A milestone in the VAT legislation process

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In brief

During the 38th Session of the Standing Committee of the 13th National People's Congress (“NPC”) held in Beijing from 27 December to 30 December 2022, the Standing Committee of the NPC reviewed and released the *Draft VAT Law of the People's Republic of China* (hereinafter referred to as the “Draft Law”), which is an important milestone in China VAT legislation process.

PwC has compared the Draft Law with the *Consultation Draft of VAT Law of the People's Republic of China* (hereinafter referred to as the “Consultation Draft”) and summarized the main contents of the Draft Law from taxpayer, taxable transaction, input VAT credit and VAT collection and administration perspectives. We summarize below our insights and hope our analysis will help enterprises have a better understanding of the Draft Law, and prepare in advance for the potential impacts arise from the Draft Law.

Considering the Draft Law was prepared by leveraging relevant policies of the Consultation Draft, we also include our previous analysis of the Consultation Draft at the end of the article for your reference.

In detail

1. Taxpayer and Taxable Transaction

- Regarding the provisions on VAT taxpayer, the Draft Law keeps consistent with the prevailing VAT regulations. The Draft Law removes “organizations and individuals whose sales turnover is below the taxable threshold are not taxpayers” stipulated in the Consultation Draft.
- The Draft Law defines the taxable scope which includes sales of goods, service, intangible assets, and immovable property. The “processing, repair and installation services” is included in the taxable scope of “sales of service” which is in line with the Consultation Draft. The Draft Law removes the separate scope of “sales of financial products” specified in the Consultation Draft, and the “sales of financial products” would probably be included in the sales of service or sales of intangible assets in the future.
- The Draft Law leverages the concept of conducting taxable transaction “in China” specified in the Consultation Draft. The wording of “purchaser is domiciled in China” in the prevailing VAT regulations is removed.

- The scope of deemed sales in the Draft Law is generally in line with the Consultation Draft, except for one change: the Draft Law does not exclude situations of public welfare undertakings from the deemed sales scope (which was excluded in the Consultation Draft). However, this change does not necessarily mean that deemed sales shall be applied to public welfare undertakings. We need to pay further attention to the implementation rules of VAT Law or other VAT regulations. Overall speaking, the scope of deemed sales has been narrowed down compared with the prevailing VAT regulations, especially for the removal of deemed sales on service provision which is in line with the Consultation Draft.
- The Consultation Draft clarifies that, for the calculation of composite assessable value of import goods, consideration related to trade of services should not be included in the dutiable value. Compared with the Consultation Draft, the Draft Law deletes the relevant wordings about "excluding trade of service in the dutiable value" which may have an impact to those taxpayers who import goods. We suggest paying further attention to the implementation rules of VAT Law for clarification.
- In the Consultation Draft, for taxpayer who choose to apply simplified tax calculation method or choose to give up VAT preferential treatment, such VAT treatment shall not be changed within 36 months. While the Draft Law amends the wording as "such VAT treatment shall not be changed within a specified period". The definition for "specified period" will probably be clarified in the implementation rules of VAT Law.
- For mixed sales transaction, the Consultation Draft stipulates that if a single taxable transaction involves two or more VAT rates or collection rates, the VAT rate or collection rate applicable to the main item shall apply. The Draft Law further clarifies that the VAT rate or collection rate applicable to the main item refers to the main transaction item of the single transaction rather than the main business activity of the taxpayer.

2. Input VAT related Items

- The Consultation Draft stipulates that when determining the input VAT which is not eligible for input credit, the input VAT generated from fixed assets, intangible assets and immovable property refers to the situation that those items are specifically used for non-creditable transactions. The Draft Law removes such restriction which may have significant impacts on taxpayers who have input VAT generated from fixed assets, intangible assets, and immovable property. We suggest paying further attention to the implementation rules of VAT Law for clarification.
- Under the prevailing regulations, input VAT generated from catering services, resident daily services and entertainment services are not creditable. In the Consultation Draft, the condition of "acquired and consumed directly" was added for determining non-creditable input VAT items, which may imply that the input VAT generated from purchase of catering services, resident daily services and entertainment services which forms a part of the final product of an enterprise for resale purpose may be credited. The Draft Law retains the above wordings which may have a significant positive impact on the enterprises engaging in catering platform, traveling and exhibition business.
- Under the prevailing regulations, input VAT generated from loan service is not creditable. The Draft Law removes loan service from "non-creditable input VAT items" which may have significant impacts on taxpayers. We suggest paying further attention to the implementation rules of VAT Law and other VAT regulations for clarification.

3. VAT Collection and Administration

- The Draft Law further clarifies that when the VAT withholding agent is overseas, the VAT shall be paid in the place where the taxable transaction takes place.
- Regarding the tax period, the Draft Law removes the tax period of "half year" in the Consultation Draft which is consistent with the prevailing VAT regulations.
- The Draft Law states that "electronic invoice has the same legal effect as paper invoice" and "the State Taxation Administration actively promotes the use of electronic invoice", laying a foundation for the further implementation of electronic invoice nationwide.
- The Draft Law increases the relevant parties for "establishing VAT related information sharing mechanism and working cooperation mechanism", from four to six subjects compared with the Consultation Draft.
- The Draft Law deletes relevant descriptions about the mechanism of depositing VAT.

The takeaway

The Draft VAT law submitted to the Standing Committee of the NPC for review basically follows the prevailing VAT regulations. It is a collection and summary of the achievements of the B2V reform and VAT deepening reform over the past decade. It is also a historic and important step in the VAT legislation process. It is expected that the Draft VAT law, after public consultation and further review and consideration by the NPC, may be approved and promulgated in the form of law in 2023 at the earliest. Subsequently, the State Council will publish implementation rules of VAT Law which would be implemented together with the VAT Law. Regarding the in-depth analysis on the Consultation Draft, please refer to the News Flash Issue 38 in 2019: VAT Legislation in Full Swing – Highlights of the Consultation Draft.

PwC suggests taxpayers to closely monitor the progress of the VAT legislation and its implementation regulations, especially for the differences between the Draft VAT law and the prevailing VAT regulations. Taxpayers should assess the potential impacts and take proper actions in advance. PwC will keep a close eye on the progress of VAT legislation and assist relevant industries and enterprises to conduct in-depth studies on the business impacts.

In addition, PwC welcomes the valuable comments on the Draft VAT Law from enterprises. PwC will summarize the comments and communicate with relevant authorities regarding the feedback and suggestions from respective industries during the VAT legislation process.

Let’s talk

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