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REFORMS REGARDING THE SUBCONTRACTING PROHIBITION IN MEXICO

This past April 23rd, 2021, a Decree prohibiting personnel subcontracting and reforming several legal dispositions of the Federal Labor Law, Social Security Law, Tax Code, Income Tax Law, and Value Added Tax Law, among others, was published in the Federal Official Gazette.

Among the most important aspects to note of the Decree are the following:

1. Personnel subcontracting

Subcontracting of personnel, defined as providing or making one's employees available for the benefit of third parties, is prohibited. Notwithstanding that the Decree does not define what shall be understood as *providing or making available*, our interpretation of the Federal Labor Law and other provisions of the Decree is that it consists of the fact that such employees remain at the instructions of the third party who benefits from said employees to perform its own activities in accordance with its main economic activity.

2. Specialized services or works

It is permitted: **i)** to subcontract specialized services or execution of specialized works which are not part of the corporate purpose or main economic activity of the beneficiary of said services; and **ii)** to subcontract specialized services between companies of the same corporate group, provided that they correspond to services or works which are complementary or shared between such entities, and that they are not part of the corporate purpose or main economic activity of the beneficiary of said services.

Accordingly to what is referred at point 1, our interpretation of the reform is that the subcontracting of specialized services or execution of specialized works necessarily entails to provide or make one's employees available in benefit of a third party.

It is of great importance to note that the Decree **does not eliminate the legal figure of provision of independent services**, for which the obligations imposed by it are applicable in the cases in which, as previously referred, to provide the services, the own employees are under the instructions of a third party in order to carry out activities of the later.

3. Obligations

The following obligations with respect to subcontracting of specialized services or execution of specialized works are imposed:

3.1. Within the following 90 days from the publication of the general dispositions from labor authorities, same which must be issued on May 26, 2021, at the latest, contractors must register before labor authorities;
3.2. Subcontracting of specialized services or execution of specialized works must be formalized through written contract, indicating, among others, the estimated number of employees that will be involved in the performance of said contract;
3.3. Contractors must file four-monthly reports before the Mexican Institute of Social Security with regards to their current contracts, in accordance with the regulations established by said institute; and
3.4. The contracting party must verify the compliance of contractors with respect to the applicable obligations.

4. Non-compliance consequences

The applicable consequences in case of non-compliance include:

4.1. Joint liability of the contractor and contracting party with respect to the employees used;
4.2. Fines for up to MXN $4'481,000.00 (approximately USD $223,558.00) for subcontracting personnel in violation of the reform, applicable both for the contractor and the beneficiary of the subcontracting;
4.3. The payments or compensations issued for personnel subcontracting in violation of the reform will not have tax effects.
4.4. Personnel subcontracting in violation of the reform and use of simulated schemes of provision of specialized services or execution of specialized works will be **sanctioned as aggravated tax fraud**.

5. Labor substitution

In accordance with the Decree, in order to legally operate under the scheme of subcontracting of specialized services or execution of specialized works, it is required to comply with the applicable obligations referred at point 3. Otherwise, to avoid incurring in the obligation to pay the applicable compensations as

consequence of labor termination, as per stated by the Federal Labor Law, it will be required to transfer the employees to the legal entity who benefits from them through a labor substitution. In this regard, for the labor substitution to have effect, the Decree includes as requirement to transfer the assets of the company or establishment to the substitute employer; in the understanding that, **such requirement will not be applicable if the labor substitution takes place on July 22, 2021, at the latest.**

6. <u>Profit sharing</u>

The amount of profit sharing for the employees is limited in accordance with the most favorable modality for such employees, either:

6.1. 3 months of salary of the employee; or
6.2. the average profit sharing received for the past 3 years.

With the exception of the tax-related dispositions, which enter into force on August 1, 2021, the Decree became effective on April 26, 2021.

We remain at your disposal for any question, clarification or comment that may arise with respect to the abovementioned.

May 3, 2021.