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# DARE YOU SUE THE TAX COLLECTOR? AN EMPIRICAL STUDY OF ADMINISTRATIVE LAWSUITS AGAINST TAX AGENCIES IN CHINA

Ji Li<sup>†</sup>

*Abstract:* Though taxes are as certain as death, each year tens of thousands of people in the United States go to court to challenge their assessed tax liabilities, and many succeed. By contrast, very few Chinese taxpayers litigate against tax agencies, and most of those who sue eventually settle, despite low formal litigation costs. China's non-litigious culture does not fully explain the reluctance to sue, as courts in Taiwan adjudicate five times more lawsuits against tax agencies. Judicial bias favoring government officials, weak enforcement of judgments against the state, and agency retaliation help to explain the aversion to litigate disputes with tax agencies in China. However, once the reluctance to sue is explained, the small amount of cases that go to trial constitutes a more intriguing puzzle. Why would anyone in China insist on judicial resolution of disputes with powerful tax agencies, given the adverse conditions that have deterred hundreds of thousands of others from doing so? This article offers a number of theoretical explanations that take into account the political and institutional context for both administrative litigation and tax administration in China. People are more inclined to sue a tax agency when they have limited extractable resources, powerful allies in government, substantial interests in the dispute without alternative resolutions, or no expectation to interact with the agency in the future. These explanations are evaluated and substantiated with an empirical analysis of all tax-related administrative lawsuits that went to trial from 2009 to 2011 in Henan Province, one of the most populous provinces in China. These findings will contribute to the literature on Chinese tax administration, administrative litigation in China, and extant trial selection theories.

## I. INTRODUCTION

Benjamin Franklin once said that only two things are certain in life: death and taxes.<sup>1</sup> Apparently not all agree. Each year tens of thousands of taxpayers in the United States go to court to challenge their assessed tax liabilities, and many succeed. For example, more than 20,000 cases were filed at the U.S. Tax Court in 2003 against the Internal Revenue Service.<sup>2</sup> Around the same time period, more than seven thousand cases were filed at

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<sup>1</sup> BARTLETT'S FAMILIAR QUOTATIONS (Nathan Haskell Dole ed., 10th ed. 1919).

<sup>2</sup> Donald E. Tidrick, *Inside the U.S. Tax Court: An Interview with the Honorable Judge Juan F. Vasquez, CPA, U.S. Tax Court*, THE CPA J., <http://www.nysscpa.org/cpajournal/2004/104/text/p20.htm> (last visited Jan. 24, 2013).

the New Jersey State Tax Court alone to challenge state and property taxes.<sup>3</sup> In addition, numerous cases are filed each year at U.S. district courts and the Federal Court of Claims for federal tax refunds. In China, by contrast, a total of 405 cases were filed nationwide in 2011 against tax agencies<sup>4</sup> and most of the cases were eventually settled, despite low formal litigation costs. The reluctance to sue cannot be easily attributed to cultural differences. In Taiwan, a place sharing the same cultural attitudes towards litigation with Mainland China, 2520 cases against tax agencies were filed in 2010 at three regional high courts, six times that of the Mainland China,<sup>5</sup> whose population of roughly 1.3 billion dwarfs the approximately 23 million people living in Taiwan.<sup>6</sup>

A structural analysis of the Chinese judiciary explains the puzzling reluctance to sue. There is a shared understanding that local courts do not normally adjudicate administrative lawsuits against government agencies impartially and judicial bias is presumably more serious when powerful agencies, such as tax bureaus, are sued.<sup>7</sup> In rare cases where the complainant manages to obtain a favorable ruling against a defendant tax agency, he will still face daunting challenges in getting the ruling enforced. To further complicate the issue, agency retaliation will most likely follow any successful enforcement of the ruling.<sup>8</sup> This article analyzes the high costs of taxpayer litigation due to the power and discretion enjoyed by Chinese tax agencies, which result in few people litigating tax disputes in China.

The cases that go to trial, though small in number, constitute another intriguing empirical puzzle. Why would anyone insist on judicial resolution of disputes with powerful tax agencies, given all the adverse conditions that deter thousands from doing so? This article argues that tax agencies in China do not enjoy unlimited power. The tax agencies' jurisdiction is

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<sup>3</sup> TAX COURT OF NEW JERSEY, ANNUAL REPORT OF THE PRESIDING JUDGE OF THE TAX COURT OF NEW JERSEY, JULY 1, 2004-JUNE 30, 2005, 2 (2005) available at <http://www.judiciary.state.nj.us/taxcourt/acrobatpdf/tca2005.pdf>.

<sup>4</sup> SUMMARY OF FIRST INSTANCE ADMINISTRATIVE LAWSUITS IN CHINA (2011), <http://www.court.gov.cn/qwfb/sfsj/201206/P020120628451878418099.xls> (last visited Aug. 27, 2012).

<sup>5</sup> Guoren Zhang, *Shuiwu Xingzheng Susong Shenglu Jin 7.6%* [Tax-Related Administrative Litigation Win Rate Only 7.6%], COMMERCIAL TIMES, (Oct. 15, 2010) [http://www.deloitte.com/view/tc\\_TW/tw/pressroom/41939/2fa3d084af9a8210VgnVCM200000bb42f00aRCRD.htm](http://www.deloitte.com/view/tc_TW/tw/pressroom/41939/2fa3d084af9a8210VgnVCM200000bb42f00aRCRD.htm).

<sup>6</sup> See CIA, *China*, THE WORLD FACTBOOK, <https://www.cia.gov/library/publications/the-world-factbook/geos/ch.html> (last visited Sept. 30, 2013) and CIA, *Taiwan*, THE WORLD FACTBOOK, <https://www.cia.gov/library/publications/the-world-factbook/geos/tw.html> (last visited Sept. 30, 2013) for the population figures of China and Taiwan, respectively.

<sup>7</sup> Kevin J. O'Brien & Lianjiang Li, *Suing the Local State: Administrative Litigation in Rural China*, 51 THE CHINA J. 75, 75-76 (2004).

<sup>8</sup> *Id.* at 90.

territorial and their power is checked by other agencies of the state. Therefore, some taxpayers may avoid the heavy losses of agency retaliation if they expect only a one-time interaction with a tax agency, lack extractable resources, or have powerful allies in the local state. For these taxpayers, administrative litigation is less costly and may be pursued if substantial interests are at stake and alternatives to litigation are unavailable. In addition, as in the resolution of all disputes, high transaction costs and optimism may also contribute to the pursuit of administrative lawsuits against tax agencies in China.

This article evaluates and substantiates these arguments with an empirical analysis of all tax-related administrative lawsuits that went to trial from 2009 to 2011 in Henan Province, one of the most populous provinces in China. As far as the author is aware, this is the first study of Chinese administrative litigation that contains a substantive analysis of an unbiased sample of cases.<sup>9</sup> The findings contribute to the literature on Chinese tax administration, administrative litigation in China, and trial selection theories.

The article is divided into eight Parts. Part II provides a brief survey of Chinese tax law and administration. Part III introduces the institutions for state control of tax agents in China. Part IV describes the puzzles about tax-related administrative litigation and relevant literature. Part V argues that factors such as limited extractable resources, the limited jurisdiction of tax agencies, substantial taxpayer interests, and lack of future interaction with a tax agency explain the puzzling persistence of tax litigation that goes to trial. Part VI evaluates and illustrates this argument by analyzing a dataset comprised of all tax-related administrative lawsuits from Henan Province (2009-2011). Part VII discusses how the findings of this article contribute to existing literature. Part VIII concludes by acknowledging the limitations of this study and making suggestions for future research.

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<sup>9</sup> For a sample of empirical research that discusses administrative litigation rates or plaintiff win rates, see Xin He & Yang Su, *Do the "Haves" Come out Ahead in Shanghai Courts?*, 10 J. EMPIRICAL LEGAL STUD. 120 (2013); Ji Li, *Suing the Leviathan—an Empirical Analysis of the Changing Rate of Administrative Litigation in China*, J. EMPIRICAL LEGAL STUD. (forthcoming 2013); Minxin Pei, *Citizens v. Mandarins: Administrative Litigation in China*, 152 THE CHINA Q. 832 (1997); Haibo He, 困顿的行政诉讼 [Administrative Litigation in Trouble], 华东政法大学学报 [J. OF E. CHINA U. OF POL. SCI. & LAW] 86 (2012). For a sample of research that contains substantive analysis of a selected sample of administrative cases, see O'Brien & Lianjiang Li, *supra* note 7; Qinghua Wang, *Zhongguo Xingzheng Susong: Duozhongxin Zhuyi De Sifa* [Administrative Litigation in China: Polycentric Adjudication], 19 ZHONGWAI FAXUE [PEKING U. L. J.] 513 (2007). For a sample of research that uses large-scale surveys to explore administrative litigation in China, see Jinhua Cheng, *Institutional Options for the Settlement of Administrative Disputes in China: From the Perspective of Public Demand*, SOC. SCI. IN CHINA 5 (2010); Pierre Landry, *The Institutional Diffusion of Courts in China: Evidence from Survey Data*, in RULE BY LAW: THE POLITICS OF COURTS IN AUTHORITARIAN REGIMES (Tom Ginsburg & Tamir Moustafa eds., 2008).

## II. THE PEOPLE'S REPUBLIC OF CHINA TAX LAW AND ADMINISTRATION

Taxation is essential to the survival of any political regime, especially those of the managerial type. The Chinese government, in order to provide basic public goods and achieve its policy objectives, established a wide variety of extractive institutions.<sup>10</sup> This article focuses on the institutions for tax administration. The state currently levies taxes on nineteen major categories.<sup>11</sup> Since the tax reform of 1994, the extractive capacity of the central government has strengthened to the extent that it achieved an annual revenue growth of approximately 20% for the last decade, almost twice the rate of China's GDP growth for the same period.<sup>12</sup>

For purposes of maintaining political legitimacy, the nineteen taxes currently levied contain a number of progressive elements. For instance, the People's Republic of China ("P.R.C.") Law on Individual Income Taxation sets the rate for the highest income bracket at 45%, much higher than the 3% rate for the lowest income bracket.<sup>13</sup> A recent amendment of the law exempts taxpayers with salary income of less than RMB 3500 from paying any income tax.<sup>14</sup> Though the value-added tax ("VAT") that accounts for a quarter of total government revenues is a regressive tax, the state has attempted to ameliorate its wealth effects on low-income individuals by, for example, reducing the VAT rates for household necessities.<sup>15</sup>

The progressive elements, however, coexist with features that reflect the state's efforts to garner support from constituencies of vested interests. For instance, the state does not levy any estate taxes.<sup>16</sup> In addition, selected local governments only recently began to experiment with the collection of

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<sup>10</sup> One important institution is the property regime, which provides that urban land is owned by the state. XIANFA art. X (1982). Local governments in China have relied heavily on leasing of land use right to enrich their coffers. See, e.g., Guining Yue, Lili Teng & Chunhua Wang, 我国地方政府“土地财政”问题研究[*Research on Local Governments' "Land Finance" Problem*], 144 开放导报[CHINA OPENING HERALD] 47, 48 (2009).

<sup>11</sup> The nineteen taxes include corporate income tax, individual income tax, value added tax, business tax, consumption tax, land appreciation tax, real estate tax, arable land occupation tax, urban land-use tax, stamp tax, custom duties, deed tax, vehicle acquisition tax, vehicle and vessel tax, resource tax, urban construction and maintenance tax, vessel tonnage tax and tobacco tax.

<sup>12</sup> STATE ADMINISTRATION OF TAXATION, CHINA TAXATION YEARBOOK (2011).

<sup>13</sup> Chart for Marginal Tax Rates, 中华人民共和国个人所得税法[P.R.C. Law on Individual Income Taxation] (on file with author).

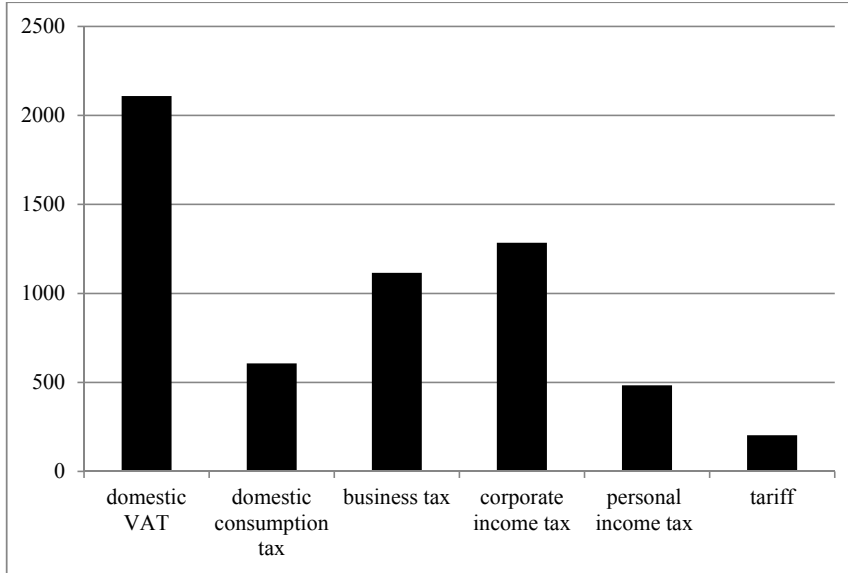
<sup>14</sup> *Id.* at art. 6, §1.

<sup>15</sup> Yan Xu, *Putting the 'Value Added' in China's Vat*, 58 TAX NOTES INT'L 487, 490 (2010).

<sup>16</sup> Shumin Guo, 遗产税应该尽快出台[*For Immediate Enactment of Estate Tax*], 中国房地产金融[CHINA REAL EST. FIN.] 2 (2012).

real property taxes.<sup>17</sup> Such tax benefits for the privileged contribute to the fast-growing wealth gap in China.<sup>18</sup>

Figure 1: Amount of several major taxes (RMB billion) collected in 2010.



Data source: China Statistical Yearbook (2011).

In the past three decades, the state constructed a powerful and rather sophisticated institutional apparatus for tax administration. By the end of 2010, tax bureaus of all levels employed more than 755,000 full-time and 105,000 part-time agents.<sup>19</sup> China is geographically administered, and the central government shares political power with regional governments. The

<sup>17</sup> Jing Zhang & Shuhui Huang, 房产税试点年内将扩容：地方草案加密上报[*Experimentation with Property Taxes Will Expand by Year End: Local Governments Submit Drafts*], 第一财经日报 [FIRST FIN. DAILY] (May 27, 2013), [http://news.xinhuanet.com/fortune/2013-05/27/c\\_124766628.htm](http://news.xinhuanet.com/fortune/2013-05/27/c_124766628.htm).

<sup>18</sup> The government refused to release the GINI coefficient, a statistical measure widely used to gauge wealth gap in a region. A 2005 study by the social science academy found the GINI coefficient to be 0.47 (coefficients below 0.4 are generally considered reasonable level of wealth disparity). See generally Xuyan Fang & Lea Yu, *Gov't Refuses to Release Gini Coefficient*, CAIXINONLINE (Jan. 18, 2012) <http://english.caixin.com/2012-01-18/100349814.html>. A recent study done by the Xinan University of Economics and Finance shows the GINI coefficient of 2010 to be 0.61, an extraordinarily high level. *Survey said China in 2010 far exceeded the world average income gap*, CAIXINONLINE (Dec. 10, 2012), <http://china.caixin.com/2012-12-10/100470254.html>.

<sup>19</sup> See STATE ADMINISTRATION OF TAXATION, SHUIWU GANBU DUIWU JIANSHE [DEVELOPMENT OF TAX ADMINISTRATION STAFF], <http://www.chinatax.gov.cn/n8136506/n8136608/n8138877/n11897218/11901216.html> (last visited October 14, 2013).

structure of the tax administration reflects that institutional arrangement. Among full-time tax agents, nearly half (357,000 by the end of 2010) work for tax agencies of regional governments.<sup>20</sup>

As illustrated in Figure 2 below, the central government established a hierarchical ordering of tax administration. Under the leadership of the national State Taxation Bureau (“STB”), offices were set up at the provincial, municipal, district, and county levels, in order of decreasing rank.<sup>21</sup> Parallel to the STB structure, each province also established a vertical ordering of tax administration, the Local Tax Bureau (“LTB”), with a provincial office at the top, subject to dual leadership of the STB and the provincial government.<sup>22</sup> The former provides professional guidance and inter-provincial coordination and supervision, while the latter exercises direct leadership.<sup>23</sup> Under the provincial bureau of the LTB are municipal and prefectural offices, which are of the same official rank, and the county LTB offices.<sup>24</sup> These sub-provincial LTBs are subject to dual leadership of the higher ranking tax bureaus and the corresponding local governments, with the latter playing the primary supervisory and leadership role.<sup>25</sup> Most of the tax bureaus set up outposts, branches, offices, information centers, and other specialized entities to assist in tax administration.<sup>26</sup> By the end of 2010, the STB system contained 3556 tax bureaus at various levels of administration, and 3414 inspection bureaus and direct branches, 10,193 outposts and tax offices, and 4346 information centers and service centers.<sup>27</sup> Similarly, the LTB system consisted of 3055 regional tax bureaus at various levels of administration, 5186 investigation bureaus and direct branches, 16,373 outposts and tax offices, and 2190 information centers and service centers.<sup>28</sup> Through such an extensive network of tax agents, the state

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<sup>20</sup> See STATE ADMINISTRATION OF TAXATION, STATE ADMINISTRATION OF TAXATION (2012), <http://www.chinatax.gov.cn/n6669073/n6669133/6886063.html> (last visited October 14, 2013).

<sup>21</sup> See STATE ADMINISTRATION OF TAXATION, SHUIWU ZUZHI JIGOU [ORGANIZATIONAL STRUCTURE OF TAX ADMINISTRATION], <http://www.chinatax.gov.cn/n8136506/n8136608/n8138877/n11897218/11901206.html> (last visited October 14, 2013).

<sup>22</sup> *Id.*

<sup>23</sup> *Id.* To reflect fiscal policy preference favoring Tibet, China established no regional tax bureau in the region. *Id.* The STB and the LTB offices collect different types of taxes. *Id.* The former is responsible for the collection of the VAT, consumption tax, automobile tax, business tax of certain SOEs, and so on. *Id.* The regional tax bureaus collect business tax, corporate tax, personal income tax, etc. *Id.* Customs is responsible for collecting tariffs and certain other specific taxes. *Id.*

<sup>24</sup> STATE ADMINISTRATION OF TAXATION, SHUIWU ZUZHI JIGOU [ORGANIZATIONAL STRUCTURE OF TAX ADMINISTRATION], <http://www.chinatax.gov.cn/n8136506/n8136608/n8138877/n1189721811901206.html> (last visited Oct. 14, 2013).

<sup>25</sup> *Id.*

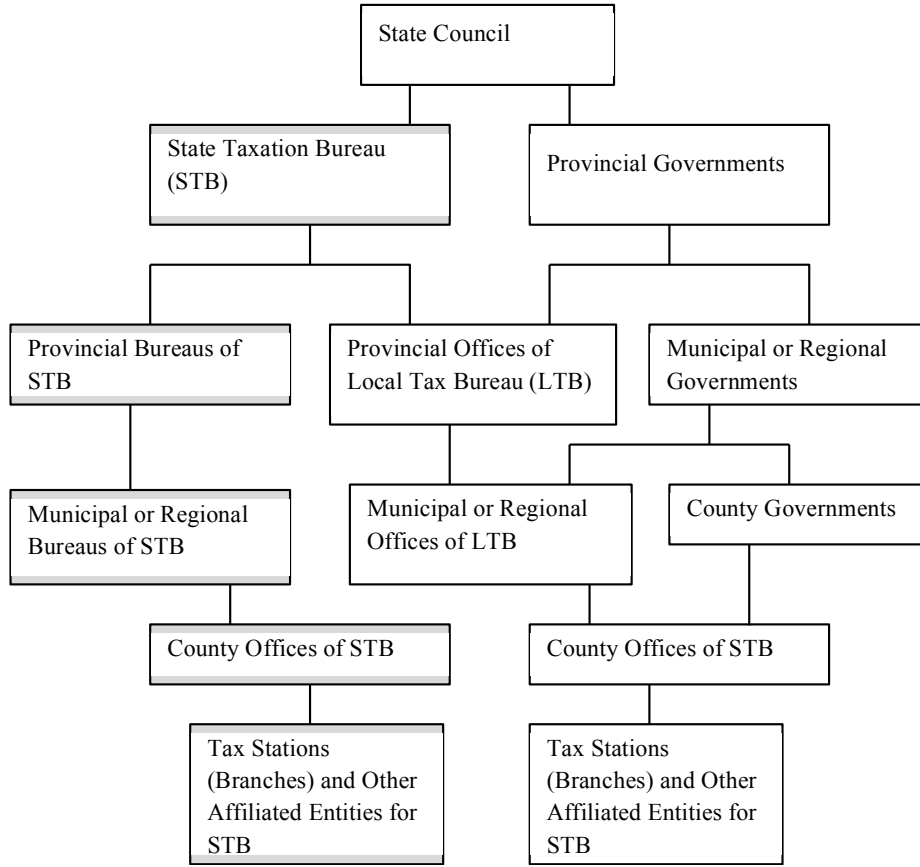
<sup>26</sup> *Id.*

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

achieved an annual revenue growth of approximately 20% in the past decade.<sup>29</sup>

Figure 2: Structure of the P.R.C. Tax Administration.<sup>30</sup>



The state empowers the agents to carry out their duties with a set of formal laws and regulations. The fundamentals are laid down in the Law of the P.R.C. Concerning the Administration of Tax Collection.<sup>31</sup> Major substantive laws include the P.R.C. Law on Individual Income Taxation, the

<sup>29</sup> CHINA STATISTICS BUREAU, CHINA STATISTICAL YEARBOOK, 8-1 (2011).

