

## CHAPTER XIV

### ADMINISTRATIVE RULE-MAKING PROGRAMS

#### Section A. *Character of the Underlying Statute*

##### 2.1 *The precision of the statute itself*

The basic principles of German income tax law are the same for individuals and for corporations. While there are two separate statutes—individuals are subject to the Income Tax Law and corporate bodies to the Corporation Income Tax Law—the corporation tax statute refers to and is based on the individual tax statute.

Both the Income Tax Law and the Corporation Income Tax Law are relatively short. The Income Tax Law fills 80 printed pages with approximately 300 words to the page. It has 73 sections.<sup>1</sup> About two-thirds of these contain substantive provisions concerning the determination of income, tax rates, etc. The remaining one-third contains procedural rules, such as the authority to issue regulatory ordinances having the force of law.<sup>2</sup> Most, but not all, of the individual sections of the law are relatively short. The most extensive sections are those which, in addition to a general principle, set forth rules granting special relief as to which the law seeks to be as precise as possible.

The Corporation Income Tax Law is shorter than the Income Tax Law, with 24 sections on 15 pages of approximately 300 words each. This brevity is possible because the Corporation Income Tax is essentially based on the Income Tax Law. Illustratively, it refers back to the Income Tax Law when dealing with income determination and tax assessment, restricting itself to special provisions governing the taxation of corporate bodies, i.e., intercompany holdings, tax rates, etc.

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<sup>1</sup> The numbered sections run only to 54, but several sections marked with letters have been added, bringing the actual number of sections to 73.

<sup>2</sup> During the post-World War II period of reconstruction, special economic considerations led to incorporation of a number of rules expected to have a short life. Their number is decreasing as the objectives of their enactment are being achieved.

A factor contributing to the relative shortness of both statutes is the fact that there is a separate code of procedure covering all taxes, the Fiscal Code, *Reichsabgabenordnung*. This code deals with assessment, conditions permitting modification of assessment notices, collection of deficiencies, tax refunds, statutes of limitations, and penalties. Although extensive, comprising 488 sections, relatively few provisions directly affect the taxation of income. However, in addition to the two basic statutes, certain other comparatively brief laws do deal with isolated specialized sectors of individual and corporate income taxation, such as contributions to industrial pension funds, investment funds, and corporate reorganizations.

Another prime factor contributing to the brevity of the basic income tax statutes are the complementary regulatory ordinances, *Rechtsverordnungen*, discussed in 2.4 *infra*.

Most important, however, is the fact that the two laws are based on abstract concepts and state abstract rules. The statutory provisions do not enumerate concrete cases which may be encountered in practice. In solving any such problem, the abstraction is applied to the factual situation, with specific rules then being derived from the guiding principle.

This approach of the statute is based on the premise that, since the law must cover a wide range of factual situations, it must leave room for flexible interpretation. An enumeration of concrete cases might be helpful to the layman, but would tend to make the law rigid and inflexible, unable to adjust to changing conditions.<sup>3</sup> Moreover, it is unlikely that inclusion of a large number of subordinate rules to govern diverse types of individual cases would reduce the volume of interpretative controversies, for no list could cover all possibilities. And in practice, it then would be difficult to classify factual situations under the competing rules however great their number. While Germany avoids this by using general provisions, and thus achieves far greater brevity than does the United States in its code, delimitations are not lacking; but they are confined to basic essentials and thus not nearly so numerous as those found in the United States code.

This greater reliance on abstract legal principles also insures greater uniformity in application of the law to economic

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<sup>3</sup>A rigid statute, out of tune with current conditions, might grant unanticipated benefits or result in unforeseen hardships. Such inequity might lead to new demands by taxpayers, further detailed specifications in the statute with increased ramifications, and even an aggravation of existing rigidity.

gain. Under the German law, income from trade or business comprises all income derived by a businessman from his business. It is immaterial whether the income arises from interest payments, capital gains, or profit from the sale of goods; income is treated as a single unit. The structure of the law itself tends to resist the insertion of complicated special rules according special or preferential treatment to isolated items.

Illustratively, the Income Tax Law, Section 2, paragraph 1, states that income tax is calculated on the basis of net income received in any one calendar year. Paragraph 2 provides, by way of deduction from the principle expressed in paragraph 1, that *net* income is the total amount of income derived from each of the listed sources of income, less losses and expenses incurred in respect of those sources.

The sources of income listed in the statute are as follows:

- (1) Income from agriculture and forestry;
- (2) Income from trade or business;
- (3) Income from independent personal services;
- (4) Employment income;
- (5) Income from the investment of capital;
- (6) Rentals and royalties; and
- (7) Other income defined and circumscribed likewise in abstract terms including
  - (a) Recurring payments such as pensions;
  - (b) Income from speculative transactions, i.e., sales of private property, if, in the case of real property, not more than two years, and in the case of other property not more than two months, have elapsed between the acquisition and the sale; and
  - (c) Income from any other payments or benefits received and not included in one of the sources of income listed as, for instance, income from the occasional leasing of movable property.

