

**OPINION OF THE EUROPEAN CENTRAL BANK****of 14 July 2009****on the taxation of the Banca d'Italia's gold reserves****(CON/2009/59)****Introduction and legal basis**

On 26 June 2009 the European Central Bank (ECB) received a letter from the Italian Minister for Economic Affairs and Finance informing the ECB that on the same day an important package of legal provisions would be approved by the Council of Ministers, containing measures aimed *inter alia* at finding the necessary resources to redress the current public finance situation (Decree-Law No 78 of 1 July 2009 containing measures on the crisis and prorogation terms and on the Italian participation in international missions¹, hereinafter the 'Decree-Law'). The Italian Minister brought the ECB's attention to the fact that Article 14 of this Decree-Law relates to the Banca d'Italia. The Decree-Law was subsequently presented to the Parliament for discussion and conversion into law within 60 days following publication in the *Gazzetta Ufficiale della Repubblica Italiana* (GU). The subject of this opinion is Article 14 of the Decree-Law as published in the GU and presented for discussion to the Parliament (hereinafter the 'draft article'), which is different in some elements from the text attached to the abovementioned letter from the Minister.

The ECB's competence to deliver an opinion is based on Article 105(4) of the Treaty establishing the European Community and the third indent of Article 2(1) of Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions², as the draft article relates to the Banca d'Italia. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

¹ *Gazzetta Ufficiale della Repubblica Italiana* No 150, 1.7.2009, p. 1.

² OJ L 189, 3.7.1998, p. 42.

1. Purpose of the Decree-Law

While the Decree-Law has the very broad intention of increasing resources available to the State budget in the present financial conditions³, the draft article under assessment in this opinion specifically provides for a substitute tax of 6% on capital gains registered in the balance sheet generated from the price evaluation of stocks of precious metals for non-industrial use⁴. The ECB understands that the tax would apply also to the Banca d'Italia's entire holdings of gold⁵, with the exception of the rate of gold stocks which the Banca d'Italia has conferred 'in fulfilment of obligations deriving from membership of the European Communities'⁶. The ECB further understands that the economic benefit expected to be received by the State budget from the new tax would mainly be produced by payments to be made by the Banca d'Italia.

2. General observations

2.1 Compliance with the consultation obligation

The ECB received the Minister's letter on 26 June 2009, the day on which the Italian Council of Ministers approved the version of the Decree-Law subsequently sent to the Parliament. In this respect, the ECB notes that Article 2(1) of Decision 98/415/EC requires national authorities to consult the ECB on draft legislative provisions concerning matters that fall within its competence. This applies in particular to the Decree-Law, since the draft article imposes financial obligations on the Banca d'Italia and therefore constitutes a draft legislative provision concerning a national central bank (NCB), on which the ECB must be consulted in accordance with the third indent of Article 2(1) of Decision 98/415/EC. This consultation obligation is not affected by the manner in which the draft article defines its addressees in general terms as holders of precious metals for non-industrial purposes. The ECB understands in this context that the Banca d'Italia will be the main entity affected by the proposed taxation and will bear a major part of the newly created tax obligations.

The ECB considers that the draft article is not clear and raises concerns from the perspective of its compliance with Community law. The ECB trusts that its comments will be given due

³ The letter from the Minister for Economic Affairs and Finance refers to emergency financial needs resulting from a recent earthquake in the Aquila province, while the Decree-Law provides for several crisis measures, as well as for other measures involving current expenditure, and states that the income of the new tax will be one of the financial sources used to cover the decrease in income and increase in expenditure arising from these measures (see Article 16(1)(a) of the Decree-Law).

⁴ Paragraph 1 of the draft article.

