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2026 China Tax Hot Topics

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2026 China Tax Hot Topics

2026 is a highly significant and memorable year in the history of Chinese taxation. Over the more than eight months that have elapsed this year, we have witnessed the implementation of the Value-Added Tax ("VAT") Law, the introduction of new Individual Income Tax ("IIT") rules on offshore trusts, and the emergence of numerous new tax policies and administration mechanisms. In this article, we shall review and discuss certain key tax policies and practical issues, with a view to assisting offshore investors in adjusting and optimizing their investment structures and arrangements in China.

I. The First Year of VAT Law Implementation

For a long time, China's tax reform has steadily advanced along the central theme of implementing the principle of statutory taxation. As China's largest tax revenue source, the VAT completed its legislative process at the end of 2024, and the VAT Law formally came into effect in 2026, marking a new milestone in the rule of law in China's taxation regime. As the VAT Law has been implemented in practice, the Ministry of Finance ("MOF") and the State Taxation Administration ("STA") have successively issued a series of supporting policies this year to refine the rules for its implementation, and the VAT legal framework has now essentially taken shape.

Building on experience with VAT implementation, the VAT Law has been refined and improved in terms of legislative technique, tax system design, and detailed rules. Key features include the following: First, the VAT Law introduces terms such as "taxable transactions," "long-term assets," and "overseas consumption," which enhance the precision and accuracy of statutory tax concepts. Second, it adjusts important rules such as the scope of input VAT credits and the definition of deemed taxable transactions, bringing the law more closely into line with the principle of tax neutrality and the inherent logic of the VAT credit chain. Third, it includes amendments addressing legislative gaps exposed during the implementation of prior policies, together with adjustments to tax incentives and tax administration rules in response to changing economic and social conditions.

Han Kun Observations

(1) Adjustment of input VAT credit rules is one key focus following the implementation of the VAT Law. With respect to the scope of non-taxable transactions for which input VAT is not creditable, an area subject to considerable uncertainty at the outset, the relevant supporting policies now provide further clarification through an enumerated list, specifying that the transfer of equity interests (other than marketable securities) constitutes a non-taxable transaction for which input VAT is not creditable. As for the specific details of input credits for long-term assets, the supporting policies set out a formula under which long-term assets with an original value exceeding RMB 5 million acquired for mixed-use purposes may first be fully credited and subsequently adjusted on a yearly basis, and clarify the treatment applicable where the use of such assets subsequently changes.

(2) A second key focus is the mechanism for withholding VAT on payments to individuals. The MOF and the STA recently issued a policy specifying that, where a PRC resident individual provides any of seven

categories of services, namely research and development, software, design, consulting, radio, film and television program production, culture, and education, VAT must be withheld and remitted by the domestic entity making the payment. Once VAT has been withheld, the individual may follow the applicable procedures to apply to the tax authority for an invoice to be issued on their behalf, providing enterprises with valid documentation to support input VAT credits and cost/expense deductions. This mechanism may help improve tax compliance in the platform economy and flexible employment sectors.

(3) A third key focus concerns the rules for conversion of small-scale taxpayer status. The new VAT Law has revised the rules governing changes in small-scale taxpayer status. First, once an enterprise's annual taxable sales exceed the RMB 5 million threshold, it may no longer be able to elect its taxpayer status and must register as a general taxpayer. Second, general taxpayer status takes effect in the same period in which annual taxable sales exceed the threshold, imposing higher requirements for taxpayer-status planning and preparation for the transition. Finally, where sales figures for prior periods are adjusted as a result of self-inspection corrections, tax audits, or similar reasons, such adjustments will be attributed to the tax period in which the tax liability arose; where this triggers a change in taxpayer status, corrections must be made period by period, with tax calculated on a general taxpayer basis.

Foreign enterprises conducting investment and financing activities in China should pay particular attention to the input VAT credit restrictions described above, while other foreign enterprises operating in China should likewise enhance their compliance in light of these changes to China's VAT policies. Given that adjustments to transaction structures can affect multiple aspects of business operations and compliance, we recommend that foreign-invested enterprises in China conduct a self-review of their VAT position and adjust their tax arrangements accordingly based on the results.

