

# VAT Treatment of Demurrage and Despatch Charges in Logistics Services

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## Facts

A logistics company (Company) based in the UAE acts as an intermediary in arranging the transportation of goods for its clients. The transportation itself takes place entirely outside the UAE.

The Company contracts a foreign carrier to transport goods on behalf of its client. If the client delays unloading beyond the free time allowed in the contract, the carrier charges demurrage to the logistics company. The Company, in turn, passes the demurrage costs to the client as a reimbursement or a separate charge.

Conversely, if the client unloads the goods earlier than the allowed time, the carrier pays a despatch incentive to the Company. The Company passes these earnings to the client.

The demurrage and despatch charges arise from contractual agreements between the carrier, the logistics company, and the client. While the logistics company does not operate the transport vehicles, it arranges transportation and related charges. However, all agreements with the carrier and the client are made in the name of the logistics company. The contract with the carrier remains distinct from the contract with the client.

Neither the foreign client nor the foreign carrier is registered in the UAE.

## Questions

- 1) Should the demurrage amount paid by the logistics company to the carrier be subject to UAE VAT under the Reverse Charge Mechanism (RCM), considering that the transportation occurs outside the UAE?
- 2) When the logistics company charges the client for demurrage, should this be considered an onward taxable supply, or is it a disbursement outside the scope of VAT?
- 3) If the logistics company receives a despatch incentive from the carrier, should this be treated as a VATable supply in the UAE?
- 4) When the logistics company passes the despatch earnings to the client, should RCM be applied?

## The summary

Based on the facts and analysis below, we conclude that:

- 1) Since the Company contracts the carrier in its own name and incurs the cost itself, the recharge is classified as a reimbursement, making it a taxable supply unless an exemption or another out-of-scope treatment applies.

- 2) Demurrage fees arise from loading/unloading delays and are closely tied to transport-related services. The place of supply for transport-related services is where transportation begins. When transportation starts outside the UAE, demurrage falls outside the UAE VAT scope.
- 3) Demurrage may also be considered liquidated damages, which are outside VAT scope, regardless of where transportation occurs.
- 4) Another alternative is to treat demurrage as an adjustment to the freight charge. In this case, demurrage modifies transportation service costs, making it functionally equivalent to a surcharge on transport services conducted abroad, ultimately placing it outside UAE VAT scope.
- 5) Since the place of supply for demurrage is outside the UAE, RCM does not apply.
- 6) Similar to demurrage, despatch is linked to transportation efficiency and is either:
  - a) A transport-related charge, or
  - b) A discount on transport services, reflecting cost savings.

In either case, despatch follows the same VAT treatment as demurrage—if transportation starts outside the UAE, despatch payments are outside UAE VAT scope, and RCM does not apply.

## Analysis

### Demurrage

- 1) Under Laytime Definitions for Charter Parties [2013](https://www.bimco.org/media/qy2neqim/laytime-definitions-for-charter-parties-2013-v2.pdf), demurrage shall mean '*an agreed amount payable to the owner in respect of delay to the Vessel once the Laytime has expired, for which the owner is not responsible*'. The Laytime means '*the period of time agreed between the parties during which the owner will make and keep the Vessel available for loading or discharging without payment additional to the freight*'.<sup>1</sup>
- 2) When the Company incurs pays demurrage and subsequently recharges it to a foreign buyer, the VAT treatment depends on whether the recharge is considered a disbursement or a reimbursement as per VAT Public Clarification [VATP013](#):
  - Disbursement: If the Company acted as an agent on behalf of the foreign buyer when incurring the demurrage fees, the recharge might be treated as a disbursement. In such cases, the amount recharged is outside the scope of UAE VAT, and no VAT is applied.
  - Reimbursement: If the Company incurred the demurrage fees as a principal, the recharge is considered a reimbursement. This is treated as a taxable supply, and the standard VAT rate of 5% applies unless it could be 0% rated as export of services or treated as being out of scope of VAT.

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<sup>1</sup> <https://www.bimco.org/media/qy2neqim/laytime-definitions-for-charter-parties-2013-v2.pdf>

Considering that the Company pays for the services of the foreign carriers in its own name (and not in the name of the foreign client), and the invoice for the freight is issued to the Company, the recharge of the demurrage fees to the foreign buyers should be viewed as reimbursement.

- 3) Since demurrage is a charge tied to the extended use of the vessel, it could be classified as Transport-Related Services.

The Transport-related Services defined as '*shipment, packaging and securing cargo, preparation of Customs documents, container management, **loading, unloading, storing and moving of Goods, or any other closely related services** or that are necessary to conduct the transportation services*'.<sup>2</sup>

A demurrage claim arises under a voyage charterparty when the charterer exceeds the allocated time for loading or unloading cargo, known as "laytime". In such cases, the shipowner has the right to impose a charge on the charterer for exceeding the agreed laytime. This charge, termed 'demurrage,' is determined based on a pre-agreed rate and is calculated according to the additional time taken for loading or discharging beyond the permitted period.

