China Tax Alert

Issue 1, January 2026

New Regulations Unveiled, Ushering in a New Era for China VAT

Summary:

In this Tax Alert, we set out our understanding of the provisions contained in the recently issued Implementation Regulations of China's Value-Added Tax (VAT) Law, followed by a summary of the key policy changes and a discussion of how taxpayers should respond to these potential changes. The developments in the Implementation Regulations signal a strategic shift towards a VAT environment in China in which businesses are advised to make increased efforts in managing their VAT affairs.

Background

The VAT Law came into effect on 1 January 2026 (see KPMG China Tax Alert Issue 10, December 2024 for details). In comparison with the existing VAT regulations, the VAT Law retains the same basic tax regime framework and is not designed to create additional tax burden for taxpayers, while refining provisions relating to the scope of taxable transactions, tax incentives, and other areas. To ensure the effective enforcement of the law, the State Council Standing Committee reviewed and approved the Draft Implementation Regulations of the VAT Law on 19 December 2025. Subsequently, on 25 December 2025, Premier Li Qiang signed the State Council Decree No. 826, officially promulgating the "Implementation Regulations". The Implementation Regulations were published on the State Council's website on 30 December 2025 and took effect at the same time as the VAT law.

The Implementation Regulations, which comprise six chapters and 54 articles, set out detailed provisions on VAT rates, taxable transactions, incentives and administration. The Implementation Regulations are designed to facilitate the effective enforcement of the VAT law by providing detailed rules on its application.

The Implementation Regulations provide clearer definitions of taxable transactions under the VAT law, specifying the scope and applicable scenarios for goods, services, intangible assets and immovable property. They also refine rules on preferential policies, including eligibility for zero-rated VAT on certain export goods, as well as the conditions under which cross-border sales of services and intangible assets may qualify for zero-rated VAT. In addition, the regulations further standardise VAT deduction practices by clarifying the types of eligible deduction vouchers and the methods for deducting input VAT. They also set out detailed criteria for VAT exemption items stipulated in the law.

Key changes observed in the Implementation Regulations

Although the VAT Law aims to retain the same basic tax regime framework and not create any additional tax burden for taxpayers, the Implementation Regulations of the VAT law still introduce a number of adjustments and amendments that could have significant impacts to the taxpayers.

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<u>Detailed Provisions on the Consumption of Services and Intangible Assets within China</u>
Article 4: The term “services and intangible assets consumed in China” as referred to in item (4) of Article 4 of the VAT Law shall mean the following circumstances:

Services or intangible assets sold by overseas entities or individuals to domestic entities or individuals, excluding services consumed onsite overseas;
Services or intangible assets sold by overseas entities or individuals that are directly related to goods, immovable property, or natural resources in China;
Other circumstances as provided by the Ministry of Finance (MOF) and State Taxation Administration (STA) under the State Council.

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Under Circular Caishui [2016] No. 36, services provided or intangible assets sold by overseas entities or individuals to domestic entities or individuals are not subject to VAT in China if the services are performed entirely overseas or the intangible assets are used entirely overseas.
In comparison with the provisions of Circular Caishui [2016] No. 36, the VAT Law has refined the definition of “sale of services or intangible assets within China” by emphasising the concept of “consumption of services or intangible assets within China.” The Implementation Regulations further clarify the circumstances that constitute domestic consumption of services and intangible assets. These detailed provisions are consistent with international practices for determining the place of consumption, as set out in the OECD International VAT/GST Guidelines, thereby enhancing the certainty and operability of VAT treatment for cross-border transactions.

Item (1) excludes “on-the-spot services consumed overseas”, which aligns with international practice for determining the place of consumption. According to the OECD International VAT/GST Guidelines, on-the-spot supplies are services that are normally physically performed at a readily identifiable place and ordinarily consumed at the same time and place where they are physically performed, and that ordinarily require the presence of both the person performing the supply and the person consuming it, i.e., Business-to-Consumer on-the-spot supply, (e.g., accommodation, hairdressing services). The place of physical performance of the supply is the appropriate proxy to determine the place of consumption for the on-the-spot supplies of services to final consumers.
Item (2) does not restrict the purchaser of the service to domestic entities or individuals. This means that overseas entities or individuals selling services or intangible assets that are directly related to goods, immovable property, or natural resources located in China may be subject to VAT in China, even if the transaction occurs between overseas parties. It should also be noted that different interpretations of the criteria for determining whether a service or intangible asset is “directly related” to goods, immovable property, or natural resources in China may lead to significant disputes. The OECD VAT/GST Guidelines provide references for determining direct relevance to goods and immovable property, and it is anticipated that supplementary notices will be issued to provide clarity in this regard.

