China: Tax updates – VAT Law Implementation Rules

Abstract: China issued the long expected Implementation Rules to VAT Law, introducing important changes to the prevailing VAT regime.

In brief

On 25 December 2025, the State Council issued the long-expected Value Added Tax (VAT) Law Implementation Rules ("**Implementation Rules**"), which enters into effect on 1 January 2026 along with the PRC VAT Law. In this client alert, we will highlight key provisions in the Implementation Rules that introduce significant changes to the prevailing VAT regime and provide our observations and perspectives.

Contents

1. Clarifications on sourcing rules for services and intangible properties

The VAT Law changes the primary criterion of determining whether a sale of services or intangible properties occurs within China to "the place of consumption", i.e., the sale of service or intangible property occurs within the territory of China if the service or intangible property is consumed within China, or if the seller is a domestic entity or individual.

Article 4 of the Implementation Rules further clarifies that service or intangible properties consumed within China refers to the scenario where:

(1) An overseas entity or individual sells services or intangible properties to domestic entity or individual, except for services consumed on-site overseas.

(2) Services or intangible properties sold by overseas entities or individuals are directly related to domestic goods, real estate or natural resources.

(3) Other scenarios are provided by the Ministry of Finance (MOF) and State Taxation Administration (STA).

Compared with the previous sourcing rules under Cai Shui [2016] No. 36 ("**Circular 36**"), the Implementation Rules introduce concepts such as "overseas on-site consumption", "directly related to domestic goods, real estate or natural resources," etc., for the first time. Unavoidably, there are some controversial cases where it is difficult to derive a clear-cut conclusion on whether the transaction occurs within China and must be subject to VAT (for example, the various types of cross-border e-commerce transactions in the digital economy space).

A reference may be made to the OECD VAT/GST Guidelines ("**OECD Guidelines**"). The OECD Guidelines principally rely on two proxies, similar to Article 4(1) of the Implementation Rules, in determining the "jurisdiction of consumption" for VAT purposes: the jurisdiction in which the service recipient is located and the jurisdiction in which the supply is physically performed. Under the OECD Guidelines, the second proxy of the jurisdiction of physical performance is limited to Business-to-Consumer (B2C) scenarios, which provides that the jurisdiction in which the supply is physically performed has the taxing rights over B2C supplies of services and intangibles that:

(1) Are physically performed at a readily identifiable place,

(2) Are ordinarily consumed at the same time as and at the same place where they are physically performed, and

(3) Ordinarily require the physical presence of the person performing the supply and the person consuming the service or intangible at the same time and place ("**on-the-spot supplies**").

Pending further clarifications on the meaning of "overseas on-site consumption", it is uncertain whether the Chinese tax authority will similarly restrict the interpretation of this concept to very limited B2C scenarios by reference to the above on-the-spot supplies rules in the OECD Guidelines. If so, many inbound services or

intangibles that were considered “completely occurring outside China” and not subject to VAT in China may now fall within the taxable scope under the new VAT Law.

2. Changes to the general taxpayer and small-scale taxpayer rules

The VAT Law retains the existing concepts of “general taxpayer” and “small-scale taxpayer”. General taxpayers are those who calculate VAT payable based on the net amount of output VAT deducting input VAT (i.e., general VAT calculation method). Small-scale taxpayers are taxable persons whose annual taxable VAT sales amount does not exceed RMB 5 million and who calculate VAT based on a fixed VAT collection rate and sales amount (i.e., simplified VAT calculation method).

The Implementation Rules further confirm that natural persons must be viewed as small-scale taxpayers, even if their annual taxable VAT sales amount exceeds the statutory threshold of RMB 5 million.

Under the previous VAT rules, entities and sole proprietorships whose annual taxable VAT sales amount exceeded the statutory threshold but did not frequently engage in taxable activities could elect to pay tax as small-scale taxpayers. Registered general taxpayer could also choose to convert to small-scale taxpayer registration under certain circumstances. However, such flexibility has been restricted in the Implementation Rules, under which only “non-enterprise entities who do not engage in taxable activities frequently and whose main business activities are not within the scope of taxable transactions” can elect to pay tax as small-scale taxpayers (Article 7). Article 36 of the Implementation Rules also disallows a registered general taxpayer to convert its registration to a small-scale taxpayer.