Considering this, demurrage fee could be attributed to both loading and unloading the goods and their transportation. Therefore, the demurrage should be treated as transport-related fee.

The place of supply of transportation services and Transport-related Services is the place where the transportation starts.<sup>3</sup> Therefore, where the transportation starts outside the UAE, the Place of Supply thereof is outside of the UAE VAT scope. Consequently, the reimbursement of demurrage fees to the foreign buyers should be out of the UAE VAT scope.

- 4) The alternative treatment is to consider the demurrage as compensation based rather than service fee. For example, Russian Supreme Arbitration Court considered demurrage as liability for late fulfillment of obligations (penalty) received by the company from the counterparty. The Court held that demurrage fees does not relate to the payment for services, therefore they are not subject to VAT.<sup>4</sup>

This position is shared in some publications in the shipping industry. For instance, Turkish Heisenberg Shipping explains that '*the term "demurrage" originates from the French word "demeurer," which means "to delay" or "to be late." International maritime law recognizes demurrage as a standard clause in shipping contracts, particularly in charter party agreements. **It serves as liquidated damages for breaching the agreed laytime.** By imposing these fees, shipping companies ensure that cargo owners or charterers take responsibility for delays, maintaining efficiency in maritime operations*'.<sup>5</sup> Heisenberg proceeds stating that '**demurrage is "liquidated damages"** in

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<sup>2</sup> Article 1 of the [VAT Law](#)

<sup>3</sup> Art. 30(8) of the [VAT Law](#), Art. 22 of [the VAT Executive Regulation](#)

<sup>4</sup> The Resolution No. 05.02.2008 r. № [111444/07](#).

<sup>5</sup> <https://heisenbergshipping.com/what-is-demurrage/>

shipping contracts. This means that it is a pre-determined amount to **compensate for losses due to delays** beyond the agreed laytime. The definition of demurrage provides a clear, enforceable mechanism for addressing delays. Demurrage serves as a **form of liquidated damages, compensating the shipowner** for the delay’.

The UK Supreme Court in *Fronsdal & Co. (Owners of SS "Hansa") v. William Alexander & Sons* also referred to the demurrage as “**compensation payable for each day that the stipulated number of ‘lay days’ are exceeded**”, and damages: ‘... demurrage will be payable for each day that ‘laytime’ is exceeded. The significance of this is that, in the current case, the extent of damages will be limited to the agreed rate for demurrage unless there is also a maximum demurrage period after which **damages for detention** may be claimed by the ship owner’.<sup>6</sup>

In [VATP001](#), the FTA addressed the cases where ‘as part of business arrangements, businesses will often make payments to compensate each other for any loss, omissions or other wrongdoings. A question arises whether VAT is due on such payments’. The FTA ruled that:

- ‘Where a payment is not consideration for supply, no VAT is due on the payment’.
- ‘The question of whether or not a payment is consideration for a supply is the matter of fact. Typically, this requires the taxpayer to consider the underlying arrangements that give rise to the payment in order to determine whether the payee has provided anything in return for the payment’.
- ‘An example of such a compensatory payment are “**liquidated damages**”. Liquidated damages are predetermined amounts that parties to an agreement designate during the formation of the agreement for the injured party to collect as compensation upon a specific breach – for example, for an early termination of a contract or a **late performance**. The **purpose of such payments is not to provide consideration for a provision of any goods or services but to compensate a party for loss of earnings. As such, the payments are outside the scope of VAT**’.

Under this view, demurrage falls outside the scope of Emirati VAT even when transportation originates in the UAE.

This view appears controversial. For instance, the Russian Ministry of Finance oppose this view in its letters No. 03-07-11/164 dated 10 June 2011 and No. 03-07-11/101 03.04.2009. In these letters, the MoF held that demurrage should be treated as amount received in close connection with transportation services. This position could be relevant in the UAE, since in [VATP001](#), the FTA specified that ‘in determining whether or not a payment is consideration for any supply, it is necessary to consider the contractual and legal arrangements

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<sup>6</sup> *Fronsdal & Co. (Owners of SS "Hansa") v. William Alexander & Sons* [1919] [UKHL 611](#).

in full to determine the reason for the payment. Thus, it may be necessary to consider whether: ... the payment is consideration for any previously agreed goods or services; ... the purpose of the payment is to **adjust previously agreed consideration for a supply**...'. The demurrage (as well as the despatch fee) is likely to fit the text **in bold**, as it effectively represents either a surcharge or a discount on the price of transportation services.

However, in the cases at hand, it results in the same treatment as transport and Transport-related Services due to the transportation origin.

