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EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 24 July 2009

on an amended draft legislative provision on the taxation of the Banca d'Italia's gold reserves

(CON/2009/63)

Introduction and legal basis

On 21 July 2009 the European Central Bank (ECB) received a request from the Italian Minister for Economic Affairs and Finance for an opinion on a draft amendment to Article 14 of Decree-Law No 78 of 1 July 2009 containing measures on the crisis and prorogation terms and on the Italian participation in international missions[1] (hereinafter the 'Decree-Law'). The Decree-Law is currently being discussed by the Italian Parliament for conversion into law (hereinafter the 'draft law') within 60 days following publication in the *Gazzetta Ufficiale della Repubblica Italiana*. Article 14 of the Decree-Law provides for a capital gains tax on non-industrial gold of firms and entities and relates to the Banca d'Italia. The subject of this opinion is an amended draft version of Article 14 (hereinafter the 'amended draft article'), in the text attached to the request 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 provisions[2], as the amended 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. Purpose of the amended draft article

The amended draft article is a new version of Article 14 of the Decree-Law, on which the ECB recently delivered Opinion CON/2009/59[3]. According to the consultation letter from the Minister for Economic Affairs and Finance, in order to address the issues raised in Opinion CON/2009/59, the amended draft article would replace the original text of Article 14. The amended draft article is divided into five paragraphs. Paragraph 1 provides that for the fiscal year in the course of which the draft law enters into force, a substitute tax of 6 %, up to a maximum amount of EUR 300 million, will be levied on capital gains registered in the balance sheet generated from the fiscal year-end price evaluation of stocks of precious metals for non-industrial use. Paragraph 2 provides for the timing of the taxation payments.

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

2 OJ L 189, 3.7.1998, p. 42.

3 All ECB opinions are available on the ECB's website at www.ecb.europa.eu.

Paragraph 3 provides for a special tax regime applicable to realised capital gains generated by a total or partial transfer of stocks of precious metals if such a transfer takes place within three fiscal years following the fiscal year in the course of which the draft law enters into force. Paragraph 4 contains other provisions relating to the substitute tax on notional gains and provides for special conditions for the application of the amended draft article in respect of the Banca d'Italia's gold stocks. Finally, paragraph 5 provides for financial measures to be adopted if, following recourse to the procedures laid down in paragraph 4 for the taxation of the Banca d'Italia's gold stocks, the increased budgeted revenue provided for by the amended draft article is lower than the estimated amount of EUR 300 million for 2009.

2. General observations

2.1 As already stated above, the original text of Article 14 of the Decree-Law was the subject of the recent ECB Opinion CON/2009/59, in which the ECB made several comments on the draft legislative provision on the taxation of the Banca d'Italia's gold reserves, with particular reference to its compliance with Article 108 and Article 101(1) of the Treaty[4], as well as Article 26.4 of the Statute of the ESCB. The comments specifically addressed the following issues: (i) central bank financial independence; (ii) central bank institutional independence; (iii) the prohibition on monetary financing; (iv) compliance with the Eurosystem accounting principles; (v) retroactive application of the new tax; (vi) the timing of the taxation payments; and (vii) the set-off right under Article 65 of Law No 289 of 27 December 2002, as amended[5].

2.2 The observations made in Opinion CON/2009/59 also apply to the amended draft article.

3. Specific comments

3.1 *Central bank financial independence*

In Opinion CON/2009/59, the ECB expressed its concern that the new tax on unrealised capital gains, generated from the price evaluation of gold stocks on the assets side of the Banca d'Italia's balance sheet[6] would weaken the Banca d'Italia's financial independence[7], since the Banca d'Italia may potentially: (i) never realise such notional gains, as a result either of its management strategy not to sell any of its gold reserves, of subsequent negative price developments, or other limitations by which it is bound[8] ; or (ii) realise profits that are lower than the notional gains constituting the tax base. Thus, the Banca d'Italia may need to decrease its resources to make the required tax payments. The ECB notes that an attempt to address the financial independence issue is made in

4 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 'Statute of the ESCB').

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

6 The notional gains, pursuant the prudence principle 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 Banks (see paragraph 3.4 below), are balanced by equal amounts booked in a dedicated revaluation account on the liabilities side of the Banca d'Italia's balance sheet. This circumstance is not taken into account by the draft article.