<sup>30</sup> STATE ADMINISTRATION OF TAXATION, SHUIWU ZUZHI JIGOU [ORGANIZATIONAL STRUCTURE OF TAX ADMINISTRATION], <http://www.chinatax.gov.cn/n8136506/n8136608/n8138877/n11897218/11901206.html> (last visited Oct. 14, 2013).

<sup>31</sup> Zhōnghuá Rénmín Gònghéguó Shuìshōu Zhēngshōu Guǎnlǐ Fǎ (中华人民共和国税收征收管理法) [Tax Collection Management Law] (promulgated by the Ninth National People’s Congress, April 28, 2001, effective May 1, 2001), ch. 1, art. 1-2, [http://www.gov.cn/banshi/200508/31/content\\_146791.htm](http://www.gov.cn/banshi/200508/31/content_146791.htm).



P.R.C. Law on Enterprise Income Taxation, and the P.R.C. Law on Vehicle and Vessel Taxation.<sup>32</sup> The P.R.C. Law on Legislation allows the State Council to make regulations regarding taxation not covered by the statutes in accordance with proper delegation from the National People's Congress or its Standing Committee,<sup>33</sup> as well as regulations about statutory enforcement.<sup>34</sup> It also allocates certain legislative power to government agencies such as the Ministry of Finance ("MOF") and the STB.<sup>35</sup> While the power to legislate tax regulations was delegated by the Standing Committee of the National People's Congress ("SCNPC") to the State Council, departmental rules about the interpretation and implementation of the tax regulations lack clear legislative delegation.<sup>36</sup> As a result, the legality of the numerous normative rules issued and applied by the STB, the MOF, and the LTB is debatable. Yet in practice the rules are largely accepted by taxpayers and tax professionals.<sup>37</sup> The sheer volume and complexity of the normative documents probably contributes to the fact that Chinese taxpayers rely heavily on personal interpretations by tax agents to comply.<sup>38</sup> Recently the national agencies have begun to rationalize tax rulemaking, especially the making and enforcement of normative rules.<sup>39</sup>

### III. CONTROLLING THE TAX AGENTS

In order to collect enough revenue to meet its ever-increasing spending needs, the state empowers its tax agents and grants them wide discretion over tax administration. Meanwhile, the state also implements a number of institutional measures to solve the inherent agency problem ubiquitous in a political system lacking freedom of press or a democratic check. For the sake of clarity, the agency-controlled institutions are

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<sup>32</sup> STATE ADMINISTRATION OF TAXATION, SHUISHOU ZHIDU DE FALU JICI [THE RANKING OF LAWS CONCERNING TAX COLLECTION], <http://www.chinatax.gov.cn/n8136506/n8136608/n8138877/n11897113/11900938.html> (last visited Oct. 14, 2013).

<sup>33</sup> Zhōnghuá Rénmín Gònghéguó Lìfǎ Fǎ (中华人民共和国立法法) [Law on Legislation] (promulgated by Ninth National People's Congress, Third Session, effective March 15, 2000), art. 9 [http://news.xinhuanet.com/legal/2003-01/21/content\\_699610.htm](http://news.xinhuanet.com/legal/2003-01/21/content_699610.htm).

<sup>34</sup> *Id.* at art. 56.

<sup>35</sup> *Id.* at art. 71.

<sup>36</sup> Wei Cui, *What Is the "Law" in Chinese Tax Administration*, 19 ASIA PAC. L. REV. 73, 75 (2011).

<sup>37</sup> Wei Cui, *Two Paths for Developing Anti-Avoidance Rules in China*, 17 ASIA PAC. TAX BULL. 1 (2011).

<sup>38</sup> *Id.* at 2.

<sup>39</sup> *Id.* at 4.

categorized according to the Ginsburg typology: hierarchy, second-party supervision, and third-party supervision.<sup>40</sup>

Mechanisms in the first category, hierarchy, include positive sanctions (e.g., merit-based bonus and promotion) and negative sanctions (e.g., administrative punishment) within the agency, merit-based recruiting, regular study sessions, and so forth.<sup>41</sup> For instance, since 2003 all candidates applying to work for the STB have been required to pass the highly competitive National Civil Servant Examination.<sup>42</sup>

When hierarchical mechanisms fail to prevent, detect, and correct agency abuses, second-party supervision comes into play. Two powerful institutions, the Communist Party of China Central Disciplinary Committee (“CDC”) and the Ministry of Supervision, which are charged with the responsibility to investigate and punish misconduct by government officials, are seriously under-staffed.<sup>43</sup> Hence, their supervision is limited to high ranking government officials and they rarely implicate tax agents at the local level.<sup>44</sup> The procuratorate may also function as an institution for second-party supervision over tax agents and subject the more abusive ones to criminal punishment.<sup>45</sup> Adopted from former Soviet Union, the procuratorate may take the initiative to investigate official misconduct.<sup>46</sup> However, the discretion enjoyed by tax agents renders it difficult to distinguish routine exercise of discretion from illegal misconduct.

To deal with the information asymmetry problem inherent in second-party supervision, the state created third-party supervisory institutions that allow parties with private information about official misconduct to report it to the government. Two examples are the letter and visit offices and the administrative reconsideration offices.<sup>47</sup> The former, in spite of its long

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<sup>40</sup> TOM GINSBURG, *RULE BY LAW: THE POLITICS OF COURTS IN AUTHORITARIAN REGIMES* 61-63, (Tom Ginsburg & Tamir Moustafa, eds. 2008).

<sup>41</sup> *Id.* at 61.

<sup>42</sup> See STATE ADMINISTRATION OF TAXATION, SHUIWU GANBU DUIWU JIANSHE [ON DEVELOPING STATE ADMINISTRATION OF TAXATION STAFF], <http://www.chinatax.gov.cn/n8136506/n8136608/n8138877/n11897218/11901216.html> (last visited July 26, 2013).

<sup>43</sup> Jiangnan Zhu, *Officials’ Promotion Likelihood and Regional Variation of Corruption in China* at 83 (Dec. 2008) (unpublished Ph.D. dissertation, Northwestern University) (on file with author).

<sup>44</sup> See, e.g., 北京地税局原局长王纪平被“双规” [Director of Beijing LTB Was Under Shuanggui], XINHUA (May 6, 2010), [http://news.xinhuanet.com/legal/2010-05/06/c\\_1275967.htm](http://news.xinhuanet.com/legal/2010-05/06/c_1275967.htm).

<sup>45</sup> The institution’s functions include prosecution of crimes and supervision of government and judicial officials. See Zhōnghuá Rénmín Gònghéguó Jiǎnchá fǎ (中华人民共和国检査法) [Law on the Procuratorate] (promulgated by the Eighth National People’s Congress Standing Committee, Feb. 28, 1995, effective July 1, 1995), art. 6, [http://www.china.com.cn/law/flfg/txt/200608/08/content\\_7063805.htm](http://www.china.com.cn/law/flfg/txt/200608/08/content_7063805.htm).

<sup>46</sup> *Id.*

<sup>47</sup> For a thorough description of the letter and visit offices, see Carl Minzner, *Xinfang: An Alternative to Formal Chinese Legal Institutions*, 42 STAN. J. INT’L L. 103 (2006).

history, have proved ineffective in resolving individual grievances.<sup>48</sup> The latter are a relatively new institution.<sup>49</sup> The State Council first enacted the Administrative Reconsideration Regulation (“ARR”) to facilitate the implementation of the Administrative Litigation Law (“ALL”), a groundbreaking statute that enabled Chinese citizens to bring government officials to court.<sup>50</sup> The ARR was upgraded to a statute after a few years of trial implementation.<sup>51</sup> The legislature intended the administrative reconsideration regime to complement, not substitute, administrative litigation, so the procedure was designed to be informal, cost-free, and expedient.<sup>52</sup> Citizens unsatisfied with any concrete administrative action may file a petition for reconsideration with a supposedly independent body lodged in the agency or a higher government body.<sup>53</sup> Besides the legality of the challenged administrative act, the reconsideration body may review its

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<sup>48</sup> *Id.* at 106.

<sup>49</sup> In a very general sense, the administrative reconsideration mechanism resembles a typical administrative appeals institution in the United States.

<sup>50</sup> For a brief summary of the legislative history, see Randall Peerenboom, *Globalization, Path Dependency and the Limits of Law: Administrative Law Reform and Rule of Law in the People's Republic of China*, 19 BERKELEY J. INT'L L. 161, 191-92 (2001).

<sup>51</sup> See Zhōnghuá Rénmín Gònghéguó Xíngzhèng Fùyì Fǎ (中华人民共和国行政复议法) [Law on Administrative Reconsideration] (promulgated by the Ninth National People's Congress Standing Committee, April 29, 1999, effective Oct. 1, 1999), [http://www.gov.cn/banshi/2005-08/21/content\\_25100.htm](http://www.gov.cn/banshi/2005-08/21/content_25100.htm).

<sup>52</sup> For instance, complainants incur no cost to file a petition for administrative reconsideration. Zhōnghuá Rénmín Gònghéguó Xíngzhèng Fùyì Fǎ (中华人民共和国行政复议法) [Law on Administrative Reconsideration] (promulgated by the Ninth National People's Congress Standing Committee, April 29, 1999, effective Oct. 1, 1999) at art. 31, [http://www.gov.cn/banshi/2005-08/21/content\\_25100.htm](http://www.gov.cn/banshi/2005-08/21/content_25100.htm). In addition, the reconsideration body is required to respond to a petition within 60 days after its filing. *Id.* The filing may be done either in writing or orally, to accommodate those who are illiterate or are not accustomed to formal written complaints. *Id.* at art. 11. The procedure was designed to be informal and flexible.

<sup>53</sup> Petitions against bureaus of the STB are handled by the bureau at the next highest level. See Shuìwù Xíngzhèng Fùyì Guīzé (税务行政复议规则) [Tax Rules for Administrative Reconsideration] (promulgated by the State Administration of Tax Bureau, Dec. 15, 2009, effective April 1, 2010), <http://www.chinatax.gov.cn/n8136506/n8136593/n8137537/n8138502/9563669.html>. Petitions against an office of the LTB may be filed with either the corresponding local government or the bureau of a higher rank, unless otherwise stipulated by regional rules. Petitions against the STB in Beijing may be filed with the bureau itself. Petitions should in general be filed, orally or in writing, within 60 days after knowledge of the concrete administrative action. Relevant administrative reconsideration body should review a petition within five days of its filing and decide whether to accept it. Rejection may be based on a limited number of situations such as nonpayment of the disputed tax liabilities and fines. Once accepted, a petition should be directed to the responding party, which carries the burden of proof. The administrative reconsideration body shall conduct investigation and render a decision within 60 days of the acceptance of the petition. An additional 30 days may be granted if the case is complex. For disputes over the exercise of discretion by tax agents or matters over the reasonableness of certain administrative action, reconciliation and mediation are allowed. The reconsideration body may uphold the administrative action, amend it, or withdraw it after determining its illegality, in which case it should order the responding party to take new administrative action in accordance with the law. *Id.*

appropriateness and the legality of relevant agency rules,<sup>54</sup> both of which fall beyond the jurisdiction of typical courts.

Once taxpayers have exhausted administrative recourse for disputes over a tax matter, they may turn to the courts.<sup>55</sup> The defendant agency generally bears the burden to prove the challenged administrative action was carried out in accordance with law.<sup>56</sup> If the court deems the evidence insufficient, it may conduct its own investigation.<sup>57</sup> Under current law, a judgment or decision must be rendered within three months after the docketing of an administrative lawsuit, and unsatisfied parties may appeal the trial decisions to a higher court.<sup>58</sup>

In sum, the Chinese government has over the years enacted a whole set of substantive and procedural laws and regulations over tax administration, and has constructed an administrative law regime to rein in abusive government officials. Though the resulting legal framework contains some elements that appear more favorable to tax agencies—e.g., payment of the purported tax liability is required for initiating the administrative reconsideration procedure<sup>59</sup>—it should provide a reasonable institutional protection to Chinese citizens against abusive tax agents or misinterpretation of tax laws and regulations.<sup>60</sup>

#### IV. EMPIRICAL PUZZLES AND EXTANT LITERATURES

While the state has set up a rather comprehensive legal framework to restrain government agencies and to protect Chinese taxpayers, very few taxpayers have chosen to use this legal framework.<sup>61</sup> According to recent

<sup>54</sup> Zhōnghuá Rénmín Gònghéguó Shuishōu zhēngshōu guǎnlǐ fǎ (中华人民共和国税收征收管理法) [Tax Collection Management Law] (promulgated by the Ninth National People's Congress, effective May 1, 2001), art. 35, [http://www.gov.cn/banshi/2005-08/31/content\\_146791.htm](http://www.gov.cn/banshi/2005-08/31/content_146791.htm).

<sup>55</sup> *Id.* at art. 88.

<sup>56</sup> Zhōnghuá Rénmín Gònghéguó Xíngzhèng Sùsòng Fǎ (中华人民共和国行政诉讼法) [Administrative Procedure Law] (promulgated by the Seventh National people's Congress, April 4, 1989, effective Oct. 1, 1990), art. 32.

<sup>57</sup> *Id.* at art. 34.

<sup>58</sup> *Id.* at art. 57.

<sup>59</sup> Shuìwù Xíngzhèng Fùyì Guīzé (税务行政复议规则) [Tax Rules for Administrative Reconsideration] (promulgated by State Administration of Taxation Dec. 15, 2009, effective April 1, 2010), ch. 6.

<sup>60</sup> Wei Cui, *supra* note 37, at 5.

<sup>61</sup> From 1994 to 2005, courts nationwide received merely 1,399 lawsuits against tax agencies, an average of 120 cases per year. See Jingjing Chen, *Shuìwù Xíngzhèng Anjian Liunian Fanfan, Nanshuiren Xiguan Falu Jiuji Shouduan* [Administrative Cases Double in Six Years, Taxpayers Used to Legal Remedies] LEGAL DAILY, Feb. 7, 2007. Another source, however, reports a much larger number (6,154 cases from 1996 to 1999). See HARBIN MUNICIPAL LOCAL TAXATION BUREAU, SHUI WU XINGZHENG FU VI SHI WU ZHONG DE WENTI VU DUICE (税务行政复议实务中的问题与对策) [ISSUES AND SOLUTIONS IN

data published by the Supreme People's Court ("SPC"), out of 136,353 first instance administrative lawsuits filed in all Chinese courts in 2011, only 405 were against tax agencies.<sup>62</sup> Among the 399 cases that were closed by the end of the year, 279 were concluded without reaching any substantive issues, and the courts issued decisions not judgments. Of the 279 decisions, 225 were court approvals for plaintiffs to withdraw their complaints, and twenty five cases were dismissed without a trial.<sup>63</sup> Of the mere 120 cases where courts rendered judgments on substantive legal issues, defendant tax agencies prevailed in 106 cases and plaintiffs in only fourteen, a victory rate of 11.7%.<sup>64</sup>

To the uninitiated, it must be puzzling that taxpayers in China avoid judicial resolution of tax disputes to such a great extent. The next part explains the unusual reluctance to sue. However, the explanations will at the same time unveil a more intriguing puzzle: why does any tax-related lawsuit go to trial at all, given all the factors that have turned thousands of taxpayer disputants away from judicial resolution?

#### A. *The First Puzzle: Why Are Potential Litigants Reluctant to Sue?*

To scholars familiar with administrative litigation in China, reluctance to sue government agencies is hardly a puzzle. Here it is posed as such mostly to set up the context for the discussion of the next empirical question: who, and under what circumstances, sues the tax bureau—arguably one of the most powerful agencies in China.

When asked to comment on administrative litigation, a Chinese businessman made the following comment: "It is very unlikely that I will win a lawsuit against the government. Even if I won in court, I would then risk losing everything."<sup>65</sup> This comment reflects a widely-shared

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THE PRACTICE OF TAX ADMINISTRATIVE RECONSIDERATION] (Oct. 24, 2008), <http://www.chinalaw.gov.cn/article/xzfy/llyj/200811/20081100066707.shtml>.

<sup>62</sup> SUMMARY OF FIRST INSTANCE ADMINISTRATIVE LAWSUITS IN CHINA (2011), <http://www.court.gov.cn/qwfb/sfsj/201206/P020120628451878418099.xls> (last visited Aug. 27, 2012).

<sup>63</sup> *Id.*

<sup>64</sup> One source cites the victory rate of all cases filed between 1994 and 2005 to be 45%. See Hong Lan, *Shuiwu Xingzheng Anjianshu Cheng Shangsheng Qushi* [Trend of Increase for Tax-Related Administrative Cases], ZHONGGUO SHUIWU BAO [CHINA TAX'N] (Feb., 5 2007). See also Wei Cui, *The Rule of Law in Chinese Tax Administration*, in THE DELICATE BALANCE: TAX, DISCRETION AND THE RULE OF LAW 362-63, (Chris Evans, et al., 2011). The STB's high plaintiff victory rate may include cases withdrawn by the plaintiffs after the defendants had changed their administrative acts. Or it may just be figures from a few years ago, before the national campaign for ADRs.

<sup>65</sup> Qian Wang & Xuena Li, *Jie Qiye Er Yu*, (竭企业而渔) [Destroying Tax Basis by Overtaxing Companies] XIN SHI JI [NEW CENTURY MAG.] (Aug. 27, 2012), <http://magazine.caixin.com/2012-08-24/100428102.html>.

understanding and explains why most taxpayers choose not to sue tax agencies when disputes arise. In theory, litigation is a preferred method for dispute resolution if and only if its benefits outweigh its costs and the net benefits outweigh those of other alternative dispute resolution methods (including not doing anything at all).<sup>66</sup>

From the viewpoint of welfare maximization, when litigation costs are high, rational disputants should agree to settle and split the cost savings. In the United States, expensive legal fees probably deter many from suing. This deterrence does not directly apply in China because the formal costs for administrative lawsuits are low. As noted earlier, the administrative law regime was established in part to encourage information-holders to assist the state in monitoring local agents. So under current law, the court fee for filing an administrative case is merely RMB 50 (USD 7.5).<sup>67</sup> In addition, the defendant government agency generally bears the burden of proof in administrative lawsuits.<sup>68</sup> Finally, relatively low attorneys' fees make the assistance of legal counsel affordable to many, though evidence shows that Chinese lawyers tend to avoid representing cases against the state.<sup>69</sup> The low formal litigation costs in China suggest that the deterrent to suing the state lies elsewhere.

Judicial weakness and bias favoring state agencies and high costs of agency retaliation explain the strong reluctance to file lawsuits against tax agencies in China. Judicial weakness and bias in administrative litigation is not a new concept to scholars of Chinese law and politics.<sup>70</sup> Courts in China are reluctant to challenge the local officials who control court funding and major personnel decisions.<sup>71</sup> When adjudicating administrative lawsuits, pragmatic Chinese judges consider the potential impact of their rulings on local stability and the compliance costs for the local government.<sup>72</sup> The tactic often employed is to dodge difficult cases.<sup>73</sup> Because of judicial

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<sup>66</sup> For the sake of clarity, responses to a grievance against a state agency can be grouped into three categories: 1) lumping it (bearing the loss without protesting), 2) negotiating a settlement or protesting through other non-judicial channels, and 3) litigating against the agency.

<sup>67</sup> *Susongfei Jiaona Banfa* (诉讼费用交纳办法) [Measures Regarding Payment of Litigation Fee] (promulgated by the St. Council, Dec. 19, 2006, effective April 1, 2007), art. 13, § 5, [http://www.gov.cn/zwqk/2006-12/29/content\\_483407.htm](http://www.gov.cn/zwqk/2006-12/29/content_483407.htm).

<sup>68</sup> *Zhōnghuá Rénmín Gònghéguó Xíngzhèng Sùsòng Fǎ* (中华人民共和国行政诉讼法) [Administrative Procedure Law] (promulgated by the Seventh National people's Congress, April 4, 1989, effective Oct. 1, 1990), art. 32.

<sup>69</sup> Ji Li, *supra* note 9, at 22.

<sup>70</sup> See Xin He & Yang Su, *supra* note 9; O'Brien & Lianjiang Li, *supra* note 7.

<sup>71</sup> Benjamin L. Liebman, *China's Courts: Restricted Reform*, 191 THE CHINA Q. 620, 627 (2007).

<sup>72</sup> Qinghua Wang, *supra* note 9, at 525.

<sup>73</sup> *Id.* at 525-26. See also, Xin He, *The Judiciary Pushes Back: Law, Power, and Politics in Chinese Courts*, in JUDICIAL INDEPENDENCE IN CHINA: LESSONS FOR GLOBAL RULE OF LAW PROMOTION (R. P.

weakness, litigants have to resort to multiple mechanisms, such as media and mass protest, to pressure judges to accept and adjudicate administrative lawsuits fairly.<sup>74</sup> Of course, not all government agencies are treated equally. Judges tend to be more inclined to rule in accordance with the law if the defendant is a weak administrative agency and the unfavorable decision would not negatively impact its interests.<sup>75</sup> In contrast, when a case touches upon critical interests of powerful administrative agencies, the court will try to avoid registering the case or ruling against the defendant.<sup>76</sup> Even if the plaintiff manages to obtain a favorable ruling in court, the subsequent enforcement is at best uncertain. Powerful state agencies face a low risk of punishment for delaying or refusing to comply with judgments against their interests.<sup>77</sup>

In the rare case where the plaintiff in an administrative lawsuit wins in court and is able to enforce the judgment, agency retaliation will most likely follow.<sup>78</sup> The costs and damages of such retaliation, if from a tax agency, are substantial. To ensure revenue collection, the state grants local tax agents wide discretion to implement tax laws and policies. Consequently, disguised retaliation is of low risk for the agents, but costly for the targeted ex-plaintiff. For instance, a tax agency may retaliate by conducting more inspections and audits of the taxpayer's books, causing excessive delays in processing the taxpayer's requests, over-assessing taxpayer's revenues or profits, and issuing harsh penalties for tax deficiencies.<sup>79</sup>

Typical business practices in China also contribute to the high costs of agency retaliation. Formality is not highly valued in small business

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Peerenboom ed., 2010). Until recently, local courts could dodge administrative lawsuits by not acting on it. Rejecting it outright would enable the complainant to appeal the case to a higher court, so the case filing division could choose not to do anything about a complaint. A recent SPC rule was intended to solve this problem. Complainants are now allowed to bring a lawsuit directly to a higher court if the first instance court ignores the filing.