II. New IIT Rules on Offshore Trusts

In late July 2026, the PRC government introduced a tax mechanism applicable to income derived by individuals from offshore trusts. This policy differs significantly from prior IIT rules on foreign-sourced income and has attracted widespread market attention. The following are the main features and key points of this policy:

(1) The scope of taxable events under the offshore trust IIT rules. Under the new rules, PRC tax resident individuals are subject to IIT on income arising at three stages: contribution of assets into a trust, income accrued during the holding period, and income realized upon termination of the trust. At the contribution stage, both a direct transfer of assets and any arrangement, such as a capital increase or targeted share issuance, through which the trust obtains substantive control over the relevant assets fall within the scope of taxation. In practice, transfers of assets to a trust, or to an offshore entity controlled by the trust, through related parties are also treated as a contribution of assets. Income accrued during the holding period is subject to a "deemed distribution" mechanism, whereby income generated by an offshore trust and the entities it controls is deemed to have been distributed to the individual, and shall be taxed annually on such income, regardless of whether an actual distribution has occurred. To avoid double taxation, no further tax is imposed when income on which tax has already been paid is subsequently actually distributed. Upon termination and dissolution of a trust, the individual is required to pay IIT on the resulting liquidation income. In addition, a tax liability is likewise triggered where a resident individual ceases to be a PRC tax resident, or where, following the death of a resident individual, the trust's beneficial

interests are inherited by a non-resident or pass to no successor.

(2) The taxation mechanism of offshore trusts. The new rules set an IIT rate of 20% across all three stages. Income at the contribution stage is taxed as "income from transfer of property"; once tax has been paid, the market value of the assets at the time of contribution may be used as the tax basis for subsequent transactions. Income accrued during the holding period is taxed, depending on its nature, either as "income from transfer of property" or as "income from interest, dividends and bonuses"; losses from the transfer of property may be offset against other property transfer gains realized in the same year, but may not be carried forward to subsequent years or offset against income from interest, dividends and bonuses. Upon dissolution of the trust, liquidation income is taxed as "income from interest, dividends and bonuses." It should be noted that expenses related to offshore trusts, such as trustee fees, trust management fees, legal fees, and investment advisory fees, are not deductible for tax purposes.

(3) Anti-avoidance measures. The new rules incorporate several anti-avoidance mechanisms. Below are the key matters: (i) offshore entities controlled by a trust are "looked through," such that income generated by such entities directly triggers the relevant individual's tax liability; (ii) an outstanding, unrepaid loan extended by a non-resident offshore trust to a resident individual as of year-end, as well as benefits conferred indirectly through expense reimbursements or payments made on the individual's behalf, will be treated as a deemed distribution; and (iii) an individual who has acquired foreign nationality or permanent residency abroad, but whose primary economic interests remain sourced from within China, may still be treated as a PRC tax resident domiciled in China.

(4) Other points to note. The new rules apply retroactively to pre-existing offshore trust arrangements: for unpaid tax at the contribution stage, the statute of limitations for retroactive assessment is generally three years and may be extended to five years where the amount involved is substantial (in practice, often benchmarked at RMB 100,000); the applicable retroactive period for income accrued during a trust's holding period has not yet been clearly addressed under current policy. In addition, the policy provides for a 90-day voluntary compliance window, during which individuals who voluntarily pay outstanding tax within 90 days from the effective date of the policy will not be subject to late-payment surcharges, an incentive intended to encourage voluntary disclosure and improve tax compliance.

Han Kun Observations

The new offshore trust IIT policy has had a far-reaching impact on the structuring and maintenance of offshore investment arrangements by PRC tax resident individuals. On the one hand, in terms of current-period tax payments (including back tax obligations), many investors, including company founders, are facing pressure both in terms of tax compliance and in funding the cash-flow requirements of tax filings. On the other hand, from a long-term tax planning perspective, offshore trusts are clearly no longer well-suited to serve as the primary vehicle for offshore investment structures. In this sense, PRC tax resident individuals will need to reassess their tax planning, taking into account factors such as their offshore investment preferences and residency preferences, and recalibrate their expectations regarding tax savings.

