

On Constitutive Requirements of VAT Taxable Transaction and Perfection of Related Legislation in China*

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Abstract

Taxable transaction forms the necessary content of the objective requirement of VAT taxable activities, which can be divided into ordinary taxable transaction and deemed taxable transaction, referring to the sales of goods and services and the deemed sales of goods and services respectively. But the definitions of the constitutive requirements of taxable transactions are unclear, incomplete and unscientific in existing China's VAT legislation. The future China's VAT legislation can be improved in the following aspects: firstly, under the classification of goods and services as the two fundamental taxable objects, define the sales of goods as the transfer of ownership or disposal rights for consideration, reflect a certain degree of generality, define goods by circulation, and enumerate the scope of goods; secondly, define the meaning of supplying services, by clarifying that the supply of services consists in fulfilling an obligation of action, inaction or permission, highlight its underpinning nature, and enumerate the scope of services; thirdly, define the requirement of for consideration individually, by highlighting that the acquisition of economic benefits is related to the transfer of goods and the supply of services and there is a direct correlation between them; lastly, restrict the composition of the deemed taxable transaction, by limiting its scope from multiple perspectives and adding the constitutive requirement of deductible input tax to the deemed sales activities such as use of merchandise for non-business activities and the gratuitous gifting of goods.

Keywords: VAT Legislation; Sale of Goods; Supply of Services; For Consideration; Deemed Taxable Transactions.

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SUMMARY: 1. The constituent requirements of ordinary taxable transactions – 1.1 The sales of goods – 1.2 Sales of services – 1.3 For consideration – 2. Constitutive requirements of deemed taxable transactions – 2.1 Fundamental characteristics of deemed taxable transactions – 2.2 Limitations on scope of deemed taxable transactions – 2.3 Two special types of deemed taxable transactions – 3. Perfection of legislative provisions on VAT taxable transaction – 3.1 Perfection of provision on ordinary taxable transactions – 3.2 Perfection of provision on deemed taxable transactions – Bibliography

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Value-added tax (VAT) is the most significant tax in China in terms of revenue raising.¹ From an economic perspective, VAT is a general tax on consumption, which is levied on the consumption of all goods or services, and constitutes a consumption tax in a broad sense. Accordingly, VAT is distinguished from consumption tax in a narrow sense (excise duty), which is additionally imposed on the consumption of specific goods or services. However, from a legal perspective, VAT is a tax on transactions with exception of VAT levied on the imports of merchandise (tangible movables) carried out by any person. VAT is usually imposed on the sale of goods or services where the taxable person is the seller and the amount of tax equals the consideration for the sale multiplied by a proportional tax rate. The legal perspective refers to the legislative provisions on the object of taxation. For example, the article 1 of 2017 Interim Regulation of the People's Republic of China on VAT (hereinafter the VAT Interim Regulation) stipulates the taxation object of VAT as "sell merchandise or labor services of processing, repair or replacement, sell services, intangible assets, or immovables, or import merchandise". But the taxable person pays the tax to the tax authorities without bearing the actual tax burden, because the tax paid by the taxable person is obtained from payment carried out by buyer, which means that the tax burden is shifted to the buyer. The tax shift is an economic phenomenon, which also gives an economic explanation of VAT as a tax on consumption.

As VAT is a tax on transactions, it is not difficult to find that the objective requirements of VAT taxable activities play the central role for constitution of VAT taxable activities which leads to the tax obligation or determines the basis on which tax obligation arises. In this regard, the article 1, paragraph 1 of the VAT Law (Draft) of the People's Republic of China (hereinafter the Draft), published in September of 2023, provides that entities and individuals that sell merchandise, services, intangible assets or immovables within the territory of the People's Republic of China, or import merchandise, are VAT taxpayers, and shall pay VAT in accordance with this Law. Except for imports of merchandise, this basic rule sets out three basic constitutive requirements of taxable activities: the subjective (taxable person), objective (taxable transaction) and spatial (sales within the territory) requirements. As a matter of fact, the rules about the object of VAT taxable activity, i.e., the taxable transaction provided in the Draft, have been improved in China's current legislation, but further improvements still need to be achieved. Specifically, the constitutive requirements of ordinary taxable transactions (normal sales of goods or services) and deemed taxable transactions (deemed sales of goods or services) remain unclear, incomplete and unscientific to some extent. Therefore, this paper will analyze the constitutive requirements of ordinary taxable transactions and deemed taxable transactions respectively, and put forward suggestions for improving the legislation and its specific provisions.

1. The constituent requirements of ordinary taxable transactions

Basically, the ordinary taxable transactions are the sales of goods or services. Unless otherwise specified by law, the basic requirement to constitute such sales is that the operator carries out the transfer of goods or supply of services for consideration in his business activities.² As a matter of fact, the operator who carries out business activities constitutes the subjective requirement of VAT taxable activities, which will not be elaborated here.³ In this way, the sales of goods or services not only include typical sales like the manufacturing and selling of computers by a computer company,

1. With regard to the overview of VAT system in China, cfr. W. Wuyao, *La riforma attuale dell'Iva in Cina*, in *Rivista di diritto tributario*, fascicolo 1, 2015.

2. See V. Thuronyi (ed.), *Tax Law Design and Drafting* (volume 1), International Monetary Fund, 1996, "Chapter 6, Value-Added Tax", p. 33.

3. With regard to the subjective elements of VAT taxable activities, see W. Wuyao, *On the Constituent Elements of the VAT Taxpayers and Their Legislative Improvement: An Analysis Based on the Core Concept of "Business Activities"*, in *Taxation Research*, 2023, n. 5.

but also include the sales of property used in business activities, like the transfer of fixed assets used for business purposes, and the sales of goods or services by using the structure in which the business activity is carried out, like the supply of goods or services by using the structure (form) of the enterprise.⁴ Accordingly, the constitutive requirements of the sales of goods and the sales of services will be analyzed in detail separately, and the common constitutive requirement of the two, which refers to being non-gratuitous (acquisition of consideration), will be explained individually.