<sup>74</sup> See, e.g., O'Brian & Lianjiang Li, *supra* note 9, at 82.

<sup>75</sup> Xing Ying & Zuo Xu, *Case Registration Politics and the Stagnation of Administrative Litigation: An Empirical Study of Two Northern China Basic Courts*, 6 TRIB. OF POL. SCI. & L. 111, 117 (2009).

<sup>76</sup> *Id.* at 116-18.

<sup>77</sup> See O'Brian & Lianjiang Li, *supra* note 9, at 90. However, some empirical evidence indicates that the enforcement of court judgment in civil cases is better than generally expected. See Xin He, *Debt Collection in the Less Developed Regions of China: An Empirical Study from a Basic-Level Court in Shaanxi Province*, 206 THE CHINA Q. 253 (2011).

<sup>78</sup> See HARBIN MUNICIPAL LOCAL TAXATION BUREAU, *supra* note 61.

<sup>79</sup> The statute in general stipulates penalties in the range of 50% to 500% of the assessed tax deficiency, and the agency has the discretion to decide the exact percentage. See Zhōnghuá Rénmín Gònghéguó Shuìshōu Zhēngshōu Guǎnlǐ Fǎ (中华人民共和国税收征收管理法) [Tax Collection Management Law] (promulgated by the Ninth National People's Congress, April 28, 2001, effective May 1, 2001), ch. 1, art. 1-2, [http://www.gov.cn/banshi/2005-08/31/content\\_146791.htm](http://www.gov.cn/banshi/2005-08/31/content_146791.htm).

transactions between Chinese companies.<sup>80</sup> A large number of small businesses pay presumptive taxes.<sup>81</sup> Jeopardizing a cooperative relationship with a tax agency will presumably result in higher tax assessments. In addition, many businesses engage in some form of tax evasion.<sup>82</sup> A good relationship with local tax agents ensures that agents ignore the tax evasion. Such a practice, however, allows tax agencies to easily retaliate against businesses if the agencies ever choose to strictly enforce relevant tax laws.<sup>83</sup> Because the actual tax burden of a Chinese taxpayer depends on his or her relationship with tax collectors,<sup>84</sup> few would jeopardize that relationship by challenging the collectors in court.

Moreover, most Chinese firms are well aware of the importance of a good relationship with tax agents and will actively cultivate and maintain one. An empirical study found that Chinese companies constantly set aside a significant portion of their business expenses as “money bribes to government officials in exchange for lower expropriation.”<sup>85</sup> Chinese companies also engage in frequent personal interactions with local tax agents to obtain information about tax law enforcement.<sup>86</sup> All these precautions reduce the probability of disputes arising in the first place.

Systemic reforms aimed at easing social tensions further reduce the filing of administrative lawsuits.<sup>87</sup> These reforms strengthened administrative reconsideration institutions and encouraged mediation at every phase of the litigation procedure.<sup>88</sup> Chinese courts even implemented target responsibility systems to increase the rate of mediation for civil and administrative litigation.<sup>89</sup> In the context of this national campaign to promote non-judicial dispute resolution, most of the administrative lawsuits against tax agencies, once docketed, must be actively mediated by the courts. If the mediation efforts succeed, the taxpayer will withdraw his complaint and the case closes. Otherwise, the lawsuit will go to trial. Even throughout the trial process, the judge will press the parties to settle before

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<sup>80</sup> See Max Boisot & John Child, *From Fiefs to Clans and Network Capitalism: Explaining China's Emerging Economic Order*, 41 ADMIN. SCI. Q. 600, 612-13 (1996).

<sup>81</sup> Wei Cui, *The Prospect of New Partnership Taxation in China*, 46 TAX NOTES INT'L. 625, 630 (2007).

<sup>82</sup> See Qian Wang & Xuena Li, *supra* note 65.

<sup>83</sup> *Id.*

<sup>84</sup> Hongbin Cai, et al., *Eat, Drink, Firms, Government: An Investigation of Corruption from the Entertainment and Travel Costs of Chinese Firms*, 54 J.L. & ECON. 55, 63 (2011).

<sup>85</sup> *Id.* at 66.

<sup>86</sup> Wei Cui, *supra* note 37, at 3.

<sup>87</sup> See generally, Carl Minzner, *China's Turn Against Law*, 59 AM. J. COMP. L. 935 (2011).

<sup>88</sup> Xing Ying & Zuo Xu, *supra* note 75, at 120.

<sup>89</sup> Minzner, *supra* note 87, at 957.



issuing a decision or judgment.<sup>90</sup> Thus, any administrative lawsuit filed against a tax agency filters through a number of institutions that are designed to provide non-judicial resolution.

In sum, judicial weakness and bias in favor of the state, high costs of agency retaliation, and the state campaign to promote alternative dispute resolutions determine that, when disputes arise between taxpayers and local tax officials, the former tend to show a high level of tolerance. If any action is taken, it is likely directed towards non-judicial dispute resolution. As a result, only a few hundred administrative lawsuits are filed each year against tax agencies in China.

*B. The Second Puzzle: Why Does Anyone Sue and Insist on a Trial?*

Given the state campaign to promote alternative dispute resolution, judicial bias, and the high cost of agency retaliation, the existence of any tried cases is an intriguing puzzle. Why does anyone in China go through the adjudicatory process to resolve disputes with powerful tax agencies, given the adverse conditions? The answer to this question is of critical importance to the understanding of tax administration in China, the development of its administrative law regime, and more generally China's legal reform.

Questions about the selection of lawsuits for trial have generated a vast amount of literature.<sup>91</sup> Assuming litigation is more costly than settlement, all lawsuits should settle but for transaction costs or information asymmetry. Further, those lawsuits that go to trial are neither a random nor a representative sample of all the lawsuits. According to the classic model developed by Professors George L. Priest and Benjamin Klein ("Priest/Klein model"), after satisfying certain assumptions, lawsuits will only be tried if they are "close cases," and plaintiffs will have approximately a 50% win rate.<sup>92</sup> Systematic deviation from the 50% rate may occur if: 1) litigation costs are low relative to settlement costs, 2) plaintiffs expect judgments to be high relative to litigation costs (encouraging litigation for a high proportion

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<sup>90</sup> Xing Ying & Zuo Xu, *supra* note 75, at 119.

<sup>91</sup> See George L. Priest & Benjamin Klein, *The Selection of Disputes for Litigation*, 13 J. LEGAL STUD. 1 (1984); Donald Whittman, *Dispute Resolution, Bargaining, and the Selection of Cases for Trial: A Study of the Generation of Biased and Unbiased Data*, 17 J. LEGAL STUD. 313 (1988); Theodore Eisenberg, *Testing the Selection Effect: A New Theoretical Framework with Empirical Tests*, 19 J. LEGAL STUD. 337 (1990).

<sup>92</sup> See Priest & Klein, *supra* note 91, at 17.

of disputes), or 3) the two parties have different stakes in the litigation's outcome.<sup>93</sup>

One notable alternative theory, the asymmetric information model, loosens the implicit assumption of the Priest/Klein model that disputants are equally informed.<sup>94</sup> Because the disputants hold asymmetric information and the informed party offers to settle only when it expects to lose at trial, the informed party should prevail in most tried cases.<sup>95</sup> So in contrast to the Priest/Klein model, the asymmetric information model does not predict a general tendency of 50% win rate.<sup>96</sup> Instead, the more informed party should have a much higher victory rate.

In the past three decades, the Priest/Klein model and alternative theories have spawned numerous empirical studies.<sup>97</sup> U.S. Tax Court cases are ideal for testing these theories because the judgments of both settled and tried civil tax controversy cases are disclosed to the public. One study found divergent expectations to be a critical factor in determining the likelihood of settlement, and active judges will facilitate the meeting of such expectations and minimize strategic behavior by the disputants.<sup>98</sup> However, taxpayers' risk preference and the use of legal counsel show no significant impact on the settlement of tax court cases.<sup>99</sup>

Very few empirical studies have touched on why administrative lawsuits go to trial in China. The most notable study is Professor Pei Minxin's article in 1995, which found both parties to an administrative dispute had incentives to settle.<sup>100</sup> According to the study, plaintiffs suing government officials in China expect to lose and are better off settling with the defendants.<sup>101</sup> The sued government agencies are also threatened by the small possibility of losing in court, which would harm not only government authority but, more importantly, the career prospect of responsible

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<sup>93</sup> *Id.* at 20.

<sup>94</sup> *Id.* at 24-29.

<sup>95</sup> Joel Waldfogel, *Reconciling Asymmetric Information and Divergent Expectations Theories of Litigation*, 41 J.L. & ECON. 451, 452 (1998).

<sup>96</sup> See Steven Shavell, *Any Frequency of Plaintiff Victory at Trial Is Possible*, 25 J. LEGAL STUD. 493 (1996); Waldfogel, *supra* note 95.

<sup>97</sup> See Daniel Kessler, et al., *Explaining Deviations from the Fifty-Percent Rule: A Multimodal Approach to the Selection of Cases for Litigation*, 25 J. LEGAL STUD. 233 (1996); Eisenberg, *supra* note 91; Daniel Klerman, *The Selection of 13th-Century Disputes for Litigation*, 9 J. EMPIRICAL LEGAL STUD. 320 (2012); Samuel R. Gross & Kent D. Syverud, *Getting to No: A Study of Settlement Negotiations and the Selection of Cases for Trial*, 90 MICH. L. REV. 319 (1991). Most of these studies use evidence from the United States.

<sup>98</sup> Leandra Lederman, *Which Cases Go to Trial?*, 49 CASE W. RES. L. REV. 315, 341 (1999).

<sup>99</sup> *Id.*

<sup>100</sup> Minxin Pei, *supra* note 9, at 844.

<sup>101</sup> *Id.*

officials.<sup>102</sup> As a result, defendant government agencies are incentivized to settle as well.<sup>103</sup> In addition, Chinese courts—stuck between the conflicting interests of maintaining their institutional legitimacy and protecting the interests of state agencies—are equally enthusiastic about settlement.<sup>104</sup> Given the stakes implicated by non-judicial resolution of administrative disputes, a significant proportion of plaintiffs in Pei's empirical study settled and withdrew their complaints.<sup>105</sup> Pei also compared the defendant win rates in administrative lawsuits against different government agencies and concluded that powerful agencies enjoy greater advantages in administrative litigation.<sup>106</sup>

In reaching this conclusion, Pei neglected the Priest/Klein theory and failed to address the causes of the deviation from the 50% plaintiff victory rate. In addition, Pei's study centered on a sample of 236 administrative cases that were published in the early 1990s as model precedents for judges and lawyers, creating a problem of selection bias.<sup>107</sup> Moreover, the study provided a survey of several general attributes of the cases—such as who were the plaintiffs, who was sued, and who prevailed—without reaching into the substance and contexts of the lawsuits.<sup>108</sup> Therefore, it fails to explain why a portion of the cases went to trial in spite of all the unfavorable conditions for administrative litigation recognized in the study.

Other empirical works of administrative litigation in China relied on either a small number of non-random cases and interviews or a large-scale social survey.<sup>109</sup> Both methodologies are flawed with the selection bias problem. And most of the studies cover administrative lawsuits against all government agencies.<sup>110</sup> It is widely recognized that all state agencies are not equal in the highly fragmented authoritarian regime, with powerful ones enjoying more advantages in court.<sup>111</sup> By treating all government defendants the same, existing studies miss this important aspect of Chinese politics.

In sum, existing literature does not sufficiently explain why some tax-related administrative lawsuits reach the trial stage despite the nationwide, state campaign for settlement, high costs of government retaliation, little chance of victory, and low possibility of enforcement of any favorable

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<sup>102</sup> *Id.*

<sup>103</sup> *Id.*

<sup>104</sup> *Id.* at 844-45.

<sup>105</sup> *Id.* at 842-45.

<sup>106</sup> *Id.* at 845.

<sup>107</sup> *Id.* at 847-48.

<sup>108</sup> *Id.* at 851.

<sup>109</sup> See sources cited *supra* note 9.

<sup>110</sup> See sources cited *supra* note 9.

<sup>111</sup> Xing Ying & Zuo Xu, *supra* note 75, at 116-18.

judgments. The next part sets out to answer the intriguing empirical question.

#### V. MAKING SENSE OF THE “IRRATIONAL” ADMINISTRATIVE LAWSUITS AGAINST TAX AGENCIES IN CHINA

This part discusses four main factors that contribute to the trial of certain lawsuits against powerful tax agencies: 1) immunity to extra-judicial retaliation; 2) substantial stake and lack of alternative dispute resolution; 3) high transaction costs; and 4) optimism of the disputants.

As discussed earlier, though formal litigation costs are insignificant in China, extra-judicial costs, i.e., the costs of agency retaliation, tend to be substantial for those who take government officials to court, which results in only a few lawsuits against tax agencies. The critical role of agency retaliation in deterring lawsuits, however, also explains why complainants who may avoid the costs will be able to significantly reduce the actual litigation costs and be more incentivized to sue.

Tax agencies in China, though powerful, are subject to certain restraints. First, their jurisdiction is territorial.<sup>112</sup> A tax agency enjoys wide discretion in tax administration within its own territory, but crossing the line into another agency's jurisdiction significantly curtails this discretion. Because of this limit on a local tax agency's power, a complainant may avoid retaliation costs if she moves her taxable assets away from the agency's jurisdiction and does not interact with the agency again after the lawsuit. Second, the exercise of local tax agencies' monitoring, investigative, and extractive authority and discretion is largely restricted to taxable income and assets.<sup>113</sup> Therefore, individuals and companies with low incomes and revenues are relatively immune to the agencies' retaliation threats. Third, the authoritarian regime of China is highly fragmented,<sup>114</sup> so having a powerful ally in the political system significantly reduces the probability of tax agency retaliation.

While retaliation costs may be curbed in these limited circumstances, persistence in continuing to trial would not exist without an expectation of high returns. Put differently, a lawsuit will more likely be tried if substantial

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<sup>112</sup> See *supra* Part II for a discussion about the system for tax administration in China.

<sup>113</sup> Zhōnghuá Rénmín Gònghéguó Shuìshōu Zhēngshōu Guǎnlǐ Fǎ (中华人民共和国税收征收管理法) [Tax Collection Management Law] (promulgated by the Ninth National People's Congress, April 28, 2001, effective May 1, 2001), [http://www.gov.cn/banshi/2005-08/31/content\\_146791.htm](http://www.gov.cn/banshi/2005-08/31/content_146791.htm).

<sup>114</sup> For a detailed discussion of the concept of fragmented authoritarian regime, see KENNETH LIEBERTHAL & MICHEL OKSENBERG, POLICY MAKING IN CHINA : LEADERS, STRUCTURES, AND PROCESSES 137-51 (1988).

interests are at stake and alternative dispute resolution channels are unavailable. Expectation of positive return depends first of all on a positive probability of winning a lawsuit. For the following reasons, such positive probability may exist in spite of the serious judicial bias discussed earlier. Though plaintiffs of administrative lawsuits are very likely to lose at the trial level,<sup>115</sup> it is possible to win upon appeal. Appellate courts tend to be less influenced by defendant government agencies.<sup>116</sup> Plaintiffs in administrative lawsuits therefore expect a better chance of obtaining favorable judgments at the appellate level.

A unique institutional feature of the Chinese legal system, the lack of judicial finality, further improves the plaintiffs' chance of obtaining an eventual victory. Though in general appellate decisions are final, in certain circumstances they may be further challenged. The procuratorate may lodge a protest of a legally binding decision to a higher court on numerous grounds, such as erroneous application of the law by judges.<sup>117</sup> For reasons similar to other second-party supervisory institutions, only a very few administrative cases are processed by the procuratorate each year.<sup>118</sup> Other possible channels to challenge an appellate decision include directly petitioning a higher court to intervene and retry the case or petitioning the deciding appellate court to reopen the case.<sup>119</sup> Such intervention is more likely if the higher court faces external pressure from the legislature,<sup>120</sup> ranking government officials,<sup>121</sup> or public media.<sup>122</sup> In sum, due to the lack of adjudicatory finality and the possibility of prevailing when higher authorities intervene, plaintiffs in a suit against tax agents may try a losing case and then appeal if substantial interests are at stake. Readers should note that the discussion of this and the preceding paragraph is only to show that

<sup>115</sup> Xin He & Yang Su, *supra* note 9, at 132.

<sup>116</sup> Minxin Pei, *supra* note 9, at 847.

<sup>117</sup> See Zhōnghuá Rénmín Gònghéguó Xíngzhèng Sùsòng Fǎ (中华人民共和国行政诉讼法) [Administrative Procedure Law] (promulgated by the Seventh National people's Congress, April 4, 1989, effective Oct. 1, 1990), art. 64.

<sup>118</sup> For example, from 2008 to 2011, Zaozhuang Intermediate Procuratorate lodged 122 protests, but only one was for an administrative lawsuit. See Jiang Yang (姜洋), *Lun Kangsu Zaishen Anjian De Tedian, Nandian Ji Jianyi* (论抗诉再审案件的特点、难点及建议) [*On the Features, Difficulties and Suggestions Regarding Protest-Triggered Retrial Cases*], CIVIL PROCEDURE LAW (June 17, 2012), [http://www.civilprocedurelaw.cn/html/jcjd\\_1174\\_2538.html](http://www.civilprocedurelaw.cn/html/jcjd_1174_2538.html).

<sup>119</sup> Zhōnghuá Rénmín Gònghéguó Xíngzhèng Sùsòng Fǎ (中华人民共和国行政诉讼法) [Administrative Procedure Law] (promulgated by the Seventh National people's Congress, April 4, 1989, effective Oct. 1, 1990), art. 62.

<sup>120</sup> See Young Nam Cho, *Symbiotic Neighbour or Extra-Court Judge? The Supervision over Courts by Chinese Local People's Congresses*, 176 THE CHINA Q. 1068, 1073-77 (2003).

<sup>121</sup> See Liebman, *supra* note 71, at 626-27.

<sup>122</sup> See *id.* at 628-29.

the probability of post-trial victory is positive, not zero. As will be illustrated in the next part, appellate courts rarely reverse lower court decisions favoring a strong state agency. In other words, the probability of winning an administrative lawsuit, at trial and afterwards, is positive but very low, so plaintiffs will insist on trial only if substantial interests are at stake.

In sum, while the high extra-judicial costs of suing tax agencies explain the small number of administrative lawsuits filed each year, they also explain why those that do not bear the costs may persist on going to trial for a reasonable amount of material rewards. Moreover, substantial stake and lack of alternative dispute resolution may also explain why some cases fail to settle. The theoretical explanations specific to China's political legal context do not necessarily conflict with general selection theories. High transaction costs and optimism of the disputants should also contribute to the filing of lawsuits against tax agencies in China.

The next part examines these theories against the results from administrative lawsuits against tax agencies in Henan Province from 2009 to 2011.

## VI. ANALYSIS OF TAX-RELATED ADMINISTRATIVE LAWSUITS FROM HENAN PROVINCE

This part evaluates and substantiates the theoretical explanations proposed in Part V with an analysis of all of the major administrative cases against tax agencies that went to trial in Henan Province from 2009 to 2011. The author selected Henan Province for the following reasons. First and foremost, the province took the lead in publishing court decisions and judgments. In response to a SPC rule about case disclosure,<sup>123</sup> the Henan

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<sup>123</sup> As part of the judicial reform, the SPC published the Six Rules on the Disclosure of Judgments and the Measures on the Publication of Judgments Online, both of which encourage public disclosure of court decisions and judgments, but also provide three general categories of non-publication: national security, privacy and adolescent crimes. See *Guanyu Sifa Gongkai De Liu Xiang Guiding* (关于司法公开的六项规定) [Six Rules on the Disclosure of Judgments] (promulgated by the Sup. People's Ct., Dec. 8, 2009, effective Dec. 8, 2009), para. 5, <http://www.chinanews.com/gn/news/2009/12-23/2034717.shtml>; *Zuigao Renmin Fayuan Guanyu Renmin Fayuan Zai Hulanwang Gongbu Caipan Wenshu De Guiding* (最高人民法院关于人民法院在互联网公布裁判文书的规定) [Measures on the Publication of Judgments Online] (promulgated by the Sup. People's Ct., Nov. 21, 2010, effective Nov. 21, 2010), §1, para. 2, [http://www.court.gov.cn/xwzx/rdzt/sfgkxeyhdzt/zdwj/201203/t20120326\\_175408.html](http://www.court.gov.cn/xwzx/rdzt/sfgkxeyhdzt/zdwj/201203/t20120326_175408.html). In addition, the rules provide that pending judgments and cases that have been mediated and withdrawn should not be publicized. See *Guanyu Sifa Gongkai De Liu Xiang Guiding* (关于司法公开的六项规定) [Six Rules on the Disclosure of Judgments] (promulgated by the Sup. People's Ct., Dec. 8, 2009, effective Dec. 8, 2009), § 2, para. 2.

Provincial High Court issued detailed implementation guidance for the rules of disclosure, according to which all judgments effective as of October 1, 2008, should be published online except those that fell clearly in the exempt categories.<sup>124</sup> To encourage compliance, the High Court linked local judges' compliance with the implementation of the rules to their performance evaluation.<sup>125</sup> Because administrative lawsuits against tax agents are unlikely to fall into the exempt categories, a large fraction of them should be published and available online. Though the author's research finds that a few cases are missing from the database, relevant information is available in published cases, which limits the potential bias.<sup>126</sup>

The second reason the author selected Henan for the study is the amount of official malfeasance in the province. Earlier research indicates that local governments in Henan suffer from a severe fiscal shortage, leading to heavy tax burdens and highly predatory local officials.<sup>127</sup> This gives rise to massive grievances against the state and a steady supply of administrative lawsuits. In particular, it gives rise to enough tax-related cases for a meaningful empirical study.