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<u>Application of Zero VAT Rate to Exported Services and Intangible Assets</u>
Article 9: For cross-border sales by domestic entities or individuals of the following services or intangible assets, a zero VAT rate shall apply:

Research and development services, energy performance contracting services, energy performance contracting design services, radio and television programme production and distribution services, software services, integrated circuit design and testing services, information system services, business process management services, offshore service outsourcing services, which are sold to overseas entities and fully consumed overseas;
Transfer technology to overseas entities that is fully used overseas;
International transportation services, aerospace transportation services, and outward repair and processing services.

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The Implementation Regulations are consistent with the current VAT policies under which a zero VAT rate applies to cross-border taxable activities.
Under Circular Caishui [2016] No. 36, “fully consumed outside of China” is defined as follows:

The actual recipient of the service is located overseas, and the service is not related to goods or immovable property within China.
The intangible asset is fully used outside of China, and is not related to goods or immovable property within China.
Other circumstances as stipulated by the MOF and the STA.

In the previous Consultation Paper of the Implementation Regulations, the condition for the transfer of technology to overseas entities was described as “fully consumed overseas.” Consistent with the specific interpretation under Circular Caishui [2016] No. 36, the final version of the Implementation Regulations has revised this condition to “fully used overseas,” which provides greater accuracy. However, in practice, the determination of what constitutes “fully used overseas” remains subject to different interpretations. It is anticipated that supplementary notices will be released to provide clarity on this matter.
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Clarification of Applicable Tax Rates and Collection Rates for Mixed Sales Transactions Article 10: The term "taxable transaction" as referred to in Article 13 of the VAT Law shall simultaneously satisfy the following conditions: 1. It includes two or more activities involving different tax rates or levy rates; 2. There exists an obvious principal-and-ancillary relationship among the activities. The principal activity occupies a dominant position and embodies the essence and purpose of the transaction; the ancillary activity is a necessary supplement to the principal activity and is premised upon the occurrence of the principal activity.	The VAT Law has removed the requirement that mixed sales must involve both goods and services in a single transaction, and now only emphasises a single taxable transaction that involves two or more different VAT rates or levy rates. The applicable tax rate or levy rate should be determined based on the principal activity of the taxable transaction. Article 10 of the Implementation Regulations further provides criteria for determining what constitutes a "single taxable transaction", explicitly requiring a clear principal-ancillary relationship between the activities, and provides additional guidance for determining the applicable tax rate or levy rate in mixed sales scenarios. In practice, distinguishing whether different business activities should be treated as a "single taxable transaction" for VAT purposes or as "two or more taxable transactions" (and thus subject to the rules for concurrent sales) has long been challenging and controversial. According to the criteria set out in the Implementation Regulations, enterprises must make substance-over-form judgements. Specifically, they must consider whether the various activities are inseparable, whether the ancillary activity is contingent upon the principal activity, and whether the ancillary activity is a necessary supplement to the principal activity. Enterprises should also pay close attention to the impact of contractual arrangements, accounting treatment, and other requirements on the determination of a "single taxable transaction". It is noteworthy that this rule is qualitative and subjective – finance and tax staff may lack the professional expertise to determine the substance and purpose of the transaction or the principal-ancillary relationship, particularly for new business models. Furthermore, this raises the question as to whether the introduction of this new rule may disrupt the equilibrium achieved over many years of practice in certain business sectors (e.g. repair and maintenance of elevators) for VAT purposes. Entities are recommended to assess the impact exerted by the mixed sales rule in light of their own industry and business and proactively communicate with tax authorities regarding the determination of a "single taxable transaction".
Clearer Definition of "Total Consideration"—Removal of the Term "Additional Charges Outside Price" Article 15: The term "total consideration" as referred to in Article 17 of the VAT Law shall not include the following taxes, fees, or amounts collected on behalf of other parties by the taxpayer: 1. Government funds or administrative charges for public institutions; 2. Consumption tax arising from commissioned processing of consumer goods subject to consumption tax; 3. Vehicle purchase tax and vehicle and vessel tax; 4. Amounts collected on behalf of a principal under the principal's name with invoices under such name.	In comparison with existing VAT regulations and the Consultation Draft, the Implementation Regulations remove the reference to "additional charges outside price". Under the Detailed Implementation Rules for the Provisional VAT Regulations, "additional charges outside price" included a variety of items charged to the purchaser outside of the main transaction price, such as handling fees, subsidies, funds, contributions, profit rebates, bonuses, penalties, late fees, interest on deferred payments, compensation, amounts collected or advanced on behalf of others, packaging fees, packaging rental, reserve fees, quality premiums, transportation and loading fees, and other similar charges. According to the VAT Law, sales amount refers to the total consideration received by the taxpayer for taxable transactions, including all monetary and non-monetary economic benefits. As the definition of sales amount already encompasses "the total consideration corresponding to monetary and non-monetary economic benefits," there is no need to separately introduce the concept of "additional charges outside price". The removal of this reference helps to reduce potential disputes in practice and enhances the clarity of the VAT system.

