AN EVALUATION OF THE SYSTEM OF TAXING CAPITAL GAINS FROM SHARES IN CAMEROON IN THE LIGHT OF DOUBLE TAXATION OF CORPORATE PROFITS

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ABSTRACT

The quest for additional revenue yield has led to fundamental changes in the Cameroonian tax system, specifically in the method of taxing capital gains on transfer of shares. Though aimed at improving the system from an equitable angle, these changes may give rise to theoretical controversy given the method of taxing these gains. In particular, the trigger of the capital gains tax (CGT) and the method of taxing corporate profits are potential elements to be raised against the recent increase of CGT rate on shares and the deletion of the incentives initially granted. This paper argues the inappropriateness of these changes through an evaluation of its rationale. Notwithstanding the primacy of the equity criterion, the theoretical basis for taxing these gains may however dictate departure from such principle in order to achieve the objective of increasing the revenue yield.

Keywords: Capital Gains, Shares, Tax System, Cameroon, Corporate Profits.

INTRODUCTION

Shares or stocks are elements materialising the participation or contribution of individuals in a company or a partnership. When a commercial activity is in its expansionary and profitable phase, the number of shares available to shareholders might increase, or the nominal value of shares may simply increase, so when these assets are transferred, capital gains are realized. From a general standpoint, the introduction of the capital gains tax (CGT) generally stems from the difficulty of imposing a tax on undistributed profits earned by shareholders as it might impose a burden on them given that they have not received any profits. As a result, introducing a CGT will actually assist in taxing retained earnings that would have otherwise escaped tax in the absence of the CGT. Thus, the introduction of the CGT recognizes the eventuality of realising gains through the retention of profits.[i] Pursuant to the Finance Act 2012, the Cameroonian legislature has increased the tax rate applicable to realized gains and extended the scope to cover capital gains made by both artificial and natural persons in conjunction with the transfer of shares owned by them on business activities established within the Cameroonian territory. After many years of preferential treatment with respect to taxing realized capital gains on shares,[ii] this new measure with the unhidden motive of reducing the scope of the tax exemption so as to spur more revenue, has been allegedly justified on equity purpose.[iii] This new provision besides its merit of redefining the scope of the chargeable persons[iv] has however increased the tax rate from ten percent to fifteen percent. The flaw in the increase of the tax rate could be overlooked provided there is an equity reason for taxing income and capital in the same manner. However, the very characteristic of capital gains has always led to the benefit of a form of preferential treatment in comparison to income either as a means to induce their realisation or simply to provide a remedy to the lock-in effect.[v] It is thus important to evaluate such increase and its rationale through a scrutiny of the development of the system of taxing these gains, the impact of the realisation rule and the classical system for taxing corporate profits and finally an evaluation of the incentive advocated on both equity and efficiency grounds.

THE INTRODUCTION AND EVOLUTION OF CGT RATE ON GAINS FROM SHARES

The CGT on the transfer of shares was first introduced in Cameroon in 1985 and was in line with the legislature`s desire to establish equity among taxpayers given the tax advantage that could be exploited through retained earnings. Hence, a new section was introduced in the general tax code (GTC) dealing with the taxation of realised gains in these terms:

> "When a partner, shareholder or unit holder transfers during the life of a company, all or part of its ownership, the excess of sale price on the purchase price or initial value of these rights is taxed at the progressive surtax".[vi]

However, the imposition of tax on these gains is subject to other conditions related to the criteria of participation of the owner of the shares as specified in these terms:

> "However, the capital gain thus obtained is subject to tax provided that the individual or his spouse, ascendants or descendants are or have served over the last five years prior to the sale as a director or manager in the business and that the rights of the same people have exceeded 25% of the profits during the same period."[vii]

In 1990, this provision was amended with the introduction of a new article 114.[viii] Although the criterion for taxing this gain remained the same, the main difference in 1990 was the deletion of the progressive surtax and the introduction of a fixed rate of twenty percent. The system of taxing capital gains, introduced since 1985 to its current application, has witnessed significant changes. When initially introduced in 1985, the realised gains were taxable only if the transferor, his wife, ascendant or descendant or family member had exercised an important office of responsibility such as director or manager for at least five years. In addition, relatives' shares in the company should exceed twenty five percent of the share profit. It therefore implies that where both conditions were not fulfilled there could not be taxation of the gains. The system then applicable also considered the length of time of the shareholding of the transferor or that of his relatives. Additionally, there has been a move from the progressive surtax to which the gains were initially taxable to a fixed tax rate.

When introduced in the GTC of 2002, these obligations were still applicable.[ix] These provisions were amended in the GTC by the Finance Act no 2002/014 of 30th December 2002

that instituted individual personal income tax (impot sur le revenue des personnes physiques IRRP) with effect from 2003 in line with the fiscal reform of 2002. It resulted in the change of the section number, the deletion of restrictions formerly applicable to the characteristic of the transferor and the length of time of ownership to comprise now only a general provision[x] and the introduction of the threshold exemption.[xi] With regard to these assets, the GTC stated: "The personal income tax shall be levied on the net, overall capital gains arising from the transfer of stocks, bonds and other capital shares made by individuals, occasionally or habitually, either directly or through a financial establishment."[xii] The net overall capital gains exempted by section 42 of this code, was an amount not exceeding XAF[xiii] 500,000 (five hundred thousand) francs."

Although the move from the former approach has led to the deletion of the restricted scope of the tax, it has however resulted in the reduction of the tax rate applicable while introducing XAF 500,000 threshold exemption. The main purpose of amending this individual income tax was aimed at simplifying the system of imposition, which in return would have resulted in securing the tax base. The introduction of these provisions was therefore the second best alternative compared to the current approach and given the incidence of the CGT rate on the sale of shares.

