Random audits on foreign financial income statements

A report from the Swedish Tax Agency's Analysis and Data Unit

01 October 2024

Swedish Tax Agency

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Foreword

The purpose of the report is to present the results of a random audit carried out on financial income statements of foreign capital income owned by Swedish residents from the automatic information exchanges DAC2/CRS/FATCA.

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The Swedish Tax Agency's analysis unit is responsible for the report's analyses and conclusions.

Sundbyberg October 2024

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Summary

In an effort to facilitate cross-border tax cooperation, Sweden participates in a number of automatic information exchanges, namely DAC2, CRS and FATCA. These reporting standards promote the exchange of information on financial accounts between different states and jurisdictions. In 2022, the Swedish Tax Agency carried out random audits on financial income statements from these exchanges relating to bank account balances and capital income. This report presents some results from these audits.

From a sampling frame of around 20,000 individuals, a random sample of 1,000 individuals was drawn. To ensure a targeted, efficient and consistent audit, a detailed and instructive audit programme was designed for the case officers. Most of the reported accounts were found in the Nordic countries, but bigger dividends and interest incomes were found mainly in Switzerland and the UK.

The results show no statistically significant difference between men and women in the average error rate or average tax errors. However, the proportion of younger account holders committing errors is generally higher than the proportion of older ones. About 56 per cent of all income in the sample originates from low tax jurisdictions and the average income is significantly higher for these compared to other jurisidictions.

Key results:

- ☑ There is no statistically significant difference between men and women in the average error rate or average tax error.
- ☑ The proportion of younger account holders committing errors is slightly higher than the proportion of older ones.
- ☑ Slightly more than half (56%) of all capital income in the sample originates in tax havens.

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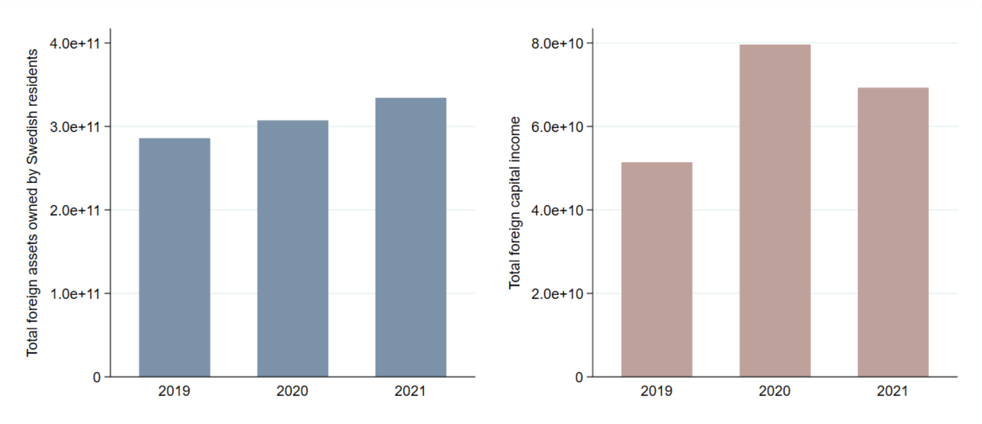
1 Background

Every year the Swedish Tax Agency receives a large amount of information from other countries through the automatic information exchanges CRS, DAC2 and FATCA. The information covers mainly different types of capital income. This type of information exchange can be compared with Sweden's own system of financial income statements from third parties. The difference, however, is that the information is determined on the basis of internationally agreed definitions or according to the country's own regulations.[1]

In 2022, the Swedish Tax Agency carried out random audits on financial income statements from the automatic information exchanges. The resulting tax gap is presented in the Swedish Tax Agency's Annual Report 2022. This report describes in more detail the foreign capital assets owned by Swedish taxpayers, such as the distribution of capital gains, description of the account holders and the errors detected in the audit.

