

Tax implications of the subcontracting reform bill

This past November 12th, the Federal Executive presented to the Chamber of Deputies the “Bill with Draft Decree reforming, adding and derogating various provisions of the Federal Labor Act, the Social Security Act, the National Workers Housing Fund Institute Act, the Federal Tax Code, the Income Tax Act and the Value Added Tax Act” (“**Bill**”).

The statement of purpose of the Bill indicated that it was intended to prohibit the subcontracting of personnel and establish precise rules so that only specialized services or specialized works are contracted, in order to eradicate certain current simulated practices that are prejudicial to workers and the treasury.

In our note of November 13th we mentioned the main changes in the labor law that the Bill contemplates, which can be consulted [here](#), and therefore below we only discuss the changes to the tax laws in the Bill.

First it is important to take into account that the tax laws are amended to harmonize them (with the proposed reform to the Federal Labor Act) in relation to the concepts: (i) subcontracting (prohibited according to that proposal) and (ii) provision of specialized services.

A) Social Security Act

It is established that the person who contracts services or the execution of works with an individual or entity that fails to comply with its social security obligations will be jointly liable in relation to the workers used to execute those contracts.

In addition, it is intended to eliminate the administrative ease that was granted to the personnel services companies to open an employer registry by class at the national level.

B) National Workers Housing Fund Institute Act (“INFONAVIT”)

It is established that the individual or entity that contracts services or the execution of works with a company that fails to comply with its social security obligations will be jointly liable in relation to the workers used to execute such contracts.

The persons authorized to provide specialized services or execute specialized works will be obligated to file certain information before the INFONAVIT every four months.

If the Bill is passed in the terms proposed by the Federal Executive, in the case of an employer substitution the substituted employer will be jointly liable with the new employer with respect to the obligations before the INFONAVIT vested before the date of substitution, for up to six months. Once that period concludes the liabilities will be attributable to the new employer.

C) Federal Tax Code

It is proposed to establish that the payments or consideration paid for subcontracting personnel cannot be deducted or credited for tax purposes.

Nor may the services providing and or making personnel available to the contracting party be deducted or credited for tax purposes when either of the following premises applies:

1. When the workers that the service provider provides or makes available to the contracting party have originally been workers of the latter and were transferred to the service provider, and
2. When the workers that the service provider provides or makes available cover the preponderant activities of the contracting party.

Notwithstanding that subcontracting would be prohibited under the reform proposal of the Federal Labor Act, it is proposed to incorporate the contractor of the personnel subcontracting services into the premises for joint tax liability with respect to any taxes that have been caused for the workers of the service provider.

It is also proposed to add the deduction or crediting of personnel subcontracting services as an aggravating factor for imposing fines. In line with this, it is also intended to establish a sanction when the service provider (of specialized services or the execution of specialized works) does not provide to the contracting party the necessary information for the expense to be deductible or the transferred tax creditable.

Finally, it is established that the conduct consisting of using simulated schemes for providing specialized services or to execute specialized works, as well as subcontracting personnel, are qualifications in committing the crime of tax fraud and its equivalent.

D) Income Tax Act

The deduction of the corresponding payments for purposes of this tax, in the case of the provision of specialized services or the execution of specialized works, is conditioned. The foregoing consists of the contracting party obtaining from the service provider the documentation specified below:

1. The authorization that the Ministry of Labor and Social Welfare would issue.
2. The tax invoices for the payment of salaries of the workers that have provided the service or executed the work.
3. Payment receipt issued by the banking institution corresponding to the tax return paying the tax withholdings made to those workers.
4. Payment of worker-employer social security dues to the Mexican Social Security Institute, as well as the payment of the contributions to the INFONAVIT.

Furthermore, for consistency with the Federal Tax Code, it is proposed to specify in the Income Tax Act that the payments made for subcontracting personnel will not be deductible.

E) Value Added Tax Act

In line with the reforms to the other tax provisions, it is proposed that the Value Added Tax that is transferred for personnel subcontracting services will not be creditable.

Additionally, the withholding of 6% applicable to services through which personnel are made available to the contracting party or a party related to it, in force beginning in 2020, is eliminated.

The following are established as requirements for crediting the tax transferred to the contracting party for the provision of specialized services or the execution of specialized works:

1. The authorization that the Ministry of Labor and Social Welfare would issue.
2. Value Added Tax return and payment receipt, corresponding to the period for which the consideration was paid, and of the Value Added Tax that was transferred to it.

The contracting party must meet such requirements no later than the last day of the month following the one in which the considerations were paid.

We will follow the legislative process of the Bill until it is passed, if applicable, as well as any relevant change made to it.

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