

TAXATION OF CUBAN CONFISCATED ASSETS AFTER PROPERTY CLAIMS SETTLEMENTS: ISSUES FOR TAXPAYERS AND THE U.S. GOVERNMENT

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From 1959 onward, the Cuban revolutionary government confiscated assets such as homes, businesses, farms, factories, and personal property belonging to U.S. taxpayers and others.¹ This was the largest seizure of U.S. property in history, greater than the value of American assets taken by all other Communist governments combined.² Although the Castro regime promised compensation for confiscated properties, most takings were uncompensated. As a result, a number of U.S. corporate and individual taxpayers took deductions on their income tax returns.

Claims for confiscated assets remain one of the most contentious issues between the United States and Cuba. A statutory condition for normalizing relations with a post-Castro Cuban government is whether the regime has taken “appropriate steps to return to United States citizens (and entities which are 50 percent or more beneficially owned by United States citizens) property taken by the Cuban government from such citizens and entities on or after January 1, 1959 or to provide equitable compensation to such citizens and entities for such property.”³ Nonetheless, normalization of U.S.-Cuban relations is in-

evitable, and U.S. claimants will receive settlements in the form of recovery of their properties or compensation. The tax implications of such settlements are substantial, as current estimates of the total value of U.S. certified claims, including 46 years of accumulated interest, range from \$6.4 billion to \$20.1 billion.⁴

This article examines prospective treatment under the Internal Revenue Code (“IRC”) of U.S. taxpayers who may recover properties or receive compensation for confiscated Cuban assets. The issue is complicated by the fact that many of the one million Cuban exiles and their legal heirs who are now U.S. taxpayers did not file claims or take deductions for confiscated properties, yet will presumably have their assets restored or receive various forms of compensation. While taxpayers who are fortunate enough to recoup their actual properties will probably not be subject to taxation except for the amount taken as a deduction for losses, such claimants may be a minority.

The majority of claimants may receive other forms of compensation that will be subject to U.S. taxation. Given the special circumstances of the Cuban Di-

1. U.S. taxpayers are fiscal residents, not necessarily citizens or permanent residents.

2. Statement of Senator Richard Stone (D-FL), *Outstanding Claims Against Cuba, Hearings Before Subcommittees on International Economic Policy & Trade, and on Inter-American Affairs, Committee on Foreign Affairs, House of Representatives*, 96th Cong., Sept. 25, 1979, at 6 (1980).

3. H.R. 927 CUBAN LIBERTY AND DEMOCRATIC SOLIDARITY (LIBERTAD) ACT, § 205 (b)(2)(D) (1996).

4. Joint Corporate Committee on Cuban Claims 2005, at <http://congress.nw.dc.us/cubanclaims/index.htm>.

aspora, and precedential Internal Revenue Service (“IRS”) treatment for assets taken by the Cuban government, the article recommends legislation to relieve certain categories of taxpayers of such inequitable liabilities.

BACKGROUND

The 45-year-old U.S. embargo on Cuba was enacted to retaliate against Cuba’s confiscation of property owned by U.S. citizens and corporations. Under Cuba’s Law No. 851, the revolutionary government was authorized to nationalize, through forced expropriation, property held by U.S. nationals.⁵ The Cuban Government was given the power to appoint persons or agencies to administer the nationalized properties and appraisers to determine their value. Law No. 851 provided for payment to be made, based on the appraised value of the expropriated property.⁶ An eventual accounting was to be made to the original owners of confiscated assets, but none occurred.⁷

Initially, Cuba offered compensation for nationalized assets based on 30-year bonds at 2 percent per annum interest in exchange for preferential sugar quotas.⁸ The proposal was rejected and the U.S. declared that the confiscations were illegal under international law because they were discriminatory and did not provide prompt, adequate and effective compensation. In 1964 Cuba reportedly offered to pay \$1 billion as compensation for confiscated U.S. properties and to release political prisoners in exchange for U.S. restoration of the Cuban sugar quota. This proposal was similarly turned down by the Johnson administration.⁹

The confiscated U.S. assets included 90 percent of all electricity generated on the island (Cuban Electric Company), the entire telephone system (ITT), most of the mining industry (Moa Bay Mining Company and Nicaro Nickel Company), and large tracts of high quality land (between 1.5 and 2 million acres).¹⁰

