

German taxation

*Dr Alexander Ressos, TEP
Attorney-at-Law (Switzerland), Solicitor (Hong Kong),
Solicitor (England & Wales)*

Germany is the most important foreign market for policies administered from Basel, with rules more detailed than those of any other country examined here. Income from life insurance is taxed as income from capital under the Income Tax Act. The taxable amount is the difference between the insurance benefit and the sum of the premiums paid. If the benefit is paid after the policyholder has completed the age of 62 and after the contract has run for at least twelve years, only half of the difference is taxed, at the policyholder's personal income tax rate. For contracts concluded before 2012, the relevant age is 60. Contracts concluded before 1 January 2005 remain subject to the old law, under which benefits from qualifying policies were tax-free.¹

The half-income rule applies only if the policy contains a sufficient risk element. For contracts concluded after 31 March 2009, the statute requires that the death benefit amount throughout the term to at least half of the premiums payable over the term. The administration has also defined when a contract counts as life insurance for tax purposes at all, requiring a biometric risk and accepting, among other options, a death benefit that exceeds the value of the policy by at least 10 per cent. Policies that do not meet these requirements are not insurance for tax purposes, so that their income is taxed under the general rules for capital income at the flat rate of 25 per cent plus solidarity surcharge. Since 2018, a partial exemption of 15 per cent applies to the income of policies linked to investment funds.²

The most important special rule concerns asset-managing insurance contracts. Where a policy is linked to assets that are managed separately for the policyholder and the policyholder can exercise direct or indirect influence over their investment, the income from the assets is attributed to the policyholder as if he held them directly. The rule does not apply where the assets consist of investment funds or similar products offered to the public and the policyholder only chooses between them. It was introduced

to end the use of private placement policies by German residents as a vehicle for tax-free accumulation of income from dedicated portfolios.³

The consequences for German residents are significant. A policy issued by a Luxembourg or Liechtenstein insurer with a dedicated fund managed according to the policyholder's wishes is, in German tax law, a transparent investment. Its income must be declared every year. An undeclared policy of this kind constitutes undeclared capital income with the consequences of German tax criminal law. A policy designed for German residents must therefore offer only a choice between predefined strategies or public funds, must contain the required risk element and must leave the investment decisions to an asset manager independent of the policyholder. Death benefits are subject to German inheritance tax in the hands of the beneficiary, since the acquisition is treated as an acquisition upon death from the deceased. The wrapper offers no inheritance tax advantage in Germany.⁴

1 Notes

1. § 20 para. 1 no. 6 EStG (taxation of the difference between benefit and premiums; half-income rule after twelve years and age 62, age 60 for contracts concluded before 1 January 2012); § 52 EStG on the transitional rules for contracts concluded before 1 January 2005. To be verified. ↩
2. § 20 para. 1 no. 6 sentence 6 EStG (minimum death benefit of 50 per cent of the premiums for contracts concluded after 31 March 2009); the letters of the Federal Ministry of Finance on the taxation of life insurance benefits (in particular BMF letter of 1 October 2009 and later amendments) on the minimum risk requirement; § 20 para. 1 no. 6 sentence 9 EStG on the partial exemption of 15 per cent for fund-linked policies since 2018. Sentence numbering, percentages and current BMF guidance to be verified. ↩
3. § 20 para. 1 no. 6 sentence 5 EStG (vermögensverwaltender Versicherungsvertrag), introduced by the Annual Tax Act 2009 for contracts concluded after the date specified in the transitional provision, and the related BMF guidance. Sentence numbering, scope and transitional rules to be verified. ↩

4. On the inheritance tax treatment of life insurance benefits as acquisitions upon death, see § 3 para. 1 no. 4 ErbStG. On the criminal law consequences of undeclared income from foreign insurance policies, see § 370 AO and the literature on tax criminal law. To be verified. ↩

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