Therefore, there is no need to choose between transport-related, transportation, or compensation treatment, as all these approaches lead to the same outcome placing the supply outside the scope of Emirati VAT.

- 5) According to Art. 48(1) of the [VAT Law](#), 'if the Taxable Person **imports** Concerned Goods or **Concerned Services** for the purposes of his Business, then he shall be treated as making a Taxable Supply to himself, and shall be responsible for all applicable Tax obligations and accounting for Due Tax in respect of these supplies'. Concerned services are those 'that have been imported, where the place of supply is considered to be in the State, and would not be exempt if supplied in the State'.<sup>7</sup>

In Art. 48(3) of the [VAT Executive Regulation](#), the Cabinet specified: 'Where a Taxable Person who has a Place of Residence in the State receives a supply of Goods or Services **with a Place of Supply in the State**, from a supplier who does not have a Place of Residence in the State and does not charge Tax on that supply, the supply shall be treated as being of Concerned Goods or Concerned Services subject to Clause 1 of Article 48 of the Decree-Law'. As explained above, the Place of Supply of Transport-Related Services is where the transportation starts, that is outside the UAE in the cases at hand. Therefore, the RCM doesn't apply to these cases.

As per Section 7.4 of the [Taxable Person Guide for VAT](#), the reverse charge mechanism ('RCM') 'applies where:

- (1) the place of supply is in the UAE;
- (2) the supply would be subject to VAT in the UAE;
- (3) the supplier's place of residence is outside the UAE;
- (4) the recipient's place of residence is in the UAE; and
- (5) the recipient is VAT registered in the UAE.'

In addition to the conditions set out above, the reverse charge mechanism also applies where a registered person imports goods from outside the UAE'.

Consequently, to determine whether the UAE company, which purchases the above services from a foreign provider, is subject to the RCM, it is necessary to assess whether the five conditions outlined in Section 7.4 of the VAT Taxable Person Guide VAT are met. In particular:

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<sup>7</sup> Article 1 of the [VAT Law](#)

- The place of supply must be in the UAE. As stated earlier, the place of supply for Transportation Services and Transport-Related Services is where the transportation begins. Therefore, when transportation starts outside the UAE, the place of supply is outside the UAE and falls outside the scope of UAE VAT.
- Another condition requires that the supply would otherwise be subject to VAT in the UAE. As previously established, demurrage is likely to be an operation that is not taxable, even when the transportation occurs within the UAE.

Consequently, RCM does not apply to demurrage .

### **Despatch**

- 6) Laytime Definitions for Charter Parties 2013 define “DESPATCH MONEY or DESPATCH” as *‘an agreed amount payable by the owner if the Vessel completes loading or discharging before the Laytime has expired’*.<sup>8</sup> Hence, despatch refers to the time that the shipowner has been able to save since the charterer completed the cargo operations quicker than anticipated/agreed and was able to despatch (sail) the ship quicker than expected which is to the benefit of the ship owner.<sup>9</sup> The difference between demurrage and dispatch is that:

- demurrage is an overtime payment for delayed loading and/or unloading operations,
- while despatch is a reward paid for early completion of cargo operations.

Both are used to encourage efficiency and minimize delays in the loading and unloading process, since time is a critical factor in shipping.<sup>10</sup>

- 7) Despatch is a sort of bonus or reward for efficient turnaround. Similarly to demurrage, the despatch fees should be treated:

- either as closely tied to the transportation operation because the timely loading and unloading of goods directly impacts the overall shipping process, or
- discount related to the transportation services, and compensation paid to refund amount saved on payment for the transportation services.

Both classifications provide a single outcome placing the supply out of Emirati VAT scope, i.e. Emirati VAT doesn’t apply neither to the dispatch reward received nor paid.

### **The disclaimer**

Pursuant to the [MoF’s press-release](#) issued on 19 May 2023 “a number of posts circulating on social media and other platforms that are issued by private

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<sup>8</sup> <https://www.fonasba.com/wp-content/uploads/2018/10/VOYLAYRULES-2013.pdf>

<sup>9</sup> <https://www.maritimeoptima.com/shipping-academy/demurrage-and-despatch>

<sup>10</sup> Ibid.

*parties, contain inaccurate and unreliable interpretations and analyses of Corporate Tax”.*

The Ministry issued a reminder that official sources of information on Federal Taxes in the UAE are the MoF and FTA only. Therefore, analyses that are not based on official publications by the MoF and FTA, or have not been commissioned by them, are unreliable and may contain misleading interpretations of the law. See the full press release [here](#).

You should factor this in when dealing with this article as well. It is not commissioned by the MoF or FTA. The interpretation, conclusions, proposals, surmises, guesswork, etc., it comprises have the status of the author’s opinion only.

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