TAXING CAPITAL GAINS FROM SHAREHOLDING IN CAMEROON VIS-À-VIS DOUBLE TAXATION OF CORPORATE PROFITS

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ABSTRACT

The Cameroonian tax system has undergone significant modifications as a result of the search for increased revenue return, particularly in the way capital gains on the transfer of shares are taxed. Although intended to make the system more egalitarian, given the way these gains are taxed, these modifications could theoretically spark debate. The recent increase in the capital gains tax (CGT) rate on shares and the removal of the initially offered incentives are two potential arguments that could be made. They centre on the capital gains tax (CGT) trigger and the mechanism of taxing corporate earnings. This essay makes the case that these adjustments are unnecessary by analysing their justification. Despite the fact that the equity requirement takes precedence, the theoretical justification for taxing these gains may nevertheless require deviating from this rule in order to achieve the goal of raising the revenue yield.

INTRODUCTION

Shares or stocks are components that make an individual's involvement or contribution in a business or partnership tangible. When a business is expanding and lucrative, the number of shares that are accessible to shareholders may rise, or the nominal value of shares may simply rise, resulting in capital gains when these assets are transferred. From a general perspective, the difficulties of taxing the undistributed profits gained by shareholders, as it may burden them given that they have not received any earnings, led to the development of the capital gains tax (CGT). Because of this, adding a CGT will help tax retained earnings that would have dodged taxation in the absence of the CGT. Thus, the CGT's inception acknowledges the possibility of profit retention as a means of realising gains. The Finance Act of 2012, passed by the Cameroonian government, increased the tax rate that is applied to realised gains and broadened its coverage to include capital gains made by both artificial and natural persons in connection with the transfer of shares they own in businesses that are based in Cameroonia. After receiving preferential treatment for taxing realised capital gains on shares for many years, this new move, which has the covert goal of narrowing the extent of the tax exemption in order to increase revenue, has been reportedly justified on the basis of equity. In addition to its benefit in redefining the taxable persons, this new rule has also raised the tax rate from ten to fifteen percent. If there is an equality justification for taxing capital and income equally, the error in the tax rate increase may be overlooked. But because of their very nature, capital gains have always benefited from a type of preferential treatment over income, either to encourage their realisation or merely to counteract the lock-in effect. Therefore, it is crucial to assess this increase and its justification by carefully examining the evolution of the taxation system for these gains, the effects of the realisation rule, the traditional system for taxing corporate profits, and finally, an assessment of the incentive promoted on the basis of both equity and efficiency.

THE DEVELOPMENT OF THE CGT RATE ON GAINS FROM SHARES

Due to the tax benefit that might be obtained through retained earnings, the legislature in Cameroon wanted to create equity among taxpayers, which led to the introduction of the CGT on the transfer of shares in that country in 1985. Consequently, a new section of the general tax code (GTC) was added that addresses the taxation of realised gains in the following manner:

"The excess of the sale price over the purchase price or initial value of these rights is taxed at the progressive surtax when a partner, shareholder, or unit holder transfers all or a portion of their ownership during the life of a corporation."

However, further requirements relating to the ownership criterion of the shares' owner as outlined in these terms must be met before tax is imposed on these gains:

"However, the capital gain thus obtained is subject to tax provided 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," the tax law states.

With the addition of a new article 114 in 1990, this clause was changed. The key change in 1990 was the elimination of the progressive surtax and the implementation of a fixed rate of 20%, even if the criteria for taxing this gain did not change. Since its introduction in 1985 till now, the capital gains tax system has undergone major adjustments. When they were first adopted in 1985, realised gains were only subject to taxation if the transferor, his wife, an ancestor, descendant, or other member of their family had held an important position of responsibility, like director or manager, for at least five years. Additionally, relatives' ownership stakes in the business should equal or surpass 25% of the share profit. As a result, it implies that gains could not be taxed in cases when neither requirement was met. The system in use at the time took into account the duration of the transferor's or his relatives' ownership of the shares. In addition, a fixed tax rate has replaced the progressive surtax under which gains were previously payable.