1.1. The sales of goods

In addition to being non-gratuitous, the constitution of the sales of goods needs to be elaborated in three aspects, including the characteristics of the goods, scope of the goods and the connotation of the transfer of goods. Overall, based on the need for taxation, the relevant concepts are understood more broadly than in civil and commercial law.

1.1.1. Characteristics of goods

The basic meaning of goods is items produced for exchange, so that the goods correspond to a trading market and thus have liquidity in that market, which means that rapid buying and selling does not cause significant price fluctuations. In other words, both the supply of and demand for this good in the market are usually large. In fact, because the goods have such characteristics, the relevant producing and selling activities of goods can constitute business activities. In other words, business operators will be able to engage in producing and selling activities in the relevant market created and maintained by the State, thus reflecting their ability to pay taxes.⁵

Thus, some properties that can be transferred, which means that the owner can transfer ownership or the right to dispose of these properties, do not necessarily constitute the goods. For instance, the equity of a limited liability company, ordinary debt, enterprises, or business departments can be transferred, but they often lack enough supply and demand in the market and therefore lack market liquidity. Consequently, they cannot be regularly traded and such transactions cannot be regarded as business activities. However, equity and debt can be goods if they take the form of stocks or bonds which have market liquidity. Furthermore, if certain properties are prohibited from trading and no market exists for its trading, they cannot be classified as goods, e.g., China's current currency, the Renminbi.⁶

1.1.2. Scope of goods

Since VAT is a general tax on consumption, the scope of goods and services should be very broad. Any goods and services that can be used to carry out business activities should be included in the taxation scope of VAT. In fact, under the dual classification of goods and services, the article 1 of the Italian VAT Act (Presidential Decree No. 633 of 1972,⁷ hereinafter the Italian VAT law) defines taxable transactions as the transfer of goods and the supply of services. The scope of goods should be as broad as possible. In fact, the Italian word corresponding to English word "goods" is "beni" used in Italian VAT law, which is translated as "property". According to the article 810 of the Italian Civil Code, property is defined as "item that can constitute the rights' object" and includes intangible property.⁸ In other words, goods are not limited to specific forms. Both tangible and intangible properties can be considered and taxed as goods if liquidity and trading markets exist. Thus, goods

4. Cfr. S. Mencarelli, R. R. Scalesse, G. Tinelli, *Introduzione allo studio giuridico dell'imposta sul valore aggiunto*, G. Giappichelli Editore, 2018, p. 32.

5. Cfr. R. Perrone Capano, *L'imposta sul valore aggiunto*, Jovene, 1977, p. 207.

6. See the article 25 of 2018 Regulations of the People's Republic of China on the Administration of Renminbi (RMB).

7. Cfr. Decreto del Presidente della Repubblica del 26/10/1972 n. 633 - Istituzione e disciplina dell'imposta sul valore aggiunto.

8. Cfr. G. Melis, *Economia digitale e imposizione indiretta*, in *Innovazione e Diritto*, n. 1, 2015, p. 109.

include not only the common tangible movable (merchandise) and immovable property, but also various types of intangible property. Accordingly, various intangible assets, such as electricity, gas, heat, stocks, bonds, virtual assets like bitcoins, virtual weapons and equipment in online games, etc., should also be treated as goods. However, the dual classification of goods and services is not adopted by China's VAT Interim Regulation.

Except for services, the objects of sale specified in the article 1 of this Interim Regulation are not goods, but merchandise, intangible assets, or immovables. Obviously, merchandise is mainly the object of typical sales in business activities, but they can also be properties that are used for business purposes, such as machinery and equipment as fixed assets. While intangible assets and immovables are mainly properties that are used for business purposes, but they can also be the object of typical sales as described above, such as immovable property sold by real estate companies. However, if only three taxable items, namely merchandise, intangible assets and immovables, are specified in law, the scope of goods is not fully comprehensive.

For instance, financial products are essentially intangible, and are mainly the objects of typical sales in business activities, which can not be classified or at least are improper to be classified as intangible assets. Therefore, financial products such as foreign exchange, stocks, and bonds cannot be covered by any of the above categories. But financial products are typical objects of sales in business activities. For this reason, 2016 Measures for Implementing the Pilot Program of Replacing Business Tax with VAT (hereinafter the Pilot Program Measures⁹) classifies financial products as financial services, which resulted in inaccurate categorization. The same problem is with virtual property, which is treated as an object of civil rights in China's Civil Code of 2021. Additionally, the article 2 of 2009 Detailed Rules for the Implementation of the Interim Regulation of the People's Republic of China on VAT (hereinafter the VAT Detailed Rules) has to deem electricity, gas and heat as tangible movable properties, so that rules such as the spatial requirements of merchandise are also applicable to electricity, gas and heat. Lastly, it is important to emphasize that goods are not limited to property with ownership, but also include property with usufruct, such as land use rights and other rights to use natural resources, as long as the rights can be disposed by their owners. These properties are classified as intangible assets under China's current VAT rules, while according to the article 15 of the EU's 2006 VAT Directive, usufruct rights built on immovable property can be regarded as tangible property.¹⁰ In accordance with the article 2, paragraph 1, of the Italian VAT law, the transfer of goods includes the transfer of usufructuary rights. Of course, based on the characteristics of goods, not all usufructs should be covered by taxation. Additionally, since usufructuary rights are related to real estate, it is necessary to distinguish them from intangible assets (or properties) and categorize them separately. It would be convenient to group usufructuary rights with immovable property so as to establish the same taxation rules for usufructs, such as the spatial requirement rule.