Following issuance of the Implementation Rules, the STA issued the STA Bulletin [2026] No. 2 (“**Bulletin 2**”) to update the tax registration regime for general taxpayers in accordance with the above provisions. Among others, a major update made by Bulletin 2 is the advancement of the effective date of general taxpayer. Previously, a newly-registered general taxpayer started to pay VAT by applying the general VAT calculation method from the first day of the registration month or the first day of the following month (as elected by the taxpayer). Under Bulletin 2, the effective date for a newly registered general taxpayer must be the first day of the VAT filing period in which its accumulated annual sales amount exceeds RMB 5 million threshold, and VAT returns after the effective date must also be rectified accordingly if still filed as small-scale taxpayer.

3. Clarifications on mixed sale rules

Under the VAT Law, where a taxable transaction involves two or more tax rates (i.e., a mixed-sale transaction), the applicable tax rate is determined by the “main business” of the transaction. As noted in our earlier client alert regarding the VAT Law, the specific definition of the main business of a mixed-sale transaction remains unclear and awaits further clarification.

Article 10 of the Implementation Rules provides that in a mixed-sale transaction, there must be a clear principal and accessory relationship between the two (or more) businesses therein. The main business holds the dominant position, reflecting the substance and purpose of the transaction, whereas the accessory business serves as a necessary supplement to the main business and is contingent upon the occurrence of the main business.

The above provision provides important reference value in understanding how to determine the “main business” of a mixed-sale transaction, i.e., based on the “substance and purpose of the transaction”. This assessment may involve both qualitative and quantitative analyses of the relevant transaction. Before the VAT Law entered into effect, real-world cases demonstrated the tax authority’s approach in this regard. For example, in a tax advance ruling case published by the Beijing tax bureau, the applicable VAT rate for a business that provides tableware cleaning services through certain intelligent cleaning equipment installed in restaurants is determined to be 6% (i.e., the VAT rate for providing services), on the ground that the **cost of providing services accounts for a relatively high percentage in the entire business**. In another Q&A published on the STA’s official website, the STA determined that the substantive nature of a battery charging and swapping business is the sale of electric power product, **as the customer’s main purpose of entering into the transaction is to acquire and use the electric power**; the replacement, positioning and maintenance of battery are just supporting services involved in the transaction process. Therefore, the VAT rate applicable to the total sales amount of the battery charging and swapping business must be 13% (i.e., the VAT rate for selling electric power products).

4. Updates on the composition of sales amount

Compared with prior rules, VAT Law and Implementation Rules delete "other charges" from composition of sales amount, and provide that sales amount for VAT purposes refers to the price earned by the taxpayer from conducting taxable transactions, which include all prices corresponding to economic benefits in monetary and non-monetary form.

Under the prior rules, "other charges" typically included surcharges collected by the seller from the buyer besides the agreed price, such as handling fees, breach of contract damages, compensation, late payment interests, package fees, etc., which are subject to VAT as part of the sales amount. Deletion of "other charges" in the new legislation does not necessarily mean that such amounts will be excluded from VAT liability. Instead, such additional charges should be included in the "sales amount" concept as defined in the VAT Law.

5. Updates on input VAT creditability

As discussed in section 2, above, general taxpayers calculate VAT payable based on the net amount of output VAT less input VAT. Article 22 of the VAT Law provides a list of the following types of non-creditable input VAT:

(1) Input VAT related to taxable transactions subject to the simplified VAT calculation method.

(2) Input VAT related to VAT-exempt transactions.

(3) Input VAT related to abnormal losses.

(4) Input VAT related to goods, services, intangible properties and real estate purchased and used for collective welfare or personal consumption.

(5) Input VAT related to catering services, resident daily services and entertainment services purchased for direct consumption.

(6) Other input VAT provided by the State Council.

The above list remains largely consistent with the general principles established in previous VAT rules. Based on these general rules, the following sections highlight the key changes to the input VAT credit regime under the Implementation Rules.

- **Input VAT for purchasing loan services remains uncreditable.**

Compared with the previous rules in Circular 36, Article 22 of the VAT Law specifically removes the input VAT related to loan services from the list of non-creditable input VAT. Such provision has aroused discussion whether this indicates an encouraging signal of removing the legal obstacles of crediting input VAT related to interests from the legislation level.

