

New VAT Law in China: Key Changes

The new VAT Law will take effect on January 1, 2026.

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INTRODUCTION

On December 25, 2024, the Standing Committee of the National People's Congress approved the new VAT Law (President's Decree No. 41), which will take effect on January 1, 2026.

The law introduces significant changes compared to the current Provisional Regulation on VAT, its Implementing Rules and Caishui [2016] No. 36 (the “**VAT Regulations**”).

However, the new VAT Law remains notably general, as its Implementing Rules and supporting regulations have yet to be released.

Consequently, many aspects will require further clarification before its full implementation.

In the meantime, this legal flash summarizes the key changes introduced by the new VAT Law.





Improved definition of VAT Taxable Transactions

VAT applies to two transaction categories: (i) the sale of goods, services, intangible assets, and real estate (“**Taxable Transactions**”) within Chinese territory; and (ii) the import of goods.

For Taxable Transactions, the new VAT Law:

- consolidates processing, repair and maintenance into services, meaning there are no separate references to these activities in the definition; and
- clarifies that “sale” refers to “paid” transactions, meaning unpaid transactions are not subject to VAT unless explicitly classified as Deemed Taxable Transactions.

To determine whether a Taxable Transaction occurs within Chinese territory, the new VAT Law introduces the following new criteria for the sale of financial products, services and intangible assets:

- For financial products, the products must be issued domestically, or the seller must be a domestic entity or individual.
- For services and intangible assets (excluding real estate sales or leasing, transfers of natural resource use rights, and financial product sales), services and intangible assets must be consumed domestically, or the seller must be a domestic entity or individual.

Narrowed scope of Deemed Taxable Transactions

The new VAT Law defines Deemed Taxable Transactions as follows:

- Entities and individual business operators using self-produced or commissioned processed goods for collective welfare or personal consumption.
- Entities and individual business operators transferring goods free of charge.
- Entities and individual business operators transferring intangible assets, real estate or financial products free of charge.

Based on the above, many activities deemed taxable under current VAT Regulations will no longer be taxable activities under the new VAT Law. For example, transfers of goods for sale across counties (cities) between a head office and its branches within the same legal entity, or the transfer of goods for investment or distribution to shareholders, will no longer be subject to VAT. Also, the sale of services free of charge is no longer considered a taxable activity for VAT purposes.

Three-tier tax rates maintained

The new VAT Law retains the three-tier standard VAT rates (i.e., 13%, 9% and 6%). For qualifying exports of goods, services and intangible assets, the zero rate continues to apply. Also, the simplified method continues to apply a collection rate of 3%.

As the new VAT Law does not grant the State Council the legislative authority to adjust VAT rates, the current 5% VAT rate for labor dispatch services, HR outsourcing services, qualifying real estate sales and leases, and other qualifying activities may be abolished and replaced with another rate stipulated in the new VAT Law. However, further clarification on this matter is needed.



Revision of VAT calculation method for overseas sale of services and intangible assets

Under current VAT regulations, when foreign entities provide services or receive royalties from domestic entities, the selling price is considered including the applicable VAT. Consequently, the seller is responsible for the VAT burden, which is a tax cost for the overseas seller. To calculate VAT, the following formula is used to first determine the VAT exclusive price, then the VAT:

$$\text{VAT to be withheld} = \text{price to be paid by the buyer} / (1 + \text{VAT rate}) \times \text{VAT rate}$$

However, because the buyer can recover the withheld input VAT through the VAT input-output deduction mechanism, the parties typically stipulate in the contract that the selling price excludes VAT, making the buyer responsible for the VAT burden while preserving VAT neutrality for both parties.

Under the new VAT Law, the calculation formula is updated as follows:

$$\text{VAT to be withheld} = \text{price to be paid by the buyer} \times \text{VAT rate}$$

This formula assumes that the selling price excludes VAT, adhering to the law's general principle that selling prices do not include VAT. In this sense, under the new VAT Law, for services and intangible assets sold by overseas suppliers, it could be understood that the buyer bears the VAT, making contractual arrangements to shift the VAT burden from sellers to buyers unnecessary. We need to wait for official interpretation on this change.

Excessively high or low selling prices subject to tax adjustment

Under the new VAT Law, the tax authorities may review selling prices that are considered excessively high or low (vs. only excessively low is subject to review under the current VAT Regulations) and that lack a valid justification. Therefore, if group companies manipulate prices—whether making them excessively high or low—solely to secure tax advantages, they have the risk of facing tax adjustments.

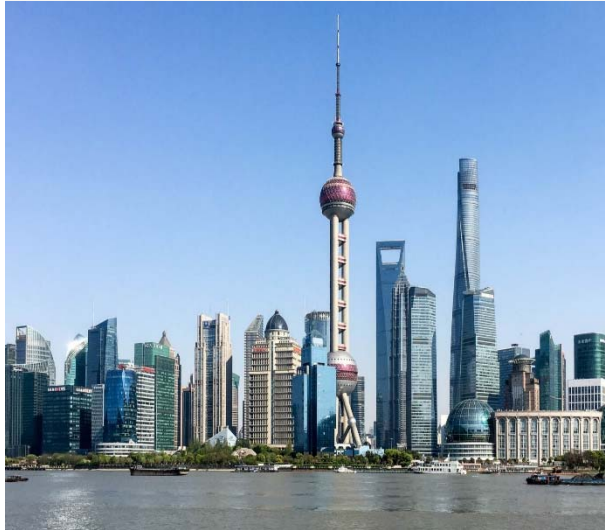
Option to carry forward or be refunded excess input VAT

If the input VAT for the current period exceeds the output VAT, taxpayers can either carry it forward to the next period for deduction or apply for a refund by following State Council regulations. Further clarification will be needed on the criteria to apply for the refund.

Revision of non-deductible input VAT

The list of non-deductible input VAT excludes input VAT on loan services. It remains unclear whether input VAT on loan services will be deductible starting next year or if its treatment will be clarified through State Council regulations, as the State Council holds the legislative authority to address this issue. If input VAT on loan services becomes deductible, it would significantly impact implementation, particularly in the financial market.

As noted, many details still require clarifications by the Implementing Rules of the new VAT Law and supporting regulations issued by the State Council. These include the preferential policies that will continue to remain in effect. These regulations are expected to be released later this year, before the new VAT Law becomes effective. We will keep you informed of any updates.



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