



Key Insights on the New PRC VAT Law: Changes and Implications

Background

On December 25th, 2024, the Standing Committee of the 14th National People’s Congress of China voted to enact the *Value-Added Tax Law of the People’s Republic of China* (“**VAT Law**”), which will take effect on January 1st, 2026. With this landmark development, 14 of China’s 18 types of tax now rest on codified laws. By largely retaining existing VAT policies, the *VAT Law* achieves a delicate balance between maintaining continuity and paving the way for a refined and robust tax framework.

In this newsletter, we will focus on the *VAT Law*’s notable reforms, analyze key changes and evaluate their potential implications for taxpayers and cross-border transactions.

Key changes from the *VAT Law*

1. Refinement of the definition of “domestic taxable transactions”

The concept of “domestic taxable transactions” introduced by the *VAT Law* is a combination of the concept of domestic sales and domestic taxable activities under the current VAT regulations. However, the following changes exist:

Issue for comparison	Current regulations	<i>VAT Law</i>	Comment
Taxable domestic sales of services and intangible assets	Refers to the situations that either the seller or the buyer is located in China.	Refers to the situations that the objects sold are consumed in China or the seller is a domestic entity or individual.	The <i>VAT Law</i> respects the principle of taxation at the location of consumption, but the term “consumed in China” is still pending for further definition.
Taxable domestic sales of financial commodities	No clear definition	Refers to the situations that the sold financial commodities were issued in China or the	Under the definition from the <i>VAT Law</i> , it is clear that a foreign seller sells an offshore-issued financial

		seller is a domestic entity or individual.	commodity to a Chinese buyer is not subject to VAT.
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2. Narrow-down of the scope of “deemed taxable transactions”

The *VAT Law* imposes clearer boundaries on the scope of “deemed taxable transactions”, which is mentioned with the term “deemed sales” under the current regulations, so that the discretion from the taxation authorities will be limited.

Issue for comparison	Current regulations	VAT Law	Comment
Deemed taxable transactions	Includes various situations kept by the <i>VAT Law</i> and consignment sales, internal sales of goods between head office / branches, using the goods self-manufactured or processed under consignment mode for non-taxable projects, investment and distribution to shareholders, provision of services for free plus a “catch-all” provision	Only keeps the situations of using the goods self-manufactured or processed under consignment mode for group welfare or individual consumption and transfer of goods, intangible assets, real properties or financial commodities for free without “catch-all” provisions	The <i>VAT Law</i> is easier to implement than the current regulations and those free-of-charge intercompany leasing and loan service transactions will not be taxed under the <i>VAT Law</i> . However, on the other hand, in the case that internal transfer of goods between head office and branches is no longer taxed (i.e., no special VAT invoices will be issued for such internal goods transfer), how the VAT payment and input VAT credit can be properly allocated between the head office and branches may become a new treasury issue of those companies with branches registered as independent accounting units.

3. Listing of non-taxable transactions

The *VAT Law*, compared with the current regulations, provides a different list of non-taxable transactions.

Issue for comparison	Current regulations	VAT Law	Comment
Non-taxable transactions	Includes various items such as provision of railway or air transportation services for free under the state’s command, insurance compensation, special renovation funds of residential properties,	Includes the services provided by the employees to the employers, administrative fees and governmental funds, compensation due to expropriation and	The <i>VAT Law</i> does not cast light on the tax position of transfer of goods and real properties in the course of asset restructuring. If such transfer should not be taxed in the end whilst it is still not covered by this non-taxable transaction list, further regulations should be issued

	transfer of goods and real properties in the course of asset restructuring and interest derived from deposit	interest derived from deposit	to clarify the VAT position of such transfers.
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4. Streamlining of the applicable scope of simplified taxation method and the applicable VAT levy rates

The *VAT Law*, compared with the current regulations, has streamlined the scope of transactions to which the simplified taxation method applies and the applicable VAT levy rate under the simplified taxation method.

Issue for comparison	Current regulations	VAT Law	Comment
Scope of transactions to which the simplified taxation method applies	Apart from the transactions conducted by the small-scale VAT payers, public transportation services, HR outsourcing services, construction services, sales or lease of real properties may also be subject to simplified taxation method.	Only small-scale VAT payers and Sino-foreign cooperative exploitation of ocean petroleum and gas are mentioned to be subject to the simplified taxation method.	It is not clear under the <i>VAT Law</i> whether and under what situations the general VAT payers can be subject to the simplified taxation method.
Applicable VAT levy rate(s)	Apart from the VAT levy rate of 3% generally applicable to small-scale VAT payers, the VAT levy rate of 5% applies in other transactions to which the simplified taxation method applies.	3% is the only VAT levy rate mentioned by the <i>VAT Law</i> when the simplified taxation method applies.	It is not clear under the <i>VAT Law</i> whether and how the VAT levy rates other than 3% can apply to what situations.

