

Tax Alert: Main Regulations for the Integrated Logistics Bonded Zone

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Saudi Arabia has issued the main regulations, including the Tax Regulations and Employment Regulations, for its first special economic zone, the Integrated Logistic Bonded Zone (ILBZ) that was announced in October 2018.

This initiative is part of Saudi Arabia's ambitious goal to make Riyadh one of the largest ten-city economies in the world and is in line with Vision 2030 efforts to make Saudi Arabia a globally competitive transportation and logistics hub for the movement of goods and services.

The ILBZ is located adjacent to the King Khalid International Airport in Riyadh and will, among other things, provide direct and indirect tax benefits and exemptions to local companies and foreign investors.

Eligibility

A company or branch of a company that is licensed to carry out activities in the ILBZ ("established entities") will be eligible for tax benefits and exemptions in relation to the following prescribed activities:

- Maintenance, repair, processing, modification, development, assembly and storage of goods;
- Sorting, packing, repacking, trading in, distributing, dealing with and using goods in any form (including simple manufacturing operations);
- Import, export and re-export;
- Value-added services, logistics services, and after sales services; and
- Recycle waste and e-waste.

The General Authority of Zakat and Tax (GAZT) will issue additional guidance to clarify the conditions and the procedures that need to be followed by established entities to benefit from the ILBZ tax benefits and exemptions.

Duration of tax benefits and exemptions

The tax benefits and exemptions are applicable from the date the established entity obtains its trading license to carry out activities in the ILBZ until the earliest of the following:

- 50 years from the day the license is obtained; or
- the established entity ceases its activity in ILBZ.

Tax benefits and exemptions

The tax benefits and exemptions that are available to established entities:

- **Income tax** at a zero percent (0%) rate for income derived from the prescribed activities;
- **Disregard of permanent establishments** of non-resident entities conducting activities related to goods in Saudi Arabia, provided the non-resident has no physical presence in Saudi Arabia;
- **Withholding tax** exemption for the following payments related the prescribed activities:
 - Dividends;
 - Loan charges;
 - Royalties paid to related persons; and
 - Payments for services (including technical services) to related persons;
- **Customs duty** suspension for goods imported into or transported within the ILBZ. No customs duty would be applicable until goods enter the KSA mainland for home consumption; and
- No **VAT** on supplies or transactions occurring with respect to goods in the ILBZ. Such supplies would be outside the scope of VAT as the supplies occur under customs duty suspension.

The Tax Bylaws refer to a special VAT refund scheme that will be introduced to allow ILBZ entities to recover input VAT incurred on services acquired from VAT-registered suppliers in the Kingdom. The GAZT will issue additional detailed guidance on the application of these tax benefits and exemptions.

The regulations are silent in relation to Zakat. Accordingly, it is expected that the introduction of the ILBZ will not affect the application of the Zakat.

Anti-avoidance

There are “anti-avoidance” rules that deny tax benefits and exemptions to an established entity if that entity or a “related person” of the entity carries or carried out prescribed activities outside ILBZ (“mainland”) and then ceased or substantially reduced such prescribed activities there and the prescribed activities are then:

- carried out from ILBZ by that established entity; or
- carried out from ILBZ by one or more related persons who are also established entities; or
- carried out from ILBZ by any other established entity as part of an arrangement to move activities from the mainland to ILBZ for the purpose of obtaining a tax benefit or an exemption.

It would therefore seem that established companies that already have prescribed activities in the mainland may benefit from the ILBZ tax benefits and exemptions for prescribed activities carried out in the ILBZ as long as their mainland prescribed activities do not cease or reduce substantially.

The GAZT may also deny tax benefits and exemptions to established entities if they facilitate payments to non-residents on behalf of a “Person” (i.e., a natural person, corporate person or the State) not eligible for the tax benefits and exemptions.

Compliance obligations

An established entity remains subject to the Saudi Arabian Income Tax Law and By-Laws as well as the following compliance obligations:

- submission of an annual confirmation to GAZT that it complies with the ILBZ requirements.
- preparation and maintenance of books and records for each year, which separately disclose information relating to prescribed activities and non-prescribed activities (if applicable).

Employment Regulations

Employment relationships between individuals and established entities, are governed by special employment regulations. These regulations include the following measures:

- sponsorship for Saudi work and residency through ILBZ for non-GCC country national employees;
- employees of established entities may not work outside the zone without obtaining the express approval of the Department for the ILBZ;
- equal opportunities to both Saudi and non-Saudi nationals (i.e. no Saudi quota); and
- the employee's salary may be paid:
 - in any currency; and
 - into a local or foreign bank account.

Get in touch

<https://home.kpmg.com/sa>



Riyadh Office

Wadih Abu Nasr

Head of Tax, Saudi Levant Cluster

E: wabunasr@kpmg.com

Nick Soverral

Senior Director,
Head of Indirect Tax

E: nsoverall@kpmg.com

Peter Bourke

Senior Director,
M&A/ Int'l Tax

E: peterbourke@kpmg.com

Mohamed Araj

Senior Director,
FS/ Tax Reimagined

E: maraji@kpmg.com

Ali Sainudheen

Senior Director, Domestic Tax

E: asainudheen@kpmg.com

Raza Qadir

Senior Director, Corporate Tax and Advisory lead- Riyadh
GCMS and inbound compliance lead

E: razaqadir@kpmg.com

Saber Al Zawaideh

Director, Domestic Tax

E: salzawaideh@kpmg.com

Faisal Tanvir

Director, Domestic Tax

E: FTanvir@kpmg.com

Oleg Shmal

Director, Indirect Tax

E: oshmal@kpmg.com

Jeddah Office

Mohamed ElSwefy

Senior Director, Family Office & Private Clients

E: mohamedelswefy@kpmg.com

Salam Eido

Director, Indirect Tax

E: seido@kpmg.com

Muhammad Masood

Director, Domestic Tax

E: muhammadmasood@kpmg.com

Khobar Office

Tareq Al Sunaid

Partner, Head of Domestic Tax

E: talsunaid@kpmg.com

Mohammad Kamran Sial

Senior Director, Domestic Tax

E: ksial@kpmg.com

Anil Bahl

Director, Indirect Tax

E: anilbahl@kpmg.com

Mohamed Gouda

Director, Domestic Tax

E: mohamedgouda@kpmg.com

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