



## Tax Newsflash

# New VAT law effective as from 1 January 2026

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On 25 December 2024, China's much anticipated VAT law was formally ratified by the Standing Committee of the 14th National People's Congress (NPC) of China and subsequently promulgated as Order No. 41 by the president of the People's Republic of China. A first and second draft of the legislation had been submitted to the committee for review in December 2022 and August 2023, respectively. The VAT law will come into effect on 1 January 2026, replacing provisional VAT regulations that have been in place for three decades.

As a tax generally imposed on sales of goods and services, China's VAT has made the greatest contribution to the country's tax revenues. To maintain a stable policy environment, the VAT law imports most of the existing VAT rules; however, certain changes that may impact businesses will be introduced.

This article provides a high-level discussion of certain key changes brought by the new law.

### Cross-border services

#### *Determination of place of supply*

Under the current VAT rules, the place of supply of services is deemed to be in China if the seller or purchaser is located in China. Under the new law, the supply of services would generally be deemed to be carried out in China if:

- the service is consumed in China; or
- the service provider is located in China.

A VAT obligation can be triggered only where a VAT-able transaction is carried out in China, therefore the location of a transaction plays a vital role in determining the applicability of VAT. Further clarification is required on how to determine whether the service is consumed in China, e.g., whether it is determined based on the location of the service recipient (aligning with the existing regulations), or where the service is actually used and enjoyed according to the OECD guidelines.

## *Withholding agents*

The VAT law provides that a domestic purchaser generally acts as a VAT withholding agent for a foreign seller that makes VAT-able supplies in China, except where a domestic agent is appointed under the regulations stipulated by the State Council.

The provision for this exception was initially omitted from the draft legislation but was subsequently reinstated in the final version. It is understood that this exception was introduced to address scenarios where the tax authorities may encounter challenges in collecting tax from Chinese purchasers (e.g., where there are multiple private individuals); however, the State Council has yet to provide the specific regulations relating to this exception.

## "Deemed sales" rules

The VAT law provides that a VAT-able transaction will be deemed to exist in the following situations:

- a. An entity or an individual industrial and commercial household uses self-manufactured goods (including goods consigned to other parties for processing) for personal consumption or employee welfare;
- b. An entity or an individual industrial and commercial household provides goods free of charge; or
- c. An entity or an individual provides intangible assets, immovable property, or financial products free of charge.

Unlike the current rules, the VAT law does not deem the free-of-charge provision of services (other than the sale of financial products, which is considered to be the supply of a financial service under the existing rules) to be a VAT-able transaction.

The draft law initially granted the State Council the authority to add more scenarios to those treated as "deemed sales"; however, the relevant provision has been removed in the final version. Consequently, any proposed addition to this list will have to be reviewed and approved by the NPC legislators.

## Input VAT from loan interest

The input VAT arising from loan interest had been explicitly listed as a noncreditable item under the existing VAT rules, published when the financial sector was brought within the scope of VAT in 2016. However, this restriction has been removed in the final VAT law.

Although taxpayers are likely to welcome this change, it is worth noting that the legislation grants the State Council the authority to broaden the range of input VAT that is not available for credit against output VAT. It therefore remains unclear to what extent the restriction on crediting input VAT arising from loan interest will be amended in the forthcoming State Council regulations.

## Mixed sales

A mixed sale is a single VAT-able transaction that is comprised of two or more elements, which would be subject to different VAT rates if the elements were provided separately. Under the existing VAT rules, only one rate (i.e., the "principal rate") is applied to a mixed sale, and the rate used is the one applicable to the taxpayer's main

business activities. The VAT law has amended this provision to use the rate applicable to the principal element in a mixed sale. A taxpayer would therefore need to review the composition of a mixed sale, rather than the taxpayer's normal business activities at the entity level, to determine the principal rate used for a mixed sale transaction.

### Net-off scheme

Under the existing VAT rules, output VAT is normally calculated based on a taxpayer's gross sales, i.e., the total consideration collected by a taxpayer, excluding any output VAT. However, in some special situations, certain items may be deducted from the gross sales figure to account for the output VAT (i.e., a "net-off" scheme). The draft law included the provision to grant the State Council the authority to determine where the net-off scheme can be applied, but the provision has been removed in the final version.

This change should not be interpreted as an indication that the net-off scheme is to be discontinued under the VAT law. Instead, further details of the scheme are likely to be provided in the upcoming implementing regulations.

### Preferential policies

The VAT law introduces the following key modifications to the current VAT preferential policies:

- Contraceptives and related devices are removed from the list of VAT-exempt goods;
- The State Council is granted the authority to develop special preferential policies to support small or micro-sized businesses, key industries, innovations, entrepreneurship, employment promotion, and charitable donations, and is also required to assess and modify these policies where appropriate; and
- A clarification has been provided regarding the waiting period, which is set at 36 months, for a general VAT payer to apply for a VAT preferential policy after having relinquished their entitlement to the policy.

### Electronic VAT invoices

Following the promotion of the use of electronic VAT invoices over previous years, the new VAT law explicitly validates that an electronic VAT invoice will have the same effect as a paper VAT invoice. It is also worth noting that, as from 1 December 2024, fully-digitalized electronic invoices have been rolled out nationwide.

### Deloitte China comments

With the implementation of the VAT law on 1 January 2026, it is anticipated that a suite of supplementary documentation, including implementing regulations, may be published within the next year. Certain key issues, such as the limitation on crediting input VAT arising from loan services, are likely to be addressed within these documents. Taxpayers may wish to closely monitor regulatory progress to evaluate potential implications for their operations and to formulate the appropriate strategic responses and action plans.

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