THE AMENDEMENTS INTRODUCED BY THE FINANCE ACTS FOR THE YEARS 2012 AND 2015

Following the enactment of the finance Act for 2012 and 2015, the approach for taxing capital gains has undergone some changes. Indeed, the former provisions remained applicable until the Finance Act 2012, which increased the tax rate from ten per cent to fifteen percent on equity grounds. Also the scope of the tax was extended to realised gains made by artificial persons either in Cameroon or abroad.[xiv] The rationale is that since distribution of dividend already bear a 15% tax rate, thus capital gains on shares transfer must equally be taxed at 15%. Such a view can be argued if one considered that capital tax gains are usually implemented in an environment where other taxes have already been applied.[xv] View from this point, a tax on capital gains may constitute a double tax on corporate profits and which can be further deferred considering the realization rule for taxing these gains which is often used by countries.

The most recent amendment was brought by the Finance Act 2015 with regard to the scope of the tax to be extended to indirect transfer of shares.[xvi] It thus shows that before the enactment of this new provision, artificial legal persons owning shares could effectively escape CGT as a result of its restricted application to only gains made by individuals. Consequently, the juridical form of the business undertaken constituted a determining factor for taxing capital gains. Already acknowledged for its objective of capturing income that would have escaped tax in the absence of the CGT on corporate forms of business,[xvii] the recent increase of the CGT can however be rationalized if one considers the country`s system of dealing with corporate profits and the incidence of the realisation rule namely the lock-in effect.

According to the Organization for the Harmonization of Business Law in Africa (OHADA) Uniform Act on commercial companies, a business can be classified either as a partnership or as a corporation.[xviii] The distinction between the juridical forms of the business undertaken also determines the level of responsibility of the shareholders for the debt of the company owed to a third party, as well as the rule governing the administration of these businesses.

From a taxation point of view, it may be noted that the juridical form of businesses do influence the taxation of profits in the country. Indeed, under the classical system of taxing corporate profits implemented in Cameroon, profits realized by businesses organized in the form of corporations bear a "double" tax, firstly on the realised profits and secondly when these profits are distributed to shareholders in the form of dividends.[xix] However, profits realised by partnerships are deemed distributed at the end of the fiscal year and only taxable at the personal income tax rate.[xx] It thus implies that, in the case of individuals, business profits will be added to other forms of income such as salary, wage or rental income received by that individual in that fiscal year

THE INCIDENCE OF THE DOUBLE TAXATION OF CORPORATE PROFITS AND CAPITAL GAINS TAXATION

The double taxation of corporate profits currently applicable in Cameroon has been subjected to much debate on its merits and incidence and some have eventually advocated the reconsideration of such an approach in dealing with corporate profits in order to alleviate the

tax burden borne by taxpayers.[xxi] Although such distinction has been criticised as influencing or better discriminating between business juridical forms, the most powerful criticism is double taxation. More precisely, the double taxation of corporate profits as currently used in Cameroon and elsewhere, has been criticised on both equity and efficiency arguments.

Evaluation of Double Taxation of Corporate Profits from Equity Grounds

From an equitable point of view, double taxation is criticised because it imposes a high tax burden on shareholders as compared to their counterparts who have opted for the unincorporated business model.[xxii] This additional burden in the form of corporate tax is therefore considered inconsistent with the equitable ideal that requires like gains to be treated equally.[xxiii] Consequently, corporate profits bear an individual income tax element on distributed dividends in addition to the corporate tax. It results in an over taxation of these profits, hence the proposal for the implementation of some form of integration.[xxiv] It should however be noted that despite the criticism on equity grounds, the importance of corporate tax is stressed from the angle of taxing undistributed corporate profits. The rationale of such an argument is underpinned by the veritable characteristic of corporate forms which national tax law generally treats as separate entities from their owners.[xxv] In accordance with these principles, the OHADA Uniform Act establishes a distinction between what should be considered “societe de capitaux” and “societe de personnes”. Under the first category are grouped unlimited liability companies[xxvi] and limited liability companies.[xxvii] In contrast, the second type of business regroups mainly two forms of partnerships as defined in sections 270 and 293 of the OHADA Act.[xxviii] The importance of this distinction is strengthened by the fact that the tax law accords the right to businesses undertaken in the form of partnership to be taxable under either the corporate tax or the individual income tax.[xxix] It thus shows the irrelevancy of the type of tax imposed as compared to the importance of the juridical form of the business.

Consequently, since the corporate form of business provides for the distribution of dividends to shareholders[xxx] in the proportion to their participation in the capital, these dividends can be taxed only if distributed and which distribution depends on management’s decisions.[xxxi] It therefore means that since corporate profits are not deemed distributed at the end of the year to shareholders, the realisation requirement utilised by the country will imply the postponement of the tax on these profits to a later time.[xxxii] An alternative to mitigate the consequence of the realisation requirement could be through the implementation of an allocation system that will

provide for a tax in proportion to the corporate profits accruing to each shareholder.[xxxiii] However, the allocation system as the most reliable solution to the lack of taxation of corporate profits is considered an inadequate solution for dealing with this issue especially, if one considers that it relies on the accrual rule and similarly imposes a tax burden though the shareholders have not received any earning.[xxxiv] Viewed from this angle, and given the importance of the realisation rule, the introduction of a corporate tax seems to be the appropriate approach to capture such undistributed income.

It should however be stressed that the equity ground of such an approach could be strengthened only if the corporate tax is in fact borne by the shareholders, the objective of which is to serve as a substitute to individual income tax that would have been payable by them provided the profits were distributed. Viewed from this angle, the introduction of some integration (imputation system) despite its weakness could be consistent. However, the issue of the real bearer of the corporate tax as compared to the general assumption that it is borne by shareholders is considered unclear.[xxxv]

If we recall that the introduction of the corporate tax is consistent with the search for substituting the individual income tax and taxing undistributed income, therefore, the introduction of an additional tax on the dividends is arguable. However, if the extent to which the corporate tax is borne by shareholders is considered unclear, perhaps such a view may justify the existence of an additional tax on dividends beside the corporate tax. From a general standpoint, it may be noted that the choice of the above mentioned options will impact the approach for dealing with distribution of profits and ultimately lead to some form of inefficiency, thus the importance of evaluating such an approach on efficiency grounds.

