"Speculative transactions tax case"

The taxation of private speculative transactions with securities in the assessment periods 1997 and 1998 is unconstitutional.

HEADNOTES:

Judgment of the Second Senate of 9 March 2004
– 2 BvL 17/02 -

1. **The principle of equality regulated by Article 3.1 of the Basic Law (Grundgesetz – GG) requires for fiscal law that fiscal statutes should impose equal burdens on taxpayers in legal and factual terms. If equality in the tax burden imposed is in principle unsuccessful as a result of the legal form taken on by the collection method, this can lead to the unconstitutionality of the statutory tax base (reference to Decisions of the Federal Constitutional Court (Entscheidungen des Bundesverfassungsgerichts – BVerfGE) 84, 239).**
2. **It is constitutionally prohibited for the statutory order of the substantive obligation-establishing fiscal provision to be contradicted by a collection regulation which is not amenable to implement this order. Inequality is not necessarily caused by the empirical inefficiency of legal provisions but by the statutory shortcoming of contradictory law amenable to promote ineffectiveness.**

Judgment of the Second Senate of 9 March 2004
on the basis of the oral hearing of 18 November 2003
– 2 BvL 17/02 –

in the procedure for constitutional examination of whether § 23.1 sentence 1 no. 1 (b) of the Income Tax Act (*Einkommenssteuergesetz – EStG*) in the new version of the Income Tax Act of 16 April 1997 (Federal Law Gazette (*Bundesgesetzblatt – BGBl*) I p. 821) material to the assessment period 1997 is incompatible with the Basic Law insofar as the implementation of the tax claim is largely prevented because of structural obstacles to enforcement – Suspension and submission judgment of the Federal Finance Court (*Bundesfinanzhof*) of 16 July 2002 – IX R 62/99 –.

RULING:

§ 23.1 sentence 1 no. 1 (b) of the Income Tax Act in the new version of the Income Tax Act of 16 April 1997 (Federal Law Gazette I p. 821) applicable to the assessment periods 1997 and 1998 is incompatible with Article 3.1 of the Basic Law, and is null and void insofar as it relates to sale transactions with securities.

GROUNDS:

A.

The submission relates to the constitutionality of the taxation of private speculative transactions with securities within the meaning of § 23.1 sentence 1 no. 1 (b) of the Income Tax Act in the new version of the Income Tax Act of 16 April 1997 (Federal Law Gazette I p. 821). The fiscal provision submitted for examination applied in the year under dispute in the initial proceedings (1997) and in the year after that. 1

I.

1. In accordance with § 2.1 no. 7 of the Income Tax Act, other items of income within the meaning of § 22 of the Income Tax Act are also subject to income tax. § 22 no. 2 of the Income Tax Act includes with other items of income transactions within the meaning of § 23 of the Income Tax Act – in this provision referred to as “speculative transactions” up to and including assessment period 1998, subsequently referred to as “private sale transactions”. § 23 of the Income Tax Act reads as follows in its version material to the assessment periods 1997 and 1998, excerpts of which are presented below: 2

§ 23 3
Speculative transactions

(1) Speculative transactions (§ 22 no. 2) are 4

1. sale transactions with which the period between acquisition and sale is: 5

a) no longer than two years with land and rights subject to the provisions of civil law 6

on land (such as ground lease, mineral exploitation right),

b) no more than six months with other assets, in particular with securities; 7

2. (...) 8

(...) 9

(2) Speculative transactions shall not be deemed to exist if assets are sold the value of which is to be assessed with income within the meaning of § 2.1 sentence 1 nos. 1 to 6. § 17 shall not apply if the preconditions of paragraph 1 sentence 1 no. 1 (b) apply. On sale of participating certificates in money market assets, securities, holdings and special land assets, as well as of foreign investment shares, sentence 1 shall apply only insofar as intercompany profits are included in the transfer price. 10

(3) Profit or loss from speculative transactions shall be deemed to be the difference between the transfer price on the one hand and the historical cost or cost of production and the income-related expenses on the other. (...) Profits from speculative transactions shall be tax-free if the total profit gained from speculative transactions in the calendar year was less than 1,000 Deutsche Mark. Losses from speculative transactions may only be offset up to the amount of the speculative gains which the taxpayer made in the same calendar year; they may not be deducted in accordance with § 10.d. 11

Through the 1999/2000/2002 Tax Relief Act (*Steuerentlastungsgesetz*) of 24 March 1999 (Federal Law Gazette I p. 402), the following terminological and material amendments, *inter alia*, were made to § 23 of the Income Tax Act for the assessment periods from 1999 onwards: In order to convey that it is not only transactions with speculative intent which are subject to taxation (cf. *Bundestag* document (*Bundestagsdrucksache – BTDrucks*) 14/443, p. 28), the term “speculative transaction” was not used in § 23 of the Income Tax Act, just as it was not used in § 22 no. 2 of the Income Tax Act. For the private sale transactions now covered by § 23.1 no. 2 of the Income Tax Act, instead of by § 23.1 sentence 1 no. 1 (b) of the Income Tax Act, the holding period with securities in particular was increased from six months to one year. Whilst prior to that losses from speculative transactions could only be offset up to the amount of the speculative gains made in the same calendar year, from that time on, the losses have, in accordance with § 10.d of the Income Tax Act, also served to reduced income which the taxpayer makes or made from private sale transactions in the immediately preceding assessment period or in the following assessment periods (§ 23.3 sentence 9 of the Income Tax Act). 12

2. The historical basis for the current form of applying income tax to private capital gains is to be found in the Income Tax Act of 10 August 1925 (Reich Law Gazette (*Reichgesetzblatt – RGBl*) I p. 189): § 6.1 no. 8 of the 1925 Income Tax Act also imposed taxation on income from sale transactions (§ 41.1 no. 1 of the 1925 Income Tax Act) in the shape of “other operating profit, in accordance with §§ 41 and 42”, if they were to be regarded as speculative transactions (§ 42.1 sentence 1 of the 1925 13

Income Tax Act). Although sale transactions were to be taxed which related to the sale of an object already acquired with the intention of selling it on for a profit, the taxable event was already objectivised at that time by means of holding periods (§ 42.1 no. 1 of the 1925 Income Tax Act; see also on this the Reasoning for the Draft Income Tax Act (*Begründung zum Entwurf eines Einkommenssteuergesetzes*) in: Deliberations of the *Reichstag* (*Verhandlungen des Reichstags*), 3rd electoral period 1924, vol. 400, Annex to the Stenographic Record no. 795 (parallel reference *Reichstag* 3rd electoral period 1924/25, document (*Drucks.*) no. 795 of 27 April 1925), p. 19 (25 and 60)). The designation “speculative transactions” was also retained in the versions of § 22 no. 2 and § 23 of the Income Tax Act applicable until the assessment period 1998 inclusively. The term can hence be regarded as a technical designation which has been handed down in the tradition of § 42 of the 1925 Income Tax Act which has not taken on its own meaning for the interpretation of § 23.1 of the Income Tax Act (see also BVerfGE 26, 302 (308)).

3. § 22 no. 2 and § 23 of the Income Tax Act constitute an exception from the previously applicable principle of German income tax law that private assets may also be sold in the event of value increases without incurring a tax burden, even if they do not solely serve to maintain a private individual’s standard of living, but are used to obtain income. The 1925 Income Tax Act was based on the idea that, insofar as earnings were obtained without work or solely on the basis of a limited administrative activity, importance attached not to the change in the assets, but only to the earnings which they yielded (see Reasoning for the Draft Income Tax Act, loc. cit., p. 41). In accordance with the will of the legislature, not all capital gains obtained “outside gainful or professional employment” were to be taxed (see Reasoning for the Draft Income Tax Act, loc. cit., p. 60). 14

The Federal Finance Court described the meaning and purpose of § 23 of the Income Tax Act by stating that (only) those value increases were to be subject to income tax where an asset was held in the taxpayer’s private estate for a relatively short period of time (see Judgments of 30 November 1976 – VIII R 202/72 –, Collected Decisions of the Federal Finance Court (*Sammlung der Entscheidungen des Bundesfinanzhofs* – BFHE) 120, 522, Federal Tax Gazette (*Bundessteuerblatt – BStBl*) II 1977, 384, at II b, and of 29 March 1989 – X R 4/84 –, BFHE 156, 465, Federal Tax Gazette II 1989, 652, at a). The reasoning of the taxable event can however also be made clear using the limits of private asset administration, as used by the Federal Finance Court in its case-law on commercial trade in land: Accordingly, the boundary between non-taxable and taxable private sale transactions is as a rule overstepped in accordance with the current nonconstitutional law if in accordance with an overview of activities, and taking account of the generally accepted standards, definite priority is attached to the exploitation of substantial assets by reallocation as against the utilisation of land within the meaning of collecting the fruits and benefits from intrinsic values which are to be maintained (see Federal Finance Court, Grand Senate, judgment of 10 December 2001 – GrS 1/98, BFHE 197, 240, Federal Tax Gazette II 2002, 291, 15

at C III 1).

4. Insofar as § 22 no. 2 and § 23 of the Income Tax Act relate to the taxation of speculative transactions or of private sale transactions in securities, repeated criticism has been expressed in the past as to the actual enforcement of the taxable event. Here, indications of shortcomings in enforcement came in particular from the fiscal administration itself, as well as from courts of audit: 16

a) In 1994, a “Revenue shortfall” working party which had been established by the North-Rhine/Westphalia *Land* (state) Ministry of Finance to examine the possibilities to fully exhaust sources of tax revenue stated in its final report (*Der Steuerberater (StB)* 1994, p. 399 and p. 446 (449-450)) that speculative gains in accordance with § 23.1 no. 1 (b) of the Income Tax Act were largely not being declared; the volume was said to be unknown. Only with taxpayers who were under an obligation to keep books of account did the law provide for an obligation to store bank account statements for business accounts (§ 147.1 no. 5 of the 1977 Tax Code (*Abgabenordnung – AO*)). These documents were however reportedly only submitted where an external audit took place. Financial movements on private accounts, by contrast, were as a rule concealed from the tax office, and could only be examined after seizure of the corresponding documents. Speculative gains could only be exposed through intensive examination of accounts which were submitted, known or discovered during an external audit, or occasionally on the basis of individual information requests when examining the tax declarations submitted. 17