Third, Henan led other Chinese provinces in promoting administrative litigation. The Provincial High Court was one of the first to establish a high-quality administrative law division.<sup>128</sup> With support from the court president and the provincial party leaders, the division actively promoted lawsuits against local officials and reported one of the highest administrative litigation rates in China (calculated as number of filings per resident).<sup>129</sup>

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<sup>124</sup> Cáipàn Wénshū Shàngwǎng Gōngbù Guǎnlǐ Bǎnfǎ (裁判文书上网公布管理办法) [Administrative Rules Regarding Online Disclosure of Court Decisions and Judgments] (promulgated by the Henan Supreme Court, Oct. 9, 2009, effective Oct. 14, 2009), <http://thxfy.chinacourt.org/public/detail.php?id=170>.

<sup>125</sup> *Id.*

<sup>126</sup> The High Court published one lawsuit that it should not have because the plaintiff withdrew the case. See Yuangao Zhumadian Shi Tian Yi Jiudian Guanli Youxian Gongsi Yu Beigao Henan Sheng Zhumadian Shi Difang Shuiwu Ju Jicha Ju Shuishou Chafeng Baoquan Cuoshi Weifa Sunhaile Qi Hefa Quanyi Yi An (原告驻马店市天驿酒店管理有限公司与被告河南省驻马店市地方税务局稽查局税收查封保全措施违法损害了其合法权益一案) [Zhumadian Tianze Hotel Management Ltd. v. Henan Zhumadian Ltd. Inspection Bureau], (Henan Zhumadian Yicheng Dist. Ct. 2009) (on file with author). Additionally, one administrative case should have been published because the plaintiff received a verdict. See Yuangao Renleliang Su Beigao Luoyang Shi Xi Gongqu Guojia Shuiwu Ju Shuiwu Xingzheng Jiangli Yi An (原告任乐亮诉被告洛阳市西工区国家税务局税务行政奖励一案) [Ren Leliang v. Luoyang STB], <http://xgqfy.chinacourt.org/public/paperview.php?id=433625> (last visited Sept. 27, 2013). Note the three decisions for the retrial of the Zhumadian cases were not published.

<sup>127</sup> See Hongbin Cai, et al., *supra* note 84 at 62.

<sup>128</sup> Ji Li, *Suing the State: A Study of Administrative Litigation at the Provincial Level in China* 108 (2012) (unpublished Ph.D. dissertation, Northwestern University) (on file with author).

<sup>129</sup> *Id.* at 110-11.

Moreover, Henan was for a long time the most populous province in China<sup>130</sup> and, located close to the geographic center of the country, the province is representative of China in many aspects. For the above reasons, theories derived from a study of tax-related administrative lawsuits in Henan should be widely applicable in many other Chinese provinces.

In addition to the lawsuits against tax agents reported by the courts in Henan, the author conducted archival research into published materials relating to the cases, the parties involved, and the underlying disputes. This included other lawsuits (civil and criminal) in which the plaintiffs participated. This research enabled the author to understand the contexts for the tax-related administrative disputes and derive a few general attributes that explain the puzzling existence of tried lawsuits against tax agencies in China.

Before proceeding to the detailed case analysis, some summary statistics of the cases are in order. From 2009 to 2011, only forty-one decisions and judgments involved tax agencies as defendants.<sup>131</sup> Because the sample contains decisions and judgments by both trial and appellate courts, some of which relate to the same underlying disputes, there are a total of only nineteen separate complainants. In addition, some courts reported multiple judgments or decisions for different claims or issues of the same case. Also, because several of the complainants are related parties, e.g., companies implicated in the same tax evasion investigation, the actual number of underlying disputes is even smaller.

Appellate courts rendered sixteen of the forty-one published decisions and judgments. Plaintiffs appealed more than half of the cases filed after 2009.<sup>132</sup> The extra efforts by the plaintiffs, however, did not translate into substantial benefits. Only three cases appealed by taxpayers were sent back for retrial, all of which satisfied the appellate court after a few cosmetic changes by the trial court.<sup>133</sup> Among the nineteen plaintiffs, seven initiated lawsuits in 2009, three in 2010, and nine in 2011. Eight of the plaintiffs are individuals, the rest are all privately-owned corporate entities. Among the defendant tax agencies, ten are STB bureaus, eight are LTB bureaus, and one

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<sup>130</sup> See CHINESE BUREAU OF STATISTICS, REPORTS BASED ON THE YEAR 2000 CONSENSUS, TABLE 1-1 <http://www.stats.gov.cn/tjsj/ndsj/renkoupucha/2000pucha/pucha.htm> (last visited Sept. 27, 2013).

<sup>131</sup> Cases on file with the author.

<sup>132</sup> Several of the trial court rulings omitted from publication are included in this total.

<sup>133</sup> One additional case was sent back to the trial court for a retrial after the procuratorate lodged a protest. See Yuanshen Yuangao Liuyongjian, Yang Feng Su Guangshan Xian Caizheng Ju Shuiwu Zhengshou Xingzheng Jiufen Yi An (刘永建、杨锋诉光山县财政局税务征收行政纠纷一案) [Liu & Yang v. Guangshan County Finance Department], (Henan Guangshan Cnty. Ct. 2010), [http://www.110.com/panli/panli\\_4014611.html](http://www.110.com/panli/panli_4014611.html) (last visited Sept. 28, 2013).



is a local finance department. Of the plaintiffs, 52.6% hired legal counsel, compared to 84.2% of the defendants.<sup>134</sup> Finally, none of the plaintiffs prevailed at the initial trial.

As discussed in the previous part, judicial bias and agency retaliation prevent escalation from disputes to administrative lawsuits. Tax agencies, however, do not enjoy unlimited power. Their jurisdiction is territorial and other powerful agencies check their power in the political system. Those that are able to avoid the heavy costs of agency retaliation may sue if substantial interests are at stake and no alternative resolutions are available. In addition, as in the resolution of all disputes, high transaction costs and plaintiffs' optimism may further contribute to the trial of administrative lawsuits against tax agencies in China. As will be shown, all of the cases in the analyzed sample contain one or more of these factors, in ways not necessarily mutually exclusive.

#### A. *Lack of Taxable Resources and Professional Whistleblowers*

Because tax agencies' authority is limited to taxable income and assets, those with low income are largely immune to any post-litigation retaliation by the agencies. In *Ren v. Zhengzhou STB Inspection Bureau*, the plaintiff, a tax whistleblower, reported suspected tax evasion by a furniture store to the local STB.<sup>135</sup> According to the factual findings of the case, the defendant investigated the reported violation, but failed to inform the plaintiff of the results.<sup>136</sup> The plaintiff alleged the STB inspection bureau violated the law by not fully disclosing the investigation and the penalties subsequently imposed.<sup>137</sup> The plaintiff in this case had a low-paying job, which exempted him from paying income taxes other than those withheld by his employer.<sup>138</sup> Without much to lose, he was therefore immune to retaliations by local tax agencies, which significantly reduced his actual litigation costs.

Nonetheless, low costs are costs. What are the plaintiffs' positive incentives for challenging powerful state agents in court? In the *Ren* case,

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<sup>134</sup> In two of these cases, it is not entirely clear whether the parties were represented by legal counsel.

<sup>135</sup> Renleiang Su *Zhengzhou Shi Guojia Shuiwu ju Jicha Ju Buluxing Fading Zhize Yi An Yishen Xingzheng Panjueshu* (任乐亮诉郑州市国家税务局稽查局不履行法定职责一案一审行政判决书) [*Ren v. Zhengzhou STB Investigation Bureau*] (Zhengzhou 27 Distr. Ct., Mar. 20, 2012), <http://www.31credit.com/caselaw/1056106.html>.

<sup>136</sup> *Id.*

<sup>137</sup> *Id.*

<sup>138</sup> Yunlong Zhao, "Yiyuan Jiangli" Jubaoren Ai Weiquan ["One Yuan Award" Informant Enjoys Rights-Protection], *JINAN TIMES* (Oct. 17, 2011), <http://news.sohu.com/20111017/n322393854.shtml>.

the plaintiff reported possible tax evasion of a local furniture store in order to receive a material reward.<sup>139</sup> Under current law, the state rewards a portion of the levies and fines subsequently assessed (capped at 5% of the deficiency) to tax whistleblowers who contribute to the tax evasion detection and prosecution.<sup>140</sup> In the *Ren* case, the plaintiff insisted on the disclosure about the penalty specifically so he could challenge the amount of his reward.<sup>141</sup> Article 20 of the Administrative Rules re Reporting Tax Violations, issued by the national office of the STB, provides that tax report centers should notify the informant of the investigation result, but only if he so requests.<sup>142</sup> In this case, the court ruled that the plaintiff did not make a clear request for investigation result, so the defendant was not obliged to inform him.<sup>143</sup>

In *Ren v. Luoyang Xigong District STB*, the same tax whistleblower directly challenged the amount the court rewarded him, which was in the amount of RMB 1, the equivalent of approximately USD 0.17.<sup>144</sup> The fact patterns of the two cases are similar: in each case, a merchant refused to issue invoices evidencing a purchase and the plaintiff reported the possible tax evasion to the local tax center.<sup>145</sup> In *Ren v. Luogong*, the plaintiff alleged that the tax inspection bureau failed to take necessary actions to investigate

<sup>139</sup> Renleliang Su Zhengzhou Shi Guojia Shuiwu ju Jicha Ju Buluxing Fading Zhize Yi An Yishen Xingzheng Panjueshu (任乐亮诉郑州市国家税务局稽查局不履行法定职责一案一审行政判决书) [Ren v. Zhengzhou STB Investigation Bureau] (Zhengzhou 27 Distr. Ct., Mar. 20, 2012), <http://www.31credit.com/caselaw/1056106.html>.

<sup>140</sup> 税收违法案件举报奖励办法 [Rules on Awards for Reporting Tax Law Violations] (July 27, 2005), <http://www.chinatax.gov.cn/n8136506/n8192153/n8192242/n8192667/n8194601/8248300.html>.

<sup>141</sup> See Renleliang Su Zhengzhou Shi Guojia Shuiwu ju Jicha Ju Buluxing Fading Zhize Yi An Yishen Xingzheng Panjueshu (任乐亮诉郑州市国家税务局稽查局不履行法定职责一案一审行政判决书) [Ren v. Zhengzhou STB Investigation Bureau] (Zhengzhou 27 Distr. Ct., Mar. 20, 2012), <http://www.31credit.com/caselaw/1056106.html>.

<sup>142</sup> Shuiwu Weifa Anjian Jubao Jiangli Banfa (税收违法案件举报奖励办法) [Rules on Awards for Reporting Tax Law Violations] (promulgated by the State Administration on Taxation, effective July 27, 2005), <http://www.chinatax.gov.cn/n8136506/n8192153/n8192242/n8192667/n8194601/8248300.html>.

<sup>143</sup> See Renleliang Su Zhengzhou Shi Guojia Shuiwu ju Jicha Ju Buluxing Fading Zhize Yi An Yishen Xingzheng Panjueshu (任乐亮诉郑州市国家税务局稽查局不履行法定职责一案一审行政判决书) [Ren v. Zhengzhou STB Investigation Bureau] (Zhengzhou 27 Distr. Ct., Mar. 20, 2012), <http://www.31credit.com/caselaw/1056106.html>.

<sup>144</sup> Yuangao Renleliang Su Beigao Luoyang Shi Xi Gongqu Guojia Shuiwu Ju Shuiwu Xingzheng Jiangli Yi An (原告任乐亮诉被告洛阳市西工区国家税务局税务行政奖励一案) [Ren v. Luoyang Xigong District STB] (Oct. 26, 2010), (on file with author). Video footage is available at <http://tv.hncourt.org/video/detail/court/0/id/10315> (last visited Sept. 30, 2013).

<sup>145</sup> Yuangao Renleliang Su Beigao Luoyang Shi Xi Gongqu Guojia Shuiwu Ju Shuiwu Xingzheng Jiangli Yi An (原告任乐亮诉被告洛阳市西工区国家税务局税务行政奖励一案) [Ren v. Luoyang Xigong District STB] (Oct. 26, 2010), (on file with author).

the case.<sup>146</sup> After repeated requests by the plaintiff, the bureau eventually found the reported merchant in violation of tax law and imposed a fine.<sup>147</sup> It then mailed a notice to the plaintiff of the reward of RMB 1 ( USD 0.17) for reporting the violation.<sup>148</sup> The tax whistleblower then filed a lawsuit to challenge the amount of the reward.<sup>149</sup> At trial, the lawyer for the tax bureau argued that if the law had been strictly followed, the reward would have been even lower (RMB 0.5, or USD 0.085).<sup>150</sup> In other words, the tax whistleblower had been excessively rewarded. The court ruled for the tax bureau, though it commented that the reward appeared unreasonably low.<sup>151</sup>

The meager award in this specific case was not the only incentive for the lawsuit, nor was the tax whistleblower solely after the legal right to be informed by tax agencies. To fully understand the plaintiff's motives, one has to look at the case in light of its social and legal context. The plaintiff was a member of an emerging group of professional whistleblowers who live on the material rewards received for being informants to government agencies or on compensations from caught violators.<sup>152</sup> Over the past two decades, the state has established a plethora of laws and regulations to sanction illegal practices such as selling fake products or tax evasion and provide material rewards to those who assist in enforcement of the law.<sup>153</sup> Such a modern-day bounty system can be found in the tax administration of most countries, including the United States. Because some of the rewards

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<sup>146</sup> Zhiqiang Huang, *Jubao Shangjia Taoshui Jinhuo Yiyuan Jiangli* (黄志强, 举报商家逃税仅获一元奖励, 东方早报) [*Reporting of Tax Violation Awarded One Yuan Only*], DONGFANG DAILY (Sept. 24, 2011), <http://www.dfdaily.com/html/33/2011/9/24/670404.shtml>.

<sup>147</sup> *Id.*

<sup>148</sup> *Id.*

<sup>149</sup> *Id.*

<sup>150</sup> *Id.*

<sup>151</sup> Yuangao Renleliang Su Beigao Luoyang Shi Xi Gongqu Guojia Shuiwu Ju Shuiwu Xingzheng Jiangli Yi An (原告任乐亮诉被告洛阳市西工区国家税务局税务行政奖励一案) [Ren v. Luoyang Xigong District STB] (Oct. 26, 2010) (on file with author). Video footage is available at: <http://tv.hncourt.org/video/detail/court/0/id/10315> (last visited Sept. 30, 2013).

<sup>152</sup> Zhengfang Tang, *Zhongguo Sanqian Zhiye Dajiaren: Qingjia Dangchan Chihaiichong* (中国 3000 职业打假人: 倾家荡产“吃害虫”) [*Three Thousand Professional Whistleblowers in China*], NANGUO DAILY (Jan. 22, 2008), <http://www.cctv.com/community315/special/C20532/20080122/104785.shtml>.

<sup>153</sup> See, e.g., *Zhōnghuá rénmin gònghéguó shípín ānquán fǎ* (中华人民共和国食品安全法) [Food Safety Law] (promulgated by order of the President of the People's Republic of China, Feb. 28, 2009, effective June 1, 2009), §96, [http://www.procedurallaw.cn/english/law/200903/t20090320\\_196425.html](http://www.procedurallaw.cn/english/law/200903/t20090320_196425.html); *Zhōnghuá rénmin gònghéguó xiāofèi zhě quán yì bǎohù fǎ* (中华人民共和国消费者权益保护法) [Law for the Protection of Consumer Rights] (promulgated by the National People's Congress, Oct. 31, 1993, effective Jan. 1, 1994), §49, <http://www.wipo.int/wipolex/en/details.jsp?id=8745>; Measures on Rewarding the Reporting of Tax Evasion (July 2005) at § 5 (on file with author).

are substantial<sup>154</sup> and non-compliance is rampant in China, some whistleblowers have engaged full-time in seeking out illegal practices and claiming compensation from the violators or rewards from relevant government agencies.<sup>155</sup>

This explains why the plaintiff in *Ren v. Luogong* sued for RMB 1 and refused to settle. Because caught violators fear negative publicity, it is easier for them to compensate a well-known litigious whistleblower directly. Whistleblowers are therefore incentivized to litigate cases that could receive intensive media coverage because this enhances their publicity and helps maintain a credible litigation threat to violators.<sup>156</sup> The media, though still subject to state control, often find stories about suing government officials interest-provoking.<sup>157</sup> After litigating the *Luogong* case, Mr. Ren quit his previous job and became devoted full-time to uncovering and reporting counterfeits and illegal commercial activities, earning enough to support his family.<sup>158</sup>

Among the nineteen plaintiffs who went to trial against tax agencies in Henan Province from 2009 to 2011, three were whistleblowers<sup>159</sup> who share a few common characteristics—namely that they were largely immune to potential agency retaliations due to their low and simple-sourced income. The extra-judicial costs of suing local officials were therefore lower for them than most other victims of abusive tax agents. In addition, some of the

<sup>154</sup> For instance, 2006 Nian Shuishou Jianmian He Weisheng Baojian Fa (2006 年税收减免和卫生保健法)[Tax Relief and Health Care Act of 2006] § 406 caps the reward at 30% of the recovered taxes.

<sup>155</sup> See Zhengfang Tang, *supra* note 152.

<sup>156</sup> *Xingzou zai Bianfengzhong de Zhiye Dajiarren* (行走在边缘中的职业打假人群) [*Professional Whistleblowers Walk on the Edge*], 379 PHOENIX WKLY. (2010).

<sup>157</sup> Daniela Stockmann & Mary E. Gallagher, *Remote Control: How the Media Sustain Authoritarian Rule in China*, 44 COMP. POL. STUD. 436 (2011).

<sup>158</sup> Shuxiang Chang & Jiwei Wan, *Bubihui Bieren Shuowo Kao Suopei Shenghuo, Jinbao Mianduimian zhi Dajian Renshi Ren Leliang* (不忌讳别人说我靠索赔生活 今报面对面的打假人士任乐亮, 东方今报) [*Not Afraid of Living on Whistleblowing, Jinbao Faces Whistleblower Ren Leliang*], DONGFANG DAILY (Mar. 13, 2012), <http://www.jinbw.com.cn/jinbw/xwzx/zsxx/201203137593.htm>.

<sup>159</sup> Renleliang Su Zhengzhou Shi Guojia Shuiwu ju Jicha Ju Buluxing Fading Zhize Yi An Yishen Xingzheng Panjueshu (任乐亮诉郑州市国家税务局稽查局不履行法定职责一案一审行政判决书) [*Ren v. Zhengzhou STB Investigation Bureau*] (Zhengzhou 27 Distr. Ct., Mar. 20, 2012), <http://www.31credit.com/caselaw/1056106.html>; Yuangao Wangpenghui Su Beigao Zhengzhou Shi Erqi qu Guojia Shuiwu Ju Jicha Ju Shuiwu Xingzheng Chuli Yi An Yishen Xingzheng Wenshu (原告王朋辉诉被告郑州市二七区国家税务局稽查局税务行政处理一案一审行政文书) [*Wang v. Zhengzhou 27 District STB Investigation Bureau*], (Henan Zhengzhou 27 District Court, Mar. 9, 2011) (on file with author); Jianguoqiang Su Henan Sheng Guojia Shuiwu Ju Bufu Fuyi Jueding Yi An Yishen Xingzheng Panjueshu (贾国强诉河南省国家税务局不服复议决定一案一审行政判决书) [*Jia v. Henan Provincial STB*] (Henan Zhengzhou Jinshui District Court, Aug. 15, 2011), <http://www.31credit.com/caselaw/651791.html>.

whistleblowers litigated *pro se* or with the assistance of fellow whistleblowers,<sup>160</sup> which further lowered the formal costs of litigation. Moreover, they were savvy users of public media, which protected them and eased negotiations for compensation.<sup>161</sup> However, while media coverage gives the whistleblowers additional incentives to sue, it also increases the stakes for the defendant agencies to prevail in the lawsuits. Furthermore, the agencies do not fully incorporate the costs of litigation as individual disputants. Therefore, in all three of the above mentioned cases initiated by the informants, the agencies engaged outside legal counsel, even in the case where the claim was for RMB 1.<sup>162</sup>

Though low-income earners are retaliation-proof, they are rarely seen in courts against tax agencies. This, however, should not be a surprise. If an individual barely survives above the subsistence level, little income is left for taxation. Therefore, the lack of interaction between low-income earners and tax collectors curtails the probability of conflicts between the two parties. Lawsuits do not exist without conflicts in the first place.

### B. *Limited Interaction with Tax Agencies*

Agency retaliation can be very costly if the complainant expects to interact with the agency for a long period of time. Therefore, the rational response to official malfeasance is often to take no action. However, if the complainant expects no further dealings with the agency, his or her exposure to retaliation is limited and litigation becomes an attractive option, especially if substantial interests are at stake.

The lawsuits by Wu Jishan and Li Wenfeng against the local STB of Xin County best illustrate this point.<sup>163</sup> Before filing the administrative lawsuit, the plaintiffs had spent years pursuing other paths towards a remedy.<sup>164</sup> After being laid off during the economic reform of the late 1990s, the plaintiffs invested all their savings and a significant amount of

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<sup>160</sup> See Jiaguoqiang Su Henan Sheng Guojia Shuiwu Ju Bufu Fuyi Jueding Yi An Yishen Xingzheng Panjueshu (贾国强诉河南省国家税务局不服复议决定一案一审行政判决书) [Jia v. Henan Provincial STB] (Henan Zhengzhou Jinshui District Court, Aug. 15, 2011), <http://www.31credit.com/caselaw/651791.html>.