Evaluation of Double Taxation of Corporate Profits from Efficiency Grounds

From an efficiency perspective, the existence of corporate tax in addition to a tax on dividends has been criticised on three main grounds namely its incidence in favouring non-corporate form of businesses. It has also been criticised for the bias against equity financing or making economically profitable investments.[xxxvi]

- ***The Bias against the Corporate Sector***

The main argument underpinning against the corporate sector is the double taxation of corporate profits as compared to profits of unincorporated businesses.[xxxvii] In the case of Cameroon, the type of tax is actually irrelevant as the unincorporated enterprises are granted

the right to opt for the payment of corporate tax which is a fixed rate as compared to the progressive individual income tax which comprises four brackets.[xxxviii] As a result, the main issue is the form of business undertaken and in accordance with the OHADA Uniform Act which defines the type of business under which dividends are considered available to shareholders. Consequently, this approach of taxing corporate profits in comparison to non-corporate business income could constitute a bias against corporate investment. The rationale for such an argument is that as far as shareholders bear the corporate tax in addition to the tax on dividends, this extra tax burden may act as a disincentive against investments leading to the preference of the unincorporated form.[xxxix] Viewed from this angle, it is thus clear that the differential in the tax treatment granted to this form of business vehicle could significantly affect the investment choices of individuals considering the existing double taxation imposed on shareholders. However, the contentious issue regarding the real bearer of the corporate tax raised in economic literature rather stresses the spreading of the corporate tax on all income from capital.[xl] As a result, it is considered that the preference for non-corporate investment as opposed to the corporate sector should not be attributable to the existing taxation[xli] but rather to the different tax treatment granted to capital invested in either corporate or non-corporate sector.[xlii]

- ***The Bias against Financing Decision of the Corporation***

Besides its influence on the investment form chosen by individuals, the existence of corporate tax is also criticised from the angle of its impact on the financing decision of corporations. The criticism here is grounded on the fact that because of the additional tax imposed on dividends or retained earnings, corporations may give preference to debt financing considering that interest payable on debt is often deductible.[xliii] Viewed from this angle, the deductibility of interest for debt financing, makes it the preferred option for financing corporate investment opportunities. Also enshrined in the Cameroon current tax system is the allowance for the deduction of interest paid to shareholders on loans advanced to the company.[xliv] Although there is a restriction concerning the rate of this interest compared to the rate applied by the Central Bank of African Countries,[xlv] still the deduction assists in reducing the tax base on the imposition of corporate tax and it is the opposite of the treatment granted to dividends paid or CGT on retained earnings. Despite this advantage granted to debt financing option, it has

however been stressed that recourse to significant level of debt may increase the risk of bankruptcy which may in turn outweigh the tax benefit relating to this option.[xlvi]

- ***The Bias in Favour of Retained Earnings***

The argument in favour of retained earnings with regard to the classical system for taxing corporate earnings stems from the hypothesis that in the presence of additional tax on dividends, companies may prefer to retain earnings rather than distribute profits. Although the impact of the dividend policy on corporate decision- making is disputed,[xlvii] it is important to stress that the deferral advantage attached to the choice to retain earnings added to some preferential treatment granted while imposing capital gains could be a catalyst to such option. It should however be noted that, this option to retain earnings, if adopted may in turn result in less efficient use of capital as it could have been the case if dividends were distributed.[xlviii] The rationale for this is that, in the absence of tax on dividends, more dividends could be distributed to shareholders, which in turn could lead to more diversification of investment.

Despite the veracity of this point, the existence of dividends distribution in the USA despite the additional tax borne, has led some to argue against the real impact of this tax[xlix] and that there may be the existence of some other significant factors which could influence the dividends policy. An example of this can be taken from public-owned companies, which generally distribute dividends. As regards this specific case, three main explanations have been emphasised to justify it. To begin with, the preference of some investors to receive dividends, which represent a steady stream of income, could be justified as compared to the transaction cost of selling their corporate stocks, as may be the case under capital gains. More importantly, the payment of dividends may as well influence positively the market valuation of corporate stocks.[l]

Overall, it may be noted that the implementation of a classical system in comparison to other alternative forms of integration has been criticised mainly on both equity and efficiency grounds. Although the incidence of such policy may be exacerbated in the case of different tax rates applied to each form of revenue (capital gains and dividends income),[li] still even in the hypothesis of similar tax rates, the double taxation may lead to some inefficiency. The primary argument on the inefficiency of such method of taxing corporate profits is the realisation rule for taxing capital gains, which may lead to the lock-in effect. As a result, even if applying

similar tax rates can contribute to reducing the effect of double taxation, it still involves the risk of revenue loss if the decision to retain earnings was adopted by the company and if taxpayers are influenced by CGT. Viewed from this point and considering the emphasis placed on transfer for consideration as a factor triggering CGT, the recent increase of CGT rate on shares is questionable even though stressed on equity grounds given the lock-in effect that may exist generally and more specifically in response to tax rate changes. Thus the importance of looking for alternative means of reducing its effect considering the difference in views (Traditional and New view) that exists in the literature with regard to dividend taxation, in addition to the realisation rule for taxing capital gains and the behavioural responses of taxpayers to tax rate changes also often emphasized in the literature. This will be discussed in the next subsection.

THE IMPACT OF A TAX ON DIVIDENDS AND ITS INCIDENCE ON CAPITAL GAINS REALISATION

Besides the criticism of the double taxation of corporate profits under the classical system, a more controversial criticism in the literature has been the evaluation of the impact of a tax on dividends payout policy, rationalized on two theories:

The Traditional View and the New View of Tax on Dividends

Under the traditional view of taxing dividends, it is important to pay dividends to shareholders as a means of attracting investors. The rationale for this is that recurrent distribution of dividends which is the manifestation of realised profits could signal profitability to both current and potential shareholders.[lii] Equally, recurrent payment of dividends is aimed at achieving the goal of imposing some managerial constraints through the reduction of the amount of the cash flow available to managers to finance self-serving projects.[liii] Consequently, since under this view, profits are ultimately distributed in the forms of dividends, hence investment projects will essentially rely on the issue of new shares as a means of financing.[liv] With regard to the tax rate applicable on dividends and given the emphasis placed on the distribution, it is thus believed under the traditional view any decrease in the tax rate on dividends could be a factor in increasing the payout of dividends.[lv] However, the underlying arguments for the rationale of the traditional view have been subject to criticism.

