

ECONOMIC RATIONALITY IN THE PRC TAX  
ADMINISTRATIVE ADJUDICATION: AN ANALYSIS  
BASED ON A UTILITY FUNCTION

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## ECONOMIC RATIONALITY IN THE PRC TAX ADMINISTRATIVE ADJUDICATION: AN ANALYSIS BASED ON A UTILITY FUNCTION

BAI Lijie\*

### **Abstract:**

*Tax administrative adjudication in the People's Republic of China (PRC) presents a persistent puzzle: courts exhibit deference in technically complex cases yet demonstrate relatively strict scrutiny in high-stakes disputes involving substantial revenue. While normative theories often attribute judicial behavior to statutory mandates or political obedience, few studies have addressed the underlying economic rationality driving these divergent outcomes. Learning from theories regarding institutional competence and judicial behavior, this paper develops Judge's Utility Function Model ( $U_j = \alpha L - \beta C + \gamma P$ ) to address the equilibrium of judicial decision-making in tax cases. This paper analyzes 391 tax administrative judgments from 2020 to 2025 using binary logistic regression to demonstrate a dual-track mechanism in judicial review. Under this model, cost-minimization in complex factual disputes leads to rational deference, while risk-aversion in high-stakes cases drives strict scrutiny to prevent serious errors. Given that tax justice emerges largely as a by-product of utility maximization under institutional constraints, reforms should focus on reshaping adjudication's cost-benefit structure. Practical measures may include improving specialized tribunals, clarifying review standards, and introducing penetrative review, which would help stabilize judicial expectations.*

*Key words: Tax Administrative Litigation; Economic Rationality; Binary Logistic Regression*

### I. INTRODUCTION

The judicial review of tax administrative acts in the PRC presents a puzzle to the observer, characterized by a contrast between passive deference in some domains and active intervention in others. This chapter introduces the research problem by highlighting the gap between the uniform statutory mandate for legality review and the reality of judicial practice.

#### A. EXAMINATION OF TAX ADMINISTRATIVE LITIGATION

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Tax administrative litigation, where the tax authority is the defendant, presents a unique landscape within the PRC judicial system. It sits at the intersection of state revenue power and private property rights,<sup>1</sup> demanding exceptional prudence from judges.<sup>2</sup> On one hand, in a large number of cases characterized by high technicality and professional barriers, courts seem inclined to accept the professional judgment of the tax authority. On the other hand, considering the close relationship between taxpayer rights and fundamental citizen rights, the court's attitude shifts when a case involves a substantial amount of tax or has significant social impact, leading it to invest judicial resources in a deep and substantive review.

This observation raises a research question regarding whether these seemingly contradictory judicial behaviors reflect inconsistent judicial standards and legal uncertainty, or if they conceal a deeper, unified adjudicative logic. Traditional administrative law theory often explains this as judicial restraint<sup>3</sup> or deference<sup>4</sup>. However, this explanation fails to adequately account for why judicial restraint exhibits such significant elasticity across different cases. To understand the behavioral logic behind this variance, it is necessary to turn to the theoretical resources of judicial behaviorism.

Traditionally, the *Legal Model* states that judges decide cases by mechanically applying existing legal rules to facts. However, this model struggles to explain the observed variability in judicial scrutiny where legal facts are similar but outcomes diverge.<sup>5</sup> The *Attitudinal Model* contends that judges primarily decide cases based on their ideological policy preferences.<sup>6</sup> While powerful in explaining the behavior of apex courts like the U.S. Supreme Court, its application to the PRC tax adjudication is limited due to

<sup>1</sup> See Deng Ganghong (邓刚宏), *Lun Woguo Xingzheng Susong Gongneng Moshi Jiqi Lilun Jiazhi* (论我国行政诉讼功能模式及其理论价值) [*On the Functional Model of China's Administrative Litigation and Its Theoretical Value*], 5 ZHONGGUO FAXUE (中国法学) [CHINA LEGAL SCIENCE] 54, 54-57 (2009).

<sup>2</sup> See Bai Lijie (白礼杰), *Sifa Caipan Zhong De Shuishou Fading Yuanze* (司法裁判中的税收法定原则) [*The Principle of Tax Legality in Judicial Adjudication*], 4 JING CHU FAXUE (荆楚法学) [JING CHU L. SCI.] 151, (2025).

<sup>3</sup> See Wu Yingzi (吴英姿), *Sifa De Xiandu: Zai Sifa Nengdong Yu Sifa Kezhi Zhijian* (司法的限度：在司法能动与司法克制之间) [*The Limits of Judiciary: Between Judicial Activism and Judicial Restraint*], 31 FAXUE YANJIU (法学研究) [LEGAL RSCH] 111, (2009).