<sup>161</sup> See *Xingzou zai Bianfengzhong de Zhiye Dajiaren*, *supra* note 156.

<sup>162</sup> See Zhiqiang Huang, *supra* note 146.

<sup>163</sup> Wujishan, Liwenfeng Yu Xin Xian Gongye He Xinxi Hua Ju, Xin Xian Gongshang Ju, Xin Xian Guojia Shuiwu Ju, Xin Xian Zhiliang Jishu Jiandu Ju Xingzheng Peichang Jiufen Yi An (吴继山、李文凤与新县工业和信息化局、新县工商局、新县国家税务局、新县质量技术监督局行政赔偿纠纷一案) [Wu Jishan & Li Wenfeng v. Xin County STB and Others for Administrative Compensation], (Henan Xin County Court, Feb. 28, 2011) (on file with author).

<sup>164</sup> *Id.*

borrowed money into a mobile gas station.<sup>165</sup> In 1999, they obtained all necessary licenses, permits, and tax registrations for the operation of the small business.<sup>166</sup> Yet, within a year of the approvals, a joint team of local government officials confiscated all of the plaintiff's permits and business licenses and forcefully shut down the gas station without any compensation.<sup>167</sup>

During this process, the officials used force and failed to follow legal procedures.<sup>168</sup> Having lost all of their investments, the plaintiffs began to petition through an alternative channel called "letter and visit" for redress, arguing that the confiscation and shutdown of their business was illegal.<sup>169</sup> Their efforts proved fruitless and Wu suffered a stroke in 2003.<sup>170</sup> When his health improved in 2008, they resumed their petition efforts.<sup>171</sup> The local officials negotiated with the plaintiffs and persuaded them to use the court to resolve the dispute.<sup>172</sup> The plaintiffs agreed that if the court accepted the case, they would cease petitioning through the letter and visit system.<sup>173</sup> With nothing to lose and their future livelihood at stake, the couple filed an application for an administrative reconsideration petition and then filed the lawsuit.<sup>174</sup>

The legal system, however, was not designed to accommodate such cases. The court ruled against the plaintiffs on the basis that the statute of limitations had run.<sup>175</sup> The whole adjudicatory process appears to have been another tactic of the local state to delay the case and add more costs to the plaintiffs' pursuit for justice. In addition, by enticing the plaintiffs in a legal battle they would certainly lose, the local state could label the plaintiffs' act "illegal." Embedded in local politics, trial courts generally cannot resist the pressure to cooperate and share the responsibilities of the politicians' illegal acts.<sup>176</sup>

As discussed earlier, a tax agency's control is limited to its own jurisdiction. Therefore, if a taxpayer's only contact with a tax jurisdiction is the holding of certain taxable assets, the interaction between the taxpayer

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<sup>165</sup> *Id.*

<sup>166</sup> *Id.*

<sup>167</sup> *Id.*

<sup>168</sup> *Id.*

<sup>169</sup> *Id.*

<sup>170</sup> *Id.*

<sup>171</sup> *Id.*

<sup>172</sup> *Id.*

<sup>173</sup> *Id.*

<sup>174</sup> *Id.*

<sup>175</sup> *Id.*

<sup>176</sup> See, e.g., Qinghua Wang, *supra* note 9.

and the tax agency ends when the ownership terminates, as was the case in *Chen v. Xingyang LBT*.<sup>177</sup> The taxpayer in that case sold all of his shares in a cemetery business to another individual.<sup>178</sup> The tax bureau of the district where the cemetery was located calculated his gains from the sale and levied heavy income taxes.<sup>179</sup> The plaintiff then filed a lawsuit challenging the calculation.<sup>180</sup> With all of the shares in the cemetery business sold and the only contact with the tax agency's jurisdiction terminated, the plaintiff freed himself from future agency retaliation and significantly reduced the extra-judicial costs of litigating the dispute.

Unlike professional whistleblowers who may litigate cases for a trivial amount of money, but high publicity, most taxpayers sue because large sums of money are at stake. In the *Chen* case, the retaliation-proof plaintiff challenged the assessed tax because it would have imposed a substantial financial burden on him<sup>181</sup> and he had nothing to lose through agency retaliation.

### C. *Substantial Interests at Stake and a Lack of Alternative Channels for Dispute Resolution*

Trial may also occur if the relationship between the complainant and the defendant tax agency has turned irremediably hostile. Hostility shuts down all less confrontational channels for resolving a conflict and litigation will add little extra cost to the complainant in such a situation. Also, if substantial interests are at stake, such as large sums of money, long-established reputations, or the survival of businesses, the lawsuit will likely go to trial, as illustrated in the following case.

In *Zhengzhou Boyu Ltd. v. Zhengzhou Zhongyuan District STB* and *Zhengzhou Boyu Ltd. v. Zhengzhou Zhongyuan District STB for Administrative Compensation*, the plaintiff was a new subsidiary of a national company in sales.<sup>182</sup> The subsidiary in *Zhengzhou* had encountered

<sup>177</sup> Chen Zhan Shengsu Henan Sheng Xingyang Shi Difang Shuiwu Ju Shuiwu Xingzheng Chufa Yi An Yishen Xingzheng Panjueshu (陈战胜诉河南省荥阳市地方税务局税务行政处罚一案一审行政判决书) [*Chen v. Xingyang LBT*], (Henan Xingyang Court, June 13, 2011) (on file with author).

<sup>178</sup> *Id.*

<sup>179</sup> *Id.*

<sup>180</sup> *Id.*

<sup>181</sup> *Id.*

<sup>182</sup> *Zhengzhou Bo Yu Youse Jinshu Luliao Youxian Gongsi Yu Zhengzhou Shi Zhongyuan Qu Guojia Shuiwu Ju Yi An* (郑州博宇有色金属炉料有限公司与郑州市中原区国家税务局一案) [*Zhengzhou Boyu Ltd. v. Zhengzhou Zhongyuan District STB*], (Henan Zhengzhou Intermediate Court, July 1, 2009) (on file with author); *Zhengzhou Bo Yu Youse Jinshu Luliao Youxian Gongsi Yu Zhengzhou Shi Zhongyuan Qu guojia Shuiwu Ju Xingzheng Peichang Yi An* (郑州博宇有色金属炉料有

numerous tax administrative problems since its establishment.<sup>183</sup> The plaintiff suspected that the STB local agent erected administrative barriers in order to assist the company's local competitor.<sup>184</sup> For instance, the defendant refused to register the plaintiff as a "general VAT taxpayer" or to properly issue VAT invoices to the plaintiff.<sup>185</sup>

Because of the wide discretion enjoyed by the tax agent, these administrative barriers were not per se illegal. The dispute that triggered the lawsuit was the tax agent's refusal to register the plaintiff as a regular general VAT taxpayer.<sup>186</sup> Under China's VAT system, newly-established companies often undergo a trial period.<sup>187</sup> For up to six months, the taxpayer conducts its business under the guidance of relevant tax agents.<sup>188</sup> The trial period ends when the agents consider the taxpayer capable of fulfilling its VAT-related tax obligations (such as properly distributing VAT invoices).<sup>189</sup> During the trial period, deduction for VAT is subject to delay because of the heightened scrutiny by the tax agency.<sup>190</sup> In this case, the local tax agent denied the plaintiff's application for registration as a regular general VAT taxpayer, citing its inability to obtain and issue VAT invoices properly.<sup>191</sup> The plaintiff company responded by publishing harsh criticisms of the tax agents on its company website.<sup>192</sup> The hostility between the two parties

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限公司与郑州市中原区国家税务局行政赔偿一案) [Zhengzhou Boyu Ltd. v. Zhengzhou Zhongyuan District STB for Administrative Compensation], (Henan Zhengzhou Intermediate Court, July 1, 2009 (on file with author).

<sup>183</sup> *Dui Zhongyuanqi Xushuizhen Guoshuiju De Zaici Tousushu* (对中原区须水镇国税局的再次投诉) [Second Petition About Zhongyuan District Xushui Township Stb], ZHENGZHOU BOYU LTD. (May 21, 2008), <http://www.myboyu.com/news/%E5%86%8D%E6%AC%A1%E6%8A%95%E8%AF%89%E4%B9%A6/tabid/1497/Default.aspx>.

<sup>184</sup> *Id.*

<sup>185</sup> *Id.*

<sup>186</sup> Zhengzhou Bo Yu Youse Jinshu Luliao Youxian Gongsi Yu Zhengzhou Shi Zhongyuan Qu Guojia Shuiwu Ju Yi An (郑州博宇有色金属炉料有限公司与郑州市中原区国家税务局一案) [Zhengzhou Boyu Ltd. v. Zhengzhou Zhongyuan District STB], (Henan Zhengzhou Intermediate Court, July 1, 2009) (on file with author).

<sup>187</sup> Guójiā shuìwù zǒngjú guānyú jiāqiáng xīn bàn shāngmào qīyè zēngzhí shuì zhēngshōu guǎnlǐ yǒuguān wèntí de jīnjí tōngzhī (国家税务总局关于加强新办商贸企业增值税征收管理有关问题的紧急通知) [STB Notice on Issues Regarding VAT Collection and Administration for Newly-Established Businesses] (repealed in 2010 by Administrative Rules On Vat General Taxpayer During Trial Period), <http://www.jincao.com/fa/17/law17.s132.htm> (last visited Oct. 14, 2013).

<sup>188</sup> *Id.* at § 3.

<sup>189</sup> *Id.*

<sup>190</sup> *Id.* at § 4.

<sup>191</sup> Zhengzhou Bo Yu Youse Jinshu Luliao Youxian Gongsi Yu Zhengzhou Shi Zhongyuan Qu Guojia Shuiwu Ju Yi An (郑州博宇有色金属炉料有限公司与郑州市中原区国家税务局一案) [Zhengzhou Boyu Ltd. v. Zhengzhou Zhongyuan District STB], (Henan Zhengzhou Intermediate Court, July 1, 2009) (on file with author).

<sup>192</sup> *Dui Zhongyuanqi Xushuizhen Guoshuiju De Zaici Tousushu*, *supra* note 183.



almost certainly ruled out the option of non-judicial resolution of their dispute.

Because the plaintiff filed a lawsuit against the local agent, the court rejected its application for administrative reconsideration immediately.<sup>193</sup> During trial and appeal, the plaintiff produced evidence, such as audio recordings of a key witness, to show that it had complied with the relevant regulations and that the defendant had abused its discretion.<sup>194</sup> The counsel for the defendant argued that the identity of the recorded person could not be verified so the audio evidence could not contradict the written testimony of the witness used by the defendant as evidence of VAT non-compliance.<sup>195</sup> Both the trial court and the appellate court, instead of exercising their judicial authority and verifying the identity of the key person, readily accepted the defendant counsel's technical argument and ruled for the tax agent.<sup>196</sup>

The plaintiff likely consulted its parent company's corporate counsel before filing the lawsuits.<sup>197</sup> Given the amount of evidence gathered from dealings with the defendant agency, the counsel was likely optimistic about winning the case and perhaps inspired the plaintiff's persistence in the trial and subsequent appeal. However, apparently fair evidentiary rules applied by a selectively passive court produced surprising results.

Similarly, in *Hua County Hongri Auto Ltd. v. Hua County LTB Chengguanzhongxin Tax Office* and the derivative lawsuit for administrative compensation, the relationship between the plaintiff and the defendant tax agency was broken prior to the filing of the lawsuits.<sup>198</sup> The plaintiff in these lawsuits registered with the local tax office in early 2007<sup>199</sup> but paid no taxes

<sup>193</sup> Zhengzhou Bo Yu Youse Jinshu Luliao Youxian Gongsì Yu Zhengzhou Shi Zhongyuan Qu Guojia Shuiwu Ju Yi An (郑州博宇有色金属炉料有限公司与郑州市中原区国家税务局一案) [Zhengzhou Boyu Ltd. v. Zhengzhou Zhongyuan District STB], (Henan Zhengzhou Intermediate Court, July 1, 2009) (on file with author).

<sup>194</sup> *Id.*

<sup>195</sup> *Id.*

<sup>196</sup> *Id.*

<sup>197</sup> *Dui Zhongyuanqì Xushuizhen Guoshuiju De Zaici Tousushu*, *supra* note 183.

<sup>198</sup> *See* Huá xiàn hóng rì chē yè yǒuxiàn gōngsī su huá xiàn dìfāng shuìwù jú chéngguān zhōngxīn shuìwù suǒ shuìwù xíngzhèng zhēngshōu yī àn èrshěn xíngzhèng pànjúeshū (滑县红日车业有限公司诉滑县地方税务局城关中心税务所税务行政征收一案二审行政判决书) [Hua County Hongri Auto Ltd. v. Hua County Ltb Chengguanzhongxin Tax Office Re Administrative Taking], (Anyang Intermediate Court) (on file with author); Shàngsù rén huá xiàn hóng rì chē yè yǒuxiàn gōngsī yīn yāoqiú huá xiàn dìfāng shuìwù jú chéngguān zhōngxīn shuìwù suǒ xíngzhèng péicháng yī àn èrshěn xíngzhèng pànjúeshū (上诉人滑县红日车业有限公司因要求滑县地方税务局城关中心税务所行政赔偿一案二审行政判决书) [Hua County Hongri Auto Ltd. v. Hua County Ltb Chengguanzhongxin Tax Office Re Administrative Compensation] (on file with author).

<sup>199</sup> *See* Huá xiàn hóng rì chē yè yǒuxiàn gōngsī su huá xiàn dìfāng shuìwù jú chéngguān zhōngxīn shuìwù suǒ shuìwù xíngzhèng zhēngshōu yī àn èrshěn xíngzhèng pànjúeshū (滑县红日车业有限公司诉滑

until May 2008 when the tax office issued a deficiency letter.<sup>200</sup> After the plaintiff failed to respond,<sup>201</sup> its legal representative was arrested under the charge of criminal tax evasion. He pled guilty and was sentenced to six months in jail with one year suspension and a fine of RMB 20,000 (approximately USD 3,000).<sup>202</sup> The plaintiff was also ordered to pay back taxes and tax penalty in the amount of more than RMB 20,000.<sup>203</sup> The criminal prosecution most likely closed the door for negotiation and settlement. Moreover, having suffered the criminal punishment, the plaintiff likely feared no further retaliation by local tax officials. With much at stake, the plaintiff filed administrative lawsuits against the tax agency.<sup>204</sup> After the trial court unsurprisingly dismissed the claims,<sup>205</sup> the plaintiff appealed.<sup>206</sup>

Upon appeal, the plaintiff's lawyer pointed out several major errors committed by the trial court, which included: 1) the court's disregard for the company's status as a newly established company (meaning the enterprise income tax should not have been imposed),<sup>207</sup> 2) the lack of a legal basis for levying real estate tax and land use tax (the evidence was collected during the criminal prosecution and after the administrative penalties had been levied),<sup>208</sup> and 3) the agency's failure to follow relevant legal procedures in providing most of the legal documents to the plaintiff, directly causing her failure to timely appeal the penalties and advance relevant legal claims.<sup>209</sup> The plaintiff asked the appellate court to reverse the trial court's ruling and to order compensation for her losses due to the defendant's illegal actions.<sup>210</sup>

The appellate court agreed with the trial court, even though the tax agency failed to provide sufficient evidence of its compliance with legal procedures.<sup>211</sup> The court emphasized that the criminal charges, unchallenged by the plaintiff, clearly established the validity of the tax penalties.<sup>212</sup>

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县地方税务局城关中心税务所税务行政征收一案二审行政判决书) [Hua County Hongri Auto Ltd. v. Hua County Ltb Chengguanzhongxin Tax Office Re Administrative Taking], (Anyang Intermediate Court) (on file with author).

<sup>200</sup> *Id.*

<sup>201</sup> *Id.*

<sup>202</sup> *Id.*

<sup>203</sup> *Id.*

<sup>204</sup> *Id.*

<sup>205</sup> *Id.*

<sup>206</sup> *Id.*

<sup>207</sup> *Id.*

<sup>208</sup> *Id.*

<sup>209</sup> *Id.*

<sup>210</sup> *Id.*

<sup>211</sup> *Id.*

<sup>212</sup> *Id.*

Another case sharing similar features is *Xin'an Huafeng Corp. v. Henan Xin'an STB for Administrative Compensation*, where the plaintiff sued local STB agents after its application for administrative compensation was rejected.<sup>213</sup> The application claimed that the tax agents forged documents causing the applicant and his company to be criminally prosecuted for tax evasion.<sup>214</sup> The plaintiff used to have close business relationships with the local government and had previously extended trade credits to two companies owned by the government.<sup>215</sup> By 1999, the two county-owned companies owed the plaintiff back payments totaling more than RMB 1.3 million.<sup>216</sup> When the debtors refused to pay back the loans, the plaintiff took them to court.<sup>217</sup> While the civil case was being litigated and the court put a lien on the debtors' assets, the plaintiff was arrested by Xin'an County police and prosecuted for tax evasion and fraud.<sup>218</sup> The county court found him guilty of both crimes and sentenced him to prison for six years, plus a fine of RMB 200,000.<sup>219</sup>

On appeal, the intermediate court sent the case back for retrial by the county court, which again found the plaintiff guilty of tax evasion, but dismissed the fraud charge.<sup>220</sup> The plaintiff was sentenced to three years in prison, with a three-year reprieve.<sup>221</sup> By the time the plaintiff was released on bail, he had spent seventeen months in jail.<sup>222</sup> The plaintiff then appealed the county court decision to the intermediate court, which affirmed the decision.<sup>223</sup> The tax evasion case was publicized that year as one of eight major cases in Henan Province.<sup>224</sup> The salience of the case and the

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<sup>213</sup> *Xin'an Huafeng Corp. V. Henan Xin'an STB for Administrative Compensation* (新安华峰中油销售公司诉河南省新安县国家税务局行政赔偿纠纷一案一审行政裁定书), (Henan Laocheng District Court) (on file with author).

<sup>214</sup> See *Xīn'ān huá fēng zhōngyóu xiāoshòu gōngsī sù hénán shěng xīn'ān xiàn guójiā shuìwù jú xíngzhèng péicháng jiūfēn yī àn yīshěn xíngzhèng cáiding shū* (新安华峰中油销售公司诉河南省新安县国家税务局行政赔偿纠纷一案一审行政裁定书) [*Xin'an Huafeng Corp. v. Henan Xin'an STB for Administrative Compensation*], (Henan Laocheng District Court) (on file with author).

<sup>215</sup> See *Henan Laoban Xiang Zhengfu Qiye Cuikuang Hou Bei Panxing, Baniang Hou Huo Qingbai* [*Henan Businessman Sentenced after Demanding Debt Payment from SOE, Acquittal After Eight Years*], DAOHE BAO (Oct. 13, 2010), [http://news.xinhuanet.com/legal/2010-10/13/c\\_12653610.htm](http://news.xinhuanet.com/legal/2010-10/13/c_12653610.htm).

<sup>216</sup> *Id.*

<sup>217</sup> *Id.*

<sup>218</sup> *Id.*

<sup>219</sup> *Id.*

<sup>220</sup> *Id.*

<sup>221</sup> *Id.*

<sup>222</sup> *Id.*

<sup>223</sup> *Id.*

<sup>224</sup> STATE ADMINISTRATION OF TAXATION, DAIHE BAO, TOUTAO KENGPAN GUOJIA SHUISHOU 1357.82 WANYUAN, BAQIYE HEIBANG YOUJING (偷逃坑骗国家税收 1357.82 万元 8 企业“黑榜”有名).”

endorsement by different levels of the local government made it difficult to reverse the judgment.

As noted earlier, the Chinese judicial system allows for the reopening or retrial of a case that has been decided by an appellate court. The lack of finality to the judicial process partially explains why some litigants persist on going to trial even though they fully expect to lose. With a possibility of favorable results at higher levels, taxpayers may litigate if the stakes involved are high enough. In the case described above, the plaintiff followed this path and petitioned the appellate court for a review of its own decision.<sup>225</sup> When the petition was rejected, he brought the complaint all the way to the provincial high court.<sup>226</sup> The high court accepted it in 2005, but waited until 2010 to render a ruling favorable to the plaintiff.<sup>227</sup>

The dramatic prosecution and subsequent quest for justice exhausted the plaintiff's wealth, insulating him for future costs of agency retaliation. Also, the prosecution by the county government inevitably resulted in deep hostility between the parties, closing all other channels for resolving their conflicts. Moreover, lengthy legal battles usually educate plaintiffs about how to navigate the judicial system, making them more inclined to sue.<sup>228</sup> With substantial interests at stake, the plaintiff filed lawsuits against a number of powerful local government agencies soon after the provincial high court reversed the lower decision.<sup>229</sup>

Litigation may also be the only option if the taxpayer is implicated in major corruption cases, as illustrated by *Zhumadian Yatai Shiye Ltd. v. Zhumadian LTB Inspection Bureau* and related cases.<sup>230</sup> All of the tax

大河报) [TAX EVASION OF 13.5782 MILLION YUAN, EIGHT COMPANIES ON BLACKLIST] (May 17, 2004), <http://www.chinatax.gov.cn/n8136506/n8136608/n9948163/10023706.html>.

<sup>224</sup> *Henan Laoban Xiang Zhengfu Qiye Cuikuang Hou Bei Panxing, Baniang Hou Huo Qingbai*, [Henan Businessman Sentenced after Demanding Debt Payment from SOE, Acquittal After Eight Years], DAOHE BAO (Oct. 13, 2010), [http://news.xinhuanet.com/legal/2010-10/13/c\\_12653610.htm](http://news.xinhuanet.com/legal/2010-10/13/c_12653610.htm).

<sup>225</sup> *Henan Laoban Xiang Zhengfu Qiye Cuikuang Hou Bei Panxing, Baniang Hou Huo Qingbai*, [Henan Businessman Sentenced after Demanding Debt Payment from SOE, Acquittal After Eight Years], Daohe Bao (Oct. 13, 2010), [http://news.xinhuanet.com/legal/2010-10/13/c\\_12653610.htm](http://news.xinhuanet.com/legal/2010-10/13/c_12653610.htm).