III. Tax Considerations in Dismantling Red Chips

The background to red-chip dismantling

Driven by developments both onshore and offshore, the past two years have seen a marked increase in transactions to dismantle red chips. On the regulatory side, rising uncertainty around U.S. listing and investment regulation, together with the tightened filing review by the China Securities Regulatory Commission (CSRC) for overseas listings, has significantly narrowed the red-chip pathway. On the valuation side, Chinese concept stocks are trading at historically low valuations offshore, creating a substantial valuation gap relative to a recovering onshore market and thereby opening up pricing room for a return to the domestic market. Unlike the establishment of a red-chip structure, when a company's valuation may still be low and the associated tax burden relatively limited, dismantling a red chip occurs after value has already been realized, so that almost every step in the process gives rise to an immediate tax liability. For offshore investors within the structure, the exit route chosen and the pricing applied will directly affect their tax cost.

The Main Transaction Steps in Dismantling a Red Chip and Tax Implications

The typical path for a return to the domestic market comprises four steps: the going-private tender offer; the transfer of onshore equity interests (severing the link between the onshore and offshore structures); the wind-down of the offshore structure; and the re-application for listing following a shareholding reform. Red-chip enterprises that are not yet listed skip the going-private step and proceed directly to severing the link and winding down the offshore structure.

Once the link has been severed, adjustments to shareholdings at the level of the offshore holding company, whether by way of share transfer, buy-back, or other means, no longer directly give rise to any PRC tax liability. The real tax risk running through the entire transaction lies in the pricing applied at each step:

(i) In the transfer of onshore equity interests, if the offshore holding company realizes a gain on a transfer or capital reduction, income tax is generally withheld at source at a rate of 10% (with the transferee bearing the withholding obligation). Where the transfer price is significantly understated, the tax authorities may adjust the taxable income by reference to fair value.

(ii) For investors who do not proceed in tandem with the restructuring, for example, those who exit by realizing their investment directly, or who exit prior to the IPO following a downward revaluation, it is necessary not only to consider the fairness of the price itself, but also to take into account the impact this price, as a benchmark for contemporaneous transactions, will have on other investors. Once an offshore investor realizes value at the level of the onshore operating company by way of a capital reduction or share transfer, any consideration that is significantly understated carries a risk of being recharacterized and adjusted by the tax authorities.

(iii) Where an investor has acquired its equity interest in the onshore operating company by way of a capital contribution, the fairness of the valuation basis for that contribution is likewise subject to scrutiny and directly determines the tax basis of its equity interest. Should the pricing at any step be challenged by the tax authorities, this may be accompanied by additional tax payable together with late-payment

surcharges.

Tax risks and opportunities for optimization

As noted above, challenges to pricing are not limited to the period in which the transaction took place: a weak valuation basis, or a discrepancy with valuations disclosed in a subsequent onshore financing or listing application, may cause consideration paid years earlier to be revisited and trigger a tax adjustment. The opportunities for optimization lie in the following: first, tax cost modelling and comparison of different exit options should be carried out at an early stage of transaction negotiations, in order to settle on the form and pricing of the transaction; second, evidence of pricing should be preserved; it is advisable to begin preparing a valuation report early on and to retain the commercial negotiation record supporting it, so as to mitigate the risk posed by other comparable transaction data; and finally, the transaction documents should address the allocation of tax liability, the price adjustment mechanism, and which party bears the risk of any loss of tax basis.

Han Kun Observations

Every step of dismantling a red chip may give rise to a tax liability under PRC tax law. For offshore investors, the key to identifying tax-saving opportunities while ensuring the transaction remains tax-compliant lies in executing on three fronts: tax cost modelling at the early stage of exit-option discussions; confirmation of, and evidentiary support for, the pricing of the restructuring transaction; and commercial arrangements in the transaction documents addressing tax liability and the risk of loss of tax basis. We have observed that sophisticated investors typically bring in tax advisors as early as the term-sheet negotiation stage and, depending on the circumstances, make the remediation of the target company's historical tax deficiencies a condition to closing. This is because, when a red-chip enterprise returns to listing after dismantling its structure, the company's historical tax compliance will also fall within the scope of review, and investors should factor any related exposure into their transaction assessment.