Figure 1 Total foreign assets and capital income owned by Swedish residents



Through the automatic information exchange, the Swedish Tax Agency receives around one million income statements per year for around 500–600 000 individuals. The data covers various types of capital incomes from almost 100 countries. Swedish account holders receive an yearly average of SEK 70 billion per year in interest income, dividends, gross income/redemptions and other income.

[1] This means that some capital income is not always taxable under Swedish regulations even if it is reported under the automatic exchange.

Table 1 Descriptive statistics for all Swedish account holders (2020)

	Medelvärde	Median
Total assets (SEK)	526,987.7	6,231.8
Dividends and interest incomes (accounts 501+502) (SEK) > 0	7,414.5	68.8

Source: Own calculations.

In 2020, about 32 per cent of all Swedish account holders earned foreign capital incomes, totalling SEK 856 million in dividends and SEK 524 million in interest income. Table 1 shows the mean and median of total assets for the whole population and dividends and interest incomes for around 186 000 individuals who earned positive capital incomes in 2020. The statistics underlines the very uneven distribution of total foreign assets and income, where the average amount of dividends and interest is around SEK 7,000 but the median is just under SEK 70.

Households' total assets abroad has increased since 2019 and amounted to an annual average of around SEK 300 billion (Figure 1). This is mainly due to more individuals investing their assets abroad, rather than increasing assets in existing accounts. The average total asset per person is around half a million, but, as we see in Table 1, the distribution is much skewed, so the median being just over SEK 6,000.

1.1 Data description

As mentioned previously, CRS and DAC2 are international reporting standards for the automatic exchange of information on financial accounts between countries and jurisdictions. CRS was developed by the OECD, while DAC2 is part of the EU Directive but has similar provisions to CRS. Both these systems interact with each other. In practice, this means that information from EU member states is delivered under DAC2 and information from OECD countries is delivered under CRS. FATCA (Foreign Account Tax Compliance Act) is the US version of these information exchanges. About 38% of the data came from the CRS, about 62% from the DAC2 and 0.3% from FATCA. The split of total assets and dividends between CRS and DAC2 is similar (50 per cent) while CRS reports more interest income (74 per cent).

Financial institutions subject to the reporting obligation under Chapter 2, Sections 21-21 b of IDKAL (Chapter 22 b, Section 4 of the SFL), such as banks, investment firms, fund management companies or insurance companies, must provide information on individuals' dividends (CRS 501), interest on foreign accounts (CRS 502), gross income or redemptions (CRS 503) and other information such as income from assets in foreign accounts (CRS 504).

The random audits carried out in 2022 only cover CRS 501 and CRS 502 balances and incomes in accordance with CRS, DAC2 and FATCA regulations. The sample was selected via proportional random sampling stratified by country of origin of accounts and income level. Stratification was performed to ensure adequate coverage on geographical region and income. The sampling frame consisted of unique combinations of taxpayer and country. However, since an individual can have accounts in several countries, some individuals have a higher probability of being included in the random sample than those with accounts in only one country. This was adjusted with weights.[2] After processing, the frame population consisted of just over 23,000 unique individuals from 68 different countries.

CRS information is submitted to the Swedish Tax Agency on an ongoing basis, but the majority of the data is reported within 9 months of the end of the reporting period. The first data for the 2020 tax period was registered with the Swedish Tax Agency in April 2021 and the latest in October 2023. This means that some data from some countries is missing from the analysis.

1.1.1 Limitations

The sample only includes individuals who met the following criteria:

1. The individual holds identified foreign capital income in the form of dividends and/or interest incomes of at least SEK 2,000.
2. The individual has been assessed to be subject to unlimited taxation in Sweden for the 2020 tax period.
3. There is up-to-date information on the individual.[3]

The Swedish Tax Agency audits individuals regardless of the country in which they have an account. The target population is therefore defined as natural persons who were subject to unlimited taxation for the 2020 tax period and received dividend income (CRS501) and/or interest income (CRS502) in accordance with DAC2/CRS/FATCA regulations and which exceeds SEK 2,000 per country where the person has an account.