<sup>4</sup> See Chen Daoying (陈道英), *Qianyi Sifa Zunzhong (judicial defence) Yuanze—Jianlun Yu Sifa Qianyi (judicial passivism) De Guanxi* (浅议司法尊重(judicial defence)原则——兼论与司法谦抑(judicial passivism)的关系) [*A Brief Discussion on the Principle of Judicial Deference—Also on the Relationship with Judicial Passivism*], 3 HUBEI SHEHUI KEXUE (湖北社会科学) [HUBEI SOC. SCIS.] 147 (2009).

<sup>5</sup> See JEFFREY A. SEGAL & HAROLD J. SPAETH, *THE SUPREME COURT AND THE ATTITUDINAL MODEL REVISITED* 48-53 (2002).

<sup>6</sup> *Ibid.*, at 93; Jeffrey A. Segal, *Separation of Power Games in the Positive Theory of Law and Courts*, AMERICAN POLITICAL SCIENCE REVIEW, MAR., 1997, at 28.

the unitary structure and the lack of partisan divisions among judges.<sup>7</sup>

More relevant is the *Strategic Model* and the *Labor Market Model* of judicial behavior. As Richard Posner (1993) argued, judges should be viewed as rational actors who maximize a utility function comprising income, leisure, reputation, and voting power, subject to constraints.<sup>8</sup> Extending this, Epstein, Landes, and Posner (2013) propose a labor market theory where judges respond to pecuniary and non-pecuniary incentives and costs.<sup>9</sup> In this framework, deference can be understood as a rational strategy to minimize “effort costs” (leisure seeking) or “reversal costs.”<sup>10</sup> Furthermore, strategic accounts emphasize that judicial behavior is interdependent; judges must anticipate the reactions of other actors, including legislators, the executive, and the public, to ensure their decisions are efficacious and to avoid sanctions. Helmke (2002), for instance, demonstrates how judges in insecure institutional environments engage in “strategic defection” to protect their tenure against incoming regimes.<sup>11</sup>

However, transplanting Western strategic models directly to the PRC context requires contextual adaptation. Unlike their Western counterparts, the PRC judges operate within a specific institutional environment where the constraints are not merely about leisure or reputation, but also about safety. This paper builds upon Ng and He’s (2017) concept of “Embedded Courts,” which posits that Chinese courts function as integral parts of a unified bureaucracy. In this system, judges must adhere not only to legal scripts but also to political and administrative imperatives to maintain stability.<sup>12</sup> Within this embedded structure, the behavior of judges shifts from simple utility maximization to what Su Li (2011) describes as a strategy of “formatting”; simplifying complex social facts to fit legal requirements to navigate the web of social and political relations.<sup>13</sup> Deepening this analysis, Liu Mingkui (2019) proposes a theory of Trial Risk Aversion, arguing that judges face Social Risks (e.g., petitions), Systemic Political Risks (pressure from local party-state organs), and Internal Judicial

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<sup>7</sup> See Lee Epstein, Urška Šadl & Keren Weinsahl, *The Role of Comparative Law in the Analysis of Judicial Behavior*, THE AMERICAN JOURNAL OF COMPARATIVE LAW, WqAAainter, 2021 at 689.

<sup>8</sup> See Richard A. Posner, *What Do Judges and Justices Maximize? (The Same Thing Everybody Else Does)*, SUPREME COURT ECONOMIC REVIEW, 1993, at 1.

<sup>9</sup> See LEE EPSTEIN, WILLIAM M. LANDES & RICHARD A. POSNER, THE BEHAVIOR OF FEDERAL JUDGES: A THEORETICAL AND EMPIRICAL STUDY OF RATIONAL CHOICE 48 (Harvard Univ. Press 2013).

<sup>10</sup> See *id.*, at 223.

<sup>11</sup> See Gretchen Helmke, *The Logic of Strategic Defection: Court-Executive Relations in Argentina Under Dictatorship and Democracy*, 96 AM. POL. SCI. REV. 291, 301 (2002).

<sup>12</sup> See KWAI HANG NG & HE XIN, EMBEDDED COURTS: JUDICIAL DECISION-MAKING IN CHINA 20–22 (Cambridge Univ. Press 2017).

<sup>13</sup> See SU LI (苏力), SONG FA XIA XIANG: ZHONGGUO JICENG SIFA ZHIDU YANJIU (送法下乡: 中国基层司法制度研究) [SENDING LAW TO THE COUNTRYSIDE: RESEARCH ON CHINA’S BASIC-LEVEL JUDICIAL SYSTEM] 165 (2011).

