International Assignment Strategies and Their Tax Implications in Mexico

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Introduction

Tax issues and global mobility go hand in hand, impacting both employees and employers. That said, tax issues related to the operation of affiliated employer entities are rarely understood in the world of Global Mobility and Human Resources, as the focus is typically on immigration, payroll and employment relationship issues.

In fact, companies operating in Mexico must consider several corporate tax risks. For instance, companies are subject to taxes in the country of assignment, without the right to take deductions or value-added tax credits. Additionally, there may be penalties imposed on companies that inaccurately report.[2]

Furthermore, if employees fail to fully comply with their tax obligations, they may become classified as tax evaders, potentially leading to fines and penalties in less severe cases, or imprisonment in more severe instances.

In my experience as a business consultant, I have advised many clients to use the following table to define how they manage their international assignments:

Business Objectives	Type of Assignment	Business Benefits	Type of Compensation	Tax Protection
▪ Lack of talent in the host country ▪ Rapid business growth	Short-term assignment or rotational assignments	Primarily, short-term reputational	Travel expenditure and advances of expenditure without verification	Pyramid on unproven expenses
▪ Development of organizational culture ▪ Strengthening internal controls ▪ Transfer of know-how ▪ Development and innovation	Medium-term assignments between 12 and 24 months	Primarily medium-term, after 3 years	Salary, performance bonuses, housing assistance, family travel assistance, increased number of vacation days	Tax equalization to the country of origin; that the employee is not benefited or affected by the tax rate of the country of assignment and additional support
▪ Talent development ▪ Leadership development	Long-term, longer than 3 years with the possibility of extension of another 2 years	Long-term, more than 5 years with strategic focus	Salary, performance bonuses, housing assistance, participation in stock plans, home travel aid, family travel assistance, dependent education assistance	Tax equalization to the country of origin; so, the employee is not benefited nor affected by the tax rate of the country of assignment and additional support

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2 For a definition of permanent establishment, please refer to Art. 2 of the Mexican Income Tax Law.

To properly document how the cost of the assignments will be shared under any of the assumptions mentioned in the table above, it's necessary to execute inter-company contracts. For example, within the second strategic group of assignments (i.e., transfer of knowledge, development, or innovation) agreements covering such areas as technical assistance, technology transfer, or any other arrangement facilitating the exchange of industrial expertise should be established.

Corporate tax issues, including transfer pricing studies, fall under Title VI, Chapter II of the Income Tax Law. In the context of employee mobility, this is an area that deals with how to document the cost of employees and perform inter-company charges within a group of companies. All inter-company agreements signed by Mexican companies with their foreign affiliates must comply with these regulations.

Therefore, international mobility professionals must adequately understand transfer pricing and inter-company chargeback issues, as this significantly impacts a company's ability to deduct operating costs, which are fundamental in determining taxable profits from a corporate tax perspective. Improper management of transfer pricing could affect the amount of the company's general deductions if the rules and regulations established in each country are not met.

BEPS and Its Influence on Global Taxation Reforms

The international tax framework of corporate taxation has undergone significant changes in recent years. In part, these changes have been prompted by efforts to combat tax avoidance and evasion, which have become priorities for the SAT (Tax Administration Service of Mexico). Therefore, it is not surprising that tax reforms in Mexico enacted since 2020 have been significantly influenced by the BEPS project (Prevent Base Erosion and Profit Shifting).

The BEPS project was developed by the Organization for Economic Cooperation and Development (OECD) and the G20, culminating in the 2013 report entitled, "Focus on Base Erosion and Profit Shifting." In it, the OECD and the G20 scrutinized the deficiencies in both national and international tax regulations that create tax loopholes and opportunities for tax avoidance.

The project targets those countries that have recognized the international scope of the problem and have decided to coordinate their efforts to eliminate these tax deficiencies. Two years after the report's release, the OECD issued specific recommendations for member countries, outlining tax rules that should be applied at the national and international levels, with a focus on 15 priority areas. Since then, significant progress has been made, and an increasing number of countries are now implementing the proposed measures.

From a global mobility perspective, two BEPS actions warrant particular attention: Action 7, which is aimed at preventing the artificial cancellation of permanent establishments, and Action 13, which focuses on country-by-country reporting.

Considering these recent BEPS changes, it is advisable that organizations review their inter-company agreements and transfer pricing policies and ensure they comply with BEPS standards to minimize potential risks. It is important to note that policies applicable to international or expatriate assignees may no longer be appropriate if they do not consider the specific activities, roles, levels, and nature or value of services provided by international assignees.

Best Practices

It is a common practice for companies to engage in inter-company loans of employees. Known as a secondment, this typically involves a company temporarily assigning an employee to another company in a different country. The host company will normally benefit, directly or indirectly, from the activities performed by the seconded employee. However, there are specific regulations that must be followed.

To adhere to best practices, the originating company should establish and maintain thorough accounting and contractual documentation that clearly outlines the employee's assignment activities and associated costs. This may include:

- Terms and conditions of the assignment (secondment).
- Description of the functions and activities to be performed by the assigned employee.
- Detailed breakdown of costs incurred.
- Criteria used for determining the costs charged.
- Terms for distributing the costs among the participating companies.

Often, the costs charged between entities pertain to labor and payroll expenses. However, it is common for entities to agree upon an additional surcharge to recognize and compensate the full services provided by the original employer, which aligns with the objectives of the BEPS project.

It is always advisable to clearly identify who will absorb the costs through an inter-company agreement (secondment agreement). This agreement should be separate from the letter of assignment or addendum of assignment signed by the employee. Under these types of agreements, the company sending the employee retains the employment relationship during the assignment period and can continue to pay the employee's salary and manage job and seniority benefits, bonuses, taxes, unemployment insurance, and social security contributions. These costs and expenses should in all cases be reimbursed by the host company, which can assume the additional expenses for travel, accommodation, food, materials, and supplies directly provided to the assignee.

Both the issuing and hosting companies can collaborate to determine how these costs will be allocated between them. In the decision-making process, it will be necessary to consider the strategic objectives of the assignment, the type of mobility policy (as outlined in table A), the allocation of short- and long-term labor benefits, as well as the profit margins that must be applied.

Also, it is important to note that inter-company charges can have implications on the assignee's tax obligations. For example, these charges may impact tax treaty exemptions or be a determining factor in the operation of mirrored payroll systems in both companies.

Suggested Actions to Take

In light of the BEPS changes, it is advisable that organizations conduct a comprehensive review of their inter-company agreements, transfer pricing policies, and criteria related to personnel assignments. This assessment is critical in ensuring that these agreements and policies align with BEPS standards and do not introduce additional risks. In the event that risks are identified, it is imperative to thoroughly evaluate and document them in order to develop a well-informed approach to risk management.

Additional Considerations

Given the changes in the definition of permanent establishment (PE) as part of the BEPS project, international assignees may create hidden PE risks. It would be prudent to review the authority given to assigned employees for negotiating and signing contracts and determine whether they are operating in a consultant or advisory role.

BEPS has also increased reporting and transparency requirements. That said, another relevant consideration for global mobility professionals is reporting on a country-by-country basis and tracking the number of full-time international assignees and those contributing per project. It is critical that your organization pays close attention to how it manages international assignees on a global scale.

Conclusion

Those working in the field of global mobility should consider consulting with their internal transfer pricing experts and work closely with their tax advisors. In addition, it is imperative to create robust and well-structured supporting documentation. In the event of a review by tax authorities, this documentation can play a pivotal role in helping to mitigate the risk of fines or penalties. Effectively addressing such reviews in an efficient and timely manner is key to safeguarding against adverse financial consequences.