

Mexico Alert: Labor Reform Initiative/Employee Leasing Companies

The administration of Andres Manuel Lopez Obrador, President of Mexico, recently submitted to the Mexican Congress a labor reform initiative (the “President’s Initiative”) that could significantly impact the use of what are commonly referred to as employee-leasing companies, or employee-outsourcing companies, in Mexico.

The President’s Initiative would amend provisions of several Mexican laws, including the Federal Labor Law, Social Security Law, National Fund Institute for the Housing of Workers Law, Federal Fiscal Code, Income Tax Law and the Value Added Tax Law. Primarily, the President’s Initiative prohibits the outsourcing of employees, limiting it to very particular cases with strict compliance requirements. Moreover, the President’s Initiative redefines the concept of outsourcing of personnel whereby a natural or legal person provides or makes available its own employees for the benefit of another party.

Not included and exempt from these changes are services that are deemed to be specialized services or specialized works that are unrelated to the operating business and corporate purpose of the party contracting the services. There are significant compliance requirements that would apply when contracting for such services. Namely, specialized services firms would require to be authorized by the Labor and Social Security Ministry (STPS), and the rendering of such services must be contracted for under a written agreement specifying the services to be rendered and the number of participant employees.

The aforementioned authorization requires the presentation of evidence of the specialized nature of the services and compliance with labor, social security and tax obligations. A renewal of this authorization by the STPS is required every 3 years. Failure to meet the particular requirements set out in the President’s Initiative would result in the refusal or revocation of the relevant authorization.

A common practice of multinationals and other businesses operating in Mexico has been to house employees in a service company that is separate and apart from the operating business. The employee services company provides the work force to the operating business typically under an employee services agreement or an employee leasing agreement. Such agreements generally provide for an arm’s-length profit (e.g., under a cost-plus method) to the employee services company, which is in turn shared with its employees under applicable rules and arrangements. Under the President’s Initiative, these contractual relationships will have to be modified and potentially terminated to comply with the new requirements.

Furthermore, the President's Initiative imposes joint and several liability to the party contracting for employee services, and imposes significant penalties including characterizing avoidance of the changes as tax fraud.

On the other hand, the function of employment placement agencies will be limited in scope, given that they will only be able to intervene in the recruitment, selection and training processes, provided that the beneficiary will be considered an employer.

The proposed amendments to the Social Security Law and the National Fund Institute for the Housing of Workers Law impose a quarterly reporting requirement for individuals and entities rendering specialized services. Such reporting would encompass information regarding their agreements, clients and employees, as well as compliance with labor and tax obligations.

The President's Initiative amends Mexico's Fiscal Code and Income Tax Law to, in general, deny a tax deduction for payments made to employee services company under employee leasing or outsourcing arrangements. In addition, the President's Initiative would deny a credit for value-added tax paid to the employee services company.

If approved by the legislature, the President's Initiative will become effective as of January 1st, 2021 for tax purposes, and on the day following its publication in the Federal Official Gazette (DOF) for other purposes noted above.

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