In October 1964, the U.S. Congress amended the Foreign Claims Settlement Act of 1949 and established a Cuban Claims Program under Title V of the Act. Under this program, the Foreign Claims Settlement Commission (“FCSC”) considered claims of U.S. nationals against the government of Cuba for their property losses. The FCSC received 8,816 claims of which 87 percent were from individual U.S. citizens. The Program certified 5,911 of these claims totaling \$1.8 billion, of which \$1.6 billion were U.S. corporate losses from such major American companies as General Motors, United Brands, Borden, International Paper, and Amstar. Assets taken from the ten largest corporate claimants—including electric and phone companies, two oil refineries, one nickel mine and five sugar producers—were ultimately certified to be worth over \$1 billion in 1964. The FCSC also evaluated international law and determined that certified claimants were entitled to 6 percent per annum simple interest on the value of their claims from the date of the actual loss to the date of settlement.¹¹

Over a million Cuban exiles who are now U.S. taxpayers also had their property seized by the Castro government.¹² These assets were more extensive and varied than claims originally certified by the FCSC, including thousands of personal residences, large agricultural properties, insurance policies, and valuable

5. The confiscations were officially called “interventions.”

6. *Banco Nacional de Cuba v. Chase Manhattan Bank*, 505 F. Supp. 412, 422 (D.N.Y. 1980).

7. *Empresa Cubana Exportadora de Azúcar y Sus Derivados v. Lamborn & Co.*, 652 F.2d 231, 234 (2d Cir., 1981).

8. James N. Wallace, *Move Termed Groundwork for Confiscation: Sugar Mills Are Likely 1st Target*, WALL ST. J., Jul 7, 1960, at 3.

9. Statement of John A. Cypher, Jr., *Outstanding Claims Against Cuba* at 12.

10. For example, North American Sugar Industries owned a tract of land approximately 42 miles by 30 miles (3,300 square kilometers) and three sugar mills, including two of Cuba’s largest.

11. See FCSC decision CU-0249, *American Cast Iron Pipe Company*.

12. Under Law No. 989 all property of persons fleeing from Cuba was confiscated.

Taxation of Cuban Confiscated Assets After Property Claims Settlements

personal property such as antique paintings and furniture.¹³ The value of Cuban exile claims was estimated as \$6.9 billion at 1957 values, which was equivalent to \$20.02 billion in mid-1993.¹⁴

In 1962, the IRS, who had been awaiting Congressional action to define deductibility for specific Cuban losses, issued a formal ruling ahead of the U.S. Congress. The IRS stated that, “[t]he taking of property without compensation is confiscation. It is no less confiscation because there may be an expressed interest to pay at some time in the future.”¹⁵ The ruling covered how to claim losses when filing income tax returns including: (1) year of deductibility; (2) a five-year carryover period for the unused portion; and (3) the nature of the loss whether capital or ordinary. According to a previous Supreme Court Ruling, the affected taxpayer was not obligated to establish that there was no possibility of restitution.¹⁶

Congress specifically addressed Cuban confiscation losses in the Revenue Act of 1964.¹⁷ This law gave taxpayers the option of electing to carryover that portion of a net operating loss rising from foreign takings for ten successive years rather than a three-year carryback and a five year carryover.¹⁸ It also added a new subsection under IRC § 165, which provided that any loss of tangible property by Cuban confiscation was to be treated as a casualty loss. The amendment treated both business and purely personal confiscations of tangible property as casualty losses.¹⁹

The legislation allowed for the losses to be deducted from the income earned, capital or ordinary, by the taxpayer affected by the confiscations. The losses provided a limited benefit to those affected by reducing income taxes for periods subsequent to the property takings (in the carryover period). Numerous Cuban exiles who became U.S. taxpayers (not necessarily naturalized citizens) and subsequently lost their properties to confiscation measures were able to use these deductions.

Before 1964, losses sustained through confiscation or seizure of property by a foreign sovereign were not eligible for casualty or theft losses. Confiscation losses incurred by taxpayers were deductible only when assets were held for business or investment purposes. Jewelry, residences, and other personal property confiscated by the Cuban government could not be taken as casualty losses.²⁰

Under § 238 of the Revenue Act of 1964, an amendment to the tax code provided that any loss of tangible property resulting from expropriation, intervention, seizure or similar taking by the Cuban government, and was not a loss incurred in a trade or business or in a transaction entered into for profit, was considered a casualty loss.²¹ The amendment allowed for casualty loss deductions to be extended with limitations to “non-business properties” for those who were U.S. citizens or residents before De-

13. *Cuba Moves to Halt Insurance Payments to Refugees in U.S.*, WALL ST. J., Dec. 6, 1960, at 10.

