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MEXICAN GOVERNMENT CHALLENGES EMPLOYEE INSOURCING AND OUTSOURCING STRUCTURES

TODAY'S SPEAKERS:

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AGENDA & SPEAKERS

- Overview of Current Framework
- The November Bill and Current Negotiations
- Employment Law Impacts
- Tax Law Impacts



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OVERVIEW OF CURRENT FRAMEWORK

Mexican labor laws mandate that employers, among other obligations, provide employees with the following social benefits:

- Payment of Social Security taxes to provide employees with universal healthcare coverage;
- Payment of Housing Fund contributions to provide employees access to government-subsidized and financed housing; and
- Sharing of 10% of the employer's pre-tax profits with their employees
 - Profit-sharing obligations are uncapped and generally nondeductible for income tax purposes

OVERVIEW OF CURRENT FRAMEWORK

A number of Mexican employers have used insourcing and outsourcing structures to manage profit-sharing obligations

- Insourcing structures entail the use of an affiliated entity (“EiCo”) separate and distinct from the Mexican company’s operations (“OpCo”). The EiCo legally employs the employees, complies with social security and housing fund requirements, income tax withholding, and other labor requirements.
- Outsourcing structures entail the use of a third party EiCo to legally employ the employees and comply with all legal requirements.

OVERVIEW OF CURRENT FRAMEWORK

- In both the insourcing and outsourcing scenarios, the EICo contracts with the OpCo to provide the services of its employees.
- In practical terms, most OpCos have few to no employees of their own.
- Most EICos provide additional fringe benefits to compensate for their employees not receiving profit-sharing payments related to the OpCo.
- Many multinational corporations use the structures in Mexico.

THE NOVEMBER BILL

- On November 12, 2020 the President of Mexico sent a bill to the Congress of the Union proposing amendments to several provisions of the Federal Labor Law, the Social Security Law, the Federal Housing Fund Law, the Federal Fiscal Code, the Income Tax Law, and the Value Added Tax Law.
- The objective of the amendments was to regulate, or with respect insourcing prohibit, these commonly used employee structures.

THE NOVEMBER BILL

- The Bill prohibits the leasing of employees from a services company. This means that, for all employment law purposes, an OpCo will be deemed as the employer of the employees leased from an EICo.
- This also means that the employees of the EICo will be entitled to profit-sharing from the OpCo.
- Additionally, under the Income Tax Law, any payments made by an OpCo to an EICo for the leasing of employees will be nondeductible and, under the Value Added Tax Law, the value-added tax paid for those services will not be creditable.
- Finally, under the proposed amendments, the use of an EICo can give rise to criminal liability to both the OpCo and the EICo, as well as joint liability among them for any unpaid Social Security taxes, housing fund contributions, or income taxes not withheld from the employees.

STATE OF CURRENT NEGOTIATIONS

- Background to date
- Draft of the amendment is moving forward, to be approved by the Mexican Congress in February 2021
- The insourcing structure will be prohibited
- The outsourcing structure will be permitted under certain circumstances
- Further discussion to be had on a profit-sharing cap
- Employers have until February 2021 to begin implementation

EMPLOYMENT IMPLICATIONS FOR INSOURCING MODEL

- The insourcing model will be prohibited under the new law.
- This means there will be a new employment structure for many Mexican companies – direct employment by the OpCo.
 - Employee transfers to OpCo, including transfer method
 - Consultations with unions
 - Timing

EMPLOYMENT IMPLICATIONS FOR INSOURCING MODEL

Contractual rights is a key consideration in the conversion to the OpCo structure:

- Reduce some non-mandatory benefits (i.e., annual bonus, performance bonus) to compensate for mandatory profit-sharing payments.
- Potential new formulas for bonuses—annual bonus (same as before) but less profit-sharing paid for the previous year.
- Practical issues with instituting these changes in connection with the employment transfers.

EMPLOYMENT IMPLICATIONS FOR OUTSOURCING MODEL

New outsourcing model

- Limited to specialized services or specific projects not related to the core business of the OpCo
- Other employees to be transferred to the OpCo
- Registration requirements for approved outsourcing providers
- Further clarification on the outsourcing model to be determined

EMPLOYMENT LITIGATION CONSIDERATIONS

- How will any past profit-sharing liabilities be addressed?
- What about employees who were terminated under the old models – any liabilities?
- Financial considerations with the new models – necessity for collective dismissals?

TAX

The proposed bill includes amendment to Mexican tax laws, which, in essence, create the financial disincentive for employers willing to continue risking the use of outsourcing or insourcing arrangements.

These proposed amendments include amending:

- The Income Tax Law, providing for the non-deductibility of payments made to unauthorized outsourcing or insourcing companies;
- The Value Added Tax Law disallowing credit of any value added tax applicable to payments made to unauthorized outsourcing or insourcing companies; and,
- The Federal Fiscal Code, defining outsourcing and insourcing activities in concert with the labor laws, and, imposing:
 - Monetary fines for the continued use of these structures, and,
 - The possibility of criminal prosecution to companies engaged in abusive, outsourcing or insourcing arrangements, as the case may be.

THANK YOU / QUESTIONS?

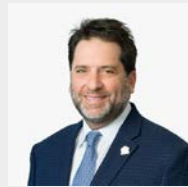
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