

# China Tax Alert

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## VAT Reimposition on Government Bonds, Local Government Bonds, and Financial Bonds

On 31 July 2025, the Ministry of Finance of the People's Republic of China (MOF) and the State Taxation Administration of The People's Republic of China (STA) jointly issued Announcement No. 4 [2025], titled "Announcement of the Ministry of Finance and Other Departments on the Value-Added Tax (hereinafter referred to as "VAT") Policy for Interest Income from Government Bonds and Other Bonds" (hereinafter referred to as "Announcement 4"). Announcement 4 stipulates that, starting from 8 August 2025, VAT will be reinstated on interest income from newly issued government bonds, local government bonds, and financial bonds issued on or after that date.

This tax policy adjustment significantly impacts financial institutions, affecting multiple business sectors including investment activities and asset management. The industry needs to pay close attention to the policy change. KPMG shares professional interpretation and analysis below, covering key points, impacts, and recommendations, aiming to offer beneficial references for the industry.

### Key points

- Distinction issuance between "the new" and "the old"

Announcement 4 stipulates that interest income from government bonds, local government bonds, and financial bonds issued before August 8, 2025 (including re-issuance of existing bonds after that date) will continue to be exempt from VAT until the bonds mature. Consequently, financial institutions must note that the VAT treatment differs for existing bonds (including re-issuance of existing bonds) and newly issued bonds. Identifying existing bonds eligible for continued exemption is crucial. Specifically, institutions must pay attention to the re-issuance of existing bonds. Given that government bonds, local government bonds, and certain financial bonds are subject to re-issuance in the market, financial institutions need to establish clear criteria (e.g., bond code, issuance date) based on regulatory requirements to define and assess re-issued bonds, ensuring tax compliance.

- Scope of Financial Institution Bonds

Announcement 4 explicitly lists three categories of bonds subject to the reinstated VAT: government bonds, local government bonds, and financial bonds. The scope of the first two categories is fairly clear. For financial bonds, Announcement 4 provides a specific definition: "valuable securities issued by financial institution legal entities established within the territory of the People's Republic of China in accordance with the law on the national interbank bond market and exchange bond markets, which repay principal and interest as agreed." This definition adopts the one for financial bonds provided in Caishui [2016] No. 70 ("Announcement 70").

Based on this definition, financial institutions need to evaluate various investment products in the market to determine which are now taxable and which remain exempt. In some cases, institutions may need to assess the VAT treatment based on specific investment scenarios. For example:

## ➤ Policy Financial Bonds

Do they fall under the bonds that need to reinstate VAT? Current VAT exemptions for policy financial bonds are mainly governed by Caishui [2016] No. 46 ("Announcement 46"), which defines them as bonds issued by development and policy financial institutions. Although not explicitly listed in Announcement 4, based on its definition, the issuers (policy/development financial institution legal entities) qualify as financial institution legal entities. If such bonds are issued on the national interbank or exchange bond markets and repay principal and interest as agreed, they meet the formal criteria of taxable financial bonds under Announcement 4.

## ➤ Other Financial Products Dealings of Financial Institutions

For other products under the "interest income of financial products dealings of financial institutions" category (e.g., interbank deposits, interbank lending, Negotiable certificates of deposit, buy-out repo as listed alongside financial bonds in Announcement 70), institutions should first assess if they fall within the definition of financial bonds. If not, their existing VAT exemption treatment should generally continue to apply.

Having said that, the above analysis is based on KPMG's interpretation of current regulations, and specific guidance will adhere to the further clarification by the tax authorities.

## Impact Analysis

Considering differing VAT treatments across financial institutions, the impact is analysed from the perspective of different types of investors:

### • Domestic Financial Institutions

Proprietary investments by domestic institutions are generally subject to a VAT rate of 6%. The reinstatement of VAT on the aforementioned bond investments will affect the returns on these investments.

VAT is merely one of the taxes applicable to bond investments by domestic financial institutions; CIT exemptions for interest income on government and local government bonds remain in effect. Institutions should assess the overall tax burden for accurate comparison.

### • Asset Management Products

Asset management products are currently subject to a simplified VAT rate of 3%. If a product currently applies VAT exemption (e.g., public funds) using the identity of financial institutions, the reinstatement of VAT will impact its net asset value and yield.

If a product does not currently apply VAT exemption under the "interest income of financial products dealings of financial institutions" category, the impact is limited to government and local government bond investments; the VAT treatment and cost of financial bond interest income remain unchanged.