14. José F. Alonso and Armando M. Lago, *A First Approximation of the Foreign Assistance Requirements of a Democratic Cuba*, in CUBA IN TRANSITION, Vol. 3, 202–204 (George P. Montalván ed., 1994). It is virtually impossible to assess the current value of these claims as many in the past decade have greatly deteriorated and collapsed. In 2003, 71 of 156 sugar mills were shut down. These will eventually become worthless.

15. *Tax Relief Given on U.S. Property Seized by Cuba*, WALL ST. J., Nov. 7, 1962, at 2. See Rev. Rul. 197, 1962–2 CUM. BULL. 66.

16. Robert Metz, *Taxes May Be Bar To Foreign Deals*, NY TIMES, March 5, 1961, at 1F. See also *United States v. White Dental Mfg. Co.*, 274 U.S. 398 (1927).

17. INT. REV. CODE OF 1954, § 172(b) and (k) as amended, Rev. Act of 1964, § 210.

18. Thomas Wolfe & John White, *Income Tax Consequences of Cuban Expropriations to Cuban Resident Aliens*, 19 U. MIAMI L. REV. 591, 601 (1965).

19. *Id.* at 599–600.

20. *Assets Lost in Cuba Get Tax Deduction*, NY TIMES, Nov. 7, 1962, at 33.

21. *7 Mertens Law of Fed. Income Tax'n.* § 28:102, Jan. 2005.

ember 31, 1958.²² This created a difference between those who were U.S. taxpayers when Castro took over and those who became fiscal residents after January 1, 1959.

Prior to 1971, IRC § 172 applied to confiscated investment property under which the confiscation loss was treated as an ordinary loss subject to carryover or carryback only to the extent of the taxpayer's investment income. In 1971 the tax code was amended regarding losses sustained in taxable years ending after December 31, 1958.²³ A special exception allowed Cuban losses to be carried over for 20 years so that the numerous immigrant taxpayers—whose income levels were insufficient—could use more of the losses.²⁴

TAX TREATMENT OF RESTITUTED ASSETS

Restitution is the process by which land or other property that was forcibly removed from its owners is restored. When the restoration of the original property is not possible, compensation of equal value is provided. Compensation for confiscated assets consists of two elements: (1) the type of remedy available; and (2) the scope of the remedy.²⁵ During the process of normalizing U.S.-Cuba relations, taxpayers can expect to receive various forms of settlements for their property claims. Remedies will range from actual restoration of original real estate and personalty, substitution for another property of equal value, vouchers redeemable for substitution, future cash payments, shares in joint ventures, privatized compa-

nies or investment funds, bonds, or other debt instruments.

The Joint Corporate Committee on Cuban Claims (“JCCCC”), an organization of 54 major U.S. companies that had their property confiscated by the Castro regime, proposed that holders of certified claims should receive negotiable tax credits in full settlement.²⁶ Another JCCCC suggestion was the establishment of a fund that would be the vehicle for a broad based royalty program which included Cuba's natural resources in nickel, copper, iron ore, petroleum, and other foreign exchange generators such as tourism. Claims would be paid to their full value from the accumulation and reinvestment of royalties.²⁷

Actual Restitution of Property

In general, return or recovery of property that was once the subject of a deduction must be treated as income in the year of its recovery unless initial use of the loss did not provide a tax saving.²⁸ Only the actual amount of loss is used, not the allowed deduction. The recouped property is taxed at the rate in effect during the year in which the recovered asset is recognized as a factor of income,²⁹ unless the taxpayer did not obtain tax benefits from the deductions.³⁰ IRC section 111 states that “[g]ross income does not include income attributable to the recovery during the taxable year of any amount deducted in any prior taxable year to the extent such amount did not reduce the amount of tax imposed...”³¹

22. *Tax Report; A Special Summary and Forecast of Federal and State Tax Developments*, WALL ST. J., July 1, 1964, at 1. See also IRC § 165(i) (as added by P.L. 88-348)

23. *S Rep No. 91-1544*, (91st Cong, 2d Sess 3).

