

How Should a Central Bank Be Treated for Tax Purposes?

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Summary

Generally, a central bank law should exempt the central bank from income taxation. Exemption from other taxes should not be included as a blanket provision in the central bank law, but rather be addressed by including details in specific tax legislation. The recommendation for exemption from income taxation presumes that the central bank law refers to an appropriate accounting framework, that the central bank does not engage in commercial banking activities, and that the central bank makes timely distributions of profits to the government after making appropriate contributions to reserves to maintain the central bank's equity capital as determined by the central bank law. These principles for good practices may differ in response to country-specific conditions.

The Nature of a Central Bank

It is generally considered good practice that a central bank law clearly define the objectives, autonomy, authority, and accountability of the central bank. The central bank should thus be an independent legal entity, ideally with price stability as its primary objective. Maximizing profits should not be a statutory objective in itself, as this would endanger price stability and financial sector stability and thus impede sustainable real economic growth. A central bank's income typically arises from being delegated the monopoly to issue the legal tender (seigniorage); managing the country's international reserves; and issuing and enforcing certain statutory and regulatory requirements that may resemble a tax, like unremunerated reserve requirements. A central bank may also earn income from charging fees for providing certain services, such as payment system services.¹ Income covers the costs of central bank functions, in particular non-revenue activities such as bank supervision in some countries, and can absorb losses. The resulting net profits are available to fund capital buffers for potential future losses, and for distribution to owners, which in most countries is the government.

General Principles

¹ Ideally, such fees should be set to ensure competitive neutrality, particularly if the central bank competes with the private sector. It is preferable that a central bank not be involved in providing services not necessary for conducting its primary functions or any quasi-fiscal activities. If it is obligated to provide such services, consideration should be given to incorporating subsidiaries to provide these services. Such subsidiaries should be taxable in the same way as other companies.

A central bank should be profitable under normal circumstances; at least in the medium-term, provided it is not obligated to conduct quasi-fiscal operations.² The central bank should thus be able to contribute to the government's revenue, either through disbursements of central bank profits directly to the budget or via taxation.

The legal framework for the operations of a central bank should establish the basis for defining the central bank's net income or profits, the accounting framework, and the rules on profit distribution. These rules must ensure the central bank's financial integrity, since such integrity is an important element of central bank autonomy allowing the central bank to achieve its objectives. They must also ensure a transparent reporting framework, since transparency is an important element of accountability.³ On the other hand, taxation of central bank activities should also respond to principles of fiscal transparency. These argue for avoiding the granting of numerous tax exemptions in institution-specific legislation, and call for any tax exemptions granted to be well specified. The following general principles, which allow for the appropriate trade-off between the central bank's financial integrity and fiscal transparency, describe good practice in relation to the tax treatment of central banks:

- the central bank law should identify an appropriate and sound accounting framework to guide central bank accounting and reporting;
- the central bank law should define a measure for, and treatment of, distributable profits that stipulates: (i) *adequate allowances for impaired assets, and other provisions, be included in the determination of net profits*; (ii) *unrealized revaluation gains be held in a separate revaluation reserve account, included in equity capital*; (iii) *contributions to reserves to maintain the central bank's equity capital be made before transfers to the government*; and (iv) *only realized profits be transferred to the government*, which should be done in a timely manner;
- the central bank law should exempt the central bank from income taxation⁴; and
- exemption from any other taxes should be addressed through specific tax legislation.

Specific Issues

Accounting

² See, for instance, "Institutional and Operational Aspects of Central Bank Losses" by Alfredo M. Leone, IMF Paper on Policy Analysis and Assessment, PPAA/93/14.

³ See, for instance, the IMF's [Code of Good Practices on Transparency in Monetary and Financial Policies: Declaration of Principles](#).

⁴ This might be repeated in the income or profit tax law, particularly if the country follows a general principle that tax provisions should be included only in tax laws. In this case, the provision in the central bank law might take the form essentially of a cross reference to the income tax law.

Accounting standards define the income measurement and reporting practices of the central bank. It is generally considered a good practice that the central bank law stipulate the use of internationally recognized accounting standards, bearing in mind the quality of national accounting standards.⁵

Compliance with standards may, however, in a central bank context, require some differing practices on the following issues:

- *Unrealized revaluation gains.* Under International Financial Reporting Standards (IFRS), gains and losses on financial instruments from foreign exchange or market price revaluations are included in the measurement of net profit.⁶ Best practice, however, is that the central bank should not distribute gains to the government until such time as they have been realized by a sale of the underlying assets. Where the central bank law allows the appropriation of unrealized revaluation gains from profits to reserves, it makes sense to fully observe standards that require all gains and losses to be recognized in the income statement. Where such appropriations are not possible, it may be preferable to record unrealized revaluation gains and losses directly to a separate revaluation reserve account in the equity section of the balance sheet. This reserve can then act to buffer capital from revaluation losses, such as those arising from the central bank's functional responsibility for managing the country's foreign exchange reserves. The concern here is that if unrealized revaluation gains are included in profits transferred to the budget, they could be monetarized and have an adverse impact on monetary control. Recording such gains as budget revenue would also be incorrect fiscal accounting. When net revaluation losses arise (i.e., after revaluation reserves have been depleted), they should remain in the income statement, and in the event that losses deplete authorized capital, the central bank law should require the government to recapitalize the central bank.
- *Impairment of assets.* Under IFRS, the central bank would be required to make timely recognition of any impairment of loans and other financial assets. In some countries, tax regulations can differ from accounting rules and prudential regulation for loan loss provisioning, and may not allow banks to recognize loan loss provisions or other impairment losses until they are realized. Although this is primarily a problem of timing, it may have an adverse impact on the central bank's capital and financial integrity.

