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RIGSREVISIONEN

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The taxation of shares

1. Introduction and conclusion

1.1. Purpose and conclusion

1. This report concerns the Ministry of Taxation's effort to ensure correct taxation of shares owned by individual citizens and companies.

2. Many citizens and many companies own and trade in shares. As a general rule, all citizens are required to pay tax on dividends and capital gains from the sale of shares, whereas losses on disposal of shares are deductible from their income. Companies are also required to pay tax on dividends and annual changes in the prices of quoted shares, if their shareholding is less than 10%.

3. The Danish Tax Agency (Tax Agency) receives an increasing amount of data from banks and others (third parties), which the agency use to calculate tax. Since 1 January 2010, the banks have been required to report data on purchase and sales sums relating to trading in quoted shares held by custodian banks in Denmark. Since 1 January 2016, the banks are also required to report data on purchase and sales sums relating to trading in unquoted shares held by custodian banks in Denmark. Tax liable citizens have an obligation to disclose all relevant information about their income in their annual tax statements, if the Tax Agency does not already have access to this information. Companies are required to report data on the company's financial statements in a form, which, however, does not include information on shareholdings.

Quoted and unquoted shares
Trading in shares can take place on either a regulated market or an unregulated market. Trading on a regulated market takes place on the stock exchange, whereas trading on an unregulated market takes place on unregulated trading platforms such as, for instance, First North.

When shares have been listed for trading on a regulated market, they are referred to as quoted shares, whereas shares that are not listed for trading on a regulated market are referred to as unquoted shares.

4. The rules governing taxation of securities, including shares, are complex, and according to the Tax Agency, many taxpayers are not familiar with or understand the rules. Many taxpayers are also under the impression that the Tax Agency already has the information. Ensuring that the taxpayers pay the correct tax on their shares is therefore a key task for the Tax Agency.

5. The purpose of the study is to assess whether the effort made by the Ministry of Taxation to ensure correct taxation of shares has been adequate. The report answers the following questions:

- Has the Tax Agency's effort directed towards citizens been adequate in ensuring correct taxation of shares?
- Has the Tax Agency's effort directed towards companies been adequate in ensuring correct taxation of shares?

Rigsrevisionen initiated the study in January 2019.

Conclusion

It is Rigsrevisionen's assessment that the Ministry of Taxation's effort has not been entirely adequate to ensure correct taxation of shares owned by individual citizens and companies. The Tax Agency has automated large parts of the taxation of quoted shares owned by individual citizens. Quoted shares are estimated to make up more than 95% of all shares owned by individual citizens. The Tax Agency can improve its effort in the areas of taxation that are not automated. The Tax Agency is not using the information provided by the banks in its calculations of capital gains and losses on the disposal of unquoted shares held by citizens. The information provided by the banks is used by the Tax Agency in the subsequent control, which is, however, limited in scope. In the corporate tax area, the Tax Agency lacks the basic knowledge required to be able to organise and implement an adequate effort. In consequence, the Tax Agency is not fully able to ensure that the citizens and, most notably, the companies pay correct taxes on their shares. This means that the state's coffers risk losing tax revenue, but also that some citizens and companies risk paying too much tax. The Tax Agency has estimated the potential losses to the state derived from taxation of securities owned by the citizens at DKK 503 million annually (the tax gap), which corresponds to approx. 2% of the annual state revenue generated from the citizens's share dividends and capital gains on sale of shares. The estimate, which was prepared prior to the agency's implementation of any control measures, is, however, incomplete and subject to uncertainty, and it is Rigsrevisionen's assessment that the potential losses can be bigger.

Today the calculation of capital gains and losses on disposal of shares held by *citizens,* which covers approx. 86% of the market value of all quoted shares, is fully automated. From an economic point of view, this is the most important area and most of the data on quoted shares that the Tax Agency receives from third parties is thus being fully utilised. The Tax Agency is not currently able to carry out a fully automated tax assessment for the remaining approx. 14% of the quoted shares. The reason is that the agency lacks information about these shares. Furthermore, unquoted shares and shares held in custody by banks abroad are not taxed unless the citizens file this income. The Tax Agency does not have a complete overview of the number of unquoted shares and shares in foreign companies the citizens own.

The study also found that the Tax Agency has information on the sale of unquoted shares that it does not use to calculate capital gains and losses on the disposal of unquoted shares. The purpose of the implementation of mandatory disclosure by banks on 1 January 2016 was for the Tax Agency to use the reported information to ensure automated calculation of tax on capital gains and losses on disposal of unquoted shares. Moreover, approx. 60% of the citizens are not reporting this information, when the Tax Agency sends out the annual tax returns and asks the citizens to report information on capital gains and losses on disposal of quoted shares held by custodian banks in Denmark. The Tax Agency has not followed up on the extent to which the citizens report capital gains and losses, nor has the agency looked into the reasons behind the citizens' failure to report this information. In consequence, not all citizens pay taxes on capital gains or deduct their capital losses.

The Tax Agency has not adequately monitored losses on disposal of shares reported by the citizens in connection with the annual tax return. This entails a risk that citizens who report and deduct losses on disposal of shares without being entitled to do so, go undetected. Furthermore, the Tax Agency's knowledge of the citizens' tax compliance is insufficient, which means that the agency has an inadequate basis for focusing its control effort on the areas where compliance is lowest.

In the period from 2013 to 2018, the agency's control and guidance activities aimed at citizens owning shares were focused on the sale of quoted shares. The Tax Agency has only to a limited extent checked the sale of shares held in foreign custody, and whether the citizens have reported the correct data in their tax returns.

The Tax Agency's knowledge of *companies'* tax compliance is not sufficient. It is the Tax Agency's assessment that the risk of incorrect taxation of shares owned by companies is low considering that most companies are not liable to pay tax on capital gains. The Tax Agency has not regularly monitored whether the companies classify taxable shares as tax exempt, despite the fact that this represents the greatest risk of incorrect taxation in the area, according to the agency. Moreover, in the period from 2013 to 2018, the Tax Agency's control effort directed at companies has only to a limited extent included taxation of shares. To some degree, the effort has addressed tax on dividends, but the Tax Agency has not carried out checks of changes in the exchange rates of shares subject to tax and owned by companies. It is Rigsrevisionen's assessment that considering the value of the shares held by companies, the risk that even a few errors add up to substantial amounts is significant.