These responsibilities continued to be applicable when they were first included in the GTC of 2002. The Finance Act No. 2002/014 of December 30, 2002, altered these provisions in the GTC by instituting the individual personal income tax (impot sur le revenu des personnes physiques IRRP) with effect from 2003 in accordance with the fiscal reform of 2002. As a result, the section number was changed, limits that had previously applied to the traits of the transferor and the duration of ownership were eliminated in favour of a general provision, and the threshold exemption was added. Regarding these assets, the GTC stated: "The personal income tax shall be levied on the net, overall capital gains deriving from the transfer by persons, sometimes or routinely, either directly or through a financial establishment, of any stocks, bonds, and other capital shares." The maximum amount of net total capital gains that were exempt under section 42 of this code was XAF 500,000 (five hundred thousand) francs.

Although the switch from the prior strategy resulted in the elimination of the tax's restricted application, it also led to a decrease in the applicable tax rate and the introduction of a XAF 500,000 threshold exemption. The fundamental goal of changing this individual income tax was to make the imposition process simpler, which would have secured the tax base. In light of the existing strategy and the impact of the CGT rate on the sale of shares, the inclusion of these provisions was therefore the second-best option.

THE CHANGES ADDED BY THE FINANCE ACTS FOR 2012 AND 2015

The method for taxing capital gains has changed somewhat as a result of the passage of the financial Acts for 2012 and 2015. The previous rules were in fact still in effect after the Finance Act of 2012, which raised the tax rate from 10% to 15% for equity reasons. Additionally, the tax's application was expanded to include gains that artificial persons, whether living in Cameroon or elsewhere, realised. The reasoning behind this is that since capital gains on the transfer of shares must also be taxed at 15% since dividend distribution already carries a 15% tax rate. If it were taken into account that capital gains taxes are typically introduced in an environment where other taxes have already been levied, such a viewpoint may be defended. When viewed from this angle, a tax on capital gains may amount to a double tax on corporate earnings, which can be further postponed when taking into account the realisation rule that many nations employ when taxing these gains.

The Finance Act 2015 introduced the most current modification, which calls for the tax's application to indirect share transfers. Thus, it demonstrates that prior to the adoption of this new rule, artificial legal persons holding shares could effectively avoid CGT due to the tax law's restriction on its applicability to only personal earnings. As a result, the legal structure of the business that was conducted affected how capital gains were taxed. However, the recent increase in CGT can be justified if one takes into account the nation's system of dealing with corporate profits and the incidence of the realisation rule, namely the lock-in effect. Its goal of capturing income that would have escaped tax in the absence of the CGT on corporate forms of business is already acknowledged.

A business can be categorised as either a partnership or a corporation under the Organization for the Harmonization of Business Law in Africa's (OHADA) Uniform Act on Commercial

Companies. The disparity between the business's legal structures also affects the shareholders' amount of liability for the debt the firm owes to a third party and the rules governing these enterprises' administration. It should be emphasised from a taxes perspective that firms' legal structures do affect how their profits are taxed in the nation. In fact, under Cameroon's traditional system of corporate profit taxation, profits generated by enterprises formed as corporations are subject to "twice" taxation: first, when the profits are made, and then again when they are dispersed to shareholders as dividends. However, gains realised by partnerships are only taxed at the personal income tax rate and are considered to have been distributed at the conclusion of the fiscal year. This implies that in the case of individuals, business profits will be added to other sources of income like salary, wage, or rental income earned by that individual during that fiscal year.

DOUBLE TAXATION OF CORPORATE PROFITS AND CAPITAL GAINS: INCIDENCE

There has been significant discussion about the pros and downsides of the double taxation of corporate earnings now in place in Cameroon, and some have even called for its revision in order to lessen the burden of taxation placed on taxpayers. The most potent critique of this distinction is double taxation, despite the fact that it has been criticised for influencing or better differentiating between firm legal forms. More specifically, both the fairness and efficiency arguments have been used to criticise the double taxation of corporate earnings that is currently practised in Cameroon and elsewhere.