<sup>226</sup> *Id.*

<sup>227</sup> *Id.*

<sup>228</sup> See Mary E. Gallagher, *Mobilizing the Law in China: "Informed Disenchantment" and the Development of Legal Consciousness*, 40 LAW & SOC'Y REV. 783, 802-05 (2006).

<sup>229</sup> See, e.g., Yuángào lúshūmín, lúzhānfēng, zhānghuīlǐng, mèng dōngjiāng yīn yǔ bèigào xīn'ān xiàn chǎnyè jījù qū guǎnlǐ wěiyuánhui xíngzhèng péicháng yī àn de xíngzhèng yīshěn cáiding, (2011) luò xíng chū zì dì 6 hào (原告卢书民、卢占峰、张会玲、孟东江因与被告新安县产业集聚区管理委员会行政赔偿一案的行政一审裁定, (2011) 洛行初字第 6 号) [Lu et al v. Xin'an County Industrial District Administration Committee re Administrative Compensation] (2011) (on file with author).

<sup>230</sup> See Yuángào zhùmǎdiàn shì jīnfǎ jīngjì mào yì yǒuxiàn gōngsī bèigào hénán shěng zhùmǎdiàn shì dìfāng shuǐwù jú jīchá jú xíngzhèng chūfǎ yī àn (原告驻马店市金发经济贸易有限公司被告河南省驻马店

disputes behind these administrative lawsuits can be traced back to a series of bribery prosecutions, and the companies suspected of playing a facilitating role were investigated by several government agencies, including the LTB inspection bureau.<sup>231</sup> After the investigation, the tax agency levied heavy fines.<sup>232</sup> For instance, the LTB fined Yatai Shiye Ltd. about RMB 85 million and Jinfa Ltd. about RMB 20 million.<sup>233</sup> Several companies' assets were insufficient to pay the penalties, so the inspection bureau went after their shareholders in an attempt to pierce the corporate veil.<sup>234</sup>

The penalties were too heavy for the investigated companies to fully comply with, especially after huge sums had been transferred to a third party.<sup>235</sup> Because other channels for dispute resolution had been closed, the companies seemingly had no choice but to file administrative lawsuits challenging the penalties. Moreover, because they had lost all of their assets, the plaintiffs were immune to further retaliation. The initial set of trial court decisions contain simple dismissals of the complaints, with the

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店市地方税务局稽查局行政处罚一案) [Zhumadian Jinfa Jingji Maoyi Ltd. v. Henan Zhumadian LTB Inspection Bureau], (Henan Zhumadian City Yicheng District Court) (on file with author) [hereinafter Zhumadian Jinfa v. Henan Zhumadian]; Yuángào zhùmǎdiàn shì yà tài shíyè yǒuxiàn gōngsī bèigào hénán shěng zhùmǎdiàn shì difāng shuìwù jú jīchá jú xíngzhèng chūfā yī àn (原告驻马店市亚泰实业有限公司被告河南省驻马店市地方税务局稽查局行政处罚一案) [Zhumadian Yatai Shiye Ltd. v. Henan Zhumadian LTB Inspection Bureau], (Henan Zhumadian City Yicheng District Court) (on file with author) [hereinafter Zhumadian Yatai v. Henan Zhumadian]; Yuángào zhùmǎdiàn shì gāoxīn qū jīnmíng shāngmào yǒuxiàn gōngsī bèigào hénán shěng zhùmǎdiàn shì difāng shuìwù jú jīchá jú xíngzhèng chūfā yī àn (原告驻马店市高新区金明商贸有限公司被告河南省驻马店市地方税务局稽查局行政处罚一案) [Zhumadian Gaoxin District Jinming Shangmao Ltd. v. Henan Zhumadian LTB Inspection Bureau], (Henan Zhumadian City Yicheng District Court) (on file with author) [hereinafter Zhumadian Gaoxin v. Henan Zhumadian].

<sup>231</sup> See Hénán shěng zhùmǎdiàn shì difāng shuìwù jú jīchá jú shēnqǐng zhíxíng bèi zhíxíng rén zhùmǎdiàn shì yà tài shíyè yǒuxiàn gōngsī, bèi zhíxíng rén zhùmǎdiàn shì jīnfā mào yì fāzhǎn yǒuxiàn gōngsī zhíxíng yìyì cáidìng shū (河南省驻马店市地方税务局稽查局申请执行被执行人驻马店市亚泰实业有限公司、被执行人驻马店市金发贸易发展有限公司执行异议裁定书) [Henan Zhumadian LTB Inspection Bureau Motion for Execution Re Zhumadian Yatai Shiye Ltd. & Zhumadian Jinfa Maoyi Fazhan Ltd.], (Henan Zhumadian Intermediate Court) (on file with author).

<sup>232</sup> *Id.*

<sup>233</sup> *Id.*

<sup>234</sup> Zhōu nóngchǎng děng yǔ zhùmǎdiàn shì difāng shuìwù jú jīchá jú lànyòng gōngsī fǎrén dúlì dìwèi hé gùdōng yǒuxiàn zérèn péicháng jiūfēn yī àn (周农场等与驻马店市地方税务局稽查局滥用公司法人独立地位和股东有限责任公司赔偿责任纠纷一案) [Zhou Nongchang and Others v. Zhumadian LTB], (Henan High Court) (on file with author).

<sup>235</sup> See Hénán shěng zhùmǎdiàn shì difāng shuìwù jú jīchá jú shēnqǐng zhíxíng bèi zhíxíng rén zhùmǎdiàn shì yà tài shíyè yǒuxiàn gōngsī, bèi zhíxíng rén zhùmǎdiàn shì jīnfā mào yì fāzhǎn yǒuxiàn gōngsī zhíxíng yìyì cáidìng shū (河南省驻马店市地方税务局稽查局申请执行被执行人驻马店市亚泰实业有限公司、被执行人驻马店市金发贸易发展有限公司执行异议裁定书) [Henan Zhumadian LTB Inspection Bureau Motion for Execution Re Zhumadian Yatai Shiye Ltd. & Zhumadian Jinfa Maoyi Fazhan Ltd.], (Henan Zhumadian Intermediate Court) (on file with author).

court briefly noting that the statute of limitations had run and the plaintiffs failed to show cause.<sup>236</sup>

The plaintiffs appealed the trial court decisions, which were reversed by the appellate court and sent back for retrial.<sup>237</sup> The trial court again ruled in favor of the tax agency but this time on technical grounds.<sup>238</sup> The legal representatives of the plaintiff companies were fugitives wanted by the local police.<sup>239</sup> Unable to appear in court, they engaged a lawyer from Beijing, who was granted the power of attorney to litigate the cases against the local LTB.<sup>240</sup> During the retrial, the defendant argued that the lawyer could not prove that the seal and signatures on the engagement letters were authentic, taking advantage of the fact that the clients could not appear in court to testify.<sup>241</sup> The lawyer made the reasonable rebuttal that the defendant should bear the burden to prove that the prima facie valid seal and signatures were forged.<sup>242</sup> The court, however, sided with the tax agency and dismissed the cases.<sup>243</sup> The appellate court, apparently reluctant to step into a battle between the fugitives and the powerful local tax agency, upheld the trial court decisions this time.<sup>244</sup>

*Xinxiang Yungongmao Ltd. v. Weihui City LTB*<sup>245</sup> is further proof that litigation is the only available channel for dispute resolution when business relations with the government fail. In this case, the plaintiff challenged an enormous deficiency assessed by the city LTB.<sup>246</sup> The plaintiff's company

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<sup>236</sup> Yuángào zhùmǎdiàn shì gāoxīn qū jīnmíng shāngmào yǒuxiàn gōngsī bèigào hénán shěng zhùmǎdiàn shì dìfāng shuìwù jú jīchá jú xíngzhèng chūfá yī àn (原告驻马店市高新区金明商贸有限公司被告河南省驻马店市地方税务局稽查局行政处罚一案) [Zhumadian Gaoxin District Jinming Shangmao Ltd. v. Henan Zhumadian LTB Inpsection Bureau], (Henan Zhumadian City Yicheng District Court) (on file with author).

<sup>237</sup> See Zhumadian Yatai Shiye Ltd. for Administrative Punishment (驻马店市亚泰实业有限公司税务行政处罚一案二审行政裁定书), (Henan Zhumadian Intermediate Court) (on file with author); Zhumadian Gaoxin District Jinming Shangmao Ltd. for Administrative Punishment (驻马店市高新区金明商贸有限公司税务行政处罚一案二审行政裁定书), (Henan Zhumadian Intermediate Court) (on file with author); Zhumadian Jinfa Jingji Maoyi Ltd. for Administrative Punishment (驻马店市金发经济贸易有限公司税务行政处罚一案二审行政裁定书), (Henan Zhumadian Intermediate Court) (on file with author).

<sup>238</sup> *Id.*

<sup>239</sup> *Id.*

<sup>240</sup> *Id.*

<sup>241</sup> *Id.*

<sup>242</sup> *Id.*

<sup>243</sup> *Id.*

<sup>244</sup> *Id.*

<sup>245</sup> *Xinxiang Yungongmao Ltd. v. Weihui City LTB* Re (2009) 005 and (2010) 005 Punishment (新乡市运工贸有限公司不服被告卫辉市地方税务局卫地税罚(2009) 005号《税务行政处罚决定书》和卫地税罚(2010) 005号《税务行政处罚决定书》一审行政判决书), (Henan Weihui City Court) (on file with author).

<sup>246</sup> *Id.*

had at one point enjoyed close business ties with the local government.<sup>247</sup> The two parties agreed to set up a joint venture, but the local government failed to invest the prior stipulated amount of capital.<sup>248</sup> Instead of letting the joint venture dissolve, the local government granted the company tax deductions as replacement for the capital investment.<sup>249</sup> It also ordered other government agencies to allow the joint venture to pass annual examination and registration, despite insufficient equity.<sup>250</sup> At a certain point, the cooperative state-business relationship must have broken down because in 2004, the tax bureau issued the plaintiff a penalty for tax deficiency, which the plaintiff paid in full.<sup>251</sup> In 2009, the LTB again audited the company's accounts from 1995 to 2009, issued a deficiency notice with penalty, and broadcasted it on local television.<sup>252</sup> The accumulated hostility, the publicity of the tax controversy, and the substantial stakes for both parties made litigation the preferred option to resolve this dispute.

Following an administrative reconsideration decision in favor of the tax agency, the plaintiff filed the lawsuit and raised numerous legal issues, both procedural and substantive.<sup>253</sup> The plaintiff claimed that the "Notice of Tax Deficiency and Penalty" was issued twice and delivered ineffectively to one of the plaintiff's lawyers, who lacked the requisite special power of attorney.<sup>254</sup> The plaintiff also presented evidence that its tax registration had been revoked so that the defendant was partially responsible for the plaintiff's noncompliance and that some of the taxes were erroneously assessed.<sup>255</sup>

The court regarded these procedural and evidentiary issues as minor flaws that were not critical to the court's decision.<sup>256</sup> Upon appeal, the plaintiff made a similar technical argument about the illegality of the

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<sup>247</sup> *Id.*

<sup>248</sup> *Id.*

<sup>249</sup> *Id.*

<sup>250</sup> *Id.*

<sup>251</sup> *Id.*

<sup>252</sup> See Zhōnghuá Rénmín Gònghéguó Shuìshōu Zhēngshōu Guǎnlǐ Fǎ (中华人民共和国税收征收管理法) [Tax Collection Management Law] (promulgated by the Ninth National People's Congress, April 28, 2001, effective May 1, 2001), ch. 1, art. 1-2, [http://www.gov.cn/banshi/2005-08/31/content\\_146791.htm](http://www.gov.cn/banshi/2005-08/31/content_146791.htm).

<sup>253</sup> Xinxiang Shi Yun Gong Mao Youxian Gongsi Bufu Beigao Wei Hui Shi Difang Shuiwu Ju Wei Dishui Fa (2009) 005 Bao "Shuiwu Xingzheng Chufa Jueding Shu" He Wei Dishui Fa (2010) 005 Hao "Shuiwu Xingzheng Chufa Jueding Shu" Yishen Xingzheng Panjueshu, (新乡市运工贸有限公司不服被告卫辉市地方税务局卫地税罚 (2009) 005 号《税务行政处罚决定书》和卫地税罚 (2010) 005 号《税务行政处罚决定书》一审行政判决书) [Xinxiang Yungongmao Ltd. v. Weihui City LTB Re (2009) 005 and (2010) 005 Punishment], (Henan Weihui City Ct.) (on file with author).

<sup>254</sup> *Id.*

<sup>255</sup> *Id.*

<sup>256</sup> *Id.*

“Notice of Tax Deficiency and Penalty,” but the appellate court affirmed without engaging in any detailed legal discussion of these technicalities.<sup>257</sup>

*Zhoukou Huilin Zhiye Ltd. v. Zhoukou City LTB* is another case where a damaged business-government relationship resulted in administrative litigation.<sup>258</sup> The plaintiff, a real estate developer, held close personal relationships with former leaders of Zhoukou City.<sup>259</sup> The plaintiff worked on an infrastructure project in Zhoukou to which the municipal government promised capital investment.<sup>260</sup> However, instead of capital investment, the government decided to grant the plaintiff substantial tax benefits to cover the cost of the project due to a fiscal shortage.<sup>261</sup> Yet before the project was completed, the developer’s political allies left local politics due to job changes and criminal prosecutions for corruption.<sup>262</sup> After the project was completed, the plaintiff negotiated with the local LTB about the promised tax benefits, but the negotiation went slowly.<sup>263</sup> The loss of political protection likely explains the delay by the LTB in approving the tax benefits promised by the former local leaders. The plaintiff then engaged in self-help and reported zero revenue gain to the LTB for year 2008.<sup>264</sup> The LTB responded immediately by assessing a tax deficiency and imposing heavy

<sup>257</sup> Xinxiang Shi Yun Gong Mao Youxian Gongsi Su Wei Hui Shi Difang Shuiwu Ju Shuiwu Chuli Jueding Yi An Ershen Xingzheng Panjueshu, (新乡市运工贸有限公司诉卫辉市地方税务局税务处理决定一案二审行政判决书) [Xinxiang Yungongmao Ltd. v. Weihui City Ltb], (Xinxiang City Interm. Ct.) (on file with author).

<sup>258</sup> Zhoukou Hui Lin Zhiye Youxian Gongsi Bufu Zhoukou Shi Difang Shuiwu Ju Er Jiu Nian Si Yue Sanshi Ri Zuochu De Zhou Dishui Fu Bu Shou Zi (2009) Di 1 Bao Shuiwu Xingzheng Fuyi Bu Yu Shouli Jueding Shu Yi An, (周口汇林置业有限公司不服周口市地方税务局二〇〇九年四月三十日作出的周地税复不受字(2009)第1号税务行政复议不予受理决定书一案) [Zhoukou Huilin Zhiye Ltd. v. Zhoukou City LTB], (Zhoukou City Chuanhui Dist. Ct.) (on file with author).

<sup>259</sup> Hong Xin, 河南一开发商“非典型逃税”领4亿元天价罚单[A Henan Developer's "Extraordinary Tax Evasion" Penalty of 400 Million Yuan], 法制日报 [LEGAL DAILY] (Feb. 11 2010), <http://unn.people.com.cn/GB/14775/21684/10972241.html>.

<sup>260</sup> *Id.*

<sup>261</sup> The method may also reflect the government’s intention to bypass the public bidding procedure required for usual public projects.

<sup>262</sup> Zhanghaiqin Fan Shouhui Zui, Jue Caichan Laiyuan Buming Zui Yi An, (张海钦犯受贿罪、巨额财产来源不明罪一案) [Zhang Haiqin for Corruption], (Henan High Ct.) (on file with author) (plaintiff’s legal representative was also suspected for bribery). *See generally*, 河南省十届人大代表范学林涉嫌行贿将逮捕 [Tenth National People’s Congress of Henan Province will arrest Fanxue Lin for alleged Bribery], HENAN PEOPLE (Sep. 28, 2007, 7:53 AM), <http://henan.people.com.cn/news/2007/09/28/223934.html>.

<sup>263</sup> Hong Xin, 河南一开发商“非典型逃税”领4亿元天价罚单[A Henan Developer's "Extraordinary Tax Evasion" Penalty of 400 Million Yuan], 法制日报 [LEGAL DAILY] (Feb. 11, 2010), <http://unn.people.com.cn/GB/14775/21684/10972241.html>.

<sup>264</sup> *Id.*



penalties that exceeded RMB 400 million (USD 63 million).<sup>265</sup> The owner of the company was arrested and charged with criminal tax evasion.<sup>266</sup>

The plaintiff then filed a petition for administrative reconsideration.<sup>267</sup> The petition was rejected on the alleged basis that the plaintiff failed to pay the deficiency, which under current law is a precondition for administrative reconsideration of tax-related issues.<sup>268</sup> The plaintiff then sued the reconsideration body for the LTB.<sup>269</sup> The plaintiff produced the minutes of the municipal government meeting, which noted in writing that the costs incurred in the project should be covered by tax deductions.<sup>270</sup> The plaintiff argued that its investment should therefore be equivalent to the assessed deficiency and sufficient to satisfy the payment requirement for administrative reconsideration.<sup>271</sup> The court found that the minutes did not constitute a valid legal basis for tax deduction.<sup>272</sup> Given the political complexity of the case and the amount at stake, the court must have been reluctant to involve itself in the dispute and readily upheld the decision of the administrative reconsideration body, leaving the plaintiff without legal recourse.

Given the high stakes and lack of alternative resolution channels due to the change in local leadership, the plaintiff sued the LTB and several other powerful local government agencies.<sup>273</sup> As noted earlier, though the

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<sup>265</sup> *Id.*

<sup>266</sup> *Id.*

<sup>267</sup> Zhoukou Hui Lin Zhiye Youxian Gongsi Bufu Zhoukou Shi Difang Shuiwu Ju Er Jiu Nian Si Yue Sanshi Ri Zuochu De Zhou Dishui Fu Bu Shou Zi (2009) Di 1 Bao Shuiwu Xingzheng Fuyi Bu Yu Shouli Jueding Shu Yi An, (周口汇林置业有限公司不服周口市地方税务局二〇〇九年四月三十日作出的周地税复不受字(2009)第1号税务行政复议不予受理决定书一案) [Zhoukou Huilin Zhiye Ltd. v. Zhoukou City LTB], (Zhoukou City Chuanhui Dist. Ct.) (on file with author).

<sup>268</sup> Shuiwù xíngzhèng fùyì guīzé (税务行政复议规则) [Tax Rules for Administrative Reconsideration] (promulgated by the State Administration of Tax Bureau, Dec. 15, 2009, effective April 1, 2010), <http://www.chinatax.gov.cn/n8136506/n8136593/n8137537/n8138502/9563669.html>.

<sup>269</sup> Zhoukou Hui Lin Zhiye Youxian Gongsi Bufu Zhoukou Shi Difang Shuiwu Ju Er Jiu Nian Si Yue Sanshi Ri Zuochu De Zhou Dishui Fu Bu Shou Zi (2009) Di 1 Bao Shuiwu Xingzheng Fuyi Bu Yu Shouli Jueding Shu Yi An, (周口汇林置业有限公司不服周口市地方税务局二〇〇九年四月三十日作出的周地税复不受字(2009)第1号税务行政复议不予受理决定书一案) [Zhoukou Huilin Zhiye Ltd. v. Zhoukou City LTB], (Zhoukou City Chuanhui Dist. Ct.) (on file with author).

<sup>270</sup> *Id.*

<sup>271</sup> *Id.*

<sup>272</sup> *Id.*

<sup>273</sup> Zhoukou Hui Lin Zhiye Youxian Gongsi Yu Zhoukou Shi Guotu Ziyuan Ju Zuochu De Zhou Tu Fa Jue Zi (2009) 5 Hao Xingzheng Chufa Jueding Yi An, (周口汇林置业有限公司与周口市国土资源局作出的周土罚决字(2009)5号行政处罚决定书一案) [Zhoukou Huilin Zhiye Ltd. v. Zhoukou Bureau of State Land Administration], (Zhoukou City Chuanhui Dist. Ct.) (on file with author); Zhoukou Hui Lin Zhiye Youxian Gongsi Yu Zhoukou Shi Renmin Zhengfu Zhouzhengtu (2009) 132 Hao Xingzheng Jueding Yi An, (周口汇林置业有限公司与周口市人民政府周政土(2009)132号行政决定一案)

probability of prevailing in the trial court was minimal, the plaintiff might have held some hope for the intervention from the appellate and provincial high courts.<sup>274</sup> The plaintiff's case, however, rests on a very narrow legal basis. The promise of tax benefits recorded in the meeting minutes contradicts the Law on Tax Administration,<sup>275</sup> limiting the chance of reversal by a higher court.

The wealthy developer in this case had accumulated significant political capital before the onset of the confrontations with the LTB and other government agencies.<sup>276</sup> The close ties between the developer and the previous local leaders, which contributed to his early business success, turned against him when he lost political support and had to rely on the judiciary for protection. Had there been more transparency in his interaction with the local government and stronger legal basis for his claim, the result might have been different, as illustrated by the following case.

In *Liu & Yang v. Guangshan County Finance Department* and its retrial, the plaintiffs were also in the real estate business.<sup>277</sup> In July 2008, the plaintiffs won a public auction to develop commercial real estate on a lot in Guangshan County.<sup>278</sup> In September 2009, the county department of finance levied a tax of RMB 355,110 (USD 56,000) over the two plaintiffs for occupation and use of arable land.<sup>279</sup> The plaintiffs contended that the tax was levied erroneously because they purchased the land-use right from the county government, which had already converted the land from agricultural use to commercial and construction use. Plaintiffs also claimed that the Provisional Rules re Taxes for Occupation and Use of Agricultural Land and its implementation rules jointly issued by the State Council and the STB stipulated that the county government, as the party responsible for the

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[Zhoukou Huilin Zhiye Ltd. v. Zhoukou Municipal Government], (Zhoukou City Chuanhui Dist. Ct.) (on file with author).