7 See paragraphs 2.2(a) and 3.2 of Opinion CON/2009/59.

8 See in particular the Central Bank Gold Agreement referred to in the 'Joint Statement on Gold' of 8 March 2004, available on the ECB's website.

the amended draft article under which: (i) the new tax applies only for the fiscal year in the course of which the draft law enters into force, i.e. it is a 'one-off' tax; (ii) a maximum amount of the payable tax is set at EUR 300 million; and (iii) the new tax applies to the Banca d'Italia's gold stocks 'to the extent appropriate to guarantee the institutional and financial independence of the central bank', and this extent is to be determined by means of a 'decree not having a regulatory nature' by the Minister of Economic Affairs and Finance, after having obtained the Banca d'Italia's assent (*parere conforme*). Although the limitations referred to under (i) to (iii) aim at mitigating the negative impact of the amended draft article on the Banca d'Italia's financial independence, paragraphs 1, 2 and 4 of the amended draft article still provide for a tax on unrealised, and thus uncertain capital gains. Therefore, the tax essentially results in a withdrawal of central bank assets. In addition, the amended draft article raises concerns as regards the difficulty in making an advance estimate of a national central bank's (NCB) financial needs: in this regard, the ECB stresses that future financial and economic developments, especially in the current crisis context, cannot be foreseen with any degree of certainty. For the above reasons, the ECB is of the view that the amended draft article would impair the principle of central bank financial independence.

3.2 *Central bank institutional independence*

3.2.1 In Opinion CON/2009/59 the ECB noted that the previous version of the draft article, by providing for the taxation of theoretical and unrealised capital gains, 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 realisation of its central bank tasks, it would need to mitigate the financial risks of the arising tax liabilities. Since holding and managing the foreign reserves of the Member States is a Eurosystem task pursuant to the third indent of Article 105(2) of the Treaty, the Banca d'Italia's institutional independence safeguarded under the Treaty would thus be infringed[9].

The amended draft article, as seen above, still provides for the taxation of merely theoretical and unrealised capital gains on gold reserves. Therefore, the ECB has to reassert the incompatibility of the amended draft article with the principle of central bank institutional independence pursuant to Article 108 of the Treaty.

3.2.2 In addition, the new paragraph 3 of the amended draft article provides for a special taxation regime that would apply to realised capital gains arising from a transfer of precious metals stocks for non-industrial use, provided that such transfer takes place within three fiscal years following the fiscal year in the course of which the draft law enters into force[10]. The ECB notes that this special

9 See paragraph 3.2 of Opinion CON/2009/59. It is noted that the amended draft article seems to confuse the concepts of financial independence and institutional independence, since it erroneously assumes that institutional independence could be safeguarded by means of quantitative thresholds. About the principle of financial independence, see, e.g., Opinion CON/2009/26; Opinion CON/2003/22; ECB's Convergence Report May 2008, pp. 20-22. About the principle of institutional independence, see, e.g., Opinion CON/2008/31; Opinion CON/2005/54; ECB's Convergence Report May 2008, pp. 18-19.

10 It is understood that the effects of the special taxation regime provided for by paragraph 3 of the amended draft article would be as follows: (i) in case a total or partial transfer of gold stocks is made within three fiscal years following the fiscal year in the course of which the draft law enters into force, the realised capital gain, which is subject to the income tax (IRES) and the regional tax on productive activities (IRAP), would be increased by the amount of the capital gains –

taxation regime: (i) would essentially apply to the Banca d'Italia, as does the substitute tax provided for in paragraph 1 of the amended draft article, to which it is linked; and (ii) given its temporary nature, would place pressure on the Banca d'Italia in terms of the timing of possible gold sales, and could thus interfere with its foreign reserve management decisions. The ECB therefore concludes that paragraph 3 of the amended draft article constitutes a more serious impairment of the institutional independence of the Banca d'Italia established under Article 108 of the Treaty than the one the ECB already addressed in Opinion CON/2009/59.

3.3 *Prohibition on monetary financing*

In Opinion CON/2009/59 the ECB noted that, since the substitute tax provided for by the previous version of the draft article is levied on unrealised capital gains, i.e. theoretical gains arising out of changes in the accounting valuation of the NCB's gold reserves, the related tax payments by the NCB would result: (i) to the extent that they are not to be covered by future realised profits, in an increase of the monetary volume through provision of central bank money to the public sector; and (ii) to the extent that they are to be covered by future realised profits, in a form of central bank credit to the public sector, through the distribution in advance of future and uncertain profits[11]. The ECB found that in both cases the previous version of the draft article was incompatible with the prohibition on monetary financing under Article 101(1) of the Treaty.

The amended draft article does not address this fundamental issue, since, as already noted, it still provides for the taxation of unrealised capital gains[12]. Therefore, the ECB reasserts that the amended draft article is incompatible with the prohibition on monetary financing under Article 101(1) of the Treaty. In addition, such incompatibility cannot be remedied by any form of agreement between a Member State and an NCB, nor by any form of 'assent' issued by the latter, as seems to be implied by paragraph 4 of the amended draft article.

3.4 *Eurosystem accounting principles*

In Opinion CON/2009/59[13] the ECB stated that the previous version of the draft article was not 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 Banks[14] and, in particular, with the basic accounting assumption of prudence, which allows the achievement and maintenance of the financial independence of Eurosystem central banks[15].

