TAX AND LABOR LAW MODIFICATIONS

In Brief

On April 20, 2021, the Mexican Senate approved legislation that will modify the tax and labor law treatment of subcontracted services in Mexico. These law reforms may result in significant financial impacts to Mexican investments, as well as human resource considerations. Failure to comply with the new rules could result in significant penalties, including the potential characterization of tax fraud.

The legislative changes to the Income Tax Law, Value Added Tax (VAT) Law and Federal Fiscal Code will be effective August 1, 2021. Generally, the Labor Law modifications become effective the day following their publication in the Official Gazette.

In Detail

On November 12, 2020, the Executive branch proposed significant tax and labor law modifications to outsourcing structures, defined as a Mexican entity contracting with a related or unrelated legal entity/individual for services and the employees of the service provider are at the disposition and benefit of the service recipient ("Outsourcing").

The business sector, the government and labor representatives spent several months negotiating the terms of the modifications, culminating in the April, 2021 approval by Congress of material modifications to various laws, including the Income Tax Law, the VAT Law, and the Labor Law.

The most significant modifications to Outsourcing are the following:

- Labor law will,generally, prohibit Outsourcing activities.
- An exception is created to allow for the rendering of specialized services or the execution of special projects that are not within the business purpose stated in the formation documents or are not part of the primary economic activity of the service recipient ("Specialized Services") so long as the service provided is duly registered (see below).
- Entities that will provide Specialized Services must comply with a new registration procedure with the Secretary of Labor. The registry will be made public.
- The profit sharing obligation will be capped at an amount per employee. The maximum profit sharing payable will be the higher of three months salary or the average profit sharing received over the last three years.
- Significant penalties will apply to entities that do not comply with the Outsourcing limitations, including potential characterization as tax fraud.
- Payments for Outsourcing will not be deductible for Income Tax purposes unless they qualify as Specialized Services and comply with all relevant formalities.
- Payments that are not deductible for the Income Tax Law will also not be creditable for purposes of the Value Added Tax ("VAT") law.
- Payments for simulated specialized services or outsourcing may be considered as tax fraud.

Although the tax law changes will not become effective until August 1, 2021, the other legal provisions will be effective the day after they are published in the Official Gazette. Given the tight timeline for compliance, taxpayers should be analyzing the effect of these changes on their Mexican operations and determine if changes to their Outsourcing framework is warranted.

Contacts

David Cuellar
Partner - Tax & Legal Services Leader
david.cuellar@pwc.com

Carlos Orel Martínez
Partner - National tax services Leader
carlos.orel.martinez@pwc.com

Brenda García
Partner Tax Policy Services
brenda.garcía@pwc.com

Pilar López Carasa
Partner - Legal Services Leader
pilar.lopez@pwc.com

Carlos Manuel Martínez
Partner - Legal Services
carlos.manuel.martínez@pwc.com

Francisco Godínez Fedenaje
Partner - Local Contributions and Social Security
francisco.godinez@pwc.com

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