However, Article 21 of the Implementation Rules reverts to the previous rules and disallows crediting input VAT related to purchasing loan services (including the directly related consultancy fee, processing fee, advisory fees, etc. paid to the lender). Nevertheless, paragraph 2 of the Article 21 allows the MOF and the STA to further analyze and assess the impacts of this restriction, thereby retaining flexibility for potential future policy adjustments.

- **Input VAT for non-taxable transactions is confirmed to be non-creditable.**

Article 22 of the Implementation Rules provides that, in addition to the categories of non-creditable input VAT items expressly set out above, input VAT related to non-taxable transactions satisfying the following two conditions is also not creditable: (1) business activities falling outside Articles 3 to 5 of the VAT Law and compensated by monetary or non-monetary economic benefits and (2) falling outside the non-taxable transaction scope provided in Article 6 of the VAT Law ("**Non-creditable Non-taxable Transactions**").

Article 6 of the VAT Law only expressly provides four non-taxable transactions including (1) employees providing services to employers in consideration of wages and salaries, (2) collection of administrative fees or governmental funds, (3) compensation obtained due to expropriation or requisition, and (4) bank deposit interest. The non-taxable transactions falling outside Article 6 of VAT Law (i.e., the above condition (2)) may include, but are not limited to, several non-taxable transactions provided under other legacy VAT regulations, such as the transfer of going concern, sale of goods for financial leaseback, etc., which may be deemed as "Non-creditable Non-taxable Transactions" under above Article 22 of Implementation Rules.

Denying the creditability of input VAT related to Non-creditable Non-taxable Transactions will give rise to significant implications and may dramatically change the long-standing market practice of relevant transactions. However, the Implementation Rules have not yet provided further explanations on the specific scope of Non-creditable Non-Taxable Transactions (e.g., how to interpret "business activities…compensated by monetary or non-monetary economic benefits" for this purpose), and on how to address the relevant input VAT that has been credited (e.g.,

whether the taxpayer should deduct the corresponding amount from input VAT in the current period, like in other non-creditable transactions). The practical interpretation and enforcement of Article 22 of the Implementation Rules remains uncertain and will require close monitoring of future clarifications.

- **Introduction of year-end adjustments on uncreditable input VAT**

Under Article 23 of the Implementation Rules, where a general taxpayer purchases goods (excluding fixed assets) and services used for taxable transactions subject to the simplified VAT calculation method, VAT-exempt transactions, or Non-creditable Non-taxable Transactions, and cannot accurately allocate the non-creditable input VAT attributable to the same, the non-creditable input VAT must be calculated based on the percentage that the sales amount (or income) from transactions denying input VAT credit accounts for in the total sales amount (or income). Such methodology is also consistent with the approach under prior VAT rules.

A new change brought by the Implementation Rules is that after each year-end (i.e., during the tax filing period in January of the following year), taxpayers need to conduct a year-end adjustment and settlement on the non-creditable input VAT accrued in the year according to the actual amount in the whole year. Under the previously applicable rules, only in-charge tax authority may make annual adjustments and settlements on the non-creditable input VAT. Therefore, the new provision under the Implementation Rules has reduced the effects of uneven distribution of non-creditable input VAT throughout the year but also imposed higher tax compliance requirements on taxpayers.

- **Complexities in crediting input VAT related to acquiring Long-Term Assets**

Under prior VAT rules, the fixed assets, real estate and intangible properties ("**Long-Term Assets**") purchased or rented by general taxpayer for mixed uses, i.e., used for both taxable transactions subject to general VAT calculation method, and for transactions denying input VAT credit (including taxable transactions subject to simplified VAT calculation method, VAT-exempt transactions, collective welfare or personal consumption), are generally entitled to input VAT credit on the full amount.

The Implementation Rules alter such preferential treatment. Under Article 25 of the Implementation Rules, if Long-Term Assets are for mixed uses, the input VAT related to acquiring such assets is creditable in full amount to the extent that the original value of a single Long-Term Asset does not exceed RMB 5 million. To the extent that the original value of a single Long-Term Asset exceeds RMB 5 million, the input VAT must be credited in full upon purchase, and then the calculated non-creditable input VAT corresponding to the transactions denying input VAT credit must be subject to annual adjustment based on the adjustment period of the asset. Further details of Long-Term Asset input VAT credit and adjustment will be provided in separate rules to be issued by the MOF and the STA.