⁵ On the Banca d'Italia's subjection to taxation, see: (i) Article 73 of Decree of the President of the Republic No 917 of 22 December 1986, *Gazzetta Ufficiale della Repubblica Italiana, S.O.*, No 302, 31.12.1986 (the Consolidated Law on Income Tax, the TUIR), as amended, relating to the entities subject to corporate income tax; (ii) Article 114 of TUIR, as amended, specifically relating to the determination of the Banca d'Italia's income; (iii) Article 3 and Article 6(7) of Legislative Decree No 446 of 15 December 1997, *Gazzetta Ufficiale della Repubblica Italiana, S.O.*, No 298, 23.12.1997) on regional tax on productive activities, as amended. As regards the identification of precious metals, including gold, see Article 1 of Legislative Decree No 251 of 22 May 1999, in *Gazzetta Ufficiale della Repubblica Italiana* No 180, 3.8.1999, as referred to in the draft article.

⁶ Paragraph 1 of the draft article.

consideration by the Italian authorities and that the Italian Government will consult the ECB at an appropriate point in time on an amended version. Moreover, the ECB notes that Article 3(4) and Article 4 of Decision 98/415/EC require Member States to suspend the process of adoption of the draft legislative provision pending receipt of the ECB's opinion.

2.2 *Treaty limitations for financial transfers by NCBs to the State budget*

The taxation provisions of the draft article would result in transfers of some of the Banca d'Italia's financial resources to the State budget. Any such transfers of financial resources by an NCB to a Member State's budget, either in the form of a profit distribution scheme or in any equivalent form, need to comply with the limitations imposed in this respect by the Treaty, and in particular with the principle of central bank independence under Article 108 and with the prohibition on monetary financing in Article 101(1)⁷. Previous ECB opinions have clarified their implications⁸ and can be summarised as follows.

(a) Compliance with the central bank independence principle

National legal provisions, and in particular NCB statutes, normally prescribe how NCB profits are to be allocated. In the absence of such provisions, the decision on allocation of profits should be taken by the NCB's decision-making bodies, and should not be subject to the discretion of third parties unless there is an express safeguard clause stating that this is without prejudice to the financial means necessary for carrying out the NCB's tasks related to the European System of Central Banks (ESCB)⁹. Moreover, compliance with the principle of central bank independence under Article 108 of the Treaty includes a requirement to ensure the central bank's financial independence. To ensure such compliance, the Member States should establish legal frameworks for NCB profit distributions which allow for an arm's length assessment of the financial needs of the respective NCB to be appropriately taken into account. Such assessments should be based on the professional judgement of the relevant NCB's independent decision-making body rather than on the financial needs of the State, so that the NCB does not become dependent for its finances on the Government, the Parliament or any other third party¹⁰. The principle of central bank independence requires that no third party should be able to exercise direct or indirect influence, not only over the performance of the NCB's tasks, but also over its ability, both operationally in terms of manpower, and financially in terms of appropriate financial resources, to fulfil its mandate¹¹, i.e. to perform their national tasks, to meet their international obligations and properly cover

⁷ As also reflected respectively in Article 7 and Article 21.1 of the Statute of the European System of Central Banks and of the European Central Bank (hereinafter the 'ESCB Statute').

⁸ See, e.g. paragraph 6 of ECB Opinion CON/99/16, paragraphs 3.2 and 3.3 of ECB Opinion CON/2008/82, paragraphs 2.2 and 2.4 of ECB Opinion CON/2009/53 and further opinions quoted in the footnotes below. See also ECB's Convergence Report December 2006, pp. 27-30; ECB's Convergence Report May 2007, pp. 19-23; ECB's Convergence Report May 2008, pp. 20-25. All documents available on the ECB's website at www.ecb.europa.eu.

⁹ See paragraph 2.3 of ECB Opinion CON/2009/26 and the ECB's Convergence Report May 2008, p. 20.

¹⁰ See, e.g. paragraph 8 of ECB Opinion CON/2003/22 and paragraph 3.3 of ECB Opinion CON/2009/53.

¹¹ See, e.g. paragraph 2.2 of Opinion CON/2008/9, paragraph 3.3.1 of Opinion CON/2008/10, paragraph 3.3 of Opinion CON/2008/20 and the ECB's Convergence Report May 2008, pp. 20-21.

their administrative and operational expenses¹². Having sufficient financial means ensures that the central bank will always and in all circumstances have at its disposal the necessary resources to conduct monetary policy. Indeed, it is of utmost importance to allow a sufficient provision of reserves during years of profits to allow the central bank to face possible losses without weakening its financial means to implement its monetary policy. Similarly, as regards financial provisions or buffers, the NCB must also be free to independently create financial provisions to safeguard the real value of its capital and assets¹³. Furthermore, Articles 28.1 and 30.4 of the Statute of the ESCB provide for calls on the NCBs to make contributions to the capital of the ECB and to make transfers of foreign reserves. The principle of financial independence requires that compliance with these provisions leaves an NCB's ability to perform its functions unimpaired¹⁴.

