



## New milestone for VAT legislation

### In brief

- » China has enacted a new VAT Law, taking effect from 1 January 2026. The new law, while fine-tuning and aligning some VAT positions, has formalized and consolidated the VAT legislation which is currently based on provisional regulations and administrative rules.

Feedback



## 2025 (No. 3 issue)

Feb 2025

## In details

China's top legislative authority, the Standing Committee of the National People's Congress (NPC), adopted the "VAT Law" on 25 December 2024, with the law set to take effect on 1 January 2026.

VAT, as China's leading source of tax revenue (contributing RMB 6.7 trillion, or 38.1% of total tax revenue in 2024), plays a pivotal role in tax reform agenda. The law enactment marks a significant milestone, elevating VAT from provisional regulations to a law and concluding a decade-long reform process that began in 2012.

With the introduction of the VAT Law, fourteen out of eighteen tax categories in China have now been formalized into law. The remaining categories continue to be governed by regulations, administrative directives.

The new VAT Law has introduced some adjustments to the current provisional regulations, in terms of the scope of taxable and non-taxable sales, deemed sales, input credits, tax rates, withholding agents, and tax administration. The key changes are outlined below.

No.	Key changes	WTS China's comments
1	Fine-tuning "taxable sales"	<p>The VAT Law introduces stricter adherence to the principle of "onshore consumption" for VAT levying, significantly impacting the tax assessment of cross-border sales of financial products, services, and intangible properties (IPs).</p> <p>In particular, for sales of services and IPs, the implications are:</p> <ul style="list-style-type: none"> <li>The law replaces the current complex and fragmented provisions under various tax circulars, which determine taxability based on multiple factors such as the location of occurrence, usage, consumption, service recipients, goods and IPs.</li> <li>Instead, VAT will be levied on "onshore consumption" defined as: <ul style="list-style-type: none"> <li>Service or IPs consumed in <u>China</u>; or</li> <li>Service or IPs provided by a <u>China-based</u> entity or individual.</li> </ul> </li> </ul> <p>Under the new principle, certain transactions currently VAT-exempt may no longer qualify, for example services between two foreign parties involving onshore consumption. Such transactions may now be subject to VAT if they meet the new "onshore consumption" criteria.</p> <p>So far, the Circular 36 is still in effect and it is worth paying attention to some VAT zero-rated or exempted cross-border transactions under Circular 36 which may be affected depending on its future changes.</p> <p><i>(Articles 12 &amp; 13 of Circular 36 are compared with Article 4 of the VAT Law).</i></p>
2	Re-defining "deemed sales"	<p>The VAT Law goes beyond merely renaming "deemed sales" as "deemed taxable transactions". It introduces significant changes by:</p> <ul style="list-style-type: none"> <li>Including the free-of-charge transfer of financial goods; and</li> <li>Excluding the following four activities: <ol style="list-style-type: none"> <li>Consignment sales;</li> <li>Inter-province transfers of goods between branches;</li> <li>In-kind investments by or in-kind distributions to shareholders; and</li> <li>Free-of-charge services.</li> </ol> </li> </ul> <p>The exclusion does not automatically render them non-taxable. Their taxability will depend on the arrangements and some existing exemption regulations which may continue to apply even after the new law takes effect. The law does not explicitly address whether in-kind distributions for public welfare purposes are taxable. Thus further clarification from authorities may be pending.</p> <p><i>(Article 4 of regulations, Article 14 of Circular 36 are compared with Article 5 of VAT Law).</i></p>