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<u>Retention of Existing Methods for Assessing Sales Value</u> Article 18: Where a taxpayer falls under the circumstances stipulated in Article 20 of the VAT Law, the tax authority may, in sequence, determine the sales amount according to the following methods: 1. Determine based on the average price at which the taxpayers sold goods, services, intangible assets, or immovable property of the same kind in the most recent period; 2. Determine based on the average price at which other taxpayers sold goods, services, intangible assets, or immovable property of the same kind in the most recent period; 3. Determine based on a composition taxable price. The formula for composition taxable price is: Composition taxable price = Cost x (1 + Cost profit margin) + Consumption tax amount The cost profit margin shall be 10%. The STA may adjust the cost profit margin according to the actual industry cost profit.	Article 20 of the VAT Law stipulates that where the sales amount is significantly lower or higher than normal without a legitimate reason, the tax authorities may assess the sales value in accordance with the Law of the People's Republic of China on the Administration of Tax Collection and relevant regulations. The Implementation Regulations maintain the approach set out in the Detailed Implementation Rules for the Provisional VAT Regulations, allowing tax authorities to determine the sales value in cases where it is unreasonably low without justified reason. This continuity enhances the certainty and operability of VAT administration.
<u>Input Tax – Irrecoverable Input VAT Incurred on Interest Related Costs</u> Article 21: A taxpayer's interest expenses on purchased loan services, and fees paid to the lender that are directly related to such loan services, such as investment and financing advisory fees, handling fees, and consulting fees, shall have the corresponding input tax amounts temporarily not creditable against output tax. The MOF and the STA shall timely study and evaluate the implementation effects of the policy under which the input tax corresponding to interest and related expenses on purchased loan services shall not offset against output tax.	Whether input VAT on loan services can be deducted has been a focus of industry attention. The Implementation Regulations explicitly prohibit the deduction of input VAT on loan services and related fees, which is consistent with the current VAT policy. It is noteworthy that the Implementation Regulations use the term "temporarily not creditable" and indicate that the relevant authorities will review and assess the policy's effectiveness in due course. This wording leaves room for potential future policy adjustments, allowing for the possibility that VAT on loan services may become creditable.
<u>Input Tax – Irrecoverable Input VAT Due to Out-of-scope Use</u> Article 22: Where a taxpayer purchases goods, services, intangible assets, or immovable property for non-taxable transactions that simultaneously satisfy the following circumstances (hereinafter collectively referred to as "non-taxable transactions that shall not offset"), the corresponding input tax amounts shall not be creditable against output tax: 1. Engaging in business activities other than those under Articles 3 to 5 of the VAT Law, and obtaining economic benefits related to in monetary or non-monetary form; 2. Not falling under the circumstances provided in Article 6 of the VAT Law.	Under the existing VAT regulations, input VAT incurred for non-taxable transactions has not been explicitly included among non-creditable items. The Implementation Regulations now specify that non-taxable transactions encompass business activities other than taxable transactions and deemed taxable transactions under the VAT Law, provided such activities generate economic benefits. However, this does not include the four types of non-taxable items listed in Article 6 of the VAT Law, such as deposit interest income. In comparison with the Consultation Draft, the Implementation Regulations have narrowed the scope of non-taxable transactions for which input VAT is irrecoverable. Taxpayers should pay close attention to whether their non-taxable transactions qualify as "business activities that generate economic benefits." If not, the corresponding input VAT does not need to be transferred out. As the Implementation Regulations do not provide a clear definition of "business activities", we recommend that taxpayers monitor subsequent supplementary notices and proactively identify scenarios where input VAT may not be creditable, such as dividend income, gains from equity transfers, fund distributions, and non-principal-protected financial products held to maturity. Enterprises should assess the potential impact of these changes on their operations.