24. Lawrence Axelrod & Jeremy Blank, *The Supreme Court, Consolidated Returns, and 10-Year Carrybacks*, 90 *Tax Notes* 138, 140 (March 2001).

25. Richard W. Barrett, *Avoiding the Expropriation Nightmare—Tax Consequences and Asset Protection Techniques*, 52 *U. MIAMI L. REV.* 831, 847 (1998).

26. Statement by Robert Hutton, vice chairman of Lone Star Industries, and chairman of the Joint Corporate Committee on Cuban Claims, *Outstanding Claims Against Cuba* at 8.

27. *Id.*

28. *IRC § 1.111-1*.

29. *Sullivan Corporation v. United States*, 381 F. 2d 399, 403 (U.S. Court of Claims 1967).

30. *IRS Revenue Ruling 1962, § 165—Losses*, 26 *CFR* 1.165-1: Losses.

31. *IRC TITLE 26, Subtitle A, Ch. 1, Subch. B, Pt. 111, § 111*.

When an original property is restored to the taxpayer or his second tier heirs, no taxable event has occurred that would constitute realization of income if no deduction was taken for the loss or any deductions taken were not fully used.³² Taxpayers who took loss deductions on recouped properties would be liable to the U.S. Treasury only for the amount of deductions; they would not owe any excess on their basis despite the asset's appreciation in value.³³

When the government of Cuba (current or post-Castro) addresses the property confiscations of U.S. taxpayers it will need to determine if it will follow any of the Central-Eastern European models or create its own for resolving claims. Several issues will make the actual restoration of original properties complicated if not impossible. For instance, if the governments of Cuba and the United States reach a bilateral compensation agreement, then certified claimants (who have not already sought a resolution to their property claims independently) will receive payments distributed to them by the U.S. government. At that point the restoration of their properties is no longer an option because they will have been compensated.

From 1959 to 1963, over 85,000 new homes were built in Cuba on confiscated land. In October 1960, Cuba's Urban Reform Law turned 85 percent of renters into "owners."³⁴ The Cuban government recognizes adverse possession. If U.S. taxpayer claims are addressed during the current regime, then those Cubans who received property titles to confiscated residences will retain their "rights."³⁵ A post-Castro regime may also recognize adverse possession in the

name of social stability in addition to reducing a potential deluge in restitution claims.

Another Cuban reality that makes the return of original assets unlikely is the present condition of many such properties. Throughout the Castro regime some confiscated residences and other structures have been demolished. Many buildings have collapsed due to deterioration and others are irreparable.³⁶

Assets Received as Substitute Restitution

Under IRC § 1033(g), if property has been compulsorily or involuntarily converted (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof), no gain shall be recognized if it is converted into property that is similar or related in service or use to the property.³⁷ The criteria for "similar or related in service or use to the property" are generally interpreted broadly by the IRS and tax courts.³⁸ Section 1033 applies to both property held for personal use and assets held for productive or investment use.³⁹

Such conversions will probably be recognized as nontaxable exchanges (also known as an unrecognized gain or loss), which is an exchange in which a taxpayer is not taxed on any gain and on which any losses cannot be deducted. The tax code considers that the basis of property in a nontaxable exchange is usually the same as the basis of the property transferred.

Therefore, if taxpayers have not taken deductions for confiscated property, they will presumably not be subject to taxation even if the substituted asset is

32. IRC § 1001 (b).

33. Harold S. Peckron, *Reparation Payments—An Exclusion Revisited*, 34 U.S.F.L. REV. 705, 712–713 (Summer 2000).

34. *Instituto Nacional de Ahorro y Viviendas* (National Institute of Savings & Housing), Havana (March 15, 2005). Ownership in Communist countries is (and was) generally limited to the use of a property, not the right to sell or rent an "owner's" property or even improve it without the express permission of the State and with materials purchased from the State. In essence, rights are greatly restricted, if not altogether nonexistent.

35. Some countries like Bulgaria allowed for nominal "private ownership," particularly for residential properties throughout Communist rule. That is, occupants held title but enjoyed no ownership rights.