(b) Compliance with the monetary financing prohibition

The provisions on central bank profit distributions must also comply with the monetary financing prohibition laid down in Article 101(1) of the Treaty and in Council Regulation (EC) No 3603/93 of 13 December 1993 specifying definitions for the application of the prohibitions referred to in Articles 104 [now 101] and 104b(1) [now 103(1)] of the Treaty¹⁵. Those provisions prohibit central bank (ECB or NCB) credit facilities in favour of Community institutions or bodies or in favour of the Member States or their public sector bodies, as well as direct central bank purchases of debt instruments from such entities. With a view to preserving the integrity of the central bank's balance sheet, the monetary financing prohibition is of key importance to ensuring the primary monetary policy objective of price stability¹⁶, which must not be impeded. Therefore, the prohibition must be interpreted extensively to ensure its strict application¹⁷. Even if Article 101(1) refers literally to 'credit facilities', i.e. with the obligation to repay such credit, this prohibition may also apply *a fortiori* to other forms of funding, i.e. without the obligation to repay, since Article 101 of the Treaty has the overall aim of public finance discipline and of prohibiting NCBs from financing the public sector. This implies that both the ultimate objective and the spirit of these provisions must be taken into account in their interpretation¹⁸. In this respect, to ensure that the distribution of central bank profits to the State fully complies with the monetary financing prohibition, it is of crucial importance that the schedule for central bank profit

12 See, e.g. in particular paragraph 6 of Opinion CON/2003/22, paragraph 2.3 of Opinion CON/2009/26, paragraph 2.2 of Opinion CON/2009/53 and the ECB Convergence Report May 2008, p. 20.

13 See, e.g. paragraph 3.3 of Opinion CON/2009/26, paragraph 3.2 of Opinion CON/2009/53 and the ECB's Convergence Report May 2008, p. 21.

14 See ECB's Convergence Report May 2008, p. 20. Moreover, Article 33.2 of the Statute of the ESCB provides that in the event of a loss incurred by the ECB which cannot be fully offset against the general reserve fund, the ECB's Governing Council may decide to offset the remaining loss against the monetary income of the relevant financial year in proportion and up to the amounts allocated to the NCBs.

15 OJ L 332, 31.12.1993, p. 1.

16 Article 105(1) of the Treaty and Article 2 of the Statute of the ESCB.

17 See ECB's Convergence Report May 2008, p. 22.

18 See paragraph 9 of ECB Opinion CON/2003/27.

distributions, in full or through instalments, do not imply advances on future or provisional profits but only result in the central bank distributing profits that are fully realised, accounted for and audited, which in turn requires due calculation of profits and losses for the relevant reporting period¹⁹.

3. Taxation of the Banca d'Italia notional gains related to gold reserves

3.1 Definition of the tax base

The draft article provides that the taxation liabilities it introduces will be calculated as a proportion of the 'capital gains registered in the balance sheet generated from the fiscal year-end price evaluation of stocks of precious metals'. The ECB notes in this respect that typically capital gain taxes are levied on the amounts of realised profit resulting from the sale of an asset or from the dividend payments, i.e. the tax base is the value of the profits generated through actual cash flows²⁰. The Decree-Law instead provides for a taxation liability to be calculated by reference to the amount of the notional gain resulting from the change in the valuation of the assets (precious metals holdings), as registered in the asset holder's balance sheet. From the perspective of the Banca d'Italia's potential taxation liability in respect of its gold reserves, such a definition of the tax base raises the following concerns.