Income taxation

⁵ While there are no IFRS that address central banks directly, there are many that have potential relevance and applicability, particularly IFRS 7 and IAS 1, 21, 30, and 39.

⁶ One exception is the treatment of available-for-sale financial assets, for which unrealized revaluation adjustments may be held in a revaluation reserve until disposal of the assets.

Most central banks are not subject to income or profit taxation, but instead transfer realized profits, after appropriate contributions to reserves, to the government. This is motivated by the following arguments:

- exempting the central bank from income tax makes, in principle, no difference to the amount of government receipts. In other words, while exemption reduces tax revenue there should be a correspondingly larger transfer of profits to the government. Therefore, from a fiscal point of view, exempting the central bank from income tax is reasonable;
- subjecting the central bank to taxation under generally applicable tax rules may lead to inappropriate results, in part because such rules tend to differ from accounting standards applicable to the central bank. For example, income tax regimes that are based on accrual accounting may include unrealized revaluations in the calculation of taxable income. Furthermore, taxable income is typically calculated *before* distribution to reserves resulting in a transfer of a portion of unrealized revaluation gains to the budget. As revaluation gains and losses may be significantly greater than other sources of income, tax proceeds may include large elements of unrealized gains, that the central bank may need to sterilize. This could expose the central bank's capital and thus endanger its financial integrity. In such circumstances, income taxation could actually be a less transparent mechanism for repatriation of the central bank's profits, which in part are due to the monopolies delegated to the central bank; and,
- income taxation might endanger the central bank's financial autonomy by inadvertently directing the central bank's focus on managing taxable earnings instead of achieving its primary objectives.

It is thus generally preferable to exempt the central bank from income taxation in the central bank law, provided it transfers its profits to the government after appropriate contributions to reserves. If the central bank is subject to income taxation, the income tax law should refer to the central bank law for rules on unrealized revaluation gains, provisions for impaired assets, and contributions to general reserves to maintain its equity capital before income taxation. Some central banks are subject to income taxation, particularly if they are stock companies partially owned by private shareholders. In this case, the central bank law will typically include a limit on the distribution of dividends to shareholders, after which remaining profits often are transferred to the government.

Other taxes

It is good practice—with the exception of income taxation—not to include a general statement in the central bank law to the effect that the central bank is exempt from taxation.

Such a statement raises more questions than it answers.⁷ Moreover, a general exemption from all taxes is not appropriate as a matter of tax policy, and it is in any event clearer to deal with the issues posed by each tax separately so that whatever exemptions are provided are well defined. Furthermore, in the case of taxes on goods and services, often the relevant issue is not exempting the central bank itself, but exempting a third party who supplies goods and services to the central bank. As well, the magnitude of taxes on goods and services is usually smaller and frequent amendments of tax legislation would be less likely to endanger the financial integrity of the central bank. It is also important to ensure fiscal transparency. As a general principle, this calls for all tax provisions to be included in the tax laws, rather than being scattered in various nontax laws. This note considers each of the generally applicable taxes in turn, discussing how the taxes might be applied to the central bank or in connection with transactions carried out by the central bank. Because each country's tax laws differ, the discussion below is not exhaustive of all the possibilities.

The general guiding principle is to treat the central bank in the same manner as government agencies in general.

Some countries have a *tax on assets of enterprises*. This tax should not be applied to the central bank. The asset tax is often related to the income tax (i.e., it may apply only if the income tax is below a certain threshold). Moreover, if the central bank owns the international reserves, it could be subject to a significant asset tax. The reasons for exempting the central bank from income taxation also apply in the case of an asset tax.

*Taxes on the ownership of real property*⁸ should be imposed on the central bank only if government agencies also are liable for such taxes. Such taxes may finance services municipalities provide. If government agencies generally are exempt, the central bank should be exempt as well.

The central bank should not have to pay *stamp duties* on issuance of its securities or bank notes. This does not mean that the bank should be exempt from stamp duties in all instances. For example, if a stamp duty applies to a contract for personal services and if the central bank enters into such a contract with an individual, the stamp duty should be payable. Likewise, if stamp duty is payable on the transfer of real estate, the central bank should be liable for this tax.

Taxes on financial transactions (e.g. on bank transfers) should generally not be applied to the transactions of the central bank, since they may impact the central bank's implementation of monetary policy and its other tasks.

⁷ For instance, if such a statement was included in a central bank law without further specificity, the question could be raised whether an exemption applied to indirect taxes on goods and services purchased by the central bank.

⁸ In civil law systems, immovable property.

Interest paid with respect to securities issued by the central bank should be subject to ***withholding of income tax*** at source on the same basis as interest paid with respect to government securities.

Imports of gold, banknotes, and coins to be delivered to the central bank should be exempt from ***customs duties, import duties, sales tax, VAT and the like***. Similarly, domestic supplies of the same should be exempt from sales tax (zero rated in the case of VAT). Other supplies of goods and services to the central bank should be taxed, in the same way that supplies to government agencies are taxed. While it may be argued that VAT on supplies to government agencies, including central banks, is simply the government paying tax to itself, there are two main reasons why it is better to tax these supplies. First, taxing these goods and services limits the opportunities for abuse by government officials and others who may seek to use an exemption to acquire goods and services for personal use. Second, it reduces the administrative burden on suppliers who would have to identify government supplies and treat them separately for reporting purposes. When central banks are subject to duties and taxes on banknotes, the taxable value should be the amount charged for their production, not the face value of the note.

The central bank generally should be liable for other taxes, for example, ***taxes on vehicle ownership, excise taxes on alcoholic beverages, automobiles, and cigarettes, and VAT on goods and services provided by the central bank*** (other than financial services) only if government agencies generally are liable for such taxes (which is often the case).