Under the heading “suggested improvements” (loc. cit., p. 450) the report referred to the annulment of § 30.a.3 of the Tax Code and the creation of a legal basis for special audits at banks with the goal of examining customer accounts. In accordance with § 30.a.3 of the Tax Code, credit accounts or deposits for which an identity check was carried out on opening in accordance with § 154.2 of the Tax Code, in respect of which the financial institution has therefore assured itself of the identity and the address of the account holder, may not be assessed or written off in the external audit of a financial institution for subsequent examination of proper taxation; tax-audit tracer notes are not to be requested in this respect (see BVerfGE 84, 239 (245 et seq.) on the previous history of § 30.a of the Tax Code, which was inserted in into the 1977 Tax Code by the 1990 Tax Reform Act (*Steuerreformgesetz*) of 25 July 1988 (Federal Law Gazette I p. 1093), in particular on the banking decree preceding the provision (Federal Tax Gazette I 1979, 590)). 18

b) The reality in the taxation situation concerning speculative gains from private security transactions was also critically evaluated by the experts Ondracek, Seip and Herzig (see in detail German *Bundestag*, 14th electoral period, VIIth Committee, minutes no. 10, pp. 9 and 13-14) at the public hearing of the Finance Committee of the German *Bundestag* (Federal Parliament) on the Draft 1999/2000/2002 Tax Relief Act (*Bundestag* document (*Bundestagsdrucksache – BTDrucks* 14/23)), held on 19 January 1999. 19

c) Civil servants of the administrative service of the North-Rhine/Westphalia fiscal administration were quoted in the periodical *Die Wirtschaftswoche* no. 6 of 4 February 1999 (p. 104 (reported on by Hüsgen)); p. 114 (interview by Hüsgen/Stepp)) on the reality in the taxation situation, in particular with regard to speculative gains made on the so-called "New Market": Whilst high profits were said to be made in a very short period on the "New Market", they were reportedly not reflected at all in the tax declarations; share profits within the speculation period were said only to be stated very rarely. The periodical's report indicated that these statements had also been confirmed by information from the Hesse Ministry of Finance. 20

d) After the May 2000 issue of "*FinanzReport*" (p. 3), published by the Ministry of Finance of the *Land* North-Rhine/Westphalia, had already stated in a report headlined "Germany in share fever" that many private investors' stock price gains were not being taxed, the *Land* government of North-Rhine/Westphalia answered as follows on 18 September 2000 (North-Rhine/Westphalia *Landtag* (*Land* Parliament), document 13/248) in response to a minor interpellation by Members of the North-Rhine/Westphalia *Landtag* (document 13/125): The *Land* government was aware of the presumptions which were made among the public about inadequate taxation of private capital gains from security transactions. This topic had been accentuated in light of the stock market boom of recent years, as well as of the accompanying popularisation of share trading among "small investors". When it came to taxation, the tax offices were said to be dependent first and foremost on taxpayers declaring all of these profits. An external audit was said not to be a suitable tool to ensure the taxation of small investors' private sale transactions; this group of individuals primarily included private investors who as a rule did not run an operation for which an external audit was permissible in accordance with § 193.1 of the Tax Code unless further prerequisites were met. 21

e) The Federal Court of Audit (*Bundesrechnungshof*) devoted its report in accordance with § 99 of the Federal Budget Code (*Bundeshaushaltsordnung*) of 24 April 2002 (*Bundestag* document 14/8863) to the taxation of income from private sale transactions in securities, *inter alia* because the prices of most stocks had increased – in some cases considerably – roughly from 1994 until the end of 1999, and for this reason private investors had made much greater profits from the sale of securities in this period than in the previous years (see *Bundestag* document 14/8863, p. 4 at 1). The Federal Court of Audit studied the question of whether all income from the sale of securities of private investors was being declared for tax, and indeed correctly taxed by the tax offices. In accordance with the information contained in the report (loc. cit., p. 5 at 1), the Federal Court of Audit studied and evaluated roughly 400 such tax cases from four tax offices in four *Länder* (states) with assessed income from private sale transactions – in most cases assessments from 1997 and 1998 – and evaluated information which the Lower Saxony *Land* Court of Audit (*Landesrechnungshof*) had obtained from a comparable audit at four Lower Saxony tax offices concentrating on the assessment periods 1997 to 1999. A large number of the cases examined by the 22

Federal Court of Audit related to “income millionaires”. The Federal Court of Audit stated (see *Bundestag* document 14/8863, pp. 6 et seq. for details) that

– all in all, conduct in declaration was largely unsatisfactory, 23

– the tax offices had as a rule given credence to the information provided by taxpayers in their tax declarations without it being recognisable that the offices had effected an examination, irrespective of the amount of the information provided and of the amount of income, 24

– the tax offices had not checked in most cases whether taxpayers had declared income from private sale transactions completely, or indeed at all, and 25

– the insufficient scrutiny by the tax offices in this instance was caused less by negligence than rather by factual and legal obstacles: The fiscal administration currently had no suitable means of ascertaining the facts in the taxation of private sale transactions with securities; the fiscal administration was much more dependent in the area under study on taxpayers providing complete, correct information than with other types of income. The collection shortfall could reportedly only be resolved by the legislature. 26

The submissions of the Federal Ministry of Finance on these examination statements (*Bundestag* document 14/8863, pp. 10-11 at 5) did not convince the Federal Court of Audit (see *Bundestag* document 14/8863, p. 11 at 6). 27

f) In its 2002 annual report, the Lower Saxony *Land* Court of Audit dealt amongst other things with the taxation of private security transactions (Lower Saxony *Landtag*, document 14/3420, pp. 59 et seq.). The *Land* Court of Audit also reached the conclusion that shortcomings in enforcement exist when it comes to the taxation of capital gains from private security transactions; these could be remedied by more careful investigation of the tax bases, and in particular by introducing a withholding tax. The investigation carried out by the *Land* Court of Audit refers largely to “cases of intensive scrutiny”, which only accounted for slightly less than 10 percent of the assessable income tax cases. 28

5. Insofar as an actual shortcoming in collection was ascertained in the taxation of speculative gains from private security transactions (A I 4), there is however no reliable information as to their scale. For instance, the Federal Court of Audit stated in its report of 24 April 2002 that it was not possible to obtain information on the amount of the declarable private capital gains with securities (see *Bundestag* document 14/8863, p. 9 at 3.6). 29

II.

1. The plaintiff and appeal on points of law plaintiff of the initial proceedings – an emeritus University professor – headed the Institute of Tax Law at the University of Cologne for many years. 30

In the annex to his income tax declaration for the assessment period 1997, the dispute year of the initial proceedings, relating to income from capital assets and other items of income (*Anlage KSO*), the plaintiff declared other items of income totalling DM 1,752 from “speculative transactions” within the meaning of § 22 no. 2 and § 23.1 sentence 1 no. 1 (b) of the Income Tax Act, for which the competent tax office allowed in his 1997 income tax notice. Against this measure, and with the concurrence of the tax office, the plaintiff filed a leap-frog action to Schleswig-Holstein Finance Court, alleging that the imposition of taxation on his speculative gains was unconstitutional; in this respect there was alleged to be a shortcoming in enforcement leading to inequality in the tax burden imposed. 31

2. By judgment of 23 September 1999 – V 7/99 – (Decisions of the Finance Courts (*Entscheidungen der Finanzgerichte* – EFG 2000, p. 178), the Finance Court rejected the action as unfounded, but admitted the appeal on points of law because of fundamental significance: The Senate considered the provision contained in § 23.1 sentence 1 no. 1 (b) of the Income Tax Act to be constitutional. It did not concur with the complaint asserted by the plaintiff of the lack of implementability of the provision. Whilst it could not be denied that a shortcoming in collection could remain with the collection of speculative transactions, the Senate did not however consider this to be grievous since it was not primarily a structural shortcoming for which the legislature had to take responsibility. 32

3. As to the subsequent appeal on points of law proceedings, the Federal Ministry of Finance declared its accession after a request from the IX Senate of the Federal Finance Court (Order of 19 March 2002 – IX R 62/99 –,BFHE 197, 562, Federal Tax Gazette II 2002, 296). At the oral hearing held on 16 July 2002, the IX Senate introduced the report of the Federal Court of Audit of 24 April 2002 in the proceedings. 33

By order of 16 July 2002 – IX R 62/99 – (BFHE 199, 451, Federal Tax Gazette II 2003, 74), the Federal Finance Court suspended the proceedings and submitted the question to the Federal Constitutional Court (*Bundesverfassungsgericht*) as to whether § 23.1 sentence 1 no. 1 (b) of the Income Tax Act in the new version of the Income Tax Act of 16 April 1997 (Federal Law Gazette I p. 821) material to the assessment period 1997 is incompatible with the Basic Law insofar as the enforcement of the tax claim was largely prevented because of structural obstacles to enforcement. 34

a) This was said to be material to the ruling. The income from speculative transactions declared by the plaintiff was said to be subject to taxation because of the substantive fiscal law provision submitted for examination by the Federal Constitutional Court if it was not incompatible with the constitution because of a structural shortcoming in collection. An interpretation of § 23.1 sentence 1 no. 1 (b) of the 1997 Income Tax Act in conformity with the constitution could not remedy the unconstitutionality to be assessed. The possible meaning of the wording of the provision – as a boundary for interpretation – was said to be unambiguous. Equally, the constitutional interpreta- 35

tion of § 30.a of the Tax Code made by the VIII Senate of the Federal Finance Court (judgment of 18 February 1997 – VIII R 33/95 –, BFHE 183, 45, Federal Tax Gazette II 1997, 499) was said to be of no further assistance.

b) The statements of the IX Senate of the Federal Finance Court on the standard for review contained in Article 3.1 of the Basic Law link to the judgment of the Second Senate of the Federal Constitutional Court of 27 June 1991 – 2 BvR 1493/89 – (BVerfGE 84, 239): Substantive fiscal statutes must be embedded in a statutory environment which in principle guarantees the equality of the tax burden also with regard to the actual burden imposed. 36

c) The IXth Senate primarily founded its conviction of the unconstitutionality of § 23.1 sentence 1 no. 1 of the Income Tax Act 1997 on the following considerations: 37

– The form of tax collection was inadequate because the investigation tools available to the fiscal administration for verification of speculative gains from private security transactions were either already not appropriate, or did not meet constitutional demands. 38

– Because of the situation as regards collection, in principle an even tax burden was not imposed on income from speculative transactions within the meaning of the provision submitted for examination. 39

– The inequality of the tax burden was also made clear by the substantive fiscal provision submitted actually not being enforced by the tax offices. 40

– The legislature must take responsibility for the unequal tax burden imposed on honest taxpayers. 41

For further grounds, the Federal Finance Court based its decision amongst other things on the findings of the Federal Court of Audit, which dealt in its report of 24 April 2002 with various tools which the finance authorities had at their disposal in accordance with current procedural law for an examination of available facts relevant to fiscal law, as well as with the historical developments and the procedural law impact of the provision contained in § 30.a of the Tax Code – which in accordance with the view of the IXth Senate is “structurally contrary”. The Federal Finance Court justified the responsibility of the legislature for the criticised inequality in the tax burden imposed *inter alia* by stating that the legislature had neither rescinded nor amended the provisions of the banking decree incorporated as § 30.a of the 1977 Tax Code, which had been referred to in BVerfGE 84, 239 (278-279) as a structural obstacle to enforcement. 42

III.

