

Mexico Imposes Digital Services Tax on Online Activities

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Possible Future Risk for U.S. Financial Services Companies

Global digitalization spurred by rapid advances in digital technology is enabling virtual business operations at a frenetic pace, including by insurance and other U.S. financial services companies. Without the need for physical presence or infrastructure in a specific jurisdiction, technological platforms facilitate the delivery of services on a worldwide basis, posing challenges to taxing authorities in collecting tax from online activities such as streaming services like Netflix, and digital intermediation services like Amazon (where the digital intermediation leads to the sale and purchase of goods) or Expedia (where the digital intermediation leads to the sale and purchase of services).

To address the tax revenue shortfall arising in connection with digital services provided to a Mexico-based user, Mexico enacted chapter III-Bis on Title I of the Value-Added Tax Law effective June 2020.

This regulatory scheme imposes a value-added tax (VAT) on widely popular streaming services in Mexico, such as movies, music, and games, and digital intermediation services for Mexico-based users provided by companies located both in and outside Mexico. Historically, Mexican companies were subject to VAT on the services they provided (which implicitly included digital services), but now, Mexican companies providing digital services are specifically subject to VAT under this new chapter.

A person will be considered a Mexico-based user if the person (individual or company) meets any of the following criteria: (a) the user has an address in Mexico; (b) payment for the service is made by a Mexican bank; (c) the company providing the service has an IP address located in Mexico; and/or (d) the user has a phone number with a Mexico area code.

For digital streaming providers, the digital VAT is 16% on the price of the services provided and applies to both foreign technology platforms without a permanent establishment in Mexico (that were not subject to tax before this amendment) and Mexican digital streaming providers. In connection with digital intermediation services, the digital VAT is 8%, if the offeror of the good or

service is an individual registered with the Mexican tax authority as a person with entrepreneurial activities, or at a rate of 16%, if the offeror of the good or service is an individual without a Mexican taxpayer identification number.

The VAT on the transaction is charged to the Mexico-based user of the services (i.e., the VAT is added to the cost of the services provided), and typically the digital provider withholds the VAT and remits it to the Mexican tax authority.

Failure to withhold and pay the VAT may result in the Mexican tax authority notifying the local telecommunications operator to temporarily block access to the digital service until the obligations of the digital service provider are satisfied.

U.S. financial services companies operating in a digital cross-border context are not subject to this digital tax yet, but a similar regulatory scheme likely will be considered and perhaps extended in the future to insurtech services.

Authored By



Thomas F. Morante

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