36. Nancy San Martin, *High winds, old age threaten buildings throughout Havana*, MIAMI HERALD, Sep. 18, 2004, at 13.

37. IRC § 1033 (a)(1).

38. IRC § 1–1033(g)(1).

39. See IRC § 121 (d)(5)(B).

worth substantially more than the basis of the original property in 1960 dollars. However, if the substituted property is sold, the amount over the basis will be included in taxable income of the restituted owner.

Monetary Compensation

Under Section 1033(a)(2), the IRS would probably classify monetary compensation received in lieu of confiscated Cuban property to be a taxable exchange.⁴⁰ A taxable exchange occurs when cash or property (e.g., bonds or shares) is received that is not similar or related in use to the property exchanged. The basis of the property received is usually its Fair Market Value (“FMV”) at the time of the exchange. If property is compulsorily or involuntarily converted into money or into property not similar or related in service or use to the converted property, any gain is recognized only to the extent that the amount realized upon such conversion (regardless of whether such amount is received in one or more taxable years) exceeds the cost of such other property.⁴¹

This would impose an inequitable burden on taxpayers if a cost basis dating from 1960 back into the early 20th century is used, as many residences and businesses were acquired decades (and in some cases, centuries) before the 1959 Revolution. This is demonstrated by claims filed by Citibank and Chase Manhattan. Citibank (which had eleven Cuban branches confiscated) had been engaged continuously in branch banking in Cuba since 1915, and Chase (which lost four branches) had been on the island since 1925.⁴² On its books Chase listed its real estate holdings at a depreciated cost of \$110,232. The last appraisal of any Chase branches was made on March 28, 1960, and applied only to the Havana office. This valued the premises owned by Chase at

\$165,090, and the necessary adjustment to bring the book value for that property to market was stated as \$54,858.⁴³ Today this building is worth at least \$400,000, and within a year after normalization of relations its value will probably double.

The IRC allows taxpayers whose property has been compulsorily converted into money or dissimilar property to avoid a taxable gain by (1) purchasing similar property with the proceeds within two years, or (2) purchasing a controlling interest (i.e., 80 percent of the total combined voting power of all classes of stock and at least 80 percent of the total number of shares of all other classes of stock) in a corporation owning such other property.⁴⁴ It would be unreasonable to expect that most compensated taxpayers would be willing or able to buy similar properties (in the U.S. or Cuba), and it is unlikely that there would be many opportunities for even large U.S. companies to purchase a controlling interest in corporations owning similar Cuban properties within two years after compensation. Furthermore, Section 1033 may not apply to Cuban properties, as Section 1031(h)(1) stipulates that real and personal property located in the U.S. and outside the U.S. are not considered property of a like kind.⁴⁵

In addition to compensation for property losses, the IRS will also have to consider treatment of tort claims and settlements of judgments against the Cuban government for confiscations or damages to persons or property.

Valuation of Assets

Another major issue that will confront taxpayers is how the IRS will value restituted properties or compensation. The U.S. government stated the total book value of confiscated U.S. investments in Cuba to be \$956 million.⁴⁶ Even though many industrial

40. IRC § 1.1033(a)(2)(c).

41. *Id.* at § 1033(a)(2)(A).

42. *Banco Nacional* at 428.

43. *Id.* at 459.

44. IRC § 1.1033(a)(2)(c).

45. IRC § 1033 provides no guidance on this issue, but § 1031 is generally considered applicable in this regard.

46. *Survey of Current Business*, Table 3, at 22–23 (August 1961).

assets will have lost their original economic value (e.g., sugar mills built in the 1920s), the discrepancy between book value and FMV after nearly half a century will be enormous in most cases. For example, in June 1994, the Mexican firm Grupo Domos purchased 49 percent of EmtelCuba for \$1.5 billion, which represented half of Cuba's generally antiquated telephone system.⁴⁷ In comparison, in 1960 the FCSC allowed ITT a claim of \$130.7 million for Cuba's *entire* telephone system.

