

China update



Speakers



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General outlook

1 Intensive tax investigations

2025 is marked as a year of intensive tax investigation with various forms of tax audits, tax inspections, self-inspections, tax alerts in new e-tax system. Financial Industry including insurance sector is one of the key industries subject to tax investigations.

2 Other tax update

capital market access

3 Pillar 2

still no clear timeline but tax authorities have asked the Chinese entities that have overseas operations to assess the impact

4 VAT law and its implementation rules effective from 1 Jan 2026

bringing new challenges to Value-Added Tax (VAT) administration

5 TP update

market observations on dimensions of potential scrutiny.

Intensive tax investigations

- Tax authorities pay close attention to the application of various tax incentive policies. The financial sector has become a key focus due to the relatively abundant income tax and VAT incentives, as well as the large scale of enterprises in this industry.
- Tax authorities are adopting increasingly stringent tax audit approaches
 - Digitalisation of supervision methods;
 - Enhanced audit intensity, stricter enforcement standards, and heavier tax penalties;
 - **Established industry practices in tax treatment may also be challenged.**
- **Common issues for financial industries:**

CIT

- applicability of R&D super deduction
- expenditures not related to business
- applicability of exemptions on certain investment incomes (i.e. government bonds)
- applicability of exemptions when investing in tax-exempt products through instruments

VAT

- applicability of VAT exemption for inter-financial institutional transactions and investing in tax-exempt products through financial instruments;
- irrevocable input VAT on purchase related to VAT exempted sales.

Specific issues for Banking companies:

- Input VAT transfer out calculation on interest income related to internal FTP
- VAT/IIT treatments on points redemption of gifts for bank's credit card business
- CIT issues: CIT deduction on (1) write-off loan; (2) valuation reserve.

Specific issues for Insurance companies:

- VAT treatment on certain insurance policies, such as Term Life Insurance, Accident Insurance etc.
- VAT treatment of management fee income from universal life and investment-linked insurance products.
- Issues concerning the calculation of VAT input tax to be transferred out and the corresponding transfer-out ratio.

Specific issues for asset managers/investment banks:

- The calculation of VAT input tax to be transferred out for asset management product managers.
- Timing of revenue recognition for EIT and VAT purpose: management fee and carry
- CIT treatment of VAT offset benefits from negative differences in operating income of asset management products under the consolidated tax payment method.

Other tax updates—capital market access

Second market

- **QFI , Stock connect & Mutual recognised fund regime, Interbank market**
 - Public Notice [2026] No. 5 extended the CIT and VAT exemption for two years from 1 Jan 2026 to Dec 31 2027 on bond interest income obtained by foreign institutions from their investments in the domestic bond.
 - Public Notice [2026] No. 6: Bond interest income obtained by foreign institutions from investments in China treasury bonds and local government bonds issued in overseas market shall be exempt from VAT from 8 Aug 2025 to Dec 2027 (interest income from China treasury bonds and local government bonds used to be exempted from VAT regardless of domestic investors or foreign investors or issued in China domestic market or overseas market; PN[2025] No. 4—VAT were reinstated on interest income derived from treasury bonds, local government bonds issued after 8 Aug 2026).
 - Still no clear rule on CIT treatment on trading gains on REITs investments and commodity future investments by QFII.

Private Equity investment

- **Offshore structure—bullet 7 & treaty benefit application**
- **Onshore QFLP—changes**
 - The applicability of treaty benefit/ beneficial ownership
 - The tax treatment of foreign LPs in QFLP has been adjusted

Attention to cross border tax

- **CFC**
- **Direct Equity transfer and indirect equity transfer**

New China VAT Law and the impact to Financial Industry



New China VAT Law

The Chinese government issued the very first China VAT Law on 25 Dec 2024, with the effect on 1 Jan 2026. To facilitate the launch of the new law, the State Council issued the Implementation Regulations on 30 Dec 2025, while the Ministry of Finance and the State Taxation Administration released a series of supporting regulations in late January and early Feb 2026, clarifying detailed guidelines on tax scope, preferential policies, taxable sales calculation, input tax credit, prepayment, and tax filing, etc.