1.1.3. Definition of goods transfer

The definition of goods transfer is essential to distinguish the sale of goods from the supply of services. For instance, the article 3 of China's VAT Detailed Rules specifies that the sale of merchandise refers to the transfer of ownership of merchandise for consideration. As a result, the sales of the right to use the merchandise would be the supply of leasing services. Considering that goods include not only tangible merchandise but also immovables and intangible assets, and that they involve not only ownership but also usufructuary rights, defining the transfer of goods requires a comprehensive consideration of attributes of different goods. In this regard, the article 2, paragraph 1, of Italian VAT law defines goods transfer as the transfer of ownership or usufructuary rights for consideration. The article 2, paragraph 2, of the same Act further provides other types of goods transfers, such as sales with retention of ownership and leases containing transfer rules that

9. This document stipulates the basic rules for the current imposition of VAT on services (except labor services of processing, repair or replacement), intangibles and immovables,.

10. See the art. 15 of Council Directive 2006 /112 /EC.

are binding on both parties. Similarly, the French VAT Law (Title II, Chapter 1 of the 1950 Tax Code,¹¹ hereinafter the French VAT law) specifies in the article 256, paragraph 2 (1) that goods transfers refer to the transfers of owner's right to dispose. The article 256, paragraph 3 (3), of French VAT law also covers the two types of goods transfers mentioned in the article 2, paragraph 2, of the Italian VAT law.

Therefore, it is evident that the definition of transfer of goods in the VAT laws of the two countries is broad in general and is not strictly limited to the transfer of ownership under civil and commercial law. In other words, even if ownership of goods is not transferred, the physical transfer, transfer of economic value or transfer of the right to dispose can also constitute goods transfers. Such rules in the VAT laws help avoid the complexity of taxation resulting from the complexity of transactions in civil and commercial law, which may affect the efficiency of taxation.¹² In addition to ownership retention sales, there is another example of case relating to sales of immovable property, in which after the buyer has taken possession of the property and prior to the transfer of registered ownership, the buyer has not acquired legal ownership but only economic ownership. Besides, the contract stipulates that only when the buyer resells the immovable property to a third party (determined by the buyer), the registration and legal transfer can be completed. The ECJ has held that such case constitutes a transfer of the right to dispose of immovable property, as well as a transfer of goods.¹³ In this way, the definition of goods transfer is harmonized at the EU level, which could help avoid complexities in taxation since there are significant differences in the rules of the transfer of ownership under the civil and commercial laws of Member States.¹⁴ Moreover, the definition of goods transfer in terms of transfer of the right to dispose can apply to not only the cases of transfer of ownership but also cases where rights such as usufructuary rights are transferred. This eliminates the need for separate definitions for different types of goods transfers. Furthermore, this also facilitates the deemed sale of goods for personal consumption and employee welfare. It is because the use of goods for personal consumption and employee welfare in some cases merely transfer the right of disposal without transferring ownership, which forms the basis for the deemed sale of goods. Namely, deemed sales are based on goods transfers and treated as sales because of the lack of consideration. Lastly, according to the definition of goods transfer, it can occur not only in transactions for private law purpose, based on the seller's intention to dispose, but also in activities for public law purpose that result in the transfer of disposal rights, such as goods transfers through enforcement measures or expropriation by administrative authorities, etc. In such cases, there is usually consideration involved.¹⁵

1.2. Sales of services

In addition to being not gratuitous, the constitutive requirements of the sale of services need to be explained from three aspects: the characterization and scope of service, and the meaning of supply of service. Overall, due to the need for taxation, the explanation of relevant concepts should be broader than those in civil and commercial law. In fact, the distinction between transfer of goods and supply of services is of great importance as they are subject to different rules concerning taxable activities, spatial and temporal requirements, tax rates, etc.

11. Voir Code général des impôts (CGI 2023).

12. See V. Thuronyi (ed.), *Tax Law Design and Drafting* (volume 1), International Monetary Fund, 1996, "Chapter 6, Value-Added Tax", p. 22.

13. See ECJ Judgment of 8 february 1990 in Case C-320/88.

14. Cfr. C. Trenta, B. Pizzoni, *La cessione di beni*, in AA.VV., *Lo stato della fiscalità dell'Unione europea*, a cura di Adriano Di Pietro, Roma, 2003, I, p. 134.

15. Cfr. G. Falsitta, *Manuale di diritto tributario – parte speciale*, CEDAM, 2008, p. 681.

1.2.1. Characteristics and scope of service

Goods are the object of the operator's obligation to transfer ownership or disposal rights, while services are the object of the operator's obligation of action, inaction, or permission. In other words, when supplying services, the operators' properties may be utilized, but there is no transfer of ownership or disposal rights, or the related transfer is not primary. Specifically, services can be activities that bring benefits or satisfy specific needs, by ways that the seller performs an act or omits to perform an act in favor of the buyer or allows the buyer to perform an act. Therefore, the fundamental characteristic of services is intangibility, as they cannot be stored and do not involve the transfer of ownership or disposal rights, or involve the related transfer which is not primary. For example, in catering service, the transfer of food and beverages (goods) is not primary and not subject to taxation separately. Besides catering service, typical services include communication, transportation, decoration, repair, entertainment, intermediation, loans, etc., all of which are actions performed by the operator. Additionally, leasing is also a typical service where the right to use is transferred. Such services are the licensing obligations performed by the operator. However, there are non-typical services in business activities, such as services provided in the form of inaction. In fact, due to the autonomy of will, the contractual obligations can vary greatly, including inaction obligations. In theory, an obligation of inaction can also constitute the content of a business activity, which is also not gratuitous and contains exchange. However, according to the judgment of ECJ, the reduction of milk production and sales by an agricultural operator in order to obtain reimbursement from local government did not constitute supply of service based on an inaction obligation.¹⁶ The reason is that, in addition to failing the requirement of being non-gratuitous, the abandonment of milk did not go with consumption, namely the local government does not consume or exchange for something¹⁷ Actually, under the classification of goods and services, the scope of services should be broader than that of goods and should serve as a fallback to ensure comprehensive coverage of taxable activities, considering the diversity, complexity, and ever-changing and innovative nature of business activities. In addition to the mentioned examples, other digital products such as online journals, e-books and online movies and music should also fall under the scope of services, possibly defined as electronic services. Furthermore, financial goods are currently categorized as services in Chinese VAT law,¹⁸ reflecting that the services play the role of "reveal all the details" on taxable scope of VAT.