The Federal Ministry of Finance, which had acceded to the initial proceedings, made a statement for the Federal Government as to the question submitted. In response to the query of the Federal Constitutional Court, the Federation and the *Länder* submitted considerable information on the status of the investigation of speculative gains 43

from private security transactions. The Federal Court of Audit, the Association of German Banks, the Federal Association of German *Volksbanken* and *Raiffeisenbanken*, the Association of German Public Sector Banks, the German Savings Bank Association and the German Stock Institute submitted statements as expert third parties. The subject-matter of the oral hearing was the information which they provided and the submission of the plaintiff of the initial proceedings; furthermore, staff of the fiscal administration of the *Land* Hesse reported as experts on recent practice in the ascertainment of speculative gains from private security transactions in the inside and field staff of Hesse tax offices.

1. The Federal Ministry of Finance considers the view of the IX Senate of the Federal Finance Court to be factually and legally incorrect, namely that the lack of a possibility to scrutinise the taxation of speculative gains gives rise to a structural shortcoming in collection. 44

a) The Ministry stated that it was already impossible in factual terms to concur with the presumptions used as a basis for statements by the Federal Finance Court invoking the report of the Federal Court of Audit of 24 April 2002: Whilst the shortcomings in processing listed in the report of the Federal Court of Audit in the tax assessments for which the *Land* finance authorities were responsible were not justifiable, they did not however permit one to conclude that there was a structural shortcoming in collection. The number of the cases of income from speculative transactions – including land transactions – investigated by the fiscal administration and actually recorded had in fact reportedly more than quadrupled from 1995 onwards (15,973 cases accounting for income of € 223.3 million) to 1998 (73,538 cases with income of € 731.8 million). What is more, it was stated that a not inconsiderable number of taxpayers was likely to have waited for the statutory speculation periods to expire; the majority of security sales was in any case said to be accounted for by the non-private area. 45

b) The presumptions of the Federal Finance Court were also said not to be tenable from a legal point of view. In applying the principles established in BVerfGE 84, 239, the unconstitutionality of § 23.1 sentence 1 no. 1 (b) of the Income Tax Act 1997, alleged by the submitting court, was not recognisable: The IX Senate of the Federal Finance Court did not sufficiently take into account that inequality of tax burdens did not give rise to a constitutionally relevant structural shortcoming if it was caused by shortcomings in enforcement in collecting taxes, as they could repeatedly take place, and indeed did take place. The IXth Senate failed to consider recent trends in the case-law of the VIIth and VIIIth Senates of the Federal Finance Court, as well as the fundamental changes in the examination practice of the fiscal administration after the Federal Constitutional Court's judgment on interest. 46

The fiscal administration has allegedly proceeded more and more courageously with the support of the VIIth and VIIIth Senates of the Federal Finance Court, and also as a result of the order of the 2nd Chamber of the Second Senate of the Federal Constitutional Court of 23 March 1994 – 2 BvR 396/94 – (*Der Betriebs-Berater* – BB 1994, 47

p. 850, *Höchstrichterliche Finanzrechtsprechung* – HFR 1995, p. 36). § 30.a of the Tax Code was no longer to be interpreted as an obstacle to enforcement – as had been the case at the time of the 1991 judgment on interest –. Insofar as tracer material may not be drawn up speculatively in the context of an external audit in financial institutions in accordance with § 30.a.3 sentence 1 of the Tax Code, which in other respects was restricted to identity-checked accounts, the judgment on interest did not require such investigations. What is more, the VIII Senate of the Federal Finance Court (Order of 18 February 1997 – VIII R 33/95 –, loc. cit.) was said to have interpreted § 30.a of the Tax Code in conformity with the constitution such that paragraph 3 of the provision did not prevent the drawing up and evaluation of tax-audit tracer notes on the occasion of an external audit with financial institutions if a sufficiently well-founded occasion existed for this. In accordance with the case-law of the VIIth Senate (Order of 21 March 2002 – VII B 152/01 –, BFHE 198, 42, Federal Tax Gazette II 2002, 495), the presumption of a non-permissible search by screening was not possible with a sufficient occasion for investigative measures by the tax investigation service with financial institutions, even if the investigation addressed a large number of persons. There were no indications that the competent finance authorities of the *Länder* – apart from shortcomings in processing which could not be ruled out in individual cases – were proceeding in accordance with these rulings of the VII and VIII Senate of the Federal Finance Court.

2. The vast majority of the *Länder* transmitted statements – drafted in most cases by their Ministries of Finance or Regional Finance Offices (*Oberfinanzdirektionen*) – and in doing so submitted internal administrative documents which largely date from 2000 and onwards and relate to actual, planned or proposed activities of the fiscal administration to verify speculative gains in 2001 onwards. In doing so, most *Länder* admitted that the assessment agencies – although in this respect there were also reports of more intensive scrutiny of “verification fields” and of staff training – had inadequate possibilities available to ascertain profits from private sale transactions in securities. With regard to bank scrutiny – in some cases referred to as “time-consuming” – the *Länder* stated, referring in most cases to § 30.a of the Tax Code, that the assessment of the tax bases of third parties, carried out on the occasion of the examination of financial institutions, was difficult. As to the instruction (not given in all *Länder*) to draft tax-audit tracer notes to assess speculative transactions with securities, there had been considerable practical implementation problems of a factual and legal nature; banks had refused to support the audit in any way, and had resisted auditors’ requests for details of identity-checked accounts to enable them to prepare tax-audit tracer notes. The Ministry of Finance of the *Land* North-Rhine/Westphalia also reported difficulties encountered in undertaking tax investigation measures to verify speculative gains: As a rule, there was neither initial suspicion under criminal law, nor sufficient occasion for investigations at a specific financial institution. Information is not available as to what contribution had been made as yet by tax investigation measures to the verification of income from private sale transactions in securities, in particular during the assessment periods 1997 and 1998. All in all, data had not been provided 48

permitting quantificationof the overall efficiency of the verification measures that had been submitted.

3. The expert third parties largely expressed themselves as follows: 49

a) The Federal Court of Audit once more summarised the statements and findings contained in its report of 24 April 2002, and conveyed the overall impression that the tax offices' inadequate ability to verify was a result less of negligence than of factual and legal obstacles. It was however not possible to estimate the extent of the income from private sale transactions with securities that was undeclared or incompletely declared, and of the revenue shortfall caused thereby; the Federation and the *Länder* did not have a set of tools at their disposal in order to determine even approximately the volume of the private sale transactions which should have been declared. 50

b) The banking industry associations stated that they had no empirical data revealing directly or indirectly the scale and the time attribution of successful sales from private individuals' security transactions. They had also stated that they had no empirical investigations or publicly accessible statistics as to private individuals' investment conduct. The presumption made by the Federal Court of Audit that, in the context of events on the "New Market", private investors had achieved considerable increases in value by means of short-term transactions was likely to be true in essence, albeit private investors had also incurred considerable losses in some cases. Whether the findings of the Federal Court of Audit were sufficient for the presumption of a structural shortcoming in collection was said to already be questionable as to the banks' obligations of registration, information and reporting to the finance authorities; § 30.a of the Tax Code was said not to oppose the existing possibilities for scrutiny. 51

c) The German Stock Institute has also admitted that there is no reliable source or method to reliably determine the amount of private speculative gains and the resultant tax revenue. The German Stock Institute, however, made a critical appraisal of the information provided by the German Union of Finance Personnel (*Deutsche Steuer-Gewerkschaft*), also quoted by the Federal Court of Audit, that the tax shortfall caused in the taxation of private sale transactions with securities was € 1.5 billion per year (see *Bundestag* document 14/8863, p. 9 at 3.6; Ministry of Finance North-Rhine/Westphalia, *FinanzReport* May 2000, p. 3); the Stock Institute stated that such a value could only be reached by presuming, highly unrealistically, that private households had made the whole annual value change of their share stocks in 1992 to 2002 within the speculation period. If one made the generous presumption that 50 per cent of the changes posted on the stock market had been made by investors, and that in turn 20 per cent of this had been made within the speculation period, the tax revenue calculated would have been € 140 to 150 million per year; this was caused by the fact that the considerable price increases in the second half of the nineties, in particular on the "New Market", had been set against losses that were almost equally high in 2000 to 2002, which it had been possible to offset against tax since 1999. 52

d) Staff of the Hesse fiscal administration reported at the oral hearing of the experi- 53

ence of the inside staff of Frankfurt am Main I tax office and of the external audit department of Darmstadt tax office. Their information has been supplemented by a report from Frankfurt am Main I tax office of 30 July 2002, submitted by the Federal Ministry of Finance, regarding the information obtained there in investigating income from private sale transactions, in particular with securities.

aa) In the first half of 2002, Frankfurt am Main I tax office is said to have audited roughly 60 tax cases in which the asserted income-related expenses in income from capital assets indicated asset administration. If there had been an asset administration contract, there had also been documents relating to private sale transactions which had simply not been submitted to the tax office. The report of Frankfurt am Main I tax office had largely related to the assessment periods 1999 and 2000. Losses had been made from 2000 onwards, which had increased taxpayers' willingness to declare; the tax office had then also made enquiries relating to the preceding years. At Frankfurt am Main I tax office, the examinations had led in 26 cases to additional income within the meaning of § 23 of the Income Tax Act, amounting to roughly DM 1.02 million. The pilot project at Frankfurt am Main I tax office had finally been expanded to cover all of Hesse; of the 515 cases dealt with, 73 had led to DM 5 million in extra revenue, but also DM 1.1 million in losses had been declared. 54

bb) The external audit department of Darmstadt tax office had audited turnover tax at banks in 2000 to 2002 where the audit period had covered 1995 onwards (concentrating on 1998). Here, considerable securities turnover had been found within a short period, but neither the names of the investors in question nor their addresses had been evident. 40 to 60 tracer notes should have been drafted at two banks, but the banks had refused to release their customers' addresses. 55

B. – I.

The submission is admissible. 56

1. The question submitted is material to the ruling. The IX Senate of the Federal Finance Court has stated logically, and hence bindingly for the Federal Constitutional Court, that it must reach different results depending on whether the standard submitted for an examination is valid or invalid. 57

2. The Federal Finance Court also explained its conviction of the unconstitutionality of the provision that has been submitted. It provided sufficiently clear reasoning for its view that the implementation of this provision had been largely prevented in the assessment period 1997 because of structural obstacles to enforcement; it linked its argument to the findings of the Federal Court of Audit and to the well-founded analysis of the set of scrutiny tools available to the fiscal administration, and also made sufficiently clear its conclusion that the legislature must attribute to itself the presumed unequal tax burden imposed on the honest taxpayer. 58

II.

