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By PwC Deutschland | 02 September 2021

# Contributions to US- 401(k) pension plan taxed as income from employment

**The Regional Tax Court of Rhineland Palatinate has decided that contributions to the US 401(k) retirement plan deducted at source from the employee's salary are to be taxed as income from employment in Germany.**

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## Background

The plaintiff is a U.S. citizen whose place of residence was in Germany together with his family. He received income from a U.S.-based company for work performed as employee in Afghanistan. The employer, as contracting party to the "401(k) retirement plan", contributed part of the salary to a pension fund. The plaintiff was the sole direct beneficiary from the employee pension plan.

The local tax office held that the plaintiff was subject to unlimited (unrestricted) income tax liability and that the right of taxation had been allocated to Germany under the German-US tax treaty. As a result, it took the plaintiff's salary into account for income tax purposes, considering the payments to the pension trust as being part of the gross salary and at the same time denied deductibility of the contributions when determining the taxable income.

## Decision

The Regional Tax Court confirmed this view and dismissed the appeal. The plaintiff has - under Internal Revenue Code § 401(k) (2) (c) in conjunction with. § 1.401(k)-1 (c) (2) of the Income Tax Regulations - the vested nonforfeitable claim for payment of the benefits accumulated in the fund. As a result, the contributions were in fact paid (accrued) to the plaintiff and thus part of his income from employment. At the same time, a tax reduction for the contributions under Art. 18A of the double tax treaty in conjunction with Sec. 3 No. 63 Income Tax Act was rejected by the court, as this could not properly be documented and evidenced by written agreements relating to the „401(k)-pension plan“.

The court stated that the plaintiff had his residence in Germany by way of domicile according to Art. 4, para. 1 of the German-US tax treaty. In the opinion of the court, the plaintiff's salary regarding his employment activity in Afghanistan is subject to German income tax following Art. 15, para. 1, sentence 1 of said tax treaty. The work was exercised in Afghanistan, rather than in the US. Because there is no double tax treaty with Afghanistan, the court did not have to address possible further issues as to the final right for taxation of the work performed in Afghanistan.

The court went on to say that payment or - as in the case of the contributions to the pension fund - accrual of wages from employment is assumed where the employee has a direct and irrevocable legal claim to the benefits against a third party to whom the employer has made payments. Here, the employee is the direct and sole beneficiary of the "401(k) plan". He has the choice to receive certain amounts as payment from the employer or that the amounts be paid into the pension plan. The plaintiff is not only a beneficiary but, by making contributions to a "trustee", acquires a separate and irrevocable entitlement against the latter under the conditions laid down in the trust agreement.

## Source:

Regional Tax Court of Rhineland Palatinate, decision of 23 October 2019 (case ref. 2 K 1234/17); the decision is final , as the appeal to the Supreme Tax Court was not permitted.

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**Keywords**

employment income, pension plan, retirement plan