

China enacted VAT Law – a journey of reform ushering a new chapter in Chinese VAT system

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In brief

The 13th Session of the 14th National People's Congress Standing Committee reviewed and passed the draft of the Value-Added Tax Law of the People's Republic of China (hereinafter referred to as the "VAT Law"). China's first VAT Law will take effect on 1 January 2026 and replace the existing Provisional VAT Regulations which has been in effect for 31 years.

Looking back at the legislative process, the Ministry of Finance and the State Taxation Administration released the Draft VAT Law (Draft for Comments) (hereinafter referred to as the "Draft for Comments") to the public on 27 November 2019. In December 2022 and August 2023, the National People's Congress Standing Committee conducted two reviews of the Draft VAT Law (hereinafter referred to as the "Review Draft"). The Standing Committee held a meeting from 21 to 25 December 2024, to conduct the third review of the Draft. Based on the opinions of the Standing Committee and various parties, the Draft was further revised and ultimately promulgated as the VAT Law.

The enactment of the VAT Law is of great significance, marking another milestone in the process of China's tax legalisation. VAT is the largest tax revenue contributor in China. The elevation of VAT to the level of law has consolidated the achievements of VAT reforms since 1994, especially those in recent years. It enhances the certainty and stability of VAT policies, providing a more solid legal foundation for the VAT system. This is an important step in implementing the "principle of tax legality" as outlined in the Third Plenary Session of the 20th Central Committee.

Based on our previous analyses of the Draft for Comments¹ and the Second Review Draft², PwC conducted a comparative analysis of the difference between the VAT Law and the Second Review Draft in this Tax News Flash, together with a summary of key issues worth noting or pending clarification in the upcoming Detailed Implementation Regulations of the VAT Law (hereinafter referred to as the "DIR").

In detail

I. Differences between the VAT Law and the Second Review Draft

Compared to the Second Review Draft, the VAT Law has made the following substantive amendments:

1. The legislative purpose has been added, clarifying that the VAT Law is formulated to promote high-quality development, regulate the collection and payment of VAT, and protect the legitimate rights and interests of taxpayers. This establishes the guiding principle for the subsequent implementation of the VAT Law.

2. The concept of "individuals" in the VAT Law has been clarified to include individual proprietary businesses, consistent with the current VAT policy.
3. The legislative authorisation scope has been narrowed. Some content previously authorised to the State Council to decide in the Second Review Draft has been deleted, including other circumstances that should be deemed as taxable transactions, special circumstances applicable to the simplified tax calculation method, and special circumstances for calculating sales amounts under balance-based VAT method.

Regarding the above amendments, PwC believes that the scope of deemed taxable transactions is limited to the scope stipulated in the VAT Law. Without amending the law, no additional deemed taxable transactions should be added in the future. Meanwhile, for special circumstances for simplified tax calculation and calculating sales amounts under balance-based VAT method, they may be reflected in the VAT special preferential policies that the State Council can formulate under Article 25, along with other tax exemption and super-credit policies.

4. The clause "the tax calculation method for VAT on Sino-foreign cooperative exploitation of offshore oil and natural gas shall be implemented in accordance with the relevant regulations of the State Council" has been added to extend the current special treatment on such matters.
5. For overseas entities and individuals conducting taxable transactions within the territory of Chinese mainland, in addition to assigning the purchaser as the withholding agent, the option of "entrusting a domestic agent to declare and pay VAT in accordance with the regulations of the State Council" has been added, which is basically consistent with the current VAT policy and provides more convenience for taxpayers. How the purchaser determines whether the seller has entrusted a domestic agent to declare and pay VAT and whether they themselves have withholding obligations may be clarified in the upcoming DIR.
6. The phrase "related to taxable transactions" has been deleted from the definition of input VAT, which is consistent with the current VAT policy. Stakeholders should pay attention to how the upcoming DIR will clarify this point, and whether input VAT corresponding to non-taxable income can continue to be credited.
7. "Contraceptive drugs and devices" have been removed from the tax exemption items, which may be related to the overall macro policy of the country.
8. "Donations for public welfare" has been added to the circumstances for formulating VAT special preferential policies. According to Article 5 of the VAT Law, the gratuitous transfer of goods, intangible assets, real estate, and financial products is deemed as taxable transactions subject to VAT. On this basis, granting tax preferential policies to public welfare donations is conducive to encouraging taxpayers to contribute to public welfare.
9. It is clarified that "the State Council shall timely evaluate and adjust VAT preferential policies," so that VAT preferential policies can duly cater to changes in economic development and industrial policies.
10. It is clarified in the VAT Law that taxpayers "who renounce the preferential treatment shall not enjoy the tax preferential treatment within 36 months," which is consistent with the current VAT policy. At the same time, the provision "except for Small Scale Taxpayers" has been added, meaning that the 36-month restriction no longer applies to Small Scale Taxpayers.