### • Overseas Institutions

According to Caishui [2021] No. 34 ("Announcement 34"), interest income earned by overseas institutions investing in China's bond market is temporarily exempt from corporate income tax and VAT.

Announcement 4 does not specify the investor type, creating uncertainty regarding the continuity of this exemption for overseas institutions. Furthermore, Announcement 34 expires on 31 December 2025, adding uncertainty about its renewal. Affected institutions should assess potential tax cost impacts if exemptions lapse and prepare contingency plans.

### • Social Security Funds & Pension Funds

According to Caishui [2018] No. 94, "Notice on Tax Policies Concerning Investment Activities of the National Social Security Fund", all interest income and income of an interest nature derived from providing loan services, as well as income from the transfer of financial products, obtained by the National Social Security Fund Council and social security fund investment management institutions during the investment process utilising the social security fund, are exempt from VAT.

Simultaneously, according to Caishui [2018] No. 95, "Notice on Tax Policies Concerning Investment Activities of the Basic Pension Fund", all interest income and income of an interest nature derived from providing loan services, as well as income from the transfer of financial products, obtained by the National Social Security Fund Council and pension fund investment management institutions during the investment process utilizing the pension fund within the scope of investment approved by the State Council, are exempt from VAT.

Uncertainty exists whether Announcement 4 affects these exemptions for the relevant bonds. Further clarification from tax authorities is needed.

The table below summarises the VAT treatment changes for key investment income types:

Investor Type	Bond Type	Interest Income During Holding Period (Note 1)	Income from Financial Product Transfer
Domestic Financial Institutions-Proprietary investments (Note 2)	Government Bonds	Exempt→6%	6%
	Local Government Bonds	Exempt→6%	6%
	Financial Bonds	Exempt→6%	6%
Asset Management Products-Public Funds	Government Bonds	Exempt→3%	Exempt
	Local Government Bonds	Exempt→3%	Exempt
	Financial Bonds	Exempt→3%	Exempt
Asset Management Products-Others	Government Bonds	Exempt→3%	3%
	Local Government Bonds	Exempt→3%	3%
	Financial Bonds	Exempt→3%	3%
Social Security Fund/Pension Fund	Government Bonds	Exempt→?	Exempt
	Local Government Bonds	Exempt→?	Exempt
	Financial Bonds	Exempt→?	Exempt
Overseas Institutions (Note 3)	Government Bonds	Exempt→?	Exempt or 6%
	Local Government Bonds	Exempt→?	Exempt or 6%
	Financial Bonds	Exempt→?	Exempt or 6%

Note 1: Changes apply to interest income from newly issued bonds during the holding period. Please refer to our previous analysis for details.

Note 2: Assuming financial institutions apply the general treatment of a 6% VAT rate.

Note 3: Financial products transfer income of overseas institutions may be exempt under specific conditions. For example, as clarified in Caishui [2016] No. 36 ("Announcement 36"), income derived from the transfer of financial products by Qualified Foreign Institutional Investors (QFII) through domestic companies entrusted to engage in securities trading activities in China is exempt from VAT. Caishui [2016] No. 70 explicitly states that both (i) income derived by RMB Qualified Foreign Institutional Investors (RQFII) through entrusted domestic companies engaging in securities trading activities in China, and (ii) income obtained by overseas institutions approved by the People's Bank of China (PBoC) from investments in the interbank domestic currency market, are subject to VAT exemption policies.

## Recommendations

Policy changes at the company level primarily manifest as cost impacts and compliance requirements. Financial institutions need to take corresponding actions from these two main directions. Considering that financial institutions also engage in asset management, it is necessary to further expand and consider the impact on product and investor-side costs and compliance management. Regarding these two main directions, we provide the following high-level recommendations:

1. **Assess Impact & Adjust Strategy:** Comprehensively evaluate the impact of the VAT policy change on existing investment models. Adjust short-term and medium-to-long-term investment strategies to mitigate cost impacts and adapt.
2. **Update Systems for Compliance & Operations:** Modify and optimise existing VAT or related systems (e.g., adding issuance date fields, reviewing tax exemption flags) to ensure compliant tax treatment. At the same time, it is also necessary to synchronously renovate and update related operation, financial, and other systems to achieve integrated management of operation, finance, taxation, and invoices.
3. **Closely monitor developments related to the new VAT Law and its implementing regulations,** as they may introduce significant changes, including adjustments to existing preferential policies. KPMG will continue tracking and sharing insights.

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