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In this article, the authors discuss Mexico's new regime for taxing digital services that takes effect June 1, including the obligations it places on both resident and nonresident digital platforms and digital intermediaries that provide services to residents of Mexico.

Along with much of the world, Mexico has been rapidly digitalizing its economy. The relentless growth of major market players within the digital economy — including digital platforms — is reshaping supply and demand channels and changing the way Mexican consumers interact with suppliers of goods and services.

Unfortunately, the disruptive nature of digital platforms has had a negative impact from a tax revenue perspective. From the standpoint of the users of digital platforms, even though the laws already taxed the activities that they were carrying out through these digital platforms, these taxes were not being effectively collected by the authorities, in part because of the challenge of auditing digital activities. From the digital platform's perspective, Mexican legislation, much like the laws in other countries, did not create a nexus that would allow Mexico to tax digital services rendered by a nonresident that did not have physical presence in the country.

Therefore, to address the challenges raised by digitalization and mitigate its impact on tax revenue, the executive branch submitted an initiative — notably, a regime developed in accordance with the OECD's base erosion and profit-shifting project — to Congress as part of the 2020 economic package. Congress approved the new legal framework regulating digital services and published it in the federal official gazette on December 31, 2019. The regime will enter into force on June 1.

Overview of the Digital Services Regime

Based on BEPS action 1, the new tax regime is intended to reinforce the effective collection of income tax and VAT from individuals (users) taking part in the sharing economy through digital platforms. The new mechanism facilitates compliance with existing taxes — namely, income tax and VAT — on transactions that are now taking place on digital platforms by having the platforms withhold the taxes owed.

As part of the new regime, individuals who obtain income through digital platforms will be eligible to opt in to a simplified, *de minimis* regime that will consider the withholdings made to be definitive payments. Also, if other requirements have been met, the simplified regime will subject direct payments from users to preferential, progressive tax rates specified in the initiative.

For digital platforms, residents and those nonresidents that do not have a permanent establishment in Mexico will have to comply with new tax obligations, which will be further analyzed below.

This does not mean that nonresident digital platforms will merely be a revenue-collection vehicle for the tax authorities. Nonresidents will be required to pay VAT on consideration deriving from rendering digital services, albeit no income tax will be owed on that consideration until there is an international consensus regarding how to tax those transactions.

VAT Law

General Digital Services

The definition of digital services applicable to the whole regime is included in the VAT law. Digital services must be rendered through applications, the internet, or any network; must be fundamentally automated — whether or not the

services require some human intervention; and consideration must be given in return for the services.

Specifically, digital services include — and are limited to — the following:

- downloads of or access to images, text, information, video (including movies), audio (including music), games, and gambling, as well as any other multimedia content (with the exception of electronic books, newspapers, and magazines);
- intermediation between third parties offering goods or services and those demanding them (excluding the sale of used goods);
- online clubs and online dating webpages; and
- distance learning, tests, or quizzes.

The recipient of digital services will be deemed to be located in Mexico if:

- he gives the service provider an address in Mexico;
- he pays the service provider using an intermediary in Mexico;
- the IP address that his electronic devices uses is in Mexico; or
- he provides the service provider a telephone number with a Mexican country code.

Nonresidents without a PE in Mexico that provide digital services to recipients in Mexico must fulfill several obligations, including:

- registering for a tax identification number;
- paying a 16 percent VAT rate on the consideration received (commission) and remitting taxes monthly using a tax return;
- keeping a record of information related to their services;
- appointing a legal representative in Mexico; and
- issuing payment receipts to the recipients of the digital services.

Although the law includes specific provisions for nonresidents without a PE in Mexico, it is important to reiterate that resident platforms that provide digital services to Mexican recipients will also need to comply with the obligations set forth by this regime.

Intermediation in Digital Services

Nonresidents without a PE in Mexico that provide digital intermediation services will be required to withhold 50 percent of the VAT — that is, they must withhold 8 percent — on behalf of individuals that sell goods, render services, or grant the temporary use and enjoyment of goods using the intermediary's services. Thus, the legislation effectively substitutes the intermediary for the seller or the service provider to fulfill some tax obligations. If the individual does not provide their taxpayer identification number, withholding agents must withhold the full amount of the VAT rate (16 percent) instead.