Under the provisions of the Tax Reform Act of 1976, the amount of casualty losses subject to deduction were based on the FMV of any confiscated property immediately prior to the time the loss was sustained.⁴⁸ The IRS will presumably value properties at their FMV price in Cuba at the time compensation or restitution takes place because the FMV of any confiscated property immediately after the time when the loss was sustained was considered to be zero.⁴⁹

The Helms-Burton legislation contemplates that, with limited exceptions, U.S. courts will adopt the valuations determined in awards issued by the FCSC's Cuban Claims Program, conducted from 1965 to 1972. In cases where a plaintiff was not eligible to file a claim (i.e., was not a U.S. national at the time of confiscation), the legislation authorized the U.S. District Courts to appoint the FCSC as Special Master to make determinations on such issues as ownership of property, for use in court actions.⁵⁰

Applying half-century-old valuations to properties in a market that will probably grow as fast as that of the East Berlin real estate sector in the post-Communist era would be unrealistic and unfair to claimants.⁵¹ For example, in Havana's upscale Miramar district, where many Cuban exiles lived, a 31-apartment complex was built in the late 1990s by Real Inmobiliaria, a joint venture between Monaco-based Pastor and Lares, the real estate arm of Cuba's Cubalse corporation. The apartments—priced from \$94,000 for a studio to \$400,000 for a penthouse—sold out in weeks to foreign buyers.⁵²

Successors in Interest

Another issue is how the IRS will treat successors in interest. Since the 1960s, a significant number of the 78 publicly owned U.S. corporations that suffered asset seizures in Cuba have been merged, acquired, or dissolved. For example, after the wholly-owned Cuban subsidiary of Canada Dry Corporation was taken, the company took a charge against the subsidiary's consolidated earned surplus of \$856,202 plus a write-off of \$309,875 of the investment in and advances to the Cuban company.⁵³ Canada Dry changed hands repeatedly in the 1980s—first to Del Monte Corporation, then to Dr. Pepper, and then Norton-Simon. In 1986, Cadbury Schweppes, PLC paid \$230 million for the company, and subsequently sold the Canada Dry brand's worldwide rights (excluding U.S. and France) to Coca-Cola.

Generally, the corporation surviving a statutory merger assumes all the powers, rights, debts, and lia-

47. Ted Bardacke, *Mexican firm breaks new ground in Cuban telecom field*, DEVELOPMENT BUSINESS, July 31, 1994.

48. See MERTENS LAW OF FED. INCOME TAX'N § 28:102, Jan. 2005. FMV is defined as the price at which a property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts. *IRC Reg. §20.2031-1*.

49. "Nor is the fair market value of an item of property to be determined by the sale price of the item in a market other than that in which such item is most commonly sold to the public, taking into account the location of the item wherever appropriate." *IRC Reg. §20.2031-1*,

50. FCSC: 2001 Annual Report, FOREIGN CLAIMS SETTLEMENT COMMISSION OF THE UNITED STATES, U.S. Dept. of Justice (2001).

51. Like Havana, the demand for housing in Berlin far exceeds the supply. Prices for residential properties in the most desirable parts of the city reach 6–7,000 EUR per square meter (\$2,575–\$3,000 per square foot), and the average in the city is 2,300 EUR per square meter (\$986 per square foot).

52. Pascal Fletcher, *Property development gives Havana partial facelift*, REUTERS, June 11, 1999.

53. *Sales Set Mark for Canada Dry*, NY TIMES, Dec. 10, 1960, at 29.

bilities of the corporation merged into it.⁵⁴ The successor corporation becomes primarily liable with regard to the tax liabilities of the merged entity. Assuming that Cadbury acquired Canada Dry's assets and liabilities, it would be the *de jure* successor in interest for both future claims and restitution tax liabilities due to its U.S. operations.

Three U.S. banks had their Cuban branches nationalized. First National City Bank (now Citibank) took bad debt charges of \$38 million on uncollectible loans and \$11 million on other losses, including bank properties.⁵⁵ First National Bank of Boston charged off \$5.3 million to its reserves after its six Cuban branches were seized. Renamed the Bank of Boston, it merged with BayBank in 1995, changing its name to BankBoston. In 1999 that firm merged with investment bank Fleet Financial Group to become FleetBoston Financial Corporation. Bank of America acquired this entity in April 2004, and is the successor in interest. The third bank, Chase Manhattan (now part of JP Morgan Chase), did not report Cuban losses, probably because it held Cuban government funds at its New York Branch.⁵⁶

A further example of the accounting and legal complexities that will be involved in Cuban settlements is the case of Moa Bay Mining Company, which claimed \$88.3 million in confiscation losses. The company was wholly owned by Freeport Nickel Company, a subsidiary of Freeport Sulphur Corporation. Freeport Sulphur merged with McMoRan Oil & Gas, LLC in 1998 but remained a wholly owned subsidiary of the successor company McMoRan Exploration Co. ("McMoRan"). In 2002, McMoRan sold Freeport to a 50–50 joint venture between IMC Global Inc.—the world's largest purchaser and user of sulphur—and Savage Industries Inc., a major ma-

terials management and transportation systems company.