[2] Note that, during the audit, more accounts were uncovered than initially reported through the information exchange. When the weights are calculated, they are based on the reported and identified information in the sampling frame, not on the total number of accounts a person may have after audits.
[3] This includes an interpretation of information that is considered by the reporting country to be replaced, withdrawn or equivalent. It also includes data that is deemed to be duplicated and where the data is largely identical.

1.2 The audit programme

To ensure a targeted, efficient and consistent audit, a detailed and instructive audit programme was designed. The programme was divided into three phases: pre-screening, audit and follow-up. The audit programme was used as an operating procedure to guide the case officers through the three phases.

The pre-screening aimed to categorise individuals in the sample into groups based on their tax reporting and available information. Pre-screening was necessary to ensure that the individuals included in the sample had been correctly identified and that resources were used efficiently. The criteria for non-response included recent re-assessments, pending cases, emigration, mis-identification and other reasons why the person was not taxable in Sweden for 2020.

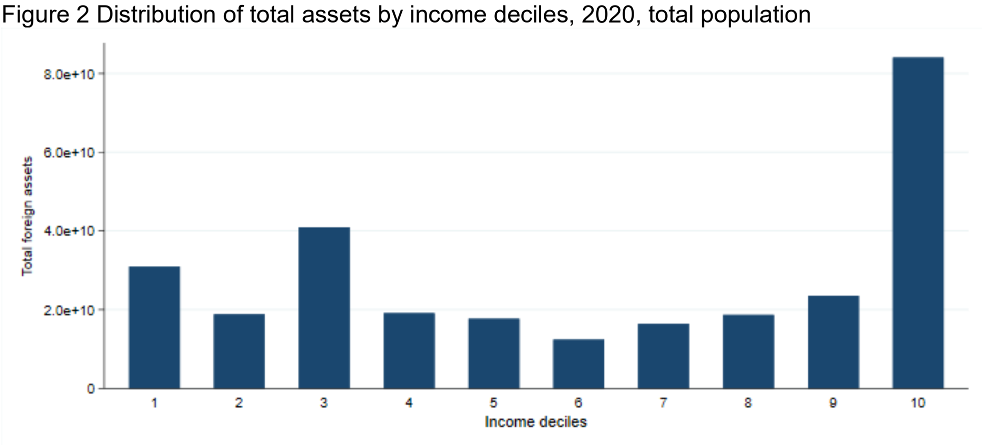
The final phase, the follow-up, was designed to assess tax errors on individuals' foreign capital income, focusing on dividends and interest, and to provide insights and a deeper understanding of those individuals who either fail to report or incorrectly report their foreign capital income.

2 Results

This section presents some descriptive statistics and results of the audits at two levels of detail: individual level and account level.

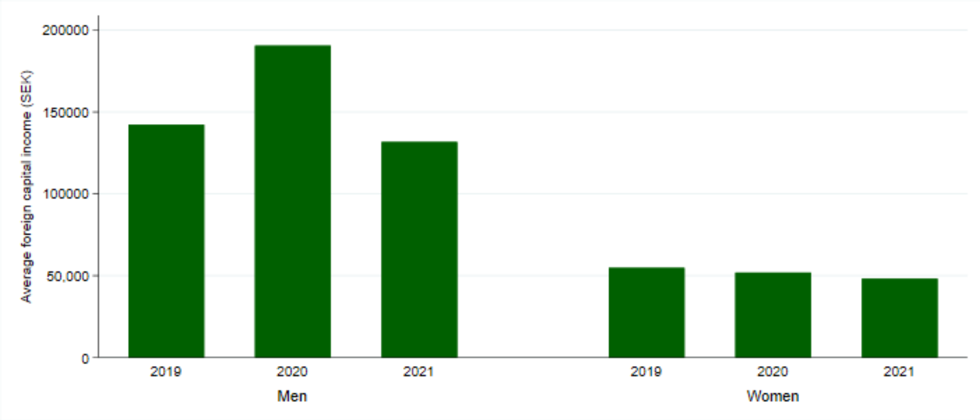
2.1 Who owns foreign capital assets?