Stable framework

- **The new law basically imports the existing VAT framework to provide a stable environment to business.**
- Core elements **remain unchanged**, including taxable scope, tax rates, general and simplified tax calculation methods, the input tax deduction mechanism, and the tax administration framework.

Integration of regulations

- **The new VAT law and supporting regulations have consolidated and integrated the existing VAT regulations**, including the definition of taxable scope, the continuation of tax incentives, and export tax incentives for goods and services, etc.

Refinement

- **The new VAT regulations refine and improve the existing VAT provisions** on certain matters, such as the "place of consumption" principle, mixed sales, deemed sales, input VAT recovery and time limits on certain tax incentives.

Key highlights for Financial Service Industry

Output VAT	Potential VAT cost impact	Input VAT	Potential VAT cost impact
<ul style="list-style-type: none"> The tax scope of financial services and VAT rates are basically unchanged, i.e. 6% for financial services, 3% for asset management products, and 5% for specific transactions (e.g. financial leasing of immovable property). 	—	<ul style="list-style-type: none"> Net-based taxation for financial products transfers remains unchanged. 	—
<ul style="list-style-type: none"> The gratuitous transfer of financial products has been explicitly added as a deemed taxable transaction. 	↑	<ul style="list-style-type: none"> The input VAT on interest expenses remains non-deductible, but on a temporary basis, and the new rules require MOF and STA to assess policy impacts, leaving room for future relaxation. 	—
<ul style="list-style-type: none"> The place of supply rule has been changed: <ul style="list-style-type: none"> For financial instruments: supplied in China if being issued in China or seller is in China; For services/intangible assets: supplied in China if consumed in China or seller is in China. 	↑	<ul style="list-style-type: none"> Input VAT attributable to non-taxable income is non-deductible. Since the scope of non-taxable transactions may be broad, the introduction of the new rule effectively narrow the scope of creditable input VAT. 	↑
<ul style="list-style-type: none"> Most preferential policies for financial institutions have been continued, with some now subject to validity periods up to 31 Dec 2027 or certain adjustment 	—	<ul style="list-style-type: none"> The new rules governing the purchased long-term assets with the original value over RMB 5mil and mixed-used for the five categories of input VAT non-deductible items (e.g., simplified taxation, VAT-exempt items, non-taxable items) will lead to an increased VAT cost and higher compliance burden. 	↑
<ul style="list-style-type: none"> A mandatory input VAT annual reconciliation is required, leading to higher tax compliance burden. 	↑		
Administration	Potential VAT cost impact		
<ul style="list-style-type: none"> Introduction of the withholding obligations for payments to individuals, leading to higher tax compliance burden and potential tax cost 	↑		
<ul style="list-style-type: none"> Introduction of general anti-avoidance rule (GAAR), requiring enterprises to maintain genuine commercial substance in arrangements 	↑		
<ul style="list-style-type: none"> Clarification of the timing of tax liability for the supply of services, the uncollected loan interest of financial institutions, etc. 	—		

Key changes

Place of supply rule

Sale of financial instruments

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. (Article 4 of the VAT Law)

In practice, transactions involving financial instruments may be highly complex, rendering it challenging to clearly identify the seller in such transactions.

Question:
How to determine the seller of the sales of financial instruments transaction?

Sale of services or intangible assets

For the sale of services or intangible assets, the place of supply is in China if the service or intangible asset is consumed in China, or the seller is a domestic party. (Article 4 of the VAT Law)

Services or intangible assets consumed in China refers to (Article 4 of Implementing Regulations of the VAT Law):

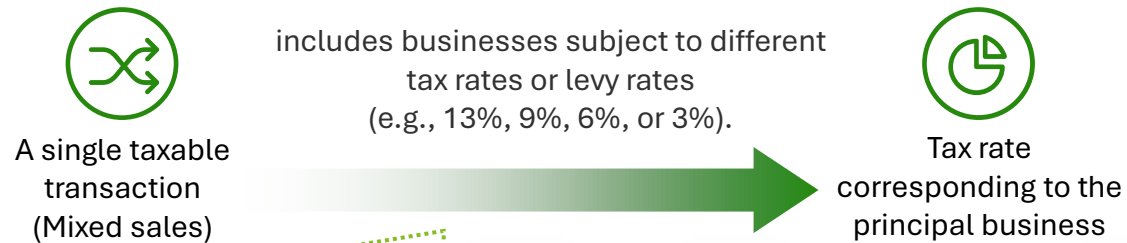
- The service or intangible asset is supplied to a domestic party, excluding services **consumed on-site overseas**; and
- The service or intangible asset is **directly linked to** goods, immovable property, or natural resources located in China.
- Other circumstances stipulated by the MOF/STA