IV. Other Hot Topics

Tax Treaty Benefits in Cross-Border Transactions

Recently, PRC tax authorities have denied the preferential treaty tax rates applied by the domestic operating entities of certain internet companies to dividends paid to their Hong Kong holding companies. Because the Hong Kong companies lacked substantive business operations, their "beneficial owner" status was denied, and the companies were required to make up the shortfall at the statutory rate, with amounts involved reaching into the hundreds of millions of RMB. The case is widely regarded as emblematic of escalating regulatory scrutiny. It should be noted that, under the current policies, entitlement to tax treaty benefits follows a "self-assessment, claim through filing, and retention of supporting documentation for inspection" approach, so filing a claim does not automatically confer entitlement. In determining beneficial owner status, tax authorities adhere to the principle of substance over form, treating factors such as a lack of personnel and assets, decision-making functions, control over funds, and short-term pass-through payments of large sums as negative indicators.

Han Kun Observations

PRC tax authorities have intensified their scrutiny of beneficial owner determinations, shifting the focus from documentary compliance to substantive evidence. Existing structures should undergo a comprehensive review to quantify the risk of retroactive dividend tax assessments. For newly established structures, the substantive functions of the intermediate holding company should be commensurate with the intended tax savings. Once a tax audit is initiated, the completeness of supporting evidence and the consistency between internal and external positions often determine the final outcome of the case.

Continued Tax Audits of PRC Resident Individuals' Offshore Income

Since 2025, tax authorities in several provinces have publicized tax audit cases concerning the offshore income of PRC resident individuals. Utilizing the information exchange mechanism under the Common Reporting Standard ("CRS") and cross-referencing this with domestic financial transaction data, the tax authorities have required high-net-worth individuals holding overseas financial accounts and financial assets to voluntarily report their overseas income. Subsequently, these individuals were subject to retrospective IIT assessments, together with late-payment surcharges.

Han Kun Observations

PRC tax residents are required to report and pay tax on their global income, and tax residency status is not automatically lost simply because an individual spends fewer days in China or has obtained a foreign nationality or permanent residency. Accordingly, the fundamental logic of offshore tax planning for high-net-worth individuals has shifted from information concealment toward structural optimization on a compliant basis. On the one hand, tax authorities' capacity to access global tax information continues to strengthen, and the increasing transparency of assets is an irreversible regulatory trend. On the other hand, the consequences in terms of late-payment surcharges, penalties, and credit repercussions differ significantly between a proactive self-review with voluntary supplemental filing and a passive, authority-initiated audit. For high-net-worth individuals, matters such as tax residency planning, reporting of offshore income, applications for tax treaty benefits and foreign tax credits all require professional handling. Furthermore, compliance costs should be factored into investment decisions from the outset.

Withdrawal of the IIT Preference on Foreign Individuals' Domestic Investment Income

Under the latest policy, which comes into effect on 1 September 2026, dividends received by foreign individuals from foreign-invested enterprises will be uniformly subject to IIT at a rate of 20%, formally ending a temporary exemption policy that had been in effect for 32 years. Foreign-invested enterprises will be responsible for withholding the IIT. Taxes paid in the PRC may be credited in the foreign investor's country (or region) of tax residence.

Han Kun Observations

Those most affected by this policy change are the foreign founders and foreign senior executives (who may hold equity) of PRC enterprises, as well as cross-border family shareholding arrangements. Where a foreign shareholder's country of residence adopts a worldwide taxation principle, this adjustment will not necessarily increase the individual's overall tax burden. On the contrary, the optimization of foreign individuals' tax burden will depend more heavily on applications for tax treaty benefits. As the preferential tax rates and application procedures under the framework of tax treaties follow clear and established

rules, the planning process is, in fact, more predictable. Accordingly, any restructuring of individual shareholding arrangements should be comprehensively evaluated in light of the relevant tax and foreign exchange regulations.

