depending on what kind of license the operator has). More serious infractions include renting to foreigners without first getting their passport and reporting their presence to immigration (\$1,000 fine); renting to foreigners while having a license to rent only to Cubans (\$1,500 fine); renting without being the legal owner of the home (between \$1,000 and \$1,500 fine); and renting a second or third room without declaring them (\$1,500 fine).

A further contravention, rather subjective in nature, falls under the general rubric of renting to those who “disturb the peace” (the actual wording in Spanish is “permite que se ocasionen alteraciones en forma grave y ostensible que perturben la tranquilidad de los vecinos, violen las normas de convivencia social o afecten la moral o las buenas costumbres”) (fine of \$1,000, plus \$1,800 for the guest him/herself). The law stipulates that homeowners have up to 30 days to pay a fine; at the end of this term, the fine doubles.

1. For an informative and quite humorous depiction of Cuban bureaucracy at the start of the Revolution, see Cuban director Tomás Gutiérrez Alea’s 1960 film, “La muerte de un burócrata” (Death of a Bureaucrat).

Homeowners have three days to appeal any fine, but all fines must be paid before an appeal will be considered (no second appeals are accepted). Finally, the law establishes three separate inspector corps (housing, tax, and immigration) who are authorized to levy fines and declares that if violations are incurred repeatedly, one's home can be confiscated.

TAXATION WITHOUT REPRESENTATION

One complaint heard repeatedly in interviews with renters is that many of the above fines are applied arbitrarily, and often abusively by the inspector corps. Furthermore, many small-scale operations lamented the fact that due to their marginal income, they could barely pay the monthly tax (either \$100 or \$250, depending on one's location within the municipality), and would be equally unable to pay such steep fines or the bribes often held over their heads by inspectors as their only real escape. Those who had dealt with the appeals process often characterized it as an exercise in futility, claiming that they had either been closed because they refused to pay "protection" to an inspector, or because they had been singled out for closure by someone in the enforcement hierarchy—"mandados a cerrar" (forced to close)—making appeals useless. Finally, most interviewees rejected out of hand the suggestion that they try to have such "abusive" laws and taxes changed, clearly seeing the laws and taxes as an imposition originating from "those above in the government" not gleaned from any consultation or participation of the taxpayers themselves (a clear case of "taxation without representation").

In his own research and interviews with various self-employed workers, Ritter (2000) has found that fines and punishments are largely left to the discretion of inspectors and that such fines can reach 1,500 pesos (amounting to almost seven times the average monthly salary of a state worker). Furthermore, Ritter found that the suspension of licenses (legislated for a minimum of two years) are nearly always permanent in reality. Another debilitating punishment

for these micro-enterprises is the confiscation of their equipment, amounting to the confiscation of the majority of their accumulated capital investment over the previous few years, making the prospect of ever re-opening far fetched.

"PARA EL CONTRIBUYENTE"

In response to queries and complaints lodged by already active renters, *Granma* journalist Susana Lee attempted to clarify some of the details of the new rental law in articles she wrote in May 1997.² First, she noted that she had received a flood of letters asking for more details on the new law. She indicated that those currently engaged in rental activity had to obtain a license within the next 60 days by registering as taxpayers in ONAT and as renters in INV or cease to practice the activity by July 15. She also reminded potential licensees that they must be the legal owners of the home they were to rent and that they could not be involved in any other self-employed or private transport activity. These points clearly implied that the new law was in fact a reaction to rental activities already under way (Lee 1997a).

In June 1997, *Granma Internacional* featured a lengthy story entitled, "Putting Our House in Order" (Rodríguez 1997), that included the reactions of many Cubans to the new legislation. The article notes that though there are no official statistics on the number of current informal rental arrangements they are "sure to be spread throughout the country as a response to the economic crisis." Regarding the issue of state competition, it was estimated that around \$20 million circulate in this "underground" rental activity, and housing and immigration authorities present statistics to the effect that in only the first third of 1997 (January – April) just over a fifth of vacationers who came into the country stayed in private homes (more than 67,900 persons). If held constant over the entire year, a total of roughly 203,700 foreign visitors could be expected to choose private accommodations. Housing Minister Manuel Miyares is quoted as saying that such numbers present "unfair

2. In fact, in response to the beginning of individual tax payment in 1994, Lee began to publish an on-going column in *Granma* called "Para el Contribuyente," aimed at giving information to tax payers, clarifying confusing legal stipulations, announcing modifications to tributary and self-employment laws, and providing a space for them to air their own views and complaints.

competition with the country's hotel network" (Rodríguez 1997).³

CUBAN HOSPITALITY

A common concern among Cubans when the housing tax regime was first put in place concerned its effect upon the practice of being hospitable to friends and family visiting from abroad. *Granma* journalist Lee allayed her readers' fears that they would now be unable to host such guests in their homes by assuring them that the tax was intended to regulate business activity only and would not extend to non-renters, such as family members and visiting "solidarity groups." However, she did indicate that certain "trámites" (paperwork) such as informing the immigration office as a "means of elemental control" would be required (Lee 1997b). In fact, these "trámites" eventually came to include the payment of between \$50 and \$80 in a special tax in order to be allowed to host foreign guests (including visiting members of one's own family).