To begin with, emphasis placed on the payment of dividends as a means of signalling corporate profits or reducing managerial decisions[lvi] has been considered a rather expensive means of achieving these ends given that other alternatives such as the share repurchases could be utilised. The share repurchase alternative has been widely adopted by many companies since the early 1980`s. Indeed, studies conducted in the U.S. show a significant increase of cash distributions in the form of share repurchases from 1974 to 1998 with a rate rising from twenty four percent to eighty one percent [lvii] As a result, even though in contradiction to the impact of tax on dividends payout policy, the share repurchase option which involves capital gains could therefore also be affected by CGT rate applicable. Similarly, the power granted to the board could be better utilised for monitoring managers as compared to the restriction of available cash flow.[lviii]

Another powerful argument against the traditional view is its reliance on the source of financing investment. Indeed, considering that all profits are ultimately distributed to shareholders, therefore the only available source is to rely on funds through the issue of new shares.[lix] However, given the ease of having recourse to retained earnings or the advantages attached to debt as means of financing, it has been argued that in reality much, if not most of the corporations give preference to retained earnings or incurring debts as compared to issuing new equity.[lx]

In contrast to the traditional view, the new view stresses on retained earnings as the principal source of financing investment projects of companies.[lxi] From the approach of the proponents of such view, the payment of dividends is not the immediate goal and it will ultimately take place only after pursuing or the realisation of all the productive investment has been achieved.[lxii] The underlying rationale of the new view is that earnings from equity-financed investments will be eventually distributed to shareholders in the form of dividends.[lxiii] Moving from the assumption that dividends will be finally distributed to shareholders provided liquidation does not take place, proponents of the new view argue that the implementation of the dividends tax cut would result in a windfall gains to shareholders[lxiv] though it would not impact on the corporate dividends policy.[lxv]

The Evaluation of both Approaches in Relation to Capital Gains Taxation

From the above development of the two strands of thought, it can be seen that while the traditional view considers the dividend tax rate as a significant factor on the dividends payout

policy of the company, the new view on the other hand considers the rate as irrelevant. With regard to the view of each of the approaches, it is important to stress that perhaps the main distinction with regard to these two views could be based on the characteristic of companies involved and their level of access to external markets.[lxvi] As result, depending upon their stage of development, they may either resort to retain earnings or to issuing of new shares.[lxvii]

Putting aside the discussion pertaining to the effect of dividends tax on corporate payout policy raised by the two views and their criticisms, it may be noted that the alternative of financing corporate investment with retained earnings or share repurchase could also give rise to capital gains[lxviii] subject to CGT.

Viewed from this angle and considering the main criticism on the issuance of new shares as stressed by the traditional view, it follows that retained earnings or share repurchase represent the most desirable option for financing. With regard to capital gains if such alternatives were adopted, and despite the criticism of the incidence of the tax rate differential on dividends and capital gains as a catalyst to the negative impact of the double taxation of corporate profits, it is believed that a preferential treatment granted for taxing capital gains can be efficient for two reasons. Firstly, because of the realisation rule for taxing capital gains as utilised in Cameroon, a low tax rate for taxing capital gains may induce the sale of shares leading to more revenue yield. Secondly, the longer the distribution of dividends is postponed, the more the taxpayer could take advantage of the preferential tax treatment by selling part or all of his holding to diversify his investments. It is thus implied that beside the increase of revenue yield, the preferential treatment for taxing capital gains could lead to diversified investment opportunities. Although specific studies have not been conducted in Cameroon to evaluate the impact of the increase of CGT rate on the realisation of stocks, still a similar study conducted in the USA with regard to the lock-in effect that results from the realisation rule for taxing these gains has proven some changes in the realization response with regard to CGT tax cut.[lxix] Although the extent to which such realisation is pronounced over a given period of time is different[lxx] and considering the adoption of the classical tax system used in Cameroon as in the U.S in addition to the realisation rule for taxing these of CGT, it is argued that the recent increase of tax on gains from shares does not represent the most efficient reform.

The rationale for such view is that, the equity ground on which the increase is stressed does not represent a strong policy in comparison to the lock-in effect that could result from the way of taxing these gains. From the substance of section 43, it can be seen that CGT applies only to

capital gains realised from the sale of shares. Since the CGT has been increased, it implies more gratuitous transfers to avoid the incidence of CGT, which may thus lead to a case of lock-in. Moreover, since the introduction of CGT on shares until the amendment made by the Finance Act 2012, a preferential treatment has always been granted for taxing these gains even coupled with a threshold exemption. It is thus implied that so far, the equity concern was not a major factor.

Even if we recognise the need for additional revenue as recently emphasised in the annual budget, it is believed that widening of the scope to cover shares owned by legal entities is a more effective source of revenue yield as compared to the increase of CGT on shares. Consequently, since with tax rate that is maintained, the appropriate method for dealing with the lock-in effect and the incidence of the classical system could be done through the introduction of additional incentive while taxing these gains. However, because of the need for financial resources in the country, such proposal will be analysed on both equity and efficiency grounds. Indeed Since 1990 two major tax reforms were implemented in 1994 and 1999 to restructure the country‘s tax policies for revenue mobilization in order to overshadow the deficit scenario A more recent tax reform was introduced from 2007 to anticipate the negative effects of the drop of revenue from import and export trade tax by improving the system of taxing income from many sources. In line with these objectives the tax system has been undergoing drastic changes with an emphasis on provisions aiming at securing the tax base, widening the scope of the tax without forgetting some tax incentives. This objective is marked by the constant increase of the expected revenue yield per year be it from corporate and personal income or VAT, customs duties etc… consequently, any tax cut needs to be justified either on equity or efficiency grounds.