The submitting court used § 23.1 sentence 1 no. 1 (b) of the Income Tax Act in the version of the Income Tax Act material to the assessment period 1997 for the constitutional examination insofar as the implementation of the tax claim is largely prevented because of structural obstacles to enforcement. The reasoning of the question submitted however shows that the Court only relates its conviction as to unconstitutionality to the sale of securities, and not also to the sale of other assets which also fall under the area of application of the provision. The submission is hence to be restricted (see BVerfGE 99, 280 (289) with further references). 59

C.

§ 23.1 sentence 1 no. 1 (b) of the Income Tax Act in the version valid for the assessment periods 1997 and (lastly) 1998 is incompatible with Article 3.1 of the Basic Law, and is null and void insofar as it relates to sale transactions with securities. The statutorily founded substantive tax obligation is constitutionally unobjectionable. However, the shortcomings in implementation of this substantive obligation to be attributed to the legislature violate the constitutional principle of the imposition of factually equal tax burdens by equal law enforcement, with the consequence that the substantive fiscal provision itself becomes unconstitutional. 60

I.

Apart from the question of its equality-orientated enforcement, the fiscal provision submitted for examination by the Federal Constitutional Court itself does not give rise to any constitutional reservations. 61

The Second Senate of the Federal Constitutional Court already denied a violation of Article 3.1 of the Basic Law in its order of 9 July 1969 – 2 BvL 20/65 – (BVerfGE 26, 302 (312)) insofar as profits from sale transactions within the meaning of the § 23.1 of the Income Tax Act are attributable to other items of income and taxed in accordance with § 22 of the Income Tax Act. Here, the Court stressed that the legislature constitutionally would not be prevented from taxing profits from any sale of private assets. 62

These statements are also to be upheld in light of the standards of the right to equality for income tax law which have in the meantime been refined and further developed by the Federal Constitutional Court (see for instance BVerfGE 99, 280 (289-290); 105, 73 (110-111); 107, 27 (45 et seq.), in each case with further references). 63

II.

1. As the Second Senate of the Federal Constitutional Court stated in its judgment of 27 June 1991 on interest taxation – 2 BvR 1493/89 – (BVerfGE 84, 239 (268 et seq.); see also BVerfGE 96, 1 (6 et seq.)), the principle of equality regulated by Article 3.1 of the Basic Law requires for fiscal law that fiscal statutes should impose equal burdens on taxpayers in legal and factual terms. If equality in the tax burden imposed is in principle unsuccessful as a result of the legal form taken on by the collection 64

method, this can lead to the unconstitutionality of the statutory tax base.

In accordance with the principle that tax burdens should be factually equal as a result of equal law enforcement, the structurally contrary collection regulation falling in the area of responsibility of the legislature gives rise to its unconstitutionality in conjunction with the substantive fiscal provision that is to be enforced. Collection regulations have a structurally contrary impact on a taxable event if they lead to a situation in which the taxation claim cannot be enforced in most cases. The question of whether the legislature achieves in practice those goals to which it aspires– in fiscal law achieving revenue, perhaps also exercising control – is not yet decisive by itself in terms of the rule of law. Shortcomings in enforcement, as they may repeatedly and indeed do take place, do not by themselves give rise to the unconstitutionality of the substantive fiscal provision (BVerfGE 84, 239 (272)). It is however constitutionally prohibited for the statutory order of the substantive obligation-establishing fiscal provision to be contradicted by a collection regulation which is not amenable to implement this order. Inequality is not necessarily caused by the empirical inefficiency of legal provisions, but by the statutory shortcoming of the contradictory law amenable to promote ineffectiveness (see Bryde, *Die Effektivität von Recht als Rechtsproblem*, 1993, p. 20-21; Eckhoff, *Rechtsanwendungsgleichheit im Steuerrecht, Die Verantwortung des Gesetzgebers für einen gleichmäßigen Vollzug des Einkommenssteuerrechts*, 1999, pp. 527 et seq.). 65

This leads to a duty incumbent on the legislature, which may not be qualified by macroeconomic considerations, to avoid the unconstitutionality of the substantive fiscal statute by embedding the latter in a statutory environment which guarantees that equal tax burdens are actually imposed on taxpayers – with the tool of deduction at source or in the assessment procedure, the declaration principle being supplemented by the verification principle (BVerfGE 84, 239 (271, 273-274)). In such a case, the statutory manifestation of fiscal confidentiality in accordance with § 30 of the Tax Code in principle forms the counterpart, meeting constitutional requirements, relating to further disclosure obligations in the taxation procedure (for details BVerfGE 84, 239 (279 et seq.)). In the event that equal enforcement of a substantive fiscal provision proves not to be possible without making excessive, in particular unreasonable, demands on taxpayers' cooperation to clarify facts, the legislature should revert to collecting a withholding tax in order to avoid fundamentally unequal tax burdens being imposed as a result of investigations being restricted accordingly (see BVerfGE 84, 239 (281)). 66

2. In line with this standard for review, the following aspects must be accommodated in the finding of a structural obstacle to enforcement: 67

a) The standard case of the taxation procedure is material to the examination as to whether shortcomings in legislation prevent the imposition of equal tax burdens (see also BVerfGE 84, 239 (275)). 68

Independently of the possibility to quantify the scope of shortcomings in declaration, 69

as well as taxable income that is not recorded, or indeed taxes which are evaded, the determination of a structural shortcoming in enforcement in the constitutional sense depends very largely on the degree to which in enforcing a certain substantive fiscal provision the form of collection or – if taxation is not already imposed at source – the taxation practice in the framework of customary administrative procedures in the high volume of cases processed by the tax offices is amenable overall to achieve equality in the tax burden imposed, and to what degree in particular inadequate declarations on the part of taxpayers also entail a suitable risk of being found out. It should be taken into account here whether special verification tools such as external audits are applied to the income in question as a rule, or whether they tend to be rare exceptions. If the standard case can be sufficiently reliably described on the basis of an analysis of the procedural law structures of the taxation procedure and on the basis of empirical information on the assessment practice so that assessed income under substantive law is only collected accurately in the case of a qualified willingness to declare on the part of taxpayers, and misconduct remains possible in the declaration without a significant risk in practice of being found out, this already provides a suitable basis for the finding of inequality of application of the law structurally inherent within the law.

b) The standard case of the taxation procedure is also to be taken as a basis, also given the general principle according to which doubt as to the completeness and correctness of the taxpayer's contribution must be based on sufficient ("tangible") indications (see Tax Code Application Decree (*Anwendungserlass zur Abgabenordnung – AEAO*) re § 88 in the version of the proclamation of 24 September 1987, Federal Tax Gazette I 1987, 664, in this respect also not amended in the version of the proclamation of 15 July 1998, Federal Tax Gazette I 1998, 630), in contrast with which speculative investigations are not permissible. Irrespective of disputed individual questions as to its concrete form, this principle to restrict the investigation of the facts in fiscal law not only has important protective and security functions benefiting taxpayers, but also provides a realistic structure of the income tax assessment procedure which must remain practicable as a high-volume procedure by appropriately concentrating investigation measures carried out by authorities. For this reason, the legislature may make it easier to implement the tax claim under procedural law, and in doing so may take into account the boundaries of the staffing and funding available to the state (see for instance BVerfGE 96, 1 (7) with further references). 70

Together with substantive law, procedural law serves to evenly compile taxpayers' capacity. Also Procedural law must hence be designed such that it guarantees even implementation in standard taxation practice of the tax burden determined by a substantive fiscal provision. The form of tax collection and – in addition to the principle of declaration – the set of control tools available to the authorities, must hence correspond as a rule to the substantive fiscal provision such that their equally fair enforcement in the high-volume assessment procedure is possible without requiring disproportionate contributions by taxpayers or excessive effort on the part of the fiscal 71

authorities in investigations.

A structural shortcoming in enforcement may hence be indicated if excessive demands are placed on the tax offices' investigation activity in order to force the implementation of the fiscal provision in question after the determination of an actual shortcoming in collection. If because of a specific substantive provision the fiscal administration must in general terms carry out more examinations in order to be able to achieve something approximating an even tax burden, this may be an indication of the existence of a shortcoming in the collection structure. This is not countered by the fact that the fiscal administration can modify the deployment of its set of verification tools and form verification fields, depending on the probability of obtaining specific types of revenue (with private security transactions for instance with increasing stock prices). 72

c) A structural shortcoming in collection can also be suggested if the taxation of specific income in comparison with other items of income demonstrates shortcomings in collection which as a rule do not take place to such a degree as with the other items of income. 73

d) When determining a structural shortcoming in collection, attempts to make improvements are also to be assessed which the fiscal administration has undertaken after becoming aware of an actual shortcoming in enforcement. The nature, extent and success of the derogation from previous assessment practice can provide indications of whether the set of tools available for the standard case of assessment was as yet only inadequately applied, or whether the "improvements" are measures to which normal enforcement is not amenable, and to which it cannot be amenable. 74

III.