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3	<p><b>Unifying VAT rate for “simplified levy”</b></p>	<p>The VAT Law introduces a unified VAT rate of 3% for the simplified levy method, eliminating the current dual-rate system (3% and 5%). This change simplifies the tax framework and provides greater consistency for taxpayers.</p> <p>However, the law does not address the future of the sales price net-off practice, which allows certain service sectors to exclude purchase costs or third-party collection charges from the sales price. It remains unclear whether this practice will continue under the new law.</p> <p>Currently, the sales price net-off method is governed by various regulations and circulars, including Circular 36. Whether these provisions will remain in force, be adjusted, or phased out is yet to be clarified, leaving uncertainty for affected sectors.</p> <p><i>(Articles 1 (3), 8 and 10 of Annex 2 under Circular 36 are compared with Article 11 of the VAT Law).</i></p>
4	<p><b>Eliminating “mixed sale”</b></p>	<p>The VAT Law has eliminated the term “mixed sale” which under the current regulations refers to sales of both goods and services in one transaction of different VAT rates, and the VAT rate is determined based on the principle business of the company (seller).</p> <p>Instead, the new VAT Law will determine the VAT rate per the “principle event” of each transaction. The change carries two significant implications:</p> <ul style="list-style-type: none"> <li>• <b>Broader scope:</b> The new approach extends beyond the traditional “goods + services” scenarios to include “services + services” and “goods + goods” transactions.</li> <li>• <b>Transaction-based assessment:</b> The VAT rate will be determined on a per-transaction basis, rather than being tied to the seller’s principal business. This shift could result in either favorable or unfavorable VAT rates, depending on the specifics of each transaction.</li> </ul> <p>This revision may create complexities for transactions involving multiple components where distinguishing the principal event from the subordinate one is difficult.</p> <p>Thus, expectedly the term “principle event” will need further definition.</p> <p><i>(Article 40 of Circular 36 is compared with Article 13 of the VAT Law).</i></p>

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5	Scaling down scope of "non-creditable input VAT"	<p><b>Loan services</b></p> <p>The VAT Law has removed "loan services" from the list of purchases ineligible for input VAT credit, a departure from the provisions of Circular 36.</p> <p>This change implies that input VAT incurred on loan interest payments will become creditable in the future—a positive development for borrowers.</p> <p>However, the practical implementation of this creditability remains unclear. For example, it is yet to be determined whether borrowers will need to provide a VAT invoice issued by the lender to support their input VAT credit claims.</p> <p><b>Catering, daily resident services, and entertainment services</b></p> <p>The VAT Law has replaced the term of "purchase" by "purchase and usage directly for consumption" when referring to service purchases not eligible for input VAT crediting.</p> <p>This modification underscores that input VAT creditability applies when the purchase is for business purposes.</p> <p>Currently, input VAT credits incurred in the purchase of catering services are not creditable. However, in the future, if these services are purchased for business purposes (e.g., in re-sale process) rather than direct consumption, their input VAT should be eligible for crediting.</p> <p>Therefore, it is necessary to see how "direct usage for consumption" will be defined in the forthcoming implementation rules.</p> <p><i>(Article 27 of circular 36 is compared with Article 22 of the VAT Law).</i></p>

## WTS China's observation

The VAT Law enactment has not only escalated the legal status of the VAT legislation but also brought about some refinements and modifications for the sake of simplicity, efficiency and alignment to international practice.

It is worth noting that the VAT Law has not yet been enforced until 1 January 2026. Some current regulations and circulars, especially Circular 36, still bearing exceptional or different treatments from the VAT Law, are still effective so far. Thus, some more clarification and reconciliation could be expected.

Notably, some of these cases could be affected by the new VAT law, either positively or negatively:

- Current VAT-exempt cases;
- Mixed sales cases;
- Loan interest cases.

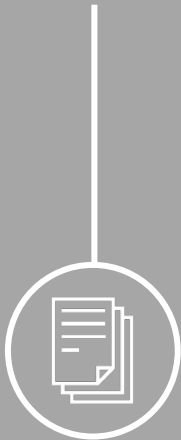
They should worth revisiting from a new perspective per the VAT Law.

In the meantime, with the full rollout of Phase IV of the Golden Tax System (a nationwide tax administration system), enterprises should stay tuned on system adjustments and make reasonable arrangements to ensure tax compliance.

2025 (No. 3 issue)

Feb 2025

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