The possible compensation for Moa Bay's Cuban assets should be of interest to IMC and Savage, as the current value of the confiscated nickel and cobalt mines is estimated at \$5–7 billion. Since 1990, Canada's Sherritt International has invested over half a billion dollars in Freeport's former mines under a joint venture with the Cuban government, and China is negotiating a similar joint venture.⁵⁷ Cuban nickel is considered to be Class II with an average 90 percent nickel plus content. Holguín Province, where the Moa Bay mines are located, is estimated to contain 34 percent of the world's known reserves of nickel, or some 800 million tons of proven nickel plus cobalt reserves, and another 2.2 billion tons of probable reserves.⁵⁸

Assignment or Relinquishment of Claims

Chase Manhattan employees who had been forced to flee Cuba were compensated by the bank for the value of any property which they had left behind (all of which was confiscated by the Cuban government). The compensated employees assigned to Chase any claims they might have against Cuba arising out of the confiscation. Chase attempted to assert these assigned claims as a set-off against its liability to Cuba's state-owned Banco Nacional as a result of Chase's failure to return to the Cuban bank a \$7,256,000 surplus which had remained after Chase liquidated Banco Nacional's loan collateral after the Revolution. Although the 2nd Circuit Court admitted that the "assignors of the claims had a special relationship to Chase, and indeed Chase had a moral obligation, and perhaps a legal one to reimburse them for their losses," the court disallowed the set-off, holding that it extended only to Chase's confiscated Cuban property, and not the property of others confiscated, even

54. See *Missile Systems Corp. v. Commissioner*, T.C.M. 1964–212.

55. *Boston First National Charges Off \$5.3 Million Loss to Cuban Seizures*, WALL ST. J., Jan. 20, 1961, at 16.

56. *Banco Nacional* at 146–147.

57. *Cubamine 501*, TED CASE STUDIES (American University 2004).

58. *Cuba and China Sign Deals to Expand Nickel Output*, METALS WEEK, Nov. 29, 2004, at 6.

when such assignments were given to Chase for a proper purpose and for full value paid.⁵⁹

The court's rationale was that:

To hold otherwise would call up a brisk trade in claims against foreign states, and would in effect nullify the Act of State doctrine, and prevent access by the Government of Cuba to the United States courts against any United States defendant having the willingness and creativity to buy up Cuban claims of others to assert as assignee.⁶⁰

Although this ruling was intended to forestall speculation in Cuban claims, it may have an adverse effect on compensated taxpayers who legitimately acquire claims (e.g., by deed or gift) from others and seek to use losses as set-offs or deductions.

Some taxpayers may choose to relinquish their property claims rights or give them to relatives or friends because they are not interested in their properties or compensation. Taxpayers who relinquish claims may nonetheless be liable for taxation. Generally, the position of the IRS is that assigned claims or property fall under the "assignment of income" doctrine, under which the taxpayer cannot avoid recognizing income by assigning it to another person, unless his renunciation of the property legally amounts to an abandonment of his rights without a transfer of rights to another.⁶¹

Taxpayers who give claims rights to friends or relatives as gifts are subject to gift tax on the transfer, with the statutory annual exclusion.⁶² The value of the gift is excluded from the recipient's gross income, regardless of the amount of the gift. Relinquishing the right to the property/compensation may be interpreted as a gift to the Government of Cuba.

Tax Planning for Public Corporations

Claimant corporations and successors in interest will need to address their future tax liabilities in compli-

ance with the Title IV (Enhanced Financial Disclosures) of the Sarbanes-Oxley Act, Section 404.⁶³ Public companies must analyze the risks and specifically review internal controls for the tax area, ensuring that extensions are timely filed, as well as assessing tax planning positions and the potential failure including the related dollar amount of the tax exposure. Section 404 (b) addresses internal controls with regard to financial statements, including "unknown or unrecorded tax liabilities." Corporations that took a loss upon the conversion and recoup the property and/or are compensated will most likely have a future tax liability recorded on their books (potentially a huge liability). Even if the tax liability does not rise to the level of being recorded, at a minimum a disclosure would almost certainly be necessary.