THE APPRAISAL OF THE PREFERENTIAL TREATMENT FOR TAXING GAINS ON SHARES

The most important issue surrounding the introduction of a preferential treatment for taxing capital gains because of the lock-in is whether the tax will successfully raise revenue. Although it is generally agreed that a preference in taxing capital gains will result in more realisation[lxxi] and therefore reducing the impact of the lock-in effect, the extent to which this increase is effective has been however considered as controversial. The controversy of the impact of the

preference on realisation stems generally from the disparity of results of the empirical works conducted to evaluate such impact. Indeed, the diversity of the forms of empirical work and absence of consideration of some important factors such as the transitory effect, the wider scope of individual as basis for the evaluation or the emphasis on the tax rate as compared to factors that could be taken into consideration, have been the source of a lot of divergence in the results.[lxxii]

Despite this disparity of results, it is important to note that from the main factors for evaluating the revenue maximising rate of a tax, the factor most stressed is the comparative ease through which taxpayers can avoid the said tax.[lxxiii] It thus shows that beside the high tax rate that could be implemented, the avoidance practice will be more propounded where taxpayers seek obvious alternatives to delay or avoid paying the tax. As a result, considering the restriction of the factors that trigger the CGT to only disposal for consideration, it can be a determining factor given that gratuitous transfers and bequests are not taxable. Viewed from this perspective and because the CGT on shares transfer can be easily avoided, therefore the increase of CGT rate to meet that applicable to dividends cannot be considered as the revenue maximising rate. The rationale for such argument is that, in comparison to the dividend tax, the CGT can be easily avoided because it captures only transactions for consideration as stated in the GTC. Consequently, if corporate profits were mainly retained than distributed to shareholders, this retention is materialised by an increase in the share price which is transferred ultimately in the form of enhanced shares value than dividends causing the state to effectively lose revenue if part of these share transfers were made under a gratuitous scheme. Thus, it appears that, because of the restriction regarding the realisation of capital gains on shares, providing some forms of incentive when taxing these gains can effectively induce their realisation.

It should be stressed that despite the disparities in the results of the empirical studies conducted in the USA to measure the impact of the tax rate on the realisation of assets, it has been noted that most of these researches stress that the revenue maximising rate for capital gains to be a rate lesser than that applicable on ordinary income even though this statement is considered not free of doubt.[lxxiv] The rationale for this is that, with a CGT rate higher than the tax on dividends, companies may instead resort to more dividends payment or debt financing as compared to retained earnings leading eventually to capital gains.[lxxv] It therefore implies that, in order to induce CGT on shares transfer, the proposal for reform of taxation should provide for a rate lesser than that applicable on dividends or better provide some form of exemption to

reduce the effective tax burden on the taxpayer such as discount based on the length of ownership of the shares. Given the important role that taxes play in the economy of the state it is important to analyse such proposal on equity and efficiency grounds.

Evaluation of the Reform of CGT Rate on Shares on Equity Grounds

The issue of introducing preferential capital gains taxation is an important one considering that tax policymakers always stress on the concept of equity (either horizontal or vertical) to evaluate the usefulness of a tax provision or even undertaking a reform in the tax system. In accordance with the spirit of the tax law amendment introduced by the Finance Act 2012, the CGT rate increase resonates with the search for rendering the system more equitable considering that a similar rate is applicable on dividends. The contentious question is therefore whether this notion of equity should be given more prevalence despite the double taxation of corporate profits as applicable in Cameroon or the lock-in effect that could result from the application of the tax law which could effectively be tackled by granting some incentives in the course of taxing capital gains.

There have been extensive discussions on the issue of the primacy to be given to either equity or efficiency while implementing a tax reform. If on the one hand, the equity criterion is stressed by those who give preference to the Haig Simons model for taxing income,[lxxvi] on the other hand, tax theorists in the search for attaining more efficiency do not consider the differential tax treatment applicable to taxpayers a major concern.[lxxvii] The most important issue here is that of implementing an optimal tax structure which combines both equity and efficiency. From such a perspective, it appears that if the optimality of the tax structure is the major concern therefore, from an efficiency point of view, the discrimination of tax treatment of income earners is inescapable considering the reliance on the taxpayers` responses to taxation. It thus shows that the appraisal of the significance of attaining horizontal equity for a better analysis should also take into account factors that may lead to inefficiency.

With regard to the current approach for dealing with corporate profits and the case of lock-in effect that stems from the realisation rule for taxing capital gains on shares, the tradeoff between equity and efficiency can be substantiated if one considers that the preferential tax treatment will induce the realisation of gains. Although the issue of capital gains preference has been extensively criticised[lxxviii] especially on equity grounds,[lxxix] in the critical evaluation of the preference for taxing capital gains, Schenk arrived at the conclusion that: “despite the

weakness of such preference as a policy, it can be defended as a second best alternative provided it resulted in sufficient efficiency and improved equity through the increase of the effective tax rate on the holders of capital".[lxxx] It thus shows that the concern of equity can be outweighed if the preference is expected to result in more efficiency and more realisation. Despite the inconclusiveness of the studies conducted to evaluate the realisation response to CGT rate, we remain optimistic that such reform could be an important step in reforming the current Cameroonian tax system given the important CGT that can be gained from corporate sector.

