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The government's opposition to the digital services tax jeopardizes the Swedish economy

The EU failed on Tuesday to reach consensus on an EU-based digital services tax. Sweden is one of the tax's main opponents, but the government's action actually leads to what it says it wants to avoid - that the world is moving in the direction of destination-based corporate tax rules, writes Torsten Fensby.

With Tuesday's Council vote, the European Commission's original proposal for a digital services tax and all subsequent compromise proposals have now in practice been declared dead.

In the past year, Sweden has been one of the digital services tax's main opponents. The Government considers the proposal to be contrary to established international tax law principles because the tax, in contrast to traditional corporate taxation, is destination-based and levied on a gross basis.

The Nordic finance ministers (Denmark, Finland and Sweden) have also warned in a joint statement that the Commission's proposal for a digital services tax may lead the world toward the development of destination-based corporate taxes. If the digitalization of the global economy requires adjustments to the international framework in the field of taxation, these issues should, according to the finance ministers, be addressed and resolved at a global level under the umbrella of the OECD.

The Swedish government’s position on the issue may at first sight appear reasonable. international developments in the direction toward destination-based corporate taxes would be deeply detrimental to both Swedish multinational industry and the Swedish tax base. The industry's global tax burden would increase (probably dramatically) and our country's tax base would shrink because our domestic market is so vanishingly small.

Furthermore, there is a great risk that Sweden would eventually be deindustrialized. If the majority of Swedish multinational industry's income in the future is taxed in large consumer markets such as the US, China and India, Swedish R&D and production would gradually move to those countries because the industry would want to report the costs where income is taxed.

So, can Sweden now take a victory lap and celebrate having successfully killed the Commission proposal? Hardly. The Government's handling of these issues is rather testimony of its lack of understanding of the the dynamics of global tax policy.

First, it is far from obvious that the proposed digital services tax is destination-based. Critics of the digital tax would like to present it as a tax on consumption, but it can just as easily be regarded as a tax on a factor of production because the users participate in the construction of the product.

The government's critical mistake, however, is that it has blocked the proposal in the hope of getting a better deal at the OECD. But today the OECD is dominated by countries such as the US, Japan, China and India, all of which have huge domestic markets and everything to gain from steering global developments toward destination-based corporate taxes.

It is therefore no surprise that the proposals for new international tax rules presented by the OECD in February go in the direction of destination-based corporate rules. On top of this, Germany and France, enthusiastically encouraged by the United States, are also proposing a global minimum tax on corporate income, which would undermine the ability of small countries to compete for foreign investment in the tax field.

Sweden's blocking of the digital services tax in the EU has thus provoked exactly what the government wanted to avoid, i.e., that the world is moving in the direction of destination-based tax rules. At the same time, several EU countries are now deciding to adopt their own national digital services taxes, which will result in the EU getting a patchwork of such taxes with different contents.

Tax managers at Swedish multinational enterprises must reasonably ask themselves how the government handles these issues.

After almost 100 years of faithful service, the international tax framework is gradually becoming obsolete and must be replaced with a new one adapted to today's globalized and digitalized environment. This process will continue for many years to come.

Instead of just saying no to everything that in the present time appears to be contrary to Swedish interests, the government should consider what it wants the international tax rules to look like ten years down the road, and develop a long-term strategy for how Sweden is going to impose its vision in the OECD and in other international fora.

Small states, which normally have limited ability to influence international tax policy, can do wonders during periods of political uncertainty when both established rules and institutions are undergoing transformation. If the Swedish government acts proactively with a defined strategy, it will be able to greatly influence the design of future international tax rules in relevant regional and global fora.