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Congress approves new rules on Outsourcing and Insourcing

On April 13, 2021 and April 20, 2021, the Chamber of Representatives (*Cámara de Diputados*) and the Chamber of Senators (*Cámara de Senadores*), respectively, approved, with some amendments, the initiative submitted by the President of Mexico on November 12, 2020 (the “Initiative”) to reform the subcontracting regime regulated by the Federal Labor Law, Social Security Law, National Workers Housing Fund Law, Federal Tax Code, Income Tax Law and Value Added Tax Law.

The Initiative aims to (i) protect labor rights, (ii) eradicate illegal subcontracting schemes, (iii) impose more rigorous conditions to permitted outsourcing and insourcing structures, (iv) ensure that all employers comply with their relevant labor, social security and tax obligations and (v) ensure an effective tax collection.

The following is a summary of the most relevant issues included in the text of the Initiative:

Federal Labor Law

- As a general rule, subcontracting of personnel (via outsourcing or insourcing structures) is prohibited.
- Outsourcing structures are permitted for the subcontracting of specialized services or work that fall outside the corporate purpose or main economic activity of the contracting party, provided that the specialized services or work provider is registered, as described below.
- Insourcing structures are also permitted for the subcontracting of complementary or shared services or work among companies of the same business group, to the extent such services or work fall outside the corporate purpose or main economic activity of the contracting party.
- The subcontracting of specialized services or work shall be formalized in writing.
- Any specialized services or work provider needs to be registered before the Ministry of Labor and Social Security (“STPS”), which registry will need to be renewed each 3 years. The authority may deny or cancel the registration of any party that fails to comply with the requirements set forth by the Federal Labor Law. In case of administrative silence in connection with the request for registration, the registration shall be deemed as granted.
- The contracting party will be jointly liable for the labor obligations of the specialized services or work provider in case the latter does not comply with such obligations, with respect to the personnel used in the performance of the relevant specialized services or work during the time they were rendered.
- Employees’ profit-sharing (“PTU”) paid to each employee will be limited to the higher amount between: (i) 3 months of salary of the relevant employee; and (ii) the average of PTU received by such employee in the last 3 years.

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- Establishes more severe sanctions for those who (i) hire in violation to the new subcontracting rules (*i.e.*, (y) specialized services or work that do not fall outside the corporate purpose or main economic activity of the contracting party or (z) specialized services or work providers that are not registered before the STPS) or (ii) provide specialized services or work without being registered before the STPS.
- Provides a term of 90 days so that any party with subcontracted personnel that do not meet the new provisions of the Initiative directly hires such subcontracted personnel.

Social Security Law

- The contracting party will be jointly liable for the non-compliance by the services or work provider of its social security obligations.
- Specialized services and work providers shall deliver to the Mexican Social Security Institute, no later than the 17th day of January, May and September, the information of the specialized services and work agreements entered into during the relevant 4-month period.

National Workers Housing Fund Law

- Similarly, the contracting party will be jointly liable for the non-compliance by the services or work provider of its obligations before the National Workers Housing Fund.
- In case of an employer substitution, the substituted employer will be jointly liable with the new employer of obligations established in this law arising within a 3-month period before the substitution, and thereafter, all obligations will be attributable to the new employer.
- Specialized services and work providers shall deliver to the National Workers Housing Fund, no later than the 17th day of January, May and September, the information of the specialized services and work agreements entered into during the relevant 4-month period.

Federal Tax Code

- Deduction (for income tax) and credit (for VAT) are denied in connection with payments for subcontracting personnel to carry out activities related with either the corporate purpose or the main economic activity of the contracting party.
- Such deduction and credit effects will also be denied when: (i) the related employees originally worked for the contracting party and were transferred to the provider by any legal means; and (ii) the referred employees cover the main activities of the contracting party.
- Accordingly, deduction and credit effects will be allowed in connection with payments for subcontracting of specialized services or work that are not part of the corporate purpose or the main economic activity of the contracting party, provided that the specialized services or work provider is registered before the STPS and all other applicable requirements established in the Income Tax Law and the Value Added Tax Law are met, respectively.
- Insourcing, as established in the Federal Labor Law, will also be allowed for tax purposes.
- The contracting party will be jointly and severally liable, together with the specialized services or work provider, of any taxes triggered with respect to the related employees.
- Failure by the specialized services or work provider to provide to the contracting party the information and documentation required by the Income Tax Law and Value Added Tax Law (which is described below) will give rise to penalties.

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- Deducting or crediting without complying with the requirements set forth in the Income Tax Law and Value Added Tax Law, will be considered as an aggravating conduct for purposes of the Mexican tax authorities establishing the corresponding penalties.
- “Qualified” tax fraud will exist when schemes are used to simulate permitted subcontracting, or when prohibited subcontracting is hired.

Income Tax Law

- In order to claim the corresponding deduction, the contracting party, when making payments for permitted subcontracting, is obliged to: (i) verify that the relevant specialized services or work provider is duly registered before the STPS; and (ii) obtain from such provider a copy of: (1) the tax invoices issued for the payment of salaries to the relevant employees; (2) the payment receipt issued by a bank for the payment of taxes withheld to such employees; (3) the payment of employer-employee fees to the Mexican Social Security Institute; and (4) the payment of contributions to the National Workers Housing Fund. The specialized services or work provider is obliged to provide this information.
- As set forth in the Federal Tax Code, payments for prohibited subcontracting will be non-deductible.

Value Added Tax Law

- In order to claim the corresponding credit, the contracting party, when making payments for permitted subcontracting, is obliged to: (i) verify that the relevant specialized services or work provider is duly registered before the STPS; and (ii) obtain from such provider a copy of: (1) the VAT return; and (2) the VAT payment receipt corresponding to the period in which the consideration and related VAT were paid to the specialized services or work provider. The specialized services or work provider is required to provide this information no later than on the last day of the following month (if not provided within this term, the contracting party is obliged to reverse the credit).
- As set forth in the Federal Tax Code, VAT on payments for prohibited subcontracting will be non-creditable.
- The 6% withholding tax obligation imposed to taxpayers who hire services in which they have personnel at their disposal, will be repealed.

Transitory Articles

- The Initiative will become effective on the day following its publication in the Federal Official Gazette, except for those provisions that amend the Federal Tax Code, the Income Tax Law and the Value Added Tax Law, which will become effective on August 1, 2021.
- The Initiative requires the Ministry of Labor and Social Security to issue the rules regarding the registration of persons rendering subcontracting of specialized services or work within 30 days following the date on which the Initiative is published and becomes effective. All persons rendering subcontracting of specialized services or work shall be registered within 90 days following the date on which the registration rules referred to in this paragraph are issued.
- Criminal conducts committed before these changes becomes enforceable, will be punished in accordance with the legislation applicable at the time such conducts were incurred.

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We will follow up on the publication process of this reform, keeping you informed when it is published.

We invite you to reach out to your usual contacts at Ritch Mueller to discuss any particular situation regarding the above, its specific consequences and potential defensive strategies in relation to any such consequences. Alternatively you may contact us at contacto@ritch.com.mx so that we may direct your concerns to the appropriate members of our team.

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