

# Tax Analysis

## China issues VAT implementation regulations

On 30 December 2025, the implementation regulations of China's value-added tax (VAT) law were published on the State Council's website. The VAT law and its implementation regulations will take effect on 1 January 2026. Upon their entry into force, the previous provisional regulations on China's VAT will be repealed.

While the VAT law and its implementation regulations have inherited and consolidated most of the previous VAT policies, certain adjustments have been introduced - notably, for example, the rules on allocating input VAT incurred on long-term assets used for both VATable and VAT-exempt/Non-VATable activities. Affected businesses are advised to thoroughly understand these changes, assess their potential impact, and develop action plans to enhance compliance and strengthen VAT management processes.

### Highlights of VAT law and its implementation regulations

#### 1. Place of supply

If the place of supply is deemed to be within the territory of China, the relevant transaction in question will be subject to Chinese VAT. The VAT law and its implementation regulations provide the following rules for determining the place of supply:

- a) For the sale of goods, the place of supply is in China if either the goods are located in China, or their place of departure is situated in China.
- b) For the sale or lease of immovable property, and the

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transfer of natural resource use rights, the place of supply is in China if the immovable property or natural resources in question are located in China.

- c) For the sale of financial instruments, the place of supply is in China if the financial instrument is issued in China, or the seller is a Chinese entity or individual.

This rule differs from the previous regime, under which the place of supply was considered to be in China if either the seller or the buyer was a PRC party. In practice, transactions involving financial instruments may be highly complex, rendering it challenging to clearly identify the seller in such transactions.

- d) For the sale of services or intangible assets (other than the situations described in b) and c)), the place of supply is in China if the service or intangible asset is consumed in China, or the seller is a domestic party.

In cases where the service or intangible asset is supplied by a foreign party, the implementation regulations further specify that the service or intangible asset is deemed to be consumed in China under the following two circumstances:

- i. The service or intangible asset is supplied to a domestic party, *excluding services consumed on-site overseas*; and
- ii. The service or intangible asset is *directly linked to goods, immovable property, or natural resources located in China*.

For the first circumstance, the above rules imply a potential expansion of the VAT scope. Unlike the previous rules, which excluded “services or intangible assets wholly incurred/utilized overseas” from the VAT scope, the new implementation regulations excluded only “services consumed on-site overseas.” That said, key concepts such as “consumed on-site overseas” and “directly linked to goods, immovable property, or natural resources located in China” remain undefined and thus require further clarification through official guidance.

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## 2. Input VAT

### 2.1 Input VAT attributable to non-VATable transactions

Under the implementation regulations, where a taxpayer acquires goods, services, intangible assets or immovable property, and such acquisition is used for non-VATable transactions that meet both of the following conditions, the corresponding input VAT (i.e. input VAT attributable to the non-VATable transactions) may not be credited against the output VAT:

- (1) the relevant operating activity falls outside the scope of VAT and generates economic benefits; and
- (2) the relevant activity does not fall within any of the four scenarios listed in article 6 of the VAT law (see below):
  - to obtain compensation for services provided as an employee to an employer;
  - to obtain government charges;
  - to obtain compensation for expropriation or requisition according to applicable law; and
  - to obtain deposit interest.

Previously, the VAT rules did not explicitly disallow the credit of input VAT attributable to non-VATable transactions. The introduction of the above rules may therefore effectively narrow the scope of creditable input VAT.

Given the limited scope of scenarios listed in article 6 of the VAT law, many activities are expected to meet the second condition. Additional guidance may be required to determine how the first condition is met. Even if both conditions are satisfied, it may still be difficult to ascertain whether the input VAT from a specific acquisition should be treated as “attributable” to the non-VATable transactions.

## 2.2 Input VAT allocation

- *New annual reconciliation requirement:* Input VAT incurred on goods (excluding fixed assets) and services used for both taxable supplies (under the general taxing method) and other purposes (e.g. those subject to the simplified taxing method, VAT-exempt activities, staff welfare, private consumption, etc.) must be allocated accordingly, with only the portion attributable to taxable supplies eligible for credit.

Previously, the allocation was typically carried out on a monthly or quarterly basis, using input VAT and sales data from the relevant period. However, the implementation regulations now introduce a mandatory annual reconciliation. Taxpayers will continue to apply the existing monthly or quarterly method for their periodic VAT filings, but they are now required to perform an adjustment in January of the following year based on full-year data. This additional step increases the complexity of VAT calculations and compliance efforts.

- *Input VAT on long-term assets:* Previously, general VAT payers in China could fully credit input VAT on long-term assets (i.e. fixed assets, intangible assets and immovable property) used for both taxable supplies (under the general taxing method) and other purposes (e.g. those subject to the simplified taxing method, VAT-exempt activities, staff welfare, private consumption, etc.), without requiring an allocation of the input VAT based on usage.

However, the newly issued implementation regulations introduce a significant change: for individual long-term assets with an original value exceeding RMB 5 million, an allocation of input VAT credit is now required. While taxpayers may still claim a full input VAT credit at the time of acquisition, they must perform an annual reconciliation to adjust and reverse portions of the credit based on the extent to which the asset is used in non-creditable activities.

The detailed rules governing this allocation methodology are pending release by the Ministry of Finance (MOF) and State Taxation Administration (STA). This change is expected to increase the complexity of VAT accounting and compliance for affected taxpayers.

### *2.3 Input VAT on interest*

The implementation regulations state that the input VAT on interest expenses is not creditable. However, the new regulations also require the MOF and STA to evaluate the policy impacts, leaving open the possibility of relaxing this restriction in the future. This provision suggests a potential pathway for revisiting the non-creditable treatment of interest-related input VAT, depending on the outcome of the ongoing policy assessment.