- 3.2 First, under the Decree-Law, the Banca d'Italia would make financial distributions to the State budget of the amounts calculated as a proportion of notional gains achieved with respect to the Banca d'Italia's gold reserves. In this regard, the ECB considers that the amount to be transferred to the State under the proposed new taxation is still uncertain²¹. Moreover, the Banca d'Italia may potentially never realise such notional gains, which may either be a result of its management strategy not to sell any of its gold reserves, or a result of subsequent negative price developments, or other limitations²² preventing the Banca d'Italia from achieving a profit from its gold sales that would correspond to the notional gains used for the tax base calculation. In view of such factors, the tax payments to be made by the Banca d'Italia under the Decree-Law would have no relationship with the amount of the Banca d'Italia's realised profits, if any, actually earned in the respective periods. If these profits were lower than the preceding tax payments, the Banca d'Italia would need to decrease its resources to make the required payments, which may eventually weaken its financial position. This would also constrain the Banca d'Italia's capacity to implement appropriate management strategies in relation to its gold reserves since, instead of targeting optimal

¹⁹ See e.g. paragraph 3.3 of Opinion CON/2008/82, paragraph 2.4 of Opinion CON/2009/26, and paragraph 2.4 of Opinion CON/2009/53.

²⁰ See e.g. judgment of the Court of Justice of 9 December 2004 in Case C-219/03 *Commission v Spain* (OJ C 31, 5.2.2005, p. 3) and judgment of the Court of Justice of 14 November 2006 in Case C-513/04 *Bernadette Morres v Belgische Staat* (OJ C 326, 30.12.2006, p. 6).

²¹ For instance, the wording of the draft article does not allow the total amount for 2009/2010 to be ascertained.

²² See in particular the 'Joint Statement on Gold' of 8 March 2004, available on the ECB's website at www.ecb.europa.eu. Although the amounts that may be payable by the Banca d'Italia are difficult to ascertain, they could be substantial and would have an impact on the Banca d'Italia's gold reserves.

realisation of its central bank tasks, it would need to mitigate the financial risks of the arising tax liabilities. Furthermore, since holding and managing the foreign reserves of the Member States is a Eurosystem task in accordance with the third indent of Article 105(2) of the Treaty, pressure may not be exerted on an NCB to pursue investment strategies aimed at mitigating the financial risks of arising tax liabilities. The draft article would thus impair the institutional and financial independence of the Banca d'Italia established under Article 108 of the Treaty.

- 3.3 Moreover, since the new tax is levied on theoretical profits arising out of changes in the accounting valuation of the NCB's gold reserves, the resulting tax payments by the NCB which would not be covered by its realised profits would amount to an increase of the monetary volume through provision of central bank money to the public sector. This, in parallel to concerns related to central bank independence, raises questions regarding compliance of the draft article with the objective of maintaining public finance discipline, which underlies the monetary financing prohibition in Article 101(1) of the Treaty. Furthermore, even if the Banca d'Italia is able to fully cover its payments to the State budget with realised profits, such profits would only be available to the Banca d'Italia at a later stage, when the actual cash flows related to any possible future central bank gold sales are realised. This implies that the Banca d'Italia would incur a tax liability in expectation of an uncertain income that may or not be realised in the future. Such a situation is in itself a form of credit to the public sector incompatible with the prohibition on monetary financing under Article 101(1) of the Treaty.
- 3.4 Finally, the draft article also appears not to be in line with basic accounting assumptions laid down in Guideline ECB/2006/16 of 10 November 2006 on the legal framework for accounting and financial reporting in the European System of Central Banks²³. In particular, under the basic accounting assumption of prudence, which allows the achievement and maintenance of the financial independence of Eurosystem central banks, unrealised capital gains are not recognised as income in the profit and loss account, but are recorded directly in a revaluation account and are thus excluded from the regular profit distribution scheme. Any capital losses are deducted from the dedicated account. These principles, laid down by the ECB's Governing Council pursuant to Article 26.4 of the Statute of the ESCB, are currently relevant also for the Banca d'Italia's taxation, according to Article 8(1) of Legislative Decree No 43 of 10 March 1998²⁴ and Article 114 of the Consolidated Law on taxation (Decree of the President of the Republic No 917/1986, as amended). In this regard, paragraph 3 of the draft article, which provides for derogation from all other legal provisions, weakens the prudence principle and appears to be incompatible with the primacy of Community law.
- 3.5 *The starting date for the taxation obligations and the timing of the taxation payments*

The draft article does not appear to clearly exclude a retroactive application of the new tax, since it does not clarify whether this tax would apply in the beginning only to the unrealised capital gains

²³ OJ L 348, 11.12.2006, p. 1.