Figure 2 Distribution of total assets by income deciles, 2020, total population



There is no strong linear correlation between income and the size of foreign assets. According to Figure 2, the 90th percentile owns around 30 percent of all foreign assets in 2020, and among those who own foreign capital assets, around 23 percent pay state income tax compared to around 10 percent of all taxpayers in Sweden. Moreover, more than 50% of all foreign assets are owned by people residing in Stockholm county.

Figure 3. Foreign capital income between men and women, 2019–2021



Around 40 per cent of those with foreign capital assets are women and their average assets are around half a million SEK per person, which is in the same order of magnitude as for men.

However, we see in Figure 3 that men account for around 80 per cent of the capital income that forms the basis for capital taxation. This means that the return on men's assets is much higher than on women's assets.[4] Based on this income alone, men pay 4.5 times more in capital tax on foreign capital income compared to women. Despite this difference in capital income, men and women make about the same amount of errors on their accounts.

Table 2. Dividends and interest income including tax errors, number of individuals for men and women, sample.

	Women	Men
Average dividends and interest, SEK	45,562	31,664
Average size of tax error, SEK	6,376	10,037
Share of tax errors	0.58	0.52
Total number of individuals in sample	355	557
Share of of individuals in sample	0.39	0.61

Source: Own calculations.

There is no statistically significant difference in the average error rate or average size of tax error between men and women. The sample is slightly skewed as men with lower dividends and interest are overrepresented in the sample compared to the target population, which may affect the average size of tax error.[5] (See Appendix 1)

[4] T-test shows no significant difference in errors between men and women, with a p-value of 0.18. Also there is no significant difference between the average errors between men and women show with a p-value of 0.12.

[5] The share of men and women are fully representative of the target population. However, the men in the sample had a lower average dividend and interest rate than the women compared to the target population.

Figure 4. Total foreign assets by age groups (2020)

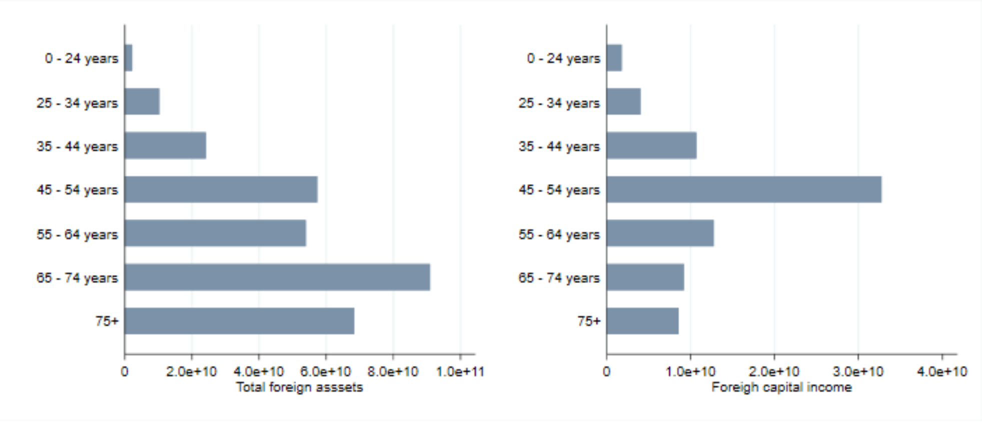
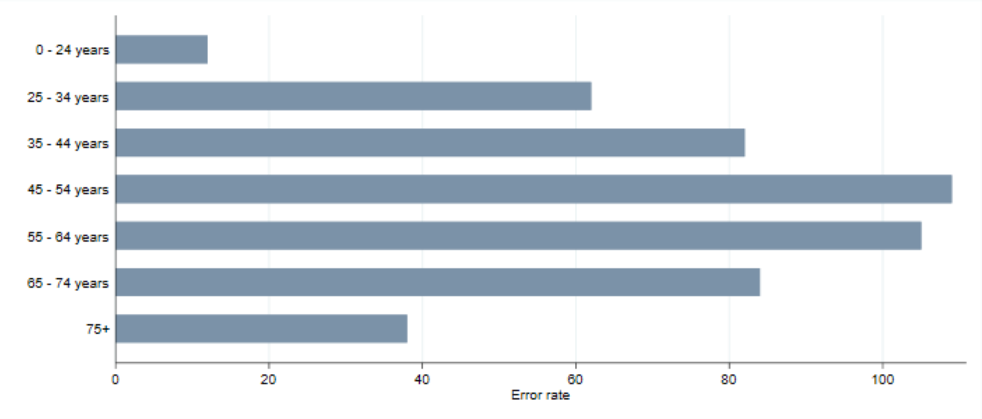
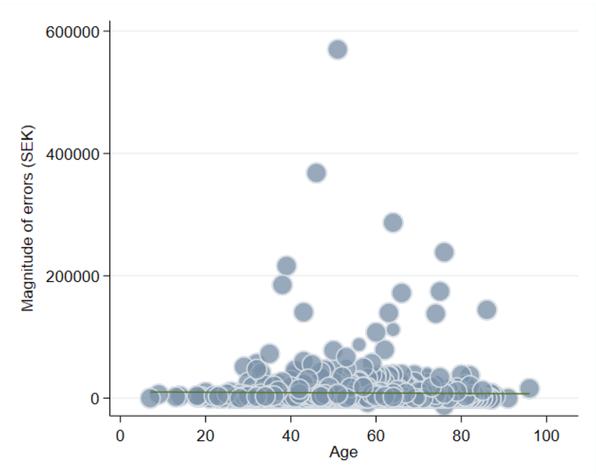