Various details regarding the annual input VAT adjustment are awaiting clarification, e.g., what is the "adjustment period," how to account for the input VAT corresponding to transactions denying input VAT credit, the transitional arrangement for Long-Term Assets acquired before 2026, etc. The new regime introduced by the Implementation Rules imposes higher requirements on taxpayers' asset management and dynamic monitoring capabilities, and adding more complexities to daily VAT compliance management.

6. VAT filing and administration regime

- **Domestic entity making payments to natural person is obliged to withhold VAT**

Another major change introduced by the Implementation Rules is that a domestic entity making payments to a natural person for taxable transactions must act as the VAT withholding agent for that individual (Article 35, paragraph 1). Further details on the VAT withholding will be issued separately by MOF and STA.

Article 35 aims to tackle the tax authority's persistent difficulties in collecting VAT from individual taxpayers and the enterprise buyer's challenges in obtaining VAT invoices from individuals. Previously, natural persons (like all other registered VAT taxpayers) needed to make self VAT filing and apply the tax bureau to issue VAT invoices on their behalf. Except for a few very limited "reverse invoicing" scenarios, enterprise buyers generally needed the individual's invoice for enterprise income tax (EIT) deduction. As such invoices are general VAT invoices in most cases, the enterprise buyer may not be able to claim input VAT credit using such invoice. As such, VAT filing and invoice issuance are greatly contingent upon the individual's cooperation and efforts.

Under the new VAT withholding regime provided under Article 35, the VAT filing and settlement obligation shifts to the domestic entity purchasing from natural persons, which is more capable and motivated to fulfil such obligation. Alongside the new obligation, it remains to be seen whether the VAT withholding agent may directly use the withholding certificate to claim tax deduction, which would be particularly welcomed by enterprises engaging

independent individuals for services. For the natural person engaging in taxable transactions, it remains unclear whether natural person is automatically entitled to the general VAT exemption/reduction preferential policy for small-scale taxpayers, which would significantly reduce or eliminate the VAT burden on individuals with low sales amount.

- **No substantial changes on offshore VAT collection regime**

The VAT Law designates the domestic purchaser as the VAT withholding agent for overseas entities/individuals engaging in taxable transactions within China, unless the foreign entity/individual entrusts a domestic agent pursuant to State Council regulations. Article 35, paragraph 2 specifies a situation where the foreign entity/individual may entrust a domestic agent to file and settle VAT on their behalf, i.e., where the overseas entity/individual rents real estate located within China to a natural person.

Apart from the above provision, the Implementation Rules do not provide any other special offshore VAT collection rules. Therefore, the general VAT withholding regime under the VAT Law will apply to all other cross-border transactions. The widely concerned question on VAT collection in the scenario of cross-border e-commerce business, as discussed in our earlier client alert, is not mentioned in the Implementation Rules either.

- **Clarification of time limit for VAT filing per occurrence**

VAT Law (as well as previously effective VAT rules) allows taxpayers that do not conduct taxable transactions frequently to pay VAT on a per transaction basis, but does not specify a statutory tax filing deadline. Article 44 of the Implementation Rules fills such vacuum by requiring such taxpayers to make VAT filing before 30 June of the year following relevant VAT liability arises. This provision enhances the overall VAT administration framework, and provides a more solid legal basis for the tax bureau to recover underpaid VAT and applicable late payment surcharges.

- **Potential time limit for applying export VAT refund**

Under Article 48 of the Implementation Rules, taxpayer must file for export VAT refund or exemption within the prescribed time limit. Late filing will subject the export transaction to VAT as a domestic sale.

However, the currently effective VAT rules do not provide a clear “prescribed time limit” for export VAT refund yet. Previously, exporting enterprises were required to collect relevant supporting documentation and apply for export VAT refund before April 30 of the year following the customs declaration date (for exported goods) or the recognition of sales revenue (for exported services). In January 2020, the STA loosened the time limit, allowing exporting enterprises to apply for export VAT refund after all relevant supporting documentation is collected, in effect nullifying the time limit.

It remains to be seen whether the STA and the MOF will issue separate rules to prescribe a time limit for export VAT refund. In the draft version of the Implementation Rules (draft for public consultation), it is proposed that the export VAT refund application must be made no later than 36 months after the customs declaration date (or the date of VAT liability arising). Removal of the 36-month time limit from the final Implementation Rules may indicate an intent to introduce more flexible timing requirements in the future.