Under each of the sources of income are listed the types of income. Thus income from trade or business is said to comprise the profits derived by a partner from a partnership, including payment for his services to the partnership, payment for assets made available to the partnership, or interest on a loan granted by him. Employment income includes non-cash benefits and pensions, while income from the investment of capital includes dividends, interest, etc.

In the case of corporations, however, their entire income is deemed to be income from trade or business.

The statute defines the terms surplus and profits. These concepts are of prime importance because for the first three sources of income listed above, income is understood to be the *profit* from the activity while for the other four it is the *surplus* of receipts over income-connected expenses.

Under the statute, profit is computed by comparing net worth at the end of one business year with that at the end of the preceding business year. This is an abstract approach, proceeding from general terms to particular elements, starting with the balance sheet not the profit and loss account. Further, the balance sheet must be prepared to accord with commercial law principles, while at the same time taking into account special provisions in the tax law governing withdrawals and investments, valuation, physical depreciation, business expenses, etc. This reference to commercial law simplifies the tax law's structure, but in practice it requires the preparation of two balance sheets, one for commercial, the other for tax purposes.

Since income is determined by comparing two balance sheets, no capital loss deduction provision is needed: this becomes a matter of asset valuation in the balance sheet. Deductible expenses, however, are specified, with those not deductible regarded as withdrawals to be added to the profits.

By specifying certain types of receipts as subject to income tax, those not so identified are excluded, such as lottery gains; this stems from the structure of the law, that is, an item is excludable because it is not specifically included. Thus, while the statute does not list every kind of payment excludable from income tax, it does list approximately sixty items which, absent such identification, could be included under a source of income.

When determining an *individual's* net income, certain personal expenses are deductible. These include interest, life insurance premiums, church tax, etc. Further the taxpayer may deduct various allowances for dependent children or advanced age, and also certain extraordinary burdens such as unusual medical costs. Thus the net income figure is reached, a sum to which the income tax rate table is applied.

A statute stating abstract concepts inevitably creates interpretative problems in the course of applying the abstractions to individual cases. The following example relating to income from trade or business illustrates this process.

In determining whether items constitute receipts or expenditures, the statute establishes certain criteria. With respect

to receipts, the only issue is whether the income was derived from the trade or business; the nature of the individual item is immaterial. With respect to expenditures, the statute provides: "Business expenses shall be understood to mean expenditures occasioned by the operation of a business."<sup>4</sup> Under this provision, expenditures for private purposes are not deductible. If the latter are shown as business expenses, an adjustment will be made, adding them back to profit. While the treatment of business expenditures is clear, disputes do arise as to the meaning of the standards, "occasioned by the operation of a business" or "incurred for private purposes." The statute attempts to clarify the abstract standards by providing that *non-deductible* expenses include expenditures to maintain a standard of living commensurate with the taxpayer's economic or social position, irrespective of whether such expenditure promotes the taxpayer's professional or business activities.<sup>5</sup> However, because the terms used in these standards ("economic or social position" and "promoting the taxpayer's professional or business activities") do not readily provide a clear answer to each of the wide range of factual circumstances to which they must be applied, courts do encounter a large number of controversies in this area.

Where deductibility depends upon the expenditure's having been occasioned by the operation of the business, the principle of causality becomes the criterion. Should a businessman incur excessively large expenditures for customer entertainment, the abstract language of the statute, standing alone, might seem to warrant their deduction. To prevent this possible construction, the statute sets out concrete criteria and classifies as non-deductible the following expenditures:

1. Expenditures for presents made to persons who are not employees of the taxpayer and do not have continuous business relations with him under either a commercial agency contract or a contract for work and services, except presents with an aggregate value during the taxpayer's business year not exceeding DM 100 for each individual recipient;
2. Expenditures for guest houses maintained by the taxpayer outside the city or town where the business is located, to the extent these facilities are used for accommodating and entertaining persons other than employees; and
3. Expenditures connected with the acquisition or exercise of hunting or fishing privileges or the maintenance of yachts or similar facilities, and the entertainment of guests through use of such facilities.

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<sup>4</sup>Income Tax Law, § 4, para. 4.

<sup>5</sup>Income Tax Law, § 12.

Finally, the following catchall provision provides a general safeguard against excessive expenses:

Expenditure affecting the standard of living of the taxpayer or another person shall not be taken into account when determining the profits, to the extent that such expenditure is deemed to be excessive by generally accepted standards.<sup>6</sup>

Since this less precise standard must be applied to each individual set of facts, here too courts encounter many controversies requiring construction of the phrase "deemed to be excessive by generally accepted standards." "Constructive dividends" is another phrase creating interpretative problems. The Corporation Income Tax Law does not define the phrase, simply stating:

The question as to which receipts are income and the method of computing such income shall be governed by the provisions of the Income Tax Law. In this connection, constructive dividends shall also be taken into account.