The liability (loss) would be classified under The Concept of a Liability No. 69 (i.e., a tax assessment) if the following conditions are met:

1. If it is probable (defined as a future event or events that are likely to occur) that an asset has been impaired or a liability had been incurred at the date of the financial statements. It is implicit in this condition that it must be probable that one or more future events will occur confirming the fact of the loss.
2. The amount of the loss can be reasonably estimated (e.g., from claims made for confiscated assets).

Another point worth noting is that along with the tax liability a "gain contingency would exist." Assuming the corporation receives liquid restitution (cash, shares, bonds or vouchers redeemable for substitution, future cash payments, shares in joint ventures, privatized companies or investment funds, or other debt instruments) then the deferred liability most likely would not rise to the level of being recorded on the balance sheet. However, if illiquid assets are re-

59. *Banco Nacional* at 146–147.

60. *Id.* at 147.

61. See *Commissioner v. Giannini*, 129 F. 2d 638 (9th Cir. 1942).

62. *IRC* § 102.

63. *Title IV of Sarbanes-Oxley Act of 2002, §404(b)*.

ceived, then the company would need to have adequate cash flow to pay the taxes or divest the asset.

LEGISLATIVE PROPOSALS

As noted above, U.S. taxpayers (including Cuban exiles) whose properties were taken by the Castro regime may suffer additional victimization under IRC § 1033 (a)(2)(A) if they receive compensation at current FMV, which in most cases would be a large multiple of their basis in the property. Many of such claimants are elderly and living on fixed incomes and would be unable to pay income tax on compensation received for properties that may now be worth millions of dollars. For example, in 2004 a 95-year-old woman filed an action in a federal court against the Club Med hotel chain for building a 337-room luxury resort on Varadero beachfront property confiscated from her family, which had also owned prime real estate occupied by two other hotels, one owned by Sandals and another by Ibero-Star.⁶⁴

One solution may be for the U.S. Congress to enact legislation to allow qualifying taxpayers to exclude compensation payments from taxable income. A precedent is the 2001 Economic Growth and Tax Relief Reconciliation Act which allowed Holocaust survivors, their heirs or estates to receive the full benefit of any compensation payment made by governments or industry by excluding from income taxes compensation payments received after January 1, 2000.⁶⁵ It can be argued that Cuban exiles (and U.S. nationals)

were similarly victims of tyranny and should not be unfairly burdened by being taxed on monetary compensation if their actual properties cannot be restored.

An argument can be made that it would be discriminatory to allow taxpayers (who did not take a tax deduction) to receive restituted or substitute properties tax-free under § 1033, whereas those who receive monetary compensation that exceeds the original basis of the property (which may happen in most cases), will have the excess taxed as ordinary or capital gains.⁶⁶ This would be contrary to the doctrine of horizontal tax equity, under which taxpayers in similar circumstances should be taxed in similar ways. This doctrine has a constitutional foundation; under the equal protection clause, tax legislation enjoys the greatest degree of freedom to classify.⁶⁷

CONCLUSION

When the normalization of U.S.-Cuban relations commences, the IRS will be confronted with unprecedented tax issues. In addition to Fortune 1000 U.S. companies, as many as one million Cuban-American taxpayers may have property claims against assets valued in tens of billions of dollars. Because of the unique circumstances involving politics, history and geography, the U.S. government will need to address these special tax circumstances in ways that redress past injustices and encourage positive economic changes in Cuba.

64. Amy Driscoll, *Club Med built on property that Cuban exiles claim*, MIAMI HERALD, July 8, 2004, at 4.

65. *IRS News Release* No. IR-2201-75, (Aug. 30, 2001).

66. See *Salt River Pima-Maricopa Indian Community v. Yavapai County*, 50 F. 3d 739, C.A.9 (Ariz. 1995). (Tax is “discriminatory” if it is not imposed equally upon similarly situated groups.)

67. *Schulz v. New York State Executive, Pataki*, 960 F. Supp. 568 N.D.N.Y., 1997); U.S.C.A. Const. Amend. 14.