

REFORM ON OUTSOURCING OF LABOR

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In April's 23th edition of the Federal Official Gazette, the Decree through which several provisions of the Federal Labor Law, Social Security Law, Law on the Institute of National Housing Fund for the Workers, Federal Tax Code, Income Tax Law, Value Added Tax Law, and others related to outsourcing of labor approved by the Senate on April 20, 2021 was published.

This way, except for certain provisions, this reform came into effect on the following day, after having been subject to rigorous scrutiny among the sectors involved under a novel open parliament exercise since last December, following the request of the business and workers' sectors, to evaluate the collateral effects, mainly with regards to the obligation companies must share profits with their employees.

It is worth pointing out that the reforms to the Federal Tax Code, Income Tax Law and Value Added Tax Law will come into effect on August 1, 2021.

Ahead we will mention the most transcendental changes, some of them previously mentioned in our Bulletin issued on April 5, 2021.

Federal Labor Law (FLL)

Outsourcing of personnel (Art. 12 FLL).

The outsourcing of personnel is prohibited, which is defined as that in which an individual or company provides or makes its own workers available in the benefit of another.

For these purposes, employment agencies or intermediaries that intervene in the hiring of personnel are regulated, limiting it to the recruitment, selection and training, among others, clarifying that the employer shall be the one that benefits from the services.

Outsourcing of specialized services or execution of specialized work (Art. 14 FLL).

The outsourcing of specialized services or the execution of specialized work is allowed, if it is not part of the beneficiary's business purpose (generally established in the company's bylaws) or the core economic activity.

These services shall be formalized in a written agreement stating the object of the services to be provided or work to be conducted, as well as the estimated number of workers that will be assigned to the fulfillment of the contracted obligations.

Additionally, it is established that whoever hires the specialized services, or the execution of the specialized work will be jointly liable for the fulfillment of the employer's labor obligations with regards to the workers used in the services provided.

Outsourcing Census (Art. 15 FLL).

The provider of specialized services or the execution of specialized work shall be registered in a public census to be established by the Ministry of Labor and Social Security (MLSS), which shall operate according to the following:

- a) Only those that prove to be in compliance with their tax and social security obligations will be allowed.
- b) It shall be renewed every three years.
- c) The requests to be incorporated in the census shall be responded within 20 days following the MLSS receipt. If there is no response within such timeframe, the interested party can demand the issuance of the resolution and in absence of such within 3 days, the registration will have full legal effects.
- d) The MLSS will deny or cancel the registration to those that do not comply with the requirements established in the FLL.
- e) The Census will be public and be available in an internet portal.
- f) The MLSS will issue procedural rules by no later than 30 days following the entry into effect of the Decree.
- g) 90 natural days will be allowed for the registration once the rules are issued.

Complementary or shared services or works between companies of a business Group (Art. 13 FLL).

Services or works that are complementary or shared among companies of the same business group are treated as the outsourcing of specialized services or the execution of specialized work, if they are not part of the business purpose or the core economic activity of the company that receives them.

For these purposes, business group is understood to be the group of companies (legal entities) organized through the direct or indirect participation in the equity, in which one sole company maintains control of said companies; that is, a holding company is required. Financial groups organized in accordance with the Law to Regulate Financial Groups will also qualify.

Employer Substitution (Art. 41 FLL).

It is established that for an employer substitution to be effective, the relevant goods of the company or establishment shall be transferred to the substitute employer. This requirement will not be necessary in the case of companies that, operating under an outsourcing regime, transfer the employees to the beneficiary person, provided that the

transfer of employees is conducted within 90 natural days following the entry into force of the Decree and their labor rights, including their seniority, are recognized.

Profit Sharing (Art. 127 FLL)

Section VIII of Article 127 of the FLL is added, to limit the workers' right to participate in the company's profits, with a maximum of three months' salary of the employee and the average profit sharing received in the three prior years.

The provisions that regulate the procedure for the determination remain intact, such as: (i) 10% on the taxable income determined in accordance with the last two paragraphs of Article 9 of the Income Tax Law; (ii) 50% of the amount to be distributed based on the accrued salaries and the other 50% based on the days worked; (iii) use of the salary cap for the union worker with the highest salary plus 20% for the distribution of the profit sharing based on accrued salaries.