Figure 5. Error rate in different age categories



It is mainly the older population that owns foreign assets, but it is in the middle of the age distribution where assets seem to yield the highest returns. Figure 5 also suggests that the error rate is highest among those with the highest foreign capital income, which seems like a reasonable relationship.

Figure 6. Correlation between tax errors and age in sample



There is no statistically significant linear correlation between age and size of tax error, as also shown in Figure 6. Tax errors appears rather evenly distributed across the age range.

However, there is a statistically significant linear correlation between age and the average error rate, which shows that a larger proportion of younger account holders report tax errors compared to older ones.[6] That is, the difference is significant for account holders under 65 years of age compared to account holders over 65 years of age. For account holders under the age of 65, the average error rate was 62 per cent, while the average error rate for account holders over 65 was 40 per cent (Table 3).

Table 3. Dividends and interest, including errors (SEK), individuals by age categories in sample

Age categories	Average dividends and interest, SEK	Average size of errors, SEK	Error rate	Number of individuals	Share of individuals
0 - 24 years	6,520	2,769	0.80	15	1.6%
25 - 34 years	10,343	6,689	0.69	90	9.9%
35 - 44 years	80,912	10,208	0.63	130	14.3%
45 - 54 years	32,577	12,633	0.66	166	18.2%
55 - 64 years	20,889	9,146	0.54	199	21.8%
65 - 74 years	26,383	4,980	0.40	207	22.7%
75+	68,372	8,811	0.38	105	11.5%
				912	**100.0%**

Source: Own calculations.

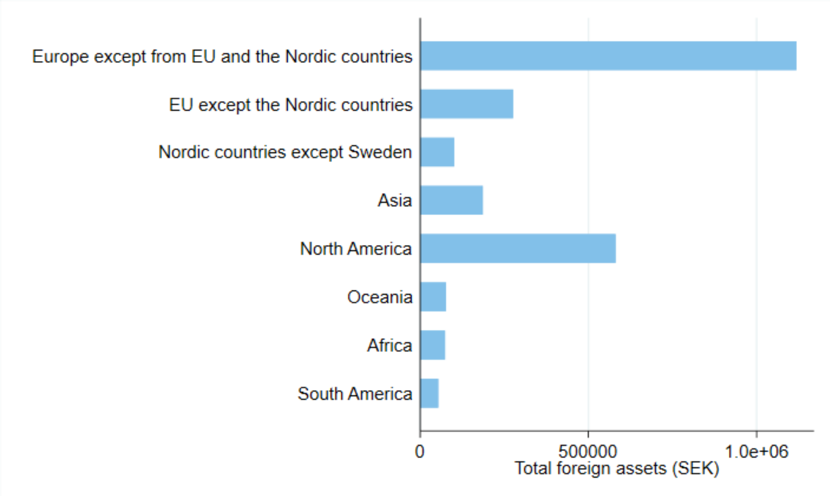
10 per cent of individuals also carry out business activities as sole traders. The three most common activities were forest management, consulting businesses and literary and artistic businesses.