1.2.2. Definition of supply of service

The above statement of the characteristics and scope of services defines the supply of service, as a separate definition of supply itself is not necessary. In other words, if the operator fulfills obligations for consideration, the service is provided. In fact, to avoid excluding specific business activities from the scope of VAT taxable transactions, services should be defined broadly and the definition of supply should not be restricted anymore.¹⁹ Therefore, the definition of supply of service should also be broad. Moreover, in cases where the definition of supply of service is coordinated with that of goods transfer, the transfer of intangible property (goods) may be included in the scope of the supply of service, as specified in the legislation, to apply the rules on the spatial and temporal requirements of the taxable activity for supply of service. In this regard, according to the article 256, paragraph 4 (1), of the French VAT law, the supply of services refers to transactions other than those defined in paragraph 2, particularly including the transfer or licensing of intangible property, fact of inaction or tolerance of an act or situation, independent labor, real estate work, and the performance of duties as a trustee. The paragraph 4 (2) of abovementioned article 256 further provides

16. See ECJ Judgment of 20 February 1990 in Case C-215/94.

17. Cfr. F. Stradini, *Le prestazioni di servizi*, in AA.VV., *Lo stato della fiscalità dell'Unione europea*, a cura di Adriano Di Pietro, Roma, 2003, I, p. 153.

18. See the explanatory note on sale of services, intangible assets and real estate attached in Pilot Program Measures.

19. See V. Thuronyi (ed.), *Tax Law Design and Drafting* (volume 1), International Monetary Fund, 1996, "Chapter 6, Value-Added Tax", p. 25.

that securities transactions belong to supply of service too. Similarly, the article 3, paragraph 1, of the Italian VAT law defines supply of service as the fulfillment of contracts related to engineering, contracting, transportation, agency, mailing, agency, intermediation, and storage, as well as, in general, the fulfillment of obligations involving action, inaction and permission for remuneration, regardless of the source of these obligations. The paragraph 2 of abovementioned article 3 further provides some special transactions in the scope of supply of service, including property leasing, transfer or licensing of copyrights (inventions, models, drawings, processes, formulas, brands and logos), lending of currency or securities, food and beverage supplies, and contract transfers. It is clear that the VAT laws of the two countries define the supply of service with the feature of “reveal all the details” and enumerate the types of services. Unlike the two countries, Chinese VAT law does not give a definition of supply of service and only lists different types of services. Specifically, in the French VAT law, the supply of services is defined in direct and negative terms, i.e. all transactions other than goods transfers are supplies of services, and the list includes specific or atypical service supplies. In the Italian VAT law, the supply of services is defined positively and abstractly, also reflecting indirectly the feature of “reveal all the details”, and typical and non-typical (special) supplies of services are enumerated. Some specific supplies of service listed involve the transfer of tangible or intangible properties or rights, but do not fall under the scope of goods transfer. It is notable that the transfer of ownership or disposal rights of certain intangible properties is also included in the scope of supply of service in France and Italy, which is related to the unified application of rules like spatial requirements. Nevertheless, it would be better to exclude such transfer from the scope of supply of service, just like in the current VAT rules on spatial requirements in China where the sale of intangible assets is separately provided and subject to the same rules applied to the supply of service.

Indeed, the sales of intangible property involve the transfer of the right to use sometimes, such as the licensing of patent or trademark, which should be classified as supply of service. Finally, it is necessary to point out that supplying service can also occur under public law due to the broad definition where the source of the obligation may not necessarily be a contract, but may also be an administrative or judicial act, as explicitly stated in Italian VAT law as “regardless of the source of these obligations”.²⁰

1.3. For consideration

In order to constitute the sales of goods or services, for consideration is required in case of the goods transfer and service supply. There is no dispute about this, but further clarification is needed regarding the meaning of for consideration and its connection to the goods transfer and service supply.

1.3.1. Economic benefit or payment

The essential requirement of for consideration is that the person who carries out the goods transfer or service supply obtains an economic benefit or an economically assessable payment. According to the article 3 of China’s VAT Detailed Rules and the article 11 of the Pilot Program Measures, the economic benefits or payments are in the form of money, merchandise or other economic interests. It is evident that payment is not limited to currency. Goods, including merchandise, and services can also be considered as payment. The provision for “other economic benefits” has the feature of “reveal all the details”. Theoretically, benefits can exist in any form, including equity, debt forgiveness, etc., as long as they are economically assessable.