The relevant regulatory ordinance, Ordinance Regulating the Corporation Income Tax Law,<sup>7</sup> gives ten examples but no definition.<sup>8</sup> Consequently the courts must define and interpret the statutory expression.

The fact that the courts are available to resolve these interpretative disputes means, on the one hand, that the statute's reliance on abstract principles does not jeopardize the stability of the legal system. In borderline cases, on the other hand, the taxpayer cannot be certain in advance as to the tax consequence of his actions, for each decision covers only the case at issue.

Finally, it should also be observed that the German statute does include some provisions which contain precise definitions with scant room for interpretation, such as those dealing with the extraordinary depreciation allowances on private housing

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<sup>6</sup>Income Tax Law, § 4, para. 5.

<sup>7</sup>For details concerning the status of regulatory ordinances, see 2.4 *infra*.

<sup>8</sup>Typically an ordinance does not contain illustrative examples. They are to be found in administrative regulations. The first two examples of constructive dividends set out in Ordinance Regulating the Corporation Income Tax Law, § 19, read as follows:

"1. A shareholder is paid an excessive salary for his services as an officer of the company.

"2. A shareholder is paid, in addition to an adequate salary, extra compensation based on the turnover of the business."

(including owner-occupied dwellings) and with charitable contributions. Thus German tax law employs deliberately a variety of drafting techniques, the overriding motive being to keep the law as flexible as possible.<sup>9</sup>

The annual number of income tax controversies which involve interpretative issues is not known. While some are resolved at the judicial level, administrative procedures handle far more. It is not even known how many reach, or how many are resolved by, either the lower echelon fiscal courts or the Federal Fiscal Court.<sup>10</sup> Only the latter tribunal publishes decisions. And while, in 1963 for example, it published 164 income tax and 17 corporation tax decisions, the total number handed down was substantially higher, for even that court does not publish all its decisions.

## 2.2 *Legislative pre-enactment aids to interpretation*

Legislative pre-enactment aids to income tax law interpretation include:

- (1) Minutes of the *Bundestag* or *Bundesrat* Fiscal Committee or of any other technical committees dealing with income tax matters;<sup>11</sup>
- (2) Reports submitted to the *Bundestag* or *Bundesrat* by the Fiscal Committee concerning the results of its discussion; and
- (3) Minutes of the plenary session debates of the *Bundestag* or *Bundesrat*.

Of these three, the *Bundestag* Fiscal Committee's minutes contain the greatest amount of information regarding the sense and purpose of a provision. The Fiscal Committee may and typically does invite the Federal Minister of Finance, senior officials of the Finance Ministry, experts from industry, etc., to participate in these clarifying discussions. However, the hearings are closed and the minutes, summary rather than verbatim reports of the discussion, generally are not available to the public.

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<sup>9</sup> One advantage: Taxpayers, rather than attempt to exploit the marginal areas hoping to find loopholes in the law, may seek sound footings, not otherwise being sure of a court's reaction.

<sup>10</sup> The Federal Fiscal Court, the supreme court for German tax matters, deals only with questions of law. See Chap. XVI, 4.4 *infra*.

<sup>11</sup> The grass-roots work on a given provision—apart from the preparatory work done by the Federal Ministry of Finance—generally is left to the several committees.

The public, however, does have access to the reports which the Committee submits to the legislature and to legislative minutes. The utility of the former is limited because they reflect only a summary of the committee's views. And typically, the legislative minutes furnish no details regarding the interpretation of a given provision. The processing of one new provision in 1964 (section 6(b) of the Income Tax Law) illustrates the relative informative quality of these three sources. The portion of that provision of interest here reads as follows:

Profit from the disposal of certain fixed assets

(1) Taxpayers who dispose of real property, fixtures attached to real property including the appurtenant lands . . . or livestock of agricultural and forestry enterprises in connection with a plant reorganization, may, in the business year in which the assets are disposed of, deduct from the cost of acquiring or producing the [especially defined . . . similar] assets purchased or produced in the said business year an amount not exceeding the profit derived from such disposal. . . .

Two questions arise. What are "fixtures attached to real property" within the meaning of the provision? What is a "plant reorganization"?

The Fiscal Committee minutes, though not available to the public, provide some clarification. They state that the expression, "fixtures attached to real property," is more or less restricted to irrigation and drainage facilities used for agricultural or forestry purposes. "Plant reorganization"—a term hitherto unused by German tax law—is said to cover not only the fundamental reorganization of a business but also situations where, for instance, a cattle farm is converted into a duck farm. The minutes go on to state that the ultimate definition of "plant reorganization" must rest with the courts.