[6] Coefficient of correlation is -0.2081 ($p = 0{,}00$)

2.2 Where are the foreign assets located?

2.2.1 Geographical location

Figure 7. Foreign assets by region, 2020



The overwhelming share of Swedes' foreign capital assets is invested in Europe with around 58 per cent of all accounts are in the Nordic countries other than Sweden. However, the return on assets in Europe outside of the EU and the Nordic countries is greater, with 43 per cent of total dividends and interest. Most of those returns are found in Switzerland.

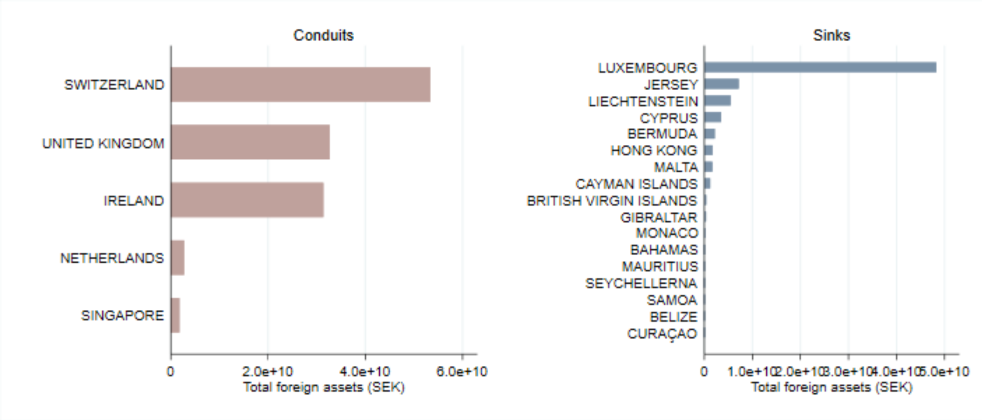
Table 4. Tax error by geographical region in sample

Geographical region[1]	Average size of error (SEK)	Average error rate	Share of accounts
Afrika[2]	0	0.00	0.0%
Asien	3,207	0.44	26.3%
EU utom Norden	4,083	0.46	13.9%
Europa utom EU och Norden	8,381	0.49	11.6%
Nordamerika	3,827	0.51	0.8%
Norden utom Sverige	3,045	0.50	44.8%
Oceanien	3,195	0.49	1.3%
Sydamerika[3]	38,361	0.00	0.0%
			100.0%

Source: Own calculations.

The error rate lies around 45–50 per cent for most regions, which probably indicates that risks are associated with characteristics on a more detailed level, such as individual countries or individual characteristics, rather than large geographical regions. However, more observations per region would be needed to draw firm conclusions.

Figure 8. Foreign assets in low-tax jurisdictions, 2020



About 56 per cent of all income in the sample originates from low-tax jurisdictions. The average income is over seven times higher for these countries compared to other countries. However, Swedes seem to invest their foreign assets specifically in low-tax European countries. Almost a fifth of all foreign accounts and a little over 60 per cent of all assets are in these countries.[7]

Low-tax jurisdictions often specialise in offering corporate and financial services to foreign investors. These services are offered with tax advantages, secrecy and other incentives that entice individuals to place their assets there while they are liable for tax in other jurisdictions. While low-tax jurisdictions have traditionally been identified as small countries with low taxes, they can also be larger, developed countries. Research based on network analysis has identified two categories of low-tax jurisdictions: sinks and conduits (Garcia-Bernardo, Fichtner, Takes, & Heemskerk, 2017).