5. Potential changes in determination of taxable sales amount

The *VAT Law* is not clear whether the “net proceeds” of certain transactions can continue to be the taxable sales amount. In addition, the basis for determining the taxable sales amount of deemed taxable transactions may also change.

Issue for comparison	Current regulations	VAT Law	Comment
Possibility for determining the taxable sales amount	The taxable sales amount shall generally be the total proceeds, but the situations such as	The stipulation of possible exceptional situations is not mentioned in the	If VAT can continue to apply to the “net proceeds” of certain transactions, there should be further clarification in the follow-up

based on "net proceeds"	determining the taxable sales amount based on the "net proceeds" as the difference between the sales price and the purchase price of financial commodities is allowed as the exceptional situations stipulated by the Ministry of Finance and the State Administration of Taxation.	relevant article of the <i>VAT Law</i> .	implementation rules of the <i>VAT Law</i> in this regard.
Basis for determining the taxable sales amount of deemed taxable transactions	The taxable sales amount of "deemed sales" is determined based on the average market price or a calculated composite taxable price.	The taxable sales amount shall be determined according to the <i>PRC Administrative Law of Tax Collection</i> (" Tax Collection Law ") and the relevant regulations. Under the <i>Tax Collection Law</i> , however, quite different determination methods are stipulated. For example, the taxable sales amount can be evaluated based on the tax burden of the comparable taxpayers, the revenue or cost-plus method, consumed energies and raw materials, etc.	The determination method under the <i>Tax Collection Law</i> is more general and is not as straightforward as the method stipulated under the current regulations. This may give rise to more leeway for discretionary evaluation from the tax authorities.

6. Update of the scope of non-creditable input VAT

The *VAT Law* has updated the scope of non-creditable input VAT by removing the input VAT arising from loan services and adding the restrictive conditions to non-creditable input VAT arising from catering services, life services and entertainment services.

Issue for comparison	Current regulations	<i>VAT Law</i>	Comment
Input VAT arising from loan services	It is clear that input VAT arising from loan services cannot credit against the output VAT liabilities.	The non-credibility of input VAT arising from loan services has been removed from the list.	The <i>VAT Law</i> gives a signal that the input VAT arising from the loan services (e.g., interests) may become creditable. If so, this policy will be very favorable to the taxpayers as many companies borrow loans from the banks or overseas lenders.

			However, this potential positive result may still be subject to further observation, because the <i>VAT Law</i> still gives a “catch-all” provision that the State Council is empowered to stipulate other non-listed situations where the relevant input VAT is not creditable.
Input VAT arising from catering services, life services and entertainment services	Input VAT arising from catering services, life services and entertainment services cannot credit against the output VAT liabilities without conditions.	Only the input VAT arising from these services “directly used for consumption” is not creditable.	It is a general rationale that the VAT relating to the purchase for personal consumption is not creditable. The restrictive condition added by the <i>VAT Law</i> has reflected this rationale, but this will bring the issue for further clarification how the relevant purchased services can be properly split by the taxpayers based on the use of the services.

7. Follow-up attention required to the preferential VAT policies

The *VAT Law* has set out the statutory VAT exemption policies, but whether and how the other preferential VAT policies stipulated by the current regulations will continue to be valid is not clear yet.

Issue for comparison	Current regulations	<i>VAT Law</i>	Comment
Preferential VAT policies	Apart from the statutory VAT exemption items, quite a lot of other preferential VAT policies, such as the Refund-upon-Levy policy applicable to software developers and financial leasing services, input VAT super-credit of advanced manufacturing enterprises, etc., are given.	Only the statutory VAT exemption items are mentioned in <i>VAT Law</i> .	It is expected that further regulations should be issued to clarify whether and how the non-statutory preferential VAT policies will continue to be valid for implementation under the new <i>VAT Law</i> regime.

Conclusion and suggestion

The enactment of the *VAT Law* represents a significant step forward in China’s tax-related legislative process and, in the meantime, refines the VAT system which aims at enhancing fairness, efficiency, transparency and compliance in VAT administration. Although there is still a year’s time for preparation before the *VAT Law* comes into effect, understanding the changes brought by the *VAT Law* and aligning the companies’ operation with the evolving tax framework will be crucial. Companies must stay ahead of

regulatory shifts, especially as the digitalization of tax management accelerates, and keep a close eye on the follow-up implementation rules of the *VAT Law* as well as the auxiliary regulations that may further clarify the unclear issues in the *VAT Law*.

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