<sup>274</sup> See Hong Xin, *supra* note 263. The provincial high court accepted the plaintiff's petition for review, but has not responded.

<sup>275</sup> See Zhōnghuá rénmin gònghéguó shuìshōu zhēngshōu guǎnlǐ fǎ (中华人民共和国税收征收管理法) [Tax Collection Management Law] (promulgated by the Ninth National People's Congress, April 28, 2001, effective May 1, 2001), [http://www.gov.cn/banshi/2005-08/31/content\\_146791.htm](http://www.gov.cn/banshi/2005-08/31/content_146791.htm).

<sup>276</sup> Hénán shěng shí jiè réndà dàibiāo fānxuélin shèxián xínghuì jiāng dàibǔ (河南省十届人大代表范学林涉嫌行贿 将逮捕) [Henan Provincial People's Congress Deputy to be Arrested for Bribery], HENAN PEOPLE (Sept. 28, 2007), <http://henan.people.com.cn/news/2007/09/28/223934.html>.

<sup>277</sup> Yuanshen Yuangao Liuyongjian, Yang Feng Su Yuanshen Beigao Guangshan Xian Caizheng Ju Shuiwu Zhengshou Xingzheng Jiufen Yi An, (原审原告刘永建、杨锋诉原审被告光山县财政局税务征收行政纠纷一案) [Liu & Yang v. Guangshan County Finance Department-Retrial], (Henan Guangshan County Ct. 2010) (on file with author).

<sup>278</sup> *Id.*

<sup>279</sup> The tax is still collected by the finance department in some localities.

conversion, should pay the tax.<sup>280</sup> Citing the STB Notice Regarding Certain Issues in the Collection of Land Occupation Tax, a normative document, the defendant county finance department argued that the party in actual use of the arable land should be liable for the tax.<sup>281</sup> The trial court ignored the conflict between the applicable law and the STB normative document (the judge actually determined that the two were consistent) and ruled against the plaintiffs.<sup>282</sup>

Instead of appealing the trial court decision, however, the plaintiffs applied for the procuratorate to lodge a protest, contending that the trial court relied on dubious evidence and applied the law erroneously.<sup>283</sup> The appellate court agreed with the procuratorate and sent the case back to the county court for retrial.<sup>284</sup> A different panel of trial judges acknowledged its mistake and ruled in favor of the plaintiffs.<sup>285</sup>

This case contrasts with *Zhoukou Huilin Zhiye Ltd. v. Zhoukou City LTB*.<sup>286</sup> In *Liu & Yang*, the plaintiffs won a bid at a public auction to develop a lot whereas in *Zhoukou Huilin* the plaintiff was designated by a local leader to invest in the infrastructural project.<sup>287</sup> The local governments levied heavy taxes on plaintiffs in both cases,<sup>288</sup> but the plaintiffs in *Liu &*

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<sup>280</sup> See Yuanshen Yuangao Liuyongjian, Yang Feng Su Yuanshen Beigao Guangshan Xian Caizheng Ju Shuiwu Zhengshou Xingzheng Jiufen Yi An, (原审原告刘永建、杨锋诉原审被告光山县财政局税务征收行政纠纷一案) [*Liu & Yang v. Guangshan County Finance Department-Retrial*], (Henan Guangshan County Ct. 2010) (on file with author).

<sup>281</sup> *Id.*

<sup>282</sup> *Id.*

<sup>283</sup> Yuanshen Yuangao Liuyongjian, Yang Feng Su Yuanshen Beigao Guangshan Xian Caizheng Ju Shuiwu Zhengshou Xingzheng Jiufen Yi An, (原审原告刘永建、杨锋诉原审被告光山县财政局税务征收行政纠纷一案) [*Liu & Yang v. Guangshan County Finance Department-Retrial*], (Henan Guangshan County Ct. 2010) (on file with author).

<sup>284</sup> *Id.*

<sup>285</sup> *Id.*

<sup>286</sup> Zhoukou Hui Lin Zhiye Youxian Gongsu Bufu Zhoukou Shi Difang Shuiwu Ju Er Jiu Nian Si Yue Sanshi Ri Zuochu De Zhou Dishui Fu Bu Shou Zi (2009) Di 1 Bao Shuiwu Xingzheng Fuyi Bu Yu Shouli Jueding Shu Yi An, (周口汇林置业有限公司不服周口市地方税务局二〇〇九年四月三十日作出的周地税复不受字(2009)第1号税务行政复议不予受理决定书一案) [*Zhoukou Huilin Zhiye Ltd. v. Zhoukou City LTB*], (Zhoukou City Chuanhui Dist. Ct.) (on file with author).

<sup>287</sup> See Hong Xin, *supra* note 263.

<sup>288</sup> Zhoukou Hui Lin Zhiye Youxian Gongsu Bufu Zhoukou Shi Difang Shuiwu Ju Er Jiu Nian Si Yue Sanshi Ri Zuochu De Zhou Dishui Fu Bu Shou Zi (2009) Di 1 Bao Shuiwu Xingzheng Fuyi Bu Yu Shouli Jueding Shu Yi An, (周口汇林置业有限公司不服周口市地方税务局二〇〇九年四月三十日作出的周地税复不受字(2009)第1号税务行政复议不予受理决定书一案) [*Zhoukou Huilin Zhiye Ltd. v. Zhoukou City LTB*], (Zhoukou City Chuanhui Dist. Ct.) (on file with author); Yuanshen Yuangao Liuyongjian, Yang Feng Su Yuanshen Beigao Guangshan Xian Caizheng Ju Shuiwu Zhengshou Xingzheng Jiufen Yi An, (原审原告刘永建、杨锋诉原审被告光山县财政局税务征收行政纠纷一案) [*Liu & Yang*

*Yang* faced less serious charges than the plaintiffs in *Zhoukou Huilin*.<sup>289</sup> Though it is unrealistic to completely rule out corruption in the public auction, it would certainly take more for the local state to challenge the legality of the auction procedure than the private deal in *Zhoukou Huilin*.

When disputes with the local governments involving substantial stakes arose, the plaintiffs in *Liu & Yang* were able to rely on formal law for remedy whereas the plaintiff in *Zhoukou Huilin* found formal law against its interests.<sup>290</sup> Though in both cases the local courts ruled in favor of the defendant local government agencies, the plaintiffs in the former solicited the assistance of both the procuratorate and the appellate court.<sup>291</sup> In *Zhoukou Huilin*, however, the plaintiff's prospect of success was more uncertain because higher courts, if reviewing the trial decision strictly in accordance with the law, would be unlikely to reverse the decision.

#### D. *Powerful Allies in the Political System*

As demonstrated by the reversal of trial court decision in *Liu & Yang*, the state is not monolithic. Power tends to be more fragmented at the municipal and provincial level, where the government structure is complex and extensive, and agencies have narrow and specialized jurisdictions. It is therefore possible for taxpayers to maintain good relationships with certain power holders and at the same time be antagonistic towards the tax agencies. Though Chinese courts exhibit systemic bias in favor of companies with political connections,<sup>292</sup> that bias is less serious when both disputants are

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v. Guangshan County Finance Department-Retrial], (Henan Guangshan County Ct. 2010) (on file with author).

<sup>289</sup> Yuanshen Yuangao Liuyongjian, Yang Feng Su Yuanshen Beigao Guangshan Xian Caizheng Ju Shuiwu Zhengshou Xingzheng Jiufen Yi An, (原审原告刘永建、杨锋诉原审被告光山县财政局税务征收行政纠纷一案) [*Liu & Yang v. Guangshan County Finance Department-Retrial*], (Henan Guangshan County Ct. 2010) (on file with author).

<sup>290</sup> Zhoukou Hui Lin Zhiye Youxian Gongsi Bufu Zhoukou Shi Difang Shuiwu Ju Er Jiu Nian Si Yue Sanshi Ri Zuochu De Zhou Dishui Fu Bu Shou Zi (2009) Di 1 Bao Shuiwu Xingzheng Fuyi Bu Yu Shouli Jueding Shu Yi An, (周口汇林置业有限公司不服周口市地方税务局二〇〇九年四月三十日作出的周地税复不受字(2009)第1号税务行政复议不予受理决定书一案) [*Zhoukou Huilin Zhiye Ltd. v. Zhoukou City LTB*], (Zhoukou City Chuanhui Dist. Ct.) (on file with author).

<sup>291</sup> Yuanshen Yuangao Liuyongjian, Yang Feng Su Yuanshen Beigao Guangshan Xian Caizheng Ju Shuiwu Zhengshou Xingzheng Jiufen Yi An, (原审原告刘永建、杨锋诉原审被告光山县财政局税务征收行政纠纷一案) [*Liu & Yang v. Guangshan County Finance Department-Retrial*], (Henan Guangshan County Ct. 2010) (on file with author).

<sup>292</sup> Michael Firth, et al., *The Effects of Political Connections and State Ownership on Corporate Litigation in China*, 54 J. OF LAW AND ECON. 573 (2011).

powerful or have powerful allies.<sup>293</sup> Fearing to offend either party, judges will carefully address issues raised by both, as illustrated in both the *Liu & Yang* retrial and the following case, *Shanghai Dazhong Auto Nanyang Sales and Service Ltd. v. Nanyang STB*.

1. *Politically-Connected Individuals Use the Law to Protect and Extend Their Interests*

In *Shanghai Dazhong Auto Nanyang Service Ltd. v. Jiang Sujian*,<sup>294</sup> the plaintiff company had a history of contested ownership. Originally owned and managed by the regional military division, the company went through a management buyout in 2003 to implement a state policy.<sup>295</sup> Jiang, the officer who had managed the company before the sale, purchased a majority of the offered shares with a loan of RMB 3.7 million from Wang.<sup>296</sup> The loan agreement stipulated that Jiang would transfer 80% of the purchased shares to Wang, but continue to serve as board director for three years after the buyout.<sup>297</sup>

Disputes arose when Jiang refused to transfer the shares to Wang. Instead of suing Jiang for breach of contract, Wang presented the loan agreement to the local bureau of industry and commerce, which allowed him to change the corporate ownership structure and to appoint himself board director.<sup>298</sup> Though his approval was legally required, Jiang did not know of these changes until he lost control of the company.<sup>299</sup> In December 2004, Jiang filed an administrative lawsuit against the local bureau of industry and commerce, seeking revocation of the new business license and restoration of the previous one.<sup>300</sup> The trial court ruled in favor of Jiang.<sup>301</sup> Both the defendant and Wang appealed the decision to the provincial high court, which reversed the trial court decision.<sup>302</sup> As noted earlier, an appellate

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<sup>293</sup> Ji Li, *When Are There More Laws? When Do They Matter? Using Game Theory to Compare Laws, Power Distribution, and Legal Environments in the United States and China*, 16 PAC. RIM L. & POL'Y J. 335, 347 (2007).

<sup>294</sup> Shanghai Dazhong Qiche Nanyang Xiaoshou Fuwu Youxian Gongsi, Jiangshujian Yin Qinquan Jiufen Yi An Ershen Minshi Caiding Shu, (上海大众汽车南阳销售服务有限公司、姜书建因侵权纠纷一案二审民事裁定书) [*Shanghai Dazhong Auto Nanyang Service Ltd. v. Jiang Sujian*], (Nanyang Interm. Ct.) (on file with author).

<sup>295</sup> *Id.*

<sup>296</sup> *Id.*

<sup>297</sup> *Id.*

<sup>298</sup> *Id.*

<sup>299</sup> *Id.*

<sup>300</sup> *Id.*

<sup>301</sup> *Id.*

<sup>302</sup> *Id.*

decision, though final in theory, may be further challenged through a petition for a retrial.<sup>303</sup> Jiang filed such a petition, and the high court reviewed and reversed its own earlier judgment.<sup>304</sup>

Armed with the favorable high court judgment, Jiang went to the local Bureau of Industry and Commerce to negotiate the restoration of the original business license for Nanyang Auto.<sup>305</sup> Wang, informed of Jiang's whereabouts, sent a group of people to harass him.<sup>306</sup> Jiang was beaten in the government building, for which Wang was arrested and jailed for seven days.<sup>307</sup> Unsatisfied with the "harsh" punishment, Wang filed an administrative lawsuit against the local police.<sup>308</sup> The trial court found sufficient evidence to uphold the police's administrative action.<sup>309</sup> Wang then appealed and the appellate court affirmed.<sup>310</sup>

## 2. *Fearing Both Parties, the Court in Nanyang Auto Conducted a Careful, Balanced Analysis*

Having participated in numerous civil and administrative lawsuits at all levels of the provincial judiciary, Wang understood how the Chinese legal system operated in practice.<sup>311</sup> He also had allies in the local state, evidenced by the assistance he received from the Bureau of Industry and Commerce and the nominal punishment he received for organizing an assault on Jiang in a government building.<sup>312</sup> Well-connected individuals

<sup>303</sup> See *Zhōnghuá rénmín gònghéguó xíngzhèng sùsòng fǎ* (中华人民共和国行政诉讼法) [Administrative Procedure Law] (promulgated by the Seventh National people's Congress, April 4, 1989, effective Oct. 1, 1990), art. 62.

<sup>304</sup> Qian Wu & Ning Wang, *Nanyang Administrative Suit Settled after Five Years, Nanyang Bic Lost* (南阳民告官案5年之后尘埃落定 南阳工商局败诉), HENAN LEGAL REP. (河南法制报) (Dec. 25, 2009), [http://news.shangdu.com/101/2009/12/25/2009-12-25\\_300054\\_101.shtml](http://news.shangdu.com/101/2009/12/25/2009-12-25_300054_101.shtml).

<sup>305</sup> *Shanghai Dazhong Auto Nanyang Service Ltd. v. Jiang Sujian* (上海大众汽车南阳销售服务有限公司、姜书建因侵权纠纷一案二审民事裁定书), (Nanyang Intermediate Court) (on file with author).

<sup>306</sup> *Wang Guihua v. Nanyang Public Security Bureau Wancheng Branch* (王贵华诉南阳市公安局宛城分局不服行政处罚一案一审行政判决书), (Nanyang City Wancheng District Court) (on file with author).

<sup>307</sup> *Id.*

<sup>308</sup> *Id.*

<sup>309</sup> *Id.*

<sup>310</sup> *Wang Gui Huawei Zhian Xingzheng Chufa I An Ershen Xingzheng Panjueshu* (王贵华为治安行政处罚一案二审行政判决书), [Wang Guihua Security Administrative Punishment for the Case of Second Instance Administrative Judgments], (Henan Nanyang Intermediate Ct. 2010) (on file with author).

<sup>311</sup> See Gallagher, *supra* note 228, for a general empirical discussion of the effect of personal experience of litigation on the inclination to sue.

<sup>312</sup> See *Shanghai Dazhong Qiche Nanyang Xiaoshou Fuwu Youxian Gongsi, Jiangshujian Yin Qinquan Jiufen Yi An Ershen Minshi Caiding Shu* (上海大众汽车南阳销售服务有限公司、姜书建因侵

such as Wang are largely immune to extra-judicial agency retaliation; therefore, when the local STB sent Nanyang Auto a notice of deficiency, Wang reacted by applying for administrative reconsideration.<sup>313</sup> The reconsideration body nullified the local STB's assessment of deficiency, citing insufficient consideration of all relevant evidence.<sup>314</sup> After amending its calculation, the local STB sent Nanyang Auto another deficiency letter, which was then upheld by the reconsideration body. Nanyang Auto, controlled by Wang,<sup>315</sup> then filed an administrative lawsuit against the local STB.<sup>316</sup> When the trial court rendered a decision that was not entirely in its favor, Nanyang Auto appealed.<sup>317</sup> The appellate court sent the case back for retrial.<sup>318</sup>

Upon retrial of this tax-related administrative case, the court conducted a thorough analysis of relevant facts and laws.<sup>319</sup> Of the five major issues disputed between the two parties, the focus was on two issues: 1) whether the local STB could determine tax deficiency based on transaction slips bearing the signatures of Nanyang Auto staff and 2) whether the penalties levied were legal in procedure.<sup>320</sup> The court rendered a judgment that appeared to be only partially favorable to the plaintiff in that the court upheld three STB decisions.<sup>321</sup> However, the plaintiff was actually victorious because the court sided with Nanyang Auto on the two major issues.<sup>322</sup> The court approved the trial court adjudicatory committee's judgment, indicating an exercise of caution.<sup>323</sup>

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权纠纷一案二审民事裁定书) [Shanghai Dazhong Auto Nanyang Service Ltd. v. Jiang Sujian], (Nanyang Intermediate Ct. 2011) (on file with author); *Wangguihua Su Nanyang Shi Gong'an Ju Wan Cheng Fenju Bufu Xingzheng Chufa Yi An Yishen Xingzheng Panjueshu* (王贵华诉南阳市公安局宛城分局不服行政处罚一案一审行政判决书) [Wang Guihua v. Nanyang Public Security Bureau Wancheng Branch], (Nanyang City Wancheng District Ct. 2010) (on file with author).

<sup>313</sup> Yuangao Shanghai Dazhong Qiche Nanyang Xiaoshou Fuwu Youxian Gongsi Bufu Beigao Nanyang Shi Guojia Shuiwu Ju Shuiwu Xingzheng Zhengshou Chufa Yi An De Yishen Xingzheng Panjueshu (原告上海大众汽车南阳销售服务有限公司不服被告南阳市国家税务局税务行政征收处罚一案的一审行政判决书) [Plaintiff Shanghai Volkswagen Sales & Service Co., Ltd. Nanyang Nanyang City, State Revenue Against the Defendant Tax Administrative Penalties Levied a Case of First Instance Administrative Judgments], (Henan Provincial High Ct. 2009) (on file with author).

<sup>314</sup> *Id.*

<sup>315</sup> *Id.*

<sup>316</sup> *Id.*

<sup>317</sup> *Id.*

<sup>318</sup> *Id.*

<sup>319</sup> *Id.*

<sup>320</sup> *Id.*

<sup>321</sup> *Id.*

<sup>322</sup> *Id.*

<sup>323</sup> *Id.*

Unlike the defendant tax agency in *Liu & Yang*, the STB appealed the decision in *Nanyang Auto*.<sup>324</sup> The practice of signing slips was common in the auto service industry and the slips were often the only written evidence of a transaction.<sup>325</sup> If the trial court decision was upheld, the SATs would inevitably incur significant costs in proving underreported revenues by auto service providers. The appellate court reversed the trial court decision over the validity of the evidence used by the STB.<sup>326</sup> *Nanyang Auto*, however, was relieved from any penalty for underpaying taxes.<sup>327</sup> The reason for nullifying the penalty was completely procedural. The penalty was nullified because it was not delivered with a notice of the taxpayer's right to a hearing.<sup>328</sup>

This is in strong contrast to other judgments pertaining to issues about procedural legality. In cases where plaintiffs pointed out defendant tax agencies' procedural flaws in carrying out their duties, the court either bypassed the issues or treated them as innocuous.<sup>329</sup> Yet in a case where a politically-connected plaintiff had abundant litigation experiences, support from within the state, and resources to distribute, procedural issues were crucial.

#### E. High Transaction Costs

Settlement may also be unattainable if the substantial interests of a third party are involved in a dispute and its resolution is a zero-sum game between the taxpayer and the third party. Such situations have a much higher transaction cost for negotiating a settlement.

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<sup>324</sup> Shangsū Ren Nanyang Shi Guojia Shuiwu Ju Yin Yishen Yuangao Shanghai Dazhong Qiche Nanyang Xiaoshou Fuwu Youxian Gongsi Su Yishen Beigao Nanyang Shi Guojia Shuiwu Ju Shuiwu Xingzheng Chuli Chufa Jiufen Yi An Ershen Xingzheng Panjueshu (上诉人南阳市国家税务局因一审原告上海大众汽车南阳销售服务有限公司诉一审被告南阳市国家税务局税务行政处理、处罚纠纷一案二审行政判决书) [*Nanyang STB v. Shanghai Dazhong Auto Nanyang Sales and Service Ltd.*], (Henan Nanyang Intermediate Ct. 2009) (on file with author).

<sup>325</sup> *Id.*

<sup>326</sup> *Id.*

<sup>327</sup> *Id.*

<sup>328</sup> *Id.*

<sup>329</sup> See, e.g., Zhengzhou Bo Yu Youse Jinshu Luliao Youxian Gongsi Yu Zhengzhou Shi Zhongyuan Qu Guojia Shuiwu Ju Yi An (郑州博宇有色金属炉料有限公司与郑州市中原区国家税务局一案) [*Zhengzhou Boyu Ltd. v. Zhengzhou Zhongyuan District STB*], (2009) (on file with author); Xinxiang Shi Yun Gong Mao Youxian Gongsi Bufu Beigao wei Hui Shi Difang Shuiwu Ju Wei Dishui Fa (2009) 005 hao "Shuiwu xingzheng chufa Jueding Shu" Yishen Xingzheng Panjueshu (新乡市运工贸有限公司不服被告卫辉市地方税务局卫地税罚(2009)005号《税务行政处罚决定书》和卫地税罚(2010)005号《税务行政处罚决定书》一审行政判决书) [*Xinxiang Yungongmao Ltd. v. Weihui City LTB Re (2009) 005 and (2010) 005 Punishment*], (Henan Weihui City Ct. 2011) (on file with author).



In *Wang v. Zhengzhou 27 District STB Investigation Bureau*, a professional whistleblower reported tax evasion of an electronics store and disagreed with the subsequent taxes and penalties imposed by the defendant tax agency.<sup>330</sup> The court granted the defendant tax agency's motion to join the electronic store as a third party in the case.<sup>331</sup> The store management had significant stakes in trying the case because the same commercial practice had been reported by other whistleblowers.<sup>332</sup> The high transaction costs for settling a case involving third parties with high stakes in going to trial diminished the chance of a negotiated settlement.