II. Key issues to focus on in the DIR

For the upcoming DIR, PwC highlight the following points which deserve special attention:

1. Interpretation of VAT items and their classification

The VAT Law divides tax items into four major categories: sales of goods, services, intangible assets, and real estate. Given that there are three tiers of VAT rates and many preferential policies, the DIR needs to specify the meaning of each category and provide clear classifications to facilitate the application of different tax rates and tax policies to various transactions.

2. Definition of consumption of services and intangible assets within the territory of Chinese mainland

The VAT Law stipulates that taxable transactions occurring within the territory of Chinese mainland refer to "the services and intangible assets are consumed within the territory of Chinese mainland, or the seller being a domestic entity or individual (unless the second and third items of this article otherwise apply)." This is in line with the internationally accepted "Destination Principle" where VAT should be imposed in the country of consumption. For transactions where the seller is an overseas entity or individual, attention should be paid to the criteria for determining "consumption within the territory of Chinese mainland" in the DIR to further determine whether domestic entities have the obligation to withhold VAT.

3. Scope of cross-border services and intangible assets applicable to the zero VAT rate policy

The VAT Law stipulates that "the tax rate for domestic entities and individuals selling cross-border services and intangible assets within the scope specified by the State Council is zero." The scope of services and intangible assets applicable to the zero VAT rate may be clarified in the DIR. Attention should be paid to whether it is consistent with the current scope and whether the criteria for determining "consumption entirely outside the territory of Chinese mainland" will be further clarified.

4. How to determine the "main business" in mixed sales

The VAT Law stipulates that "if a taxpayer's single taxable transaction involves two or more tax rates or collection rates, the rate applicable to the main business of this transaction shall apply." Since a single taxable transaction may only have one price (instead of split price), in cases where there is different tax rates or treatments, it is necessary to determine the main business of the transaction. The DIR may clarify how to determine the "main business."

5. Issues related to input VAT

- In the VAT Law, the input VAT arising from interest on loan services is not included in the non-creditable input VAT. Therefore, it is important to note whether the DIR will list such input VAT as non-creditable input tax.
- Under the existing regulations, "only the relevant fixed assets, intangible assets, and real estate solely used for aforementioned items" cannot claim input VAT credit. However, the VAT Law does not mention this in the article addressing non-creditable input tax. We look forward to the clarification of this issue in the DIR.
- The VAT Law stipulates that "input VAT related to the purchasing of catering services, daily citizen services, and entertainment services that are directly consumed" cannot be credited. This expands the scope of input tax credit under current regulations. In practice, further clarification on how to determine "purchase and directly consume" may be required in the DIR.

6. Specific measures for VAT refund

The VAT Law clarifies that "for the portion where the current input VAT exceeds the current output VAT, taxpayers may choose to carry it forward to the next period for further credit or apply for a refund in accordance with the State Council's regulations." Therefore, the DIR or subsequent rules will further specify the mechanism and process for the VAT refund.

7. Specifics of VAT special preferential policies

The current VAT policies include various preferential measures such as exemptions, simplified tax calculation, calculation of sales amount under balance-based VAT method, and super-credit. Except for some exemptions related to basic livelihood and fundamental scientific research, which have been explicitly stated in the VAT Law, the integration, continuation, and termination of other preferential policies will be reflected in the VAT special preferential policies, warranting close attention.

The takeaway

The enacted VAT Law reflects the achievements of the VAT reforms over the past thirty years, marking a milestone in the process of tax legalisation in China. The VAT Law will officially take effect on 1 January 2026. PwC recommends that stakeholders assess the impact of the VAT Law on their operations in light of the changes in the VAT Law and the key points to focus on in the DIR, taking into account industry-specific characteristics and their own unique features, to fully prepare for the implementation of the VAT Law in the future.

PwC will continue to monitor the progress of the DIR and other related rules, share our insights, and assist relevant industries and enterprises in conducting in-depth research. Please stay tuned.

Endnote

1. For our insights on the Draft for Comments, please refer to PwC's article "VAT Legislation in Full Swing – Highlights of the Consultation Draft" published in 2019:
<https://mp.weixin.qq.com/s/lG3ke5YpPCUmUjMF7AoXlq>
2. For our analysis on the Second Review Draft, please refer to PwC's Tax and Business News Flash "A milestone in the VAT legislation process" published in 2023:
<https://www.pwccn.com/en/china-tax-news/2023q1/chinatax-news-jan2023-2.pdf>

Let's talk

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