In accordance with these standards (C II), the taxation of speculative gains from private security transactions in the assessment periods 1997 and 1998 does not meet the requirements of Article 3.1 of the Basic Law. Fair implementation of the tax claim fails because of structural shortcomings in collection. 75

1. A shortcoming in collection leading to inequality in the above assessment periods can be determined even though the actual scope of the untaxed speculative gains and corresponding revenue shortfall is unknown. 76

a) The Senate cannot make concrete findings based on the written and oral statements of the parties of the initial proceedings, those entitled to make a statement and the expert third parties, on the amount of the undeclared taxable capital gains from private security transactions and the tax revenue lost as a result of that; it was not possible to ascertain representative figures on the efficiency of the fiscal administration's verification measures. A quantitative description of enforcement practice in the taxation of speculative gains from private security transactions comes up against not only a factual situation that is similarly difficult to access as is the case with the taxation of private capital gains (see BVerfGE 84, 239 (276 et seq.)). There is not even a 77

reliable foundation for estimating the tax shortfall caused by actual shortcomings in collection. The concurrent statement made by the Federal Court of Audit (*Bundestag* document 14/8863, p. 9 at 3.6) and by the Federal Finance Court (Submission order of 16 July 2002 – IX R 62/99 –, loc. cit., at B III 4 b), namely that there was no knowledge of the amount of private sale transactions with securities that should have been declared and of the tax shortfall to be recorded in this respect, has not been denied by the documents submitted by the Federation and the *Länder*. Above all, the figures named by the Federal Ministry of Finance on the increase in the speculative transactions taxed in 1995 to 1998 (see A III 1 a above) contain, firstly, no authoritative information specifically on the security transactions that are of interest here, since they also include land transactions without distinction; secondly, there is no reference value which might facilitate a comparison with the figures of speculative transactions with securities actually carried out.

b) The lack of “tangible” figures of presumed tax shortfall resulting from inadequacies in law enforcement however does not rule out the possibility of ascertaining shortcomings in enforcement which are in fact grievous and structural in a constitutional sense. Firstly, diagnoses of the administrative reality in conjunction with analyses of procedural law provide a tenable foundation for the determination of major factual shortcomings in collection (aa); secondly, it is a matter of suitably weighting major procedural law shortcomings to meet the requirements of equal law enforcement in fiscal law (bb). 78

aa) Information on the reality faced in assessment may also form a tenable basis for the conviction of the existence of actual shortcomings in collection, even if there is no quantification of the undisclosed income and revenue shortfall, because and to the extent that administrative enforcement provides indications that are relevant in particular to shortcomings in declaration conduct by taxpayers for a lack of control measures actually carried out by authorities, or to be expected (C II 2 above). 79

The analysis of procedural law, taking account of the particularity of the concrete sphere of life (private security transactions) and of the taxable event which is of relevance in the present instance, is suited to document the structural shortcoming in enforcement. In this respect, the two questions of whether an actual shortcoming in collection exists, and whether this is caused in most cases by a structural shortcoming in enforcement, are closely intertwined. The procedural law analysis serves not only the constitutional assessment of whether collection regulations counteract one another structurally, but can also form the basis for the conviction of the existence of an actual shortcoming in enforcement: A “structural counteraction” of collection regulations found in the context of a procedural law analysis gives rise to a presumption that a shortcoming in collection in fact also exists with regard to the substantive fiscal provision. 80

bb) An analysis of the collection regulations using the standards which have been described may also provide a tenable basis to form a conviction because the weight 81

of shortcomings in legislation is of decisive significance for the determination of a structural shortcoming in enforcement (see C II 1 above). Even without quantifying revenue shortfall, it is possible as a rule for income tax law to ascertain with a sufficient degree of certainty to what degree collection rules are amenable to implement the statutory order of a specific substantive fiscal provision.

2. Already the investigation results outlined above (A I 4) provide in their entirety – especially with the finding of considerable rises in stock prices from the mid-nineties to the end of the decade – clear indications of factual shortcomings in enforcement in the taxation of speculative gains from the sale of securities during the assessment periods 1997 and 1998. Where the cases examined by the Federal Court of Audit related in particular to “income millionaires”, and given that the Lower Saxony *Land* Court of Audit has largely investigated the small proportion of “intensive scrutiny cases”, a generalisation of the investigation results above all is also favoured by the fact that the taxpayers concerned were already the subject of heightened attention from the assessment agencies examined. This circumstance is suited to further strengthen the impression of insufficient verification for the normal case of the taxation procedure gained from the cases that have been examined. 82

3. The enforcement of the statute to be examined in its version applicable to the dispute year 1997, and lastly to the subsequent assessment period 1998, is characterised to such a degree by an interplay on the one hand of investigation-limiting standards and on the other hand of a lack of investigation-promoting standards (amongst other things with regard to the collection and storage of documents by taxpayers, obligations of the financial institutions to report, tax-audit tracer notes and requests for third-party information) that one should presume an unconstitutional legal situation that is not amenable to promote the imposition of equal tax burdens, which leads to major actual shortcomings in collection. 83

a) Taking an overall look at the collection rules material to the assessment periods 1997 and 1998, the imposition of income tax on speculative gains from private security transactions in accordance with the fiscal provision submitted for examination is as a rule largely characterised in the assessment procedure by its dependence on taxpayers’ willingness to declare. 84

aa) The material indication of the taxation of speculative gains with securities for the assessment periods 1997 and 1998 is the income tax declaration. Its official forms require taxpayers to provide information on “speculative transactions” (without distinction as to the nature of the asset sold) at “Other items of income” on page 2 of the annex to the income tax declaration relating to income from capital assets and other items of income; the corresponding income should be declared as the difference between the two columns “transfer price” and “historical cost/cost of production minus deductions, increased deductions and special depreciation; income-related expenses (enclose list where necessary)”. 85

bb) Anyone who submitted their tax declaration in the prescribed form for 1997 and 86

1998 and did not make recognisably contradictory or improbable statements on speculative transactions with securities as a rule only had a slight risk of being found out if their declaration of the profits made therefrom was incomplete or untruthful. Here, a structure of tax declaration forms which only requires the statement of very much condensed numbers does as such not yet give rise to an indication of the presumption of a structural shortcoming in collection . It reduces the information content of the tax declaration, but also meets the practicability requirements both of taxpayers and of the fiscal administration in the high-volume procedure; whilst it does not increase the willingness of the finance authority to carry out investigations, it also does not oppose examination of the information, whilst a tax declaration form requiring many details is also unable to prevent income being concealed altogether.

The design of the declaration forms however promotes unequal enforcement as to the provision submitted because procedural principles which have the effect of generally restricting investigations (cc) for the assessment periods 1997 and 1998 are not sufficiently supplemented by practicable, efficient collection rules amenable to sufficient verification in the regular assessment procedure (dd and ee). 87

cc) As an important principle of the taxation procedure, § 88 of the Tax Code regulates the investigation principle: “The finance authority shall investigate the facts *ex officio*. It shall determine the nature and scope of the investigations; it shall not be bound by the submission and the applications for the taking of evidence of those concerned.” Even if information from those obliged to cooperate is accepted by the finance authority without a more detailed examination, this does not mean that the authority would be bound by the declaration submitted by the taxpayer. The factual and legal significance attributed to the cooperation of the taxpayer can rather be described as the consequence of a fair, acceptable and effective design of the procedure of official investigation which depends on the dialogue with those obliged to cooperate, and hence is structured towards creating that dialogue. There must always be the “unrestricted” ruling on the need for clarification (and possibility for clarification) of the facts between the investigation contribution of those obliged to cooperate and the establishment of the facts which are material to the ruling. This ruling is to be made by the finance authority in exercising its investigative competence. The standards for this decision are however not determined by the principle of investigation as a competence provision, but these follow amongst other things from general maxims of a fair, effective investigation procedure. 88

In particular the efficiency of the high-volume assessment procedure is considered by both the Tax Code Application Decree (loc. cit., above C II 2 b), insofar as it relates to § 88 of the Tax Code, and the so-called 1997 Identical Decrees of the Highest Finance Authorities of the *Länder* (*Gleichlautende Erlasse der obersten Finanzbehörden der Länder – GNOFÄ*), which entered into force on 1 January 1997 “Organisation of the tax offices and reorganisation of the taxation procedure; here: Modus operandi in the assessment agencies” of 19 November 1996, Federal Tax Gazette I 1996, p. 1391): Accordingly, revenue shortfall is only to be intensively compiled in exceptional 89

cases, and the finance authorities must in principle concur with the data provided by the taxpayer in the tax declaration insofar as they are cohesive and there is no tangible evidence that they are incorrect.

These principles must as a rule also be considered to define the procedure for the taxation of speculative gains from private security transactions in the assessment periods 1997 and 1998. Where the 1997 *GNOFÄ* have made provision for the creation of special verification fields, and the Federal Ministry of Finance has stated in the initial proceedings that in North-Rhine/Westphalia alone at the end of 2001, 55 out of a total of 111 assessing tax offices had declared income from private sale transactions (with different foci) to be a verification field within the meaning the *GNOFÄ*, concrete effects of such verification fields, at least on the verification of the assessment periods that are material here, are not recognisable. Private security sale transactions do not tend to emerge as a “classical” verification field; rather, in assessment practice, the fact that there are no storage obligations as concerns the “records and other documents” mentioned in no. 5 of the *GNOFÄ*, and certainly also the fact that taxpayers are not obliged to submit documents that are not/no longer available and which are not subject to storage obligations, speaks against the formation of such a verification field (more details on this below C III 3 a ee). 90

dd) Considering these procedural principles, the risk of being found out with incorrect and incomplete information on taxable income from private security transactions is decisively determined in individual cases by the probability with which an assessment office can see a sufficiently concrete occasion for the examination of such income, and how easily the facts required for correct taxation can be ascertained. This essentially depends on how much evaluable control material the finance authority already has in the assessment work, or how quickly it can be made accessible in the context of normal assessment activity; if the data necessary for a comparison of (presumed) target and (declared) actual values tend not to be available, it is impossible in the standard taxation procedure even to become aware of discrepancies in the tax declaration – which would in any event require further investigation. A lack of experience on the part of the assessment agencies or the lack of special characteristics on the part of the taxpayers to be assessed reduce the risk of being found out, whilst this risk is much greater if a later examination by the field staff is considered not only in exceptional cases. 91

Accordingly, the risk of being found out in the event of shortcomings in declaration of the speculative gains made in the assessment periods 1997 and 1998 in the standard taxation procedure is very low: The collection rules that are material to both assessment periods in the standard taxation procedure give no concrete occasion to an assessment agency to verify taxable income from private security transactions; the existing collection rules also counter enquiries in individual cases. A subsequent examination by the field staff is not provided for with “private individuals” in the standard case. 92

(1) The taxpayer is not obliged to give information to the competent finance authority outside the tax declaration on the speculative transactions he or she has carried out; duties to report, as regulated in §§ 137 to 139 of the Tax Code, do not apply here. Although in accordance with the findings of the Federal Court of Audit (*Bundestag* document 14/8863, p. 3 at 0.3 and p. 6 at 3.1), and with the experience of Frankfurt am Main I tax office described in the oral hearing, financial institutions frequently provide their customers with documents in which taxable speculative gains are shown separately, even without being legally obliged to do so, and the data necessary for their calculation are transmitted, taxpayers are not obliged to make their statements plausible by enclosing documentation; an order under an (individual) fiscal statute to enclose such documents with the tax declaration, which is presumed under § 150.4 sentence 1 of the Tax Code, does not exist. . Taxpayers are also not obliged to draw up and store records on their speculative transactions; the statutory obligations on drawing up records and on storage (of documentation) regulated in §§ 140 et seq. and § 147 of the Tax Code are not applied to such transactions. Under such circumstances, a recipient of taxable income from private security transactions can in most cases only offer occasion for further investigation of the facts by providing questionable information in their tax declaration. 93