Another example of high transaction costs preventing settlement is *Hengxin Real Estate Development Ltd. v. Jiyuan LBT*, in which the plaintiff entered into a contract with two other parties (individual A and company A, where individual A is 99% shareholder of company A) to invest in a real estate development project.<sup>333</sup> In exchange for the plaintiff's capital investment, individual A agreed to cede control of company A to the plaintiff.<sup>334</sup> Upon closing, the plaintiff received possession of all the company seals, licenses, and registrations.<sup>335</sup> Not long after the deal, the partnership broke and the plaintiff ceased its investment.<sup>336</sup> In order to regain control, Company A published an advertisement in a local newspaper claiming that it had lost the company's seals and registration documents.<sup>337</sup> The publication was a necessary precondition for the company to obtain new registrations.<sup>338</sup> Alerted by the advertisement, the plaintiff reported to the defendant LBT its possession of the registration and requested that the agency not issue new registration documents to company A.<sup>339</sup> The agency allegedly agreed to investigate.<sup>340</sup> However, when company A applied for

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<sup>330</sup> Yuangao Wangpenghui Su Beigao Zhengzhou Shi erqi Qu Guojia Shuiwu Ju Jicha Ju Shuiwu Xingzheng Chuli Yi An Yishen Xingzheng Wenshu (原告王朋辉诉被告郑州市二七区国家税务局稽查局税务行政处理一案一审行政文书) [Wang v. Zhengzhou 27 District STB Investigation Bureau], (Henan Zhengzhou 27 District Ct. 2011) (on file with author).

<sup>331</sup> *Id.*

<sup>332</sup> Jiaguoqiang Su Henan Sheng Guojia Shuiwu Ju Bufu Fuyi Jueding Yi An Yishen Xingzheng Panjueshu (贾国强诉河南省国家税务局不服复议决定一案一审行政判决书) [Jia v. Henan Provincial STB], (Henan Zhengzhou Jinshui District Ct. 2011) (on file with author).

<sup>333</sup> Yuangao XinXiang Shi Hengxin Fangdichan Kaifa Youxian Gongsi Su Beigao Jiyuan Shi Difang Shuiwu Ju Shuiwu Dengji Banfa Zhengzhao Yi An Yishen Xingzheng Panjueshu (原告新乡市恒信房地产开发有限公司诉被告济源市地方税务局税务登记颁发证照一案一审行政判决书) [Xinxiang City Hengxin Real Estate Development Ltd. v. Jiyuan LTB], (Henan Jiyuan Ct. 2011) (on file with author).

<sup>334</sup> *Id.*

<sup>335</sup> *Id.*

<sup>336</sup> *Id.*

<sup>337</sup> *Id.*

<sup>338</sup> *Id.*

<sup>339</sup> *Id.*

<sup>340</sup> *Id.*

new registration, the agency not only approved it but also allowed changes to the corporate registration that nullified the initial contract between the plaintiff and company A.<sup>341</sup>

The plaintiff sued the LBT for approving the registration changes and asked the court to revoke the new registration.<sup>342</sup> The court ruled against the plaintiff, noting that the contractual agreement between the plaintiff and the tax agency was not binding and that the agency did not violate any procedural or substantive law in approving the registration changes.<sup>343</sup> The plaintiff in this case was located in a different city from the LTB and the failed investment was its one-time interaction with the defendant's jurisdiction.<sup>344</sup> Therefore, it was unlikely that the defendant LTB would retaliate against the plaintiff. A trial was probably the only viable option given that the action concerned a third party (company A), substantial interests were at stake, and the zero-sum nature of the dispute. Furthermore, real estate developers command substantial political and economic resources, enabling them to hire counsel and mount legal challenges to local government officials.

In sum, the substantive survey of the tax-related administrative lawsuits in Henan Province from 2009 to 2011 illustrates the major reasons behind a complainant's decision to go to trial. The cases show a strong judicial bias favoring the tax agencies that, coupled with the high costs of agency retaliation, explains the acute reluctance to sue tax agencies in China. However, if a party can prevent or evade the retaliation, litigation may be a preferred option when substantial interests are at stake and other channels prove costly or unavailable. Because of the limits to a tax agency's power and discretion, such defense to retaliation may exist in situations where the complainant expects no future interaction with the agency, owns little taxable income or assets in the agency's jurisdiction, or has powerful allies in the political system. In addition, even when a party is not resistant to retaliation, a damaged relationship with tax agencies can lead to litigation if high stakes are involved. In that case, the hostility has shut down non-judicial channels to resolve conflicts, and litigation adds little extra costs for the complainant. Moreover, general factors from conventional trial selection theories, such as high transaction costs and disputants' optimism, apply as well. The cases analyzed in this part substantiate these arguments and illustrate how the theoretical factors work in different factual settings.

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<sup>341</sup> *Id.*

<sup>342</sup> *Id.*

<sup>343</sup> *Id.*

<sup>344</sup> The Plaintiff is registered in Xinxiang City and the defendant's jurisdiction is in Jiyuan City.

## VII. CONTRIBUTIONS OF THE RESEARCH

This part briefly discusses the contributions of this study to three literatures: tax administration in China, administrative litigation in China, and the selection of cases for trial.

### A. *Tax Administration in China*

Professor Cui points out that the current tax administration in China operates on a feeble legal basis. Taxpayers in general prefer interacting with tax agents to obtain information about tax law compliance and enforcement, and few go to court to resolve disputes.<sup>345</sup> As noted earlier, a mere 405 lawsuits were filed in 2011 against tax agencies in all of China.<sup>346</sup> Even fewer cases were filed in 2009 and 2010—293 and 398 respectively.<sup>347</sup> Furthermore, plaintiffs withdrew most of the lawsuits. This study offers a few explanations for the general reliance by Chinese taxpayers on informal institutions, such as personal interactions with tax agents, instead of courts, for tax compliance and dispute resolution in China, and the difficulties for the two paths to converge.

For reasons listed below, current interactions between taxpayers, tax agents and the courts reflect an equilibrium that resists swift changes. The equilibrium is conditioned on: 1) taxpayers failing to comply with tax laws and regulations, 2) tax agents enjoying great flexibility in administration and facing low risk of punishment for abusing their discretion, and 3) courts enforcing the law loosely and with strong bias in favor of the tax agents. Several structural factors determine the quasi-legal equilibrium for taxation in China.

First, from a taxpayer's perspective, full compliance with Chinese tax law is costly due to conflicting and ambiguous legal authorities (e.g., *Liu & Yang* and *Nanyang Auto*), gaps between business practice and what is required by the law (e.g., *Nanyang Auto* and *Zhoukou Huilin*), and high formal tax burdens. As noted by a local tax agent, "most companies would go under if they had to pay all the taxes required by law."<sup>348</sup> Moreover, tax evasion is pervasive.<sup>349</sup>

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<sup>345</sup> See Wei Cui, *supra* note 37.

<sup>346</sup> See SUMMARY OF FIRST INSTANCE ADMINISTRATIVE LAWSUITS IN CHINA, *supra* note 4.

<sup>347</sup> See Haibo He, *supra* note 9.

<sup>348</sup> See Qian Wang & Xuena Li, *supra* note 65.

<sup>349</sup> Jinyan Li, *Tax Transplants and Local Culture: A Comparative Study of the Chinese and Canadian GAAR*, 11 THEORETICAL INQUIRIES IN LAW 655, 683 (2010).

From the angle of tax agents, on the other hand, wide discretion is necessary for tax administration because of their multiple concerns with local business development, meeting revenue targets, personal connections with the taxpayers, and rampant tax evasion. Exercising this discretion often results in lax enforcement or violations of the law.<sup>350</sup>

Meanwhile, when balancing noncompliance by taxpayers and violations of law by tax agents, weak Chinese courts easily side with the latter, finding their violations minor and innocuous or completely sidestepping the issues (e.g., *Zhengzhou Boyu Ltd.*). In addition, the gap between business practices in China that de-emphasize formality on the one hand and the formal evidentiary, and procedural rules required for litigation on the other, curbs the role of the courts and provides reluctant judges with easy exits from adjudicating difficult administrative lawsuits (e.g., *Zhoukou Huilin*).

As illustrated by the trivial number of tax-related administrative lawsuits filed each year, tax administration and dispute resolution are quite stable. If a shift to a law-based equilibrium is considered a desirable policy goal, the state should coordinate changes to all the three parties and the institutional contexts in which they act, including: 1) a reduction of formal tax burdens and clarification of legal authorities that will reduce compliance costs for taxpayers, 2) preventing post-litigation retaliation by tax agencies,<sup>351</sup> and 3) encouraging judicial activism and independence in deciding administrative cases.

Though the equilibrium is stable, this study nonetheless suggests that certain institutional conditions will nudge China towards a more law-oriented society. As illustrated by the contrast between the *Liu & Yang* case and the *Zhoukou Huilin* case,<sup>352</sup> private Chinese companies can lower their risks by conducting business in compliance with basic laws and regulations,

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<sup>350</sup> Wang Xiang-kun, *Wógúo shuìwù zhífǎ zhōng cúnzài de wèntí jí duìcè yánjiū* (我国税务执法中存在的问题及对策研究) [Enforcement of Tax Problems and Countermeasures: Research on Problems and Countermeasures in China Tax Administration], CHINA LAW INFO, [http://www.cftl.cn/show.asp?a\\_id=6861](http://www.cftl.cn/show.asp?a_id=6861) (last visited October 14, 2013).

<sup>351</sup> Plaintiffs in any tax-related administrative lawsuits should receive heightened protection from abuse of power by defendant tax agencies and their related parties. For instance, if a taxpayer sues a LTB and the case is fully adjudicated at the taxpayer's insistence, the law should require any non-random audits of the taxpayer in the following two years to be pre-approved by an independent review body.

<sup>352</sup> See Yuanshen Yuangao Liuyongjian, Yang Feng Su Yuanshen Beigao Guangshan Xian Caizheng Ju Shuiwu Zhengshou Xingzheng Jiufen Yi An, (原审原告刘永建、杨锋诉原审被告光山县财政局税务征收行政纠纷一案) [*Liu & Yang v. Guangshan County Finance Department-Retrial*], (Henan Guangshan County Ct. 2010) (on file with author). The taxpayers obtained its business opportunity through public bidding and were able to prevail in a suit against local government upon retrial. In comparison, the plaintiff in *Zhoukou Huilin* did not comply with the legal procedure in obtaining business and found the law against him.

especially if the companies expect to operate long-term and face unpredictable political support. As the Chinese economic structure transforms and more business entities adopt a long-term time trajectory, law will play a more important role in corporate transactions and business interactions.

One may wonder what is holding the tax agents back from excessive predatory acts, given their wide discretionary authority and the lack of political accountability and judicial supervision. As noted earlier, hierarchy and second-party monitoring institutions play certain role in restraining the tax agents. An equally important factor is the regional competition for investments and local leaders' efforts in generating growth, which is critical to their career prospect.<sup>353</sup> Due to page limit and the focus of this study, this article will not expand on the discussion. Suffice it to say that empirical evidence from this study clearly suggests that the Chinese judiciary plays, at most, a marginal role in facilitating tax administration in accordance with the law.

### *B. Administrative Litigation in China*

This study also contributes to the literature on administrative litigation in China by adding new empirical evidence about the dynamics of suing powerful tax agencies. First, an interesting common feature of the court decisions and judgments analyzed in this article is the engagement of legal counsel by defendant tax agencies. As noted earlier, defendant government agencies hire lawyers more frequently than the plaintiffs. With state agencies being their major clients, administrative law attorneys, when representing the plaintiffs, cannot constantly be zealous guards of their client's legal interests, and may persuade the plaintiffs to settle even when a trial would be more beneficial. Moreover, even though legal representation may be responsible for more sophisticated judicial deliberation, it does not appear to have significantly improved plaintiffs' chances of winning.<sup>354</sup>

In addition, the study finds certain groups to be exposed to a smaller risk of extra-judicial agency retaliation, which is crucial to judicial resolution of grievances against government officials in China. First, there

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<sup>353</sup> SUSAN H. WHITING, THE CADRE EVALUATION SYSTEM AT THE GRASS ROOTS: THE PARADOX OF PARTY RULE, IN *HOLDING CHINA TOGETHER: DIVERSITY AND NATIONAL INTEGRATION IN THE POST-DENG ERA* (Barry J. Naughton & Dali L. Yang eds., 2004).

<sup>354</sup> See Ji Li, *supra* note 9, at 31. The marginal role and effect of lawyers in representing the plaintiffs' interests is consistent with an earlier empirical study finding that lawyer density has negative impact on the rate of administrative lawsuits in China. However, such a conclusion should be viewed with caution because tried cases differ systemically from the settled ones.

appears to be an emerging group of urban residents, professional whistleblowers, who frequently use the judiciary for personal gain. Compared to an average Chinese, they file significantly more administrative lawsuits.<sup>355</sup> The cases analyzed in this article suggest that such profit-motivated administrative litigation may have some positive effects on rationalizing local governance. However, because lawsuits filed by the whistleblowers are driven mainly by profits, their subject matter is limited to disclosure of government-held information critical to the calculation of their rewards. None of the lawsuits will likely lead to more judicial oversight of powerful state agencies when their core interests are at stake.

Immunity to agency retaliation may also come from limited future interaction. Both high population mobility and agency specialization create more one-time interactions between residents and a specific agency. Therefore, we will likely observe a growing number of administrative lawsuits as a result of the economic development and accelerating urbanization in China.

Parties to disputes with government officials may also be relatively immune to extra-judicial retaliation if they have ample political resources.<sup>356</sup> Though local courts exhibit strong judicial bias in favor of defendant state agencies, they face heightened pressure to be impartial when the plaintiffs have powerful allies within the political system. In such situations, judges will often stay close to the law to mitigate the risk of being punished post-trial by the losing party. For this reason, decentralization of political power will provide a more benign environment for the adjudication of administrative lawsuits.

### C. *The Trial Selection Theories*

The findings of this study also contribute to the literature on the selection of cases for trial. As noted earlier, the Priest/Klein model predicts a central tendency for the plaintiffs to achieve a win rate of 50% in tried cases, and that most tried cases are “close cases.” The asymmetric

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<sup>355</sup> Renleliang Su Zhengzhou Shi Guojia Shuiwu Ju Jicha Ju Buluxing Fading Zhize Yi An Yishen Xingzheng Panjueshu (任乐亮诉郑州市国家税务局稽查局不履行法定职责一案一审行政判决书) [Ren v. Zhengzhou STB Investigation Bureau], (Henan Zhengzhou 27 District Ct. 2012) (on file with author).

<sup>356</sup> Shangsū Ren Nanyang Shi Guojia Shuiwu Ju Yin Yishen Yuangao Shanghai Dazhong Qiche Nanyang Xiaoshou Fuwu Youxian Gongsi Su Yishen Beigao Nanyang Shi Guojia Shuiwu Ju Shuiwu Xingzheng Chuli Chufa Jiufen Yi An Ershen Xingzheng Panjueshu (上诉人南阳市国家税务局因一审原告上海大众汽车南阳销售服务有限公司诉一审被告南阳市国家税务局税务行政处理、处罚纠纷一案二审行政判决书) [Nanyang STB v. Shanghai Dazhong Auto Nanyang Sales and Service Ltd.], (Henan Nanyang Intermediate Ct. 2009) (on file with author).

information theory, in contrast, predicts that only cases where the informed defendant expects to prevail will go to trial. The empirical findings of this study, though limited by the small sample size and possible missing cases, are consistent with the asymmetric information theory. In addition, the asymmetric information model better reflects the real world situation in China.

Though the asymmetric information theory predicts a win rate that approximates the empirical finding of this article, the interpretation of the logic has to be adjusted to the context of Chinese judicial politics. The original model implicitly treats the court's decision standard, even if biased, as an exogenous factor against which the parties apply their facts.<sup>357</sup> When applied to administrative lawsuits in China, however, the model should incorporate the fact that the decision standard is often a variable of the power balance between the two parties. So instead of the informed defendant knowing the cases he will win and selecting them for trial as prescribed by the original model, the defendant government officials in China, when sued, may refuse to settle for various non-judicial reasons and then press the local court to render them a favorable verdict. In other words, existing models based on litigation experiences in the United States or other countries with an independent judiciary are over-simplified and insufficient if applied directly to the Chinese context or the context of another country with a dependent judiciary, such as Vietnam.<sup>358</sup> In addition to asymmetric information, the model should incorporate asymmetric political power between the disputants to be a more useful analytical tool for research on trial selection in China.<sup>359</sup>

## VIII. CONCLUSION

By reviewing all tax-related administrative lawsuits in Henan from 2009 to 2011, this study unveils a few reasons for the puzzling persistence of

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<sup>357</sup> Lucian A. Bebchuk, *Litigation and Settlement under Imperfect Information*, 15 RAND J. OF ECON. 404, 406 (1984).

<sup>358</sup> An empirical study of selected civil cases in China also finds inconsistencies with the Priest/Klein prediction. See Yingmao Tang & Liugang Sheng, 中国司法执行难的计量分析 [A Quantitative Study of the Difficulties in the Enforcement of Court Judgment in China], 4 法律和社会科学 [LAW AND SOC. SCI.] 1(2011).

<sup>359</sup> While such efforts by the SCP and regional high courts to publish court decisions are commendable, it should be made clear that tried cases are not a representative sample of all lawsuits. For lawsuits against government officials, the high win rate for the defendants renders the disclosure of court decisions less useful as clarification of ambiguities and conflicts in legal authorities, deterrence for future violations by defendant agencies, or encouragement for more administrative lawsuits. To achieve such policy goals, settled cases need also be disclosed to the public.

some lawsuits against powerful agencies in China. Individuals and companies with limited extractable resources, powerful allies in government, and substantial stake in litigation are more inclined to sue, especially when transaction costs of alternative resolution are high.

This article adopts an institutional rational choice approach, taking into consideration the political and legal contexts in exploring how Chinese resolve their disputes against powerful state agencies. This approach has its obvious limitations. For instance, not all aggrieved parties sue for material interests. An earlier study suggested that some plaintiffs in China will invest much more in an administrative lawsuit than they expect to receive if prevail.<sup>360</sup> Several of the disclosed lawsuits against tax agencies also suggest factors beyond expected costs and benefits in the persistence to sue.

In *Li v. Luohe STB*, for example, the plaintiff litigated repeatedly at the trial and appellate level against local STB bureau for an insubstantial amount of vehicle tax.<sup>361</sup> After the appellate court upheld the trial court decision,<sup>362</sup> the plaintiff filed another complaint over the same dispute, with slightly different wording.<sup>363</sup> The trial court refused to docket the case. The plaintiff, instead of accepting the ruling and paying the deficiency, appealed the decision. The appellate court affirmed the trial court holding yet again. The tax deficiency could hardly justify the efforts by the plaintiff.

In addition to the limitations of the theoretical approach, the small size and the regional restriction of the sample cases caution broad and definitive conclusions. Though the cases analyzed in the article should represent the pool of tried administrative lawsuits against tax agencies in Henan Province, it is possible that omissions and errors in publishing the court decisions and judgments will cause biases in the sample, especially if the omissions are systematic, e.g., judgments against tax agencies were excluded. But even if the biases lower the plaintiffs' win-rates, the rate for the unbiased sample will probably remain low given the current basis of zero.

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<sup>360</sup> Qinghua Wang, *supra* note 9, at 532.

<sup>361</sup> Lijunan Su Luohe Shi Guoshui Ju Xingzheng Bu Zuwei Shangsu Yi An Ershen Xingzheng Caiding Shu (李君安诉漯河市国税局行政不作为上诉一案二审行政裁定书) [*Li v. Luohe STB-Appeal*], Luohe City Intermediate Ct. 2009) (on file with author).

<sup>362</sup> Lijun'an su luòhé shì guóshuì jú xíngzhèng bù zuòwéi shàngsù yī àn èrshēn xíngzhèng cáiding shū (李君安诉漯河市国税局行政不作为上诉一案二审行政裁定书) [*Li v. Luohe STB Appeal*], (Luohe City Intermediate Court) (on file with author).

<sup>363</sup> Lijunan Bufu Yan Chengqu Renmin Fayuan (2011) Yan Xing Chu Zi di 38 Hao Bu Yu Shouli Qisu Xingzheng Caiding Shangsu Yi An Ershen Xingzheng Caiding Shu (李君安不服郾城区人民法院(2011)郾行初字第38号不予受理起诉行政裁定上诉一案二审行政裁定书) [*Li for Case Registration*], (2009) (on file with author).



In comparison, extending the findings to other provinces may be more problematic. Though Henan Province is arguably representative of China in many aspects, such as its population size, there remains significant regional variation in administrative litigation.<sup>364</sup> Once other provincial high courts begin to implement the SPC policies on judgment disclosure, more cross-regional data will be available, the study of which should make the findings of this study more robust to various regional differences. Furthermore, the arguments presented in this study will be greatly strengthened if they can be evaluated against cases where parties opt not to sue tax agencies even though all the conditions described above are satisfied.

In spite of these limitations, the study presents a comprehensive and in-depth analysis of a relatively unbiased sample of administrative cases against a powerful agency in China. Theories derived from the study should be applicable to administrative litigation in other areas. Factors that enable Chinese citizens to sue a powerful agency should have even stronger effects on lawsuits against less powerful ones. For instance, it should not be a surprise to find professional whistleblowers sue an environmental protection agency (a weak government agency) in China for information disclosure or nonfeasance, if their income depends on the disputed agency performance. The findings of this study make valuable contributions to our knowledge about tax administration, administrative litigation and trial selection in the Chinese context.

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<sup>364</sup> See Ji Li, *supra* note 9, at 12.