Evaluation of the Reform of CGT Rate on Shares on Efficiency Grounds

The evaluation of CGT preference on efficiency grounds needs to be done with regard to the recent increase of the tax rate in comparison to what was applicable formerly. Before evaluating the efficiency of such proposal, it is important to note that despite the emphasis placed on attaining equity, this increase is mainly aimed at extending the scope of charge of the CGT and similarly yielding more revenue. For this purpose, whether the introduction of the CGT preference will prove effective also depend on this revenue-raising criterion. Cognizant that an increase in the CGT will contribute in raising a non-negligible amount of revenue, the most important question is whether the increase of the CGT to be equivalent to the dividend tax is the best alternative to induce the realisation of gain. In arriving at such decision, namely whether a proposal is better than another, economists do generally use the Pareto efficiency standard[lxxxi] for evaluating the desirability of an allocation of resources. Indeed under this approach an allocation is considered as Pareto efficient if the only way to make one individual better off is to make another individual worse off. Practically it should mean that since the government has emphasised the increase of the CGT rate on equity grounds, the Pareto efficient standard regarding the solution to the lock-in effect will command that for any decrease in the CGT rate or any form of incentive, an equal tax burden will be increased on dividends or other taxes. Thus, this principle will lead to the inefficiency of the allocation. However, with regard to the incidence of such approach a similar notion often used is that of the Pareto improvement. Indeed, under this notion, a reallocation of resources is a Pareto improvement if it makes at least one person better off without making anyone worse off.[lxxxii] From the angle of optimality, the Pareto concept stresses on the availability of one alternative among a set of alternatives, which can be considered the Pareto better wise. Consequently, this reallocation may be Pareto

optimal if there is no other alternative that everyone will regard it as at least as good, and at least one person will regard it as better.[lxxxiii]

Viewed from this angle and if one considers that the 15% CGT rate equivalent to what is also applicable to dividends is the revenue maximising rate for capital gains, therefore, the introduction of some discount for taxing share gains can be thus considered as a Pareto improvement. Consequently, by maintaining the same tax rate in comparison to the former low tax rate, the alternative of introducing a discount on CGT taxpayers will result in making them better off. The rationale for this is that, through this incentive, dividends will be taxed at the same rate, while capital gains taxpayers subjected to the increased tax rate will also be granted incentives to reduce the lock-in effect. Finally the government will acquire more revenue from both sides namely through the widening the scope of the CGT and the realization of capital gains through the incentives granted.

Moreover, since capital gains are only taxed when realized, taxpayers get to choose when they pay their capital gains taxes, which makes them significantly more responsive to tax changes than other types of income. Consequently under a higher tax rate on capital gains can push investors to delay the sale of their assets or do it less frequently, which leads to less taxes being assessed.[lxxxiv]

It is important to note that the introduction of CGT preference raises the complexity argument in implementing such proposal. Concerning gains on shares, given that the emphasis is on granting discount of the taxable base depending on the length of ownership of these assets, the simplest way to avoid the administrative complexity of the proposal could be to decide the time from when the exemption will be applicable. Therefore, only shares acquired after this date will be eligible to this preference.

CONCLUSION

Mobilization of revenue from taxes occupies an important place in the financing system of Cameroon. A distinctive feature of the annual budget shows a high reliance on revenue from taxes as a means to finance public expenditure. As a result, efforts to enhance this revenue yield could be made either through the extension of the chargeable assets, the reduction of the scope of exemptions or even an increase in the tax rate. Despite being emphasised on equity grounds, it is quite clear that the recent increase in CGT rate on shares aims mainly at increasing the yield. Clearly efforts to reform the system of taxing these gains should take into account the

incidence of the tax and its correlation to taxpayers' realisation responses. It can therefore be concluded that the recent increase of the CGT is an inefficient measure which needs to be reformed to comprise discounts, exemptions and that the extension of the scope of the CGT on shares is an adequate source of revenue for the State.

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ENDNOTES

[i] Blum, Walter J., "A Handy Summary of the Capital Gains Arguments" (1957) 35 No. 4 *Taxes 247* at 264-265.
[ii] From the introduction of the CGT on share as introduced in 1985, the method of assessing the gains and the imposition of the tax rate has been amended several times.
[iii] See the budget highlights of 2012.
[iv] In the light of general tax code (GTC), which extends to the taxation of income realised by physical persons, section 42 in its former version before the amendment made by the Finance Act for 2012, did not define explicitly that the scope of the CGT covered also gains on shares transfer made by natural persons.
[v] Cunningham Noel and Deborah H Schenk "The Case for a Capital Gains Preference" (1993) 48 *Tax L. Rev* 319 at 344.
[vi] See new section 114 of the tax code as enacted through the Finance Act, 1985 (Law No 85/01 of 29 June 1985).
[vii] *ibid.*
[viii] See Finance Act, 1990 (Law No 90/001 of 29 June 1990).
[ix] Section 92 and 93 of the GTC in its version applicable in 2002 as introduced by the Law N° 2002/003 of April 19, 2002.
[x] Section 42 of the GTC, which is rather general.
[xi] Section 43 which provides for the exemption of the 500.000 XAF CFA.
[xii] See section 42 of the GTC. It should be noted that the word personal income tax in the context refers to the income tax imposed on individual at the opposite of the corporate tax. Thus this income tax which is applicable only to natural persons is imposed on various form of income realised by them at a progressive rate, though there is an exception for example in the case of dividends and capital gains.
[xiii] It refers to the Central African CFA (African financial community) franc.
[xiv] See Finance Act 2012 (Law No 2011/020 of 14 December 2011). See also Circular N° 01 /MINFI/DGI/LC/L of 30 January 2012 which defines the methods of implementation of the Finance Act 2012.
[xv] Scott Eastman, "The Trade-offs of Repealing Step-Up in Basis," Tax Foundation, March 13, 2019, https://taxfoundation.org/step-up-in-basis/.
[xvi] The appreciation to be given to this concept of indirect transfer is defined in the sub paragraph of section 42 to mean: "The indirect transfer of stocks, shares and bonds of enterprises governed by Cameroonian law including notably any transfer made in Cameroon or abroad between two foreign companies under the same consolidation scope when one of the entities of this scope, completely or partially, holds the share capital of an enterprise governed by Cameroonian law." See section 42 of the GTC as amended by the Finance Act 2015 (Law N° 2014/026 of 23 December 2014).
[xvii] Blum, Walter J., above, 264-265.
[xviii] See section 6 of the OHADA Uniform Acts on Company Law adopted on 30 January 2014. OHADA Official Journal special number of 4th February 2014. .
[xix] Section 36 of the GTC.
[xx] Section 26 of the GTC.
[xxi] Indeed, with regard to the incidence of this approach for dealing with corporate gains, alternatives stressing the elimination of the double taxation either through the implementation of a partial or full integration have been advocated. See Warren Alvin, "The Relation and Integration of Individual and Corporate Income Taxes," (1981) 94 *Harv. L. Rev* 717 *at* 728-744, see also Peel Fred W., A Proposal for Eliminating Double Taxation of Corporate

