

Update to the labor outsourcing initiative

Tax | Labor – December 10, 2020

The discussions regarding the initiative proposed by the Federal Executive on 12 November 2020 to prohibit labor outsourcing, save for certain exceptions, has been postponed to be resumed in February 2021. However, companies should continue analyzing their alternatives to comply with the potential reform.

This *alert* aims to provide an update to our clients on the status of the initiative.

I. Background

On 12 November 2020, the Federal Executive submitted a Law initiative before the Mexican Congress containing several reforms to the Federal Labor Law ("FLL"), the Social Security Law ("SSL"), the National Housing Fund Institute for Workers Law ("LINFONAVIT"), the Federal Fiscal Code ("FFC"), the Income Tax Law ("ITL") the Value Added Tax Law ("VATL") with aims to regulate the labor outsourcing ("outsourcing") regime in Mexico.

The initiative filed by the Federal Executive would affect the operation of Mexican companies since it would eliminate the possibility of having an "insourcing" or a service company within the same group, or contracting with "*outsourcing*", even though de same had been in due compliance with their tax and social security obligations. Generally, the proposal consists in the following:

- Labor outsourcing schemes would be legally prohibited (i.e. a general labor outsourcing structure or an "insourcing" structure would no longer be permissible).
- The provision of specialized services or the execution of specialized tasks not included within the corporate purpose or the economic activity of the contracting party would be the sole exception.
- The contractor would need to procure an authorization from the Labor and Social Security Ministry to operate as a specialized labor services supplier.

- Any party either continuing to use a subcontracting regime, rendering specialized services without due authorization, or contravening the provision of specialized services or tasks, would be subject to a fine.
- For tax purposes, it is generally established that tax invoices issued to document labor outsourcing services will not produce any tax effects (i.e. the expense would not be deductible from the income tax basis and the VAT credit would be disallowed), unless it is specialized.
- The use of schemes involving the simulation of the provision of specialized services or the execution of specialized tasks, as well as the implementation of labor outsourcing schemes, would qualify as tax fraud or a comparable offence.

For further details, please refer to our "[Client Alert](#)" previously published in this respect.

II. Recent developments

Since its remittance to Congress, the initiative filed by the Federal Executive has been subject to negotiations between the private sector and the Federal Executive, and recently, the labor sector. Such negotiations have resulted in the execution of a tripartite agreement on 9 December 2020 which main items in the agenda are the following:

- It has been requested to Congress to postpone the discussions on the initiative filed by the Federal Executive in order to resume such discussions preferably in the next ordinary legislative period, that is on February 2021. It being a priority in the agenda, the discussion should conclude within 30 days, in which case this process could result in legislative changes in March 2021.
- We understand that, as of today, no consensus has been reached on whether the initiative would be enforceable as of its publication in the Official Gazette or whether a transition period would be granted for its enforcement.
- Jointly with the referred initiative, discussions have arisen within the private sector to propose a new mechanism to regulate the profit sharing (*Participación de los Trabajadores en las Utilidades* or PTU) to which employees are entitled, which currently amounts to 10% of the Income Tax taxable basis. From several communications that have been published in the media, we understand that the proposal of the private sector consists of limiting the PTU to certain number of months of salary of the employee. The lack of consensus as to this point has been one of the main reasons for the prolongation of the negotiations. Although it is preferable that the private sector, the Mexican government and the labor sector reach an agreement, the possibility that no such agreement is reached is of course existent, in which case such scenario shall be considered by each company in the assessment of the measures to be considered.

- It is worth noting that certain entrepreneurial chambers did not subscribe to the tripartite agreement previously mentioned, and we also understand that there is certain foreign pressure to continue allowing labor outsourcing of personnel in Mexico as it is permissible in other parts of the world. It will be important to follow up on the evolution of the initiative to be finally approved, considering the effect that these postures may or may not produce.

III. Recommended course of action

If an initiative limiting labor subcontracting is approved in similar terms to those currently proposed, in general terms, entities operating in Mexico would need to conduct their activities with their own employees.

The tripartite agreement to which we have referred would seem clear in the sense that the initiative should be discussed and, as the case may be, approved within the month of February 2021. Derived from the foregoing, we consider that although the discussion has been postponed to the first months of the coming year, it is important to start analyzing any viable alternatives with aims to complying with the potential reform in the most efficient way from a tax and labor standpoint, considering a scenario in which no transition would be granted for its enforceability.

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