Question:
How to interpret the concepts “consumed on-site overseas” and “directly linked to” to determine “consumed in China” for supply of services?

Key changes

Mixed sales

Where a taxable transaction involves two or more tax rates and levy rates, the tax rate or levy rate corresponding to the principal business of the transaction shall apply. (Article 13 of the VAT Law)






There is an obvious principal-and-ancillary relationship among the businesses.

- The principal business is dominant and reflects the essential nature and purpose of the transaction;
- the ancillary business serves as a necessary supplement to the principal business and is premised upon the occurrence of the principal business.

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.

Deemed sales

The new law has significantly simplified the scope of deemed taxable transactions. (Article 5 of the VAT Law)

-  Use self-produced or consigned processed goods for collective welfare or personal consumption
-  Transfer goods without consideration
-  Transfer intangible assets, real property, or **financial instruments** without consideration

- **"Free-of-charge services" removed**
- Some other circumstances removed
- "Other circumstances stipulated by the Ministry of Finance and the State Administration of Taxation" removed

The applicability of anti-avoidance rules to the gratuitous provision of taxable services remains to be clarified.

Preferential VAT policies for financial institution

For the financial industry, most of the existing VAT preferential policies have been retained, while implementation periods have been added to some incentives and adjustments have been made to certain preferential policies.

Long-term

- **From 8 Aug 2025**, to **re-impose VAT on the interest income** from new-issued government/local government/financial bonds
- **VAT on uncollected loan interest**: payable if within 90 days of settlement date; deferred beyond 90 days until cash receipt
- **From 1 Jan 2026**, to continue the VAT preferential policies for **Mainland and HK capital markets interconnection mechanism**: investors in the Hong Kong market (including entities and individuals) are exempt from VAT on income derived from trading in stocks and funds

Phased ones

From 1 Jan 2026 to 31 Dec 2027

- **Interest income earned by foreign institutions** from investing in **the domestic bond** market shall be temporarily exempt from EIT and VAT.
- **Income derived from QFII&RQFII** investments shall be exempt from VAT.
- **Interest income from financial interbank transactions** shall be exempt from VAT.
- **Premium income** obtained by insurance companies from personal insurance products with a term of more than one year shall be exempt from VAT.
- Income derived from stock and bond transactions by managers of **publicly offered securities investment funds** (including closed-end and open-end securities investment funds) is exempt from VAT.

Favorable VAT policies for asset restructuring

Key changes

Bulletin [2026] No. 13 by the MOF and SAT

- **The conditions for VAT exemption on asset restructuring have been further clarified and refined.**
- **A taxpayer that carries out asset restructuring via merger, division, sale or exchange and meets the following conditions shall be exempt from VAT on the transfer of goods, financial instruments, intangible assets and real estate (collectively “Assets”). The corresponding input VAT may be deducted against output VAT as prescribed.**
 1. The restructuring targets a relatively independent business.
 2. The taxpayer transfers assets, claims, liabilities and employees as an integrated package.
 3. The restructuring has a reasonable commercial purpose and is not for tax avoidance.
 4. If the transferor in the asset restructuring is a general taxpayer, the transferee shall also be a general taxpayer.
- **Where a taxpayer is merged in the aforementioned asset restructuring and undergoes deregistration for tax purposes, the unused input VAT credits prior to deregistration may be carried forward and deducted by the merged taxpayer.**

Key changes

Input VAT of loan interest

Input VAT on loan interest and directly related fees (e.g., investment and financing advisory fees, handling fees, and consulting fees) is **temporarily non-deductible**. Finance and taxation authorities will duly assess the implementation of the policy that input VAT on loan interest and related expenses is non-deductible.