In practice, Cubans rarely seek this permission and are more likely to take their chances with fines and inspectors. For example, a Cuban intellectual who travels frequently abroad shared the following strategy in an interview: "When I travel, I normally stay with friends I know in the various universities where I give lectures. It's only natural that I host these people in my home when they come here." He admitted that he does not inform immigration or pay the required tax. However, he indicated, "I don't comply with the letter of the law, but neither do I try to hide what I'm doing. I make it my policy to inform the neighborhood CDR that I have a houseguest staying with me. That way, at least I am not trying to get away with some secret activity, but nor do I have to pay an unreasonable tax" (Henken 2001).

CONCLUSION

Nearly four months after the first announcement of the new private rental tax, Lee found herself continuing to respond in her column to her readers' frustration with the slowness of the registration process and confusion over conflicting information about tax payment procedure. However, she made a point of stressing that stepped up inspections and immediate sanctions were the best way to combat the fact that many persons have decided to continue renting without a license. Though there are no reliable statistics on the numbers of existing clandestine renters, the numbers provided by Lee do give a clear idea of the extent of underground activity. For example, she indicated that in the province of Ciudad de La Habana, a total of 3,069 persons requested information on rental procedures from municipal housing offices. However, only 1,364 persons actually requested applications to formalize their registration, and just 419 of these became registered once approved. Finally, by the end of August 1997, a mere 92 renters were paying the corresponding monthly taxes.

Given the startling numbers of Cubans who had presumably decided to remain underground, one might be moved to reassess the suitability of the legal framework. However, Lee's conclusion is just the opposite: "The key to bring under control what is happening lies in the rigorous work of inspection in order to detect and sanction those who violate what has been established" (Lee 1997c).⁴ However, a recent study of the self-employed sector carried out by Cuban sociologist Fernández Peláez (2000) comes to a very different conclusion. The author argues that it is not a desire to work underground and avoid paying taxes that causes the disarticulation of micro-enterprises in Cuba. Instead, she makes the case that the antagonistic institutional framework practically obliges the self-

3. Two years later, an article from Cuba's fledgling independent press estimated that as many as 35 percent of Cuba's tourists stay in private homes and that an estimated 200,000 tourists had lodged in such homes in just the first six months of 1999. The article indicated that Cuban authorities are becoming concerned about the loss of tourism revenue to the second economy and reason that they cannot adequately "protect" tourists who stay in private homes. It is worth asking whether the government also wants to "protect" Cubans from the "corrupting" influences increased exposure to foreigners may bring (Zúñiga 1999).

4. One is reminded here of Reinaldo Arenas' quip about the difference between socialism and capitalism. When socialism kicks you in the behind, you have to applaud, while when capitalism kicks you, you can at least scream. Homeowners' rights are reined in and they are expected to respond by eagerly joining the fold of taxpayers, with no effective opportunity to voice their concerns.

employed to invent illegal strategies to survive, leading to a polarization phenomenon, “where those with the lowest income are the ones who have the least possibility of success” (Fernández Peláez 2000: 35).

What is the logic behind such a seemingly draconian tax regime? It is possible that the tax system was originally designed with the purpose of driving the majority of micro-enterprises out of business for ideological reasons. This explanation would see the government legalize the private sector in a time of crisis, but as the economy improves, the state would begin to raise taxes and step up inspections, in order to rid the country of these illegitimate, capitalist, bourgeois elements. In fact, interviews with the operators of “bed and breakfasts” in Havana indicate that this explanation is most common among micro-entrepreneurs themselves (Henken 2001; Ritter 2000). However, there are at least three other reasonable explanations of Cuba’s public policy based on the difficult reality of Cuba’s economic crisis of the 1990s.

First, since legal self-employment in Cuba originally grew out of the informal sector in a context of great scarcity, it has tended to provide extremely high earnings to its practitioners (at least relative to the then falling value of peso salaries). Ritter (2000) points out that this situation was true especially when self-employment was first legalized because money flooded this newly-legalized market (i.e., there was an overabundance of cash in the hands of population with little to buy, combined with a small initial number of providers of goods and services). In response, the regulatory and tax structure of self-employment was designed to extract a large part of this excess liquidity and reduce inequality.

Second, there is a lack of a tradition of disciplined tax payment in Cuba partially justifying such a harsh tax regime. In other words, taxpayers are expected to cheat, so the law seems to have been designed to preempt such a possibility. Unfortunately, such a cure may be worse than the disease in the sense that the imposition of a severe tax policy regime actually tends to exacerbate the original distrust and lead to greater tax evasion, the very problem it was designed to solve.

And third, Cuba’s black market has traditionally been fed through the theft of state supplies. As a result, policy makers seemed to have concluded that it would be dangerous to allow micro-enterprises to calculate their own expense costs. Thus, the rule limiting expense deductions was likely intended to discourage theft.

To summarize, the unique characteristics of the tax regime in place for Cuba’s private renters favors larger, foreign operations over smaller-scale Cuban ones. Cuban entrepreneurs find themselves in an ironic Catch-22: remaining small is made tenuous by the high fixed monthly taxes and yet growing too large is penalized through a greater tax burden, forcing many to evade higher taxes by underreporting their income. It is quite understandable, then, that most self-employed workers seem convinced that the government is trying to quietly run them out of business. As a response, both small, “mom-and-pop” rental operations and large, well-endowed enterprises have developed (illegal) strategies to stay in business. The smaller operations either remain underground or “hedge” (engaging in non-licensed activities), while the larger ones underreport their incomes and make systematic use of black market inputs and informal employees.

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