(2) It is not evident for the assessment periods 1997 and 1998 that the assessment agencies could verify the income in question already in implementing the assessment work other than in exceptional cases where manifestly incorrect or incomplete information is recognised to have been provided by the taxpayer: 94

(a) The probability that the assessment tax office has tax-audit tracer notes from an external audit with financial institutions is very slight. 95

There is no reliable information on the actual scope of such tax-audit tracer notes and their evaluation (also) for income tax from 1997 and 1998; nor is it evident from the investigations of the enforcement practice mentioned, or in the concrete proceedings on the constitutionality of a statute, or in the initial proceedings submitted, that such tax-audit tracer notes are or were in fact available in the standard assessment practice (also) for the assessment periods 1997 and 1998. Rather, indications emerge from the practice of external audits at financial institutions of the difficulty of obtaining the data necessary for the taxation of private security transactions; hence, a staff member of Darmstadt tax office reported in the oral hearing that the intention to request relevant tax-audit tracer notes had failed. Moreover, as a rule there are aspects of fiscal procedural law which oppose the verification of the statement of income from speculative transactions with securities in the tax declaration on the basis of tax-audit tracer notes in a standard case. 96

It is true that § 194.3 of the Tax Code in principle provides the finance authorities with a possibility to also make and evaluate statements on the circumstances of third parties in external audits carried out at financial institutions. Without this having been expressly mentioned in the provision, the production and evaluation of tax-audit trac- 97

er notes is also fundamentally permissible; hence, § 9 of the General Administrative Audit Regulation (*Allgemeine Verwaltungsvorschrift für die Betriebsprüfung – Betriebsprüfungsordnung*) of 15 March 2000 (Federal Tax Gazette I 2000, p. 368) indicates that findings which can be evaluated in accordance with § 194.3 of the Tax Code for the taxation of other taxpayers should be provided to the competent finance authority. In accordance with its wording, it is significant that § 194.3 of the Tax Code makes the permissibility of the evaluation of the determinations of circumstances of third parties solely dependent on its knowledge being significant for the taxation of these other persons. In accordance with § 30.a.3 sentence 1 of the Tax Code, however, identity-checked credit accounts or deposits may not be assessed or written off in the external audit of a financial institution for subsequent examination of proper taxation, and in accordance with sentence 2 of the provision tax-audit tracer notes are not to be requested in this respect (see also 4 a). The correspondence of the financial institution referring to existing credit accounts and deposits is also protected here (see Order of the Federal Finance Court of 28 October 1997 – VII B 40/97 –, Collected Decisions of the Federal Finance Court (*Sammlung der Entscheidungen des Bundesfinanzhofs* – BFH/NV) 1998, 424, at II 2 d cc, with further references). Hence, a major section of the accounts suited to directly expose speculative gains from private security transactions remains closed to the external audit; the Second Senate of the Federal Constitutional Court nevertheless already evaluated the predecessor regulation in no. 3 of the banking decree (on the wording see BVerfGE 84, 239 (249)), the wording of which is identical to § 30.a.3 of the Tax Code, as a “prohibition of tax-audit tracer notes” (see BVerfGE 84, 239 (278)).

98 This is changed little by the fact that in accordance with the case-law of the VIIth and VIIIth Senates of the Federal Finance Court (see Order of 28 October 1997 – VII B 40/97 –, BFH/NV 1998, 424, at II 2 d cc; Judgment of 18 February 1997 – VIII R 33/95 –, BFHE 183, 45, Federal Tax Gazette II 1997, p. 499, at B III 4 a ee ccc) coincidental information giving rise to the suspicion of tax evasion in an individual case can also be transmitted as to identity-checked accounts – this restriction of § 30.a.3 of the Tax Code is not amenable to obtaining review material for the standard case of assessment.

99 Insofar as the VIII Senate of the Federal Finance Court (see Judgment – VIII R 33/95 –, loc. cit., at B III 4 a ee ddd; re the ruling for instance Streck/Peschges, *Die Fertigung von Kontrollmitteilungen bei Außenprüfungen in Banken*, DStR 1997, p. 1993 (1994 and 1996-1997); Bilsdorfer, *Der BFH und die Zinsbesteuerung – ein bemerkenswerter Eiertanz*, NJW 1997, p. 2368 (2369-2370); Eckhoff, *Verfassungsmäßigkeit der Zinsbesteuerung?*, DStR 1997, p. 1071 (1072); Leist, *Verfassungsrechtliche Schranken des steuerlichen Auskunfts- und Informationsverkehrs*, 2000, p. 321 et seq.; Tipke, in: Tipke/Kruse, *Abgabenordnung Finanzgerichtsordnung § 30.a AO*, marginal nos. 17-18 and *§ 194 AO*, marginal no. 31) interpreted § 30.a.3 of the Tax Code such that tax-audit tracer notes may also be produced and requested by the external auditor if sufficient reason exists, this is opposed by the critical state-

ments of the VII Senate of the Federal Finance Court (– VII B 40/97 –, loc. cit., at II 2 f) according to which – in contradistinction to the view of the VIIIth Senate – § 30.a.3 of the Tax Code constitutes a conscious, deliberate restriction of § 194.3 of the Tax Code by the legislature for examinations in the banking area. The contradictions have also not been eliminated by further statements of the VII Senate of the Federal Finance Court (see Order of 25 July 2000 – VII B 28/99 –, BFHE 192, 44, Federal Tax Gazette II 2000, p. 643; Order of 21 March 2002 – VII B 152/01 –, BFHE 198, 42, Federal Tax Gazette II 2002, p. 495), and lead in the examination practice of the tax offices, to a situation in which in individual bank scrutiny cases measures to verify speculative gains from private security transactions cannot be securely planned, and their lawfulness cannot be securely estimated. Hence, in practice, there are considerable legal uncertainties as to when in relation to bank scrutiny a “sufficient indication” for tax-audit tracer notes exists and when (already) non-permissible search by screening applies. The tax offices are hence unable in practice to see clearly from the outset which powers they actually have in individual cases of bank scrutiny and how the finance courts will legally evaluate scrutiny measures. It is only certain that tax-audit tracer notes relating to speculative gains may not be obtained at random – i.e. with no well-founded reason – in the framework of bank scrutiny.

Factually, the existing legal uncertainties also give third parties which are subject to examination wide scope to oppose attempts to verify on the part of the external audit department. 100

(b) For the standard case of assessment, it is also not possible as to the assessment periods 1997 and 1998 that information on private security transactions is available which was obtained on the basis of requests for third-party information carried out by the fiscal administration. Whilst the VII Senate of the Federal Finance Court denied in its order of 21 March 2002 – VII B 152/01 – (loc. cit.) the requirements of a non-permissible search by screening or of non-permissible speculative investigations in a case in which the tax investigation service had investigated a large number of bank customers for security transactions on the “New Market” on the basis of § 208.1 sentence 1 no. 3 of the Tax Code. However, this order, as a ruling on an individual case relating to a special information situation, did not give rise to sufficient legal certainty for the fiscal administration. The preconditions for requests to financial institutions for third-party information were not sufficiently differentiated to permit the lawfulness of such measures for the fiscal administration to be estimated with sufficient certainty from the outset. 101

(c) Reports from financial institutions to the Federal Finance Office (*Bundesamt für Finanzen*) in accordance with § 45.d.1 of the Income Tax Act are not suitable to verify speculative gains from private security transactions in the assessment periods 1997 and 1998. In paragraph 2 of the provision in its version valid up to and including the assessment period 1998, the use of the reports is expressly restricted to the examination of the lawful use of the savers’ tax-free amount and of the blanket deduction for income-related expenses with capital gains. Even the expanded possibility to use the 102

reports available from the assessment period 1999 onwards, which the Federal Ministry of Finance has particularly indicated, can at the most give rise to laborious investigations on the part of the assessment agency, which this authority will however as a rule hardly be able to undertake in enforcement practice.

(d) No other circumstances which might give assessment agencies concrete reason to investigate the facts further as to possible speculative gains from private security transactions, regardless of the information contained in the tax declaration, are recognisable for the assessment periods 1997 and 1998. In accordance with the convincing arguments of the Federal Court of Audit (*Bundestag* document 14/8863, p. 6 at 3.4), it can be ascertained that since the abolition of the property tax, information has no longer been available on trends in private security investments, that the sale of privately held securities does not belong among the regular transactions, and hence that irregular declaration conduct still does not offer occasion for making enquiries to clarify the situation, that no profiles of the taxpayers concerned are to be drafted for private security transactions, and that it can also not necessarily be concluded that speculative gains are being made from private security transactions if income from capital assets is declared. The causes of such obstacles to verification do not lie in procedural law directly; however, it is vital to the legal assessment of the resultant extremely slight risk of being found out if false information is provided that the currently applicable collection regulations do not sufficiently compensate for such easily recognisable factual obstacles to the verification of income from private security transactions. 103

(3) A (subsequent) verification in the framework of an external audit is usually not provided for with “private individuals”, and hence is not part of the regular procedure of taxation of speculative gains from private security transactions. An external audit for which no prerequisites must be met in accordance with § 193.1 of the Tax Code only relates to taxpayers who make profit income; that for instance income of a trader from private security transactions is also examined is however not the case that is significant in practice. In accordance with § 193.2 no. 2 of the Tax Code, an external audit of other taxpayers is conditional on the circumstances relevant for taxation requiring clarification and an examination at the tax office not being expedient in accordance with the nature and scope of the circumstances to be examined. Such an external audit is already permissible here if there are indications making it seem possible in accordance with the experience of the fiscal administration that a taxable event has taken place, or that the taxpayer has not submitted his or her declaration, or that the declaration is not complete or that its content is incorrect (see also the Tax Code Application Decree to § 193 at no. 5, which refers to the Federal Finance Court judgment of 17 November 1992 – VIII R 25/89 –, BFHE 169, 305, Federal Tax Gazette II 1993, p. 146). Nevertheless – as the Tax Code Application Decree also indicates in § 193 no. 5 – an examination of “private individuals” is the exception: The above obstacles to further clarification of the facts by the assessment agencies already constitute an obstacle to their willingness to see corresponding need for clarifi- 104

cation; what is more, it must be reasoned amongst other things why the desired clarification cannot be achieved by means of individual investigation in the tax office.