- **Tax authority’s expanded information access**

Under Article 52 of the Implementation Rules, tax authorities can obtain information related to exporting tax collection and administration from relevant entities or individuals in accordance with applicable laws, including logistics, customs declarations, freight forwarding, and fund settlement information, etc., and the relevant entities or individuals must provide the same accordingly. Such information accessed by the tax authorities must be kept confidential and must not be used for purposes other than tax administration.

The above new provision demonstrates the tax authority’s special focus and enhanced tax collection capacity on exporting business.

7. General anti-avoidance rules for VAT

Prior VAT rules do not include an anti tax avoidance rule, except for the provision regarding the tax bureau’s authority to assess and adjust unreasonably low price. Article 53 of the Implementation Rules introduces the general anti-avoidance rule (GAAR) into VAT regime for the first time. Under GAAR, the tax authorities have the right to make adjustments (in accordance with the Tax Collection and Administration Law and relevant administrative regulations) if

a taxpayer engages in arrangements without a reasonable commercial purpose that result in the reduction, exemption, or deferral of VAT, or in the increase or acceleration of VAT refunds.

The currently effective Tax Collection and Administration Law has no GAAR provisions, but a similar GAAR has been included in the Draft Amendments to the Tax Collection and Administration Law (draft for public consultation) issued in March 2025, which, if adopted in the formal legislation, will cover all taxes. Against such backdrop, taxpayers must pay additional attention to the reasonable commercial purposes of their transactions and relevant tax implications.

8. Narrowed scope of "deemed sales" rules

As noted in our earlier alert on VAT Law, the VAT Law expressly and significantly narrowed the scope of "deemed sales" to only a few specified scenarios. A wide range of transactions previously deemed as taxable sales and subject to VAT, e.g., service provision free of charge, movement of goods between establishments of the same taxpayers, etc., are now excluded from the scope of "deemed sales" under the VAT Law. The Implementation Rules also do not provide any special explanations in this regard. This silence, given the high legal hierarchy of the Implementation Rules, confirms that the narrowed scope is definitive and binding.

The significant narrowing of the deemed sales rules is undoubtedly a welcomed development, which represents a policy shift with profound impacts. However, persistence of past policy practices may still compromise the intended effects of the new rule. Absence of detailed implementation guidance also grants local in-charge tax authority substantial autonomy. For example, the following provisions may be interpreted in a way to potentially re-expand the "deemed sales" scope:

- Article 17 of the VAT Law defines sales price as the price associated with a taxable transaction by a taxpayer, including "all prices corresponding to economic benefits in monetary and non-monetary form". The "economic benefits…in non-monetary form" could be interpreted broadly to cover various considerations, and tax authorities may therefore deem free-of-charge transactions to involve some form of non-monetary economic benefit and levy VAT accordingly.
- Article 20 of the VAT Law empowers tax authorities to adjust significantly low or high sales price that lacks legitimate reasons, which may also be used to challenge the basis of free-of-charge transactions.
- GAAR under Article 53 of the Implementation Rules may also be applied to adjust the free-of-charge transactions that lack reasonable commercial purposes.

9. Recommendations and outlook

The VAT Law and its Implementation Rules took effect on 1 January 2026, and have attracted significant attention. While the overall VAT framework and burden remain largely unchanged, several important changes, such as the new sourcing rules for services and intangibles, mixed sales rules and VAT withholding for natural persons, introduce profound impacts on the taxpayer's VAT position and compliance management.

As discussed above, critical details await further clarification in the future rules to be issued by the MOF and the STA (e.g., year-end adjustment on uncreditable input VAT, VAT withholding rules for natural persons, the timeline for export VAT refund, etc.). We therefore expect more new VAT policies in the coming months. In light of the ongoing and upcoming VAT reforms, taxpayers should carefully consider their existing VAT treatment, understand the challenges and opportunities coming along with the new rules, and make necessary adjustments appropriately.

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Jason Wen, Senior Tax Consulting Director, and Jinghua Liu and Luis Zhang, Partners, FenXun, have co-authored this legal update. FenXun established a joint operation office with Baker McKenzie in China as Baker McKenzie FenXun, which was approved by the Shanghai Justice Bureau in 2015.

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