Critical Changes to Mexico's Outsourcing Practices Loom

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Last week, the President of Mexico (Andrés Manuel López Obrador), citing his concerns of abusive and simulated practices in outsourcing practices, announced a bill aimed to virtually eliminate or substantially limit all employee outsourcing in Mexico (the "Bill"). The outsourcing of work provides a way for a company to hire workers from a third party for the Company's benefit. Outsourcing structures are lawful and very common in Mexico. Unfortunately, some employers abused this practice to skirt profit-sharing with employees mandated by Mexican law to their employees. This is often done by outsourcing work to related entities at prices guaranteed to create very small profits. Various efforts to eliminate such practices in the past have been unsuccessful.

The Bill will require changes to Mexico's Federal Labor Law ("FLL"), the Social Security Law ("SSL"), the Law of the Institute of the National Fund for Employees' Housing ("LINFONAVIT"), the Federal Tax Code ("FTC"), the Income Tax Law ("ITL') and the Value Added Tax Law ("VATL") in connection to the employment subcontracting structures.

However, the Bill is only in its initial stages-it has not been approved by Mexico's Congress. Already industry associations have voiced their objections and concerns with the Bill. If approved, the Bill will raise momentous employment and tax concerns for companies with operations in Mexico. The following are the most relevant aspects of the Bill:

> **Prohibitions on Outsourcing.** Except for specialized work, employee outsourcing will now be prohibited. Employee outsourcing should be interpreted to mean when an entity or individual (contractor or providers of outsourcing services) makes its own employees for the benefit of others (contracting companies or recipients of subcontracting services) under a service agreement.

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Specialized Work. The new Bill will only allow companies to outsource their required specialized services and work. Such specialized services and work may not be part of the Company's regular economic activity. Companies that provide such permitted outsourcing services will now be required to obtain prior authorization from Mexico's Secretary of Labor and Social Security Institute and register their contracts with the corresponding public registry. Contracting companies would have to properly justify their specialized services purpose (e.g., security, waste management, legal advice, cleaning, training, and logistics, among others) to be provided.

Registration Requirements. Companies providing outsourcing services and companies that hire outsourcing services will need to register in a newly created national registry. The registration requirements are aimed to have greater visibility and control over such companies. Only registered companies may provide outsourcing services.

Tax Implications. Generally speaking, no deductions/credits for VAT or income tax purposes will be allowed for outsourcing activities except for payments to registered outsourcing providers.

Fines and Penalties. Fines will be applied to firms providing subcontracting services and firms receiving such services. The same sanctions will be applied to the provider and receiver of services performed without the authorization of the Ministry of Labor. Repeat offenses will be considered as an aggravating factor for the imposition of fines. In some instances, unlawful or simulated labor subcontracting schemes may be considered tax fraud.

Intermediaries. Intermediaries, such as recruiting agencies, may continue to be involved in the recruiting process. However, their role will be strictly limited to recruiting, selection, and training. They shall not provide their own employees to perform work.

Many suppliers and their respective supplier bases currently rely on work performed by outsourced employees to meet their contractual obligations to their customers. According to the *Asociación Mexicana de Empresas de Capital Humano* 4.5 million Mexican employees are working under outsourcing services agreements. Out of those 4.5 million 1.2 million work in the manufacturing sector. In states like Nuevo Leon, that have a huge impact on Mexican exports, 1 out of 5 employees are expected to be impacted by the new Bill.

This new Bill —if approved— will require companies to restructure hiring practices and human resources management. Some companies with personnel engaged through outsourcing may need to plan for the potential termination of their service agreements and provide for alternate staffing solutions. Suffice to say that this is a good time to consider your options and to lend your support to industry groups providing constructive analysis to the Congress. To lend your support in opposing the Bill we suggest reaching out to Mexican industry organizations of which you are already a member or contact organizations such as the *Consejo Cordinador Empresarial*.

Butzel will be providing further Client Alerts and other updates as we analyze and continue to monitor the Bill's progress through the Mexican Congress. For assistance in properly following Mexico's work guidance, or if you have any specific questions you would like us to address, please contact us. We are here to assist you.

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