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corresponding to the transferred stocks – subject to the substitute tax under paragraph 1, and the substitute tax paid with reference to the same stocks would be deducted by income taxes; (ii) on the contrary, in the event that such a transfer is made after the abovementioned deadline, the realised capital gains subject to IRES and IRAP would no longer be increased by the said amount, and the substitute tax paid would no longer be deductible.

11 See paragraph 3.3 of Opinion CON/2009/59.

12 See paragraphs 1, 2 and 4 of the amended draft article.

13 See paragraph 3.4 of Opinion CON/2009/59.

14 OJ L 348, 11.12.2006, p. 1.

15 It is recalled that under the basic assumption of prudence, 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 profit

The ECB notes that this issue is not addressed by the amendment under consideration. Furthermore, the amended draft article still provides for a derogation from all other legal provisions, which, as already stated in Opinion CON/2009/59, weakens the prudence principle and appears to be incompatible with the primacy of Community law.

3.5 *Retroactivity of the new tax*

3.5.1 In Opinion CON/2009/59, the ECB noted that the previous version of the draft article did not clearly exclude a retroactive application of the new tax, i.e. its application to the entire amount of unrealised capital gains currently registered in the dedicated revaluation account, instead of the mere amount of notional gains accrued in the first fiscal year from its entry into force. The ECB also noted that any 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 tax, would be detrimental to central bank financial independence, since it would impair the NCBs' ability to efficiently plan the use of their financial resources[16].

3.5.2 In the light of the amended draft article and of the explanatory memorandum to the draft law[17], which has now become available, the ECB understands that the new tax is indeed retroactive in two different ways: (i) it would apply to the current reporting period, which started before its entry into force; and (ii) it would apply to the entire amount of unrealised capital gains currently registered in the dedicated revaluation account, without prejudice to the maximum tax amount set pursuant to paragraphs 1 and 4 of the amended draft article[18]. The ECB remarks that such retroactive effects of the new tax aggravate its non-compliance with the principle of central bank independence.

3.6 *Timing of the taxation payments*

3.6.1 In Opinion CON/2009/59 the ECB stated that, without prejudice to the preceding observations, the taxation payments mechanism provided for by the previous version of the draft article could represent *per se* a further breach of Article 101(1) of the Treaty[19].

3.6.2 The ECB confirms this statement and furthermore notes that this breach is now aggravated by the amended draft article, which deleted the taxpayer's option, originally provided for by paragraph 2 of the previous version of the draft article, of paying 50 % of the instalment on the tax in two instalments of equal amounts within the deadline for annual settlement of income tax.

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distribution scheme. 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 1998 (*Gazzetta Ufficiale della Repubblica Italiana* No 61, 14.3.1998) and Article 114 of the Consolidated Law on taxation (Decree of the President of the Republic No 917/1986, in *Gazzetta Ufficiale della Repubblica Italiana*, S.O., No 302, 31.12.1986, as amended).

16 See paragraph 3.5 of Opinion CON/2009/59.

17 The explanatory memorandum is now available on the Italian Parliament's website at www.camera.it.

18 It is noted that the maximum tax amount set at EUR 300 million does not exclude the retroactive effects described above.

19 See paragraph 3.6 of Opinion CON/2009/59.

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

The last statement made in Opinion CON/2009/59[20] concerns the exclusion, with reference to the new tax, of the set-off right granted to the Banca d'Italia by Article 65 of Law No 289 of 27 December 2002[21], as amended. Also this issue is not addressed by the amended draft article; therefore the ECB entirely refers to and reasserts its statement, which relates to a further issue of non-compliance with Article 101(1) of the Treaty.

4. Conclusions

In view of the above, the ECB concludes as follows.

First, the amended draft article impairs the Banca d'Italia's financial independence, by allowing for a decrease in the Banca d'Italia's resources which has no relationship with the amount of the Banca d'Italia's realised profits. Second, the amended draft article impairs the Banca d'Italia's institutional independence, since it potentially forces the Banca d'Italia, with particular reference to its Eurosystem task of holding and managing foreign reserves, to deploy asset management strategies targeting financial risks created by the proposed new tax provisions. Third, the amended draft article is incompatible with the prohibition on central bank monetary financing of the public sector, to the extent that it provides for profit distributions in the expectation of uncertain central bank income potentially realised in the future and, in addition, it excludes set-off rights applicable under earlier legislation. Fourth, the amended draft article is not in line with the rules established by the ECB pursuant to Article 26.4 of the Statute of the ESCB.

The ECB trusts that it will be consulted on any future or revised draft legislative provisions in this matter.

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

Done at Frankfurt am Main, 24 July 2009.

[signed]

The Vice-President of the ECB

Lucas D. PAPADEMOS

20 See paragraph 3.7 of Opinion CON/2009/59.

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