Key Policy Point	Detailed Interpretation and Impact Analysis
<u>Annual Reconciliation for Unallocated Non-deductible Input VAT</u> Article 23: Where a general taxpayer purchases goods (excluding fixed assets) or services for projects taxed under the simplified tax calculation method, VAT-exempt items, and non-taxable transactions for which offsetting is not allowed, and is unable to apportion the non-creditable input tax amounts, such taxpayer shall, period by period, calculate the non-creditable input tax amounts for the current period based on the proportion of sales amounts or income, and shall carry out an annual settlement and clearance during the tax return period in January of the following year.	Under the existing VAT regulations, tax authorities have the discretion to perform annual reconciliations of non-allocable input VAT transfer-out based on annual data. The Implementation Regulations now require taxpayers to conduct an annual reconciliation and adjustment of such input VAT during the tax filing period in January of the following year. This means that, following the implementation of the VAT Law, the responsibility for annual reconciliation of non-allocable input VAT transfer-out will shift from the tax authorities to taxpayers, raising the bar for VAT compliance and reporting. In comparison with the Consultation Draft, the Implementation Regulations provide a more comprehensive and accurate description: annual reconciliation is required for projects subject to the simplified tax calculation method, VAT-exempt items, and non-taxable transactions that are not creditable. The terms "sales amount and income" are used to correspond to taxable and non-taxable transactions, respectively. We recommend that enterprises pay close attention to subsequent guidance from tax authorities regarding the specific operational requirements for annual reconciliation of non-allocable input VAT transfer-out, and prepare in advance to ensure compliance.
<u>Input VAT Treatment for Long-Term Assets</u> Article 25: Where fixed assets, intangible assets, or immovable property obtained by a general taxpayer (hereinafter collectively referred to as "long-term assets") are used both for items subject to the general tax calculation method and for items subject to the simplified tax calculation method, VAT-exempt items, non-taxable transactions for which offsetting is not allowed, collective welfare, or personal consumption (hereinafter collectively referred to as the "five categories of non-creditable items"), such long-term assets shall be deemed mixed-use long-term assets, and the corresponding input tax shall be handled in accordance with the VAT Law and the following provisions: 1. For a single long-term asset with an original value not exceeding RMB 5 million, the corresponding input tax may be fully offset against output tax; 2. For a single long-term asset with an original value exceeding RMB 5 million, the input tax shall first be fully offset upon purchase; thereafter, during the period of mixed use, the input tax amounts corresponding to the five categories of non-creditable items that shall not be offset against output tax shall be calculated based on the adjustment years and adjusted year by year. The specific operational measures for input tax offsetting of long-term assets shall be formulated by the MOF and the STA.	Under the existing VAT regulations, input VAT incurred on fixed assets, intangible assets, or immovable property used exclusively for projects subject to the simplified tax calculation method, VAT-exempt projects, collective welfare, or personal consumption is not creditable. The scope of non-creditable assets is limited to those used exclusively for such purposes and does not include other types of equity-based intangible assets. This means that, under the current VAT regime, if fixed assets, intangible assets, or immovable property are used for both general VAT projects and non-creditable projects, the input VAT may be fully credited—a preferential policy unique to China's VAT system. Article 25 of the Implementation Regulations introduces the concept of "long-term assets" and new rules for input VAT credit on long-term assets used for mixed purposes. For individual long-term assets with an original value not exceeding RMB 5 million, the input VAT may continue to be fully credited, in line with the current policy. For individual long-term assets with an original value exceeding RMB 5 million, the input VAT may be fully credited at the time of acquisition, but during the period of mixed use, the portion of input VAT attributable to the five categories of non-creditable use (simplified tax calculation method projects, VAT-exempt projects, non-taxable transactions that are not creditable, collective welfare, or personal consumption) must be calculated and adjusted annually over the adjustment period. Issues regarding the input VAT credit mechanism for long-term assets with an original value exceeding RMB 5 million require further clarification, including but not limited to the following. We recommend that enterprises closely monitor subsequent policies to be issued by the MOF and the STA and proactively assess the potential impacts and prepare for the changes accordingly. • How should the original value of RMB 5 million be determined? • Will the annual adjustment of non-deductible input VAT for long-term assets align with the annual reconciliation approach in Article 23 (i.e., adjustment in the January filing period for the previous year)? • Does depreciation/amortisation schedule follow accounting standards or corporate income tax rules? • Will transitional policies be set out for existing long-term assets to ensure reasonable alignment of VAT treatment?