Analyzing the effects of double taxing corporate profits on equity grounds

Double taxation is criticised from an equitable standpoint since it places a heavier tax burden on shareholders than on their competitors who have chosen the unincorporated business form. Therefore, it is believed that this additional cost in the form of corporate tax is at odds with the equitable principle that calls for like gains to be treated equally. As a result, in addition to the corporate tax, business profits also include an individual income tax component on dispersed dividends. It leads to an overtaxation of these gains, which is why some type of integration is proposed. However, it should be highlighted that despite the criticism on equity grounds, the significance of corporate tax is emphasised from the standpoint of taxing corporate earnings that have not been distributed. The verifiable nature of corporate structures, which national tax law normally recognises as separate entities from their owners, serves as the foundation for such an argument. The OHADA Uniform Act makes a distinction between what constitutes a "societe de capitaux" and a "societe de personnes" in accordance with these criteria. Limited liability corporations and companies with unlimited liability are included under the first category. The second category of business, in contrast, primarily consists of two types of partnerships as defined in Sections 270 and 293 of the OHADA Act. The fact that enterprises operated in partnership have the option of being subject to either corporate tax or individual income tax serves to emphasise the significance of this distinction. Thus, it demonstrates how irrelevant the sort of tax levied is when compared to how crucial the business's legal structure is. Since the corporate form of business allows for the payment of dividends to shareholders in proportion to their involvement in the capital, these dividends can only be taxed if dispersed, and distribution is at the discretion of management. Because corporate gains are not considered to be delivered to shareholders at the end of the year, the country's realisation requirement will result in the taxation of these profits being delayed until a later date. Implementing an allocation mechanism that will impose a tax in proportion to the company earnings accruing to each shareholder is an alternative to reducing the impact of the realisation requirement. Even though it relies on the accrual rule and similarly imposes a tax burden even though the shareholders have not received any earnings, the allocation system, which is considered the most reliable solution to the lack of taxation of corporate profits, is not considered adequate for resolving this issue. When viewed from this perspective and in light of the significance of the realisation rule, it would appear that introducing a corporate tax would be the best way to collect such unremitted revenue. However, it should be noted that the equity foundation of such a strategy could only be enhanced if the corporation tax, which serves as a replacement for the individual income tax that would have been due by the shareholders had the profits been dispersed, is actually paid by the shareholders. This perspective suggests that despite its flaws, some integration (imputation system) could be introduced. Contrary to the widespread belief that shareholders are responsible for paying corporation taxes, it is unclear who is actually responsible for paying them. The imposition of an additional tax on dividends is debatable if we keep in mind that the creation of the corporate tax is consistent with efforts to replace the individual income tax and tax undistributed money. If the amount to which the corporation tax is paid by shareholders is questioned, it may be justified to impose a separate tax on dividends in addition to the corporate tax. From a broad perspective, it should be noted that selecting one of the aforementioned options will have an impact on the strategy for handling profit distribution and will ultimately result in some sort of inefficiency, emphasising the significance of assessing such a strategy on the basis of efficiency.

Assessment of Double Taxation on Corporate Profits on the Basis of Efficiency

The existence of corporate tax in addition to a tax on dividends has been criticised from an efficiency standpoint on three primary reasons, including its incidence in favouring non-corporate forms of firms. The prejudice against equity financing and making financially successful investments has also drawn criticism.