Sanctions for lack of compliance with labor provisions

A fine of 250 to 5,000 times the Measure and Restatement Unit for not allowing the inspection and vigilance that the labor authorities order. (Art. 1004-A FLL).

Whoever outsources personnel, as well as the individuals or companies that provide outsourcing services without the corresponding registration, will be fined with 2,000 to 5,000 times the Measure and Restatement Unit, regardless of the other responsibilities they may have pursuant to the applicable legislation. The MLSS will share the facts to the authorities that may be competent.

The same sanction in the last paragraph will apply to individuals or companies that benefit from the outsourcing contravening the reformed articles (Art. 1004-C FLL).

Social Security Law (SSL)

Consistent with the reforms to the FLL, the changes to this Law seek to prohibit the outsourcing of personnel and regulate the outsourcing of specialized services and the execution of specialized work, specifying that these services or works shall comply with the conditions and requirements established in the FLL.

Joint Liability (Art. 15 A LSS, second paragraph)

Those that hire services or the execution of work with those that do not comply with their social security obligations, will be jointly liable with regards to the workers used to execute said services or work.

Informative return (Art. 15 A, third paragraph)

The individual or company that provides specialized services or executes specialized work will provide the information of the corresponding 4-month period by the 17th day of the months of January, May, and September according to the following:

- a) General information and Tax ID information of the parties that intervene in the agreement.
- b) The object of the agreement, term of validity, information of the workers or other individuals that will provide the specialized services or execute the specialized work in favor of the beneficiary.
- c) Copy of the registration issued by the MLSS for the rendering of specialized services or the execution of specialized work.

The information referred to in the first two points above will have to start being provided following 90 natural days after the entry into force of the reform, while the third point shall be observed once the MLSS publicizes the mechanism to obtain such document.

For the verification of the compliance of the obligations established in both the FLL and the LSS, the Social Security Institute (SSI) and the MLSS shall execute collaboration agreements for the exchange of information and carry out joint verification actions.

The SSI will inform the MLSS of any lack of compliance with the previously mentioned requirements.

Sanctions. (Arts. 304-A y 304-B SSL)

Not filing (or late filing) the information established in Article 15-A of the Law will be sanctioned with a fine of between 500 and 2,000 times the Measure and Restatement Unit.

Housing Institute Law (HIL) (Art. 29 HIL)

It is established that for the employer substitution, the substituted employer shall be jointly liable with the new one for the obligations derived from the same law, borne prior to the date of the substitution, for up to a three-month term, after which all of the responsibilities will be attributed to the new employer. Before the reform, the joint liability term for the substituted employer is of 2 years.

Informative Return (Art. 29 Bis HIL)

The individual or company that provides specialized services or executed specialized work that registered before the MLSS, will provide every four months, by the 17th day of

January, May and September, the information of the agreements executed in the corresponding period, including the following:

- a) General information;
- b) Service agreements;
- c) The amounts of the contributions and amortizations;
- d) Information of the workers;
- e) Determination of the base salary for contribution; and
- f) Copy of the registration issued by the MLSS.

The requirements previously mentioned and the due dates for the filing before the Housing Institute shall be complied in accordance with the procedures to be published by the Institute through electronic means.

The Housing Institute and the MLSS will execute collaboration agreements to exchange information and conduct corresponding the joint verification actions.

The Housing Institute will inform the MLSS of any lack of compliance of the previous requirements.

Joint Liability (Art. 29 Bis, second to last paragraph).

Those that hire specialized services or the execution of specialized work with a company that does not comply with the obligations established in the law, will be jointly liable with regards to the workers used.

Federal Tax Code (FTC)

Tax effects of the payments of outsourcing of personnel and services (Art. 15-D CFF).

No deduction or tax credit effect will be allowed for the payments or considerations related to the outsourcing of personnel to conduct activities related both to the business purpose or the core economic activity of the recipient.

In the case of outsourcing of specialized services or the execution of specialized work that are not part of the business purpose or of the core economic activity of the beneficiary, will be allowed to have tax effects (deduction or credit), provided that the provider has the registration referred to in Article 15 of the FLL and the other requirements established for such purpose in the Income Tax Law and the Value Added Tax Law are met.