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Tax Incentives—Statutory Exemption Criteria Article 27: The term "medical institutions" as referred to in item (2), paragraph 1, Article 24 of the VAT Law shall mean institutions established in accordance with relevant provisions and possessing qualifications to practice as medical institutions, including medical institutions at all levels of the military and the armed police force; excluding for-profit cosmetic medical institutions. Article 30: The term "schools" as referred to in item (8), paragraph 1, Article 24 of the VAT Law shall mean institutions established in accordance with relevant provisions that provide academic education, as well as technical schools, advanced technical schools, and technician colleges. (Other articles omitted.)	Article 24 of the VAT Law enumerates nine categories of statutory VAT exemption items and stipulates that the specific standards for these exemptions shall be determined by the State Council. Articles 26 to 31 of the Implementation Regulations set out the detailed criteria for statutory exemption items, which largely follow the existing VAT regulations. A notable change is that the Implementation Regulations explicitly exclude for-profit cosmetic medical institutions from the scope of medical institutions eligible for VAT exemption. Additionally, technical schools, advanced technical schools, and technician colleges are now included as schools eligible for VAT exemption.
Withholding Obligations for Taxable Transactions conducted by Individuals Article 35: Where a natural person engages in a taxable transaction in conformity with provisions, the domestic entity making the payment shall be the withholding agent. The specific operational measures for withholding filing and payment shall be formulated by the MOF and the STA. Where overseas entities or individuals lease immovable property in China to individuals, they shall appoint a domestic agent to handle VAT filing and payment.	Under the existing VAT regulations, individuals engaging in taxable transactions are generally required to file and pay VAT on a self-declaration basis. However, with the growing prevalence of the platform economy, sharing economy, and similar models, the number of individuals independently conducting taxable transactions has increased significantly. The self-declaration model for individuals presents loopholes in tax collection and administration. Additionally, entities making payments often face difficulties in obtaining valid deduction certificates from individuals, which prevents input VAT credits and deductions for corporate income tax purposes. The Implementation Regulations introduce a withholding mechanism whereby, for specified taxable transactions conducted by individuals, the domestic entity making the payment is designated as the withholding agent. This mechanism is expected to enhance the coverage and efficiency of tax administration, reduce the compliance burden on individuals, and enable enterprises to obtain deduction certificates through the withholding process, thereby strengthening the whole input VAT deduction chain. Nevertheless, the scope of taxable transactions subject to the withholding mechanism, the definition of "specified" taxable transactions, and the detailed operational procedures remain to be clarified in subsequent supplementary notices. For enterprises involved in a large volume of C2B transactions—such as those in insurance, tourism, platform-based businesses, education and training businesses—the new withholding mechanism may introduce additional compliance requirements and challenges. Enterprises should closely monitor the issuance of detailed operational guidelines, assess the differences compared to existing policies and practices, and prepare in advance to ensure compliance.
Filing Deadline for Taxpayers Declaring VAT on a Per-Transaction Basis Article 44 of the Implementation Regulations provides that taxpayers who declare VAT on a per-transaction basis and whose sales reach the VAT threshold must file and pay VAT from the date the tax obligation arises before and by 30 June of the following year.	The Implementation Regulations clearly stipulate that taxpayers declaring VAT on a per-transaction basis, whose sales reach the VAT threshold, must file and pay VAT from the date the tax obligation arises before and by 30 June of the following year. In comparison with the 90-day deadline proposed in the Consultation Draft, this represents a significant extension, providing per-transaction taxpayers with more time to fulfil their compliance obligations. In addition, the filing deadline of 30 June aligns with the annual final settlement deadline for individual income tax, facilitating tax compliance for individuals subject to per-transaction VAT filing.

