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By PwC Deutschland | 31 May 2026

Disability indemnity granted by the United States exempt from German income tax

In a most recently published decision, the Supreme Tax Court held that a disability compensation received by a former member of the U.S. Armed Forces for an injury suffered in the line of duty is tax-exempt under Section 3 No. 6 Income Tax Act.

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Background

According to **Section 3 No. 6Sentence 1 of the Income Tax Act** (ITA), payments made in accordance with statutory provisions **from public funds** as a means of pension to, among others, persons disabled in military service, persons disabled during voluntary military service, war invalids, and persons treated as equivalent to them are tax-exempt provided that such payments are not granted on the basis of length of service.

The plaintiff had been a member of the United States Armed Forces and had sustained a physical injury while on duty. He was honorably discharged from military service. Due to his disabilities, the plaintiff received compensation from the U.S. federal government based on U.S. law.

The couple (plaintiffs) reported the disability compensation in their income tax return as other income being exempt from tax under the double tax treaty with the United States. In calculating the tax rate, the tax office applied the “progression proviso” (by taking into account the compensation received when calculating the overall tax rate of the couple’s income).

The lower tax court held in favor of the plaintiff: The progression proviso was not to be applied because it was precluded by the tax exemption provision of Section 3 No. 6 ITA.

Decision

The Supreme Tax Court upheld the lower court’s ruling and dismissed the tax office’s appeal. The disability compensation in question is tax-exempt under Section 3 No. 6 ITA. The criterion contained in this provision - “remuneration from public funds” - is not limited to domestic sources but also includes foreign financial resources.

Already in an earlier judgment from 1997, the Supreme Tax Court held that tax exemptions for foreign disability or invalidity pensions must also apply to equivalent pensions from other EU member states and further found, among other things, that Section 3 No. 6 ITA also covers payments from foreign public funds. The former case involved a German citizen who received an invalidity pension from the French government due to his former service in the French Foreign Legion.

The Supreme Tax Court has now clarified that this also applies to

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compensation paid by a third country, i.e., a non-EU/EEA member state because the wording of Section 3 No. 6 ITA does not restrict the scope to domestic or EU/EEA member states. The important point is that the damaging event occurred “while on duty.”

Furthermore, the tax-exempt payments from foreign countries are not subject to the progression clause even if, in addition to the tax exemption under Section 3 ITA, such an exemption also exists under the relevant double tax treaty.

Source: Supreme Tax Court, judgment of 23 April 2026 (X R 29/22) published on 28 May 2026.

Keywords

compensation, pension fund, public body