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By PwC Deutschland | 19. Dezember 2025

German taxation of payments from US 401(k) pension plan

Payments from a pension plan under Section 401(k) of the US Internal Revenue Code are subject to income tax according to Section 22 No. 5 Sentence 2 letter b of the German Income Tax Act if made before 1 January 2025. The Supreme Tax Court’s conclusion on the matter is largely the result of the structural comparability recognized and acknowledged by Germany pursuant to Section 1 (1), § 1b (2) and (3) of the Law on Promotion of Employer Pension Schemes (Betriebsrentengesetz) specifying ways and means in which employers can organize occupational pension schemes.

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Background

A US 401(k) is an employer-sponsored retirement savings plan where employees contribute a portion of their paycheck, often with employer matching, into investment accounts for tax-deferred (traditional) helping them build retirement funds with significant tax advantages. A 401(k) Plan is a defined contribution plan that is a cash or deferred arrangement. Employees can elect to defer a portion of their salary which is instead contributed on their behalf, before taxes, to the 401(k) plan. There is a limit on the amount an employee may elect to defer each year. A 401(k) plan is a tax-advantaged retirement savings plan. During the term of the 401(k) plan, neither the contributions made to the plan nor the income from the invested assets are subject to tax under US law. If benefit payments from the 401(k) plan are made prior to reaching retirement age in the US (59.5 years), these trigger a penalty tax in addition to the regular taxation of the amount paid out.

For taxpayers who are resident in Germany at the time of payment, the question arises as to which provision of the German Income Tax Act (ITA) applies and, as a result, the extent to which payments from such 401(k) plans are subject to income tax.

Case in dispute

The plaintiff was employed in the United States from 1999 to 2007. He had already signed an application or registration form (enrollment form) for a US 401(k) pension plan in 1999. According to this form, the employer was to withhold and pay contributions to the pension plan amounting to 15% of the plaintiff's salary. The 401(k) plan was to be administered by a US trust with a trust company acting as trustee. In the year in dispute (2015), that is, after his return to Germany, the plaintiff received a payment from a 401(k) plan which was not subject to income tax in the United States. While the employee treated the payment as tax-free in his income tax return, the tax office took the difference between the insurance benefit and the total premiums paid as basis for assessing the income tax. The tax court of first instance, in turn, considered only half of the difference to be subject to tax.

Decision

The **Supreme Tax Court** considered the appeal brought by the tax office to be justified and referred the matter back to the lower tax court for further hearing and decision.

Taking only half of the difference between the amount paid and the paid-in premiums, as assumed by the lower tax court, is not possible. Payments from a 401k plan are subject to income tax as other income pursuant to Section 22 No. 5 Sentences 1 and 2 letter b ITA.

Other income within the meaning of Section 22 No. 5 Sentence 1 ITA includes benefits from pension plans, pension funds, pension schemes, and direct insurance policies. These are subject to income tax if the taxpayer receives them during his or her unlimited income tax liability or as domestic income during a limited income tax liability. Benefits

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within the meaning of Section 22 No. 5 Sentence 1 ITA include not only ongoing, i.e., recurring payments from the pension institution but also one-time capital payments or lump-sum settlements in place of a pension.

Supreme Tax Court draws a distinction between the years prior to 1 January 2005 and following years

(1) If the contract was concluded after December 31, 2004, the age and term at the time of payment are irrelevant and therefore the difference between the insurance benefit and the total contributions paid is taxable. If the insurance payout is made after the taxpayer has reached the age of 60 and after twelve years since the conclusion of the contract, only half of the difference is to be taken into account in accordance with Section 20 (1) No. 6 Sentence 2 ITA.

(2) If the underlying contract was concluded before January 1, 2005, and the requirements for setting up a funded pension plan were met, the payment is tax-free. This applies to interest from insurance policies within the meaning of Section 10 (1) No. 2 letter b ITA (as applicable at the time) which is offset against premiums or paid out in the event of a claim or in the event of surrender of the policy twelve years after the date of conclusion of the contract.

Until 2024 (before new regulations were introduced in the course of the Annual Tax Act 2024) and thus also in the year in dispute (2015), taxation follows from Section 22 No. 5 Sentence 2 ITA and not Sentence 1. Thus far, there has been no legal basis for deferred taxation of payments from a 401(k) plan retrospectively because the insurance premiums were tax exempt in the United States or could have been claimed as tax exempt under Section 3 No. 63 ITA.

Lower tax court to reconsider additional aspects

In a second instance procedure, the lower tax court is - among others - asked to determine, on the basis of US law, whether the 401(k) plan on which the capital payment is based had a term of at least twelve years and whether, in terms of comparative analysis, it can be regarded as insurance within the meaning of Section 10 (1) No. 2 letter b (cc) or (dd) ITA in its version of 2004. In this case, the difference between the capital payment and the contributions made could remain tax-free. Otherwise, half of the difference amount would have to be taxed.

Based on the documents submitted by the plaintiff, it cannot be ruled out that there was more than one 401(k) plan for the plaintiff, the Supreme Tax Court said. Whether capital could have been rearranged instead and what impact this would have had on a contract term that had already begun still needs to be clarified.

In particular, the Supreme Tax Court cannot assume from the outset and with the necessary conviction that the disputed payment is based in whole or in part on a contract

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already concluded in 1999 or that a contract was even concluded in that year. Additional findings would also be necessary on this point.

Source:

Supreme Tax Court, decision of 25 June 2025 (X R 23/22), published on 18 December 2025.

Schlagwörter

US Pensionsplan, pension plan