Sinks are jurisdictions where a disproportionate amount of value 'disappears' from the global financial system. They act as final destinations for capital and assets. Conduits are jurisdictions where a disproportionate amount of value passes through to sinks. Almost 63 per cent of all foreign assets found in low-tax jurisdictions are conduits, mainly in the UK (63 per cent) and Switzerland (20 per cent). According to Alstadsæter et al (2018), Swedes' assets in Switzerland are disproportionately small compared to other countries. Around 70 per cent of all foreign assets in sinks are in Luxembourg and around 6 per cent are in Liechtenstein and Hong Kong.

[7] Bahamas, Belize, Bermuda, Cayman Islands, Curacao, Cyprus, Gibraltar, Grenadines, Hong Kong, Ireland, Jersey, British Virgin Islands, Liechtenstein, Luxembourg, Malta, Mauritius, Monaco, Netherlands, Samoa, Switzerland, Seychelles, Singapore, United Kingdom.

Table 5. Average size of error and capital income, including error rate by low-tax jurisdictions (*sinks* och *conduits*) and Other in sample (unit of observation is accounts)

	Other	**Low-tax jurisdictions**
Average size of error, SEK	3,189	8,393
Average capital income, SEK	8,821	64,644
Error rate	0.62	0.55

Source: Own calculations.

The sample included accounts in five "sinks" and five "conduits". The jurisdictions classified as sinks are Cyprus, Hong Kong, Jersey, Luxembourg and Monaco, and the jurisdictions classified as conduits are Switzerland, the United Kingdom, Ireland, the Netherlands and Singapore. Most of these account holders have placed all their foreign assets in a sink or conduit. Only around 13 per cent of individuals with accounts in low-tax jurisdictions also have accounts in other jurisdictions.

About 15 per cent of all accounts in the sample are located in low-tax jurisdictions (17 per cent in the sampling frame) and the average income is significantly higher in low-tax jurisdictions compared to other jurisdictions (Table 5). About 30 per cent of the total amount from tax errors comes from errors in accounts located in low-tax jurisdictions and the average error rate is significantly higher. Moreover, the average size of error is 2.6 times larger. However, the average error rate is comparable between low-tax jurisdictions and other countries.

3 Concluding remarks

Every year, the Swedish Tax Agency receives around one million tax returns for 500–600,000 individuals. The information covers various types of capital income from almost 100 countries. Total household assets held abroad amount to around SEK 300 billion per year, though over half of the population own less than 10,000 SEK in assets. For these foreign assets, Swedish account holders receive an average of 70 billion SEK per year in interest income, dividends, gross income/redemptions and other incomes. In a random audit of dividends and interest conducted in 2020, it was found that a little over 50 per cent of account holders reported their foreign capital income incorrectly, resulting in 2.4 million SEK in extra tax revenue. The random audit also allowed for a risk analysis of incorrectly declared capital income, which will form the basis for improved and efficient audits in the future.

It is mainly the older population that owns foreign assets, but the middle-aged population has higher returns, so it is mainly this group that constitutes the largest tax base for capital taxation. It is also where most tax errors are found. Around 40 per cent of account holders are women, but men account for around 80 per cent of the capital gains on which capital taxation is based.

The majority of Swedes' foreign capital assets remains in Europe, particularly Switzerland, which is a so-called low-tax jurisdiction. But large amount of assets are also held in the UK and Luxembourg. One fifth of all foreign accounts and just over 60 per cent of all assets are found in low-tax jurisdictions.

It seems like the number of Swedes with foreign capital income is increasing and audits have shown that around 50 per cent of the target population commit tax errors. It is therefore important to analyse the effects of the audits in order to understand the sources of such errors and possibly consider appropriate interventions, such as information campaigns.

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