The Fiscal Committee's published report to the *Bundestag* does not refer at all to "fixtures attached to real property." "Plant reorganization" is explained only by an illustration, "e.g., when changing from bovine cattle farming to small cattle farming."

The *Bundestag* minutes of the debate on the 1964 Tax Amendment Law mentions neither of the previously quoted statutory phrases. The plenary session did not concern itself with these details; it explored only the economic, political, and fiscal effects of provisions granting tax reliefs.

### 2.3 *Standards of construction followed by the judiciary in interpreting the statute*

A German court, construing a statute, takes as a point of departure the premise that the language of a law determines its construction, for the language reflects the legislature's intention. Therefore, any construction must accord with the language used in the law, unless a literal application were to lead to an obviously unreasonable result.

The extent of judicial interpretation depends, of course, on the way a provision was drafted. When a statute is phrased in abstract form, there is much scope for judicial interpretation. When a statute is expressed in precise terms, there is little judicial interpretation. Since each provision reflects its own character, the courts try to ascertain from the statute itself the proper degree of interpretative freedom. For example, a sweeping term such as constructive dividends obviously gives wide latitude.

That interpretations will be realistic and responsive to new situations is insured by the fact that certain principles of construction, not set out in any statute, ride piggy-back on the text of the law itself. Among those to which the judiciary adheres, the most important is the so-called economic approach, *wirtschaftliche Betrachtungsweise*. This approach stresses the economic aspects of a transaction, its substance rather than the niceties of its legalistic form. The interpretation accorded "concealed capital stock" illustrates the use of this overriding economic approach. Should an interest-bearing loan be granted to a limited liability company by a shareholder, the loan will be scrutinized in the light of all facts pertaining to the company to determine whether it constitutes additional capital rather than a liability. If it is determined to be additional capital, interest payments are deemed distributions rather than recognized deductible business expenses.

This realistic approach also enables the courts to keep the law in tune with current economic developments. For example, changes in agricultural practices with greater use of farm machinery, fertilizer, etc., led courts to recognize that partnership agreements between farm parents and children should no longer be regarded as tax avoidance devices reflecting mere family ties, but as genuine contractual relationships.

This approach to interpretation also has enabled the judiciary to assure that cases of like economic substance receive identical tax treatment even in the instance where a literal interpretation of the law would produce different results.

Illustratively, the statute literally accords different treatment to businessmen and to individual investors in depreciating capital improvements to realty. Should a businessman shift from coke to oil heat, the rules concerning the determination of profits from trade or business would apply with the consequence that his depreciation would be geared to the useful life of the new system. The private investor, however, is governed by the provisions relating to rental income, and literally would be forced to gear his depreciation to the longer useful life of the building. This obviously discriminatory treatment caused the courts to rule that the private investor, at the point when the new oil furnace became unserviceable, could write off as income-connected expenses the then remaining undepreciated basis of the furnace.

Finally, where the courts are uncertain as to the legislative intent, consideration is given to the historical background of a provision, though this may not be used to justify an interpretation incompatible with the thrust of the provision itself. The background includes the pre-enactment documents mentioned previously<sup>12</sup> though, in general, these do not rank high among the guides to interpretation.

## Section B. *The Regulations Program*

### 2.4 *Types and force of regulations*

As noted in 2.1 *supra*, German tax statutes are supplemented by regulatory ordinances, *Rechtsverordnungen*. These are issued by the Federal Government with the consent of the Federal Council, *Bundesrat*, pursuant to authority contained in the individual laws which lay down the scope, limits, and purpose of the authority. These ordinances then serve only to implement the law, providing specifics in accordance with the general legislative intent reflected by the statute itself.

Regulatory ordinances cannot change or modify the law's provisions nor can they create new obligations and privileges. Unless they fail to conform to the language and purpose of the law, they are regarded as binding legislation susceptible to interpretation. Thus they are far more than mere administrative instructions. They bind both the administrative authorities and the courts except where the courts hold either that a regulatory provision exceeds the delegated authority, or that the

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<sup>12</sup> See 2.2 *infra*.

delegation itself was invalid because insufficiently defined in the statute.

Despite these limitations, regulatory ordinances can be used effectively to supply details not incorporated in the law itself or to permit adaption to changing conditions without further resort to the more time-consuming legislative process. Illustratively, the statute authorizes the issuance of regulatory ordinances granting special depreciation allowances for such items as sewage plants, mining, air purification, and research equipment, and to provide special deductions for certain categories of goods, including imported goods the prices of which have declined sharply on the world's market and other goods of particular importance to the German economy. Other regulatory ordinances are authorized to permit increased accumulation of reserves when prices rise or to allow special depreciation allowances during a recession. Again, authority is delegated to issue ordinances according tax relief to inventions by employees, independent inventors, etc.