Dividends," (1986) 39 (1) *Tax Law* 1 at 1-12 and 15-30. For a counter argument on the double taxation, see Kwall Jeffrey L., "The Uncertain Case against the Double Taxation of Corporate Income" (1990) 68 *N.C. L. Rev* 613 who provides limitation on the criticism of the double taxation on both equity and efficiency grounds at 633- 638 and 645-655.

[xxii] Peel Fred W, above, 2.

[xxiii] Richard A. Musgrave, *The Theory of Public Finance, A Study in Public Economy* (1959, McGraw-Hill) at 160.

[xxiv] The method of implementing an integration system can be made through either a partial or a complete integration scheme. For detail on the proposal for eliminating the double taxation of corporate profit, see Peel Fred W., above at 1-36. See also Litzenberger, Robert H and Van Horne, James C., "Elimination of The Double Taxation of Dividends and Corporate Financial Policy," (1978) 33 (3) *The Journal of Finance* 737 at 737-750.

[xxv] In accordance with this principle, the OHADA Uniform Act mainly establishes the difference between what should be considered as "societe de capitaux and societe de personnes". Under the first category are grouped liability and limited liability see section 385 and 309 of the OHADA Uniform Acts on Company Law adopted on 30 January 2014. OHADA Official Journal special number of 04 February 2014, while under the second category are found two forms of partnership as defined in sections 270 and 293 of the above-mentioned Act.

[xxvi] Section 385of the OHADA uniform Act on Company Law.

[xxvii] Section 309 of the OHADA uniform Act on Company Law.

[xxviii] OHADA Uniforms Act on Company Law adopted on 30 January 2014.

[xxix] Section 26 of the GTC.

[xxx] See section 346 and section 754-756 of the the OHADA Uniform Acts on Company Law adopted on 30 January 2014. OHADA Official Journal special number of 4 February 2014. . .

[xxxi] Section 144-146 of the the OHADA Uniform Acts on Company Law adopted on 30 January 2014. OHADA Official Journal special number of 4 February 2014.

[xxxii] Kwall Jeffrey L., above at 629.

[xxxiii] Warren Alvin, above at 740 -41.

[xxxiv] Despite recognizing the consequence of implementing such approach as the result of the realization rule, Warren however states that: **"**These objections to allocation do not seem sufficiently persuasive to preclude future exploration of such a program. That exploration is not undertaken here because enactment of allocation would involve a significantly greater departure from existing law than would either of the two proposals to be examined in detail. Nothing in this Article should be taken to suggest, however, that allocation might not be desirable at some point in the future."

[xxxv] Pechman, Joseph, *Federal Tax Policy*, (5th ed, 1987, Brookings) at 141-146. See also Goode, "Who Bears the Corporation Income Tax?" (1965) 32 *Chi. L. REV* 410 for a brief review of the assumption pertaining to the corporate tax remaining on corporations and their shareholders opposite to the assumption that the tax is fully passed on to consumers resulting in higher prices while commenting on the study made by Krzyzaniak and Musgrave.

[xxxvi] Warren Alvin, above at 732-733.

[xxxvii] See respectively section 6 and 7 of the GTC, which provides the rules for arriving at the taxable profit and section 17 which provides for the tax rate applicable to corporate profits. It should be noted that this rate has been amended by the Finance Act 2015 (Law N° 2014/026 of 23 December 2014) from 35% without surcharges to 30%. Following the covid 19 pandemic, the tax rate was further reduced to 28% even though the decrease was restricted to companies realising an annual turnover lesser than 3 billion which refers to small and medium enterprises.

[xxxviii] Section 69 of the GTC.

[xxxix] Warren Alvin, above at 725. Eric M. Zoltt, "Corporate Taxation after the Tax Reform Act of 1986: A State of Disequilibrium" (1988) 66 *N.C. L. Rev* 839 at 860.

[xl] Feldstein, "On the Theory of Tax Reform," (1976) 6 *J. Pub. Econ* 77 at 88.

[xli] Gregory Ballentine, J., *Equity, Efficiency and the U.S. Corporate Income Tax* (1980, American Enterprise Institute for Public Policy Research) at 73-82.

[xlii] Jeffrey L. Kwall, above at 645-650.

[xliii] Eric M. Zoltt, abve at 863-866.

[xliv] Section 7 B of the GTC which provides: "Interest paid to partners in respect of the sums they leave with or place
at the disposal of the company over and above their capital, irrespective of the type of company, shall be acceptable within the limits of those calculated at the rate of the central bank discount rate, raised by 2 points."

[xlv] The French acronym of this bank is BEAC.

[xlvi] Eric M. Zoltt, above at 843.

