June 2021 Special Report

Major Legislative Developments in Mexico

Impact and Call for Action

Part I: Outsourcing Services

ALTA ACTUARIES

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PART I: OUTSOURCING SERVICES

REFORM OF MEXICAN LABOR LAWS

On April 23, 2021 the Mexican Government published legislation that reforms several laws and norms that regulate outsourcing practices employed by companies. According to Mexican Government statistics, there are about 5 million workers employed in outsourcing schemes in Mexico.

The main objectives of the reform are to improve working conditions of employees and to close certain tax and labor law loopholes that have been historically adopted by some companies through those schemes.

A key issue being addressed is a particular organizational strategy being used by many companies to break up their business operations into two separate legal entities – a production entity (which employs all or most of the workers of the combined group) and a commercial entity with either no personnel or just executives and staff in higher-level positions.

Concerns have been voiced that the key motivation behind the adoption of this setup is to minimize the distributions under the statutory profit-sharing program (10% of pre-tax profits to be distributed to employees according to prescribed procedures).

Critics have claimed that profits of the combined group of related companies are suitably arranged via transfer pricing or inter-company billing schemes whereby the production entity reports low or no profit, while all or most of the profit is shifted to the commercial entity.

Furthermore, the workers in the production entity often have lower benefit levels and more modest working conditions than the employees of the commercial entity.

Unions have been aware of this practice and some have negotiated minimum “profit-sharing” payouts in the production entity usually a multiple of monthly or weekly basic pay, regardless of the amount actually reported as profit.

The new law introduces a blanket prohibition of sub-contracted services

but does include the following exceptions:

1. Subcontracting of specialized services deemed not to be part of the company's social charter or core business via third-party labor providers (subcontractors). This type of service provision contract is typically used by companies to subcontract payroll, cleaning, IT, temporary staff and other specialized services which are away from the core business and which are externalized to third party specialists.

2. Shared services entities of a business conglomerate are allowed under the new law so long as the shared services are of a specialized nature such as the HR, IT, accounting and other administrative functions that support the group of related companies.

The new law introduces significant registration, conditions and reporting requirements for outsourcing transactions

Third-party service providers would have to be registered with the regulators (Labor and Social Welfare Authorities) by July 23, 2021.

Companies using subcontracted labor will become jointly responsible with the formal employer of the subcontracted staff on matters relating to social security.

All outsourcing contracts, worker information, base salaries, social contributions and other related items will need to be reported to the Mexican Institute of Social Security (IMSS) and the National Housing Fund (Infonavit) every four months.

PROFIT SHARING CONSIDERATIONS

The outsourcing prohibition implies that companies using outsourcing schemes that become disallowed will need to directly employ the outsourced employees thereby extending the profit-sharing program to these employees.

Most likely as a response to pressure from employers in the financial sector, the profit-sharing distributions for these entities will have a limit of the higher of three months' salary, or the average distribution in the last three years prior to the reform, whichever is greater. However, the limit does not affect the existing profit-sharing payout determination and distribution procedures, which have built-in mechanisms to promote equity between high and low paid workers.

The reform would propose clearer rules with regard to the registry of a company's workers and establishes a profit-sharing scheme for employees. Former employees of third-party labor providers absorbed by the contracting company will also be entitled to this benefit.

INDEPENDENT CONTRACTORS

The new law does not aim to compromise the provision of services between unrelated companies or the provision of services by independent contractors. However, the service agreement cannot entertain having personnel from the service provider under the control, supervision or direction of the beneficiary of the services.

Transition Terms

The transition timetable is extremely tight

The key compliance deadlines are:

1. Effective date of Law – April 24,2021
2. Regulations issued by the Labor Authorities – Stipulated in the Law as May 24, 2021 These have already been published and became effective on May 25, 2021.
3. Registration of authorized outsourcing service providers – 90 days after issuance of regulations
4. Employer substitution initiatives, reporting of contracts and required information – 90 days after registration deadline
5. Issuance of regulations by Housing Fund (Infonavit) – 60 days following the reporting requirement

For outsourcing arrangements that are no longer permitted, the company using the outsourced services will need to absorb the subcontracted labor via a special employer substitution initiative that recognizes acquired rights of the transferred employees.

Non-Compliance Penalties

The new law introduces sizable fines for non-compliance from 2,000 to 50,000 UMAs (UMA: Unit of Measurement and Indexation, currently MXP 89.62 per day) that would apply to both the recipient and the provider of the outsourcing services.

Furthermore, when a single infraction applies to more than one worker, the fines are imposed on each affected worker opening up the possibility of draconian fines being imposed on companies that violate the provisions of the new law.

Aside from the fines, there are also tax penalties in the form of disallowance of tax deductions and accreditation of value added tax for non-compliant outsourcing contracts.

KEY IMPACT AREAS AND SUGGESTED ACTION

The transition timetable is extremely tight. We urge employers to undertake the indicated action as soon as possible.

- Companies that have any type of outsourcing arrangements, have shared services affiliates and/or utilize independent contractors will need to review the contracts in order to determine if they will continue to be allowed under the new law.
- For allowed outsourcing arrangements, the beneficiaries of outsourced services:
  a. Need to work with their authorized outsourcing service providers to ensure that the required registrations and reporting protocols are followed in a timely fashion.
  b. Should adopt procedures to scrutinize the on-going compliance of their outsourcing service providers and consider imposing collateral requirements on them to deal with the joint liability for non-compliance with labor and social security laws in regard to the individuals involved in the service provision.
- For companies that have outsourcing arrangements or corporate organizational setups that contravene the dispositions of the new law:
  a. A reorganization plan needs to be developed with their legal, tax and labor advisors.
  b. The impact of additional profit sharing, employee benefits, severance, overtime pay and social security costs should be quickly estimated with their employee benefit advisors and payroll managers.
- Regulations from the Labor and Social Security Authorities may impose additional restrictions and/or compliance burdens on employers and hence will need to be carefully examined when these are issued

ALTA ACTUARIES

Coming Soon

Part II: Legislative Developments in Mexico

Telework/Work from Home Arrangements

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Alta Actuaries & Consultants, LLC
332 S. Michigan Avenue, Suite 900
Chicago, IL 60604
+1 312.961.4375

Info@altaactuaries.com
www.altaactuaries.com
linkedin.com/altaactuaries

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Contact us for further info

camsa actuarios y consultores

CAMSA Actuarios y Consultores
Emerson No. 316 piso 3,
Col. Chapultepec Morales
Alc. Miguel Hidalgo ,
Ciudad de México,C.P. 11560
+ 55 8840.7000

joseluis.salas@camsaconsultores.com.mx
www.camsaconsultores.com.mx
linkedin.com/camsa-consultores