The Income Tax Law confers both specific and general authority to issue regulatory ordinances. Specific authority is conferred in certain selected areas,<sup>13</sup> such as those previously mentioned. In order to insure equality of all taxpayers before the law, to provide relief in hardship cases, or to simplify tax procedures, general authority is granted to facilitate implementation of the Income Tax Law with respect to the delimitation of tax liability, determination of income, assessments, application of tax rate provisions, and payment of taxes.

The most important ordinance issued under the Income Tax Law is the General Ordinance regulating the Income Tax Law. It contains 91 sections and comprises about 60 pages of approximately 300 words each, and thus is somewhat smaller in size than the Income Tax Law itself. Also relevant to this comparison of size is the fact that this ordinance—like all regulatory ordinances—for more complete understanding frequently repeats the text of the various parts of the law with which it deals. However, not every section of the statute is supplemented by a corresponding portion of the regulatory ordinance. Only portions are so complemented, selected usually because

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<sup>13</sup>The identification of these specified areas is primarily a matter of drafting technique. At the end of the Income Tax Law, the text reflects both the general authority to issue regulatory ordinances, as well as specific authority in selected areas to make certain that the Federal Government is authorized to issue the latter ordinances with the approval of the *Bundesrat*.

the statute is not exhaustive enough on a given point. Subject to the overriding requirement that a regulatory ordinance conform to the law itself, the government in exercising its authority to issue regulatory ordinances has full administrative discretion in determining what it will include within a particular regulation. In addition to the General Ordinance, there are approximately ten major regulatory ordinances covering important special income tax areas. The most voluminous of these is the Wage Tax Ordinance, which comprises 58 selections dealing in large part with the technical aspects of the wage tax. Other ordinances bear on the withholding tax on income from capital, taxation of independent inventors, tax treatment of inventions by employees, and on the calculation of the rental value of owner-occupied homes. Together, these ordinances add slightly less than a hundred sections.

These regulatory ordinances fulfill the purpose of making precise whatever may have been left open or unclear in the statute. They do not interpret the statute. Rather they set out supplementary rules omitted by the legislature. Further, they do not include summaries of Supreme Court decisions.

The Ordinance regulating the Corporation Income Tax Law, issued under the authority contained in the statute itself, has only 38 sections, for it deals only with the special problems peculiar to corporate taxation.

Whereas the regulatory ordinances establish legally binding rules, the quite separate administrative regulations discussed below serve only to reflect the government's interpretative position.

### 2.5 *Precise purpose of interpretative regulations*

The introductions to the Income Tax Regulations, Corporation Income Tax Regulations, and Wage Tax Regulations state their purpose as follows:

The regulations deal with questions of doubt and interpretative questions of general importance with a view to insuring uniformity in the application of the income tax law [corporation income tax law, wage tax law] by the tax authorities. In addition, they give instructions to the local finance offices on how to proceed in certain cases in order to prevent undue hardship and to simplify administrative procedures.<sup>14</sup>

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<sup>14</sup>Under German tax law (Fiscal Code, §131), taxes may be forgiven or refunded in whole or in part where, in the circumstances of the individual case, taxation would result in undue hardship. It also is permissible to reduce the base of income on which the tax rates are applied. Although this provision refers to hardship in relation to

These administrative regulations describe and interpret both the law and the regulatory ordinances. They do not supplement the law, i.e., fill gaps left open by the legislature. This is left to the regulatory ordinances.

The authority to issue these administrative regulations is derived by the Federal government from the Basic Law,<sup>15</sup> not from specific delegations in the tax statutes. However, because of the power held by the several states in income tax matters, the administrative regulations covering this area can be issued only after receiving the approval of the *Bundesrat* (comprised of representatives of the states).

Administrative regulations, unlike statutes or regulatory ordinances, do not bind the courts. A regulation may be taken into account, however, either because it is deemed to represent a well thought out administrative view or because it is a source of information regarding methods which have been applied in practice. Even so, in the end a court renders its decision on the basis of *its own* interpretation of the law.

Nevertheless, the abstract language of the German statutes makes centralized administrative interpretation a prerequisite to uniform application of the law by all administrative officials, and is peculiarly important as to matters having wide application. Since the focus on interpretative problems is only to assure uniform application by fiscal authorities, rather than to guide the lay public, lay language is not used. Nor are examples provided where the law itself provides a clear answer. In general, the aim is to strive to interpret the law to conform with objective criteria, i.e., as the courts would be expected to interpret it.

