

November 4, 2019

EY TAX Flash

Bill is introduced in the Mexican Senate to ban the use of subcontracting structures

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On October 23, 2019, a bill was introduced in the Mexican Senate, which, if enacted, would eliminate the ability to use most sub-contracting structures and would make intercompany type of sub-contracting structures a criminal offense. This proposal is still in the early stages of the legislative process and as such it is not clear if it will be enacted in the current form.

Specifically, this proposal would amend the Federal Labor Law as well as the Social Security Law, to provide that sub-contracting may only be legal in the case the sub-contracting is required for specialized services or activities distinct from the primary activity of the business. In other cases, subcontracting would be illegal. Furthermore, the proposal indicates that in certain circumstances where subcontracting is considered to be simulated, a criminal activity would be deemed to occur. Amongst the activities considered to be simulated outsourcing are the scenarios whereby the primary activity of the business is outsourced, when employees are transferred to a third party and then subcontracted and in the case when substantially all services are contracted with a company within a group of related parties (in-sourcing).

For various reasons, these subcontracting structures are commonly used in Mexico by both foreign and Mexican businesses and generally consist of a group of companies establishing one or more operating companies and one or more service companies to provide the labor component of the business activity. This type of structure is usually implemented either with companies of the same group, known as insourcing, or with a company outside of the group, known as outsourcing.

Unfortunately, these structures have been abused in the past, depriving employees of their social security, union, and housing benefits, among others. The intention of the proposal is to combat these abuses and also to make the profits of the operating companies subject to profit sharing. Under the proposal, profit sharing as well as

social benefits would be due for the period that the illegal subcontracting is in place.

The bill provides a timeframe of 180 days after the changes to the law enter into force for companies to become current with respect to omitted taxes and profit sharing during which no criminal activities will be asserted. If the criminal activity were to occur as defined in the proposal general penalties and consequences would apply for the criminal act. Recently, the Mexican Congress approved changes to several laws which aim to consider certain tax offenses, such as the simulation of acts, as organized crime, for which the applicable penalties can include the seizure of assets and pre-trial detention.

Please note that this bill was introduced by a single Senator and will have to go through the legislative process to get approval in the Senate, and then in the Lower House of Congress.

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