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Labor, Social Security and Tax Practice Group Joint Newsletter



Reform to the subcontracting regime law in Mexico

On April 23, 2021, the amendment that regulates the subcontracting regime in Mexico was published in the Official Gazette of the Federation, reforming various provisions of the Federal Labor Law ("FLL"), Social Security Law ("SSL"), INFONAVIT Law, Federal Fiscal Code ("FFC"), Income Tax Law ("ITL") and the Value Added Tax Law ("VATL"), Federal Law of Workers at the Service of the State, Regulatory of Section B) of Constitutional Article 123, Regulatory Law of Section XIII Bis of Section B and Article 123 of the Constitution.

Below is a summary of the main changes and relevant aspects of the amended laws:

a. Reforms to the FLL

- » The subcontracting of personnel is prohibited, subcontracting being when a natural or legal person provides or makes available their own workers for the benefit of another.
- » The subcontracting of specialized services or the execution of works that are not part of the corporate purpose or the predominant economic activity of the beneficiary will be allowed, as long as the contractor is registered in the public registry of the Ministry of Labor.
- » Similarly, complement or shared services or works within the same business group ("shared services" or "back office") are allowed, and are also considered to be specialized as long as they are not part of the corporate purpose or the preponderant activity of the beneficiary company.
- » It is established that employment agencies or intermediaries may only participate in recruitment, selection, and training, and certain other services. These will not be considered employers, since such character is held by the beneficiaries of their services.
- » Individuals or legal entities that provide subcontracting of specialized services or works must be registered before the Ministry of Labor. The registration must be renewed every three years.
- » Subcontracting must be formalized by a written agreement establishing the purpose of the services to be provided or the works to be executed, as well as the approximate number of employees who will participate in the fulfillment of the purpose.
- » The beneficiary will be jointly responsible if the

services provider fails with its labor and social security obligations.

- » For an employer substitution to take effect, the assets that are the object of the company or establishment must be transferred to the substitute employer. However, there will be an exception period of 3 months from the entry into force of the reform, where such requirement will not be necessary.
- » The amount of the profit sharing will have a maximum limit of 3 months of the worker's salary or the average of the participation received in the last 3 years, applying the amount that is most favorable to the worker.
- » The fines for providing subcontracting services or receiving such services will be from 2,000 to 50,000 times the Unit of Measurement and Update ("UMA"). The same fine will be applied to the provider of specialized services or that executes specialized works, without the authorization of the Ministry of Labor.

In accordance with the First Transitory Article, the amendment entered into force the day following its publication in the Official Gazette of the Federation, that is, on April 24, 2021.

The Ministry of Labor must issue the general provisions for the registration of specialized service providers within 30 calendar days following the entry into force of the amendment.

Individuals or legal entities that provide subcontracting services must register before the Ministry of Labor within 90 calendar days from the publication of the general provisions.

b. Reforms to the SSL

- » As regards social security, the subcontracting regime is also eliminated. There is still the possibility of providing services and executing specialized works where there will be joint and several liabilities between the contractor and the beneficiary for breach of social security obligations. The contractor must inform the Mexican Institute of Social Security ("IMSS") every four months of the contracts entered into, as well as information on his personnel.
- » The fine for not submitting information to the IMSS by specialized service providers, or doing so outside of the established deadlines, is 500 to 2,000 times the UMA.

In accordance with the Transitory Articles, the employers who, prior to the entry into force of

the amendment, had requested of the IMSS the assignment of one or more employer registers per class to register their employees, will have a period of 90 calendar days counted from the entry into force of the amendment to terminate said employer registers and, if appropriate, request that an employer register be granted in terms of the provisions of the Regulations of the Social Security Law regarding Affiliation Classification of Companies, Collection and Inspection. Once this period has concluded, those employer records that have not been canceled will be canceled by the Social Security Institute.

c. Reforms to the INFONAVIT Law

- » Companies that have already obtained the registration before the Ministry of Labor are obliged to provide to INFONAVIT every four months information on the contracts they have entered into, object and period of validity, relationship of workers indicating their CURP, social security number and base salary for contribution, as well as the name and federal taxpayer registry of the beneficiary of the services.

d. Reforms to the FFC

- » Labor subcontracting is deemed to exist when a contractor provides its own employees for the benefit of a third party, or when the employees are made available to such third party.
- » It is prohibited to give tax effects to payments made for outsourcing services.
- » The provision of specialized services or the execution of specialized works that are not related to the corporate purpose of the beneficiary, or the predominant economic activity of the beneficiary, will be allowed.
- » A new assumption of joint and several liability is established for the contracting parties, in order to guarantee the payment of the taxes related to the contractor and the workers with whom the service is provided.
- » Failure to deliver information by the contractor as required by the ITL and the VATL, would be sanctioned with fines from \$150,000 to \$300,000 pesos for each breach related to the delivery of unfulfilled information.
- » Any type of act that involves prohibited labor outsourcing schemes or simulated specialized services would be treated as a crime of tax fraud.

e. Reforms to the ITL and VATL

- » The consideration payable for labor subcontracting services will not produce tax effects for the recipient, no income tax deduction nor VAT credit would be allowed.
- » Payment for specialized services or works would be allowed as deductible expenses for income tax and value added tax, when the service providers provide the following information:
 - ◇ Proof of the current registration before the Ministry of Labor as specialized service or work provider;
 - ◇ Internet Digital Tax Receipt ("CFDI") regarding the payment of wages to the workers who have provided the service or executed the specialized work, showing the amount of income tax withheld;
 - ◇ Tax return that reflects the payment of income tax withholdings made to said employees;
 - ◇ Tax return that reflects the payment by the Contractor of the VAT paid by the recipient of the service; and
 - ◇ Proof of the payment of worker-employer fees made to the IMSS, as well as payment of the contributions to INFONAVIT, corresponding to the workers involved in the provision of services.
- » The obligation to withhold 6% VAT for personnel services is repealed when they are made available to the contractor.

In accordance with the First Transitory Article of the amendment, changes to tax laws will enter into force August 1, 2021.

f. Conclusions

Given the entry into force of the Reforms to the subcontracting regime, it is necessary for all companies to carry out a diagnosis in order to identify personnel subcontracting schemes, provision of specialized services, payment of profit sharing, and to know the financial impact on their operations of the new regulatory framework.

It is important to make the applicable contractual and business model modifications to avoid relevant sanctions that are now introduced in various laws.

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