Two illustrations will indicate the type of interpretative assistance these administrative regulations provide. The first relates to Sections 2 and 21 of the Income Tax Law which require inclusion of rental income from real property. Income means receipts less income-connected expenses. The latter are defined in Section 9 precisely, to mean those incurred in obtaining, conserving, and maintaining receipts. In practice, however, it is difficult to distinguish between expenditures constituting income-connected expenses and expenditures requiring capitalization. The administrative regulations seek to clarify the distinction, as follows:

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(footnote continued)

the circumstances of individual cases, it expressly allows similar arrangements to be provided for certain groups of analogous cases.

<sup>15</sup>Basic Law, art. 108, para. 6.

There is no fixed borderline between maintenance-connected expenditure and capital expenditure. Maintenance-connected expenditure invariably includes expenditure

1. Which does not change the nature of the real property and
2. Which is incurred with a view to maintaining the property in proper operating condition and
3. Which recurs regularly in about the same amounts.

Even if not all of these conditions are fulfilled, expenses incurred may, under certain conditions, constitute maintenance-connected expenditure (*cf.* Federal Fiscal Court Decisions, July 9, 1953 and March 1, 1960—BStBl (Bundessteuerblatt) III, 245 and BStBl III, 198). In particular, maintenance-connected expenditure includes expenditure on current maintenance and on repair (backlog of maintenance work). . . .<sup>16</sup>

This effort to be as precise as circumstances permit is illustrated by the regulation dealing with Section 9a of the Income Tax Law. The latter allows, in lieu of a deduction for actual income-connected expenses, a standard deduction in the following amounts:

- (1) DM 564 deductible from employment income;
- (2) DM 150 deductible from the income from capital assets.

From this emerge several questions. Is a taxpayer with more than one employer allowed to claim more than one standard deduction? If a taxpayer receives both employment income and income from capital, can he claim both standard deductions? If he ceases to be liable for tax during part of a given year, must the standard amounts be reduced proportionately?

The Income Tax Regulations respond as follows:

The standard deduction for income-connected expenses shall be allowed only *once* in respect from the same *source*[17] of income (*cf.* Federal Fiscal Court Decision, April 3, 1959—BStBl III, 220). In the case of income from two or more sources, the standard deduction shall be allowed in respect of *each* source of income up to the amount of the income involved. The standard amounts shall not be reduced if the taxpayer's liability to tax during a given year failed to extend over the full year.

Observe that both of the above examples from the regulations cite decisions of the Federal Fiscal Court, the highest

<sup>16</sup> Income Tax Regulations, para. 157.

<sup>17</sup> *E.g.*, employment income irrespective of the number of employers.

German court in tax matters. Thus the regulations not only clarify but serve also to indicate the issues which the tax administration regards as now settled but which at some point were doubtful enough to have reached the highest judicial tribunal.

Finally, it should be noted that administrative regulations do not try to cover exhaustively all interpretative questions. Coverage depends on foreseeable or actual needs. Consequently, initial regulations must be supplemented with amendments and, in practice, almost every year amended versions of the Income Tax and Wage Tax Regulations are issued.<sup>18</sup> The bulk of the provisions remain unchanged, but for identification purposes the particular year is added to the title, i.e., *Income Tax Regulations for the Calendar Year 1963*.

Administrative regulations are subdivided into paragraphs, unlike the laws and the regulatory ordinances which are subdivided into sections. The Income Tax Regulations contain 224 paragraphs covering 215 pages with approximately 300 words to each page. While procedural rules are of secondary importance in the case of the Income Tax Regulations, they are more important for the Wage Tax Regulations. Wage Tax Regulations spread 94 paragraphs across 120 pages, and the Corporation Income Tax Regulations include 69 paragraphs which run about 100 pages.

### 2.6 *Manner of processing regulations*

A division of the Federal Ministry of Finance, responsible for taxes on income, capital, and transactions, prepares all statutes, regulatory ordinances, and administrative regulations relating to the taxation of income.

Section heads within this division,<sup>19</sup> assisted by senior officials and officials of the administrative class,<sup>20</sup> handle the actual preparatory work. The section heads and senior officials are lawyers. Their prime guidance comes from the debates on the statute. Consequently the basic thrust is fixed by the time of enactment. But actual drafting takes place later, after all interested parties—i.e., the State Finance Ministries,

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<sup>18</sup>The regulations constitute definite instructions for local finance offices for the calendar year of issuance. Consequently, amendments are introduced only once a year.

<sup>19</sup>See Chap. XIII, 1.2 *supra*.

<sup>20</sup>See Chap. XIII, 1.5 *supra*, for a discussion of officials of the administrative class.

other Federal Ministries,<sup>21</sup> and private organizations (particularly the leading professional and industrial groups)—have expressed their opinions and made recommendations. Public hearings are not held though regulations are normally prepared after discussing matters with all interested groups—who may in fact have made the initial suggestion for the proposed regulation.