[xlvii] Black & Scholes, "The Effects of Dividend Yield and Dividend Policy on Common Stock prices and Returns" (1974) 1 J. Fin. Econ1 at 21; Miller & Modigliani, "Dividend Policy, Growth and Valuation of Shares," (1961) 34 *J. Business* 411, emphasizing the irrelevancy and the independence of dividends policy on the value of the corporation.
[xlviii] Norr, Martin, *The Taxation of Corporations and Shareholders* (1982, Kluwer Law and Taxation Publishers) at 56-57.
[xlix] Omrod Phillip, "Dividends and Taxation," (1987) 13(¾) *Managerial Finance* 21 at 22.
[l] Eric M. Zoltt, above at 844.
[li] Warren Alvin, above at 723-724 and 731-733. From an evaluation of the double taxation system on dividends investment, corporate debt, corporate equity(with dividends) or corporate equity (with retention) from the result obtained, Warren states that: " the difference in the result for both taxpayer are due to three factors; the application of an extra level of taxation on the return to corporate equity, the difference in rate or the deferral of the shareholders tax on retained earnings until the CGT is imposed on disposition of the corporate stocks.
[lii] Bergheim B. Douglas & Adam Wants, "A Tax-Based Test of the Dividend Signaling Hypothesis," (1995) 85 *Am. Econ. Rev* 532 at 532-33.
[liii] Frank H. Easterbrook, "Two Agency-Cost Explanations of Dividend," (1984) 74 (4) Am. *Econ. REV* 650 at 654.
[liv] Hans-Werner Sinn, "Taxation and the Cost of Capital: The "Old" View, the "New" View, and Another View," (1990) *Working Paper* No. 3501 *Nat'l Bureau of Econ Research 1 at* 5.
[lv] Hubbard, R. Glenn Corporate Tax Integration: A View from the Treasury Department" (1993) 7 *J. Econ. Persp* 115 at 120.
[lvi] Zodrow, George R, "On the "Traditional" And "New" Views of Dividend Taxation," (1991) 44 *National Tax Journal* 497 at 503.
[lvii] Franklin Allen & Roni Michaely, "Payout Policy", in George M. Constantinides et al. (ed) *Handbook of The Economics of Finance,* (2003 Elsevier) at 345-346.
[lviii] Id at 384.
[lix] Hans-Werner Sinn, above at 51.
[lx] Id at 5-6.
[lxi] Auerbach Alan J. & Kevin A. Hassett, "On the Marginal Source of Investment Funds," (2002) 87 *J. Pub. Econ* 205 at 206.
[lxii] McKenzie Kenneth J. & Aileen J. Thompson, "The Economic Effects of Dividend Taxation," (1996) Working Paper 96-97 *Technical Committee on Business Taxation* 1 at 7, 8.
[lxiii] Zodrow George R., above 498.
[lxiv] Ibid.
[lxv] Kenneth J. McKenzie & Aileen J., above at 10.
[lxvi] Auerbach Alan J & Kevin A. Hassett, above at 222.
[lxvii] Ibid., 228-229. The characterization of these firms mainly stresses on newly established firms having weak capital-market access and with no bond rating or analysis on record as opposed to larger firms with high bond ratings and several analysts following them.
[lxviii] Section 36 paragraph 2 (b) of the GTC. Thus the recent increase of the CGT on equity grounds call for a deeper analysis of this move in the light of the characteristics of capital , the methods of imposing them and the eventual lock-in effect that could result from imposition and ultimately the loss of revenue or deferral of the imposition.
[lxix] Erica York, "An Overview of Capital Gains Taxes" (2019) FISCAL FACT No. 649 at 8. See also Kiefer, Donald W., "Lock-In Effect within a Simple Model of Corporate Stock Trading," (1990) 43 *Nat'l Tax Journal* 75 at 82.
[lxx] Id at 82-85. Indeed from the studies conducted, results showed a triple phase of realisation responses to CGT namely a sharp increase following the tax cut, an intermediate phase between 2 to 5 years consisting of a decline in the realisation of gains and finally a long term phase characterized by a gradual increase of realisation.
[lxxi] Indeed, with regard to the USA many studies have been conducted to evaluate the impact of the lock-in effect of the tax rate and the inducement of realisation. Gerard M. Brannon, The Lock-in Problem for Capital Gains: An Analysis of the 1970-71 Experience (1974); Donald W. Kiefer, above at 75-76.
[lxxii] Given the importance of the realisation effect in taxing capital gains and the wide approach of evaluation, Zodrow summarily described and evaluated these studies and their outcome. See Zodrow, George R., "Economic Analyses of Capital Gains Taxation: Realizations, Revenues, Efficiency and Equity" (1993) 48 Tax L. Rev 419 at 429-464.
[lxxiii] Joseph E. Stiglitz, "Some Aspects of the Taxation of Capital Gains," (1983) 21 *J. Pub. Econ* 257 at 257-294.

[lxxiv] Eric Toder & Larry Ozanne, "How Capital Gains Tax Rates Affect Revenues: The Historical Evidence" (1988) *Congressional Budget Office*, [17] available at http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/84xx/doc8449/88-cbo-007.pdf (last accessed on May 22, 2012).

[lxxv] Ibid.

[lxxvi] Walter Hettich & Stanley Wimer, "Blueprints and Pathways: The Shifting Foundations of Tax Reform*,"(1985) 38 Nat'l Tax Journal* 424

[lxxvii] Id at 429. With regard to the importance of attaining equity taxation, Phelps stated: "this canon may be in Aristotle, but it is not in economics." See Phelps, E. S. "Rational Taxation," Social Research 44, (1977): 658 as quoted in Walter Hettich & Stanley Wimer, 429.

[lxxviii] For an in depth analysis of the criticism of the arguments stressed to justify the preference, see Noel B. Cunningham and Deborah H. Schenk, above at 319.

[lxxix] Joseph M. Dodge, "Restoring Preferential Capital Gains Treatment under a Flat Rate Income Tax: Panacea or Placebo?" (1989) *44 Tax Notes* 1138. With regard to the importance of providing more incentive to induce the realisation of gins, Dodge argued that such preference is perverse and even unfair to provide a taxpayer who has taken advantage of the realization requirement an incentive to sell.

[lxxx] Noel B. Cunningham and Deborah H. Schenk, above at 375.

[lxxxi] Harvey S. Rosen, *Public Finance, (* 2nd ed, 1988, Irwin) at 42.

[lxxxii] Id at 42-44.

[lxxxiii] Amartya K. Sen, *Collective Choice and Social Welfare*, (1984, Elsevier science) at 21-22.

[lxxxiv] Erica York, "An Overview of Capital Gains Taxes" (2019) FISCAL FACT No. 649 at 8