In addition, it is important to mention that for consideration means being not gratuitous, so payment also includes amount paid in the name of compensation or cash deposit. For example, in the case of a goods transfer, in which the ownership does not transfer until the purchaser is fully sat-

20. Cfr. G. Falsitta, *Manuale di diritto tributario – parte speciale*, CEDAM, 2008, p. 686.

ified with the use of the good, the amount paid by the purchaser to the seller is cash deposit not corresponding price, but it is already not gratuitous.²¹

1.3.2. Connection between goods transfer or service supply and obtainment of payment

Regarding the requirements of for consideration, not only does the transferor of goods or the supplier of services have to obtain a payment, but there also has to be a direct connection between the obtainment of the payment and the transfer of the goods or the supply of the service. If there is no direct connection, the presence of for consideration will not be established.²² Typically, in a transaction, the direct connection is reflected in the legal relationship between the parties where they are required to make mutual payments.

The payment made by the buyer is the effective counterpart of the sale of goods or services by the seller.²³ However, based on the broad interpretation of for consideration mentioned above, the existence of a direct connection does not necessarily mean that the payment must come directly from the buyer. Even if the payment comes from a public institution or a third party, it can still satisfy the requirement of a direct connection. Therefore, it is reasonable that for consideration defined in the article 11 of the Pilot Program Measures as “obtaining currency, merchandise, or other economic benefits” is not also required to be obtained “from the purchaser” as in the article 3 of China’s VAT Detailed Rules. For example, if the government grants subsidies to enterprises for producing and selling specific goods or services, and the amount of subsidy is connected to the revenue or quantity of sales, the subsidy can be considered as part of payment the enterprises receive. Similarly, according to China’s VAT rules, if a taxpayer receives financial subsidies that are directly connected with the revenue or quantity of sales of goods including merchandise or services, the subsidies are subject to VAT. Otherwise, they do not count as taxable payments for VAT purposes.²⁴ Another example would be the case in which Company B sells goods or services to Company C, but the payment made to Company B is done by Company A. In this case, there might be disputes over whom the goods or services were sold to (Company A or Company C). The payment made by Company A constitutes consideration which satisfies the requirement of direct connection under VAT Law, even if there is no contract between Company A and Company B.²⁵ Accordingly, a street performer who engages in purely artistic performances like singing or playing an instrument, which is gratuitous, does not constitute the supply of a taxable service, even if passersby happen to give them money.²⁶ Actually, the money is not a payment for purchasing the performance service because whether and how much passerby gives is not directly related to the access or not to service and the level of performance.

2. Constitutive requirements of deemed taxable transactions

2.1. Fundamental characteristics of deemed taxable transactions

In the course of their business activities, if an operator utilizes relevant goods (including the operator’s capital assets) or services for purposes other than sales, such as personal or family con-

21. Cfr. S. Mencarelli, R. R. Scalesse, G. Tinelli, *Introduzione allo studio giuridico dell'imposta sul valore aggiunto*, G. Giappichelli Editore, 2018, p. 24.

22. Cfr. C. Trenta, B. Pizzoni, *La cessione di beni*, in AA.VV., *Lo stato della fiscalità dell'Unione europea*, a cura di Adriano Di Pietro, Roma, 2003, I, p. 146.

23. Cfr. G. Falsitta, *Manuale di diritto tributario – parte speciale*, CEDAM, 2008, p. 687.

24. See 2019 Announcement of the State Taxation Administration on Cancelling the Time Limits for the Certification and Confirmation of VAT Credit Vouchers and Other Issues Concerning the Administration of VAT Collection.

25. See V. Thuronyi (ed.), *Tax Law Design and Drafting* (volume 1), International Monetary Fund, 1996, “Chapter 6, Value-Added Tax”, p. 36.

26. See Judgment of ECJ (Sixth Chamber) of 3 March 1994 in Case C-16/93.

sumption and employee welfare, or gives or provides them to others for free, how should the VAT law treat such situations? According to the constitutive requirements of ordinary taxable transactions, i.e., the sale of goods or services, none of the aforementioned situations would be qualified as taxable transactions as they do not involve sales. As a result, these situations should naturally be treated as non-taxable transactions, and any input VAT previously deducted on the related goods or services should be adjusted. But most countries' VAT laws adopt a treatment of deemed taxable transactions (hereinafter referred to as deemed treatment), wherein the use of goods or services for non-business activities is treated as the sale of goods or services for VAT purposes, resulting in VAT liability while allowing for the deduction of input VAT on the related goods or services. For example, the EU's 2006 VAT Directive,²⁷ Canada's Goods and Services Tax Act (Part IX of the Excise Tax Act of 1985²⁸), and Singapore's Goods and Services Tax Act of 1993²⁹ all adopt the deemed treatment for the aforementioned situations while specifically stipulating that deemed treatment should be conditional on the input VAT on related goods or services being deductible.³⁰

In this context, the relevant provisions of the Italian and French VAT laws are taken as examples. Firstly, the article 2 (regarding the transfer of goods), paragraph 2, of the Italian VAT law stipulates that "the transfer of goods (for consideration) also includes: ... (d) transfer of goods for free, with the exception of transfer of goods the production or circulation of which is not related to the enterprise's own business activities and the unit cost (unit price) of which does not exceed 50 euros, or with the exception of transfer of goods the input VAT on which is not deducted under the article 19 at the time of purchase or importation; (e) use of goods for the personal or family consumption of the entrepreneur or freelancers or for purposes other than the business or artistic or professional activities, even if such use results from the termination of business activities, with the exception of goods the input VAT on which is not deducted under the article 19 at the time of purchase." The article 3 (regarding the supply of services), paragraph 3, of the Italian VAT law stipulates that "the services referred to in paragraphs 1 and 2, where each business's value exceeds 50 euros, and the tax related to the purchase of goods and services during the implementation process can be deducted, even if such services are provided for the personal or family use of the business owner or performed gratuitously for purposes other than the business operations, they shall still be deemed as supply of services. However, the following services are excluded: canteen catering, transportation, training, education, entertainment, assistance and healthcare services provided to employees, advertising and promotional services provided for non-commercial institutions' organizational activities, as well as information, performance, image, or communication services for public interest as required or supported by the State or public institutions."