Typically a few months elapse between the enactment of the statute and the issuance of the regulatory ordinances. The administrative regulations, on the other hand, are published annually.<sup>22</sup>

### Section C. *The Rulings Program*

#### 2.7 *Formal advance private written rulings to taxpayers*

The German tax administration is not required to supply taxpayers with rulings concerning the tax consequences of proposed transactions. There is only one exception: it is possible to obtain a ruling on whether and to what extent wage tax provisions must be applied. This exception is justified because the employer is liable for the proper deduction of this tax, even in the absence of fault. Information as to this liability may be obtained without formality, even over the telephone. While the administration is not legally bound by its answer, should it prove to be erroneous, in practice the administration legally stands by the position taken if the applicant relied thereon in good faith.

Though not legally bound to do so, the administration often does issue advance written rulings to accommodate taxpayers who plan to conclude important contracts or to commence large-scale transactions. But this is a discretionary matter. No rules define the questions which will or will not be answered. And in exercising discretion as to whether or not a ruling should be issued, the administration is guided by the principle that a taxpayer deserves the protection of a ruling *only* in cases involving doubtful questions of law which impose an undue burden on a taxpayer unable by himself to clarify the problem. Further, rulings are never issued in two types of situations.

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<sup>21</sup> Most important of these ministries is the Ministry of Economics. Others likely to be invited, depending upon the nature of the questions involved, are the ministries of Labor, Transport, Food and Agriculture.

<sup>22</sup> See 2.5 *supra*.

Requests involving an issue of fact are rejected; this type of problem can be resolved only during a tax audit. Also rejected are requests for rulings with respect to transactions possibly inspired by tax avoidance possibilities.

Since no office is formally designated as a rulings office, requests may be addressed to, and rulings issued by, the local finance offices, Regional Finance Offices, State Finance Ministries, or the Federal Ministry of Finance. Each level may answer a request submitted to it. But Regional Finance Offices and State Finance Ministries will usually decide to refer the matter to the local finance office which is responsible for the applicant's assessment and hence familiar with his circumstances. In consequence, the local finance offices issue the bulk of all income tax rulings. This means that most rulings are prepared by officials who did not participate in any of the preparatory work on the statute, the regulatory ordinances, or the administrative regulations. However, if the question is of fundamental importance or involves large sums, the final ruling will usually come from the Regional Finance Office or the State Finance Ministry. The Federal Ministry of Finance avoids becoming involved in ruling on specific cases, and tends to rule only on abstract questions usually involving matters of fairly wide significance. Should a State Finance Ministry receive a question of this caliber, it forwards it to the federal level,<sup>23</sup> because the officials there have participated in the preliminary work on the statutes, regulatory ordinances, and administrative regulations.

In theory, an advance ruling is only an expert opinion of the tax authorities. In preparing them, the officials strive to formulate and adhere to the line of reasoning which would be valid for the final decision on an assessment.

In the abstract, an expert opinion does not legally bind the tax administration. However, when a taxpayer obtains a ruling on a particular set of facts, the ruling is treated as a decision taken in anticipation of a subsequent assessment upon which the taxpayer may rely. In other words, even if the administration later concludes, on balance, that a different legal conclusion should have been drawn, it will adhere to the position taken in its ruling, regarding it as the equivalent of a promise. This is based on the well-established principle of fair dealing, originally developed under that part of the civil law which governs

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<sup>23</sup>This is in consequence of the constitutional status of the federal states. See Chap. XIII, 1.1, 1.2 *supra*.

taxpayer-government relations. However, if the ruling was *clearly* erroneous, the principle of fair dealing is not deemed to override the competing principle, that no tax claim can be subjected to arbitrary manipulation. Thus the administration does not consider itself bound by *clearly* erroneous rulings it had no power to issue.

The absence of legal provisions covering the status of rulings is causing increased dissatisfaction. Disputes between tax authorities and taxpayers arise continuously over the degree of reliance a taxpayer is entitled to place upon a ruling in a given case. There is a widespread belief that a matter of such great importance should be governed by statute, and the Federal Government is planning to amend the Fiscal Code by adding provisions to permit local finance offices to issue binding advance rulings. The ruling will provide the basis of subsequent assessment provided there has been no change in the facts as presented. To secure such a ruling, the taxpayer will have to file a written application, describe the contemplated transaction, and analyze the tax question. Oral conferences with the issuing officials would be permitted, but in these the taxpayer may not alter the facts as originally presented. Nor need the local finance office audit the facts, though in suitable cases it may invite the applicant to supplement his presentation of the facts. In any event, the ruling would be binding only if all relevant facts were exposed and the transaction is carried out as presented.

The ruling itself will include an analytical explanation. The taxpayer will be informed also that the ruling may be appealed to the appropriate fiscal court, from whence appeal lies to the Federal Fiscal Court.