The partiality for the corporate sector

The double taxation of corporate profits relative to those of unincorporated firms is the fundamental justification for opposing the corporate sector. In the case of Cameroon, the type of tax is actually unimportant because unincorporated businesses have the option of paying corporate tax, which has a set rate as opposed to individual income tax, which is progressive and has four brackets. Due to the OHADA Uniform Act's definition of the type of business in which dividends are regarded available to shareholders, the major issue is the type of business conducted. This method of taxing corporate profits differently from non-corporate business revenue may therefore be biassed against corporate investment. The justification for such a claim is that, insofar as shareholders are responsible for both corporate tax and dividend tax, the additional tax burden may operate as a deterrent to investment, favouring the unincorporated form. When seen from this perspective, it is evident that the differing tax treatment given to this type of business vehicle might have a big impact on people's investment decisions given the current double taxation placed on shareholders. The debate about who is really responsible for paying corporate taxes, as expressed in economic literature, instead emphasises the need to apply the company tax to all capital gains. Due to the varied tax treatment given to capital invested in the corporate or non-corporate sectors, it is believed that the preference for non-corporate investment over the corporate sector should not be attributed to the current taxation.

The corporation's bias against financing decisions

The existence of corporate tax is criticised from the standpoint of its influence on firms' financing decisions in addition to its impact on the investment vehicle that individuals choose. The complaint in this case is based on the idea that since interest paid on debt is frequently deductible, firms may favour debt financing as a result of the increased tax levied on dividends or retained earnings. When viewed from this perspective, debt financing is the best choice for funding corporate investment prospects due to the deductibility of interest. The provision for the deduction of interest paid to shareholders on loans made to the firm is also included in the current tax code of Cameroon. The rate of this interest is restricted relative to the rate used by the Central Bank of African Countries, but even so, the deduction helps to lower the tax base when corporate tax is imposed, which is the reverse of the treatment given to dividends paid or CGT on retained earnings. Despite this tax benefit associated with the debt financing option, it has been emphasised that resorting to a high amount of debt may increase the danger of bankruptcy, which may ultimately offset the tax gain.

The Favoritism for Retained Earnings

The case for retained earnings in favour of the traditional method of taxing corporate profits is based on the idea that businesses would choose to keep their money rather than share it with shareholders if there is an additional tax on dividends. It is important to note that the deferral advantage associated with the decision to retain earnings combined with some preferential treatment granted while imposing capital gains could be a catalyst for such option, even though the impact of the dividend policy on corporate decision-making is disputed. However, it should be highlighted that if chosen, this choice to keep earnings could lead to a less effective use of capital than would have been the case if dividends were paid. The justification for this is that if there were no tax on dividends, shareholders may get greater dividend payments, which could increase investment diversification. Despite the validity of this claim, some have argued that the fact that dividends are distributed in the USA despite the additional tax paid undermines the impact of this tax and suggests that other important factors may exist that could affect the dividend policy. An illustration of this can be found in publicly traded businesses, which typically pay dividends. Three key justifications have been emphasised with reference to this particular situation. To begin with, compared to the transaction costs of selling their company equities, as may be the case under capital gains, some investors' preference for dividends, which constitute a consistent stream of income, may be justified. More crucially, the distribution of dividends may also have a favourable impact on how much business equities are worth in the market. Overall, it should be emphasised that the installation of a classical system has faced more criticism for equity and efficiency issues than other alternative forms of integration. Even though the impact of such a policy may be increased if different tax rates are used to each type of revenue (capital gains and dividend income), the double taxation may still result in some inefficiencies even under the assumption of identical tax rates. The realisation rule for capital gains taxation, which may result in the lock-in effect, is the main justification for the inefficiency of such a way of taxing corporate earnings. As a result, even while using similar tax rates can help to lessen the effects of double taxation, there is still a danger of revenue loss if the corporation choose to keep earnings and if taxpayers are swayed by CGT. Aware of the lock-in effect that may exist generally and more specifically in response to changes in tax rates, the recent increase in the CGT rate on shares is debatable when viewed from this perspective and in light of the emphasis placed on the transfer for consideration as a factor triggering CGT. Given the conflicting perspectives (Traditional and New view) on dividend taxation that exist in the literature, as well as the realisation rule for taxing capital gains and the behaviour responses of taxpayers to tax rate changes that are also frequently highlighted in the literature, it is crucial to look for alternative means of reducing its effect. The following sections will go over this.