In the French VAT law, article 257, paragraph 2 (1) stipulates that "the following shall be considered as transfer of goods for consideration: taxpayers withdraw enterprise's goods for private use of themselves or their staff, or make gratuitous transfer of goods, or, more generally, use goods for purposes unrelated to their business operations, when the right to deduct all or part of the VAT on their goods or their constituent parts has arisen. However, supplying low-value gifts and samples for commercial purposes is not included." The sample paragraph 2 (2) stipulates that "the following activities shall be considered as supply of services for consideration: using goods, which are allocated to enterprise, for the taxpayer's private needs, or more generally, for purposes unrelated to business operations, when the right to deduct all or part of the VAT in respect of the goods has arisen; supply of services gratuitously for the private use of taxpayers or their staff, or more generally, for purposes unrelated to their business operations."

It is evident that VAT law treats the use of relevant goods or services for non-business activities,

27. See the art. 16 (para. 1) and the art. 26 (para. 1) of Council Directive 2006/112/EC.

28. See Excise Tax Act (R.S.C., 1985, c. E-15) of Canada.

29. See Goods and Services Tax Act (26th November 1993) of Singapore.

30. See W. Wuyao, R. Xue, *An Analysis of EU VAT Rule on Deemed Taxable Transactions and Its Implications to China*, 2021, *International Taxation*; W. Wuyao, S. Xiaoya, *Analysis of Foreign GST Rules on Deemed Taxable Transactions and Their Experiences for Reference in China*, 2021, *Taxation and Economy*.

donation of goods or gratuitous supplies of services as deemed sales of goods or services mainly for correcting the tax deviation (*salti di imposta*), aiming to prevent the situation where the output tax is not generated but the input tax is deducted.³¹ However, this reason alone might not be fully sufficient. In fact, if the relevant goods or services are used for private consumption, they are equal to be used for final consumption without entering into the economic chain for further circulation. In such cases, an alternative approach to the deemed treatment is to roll out the input tax. Specifically, when a business operator uses purchased goods for non-business activities, since the value of sales is determined based on the market price, which is usually the same as the purchase price, no added value occurs and the government cannot collect any tax revenue. Therefore, it is fairly feasible not to treat this situation as a deemed sale. For example, the article 4 (5) of China's VAT Detailed Rules stipulates that the merchandises, whose use for purpose of collective welfare or personal consumption should be deemed as sales, only include those produced by enterprises, not those purchased by enterprises from others. Hence, it can be inferred that the deemed treatment is also related to the government's revenue. Otherwise, rolling out the input tax is enough.

Moreover, if relevant goods are gratuitously provided to other enterprises, the latter may use these goods for business purposes, indicating that the goods continue to circulate within the economic chain. In this scenario, the deemed treatment can ensure the integrity of the input tax deduction chain and enable other enterprises to claim input tax deductions based on the invoices obtained through deemed sales. For instance, the article 4 (8) of China's VAT Detailed Rules stipulates that the merchandises, the gratuitous transfer of which to other entities or individuals should be deemed as sales, include not only those produced by enterprises but also those purchased by enterprises from others.

2.2. Limitations on scope of deemed taxable transactions

Treating non-sales activities as deemed sales of goods or services actually expands the scope of VAT taxable transactions. Thus, this expansion should be limited, as it taxes activities that were originally not sales of goods or services, potentially breaching the uniformity of VAT taxable activities. To address this issue, there are five aspects on how to limit:

A. Introduce the deduction requirement, indicating that the input VAT on relevant goods or services should be deductible as it is the fundamental rationale of deemed treatment. Without this requirement, there would be double taxation, deviating from the neutrality principle of VAT. For this purpose, both Italian and French VAT laws have introduced the related provisions.

B. The difference between ordinary taxable transactions and deemed taxable transactions primarily lies in the distinction between sales and non-sales activities. However, this difference is partial as the non-sales activities subject to deemed treatment share specific similarities with sales activities, which is especially important for deemed sales of goods. For goods, the deemed treatment should be restricted to cases where the ownership or effective disposal rights are transferred, i.e., intentionally transferred from the business operator (enterprise) to controllers (individuals) of the enterprise, their families, employees and other entities. In this regard, it aligns with sales activities. If such transfers do not occur, it might constitute a deemed sale of services, for example, when a business operator uses a factory building for purpose of employees' accommodation. For deemed sales of goods in case of collective welfare or personal consumption, it is reasonable that such rule only applies to merchandise under Chinese VAT law. In fact, the French VAT law, in the article 257, paragraph 2 (1) (regarding the deemed sale of goods) and (2) (regarding the deemed sale of services), gives separate provisions: the former applies to the withdrawal (implying the transfer) of enterprises' goods, while the latter applies to the use (not implying the transfer) of goods allocated for enterprise.