It is not contemplated that the procedure under the proposed statute would supersede the present practice. Moreover, there is no plan to limit the areas in which binding rulings would be issued. Because of the continuance of the present practice and because it is proposed to charge for a ruling with the added requirement that the request analyze the tax questions presented, a flood of requests is not anticipated.

At present, since most rulings are issued at the local level, statistics are not available showing the number requested.

### *2.8 Informal technical advice to taxpayers on proposed transactions*

Authorities at all echelons typically are willing to discuss informally any problem with a taxpayer. The importance of

the question determines the level at which the discussions will take place, however. If the case is relatively unimportant, higher-echelon authorities will refer the taxpayer to his local finance office. Taxpayers, however, try to get their advice from the higher echelons because of their fear that the local office's view may not accord with that of the Regional Finance Office and State Finance Ministry whose hierarchical status entitles them to send instructions to the local offices. Moreover, local offices tend to be far more reluctant to render definitive, albeit oral informal opinions, than the higher-echelon authorities with more extensive powers.

### 2.9 *Technical advice to field offices*

The local finance offices have full autonomy to render decisions on their own responsibility. They receive, however, binding administrative instructions from the competent Regional Finance Office,<sup>24</sup> which usually acts under directions given by the State Finance Ministry, not on its own initiative.

State Finance Ministries are the highest level entitled to give instructions to the local finance office. To insure uniformity through the Federal Republic, heads of divisions (i.e., income tax, wage tax, corporation income tax) of the several State Finance Ministries frequently meet in the Federal Ministry of Finance to discuss interpretative questions under the chairmanship of one of that Ministry's competent top officials. Conclusions reached at such discussions are set out in minutes which are *not* published, but are used by the State Finance Ministries as the basis for instructions issued to the lower level authorities on interpretative problems.

The more important instructions, however, are published as general rulings, *Erlasse*, in the Federal Tax Gazette, *Bundessteuerblatt*, the official publication of the Federal Ministry of Finance which is available to the public. While published in this manner, the instructions are not actually issued by the Federal Ministry. Rather each State Finance Ministry has exclusive power to issue its own instructions in its jurisdictional area. However, publication is usually discussed and decided upon in the meetings held under federal auspices and the texts of each state's instructions ordinarily are drafted by the federal officials and are more or less identical. Consequently

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<sup>24</sup> For practical reasons, the more important instructions are arranged in card files which are supplemented regularly and kept up to date. Thus officials of local finance offices can draw on a convenient collection of important instructions to guide them in their work.

these general rules are termed *Coordinated Laender Rulings*, and appear as such in the *Federal Tax Gazette*.

It not infrequently happens that when the annual volume of administrative regulations is issued, an important interpretative question has not been clarified sufficiently. Rather than wait until the next annual set of regulations is published, a *Coordinated Laender Ruling* can be issued in the interim.

While senior officials at the local finance office normally have ultimate responsibility for any decision, upon encountering a complicated question of tax law, it is under instructions to refer the question to the Regional Finance Office which then assumes responsibility for the decision. The referral is accomplished by submission of a detailed statement of the facts and a legal analysis of the issues involved. The Regional Office either will decide the question itself or, if it is a matter of prime importance, refer it to the State Finance Ministry. Should the State Finance Ministry consider the issue to be of interest to the tax administrations of all the states or one which should be the subject of future legislation, it will forward the question to the Federal Ministry of Finance.

Since the typical case referred to the Regional Finance Office presents a difficult question of law which the local office has explored extensively with the taxpayer, the taxpayer customarily is informed that the matter has been sent to a higher-level authority. The taxpayer then is free to contact and discuss his problem with the appropriate higher office, whether it be the Regional Office, the State Finance Ministry, or the Federal Ministry of Finance.

No information is available as to the number of cases sent to the Regional Office by the local offices. In general, local offices usually try to solve their own problems and secure higher level decisions only in exceptional cases.

### 2.10 *Publication of technical advice given taxpayers and local offices*

The *Federal Tax Gazette* publishes as rulings the instructions State Finance Ministries send to all local finance offices, instructions which normally stem out of concrete cases decided by the same Ministries. When an instruction is derived from a concrete case, the taxpayer's name is omitted and the solution shaped in terms of general application. Such an instruction sets out only one or two specific points decided, together with a rough indication of the legal issues involved.

The State Finance Ministries and the Federal Ministry of Finance also issue information circulars, the more significant of which are published in the *Federal Tax Gazette*.

Other information is made available to the public in various ways. For example, the tax administration annually publishes standard profit margins for the most important types of trade and commerce, as well as tables of normally recognized depreciation rates. Less sophisticated information on topical tax matters is provided through press conferences and newspaper articles. Television and radio also are used. Whatever the method of publication employed, effort is made to provide not only the decision or conclusion but also the underlying rationale.