- 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.

Input VAT attributable to non-taxable transactions

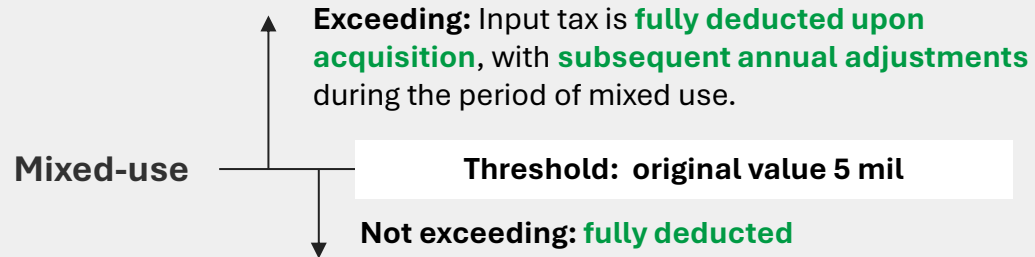
Where a taxpayer purchases goods, services, intangible assets, or real estate that are used for non-taxable transactions meeting certain conditions (collectively referred to as “**non-taxable transactions**”), the corresponding input tax may not be credited against output tax.

There is uncertainty regarding the deductibility of the input VAT of the non-taxable transactions:

Non-taxable transactions	Input VAT
<ul style="list-style-type: none"> • Transfer of equity; • Dividend income 	<ul style="list-style-type: none"> • Handling fees, professional service fees and other fees related to the purchase and sale of equity as well as other related expenses
<ul style="list-style-type: none"> • Non-principal-guaranteed investment returns 	<ul style="list-style-type: none"> • Handling fees and professional service fees related to the purchase and sale of relevant investments
<ul style="list-style-type: none"> • Government subsidies 	<ul style="list-style-type: none"> • Professional service fees and other related fees

Key changes

Input VAT of long-term assets



Input VAT on loan interest and directly related fees (e.g., investment and financing advisory fees, handling fees, and consulting fees) is **temporarily non-deductible**. **Finance and taxation authorities will duly assess the implementation of the policy that input VAT on loan interest and related expenses is non-deductible.**

- The introduction of new requirements for input VAT deduction on mixed-use long-term assets has further raised the threshold for business tax compliance.
- **Businesses are required to sort out the usage of long-term assets, establish ledgers for their purposes, and regularly review, update and maintain such ledgers.**

Input VAT annual reconciliation

Where a general taxpayer is **unable to clearly allocate the portion of non-deductible input tax**, the **non-deductible input tax** in the current period shall be calculated based on the proportion of sales revenue or income. **An annual adjustment shall be conducted during the tax filing period of Jan in the following year.**

Where a taxpayer purchases goods, services, intangible assets, or real estate that are used for non-taxable transactions meeting certain conditions (collectively referred to as **“non-taxable transactions”**), **the corresponding input tax may not be credited against output tax.**

- **While taxpayers would continue to use the existing monthly or quarterly method for their periodic VAT filings, they would also be required to perform an annual adjustment in January of the following year based on full-year data.**
- This proposed process is expected to increase the tax compliance costs for businesses.

Withholding obligations

Key changes

VAT Withholding on C2B Transactions

Article 35 of Implementing Regulations of the VAT Law

Where a private individual engages in a taxable transaction, **the domestic entity paying the consideration shall be the withholding agent**. The specific operational measures for withholding and remitting shall be formulated by the competent departments of finance and taxation under the State Council.

In practice, enterprises procuring taxable services from a large number of individuals may face a material impact.

Banking

Engaging external individual experts to provide consulting, training, risk control assessment and other services, and paying the service fee.

Insurance

Engaging numerous individual insurance agents on insurance sales, customer services and other agency services and paying commission fee.

Securities

Engaging individual agents on brokerage services such as client solicitation and account services and paying commission fee.

Announcement No. 4 [2026] of the STA

Where **insurance and securities companies** file VAT returns on behalf of individual agents and brokers, the tax filing shall be conducted on a monthly basis, and the threshold to start to pay VAT is RMB 100,000 per person per month.



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