The Federal Ministry of Finance has admitted, referring to BVerfGE 96, 1 (7), that – also with regard to the available staffing and funding – the use of the external audit was not suitable to ascertain security capital gains with a large number of – in meaning "private" – taxpayers. The *Land* government of North-Rhine/Westphalia already expressed the view in autumn 2000 that the external audit was – in meaning: outside the framework of § 193.1 of the Tax Code – not the suitable tool to clarify the taxation of private sale transactions; one should not expect to see an increase in external audits of small investors (see *Landtag* North-Rhine/Westphalia, 13th electoral period, response of the *Land* government to minor interpellation 56, document 13/248 of 5 October 2000). 105

(4) Individual measures of tax investigation – both on tax procedure and on criminal prosecution investigation – cannot be regarded as an element of the standard case of taxation that is relevant here. In this respect, it is not a matter of its possible range for the determination of a structural shortcoming in collection. Tax investigation measures can at most be significant in the evaluation of "improvements" of the fiscal administration in enforcement practice. 106

ee) The risk of being found out however remains slight in the standard assessment procedure, even if one concurs with the view that requests for information from the finance authorities are only not permissible if there are no indications of circumstances relevant to tax at all. Even if under these circumstances the right of the finance authorities to information in accordance with § 93.1 of the Tax Code is not in principle restricted to those cases in which specific indications already exist to presume that a tax debt has probably arisen, and that the taxes in question have been evaded (see Federal Finance Court judgment of 18 February 1997 – VIII R 33/95 –, BFHE 183, 45, Federal Tax Gazette II 1997, p. 499, at B III 4 a dd with further references; see also Order of the 1st Chamber of the First Senate of the Federal Constitutional Court of 6 April 1989 – 1 BvR 33/87 –, HFR 1989, p. 440 (there for requests for information by the tax investigation service in accordance with §§ 93.1 sentence 1, 208.1 sentence 1 no. 3 of the Tax Code)), it cannot be determined that requests for information in respect of speculative gains in the assessment periods 1997 and 1998 have characterised the standard taxation procedure. On the contrary, factual and legal obstacles to investigations can also be observed in this respect. 107

Practical obstacles to such investigation lie in the difficulties encountered in calculating speculative gains, in particular when it comes to the collective deposit of securities (see report of the Federal Court of Audit of 24 April 2002, loc. cit., p. 8 at 3.2). If the documents required for the calculation are missing from the assessment, it is made more difficult to process cases quickly in the high-volume procedure. The presumption of the Federal Court of Audit is understandable in this respect that the willingness of the assessment agencies to concur with the taxpayer's declaration without 108

objection in the high-volume transactions of the income tax assessment will increase in cases in which the large amount of data required for the calculation of speculative transactions with collectively deposited securities is unavailable.

Further factual and legal obstacles to investigation emerge for those seeking information on private security transactions because the taxpayer is not obliged to record, retain or obtain relevant documents. Even in the event that appropriate certificates in fact (still) exist, it is disputed whether § 97 of the Tax Code, in accordance with which the finance authority may require the submission of certificates, refers solely to certificates which must be retained, or also to those with regard to which – as with private sale transactions – there is no storage obligation in accordance with the current legal situation (see on the dispute for instance Tipke in: Tipke/Kruse, *§ 97 AO*, marginal no. 5 with further references, and *§ 200 AO*, marginal no. 10, in each case referring to Rhineland-Palatinate Finance Court, judgment of 25 April 1988 – 5 K 351/87 –, EFG 1988, p. 502). Furthermore, in accordance with § 97.2 sentence 1 of the Tax Code, records and documents are not required as a rule until the taxpayer has failed to provide information, the information is insufficient or there are reservations as to its correctness. Even in the event of a request for information being addressed to a taxpayer, hence, as a rule the submission of a coherent declaration will be sufficient to rule out further investigation measures as to the assessment periods 1997 and 1998. In this respect, the use of third parties as information sources, here in particular of financial institutions, will not be considered as a rule; in accordance with the current law, these may only be requested alternatively if it is impossible to obtain from the taxpayer sufficient oral or written information to supplement the information. If one takes the small amount of information contained in the tax declaration and the circumstances already named, which counteract an effective investigation, the threshold for the acquisition of information from third parties is too high for the fiscal administration in enforcement practice to regard this source of information as a regular element of the taxation procedure as to the assessment periods 1997 and 1998. 109

ff) In accordance with the above, the procedural law for the assessment periods which are to be assessed here in the standard case of the taxation procedure is not amenable to effective ascertainment and scrutiny of income from private sale transactions with securities. 110

b) Also from the point of view of establishing a realistic collection method, which is closely related to the concentration on the standard case of the taxation procedure, one must presume a structural shortcoming to exit in collection in the assessment periods 1997 and 1998. Those who have at their disposal the information necessary for taxation are not obliged for this period to make the relevant data transparent to the finance authorities in a general procedure as required by the assessment of a large number of cases – such as in the shape of an “annual certificate on capital gains from financial investments” as was proposed at the end of 2002 in Article 1 no. 17 of the Draft Act to Reduce Tax Relief and Exceptional Regulations – Tax Relief Reduction Act (*Gesetz zum Abbau von Steuervergünstigungen und Ausnahmeregelungen –* 111

Steuervergünstigungsabbaugesetz, *Bundesrat* document (*Bundesratsdrucksache – BRDrucks)* 866/02 and *Bundestag* document 15/119) and is now required in § 24c of the Income Tax Act, introduced by Article 1 no. 9 of the Second Act Amending Fiscal Provisions (*Zweites Gesetz zur Änderung steuerlicher Vorschriften*) of 15 December 2003 (2003 Tax Amendment Act (*Steueränderungsgesetz – StÄndG*), Federal Law Gazette I p. 2645) in particular of financial institutions and financial service institutes *inter alia* for sale transactions concluded after 31 December 2003 within the meaning of § 23 of the Income Tax Act (see § 52.39.a of the Income Tax Act in the version of Article 1 no. 34 (g) of the 2003 Second Act Amending Fiscal Provisions).

In this context, it should be particularly stressed that the production of tax-audit tracer notes in the context of bank scrutiny is subject to considerable legal and factual obstacles for the period of the validity of the provision submitted for examination. Regardless of a "constitutional interpretation" – also disputed – of this provision by the VIII Senate of the Federal Finance Court, the query of the Second Senate of the Federal Constitutional Court from 1991 (BVerfGE 84, 239 (278)) on the previous banking decree in the main also affects its successor provision in § 30.a of the Tax Code: It is above all with the prohibition of tax-audit tracer notes that the fiscal administration is deprived of one of the most effective means to ascertain facts. 112

c) Over and above this, the fact that the collection of income tax on speculative gains with securities, in comparison with tax collection on other items of income, constitutes an outright invitation to engage in unlawful activity as to the assessment periods 1997 and 1998, suggests a structural shortcoming in collection – irrespective of shortcomings in enforcement, which one also finds here. 113

aa) Thus, with speculative transactions in land, for instance, efficient control is offered through the offices of a notary whose collaboration is prescribed by civil law, who in turn is subject to statutory duties to report to the fiscal administration in accordance with § 18 of the Land Transfer Tax Act (*Grunderwerbsteuergesetz*). In any case, it is possible that fiscal events with regard to the asset traded cannot be hidden from the eyes of the fiscal administration in a manner similar to that which is possible with securities. 114

bb) With taxpayers who operate a commercial or agricultural and forestry establishment, or who pursue an independent freelance activity, an external audit can be implemented without meeting prerequisites in accordance with § 193.1 of the Tax Code because the legislature has reached the generalising valuation that the difficulty and economic significance of a correct evaluation of the fiscally material "factual and legal circumstances" (§ 199.1 of the Tax Code) justify in principle both more intensive official investigation activity, and more intensive demands on those concerned in these cases. Income which a taxpayer makes in the context of the so-called "grey economy" has in this respect in enforcement practice certainly not only a marginal risk of being found out. The major cause of the non-taxation of such income is not that the structure of the collection method in itself constitutes an invitation to conceal such in- 115

come.

As to profits from the sale of (private asset) shares in corporations included in commercial income which are taxable in accordance with § 17 of the Income Tax Act, one may nonetheless refer to § 54 of the Income Tax Implementation Ordinance (*Einkommensteuer-Durchführungsverordnung – EStDV*). In accordance with this provision, notaries must send to the competent tax offices certified duplicates of certificates which amongst other things relate to the conversion and dissolution of corporations or disposal of shares in corporations. Furthermore, the regulations for an external audit of commercial income apply to such private capital gains. 116

cc) With income from leasing and letting, the asset used for income acquisition can also not be concealed, especially since it is as a rule retained in the long term. Losses are also frequently intended to be deducted from tax in the context of such income, so that already in this sense taxpayers have little interest in concealing such income. 117

dd) When it comes to income from capital assets, a withholding tax as well as the control mechanism is available in accordance with § 45d of the Income Tax Act. By contrast, the taxation of speculative gains from private security transactions for 1997 and 1998 is exceptional in nature, even if one presumes that roughly two-thirds of interest credited with capital income is not taxed today because of "runaway capital" that is transferred abroad (see in detail Risto/Julius, *Die Verfassungswidrigkeit der Zinsbesteuerung*, *Der Betrieb* – DB, supplement no. 4/2002 to vol. no. 17, p. 5 with further references). Even the most effective form of collection, namely withholding tax, does not apply abroad. What is more – as critics of the current interest taxation do not deny (see Risto/Julius, loc. cit., p. 5) – the fiscal administration in particular has undertaken major efforts in the framework of tax investigation measures to ensure the taxation of income from capital assets that have been transferred abroad. What we are dealing with in this respect is special measures of the verification of income is less important here because the fiscal administration – as shown by the provision contained in § 90.2 of the Tax Code –generally must rely on the increased participation of the taxpayer with facts only ascertainable abroad and – if this is not possible – must use special means for verification. 118

ee) With income from dependent employment, the legislature has designed collection of income tax in the form of a withholding tax (wage tax), and hence selected one of the most efficient ways of collecting tax. In the standard taxation procedure, it is hence not only a matter of taxpayers' willingness to declare items. 119

ff) As a result, therefore, the taxation of speculative gains from private security transactions in the assessment periods 1997 and 1998 shows particular shortcomings in comparison with the taxation of other items of income which support the presumption of a structural shortcoming in collection. 120

d) The "improvements" in enforcement submitted by the Federal and *Land* fiscal administrations – insofar as they apply at all to the assessment periods relevant here – 121

are largely not based on the use of a set of tools belonging to the customary elements of the regular assessment procedure to verify speculative gains. In this respect, nothing indicates that the actual shortcoming in collection that can be ascertained is only a consequence of temporary shortcomings in the fiscal administration. The improvement measures that have been submitted hence have an indicative effect that is more in favour of than against the existence of a structural shortcoming in enforcement in the dispute year of the initial proceedings and in the following year.