Amendment to the Law on the Administration of Tax Collection Enters a Key Legislative Stage

On 31 August, 2026, the executive meeting of the State Council approved in principle the Law on the Administration of Tax Collection (Revised Draft) and decided to submit it to the Standing Committee of the National People's Congress for deliberation. This comprehensive revision, the first in 25 years, has entered a critical stage. Highlights of the draft include: elimination of the requirement that outstanding tax be paid as a precondition to administrative reconsideration, allowing taxpayers to apply for reconsideration of tax disputes without first paying the tax owed or providing a guarantee; renaming of the "late-payment surcharge" as the "tax payment delay surcharge," together with new circumstances under which such surcharges may be waived or reduced. However, once this delay surcharge is distinguished from the late-payment surcharge under the Administrative Compulsion Law, whether it may be assessed in excess of the principal amount of tax owed remains to be clarified in the final legislative text; and extension of the arm's length principle to natural persons, together with the incorporation of general anti-avoidance rules into the law.

Han Kun Observations

The draft reflects a parallel trend toward easing relief mechanisms and expanding administrative powers. While the cost to taxpayers of pursuing disputes will decrease, tax authorities' capacity to obtain information and make adjustments will be systematically strengthened. Before the law comes into force, the review of existing mechanisms and the consolidation of evidence should be completed; meanwhile, new strategic considerations will arise regarding the procedural handling of disputed matters.

New Developments in Tax Administration of Related-Party Transactions

In the area of related-party transactions, PRC tax authorities are advancing regulatory explorations with far-reaching implications. For a long time, in order to prevent the loss of PRC tax revenue, tax authorities focused primarily on cross-border related-party transactions. They conducted deep research on such transactions, adjusted the pricing of numerous major cross-border transactions through tax audits and other methods, assessed additional tax and interest, and accumulated substantial enforcement experience. However, starting from 2026, tax authorities in many provinces began to extend their regulatory focus to the purely domestic related-party transactions; that is, they began to review the pricing mechanisms used by domestic Company A when providing services, selling goods or transferring the right to use intangible assets to its related party, domestic Company B.

When examining the fairness of pricing in domestic related-party transactions, tax authorities consider not only traditional factors such as tax rate differentials between the parties, their profit and loss positions, and tax incentives, but also analyze the issue from several new perspectives. In this context, the verification of the alignment between functions and risks has become a key focus. Based on the operating functions, operational responsibilities, and market risks undertaken by each party in the industrial chain, tax authorities may propose adjustments to related-party pricing where functions, risks, and profit returns

are mismatched. In addition, with the upgrading of big-data-driven tax administration, tax authorities have enabled multi-dimensional linked data screening. By cross-referencing enterprises' tax return data, financial accounting records and VAT invoicing information, and combining these with core financial and tax indicators such as cost-to-profit ratios and debt-to-equity ratios, PRC tax authorities are able to accurately identify anomalous related-party transactions.

For corporate groups, should the transfer pricing of related-party transactions be adjusted by the tax authorities, this will not only result in additional tax and interest and direct financial losses, but will also trigger a series of ongoing chain effects. Tax authorities may continue to monitor the transfer pricing of the group's subsequent related-party transactions, forcing the enterprise to adjust its internal pricing system, which may ultimately have a direct impact on the group's overall profit allocation methods and may even exert pressure for systemic adjustments to the enterprise's existing operational structure and development plans.

Han Kun Observations

In the process of responding to tax authority inquiries, and in certain ongoing discussions, we have observed that traditional transfer pricing analysis and documentation support may be of relatively limited value in defending a related-party tax position. For group enterprises—such as listed companies—which face stricter compliance requirements and greater regulatory scrutiny, there is an urgent need to keep pace with changes in tax regulatory policies, shift away from a passive compliance mindset, and implement refined, substance-based compliance management measures. In light of the above changes in tax administration, the relevant materials and documentation of enterprises should move from a template-based approach to a substance-based one. Enterprises should establish a functional risk analysis framework grounded in economic substance and tailored to their own business operations and prepare internal pricing analysis memoranda in accordance with standards for cross-border related-party transactions. At the same time, they should fully retain comprehensive supporting materials—such as functional and risk comparisons, value chain contribution assessments, and pricing reasonableness calculations—to build a full-chain, traceable compliance evidence system, so as to respond effectively to tax inquiries and special audits and to mitigate tax-related risks.

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