²⁴ *Gazzetta Ufficiale della Repubblica Italiana* No 61, 14.3.1998.

accrued in the first fiscal year from its entry into force, or to the entire amount of unrealised capital gains currently registered in the abovementioned dedicated account. For the ECB, without prejudice to the above observations, there should be no retroactive application of new taxes to NCBs, retroactive application being understood as application of the taxation obligations to reporting periods earlier than the first full reporting period after entry into force of the draft law. Retroactive application of new taxes would impair the NCBs' ability to efficiently plan the use of their financial resources which is essential to effectively fulfil their mandate; this would be detrimental to the NCBs' financial independence.

3.6 The draft article foresees taxation payments in instalments transferred in the course of the financial year on profits whose actual realisation and effective amount are still uncertain. Therefore, payments in instalments may result in profit distributions made in anticipation of the central bank income to be realised in the future, which is a prohibited form of central bank financing of the public sector under Article 101(1) of the Treaty. In this context, the ECB considers that any profit transfers to be made by the Banca d'Italia should ensure that such transfers are made on the basis of actual realised profits stemming from the last reporting period.

3.7. *Set-off right under Law No 289/2002*

In addition, pursuant to Article 65 of Law No 289 of 27 December 2002²⁵, as amended, the losses stemming from the swap transaction carried out by the Banca d'Italia with the Italian Treasury in 2002 may be set off annually against the taxable income, up to 50% of its annual amount. The proposed new tax rule under examination would provide for a taxation of the unrealised gains coming from appreciation of central bank gold reserves, as registered in the Banca d'Italia's balance sheet and without considering the abovementioned right to set off. The ECB assessed the mechanism laid down by Law No 289/2002 for compliance with Article 101 of the Treaty²⁶, and is concerned that the draft article now under consideration will result in a circumvention of this mechanism, producing a further incompatibility with the Treaty.

4. Conclusions

4.1 The ECB concludes as follows. First, although the pool of addressees of the draft article is defined in general terms as holders of precious metals for non-industrial purposes, the Banca d'Italia, due to the extent of its gold reserves, is the entity primarily affected. Second, the draft article raises concerns with respect to the prohibition on central bank monetary financing of the public sector to the extent that it foresees profit distributions in expectation of uncertain central bank income potentially realised in the future, and, in addition, it excludes set-off rights applicable under earlier legislation. Third, the draft article raises concerns with respect to the Banca d'Italia's institutional and financial independence by allowing for an arbitrary decrease in the Banca d'Italia's resources

²⁵ *Gazzetta Ufficiale della Repubblica Italiana, S.O.*, No 305, 31.12.2002.

²⁶ See ECB Opinion CON/2002/30.

and by potentially forcing the Banca d'Italia to deploy asset management strategies targeting financial risks created by the proposed new tax provisions. In particular, the proposed introduction of the new tax scheme has not been preceded by an assessment of the impact on the Banca d'Italia's financial needs. As a result, the Banca d'Italia's financial position would be weakened, increasing the risk that it may not have sufficient resources in the future to carry out its ESCB-related and other tasks. In addition, the Banca d'Italia implements a Eurosystem task by holding and managing foreign reserves and, to the extent that the proposed new tax provisions would oblige the Banca d'Italia to pursue certain asset management strategies, its institutional independence would be impaired.

- 4.2 In view of the above, the draft article needs to be reconsidered to address the concerns expressed in this opinion, relating in particular to central bank independence and the prohibition on monetary financing. The ECB expects to be consulted on any revised draft legislative provisions in this matter.

This opinion will be published on the ECB's website.

Done at Frankfurt am Main, 14 July 2009.

[signed]

The President of the ECB

Jean-Claude TRICHET