16 November 2020

Global Tax Alert

News from EY Americas Tax

Mexico introduces bill to amend labor and tax laws to prohibit outsourcing

On 12 November 2020, Mexico's Executive branch introduced a bill (the Bill) that would amend, among other laws, the Federal Labor Law, Income Tax Law, Value-Added Tax (VAT) Law, and Federal Tax Code. If enacted, the Bill would effectively eliminate, in most cases, the use of service companies in Mexico. The Bill is in the early stages of the legislative process and may be subject to changes before possibly being enacted. The explanatory notes to the Bill state that this is another attempt to eliminate sham transactions that affect Mexican workers, such as non-payment of payroll and social security contributions.

According to the explanatory notes, the Bill seeks to strengthen employment and abolish practices that harm labor rights and reduce the obligations of employers in Mexico. The Bill would prohibit individuals and entities from outsourcing services. Specifically, they could not provide their own employees for the benefit of another. By prohibiting the outsourcing of services and establishing precise rules, the bill would only allow individuals and entities to hire entities to provide services of a specialized nature or to perform specialized work.

These specialized services will not be considered outsourcing to the extent they are not part of the business purpose or the economic activity of the beneficiary and comply with certain requirements.

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Income Tax Law

The Bill would amend the Mexican Income Tax Law to prohibit taxpayers from deducting payments for outsourced services. To deduct payments for services of a specialized nature or the execution of specialized work, taxpayers would need to maintain certain documentation for those payments.

VAT Law

The Bill would not allow input VAT paid on outsourcing services to be creditable, which would be consistent with the requirement that a VAT credit is generally only allowed if the underlying good or service is deductible.

The Bill also would prohibit a VAT credit and income tax deduction for payments for services in which employees are transferred to the subcontractor from the original employer, to the extent these employees carry out the contractor's principal activities.

Additionally, input VAT paid on services of a specialized nature or the execution of specialized work would be creditable subject to certain documentation requirements.

Implications

The amendments to these laws could present significant labor and tax challenges for service company structures, which are common in Mexico. Taxpayers should continue to monitor the Bill's progress and evaluate how the Bill, if enacted, would affect their operations. Restructuring may be required for taxpayers to comply with the new rules.

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