## **3. Mixed sales**

A mixed sale is a single VAT transaction that is comprised of two or more elements that would be subject to different VAT rates if supplied separately. According to the VAT law, the VAT rate applicable to the principal element must be applied to the entire revenue derived from such a mixed sale.

The implementation regulations further clarify that the principal element should reflect the substance and purpose of the transaction, while any additional elements would serve as necessary supplements and arise only in conjunction with the principal element.

As economic activities grow increasingly complex, it may become challenging to clearly determine whether certain business operations should be treated as “mixed sales” or as multiple distinct supplies. The assessment of what constitutes the “principal element” of a single transaction may also become a potential area of dispute. More guidance or illustrative examples from the tax authorities could help mitigate uncertainty in applying these rules consistently.

## **4. General anti-avoidance rule**

The implementation regulations have also introduced a general anti-avoidance rule, granting tax authorities the power to challenge arrangements that lack a genuine commercial purpose and make tax adjustments accordingly. This reflects the tax authorities’ increasing emphasis on anti-avoidance from an administrative perspective.

## **5. Miscellaneous**

### *5.1 VAT rate structure*

The VAT law and the implementation regulations remain consistent with the previous VAT regime, maintaining the applicable tax rates of 13%, 9%, 6%, and 0%. The scope of taxable supplies for each rate is largely unchanged from the previous rules. For taxpayers adopting simplified taxing method, the collection rate remains at 3%.

Previously, a simplified taxing method with a 5% collection rate applied to certain transactions, particularly the sale or lease of qualifying immovable property. However, neither the VAT law nor the implementation regulations explicitly address the continued application of the 5% rate. As a result, it remains unclear whether this provision will remain in effect after 1 January 2026.

### *5.2 Domestic agents*

Where a foreign taxpayer leases immovable property located in China to an individual, the implementation regulations allow the taxpayer to appoint a domestic agent to handle VAT filing and payment obligations in China. However, in cases where a foreign taxpayer supplies other services or intangible assets to individuals and thus becomes subject to Chinese VAT,

the VAT law and its implementation regulations remain silent as to whether such taxpayer may similarly appoint a domestic agent to handle its VAT affairs, or whether the VAT must instead be withheld and remitted by the individual purchasers.

### *5.3 Free-of-charge services*

Previously, free-of-charge services were treated as “deemed sales” and thus subject to VAT, even though the service provider received no consideration. The VAT law has now removed free-of-charge services from the list of situations to which the “deemed sales” rule applies. As a result, it would appear that no VAT is chargeable on such gratuitous services. However, uncertainty remains as to whether certain gratuitous service arrangements might still be challenged by the tax authorities through the application of anti-avoidance rules to recharacterize the relevant transactions.

### *5.4 Business transfer*

Previously, the transfer of goods, immovable property, or land use rights as part of a business transfer (or part thereof) could be regarded as outside the scope of VAT, meaning no VAT was chargeable. However, the new VAT law and its implementation regulations do not explicitly address whether this treatment will continue. As a result, further clarification from tax authorities may be needed in the future.

### *5.5 Withholding agents*

The implementation regulations introduce a new provision stipulating that when an individual engages in qualifying taxable transactions, a domestic entity paying the consideration must serve as the VAT withholding agent. This change could have significant implications for businesses that routinely procure taxable supplies from a large number of individuals. These businesses should closely monitor the application of the rules and any related guidance expected to be issued in the future.

### *5.6 Exports of goods/services*

Most exports of goods or services are either exempt from VAT or qualify for zero-rating (under which eligible input VAT may be refunded). The implementation regulations require taxpayers engaged in export transactions that qualify for zero-rating or VAT exemption to file their applications within the prescribed time frame. Failure to meet these filing requirements will result in the exported supplies being treated as domestic taxable supplies, subject to VAT accordingly. However, the regulations do not specify the exact filing deadlines, and further clarification is expected in upcoming supporting guidance to be issued by the tax authorities.

### *5.7 VAT information collection*

The implementation regulations introduce a new provision authorizing tax authorities to collect relevant information from entities and individuals in the context of export tax administration. This information may include details related to logistics, customs declarations, transportation, fund settlements, etc. The expanded data access aims to enhance oversight and ensure compliance with export-related VAT policies.

## Recommendations

We recommend that businesses promptly take the following actions to ensure a smooth transition and enhance the effectiveness of tax management:

### *Assess overall impact*

Systematically evaluate the impact of the new law on enterprise revenue, profitability, and cash flow; estimate potential changes in tax liabilities; and proactively develop or refine strategies based on these assessments.

### *Improve business processes*

Review business models and operations for VAT compliance, with particular focus on contract terms, invoice management, and eligibility for tax incentives; pay close attention to the proper treatment of cross-period transactions before and after the law's enactment, and take preventive measures to mitigate potential tax risks.

### *Strengthen internal tax controls*

In response to policy changes, enhance internal tax control procedures and reinforce oversight of key tax risk areas; ensure the accuracy and reliability of tax-related data sourced from various departments, and implement necessary system enhancements to support compliance.

### *Leverage external expertise*

For complex or uncertain issues, proactively seek clarification from tax authorities. Where appropriate, engage external advisors to support policy interpretation, implementation planning, and change management.

As government authorities continue to release detailed guidance, training materials, and practical interpretations, we encourage businesses to stay actively informed about evolving requirements and emerging practices. By adopting a coordinated, forward-looking approach now, organizations can achieve seamless compliance and build long-term resilience under the new VAT regime.

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