C. Since the distinction between sales and non-sales activities hinges on whether they are for consideration, and the essential characteristic of sales activities is being not gratuitous, some non-sales

31. Cfr. G. Falsitta, *Manuale di diritto tributario – parte speciale*, CEDAM, 2008, pp. 687-688.

activities that involve consideration should consequently be included in the scope of ordinary taxable transactions. According to the articles 10 and 11 of the Pilot Program Measures, the sales are defined as transfers or supplies for consideration, and the requirement of for consideration is defined as acquiring money, merchandise, or other economic benefits. Clearly, “other economic benefits” can be explained in a broad way, so that certain non-sales activities that involve the transfer of goods can be regarded as sales activities because other economic benefits are acquired. For instance, in the case of distributing dividends, a business operator may distribute goods to shareholders directly, which is economically equivalent to the scenario where the same operator sells the goods to shareholders, creates a credit in front of shareholders and then with offsets against the obligation of the operator to pay (cash) dividends. In other words, the operator acquires some form of economic benefit by distributing the goods to shareholders directly. Similarly, the business operator can also acquire some form of economic benefits by using goods for investment (capital contribution) in exchange for shares or ownership interests in the invested enterprise. In this regard, according to the article 2, paragraph 2, of the Italian VAT law, the distribution of goods by enterprises or other organizations to shareholders or members, regardless of the form of transfer, constitutes transfer of goods for consideration. Additionally, in Italy, using goods for investment also constitutes the transfer of ownership or usufruct rights for consideration prescribed in the article 2, paragraph 1 of the Italian VAT law, being subject to VAT as ordinary taxable transactions.³²

However, according to the article 4 (6) and (7) of China’s VAT Detailed Rules, the aforementioned two types of non-sales activities concerning merchandise are still treated as deemed sales of merchandise. Accordingly, it can be concluded that the sale of merchandise is defined in a formal sense rather than a substantive sense under Chinese VAT law, which is acceptable. By contrast, the distribution of real estate and intangible assets to shareholders and the use of real estate and intangible assets for investment is not treated as deemed sales of real estate or intangible assets in the article 14 of the Pilot Program Measures, which does not imply that they are not subject to VAT. In practice, VAT is levied on the transfer of real estate and intangible assets for investment according to the rules for transferring such assets for consideration.³³ In fact, since the distribution of goods to shareholders and their use for investment also qualifies as transfer of goods for consideration, which meets the constitutive requirements of ordinary taxable transactions, it would be more reasonable to treat them as ordinary taxable transactions.

D. Specify the exceptions to deemed treatment. For example, both the Italian and French VAT laws provide exceptions to deemed treatment for the gratuitous transfer of low-value goods, as well as certain welfare services or public services provided to employees. In the context of the Pilot Program Measures in China, the article 14 concerning the deemed treatment of the gratuitous supply of services or gratuitous transfer real estate and intangible assets also stipulates exceptions to deemed treatment for the purpose of public welfare or aimed at the general public. In fact, the exceptions to deemed treatment in current China’s VAT law are not enough, and new exceptions for other purposes which deserve the tax relief could be added.

E. Consider the feasibility in practice. If the cost of administration is excessively high, tax should not be imposed under the rule of deemed treatment. For instance, the use of services for personal consumption, including family members’ consumption, or for employees’ welfare can be exempted from deemed treatment because services are intangible. In addition, the cost of input (tax) is limited.

2.3. Two special types of deemed taxable transactions

In addition to the use of goods for personal consumption and employees’ welfare or the gratuitous transfer of goods or supply of services to others, there are another two special types of deemed treat-

32. Cfr. G. Petrelli, *Regime fiscale dei conferimenti in società ed enti*, in *Rivista Studi e Materiali CNN*, n. 2, 2003, p. 603.

33. See Ningbo Tax Service of State Administration of Taxation, *Is the acquisition of equity by investment in real estate and intangible assets subject to VAT?*, http://ningbo.chinatax.gov.cn/art/2021/6/30/art_23_185285.html.

ment which should be specifically clarified. The first type is the consignment of merchandise which is composed of two deemed treatments, respectively the delivery of merchandise from principal to any other entity or individual (mandatary) for sale and sale of the same merchandise by mandatary in his own name, as prescribed in the article 4 (1) and (2) of China's VAT Detailed Rules. Similarly, the article 2, paragraph 2 of Italian VAT law stipulates that "in the execution of a mandate contract, the property sold or purchased is transferred from the principal to the mandatary or from the mandatary to the principal." It is clear that the first special type of deemed treatment is grounded in specific delegation relationship, where the mandatary sells goods in his own name but for the principal's interests. In Italy, this is commonly referred to sales without representation, the same as entrusted sales under indirect delegation in China. If the mandatary sells goods in the name of the principal, there is no deemed sale between the principal and the mandatary evidently, which is a case of the principal selling goods to a third party and the mandatary providing delegation services to the principal. While under the condition of sales without representation, there is a presumption in the VAT law that two separate transactions of goods exist: one between the principal and the mandatary, and the other between the mandatary and the third party. In this case, the ownership does not transfer between the principal and the mandatary, but directly transfer from the principal to the third party when the mandatary completes the transfer of the goods to the third party. Therefore, the VAT law applies deemed treatment to the transfer between the principal and the mandatary, which constitutes a genuinely legal construct.³⁴

As regard to the transaction between the mandatary and the third party, the mandatary is the nominal seller, and the transaction can be directly subject to VAT based on the ordinary sale of goods without deemed treatment in Italian VAT law. Since the deemed treatment of the sales without representation, the delegation service provided by the mandatary is consequently excluded from supply of service according to the article 3, paragraph 4, of the Italian VAT law. The reason for introduction of the first special type of deemed treatment is to avoid the difficulty of attributing the transaction between the mandatary and the third party to the principal in tax administration. Besides, the deemed treatment allows for the straightforward and convenient deductions and transfers of tax burden among the principal, mandatary, and third party.³⁵

In summary, the deemed treatment of sales without representation indicates the principle of formal taxation and facilitates tax administration. While it is worth noting that, compared to Chinese VAT law, the deemed treatment of sales without representation under the Italian VAT law includes not only the consignment sales (representative sales) but also reverse deemed sales under consignment purchases (reverse representative sales). Thus, if the mandatary purchases from a third party and then transfers the goods to the principal, such transfer still constitutes a deemed sale, making the rule in Italian VAT law a more comprehensive approach. Of course, it is also feasible not to stipulate the deemed treatment of consignment sales, but directly levy tax on the principal's sale to the third party according to the principle of substantive taxation after the indirect agency relationship is recognized.