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Declaration for Export Business Article 48: For export business subject to VAT refund (exemption) or exemption from VAT, taxpayers shall file within the prescribed time limit; where no filing is made within the time limit, VAT shall be paid as being considered as a domestic sale. Where a taxpayer exports goods by way of commissionaire, the commissionaire export formalities should be completed in accordance with the provisions set out by STA, and the principal shall apply for export VAT refund (exemption), exemption from VAT, or payment of VAT. Where the commissionaire export formalities are not handled, the consignor of exported goods shall file and pay VAT.	Under the Announcement of the MOF and the STA on Clarifying VAT Policies for the Leasing of State-Owned Agricultural Land (Announcement [2020] No. 2), if a taxpayer exports goods or services or conducts cross-border taxable activities but fails to declare for export tax refund (exemption) or issue the "Certificate of Agent for Goods Exportation" within the prescribed time limit, they may apply for export tax refund (exemption) after collecting all required tax refund (exemption) certificates and related electronic information. If foreign exchange collection or the formalities for inability to collect foreign exchange are not completed within the prescribed time limit, the taxpayer may apply for tax refund (exemption) after completing foreign exchange collection or the relevant formalities. Article 48 of the Implementation Regulations now requires that export transactions eligible for VAT refund (exemption) or VAT exemption must be declared within the prescribed period. Failure to declare within the prescribed period will result in the export transaction being treated as a domestic sale, and VAT must be paid accordingly. The Consultation Draft of the Implementation Regulations previously proposed a maximum declaration period of 36 months from the date of export customs declaration (for goods) or from the date the tax obligation arises (for services). However, the Implementation Regulations do not specify a concrete deadline or maximum period for applying for export VAT refund (exemption) or exemption. Enterprises should closely monitor subsequent operational measures to be issued by the MOF and the STA regarding export VAT refund (exemption), to ensure compliance with the relevant requirements.

A new era for China VAT

The Implementation Regulations were prepared during a period of uncertainty in both the Chinese and global economies, driven by geopolitical developments. As a key observation, the approach of Chinese VAT policymakers towards input VAT recovery has shifted from "lenient" to "conservative". For instance, the Implementation Regulations have introduced the Capital Good Scheme "CGS" which can often be found in European VAT rules:

> "Since 2008, the Chinese tax authorities allow taxpayers to enjoy full recovery of input VAT incurred for the purchase of fixed assets as long as the fixed assets are not only used for VAT exempt purposes (e.g., for mixed taxable and exempt use, fully recovery is available). Under the Implementation Regulations, taxpayers are required to set up new processes to limit the input VAT recover of "long term assets" based on the annual taxable use status of the assets."

The introduction of the CGS, together with other input VAT restrictions brought by the Implementation Regulations, is expected to reduce the level of recoverable input VAT for certain taxpayers.

To facilitate the effective enforcement of the Implementation Regulations, a series of supplementary VAT notices is expected to be issued by the MOF and the STA soon. They are anticipated to cover the detailed classification of taxable items for goods, services, intangible assets, and immovable properties; special tax calculation methods such as net-of-tax assessment; operational procedures for input VAT credit on long-term assets; operational procedures for export VAT refund and exemption and etc., in order to provide clarity and guidance on specific tax administration and compliance matters.

In light of the above changes, we recommend that enterprises assess the impact of these developments and key areas of concern in relation to their specific business circumstances and prepare for operating in the new VAT era. We look forward to engaging with you further. Should your company have any questions regarding the implementation of the VAT Law, the Implementation Regulations, or related supplementary notices, please feel free to contact us at any time. KPMG has been actively involved in the VAT legislative process and has acted as a key advisor to VAT policymakers. We are keen to provide professional insights and tailored services to help businesses navigate the ongoing changes in China's VAT policies.

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