The deduction or credit will also not be allowed for the services in which personnel is provided or made available to the recipient, in any of the following situations:

- a. That the workers provided or made available by the service provider were originally employees of the recipient and they were transferred to the service provider by any legal means, and
- b. That the workers provided or made available by the service provider cover the recipient's core activities.

The complementary or shared activities or work, among companies of the same business group, will also be considered specialized provided that they are not part of the recipient's business purpose or core economic activity.

Joint Liability (Art. 26 CFF, section XVI).

A new joint liability situation is created for individuals or companies that receive services or hire work referred to in Article 15-D of the FTC, with regards to the taxes triggered on the employees with whom the services are rendered.

Sanctions.

Claiming the deduction or the credit, contravening what is established in Articles 28.XXXIII of the Income Tax Law or 4, third paragraph of the Value Added Tax Law is established as an aggravated conduct for the grounds and motivation of resolutions imposing fines (Art 75, Section II, Subsection h) FTC).

When the provider does not comply with the obligation to deliver the information and documentation referred to in Articles 27, Section V, third paragraph of the Income Tax Law, and 5, Section II, second paragraph of the Value Added Tax Law to the recipient, it will be subject to a fine between MX\$150,000 and MX\$300,000 for each delivery not made (Arts 81, Section XLV and 82, Section XLI FTC).

Qualified offense of tax fraud (Art. 108 Section i) FTC)

The tax fraud crime originated from the use of simulated schemes of rendering specialized services or the execution of specialized work, or for claiming the deduction or the credit of the consideration that is restricted, will be deemed a qualified offense subject to a 50% increased sanction.

It is important to point that through transitory provisions, it is established that all criminal conducts committed prior to the entry into force of this reform, will be sanctioned in accordance with the legislation in effect at the time they were committed.

Income Tax Law (ITL)

Requirements for the deduction of specialized services (Art. 27, Section V, third paragraph ITL).

For the deduction of payments made for the rendering of specialized services or the execution of specialized work, the recipient shall verify that the provider has been registered in the MLSS census and obtain a copy of the tax-compliant payroll receipts of the workers with which the service was provided, or the work executed, the receipt of the payment of the tax withholdings made to such workers, the payment of the social security contributions, as well as the housing fund contributions. The provider will have the obligation to deliver such information to the recipient.

Non-deductibility of outsourcing payments (Art. 28 LISR, Section XXXIII, ITL)

Payments made for outsourcing of personnel to develop activities related to the business purpose of the core economic activity of the recipient will be non-deductible.

Also, services in which personnel is provided or made available of the recipient will be non-deductible when the personnel provided were originally employees of the recipient and were transferred to the provider by any legal means, or, when the personnel provided by the provider covers the recipient's core activities.

Value Added Tax Law (VATL)

6% withholding on outsourcing payments

Article 1-A, Section IV of the VATL, which obligates the beneficiaries of subcontracting services to withhold 6% of the consideration effectively paid to the provider, is eliminated.

Non-creditable VAT on the payment of non-deductible outsourcing payments (Art. 4, third paragraph VATL).

The VAT that is shifted on the payment of the consideration of outsourcing services that are non-deductible for income tax purposes, will not be allowed as a credit in terms of the VATL.

VAT credit for specialized services or the execution of specialized work (Art. 5, Section II, second paragraph, VATL).

To be entitled to claim the credit of the VAT shifted to the recipient on the payments made for specialized services or the execution of specialized work, the recipient shall verify that the provider is registered before the MLSS and obtain copy of the VAT return and the confirmation of the payment of both the consideration and the VAT that was shifted in the corresponding month.

The provider shall deliver to the recipient, a copy of said documentation by no later than the last day of the following month in which the recipient paid the consideration for the service received and the VAT was shifted. When the recipient does not receive the documentation within such timeframe, it shall file an amended return reducing the amounts claimed as a credit.

Final Considerations.

Undoubtedly, this reform will bring important repercussions in the companies' operating and business sphere, as well as in its relations with the suppliers of goods and services, workers, unions, and government agencies; therefore, it will be necessary to conduct a comprehensive analysis in order to identify any need to adapt to these new provisions and avoid negative effects.

In SKATT, we are at your service for any doubt, as well as to explore the legal options that may be available to successfully handle what is certainly a historic reform with important repercussions for companies in Mexico.