Furthermore, the article 4 (3) of China's VAT Detailed Rules provides another type of deemed treatment, where taxpayer transfers merchandise from its one institution to its another institution in the different region for the purposes of sales, the two institutions being under unified accounting system. Similar to the sales without representation, this is also the case where the merchandise moves or transfers but the ownership does not. Even though the two institutions belong to the same enterprise, both the branch institutions can be taxpayers under the VAT law. According to the explanation of the use for sales, the receiving institution needs to issue invoices and/or collect payments in their own name³⁶ and should register in the local administration. Therefore, since

34. Cfr. N.Al Najjari, *Le operazioni tra committente e commissionario*, il 5 novembre 2014, disponibile nel seguente sito: <http://www.anasped.it/le-operazioni-tra-committente-e-commissionario>.

35. Cfr. R. Perrone Capano, *L'imposta sul valore aggiunto*, Jovene, 1977, p. 308.

36. See 1998 Notice of the State Administration of Taxation on the Collection of VAT on the Transfer of Goods between Institutions Affiliated to Enterprise; 1998 Notice of Shanghai Municipal Bureau of National Taxation on the Trans-

the transfer between the two institutions is gratuitous, this type of deemed treatment is analogous to the deemed treatment of gratuitous transfer of goods. Moreover, this type of deemed treatment also contributes to the balanced distribution of tax revenues between regions, especially between the regions of production and sales.

3. Perfection of legislative provisions on VAT taxable transaction

3.1. Perfection of provision on ordinary taxable transactions

The provision on ordinary taxable transactions should be divided into three paragraphs; the first two paragraphs define the sale of goods and the sale of services respectively with emphasis on the definition of the transfer of goods (including the connotation and scope of goods) and the supply of services; in the third paragraph, the concept of for consideration should be defined.

In fact, the Draft (in the article 1, paragraph 2) in continues the current legislation concerning taxable transactions stipulating that “the sales of merchandise, services, intangible assets, and real estate refer to the transfer of ownership of merchandise and real estate for consideration, the supply of services for consideration, and the transfer of ownership or use rights of intangible assets for consideration.” Thus, Several modifications are required. The Draft does not specify the definition of for consideration directly, which need to be supplemented. Nevertheless, there is substantial convergence between the proposed rule on the definition of for consideration and the new definition of sales amounts in article 16 of the Draft stipulated as “the consideration, received by the taxpayer, related to taxable transactions, including all forms of monetary and non-monetary economic benefits”, which should be regarded as an improvement. In conclusion, the provision on taxable transactions can be formulated as follows:

The sales of goods refer to the transfer of ownership or disposal rights of goods for consideration. Goods are properties with the nature of circulation in market, including merchandise, real estate, usufructuary rights, financial commodities, and other intangible assets.

The sales of services refer to the supply of services for consideration. The supply of services encompasses transactions other than the sales of goods in paragraph 1 in the form of an obligation to perform or not perform an act, or to permit, regardless of the origin of the obligation. The services supplied includes transportation service, postal service, telecommunication service, construction service, financial service, modern services, daily life service, etc.

“For consideration” refers to the monetary or non-monetary economic benefits received by the taxpayer related to the transfer of goods or the supply of services.

3.2. Perfection of provision on deemed taxable transactions

Compared to the current legislation, the article 4 of the Draft has narrowed down the types of deemed taxable transactions, retaining only two types: the use of merchandise for collective welfare or personal consumption and the gratuitous transfer of goods, intangible assets, real estate, or financial commodities, which should be viewed as a positive modification. The reasons for narrowing the scope of deemed treatment have been explained above. However, the article 4 of the Draft concerning deemed taxable transactions still need to be modified in the following aspects:

Firstly, the input tax deductibility as additional condition for deemed treatment should be added in order to limit the application of deemed treatment.

mission of the State Administration of Taxation on the Issues of VAT on the Transfer of Goods between Institutions Affiliated to an Enterprise.

Secondly, the rule on specifications of person implementing deemed treatment as “an entity or individual industrial and commercial business” or “entity or individual” should be deleted. On the one hand, the person is undoubtedly the taxpayer as determined by the taxpayer provisions. On the other hand, the scope of taxpayer is no longer prescribed as “entities and individuals” according to the renewed taxpayer provisions.

Thirdly, the gratuitous transfer of merchandise and the gratuitous transfer of intangible assets, real estate, or financial commodities, as provided separately in the Draft, can be merged into one simplified type as gratuitous transfer of goods.

Finally, the “catch-all” rule in the article 4, paragraph 4 as “other circumstances prescribed by the State Council” can be retained. However, this rule should be used to specify new types of deemed taxable transactions to address new scenarios in the future and fill potential gaps in new tax legislation. Therefore, it is necessary to avoid using the “catch-all” rule to reintroduce the numerous current types of deemed treatment that are not retained in the Draft through implementation regulation or tax normative documents in the future. In other words, if it is necessary to retain these types of deemed treatment, for instance, the transfer of goods between the principal and mandatary in cases of indirect agency, they should be stipulated by the VAT Law (the Draft) only.

In conclusion, the provision on deemed treatment can be formulated as follows:

The following circumstances of taxpayers shall be deemed as taxable transactions:

(1) Use of self-produced merchandise or merchandise processed upon commission for collective welfare or personal consumption, where the VAT on the merchandise or its components is deductible.

(2) transfer of goods gratuitously, where the VAT on the goods or their components is deductible.

(3) Other circumstances as prescribed by the State Council.

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