122 What is more, it is not evident that the measures have been noticeably successful for the assessment periods in question in a manner which could weaken or remedy such an indicative effect. In accordance with the information obtained by the Senate, it cannot be concluded that measures of the fiscal administration taken after the initial proceedings and after the report of the Federal Court of Audit of 24 April 2002 in particular have fundamentally changed anything as to the enforcement situation for the assessment periods 1997 and 1998. Thus, for instance, the “income millionaires” particularly mentioned are already the object of the increased attention of the fiscal administration, irrespectively of whether or not they have made speculative gains from private security transactions. Also as concerns the approach of Frankfurt am Main I tax office practised since 2002 to conclude that the declaration of income-related expenses indicates asset administration, and hence private security transactions, its efficiency as to 1997 and 1998 is unclear, even if one presumes that this control approach has been taken up by other tax offices. What is more, this is an attempt to subsequently verify speculative gains via an indirect route, to which the standard case of the assessment procedure is not amenable; it remains questionable whether the investigation measures which have been reported can be implemented in light of the large number of cases. That the declared objective of the fiscal administration to write more tax-audit tracer notes in the context of bank scrutiny has been implemented in practice may be doubted in light of the statements of the *Land* fiscal administrations and the experience put forward in the oral hearing of the external audit of Darmstadt tax office; with what degree of success it has been possible to evaluate tax-audit tracer notes has also not been proved. The extent and impact of tax investigation measures – which in any case do not constitute the standard case of the taxation procedure, and are hence fundamentally unsuited to refute a structural shortcoming in enforcement – are unknown.

IV.

123 It is to be attributed to the legislature that the enforcement order of the substantive fiscal provision submitted for examination in the practice of the collection method for the assessment periods 1997 and 1998 cannot be implemented equally. It is the responsibility of the legislature to see to it that with the envisioned form of collection the material procedural law does not contain any regulations by means of which effective control of speculative gains from private security transactions is guaranteed, but the provisions of procedural law applicable to both collection periods indeed counter such control.

The legislature should already realise for the dispute year of the initial proceedings (1997) that the constitutional goal of equality in the tax burden imposed “in principle” would not be achieved for the speculation tax under discussion with regard to the form of the collection and the detailed regulation of the collection method. Both the investigation restricting impact of the earlier banking decree, and the preconditions for equality in the tax burden imposed, are clarified in the Second Senate’s judgment on interest of 27 June 1991. It was hence clear to the legislature what equality law requirements the enforcement of the substantive fiscal provision of § 23.1 sentence 1 no. 1 (b) of the Income Tax Act had to meet. The criticism of the enforcement of § 23.1 no. 1 (b) of the Income Tax Act was made ever clearer, and not only in the years after 1997. It was already stated in the final report of the “Revenue shortfall” working party established by the Ministry of Finance of the *Land* North-Rhine/Westphalia at “Individual examples of the fight against abuse” submitted in 1994 that most speculative gains were not declared (see *Überprüfung der Möglichkeiten zur vollständigen Ausschöpfung der Steuerquellen (Teil II)*, final report of the “Revenue shortfall” working party, StB 1994, pp. 446 (449-450)). In a special manner, the question of the verification of speculative gains from private security transactions for the legislature also had to arise in relation to sharply rising stock prices. 124

In contradistinction to its responsibility to make a subsequent improvement, the legislature however held to the successor regulation of the banking decree (§ 30.a of the Tax Code), did not change the form of collection of income tax on private capital gains with securities, and certainly for the period of the validity of the fiscal provision examined here did not make available any tools for effective scrutiny of the taxation of private capital gains with securities. The legislature did not take as a reason to remedy the legal uncertainties thereby arising the differences in the case-law of the VIIth and VIIIth Senates of the Federal Finance Court which have been in existence since 1997 (above C III 3 a dd 2 a) on the permissibility of tax-audit tracer notes on the occasion of bank scrutiny, or the circumstance that the VII Senate of the Federal Finance Court phrased the prerequisites of requests for third-party information in the result only for a special individual case (above C III 3 a dd 2 b). 125

D.

The unconstitutionality of § 23.1 sentence 1 no. 1 (b) of the Income Tax Act, insofar as it relates to sale transactions with securities, leads to the nullity of this fiscal provision to the named extent for 1997, the dispute year of the initial proceedings, and the following assessment period 1998, the last year in which the provision which has been submitted was valid. The consequence of this nullity declaration is that the private sale transactions with securities with which the period between acquisition and sale is not longer than six months covered by the unequal provision, does not lead/no longer leads to speculative transactions within the meaning of § 22 no. 2 and § 23 of the Income Tax Act, and hence also does not fall under the other items of income within the meaning of § 22 of the Income Tax Act which are subject to income tax in accordance with § 2.1 no. 7 of the Income Tax Act. 126

I.

In its judgment on interest, the Second Senate continued to accept the unequal taxation of capital income for a transitional period (see BVerfGE 84, 239 (283)). The reasons which spoke in favour of granting a transitional period for legislative improvements in that ruling from 1991 now no longer apply. The constitutional situation was certainly in principle clarified for the assessment period 1997. That no constitutional court ruling corresponding to the judgment on interest had yet been handed down in relation to the substantive fiscal provision submitted for examination at that time is without significance. 127

II.

If a provision breaches the Basic Law, this can lead either to a nullity declaration in accordance with § 78 of the Federal Constitutional Court Act (*Bundesverfassungsgerichtsgesetz – BVerfGG*), or to the Federal Constitutional Court finding that the provision is (merely) incompatible with the Basic Law (see § 31.2, § 79.1 of the Federal Constitutional Court Act). If unconstitutionality refers exclusively to a violation of the general principle of equality, in accordance with the established case-law of the Federal Constitutional Court a converse rule-exception relationship now applies: As a general rule, the consequence is incompatibility (e.g. BVerfGE 99, 280 (298); 105, 73 (133)), whilst nullity is the exception (e.g. BVerfGE 88, 87 (101 et seq.); 92, 91 (121); 99, 69 (83)). In the event of violations of the general principle of equality, as a rule the legislature has various ways of remedying this violation of the constitution. Then however the legislature is in principle entitled and obliged in exercising its (shaping) competence to remedy the unconstitutional circumstance unless a further application order has been pronounced, retroactively for the whole period to which the incompatibility declaration relates. Here, as a rule it is also a task for the legislature to reform in constitutional terms the relationship between the substantive taxable event and contrary procedural provisions (here for instance § 30.a of the Tax Code and the lack of specific obligations incumbent on taxpayers and third parties to keep records and to collaborate). Where the relationship between the provision and the reality of enforcement is decisive – as here – in addition to the relationship between various provisions constitutive for unconstitutionality, the legislature is in principle also entitled, in addition to changes of the statutory environment, to also suitably accommodate those of the real environment of a fiscal provision (see also below D III 2). 128

Nevertheless, the unconstitutionality of the provision submitted for examination leads to its nullity. It can be disregarded here whether the considerable uncertainties would be constitutionally acceptable with which enforcement practice would be burdened were there to be a declaration of incompatibility, or whether these uncertainties are not already an exceptional case of the consequence of nullity. The Senate is certainly convinced that subsequently remedying unconstitutionality by reforming substantive and procedural law provisions, as well as through blanket enforcement that is based on the reformed legal situation, is not possible. The possibility of estab- 129

lishing in good time an enforcement system in which the shortcomings are remedied for the assessment periods 1997 and 1998 is already opposed by the circumstance that this enforcement would as a rule have to be successful in an individual case within the course of a four-year assessment period (§ 169.2 sentence 1 no. 2 of the Tax Code); the unconstitutionality of the provision that has been submitted rules out the application of the extended assessment period in accordance with § 169.2 sentence 2 of the Tax Code for cases in which solely speculative gains have been insufficiently declared.

III.

1. The declaration of nullity also becomes valid for the assessment period 1998. The dispute year of the initial proceedings is only the assessment period 1997; the subject of examination of the submission is however formed by § 23.1 sentence 1 no. 1 (b) of the Income Tax Act in its version also relevant for the assessment period 1998. If a provision is (partially) declared null and void in accordance with §§ 82.1 and 78 sentence 1 of the Federal Constitutional Court Act, this declaration of nullity in principle has effect for the entire period in which the provision in question claims validity. Certainly insofar as – in this instance – one can presume unchanged circumstances in the assessment periods concerned, this also applies to the case of an unconstitutional shortcoming in enforcement. In accordance with this principle, the assessment period 1998 is also covered by the declaration of nullity. 130

2. The declaration of nullity, by contrast, does not cover successor provisions of the provision submitted for examination. 131

The Federal Constitutional Court, in application of §§ 82.1 and 78 sentence 2 of the Federal Constitutional Court Act, may also declare null and void successor regulations which are not the subject-matter of the submission to be ruled on (see Maunz/Schmidt-Bleibtreu/Klein/Bethge, *BVerfGG, § 31*, marginal no. 162 et seq. and § 78, marginal no. 25 with further references). This is however not necessary here since answering the question that has been submitted cannot easily lead to a corresponding adjudication of the successor provisions valid in the assessment periods from 1999. 132

The relationship between a provision and enforcement reality material to the unconstitutionality of a fiscal provision because of a structural shortcoming in enforcement can change over time in a manner material to the ruling. Already for this reason, the finding of a structural shortcoming in enforcement cannot be easily transferred from one collection period to its successor years. This is already the case for the assessment periods 1997 and 1998 with the unequal shortcoming in collection determined here because the ordinary law situation has clearly changed with effect from the assessment period 1999, as shown by taking a look at the expanded possibilities of the comparison of speculative gains by corresponding speculation losses (see above A I 1); added to this is a negative price trend on the capital markets which certainly applied, and was accelerated from spring 2000 (see for instance German Stock Insti- 133

tute, *Kurzstudie* 3/2001 of August 2001, pp. 1 and 3). In this respect, it is already possible, regardless of more intensive control activity on the part of the fiscal administration, that one may not necessarily conclude a comparable shortcoming in enforcement in the following assessment periods as to income from private security transactions. If taxable capital gains made with private security transactions are increasingly neutralised by the offsetting of losses, and if one may expect no more major earnings from the corresponding fiscal provision also otherwise because of market developments, even ongoing shortcomings in legislation may no longer have a constitutionally relevant impact – the enforcement order issued by the substantive fiscal provision would have no effect, irrespective of shortcomings in the collection regulations. Without a requirement to make further determinations in this respect over and above the subject-matter of the submission, such circumstances do not justify also extending the (partial) nullity declaration of a provision submitted for examination to its successor provisions.

Judges: Hassemer, Jentsch, Osterloh, Mellinghoff, Lübbe-Wolff, Gerhardt; Judges Broß and Di Fabio are unable to be present for signing.

Bundesverfassungsgericht, Urteil des Zweiten Senats vom 9. März 2004 - 2 BvL 17/02

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