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Global Tax Alert

News from Americas Tax Center

Mexico's new compliance rules for outsourcing relationships will go into effect in January 2017

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Companies that do business with service companies in Mexico should be aware of new compliance rules and obligations that are effective 1 January 2017. The new rules address payments to service companies, invoicing requirements for payroll-related expenses, and anti-money laundering compliance. Furthermore, companies must continue to comply with the outsourcing rules in the Federal Labor Law (FLL).

Background

It is a common practice for Mexican companies to work with various entities and to outsource their employee activities (e.g., payroll operations) to service companies. This structure is commonly used for various reasons, including to share resources among different business lines, protect assets, segregate activities or to limit liabilities.

Under the general outsourcing structures, the service company will recognize income for the service fee, transfer the corresponding value added tax (VAT) on the service fee to the operating company and deduct payments to employees. The operating company will deduct the service fee on an accrual basis and credit the VAT paid on the service fees.

Building a better working world

On 15 July 2016, a Circuit Court in the state of Jalisco ruled that, when an outsourcing relationship does not comply with certain conditions, as provided in Article 15-A of the FLL, the relationship between the service company and the operating company will be treated as a payroll cost and not as the rendering of independent personal services. As such, VAT will not be imposed on the service payments and the operating company's VAT credit will be disallowed. In this regard, Article 15-A of the FLL requires an outsourcing relationship to: (a) not encompass all activities (i.e., activities that are the same or similar to the activities carried on by the operating company; (b) be justified due to its "specialized nature"; and (c) not include tasks that are the same or similar to the ones carried out by the operating company's employees.

Based on the requirements in Article 15-A of the FLL, Mexico's tax authorities have challenged the creditability of the VAT and the deductibility of payments to employees. Consequently, if the requirements for outsourcing relationships provided in Article 15-A of the FLL are not met, the operating company could be considered the employer for purposes of the FLL. As an employer, the payments would not be subject to VAT and the operating company would not be able to credit the VAT, if paid.

Amendments to the Income Tax Law and VAT Law

On 26 October 2016, the 2017 tax reform package was approved by Congress. It will be effective 1 January 2017, once signed by the President and published as law. The tax reform includes modifications to the Income Tax Law and VAT Law with regard to outsourcing relationships. The modifications include new compliance requirements that refer to subcontracting in accordance with the FLL, which means an operating company must comply with the subcontracting obligations and the rules under Article 15-A of the FLL.

To deduct the payments for services provided by the service company under the approved tax reform, the operating company must obtain copies of: (1) the tax invoices for the salary payments to the personnel providing the service; (2) the return receipt for the payment of the taxes paid, along with the withholding tax returns; and (3) the payments of the fees to the Mexican Social Security Institute.

In addition, the approved tax reform requires the operating company to obtain a copy of the VAT tax return and receipt of payment, along with other information on the VAT paid by the service company and reported to the Mexican tax authorities in order for the operating company to claim a credit for the VAT.

New tax digital document for payroll

The tax authorities will require additional information on the electronic invoices (CFDI by its acronym in Spanish) provided by a service company for payroll-related expenditures beginning on 1 January 2017. The Mexican tax authorities issued an amended version of the CFDI on 28 October 2016. The amended CFDI requires service companies to provide a significant amount of information to the Mexican tax authorities and includes a specific "Outsourcing" section. In this section, the service company must report the operating company's RFC (i.e., taxpayer identification number), as well as the percentage of time that services are provided by the service company's employees.

Criterion issued by the Financial Intelligence Unit of the Mexican tax authorities

On 21 October 2016, the Financial Intelligence Unit of the Ministry of Finance and Public Credit issued a notice for those rendering outsourcing services under Article 15-A of the FLL. The notice establishes that outsourcing services will be considered a "vulnerable activity" in terms of Mexico's anti-money laundering law, the Federal Law on the Prevention and Identification of Operations from Illicit Sources. Service companies engaged in vulnerable activities must comply with certain legal obligations. Although vulnerable activities would not affect the ability of a service company to deduct payments made to employees for services provided to the operating company, service companies would be subject to money-laundering penalties.

Considerations

As a result of these developments, beginning 1 January 2017, the level of compliance will increase for operating companies. Operating companies that fail to comply with the requirements will not be able to deduct the payments made to service companies and credit the related VAT.

In this regard, it is essential for taxpayers to evaluate their compliance with the requirements set out in Article 15-A of the FLL; otherwise, the payroll-related services will be non-deductible and VAT will not be creditable. In addition, compliance with the anti-money laundering rules must be met or money laundering penalties may apply.

For additional information with respect to this Alert, please contact the following:

Mancera, S.C., Mexico City

‣ Enrique Ramírez	+52 55 5283 8757	enrique.ramirez@mx.ey.com
‣ Nora Morales	+52 55 5283 8604	nora.morales@mx.ey.com
‣ Manuel Gonzalez	+52 55 5283 8632	manuel.gonzalez@mx.ey.com

Mancera, S.C., Monterrey

‣ Juan Pablo Lemmen-Meyer	+52 81 8152 1828	jpablo.lemmen@mx.ey.com

Ernst & Young LLP, Latin American Business Center, New York

‣ Ana Mingramm	+1 212 773 9190	ana.mingramm@ey.com
‣ Pablo Wejcman	+1 212 773 5129	pablo.wejcman@ey.com
‣ Enrique Perez Grovas	+1 212 773 1594	enrique.perezgrovas@ey.com
‣ Calafia Franco	+1 212 773 2779	calafia.francojaramillo@ey.com

Ernst & Young LLP, Latin America Business Center, Chicago

‣ Michael Becka	+1 312 879 3370	michael.becka@ey.com

Ernst & Young LLP, Latin America Business Center, Houston

‣ Oscar Lopez-Velarde Perez	+1 713 750 4810	oscar.lopezvelardeperez@ey.com

Ernst & Young LLP, Latin America Business Center, Miami

‣ Terri Grosselin	+1 305 415 1344	terri.grosselin@ey.com

Ernst & Young LLP, Latin America Business Center, London

‣ Jose Padilla	+44 20 7760 9253	jpadilla@uk.ey.com

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