The applicable legislation sets forth additional obligations for intermediaries. Under the regime, intermediaries must:

- issue digital invoices to those individuals on whose behalf the intermediary makes withholdings;
- register for a TIN as a withholding agent; and
- by the 10th day of each month, provide the tax authorities with the following information regarding their clients' operations (that is, those transactions in which the taxpayer acted as an intermediary):
 - name (individual or corporate);
 - TIN;
 - personal identification number;
 - tax address;
 - bank account information;
 - transaction amounts; and
 - if the client is rendering lodging services through the digital platform, the relevant real property address.

A simplified regime is available for VAT purposes when specified requirements and obligations are met and the income that a particular seller or service provider obtains through the intermediation platform does not exceed MXN 300,000 (about \$12,000) annually. Those eligible may opt to consider the VAT withheld to be a definitive payment.

Income Tax Law

Under the digital services regime, individual taxpayers who sell goods or render

intermediation services via the internet, digital platforms, software applications, or similar media must pay tax on the income they obtain through those platforms. Resident legal entities, nonresidents (with or without a PE in Mexico), and other foreign entities or legal vehicles that, directly or indirectly, provide such digital platforms must withhold tax. This withholding must be based on the total amount of income that individual users effectively obtain through the platforms (not including the corresponding VAT). This will not be considered a definitive payment unless specific conditions are met.

The applicable withholding tax rates vary based on the type of activity and the amount of income that the individual platform user obtains each month. For example, for ride-hailing services and the delivery of goods, preferential rates of between 2 and 8 percent apply on income ranging from MXN 5,500 to more than MXN 21,000. For lodging services, rates from 2 up to 10 percent apply to income ranging from approximately MXN 5,000 to over MXN 35,000. For the sale of goods or rendering of services, rates from 0.4 to 5.4 percent apply to monthly income from approximately MXN 1,500 up to over MXN 100,000.

A simplified, *de minimis* regime is also included. Individuals operating through platforms that receive part of their income directly from users (that is, not *through* the platform) but who do not earn more than MXN 300,000 annually may opt to pay their income tax directly using the aforementioned rates and consider those amounts to be definitive payments if some requirements have been met. The amounts withheld from taxpayers will be creditable. Individuals who opt for the simplified regime will not be able to take deductions for activities performed through digital platforms and must fulfill specific obligations such as issuing digital invoices, filing a notice with the tax authorities informing them of the decision to exercise this option, and being locked into the regime for five years.

Likewise, resident legal entities, nonresidents (with or without a PE in Mexico), foreign entities, and legal vehicles that directly or indirectly provide the use of digital platforms, applications, and similar services will have specific obligations

under the Mexican Income Tax Law. These include registering for a tax ID, issuing digital invoices, sharing user data with the tax authorities, and submitting withheld taxes via a monthly tax return.

It is important to keep in mind that if individuals who obtain taxable income in accordance with this section do not provide the withholding agents (digital platforms) with their TIN, then the platforms must withhold a general 20 percent tax rate instead of the progressive tax rates detailed above.

Other Considerations

Although the tax authorities have published regulations to shed some light on some practical compliance issues raised by parties working in the digital sector that have been directly affected by the regime, several gray areas remain from an implementation standpoint. Hopefully, the tax authorities will soon publish regulations addressing these issues.

The new regime attempts to level the playing field between Mexican and nonresident digital platforms, as well as between parties carrying out business activities in the digital economy and the traditional economy, from a revenue-collection perspective.

This is a good opportunity for individuals and digital platforms to plan so that they can fully comply with their new obligations once the regime takes effect in June. Digital platforms have a relatively short amount of time to catch up and add various elements to their systems to allow them to comply with the obligations set forth by the regime. Likewise, contracts will have to be adapted to fit the new regime — as will privacy policies, terms and conditions of use, and data protection clauses, along with a wide range of other documentation.

However, if any of these adjustments would cause irreparable damage to a taxpayer's operations to the point that its fundamental rights are transgressed, the taxpayer should be able to challenge the measures. In other words, if the issues that arise from the implementation of the obligations provided by the regime are not manageable from an operational perspective, legal grounds exist to challenge its constitutionality via an *amparo* procedure before the competent authorities.

In conclusion, through the digital services regime, Mexico's tax authorities have shifted a heavy administrative burden — responsibilities that include both tax collection and data-related obligations — to the digital platforms. Multinationals must adapt their existing systems to comply with the new rules of the game. ■

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