Risks (draconian accountability for wrongful cases).<sup>14</sup> Consequently, the judge becomes a risk minimizer. As Weng Ziming (2009) notes on the production of judicial decisions, judges rationally seek to distribute responsibility through collective mechanisms like the Adjudication Committee.<sup>15</sup> He Yongjun further identifies “Relying on the Organization” as a primary strategy to dilute these risks.<sup>16</sup> Crucially, the safety directly informs the variables in this paper’s model: the high deference to administrative reconsideration is a strategy of risk dilution, while the intervention in high-stakes cases is a strategy to avoid the greater social risk of instability.

## B. THE THEORY AND GOALS OF THIS PAPER

Based on the analysis above, this paper proposes an economic rationality framework specific to the PRC tax administrative adjudication. It argues that the court, as a rational decision-maker, engages in a sophisticated cost-benefit analysis in every case.

The core research question this paper explores is: Under information asymmetry and a professional knowledge gap, how can we understand the court’s determination of the boundary and depth of its intervention into administrative actions through this economic rationality model? Specifically, how do factors like the technical complexity of facts and the administrative rank of the defendant weigh against the high stakes of a case to drive the judge towards either rational deference or rational intervention? Furthermore, what insights can this provide for the optimization of the tax-related judicial system?

## II. NORMATIVE BASIS OF TAX ADMINISTRATIVE ADJUDICATION

Before dissecting the positive economic logic of *how judges decide*, it is essential to map the normative landscape of *how judges are expected to decide*. This chapter reviews the legal framework and academic debates surrounding the standard of review, arguing that existing normative theories provide the rules of the game but do not fully explain the strategic behavior of judges within the competence gap.

### A. LEGAL FRAMEWORK AND ACADEMIC DISPUTES IN THE PRC

<sup>14</sup> See Liu Mingkui (刘明奎), Jiceng Faguan Shenpan Fengxian Guibi Xingwei Yanjiu (基层法官审判风险规避行为研究) [Research on Risk Aversion Behavior of Grassroots Judges] 88–93 (June 1, 2019) (Ph.D. dissertation, Jilin University).

<sup>15</sup> See WENG ZIMING (翁子明), SIFA PANJUE DE SHENGCHAN FANGSHI: DANGDAI ZHONGGUO FAGUAN DE ZHIDU JILI YU XINGWEI LUOJI (司法判决的生产方式: 当代中国法官的制度激励与行为逻辑) [THE MODE OF PRODUCTION OF JUDICIAL DECISIONS: INSTITUTIONAL INCENTIVES AND BEHAVIORAL LOGIC OF CONTEMPORARY CHINESE JUDGES] (Peking Univ. Press 2009).

<sup>16</sup> See HE YONGJUN (何永军), DUANLIE YU YANXU—RENMIN FAYUAN JIANSHE (1978–2005) (断裂与延续—人民法院建设(1978–2005)) [RUPTURE AND CONTINUITY: THE CONSTRUCTION OF PEOPLE’S COURTS (1978–2005)] 23 (China Soc. Scis. Press 2008).

The normative foundation of tax administrative adjudication in the PRC is grounded in the *Administrative Litigation Law* (ALL) and the *Law on the Administration of Tax Collection*. At the principle level, Article 6 of the ALL provides that “the People’s Courts, when hearing administrative cases, shall review the legality of the administrative action,” thereby establishing legality review as the core standard of judicial scrutiny. Importantly, legality in this context is not confined to formal compliance with statutory provisions, but extends to substantive legality, encompassing adherence to legal principles, the purpose and spirit of the law, as well as considerations of fairness and justice.

This expanded understanding of legality is concretized through the ALL’s specific review mechanisms. Article 70 stipulates the grounds upon which an administrative action may be annulled, including insufficient main evidence, incorrect application of laws or regulations, procedural violations, excess of authority, abuse of power, and actions that are “obviously improper.” In addition, Article 77 authorizes courts to modify administrative penalties that are “obviously improper.” Taken together, these provisions clarify that legality review of a specific administrative act necessarily involves an examination of evidentiary sufficiency, legal interpretation, procedural regularity, and elements of substantive reasonableness.

It is precisely this overlap between legality and reasonableness that has generated academic debate when the legality review principle is applied to the highly technical field of taxation. While Article 6 doctrinally limits courts to assessing compliance with explicit legal norms, the practical application of Article 70 compels deeper substantive evaluation. For instance, determining “insufficient key evidence” in complex tax cases often requires assessing the probative value and coherence of evidence, similar to re-examining the authority’s factual findings. Most directly, the “obviously improper” standard, especially for discretionary penalties, invites courts to evaluate proportionality, fairness, and overall appropriateness. Consequently, legality review in tax adjudication functions as a hybrid standard integrating substantive reasonableness.<sup>17</sup>

This triggers an ongoing academic debate regarding the conceptual relationship between legality and reasonableness in the PRC context. Some scholars maintain a stricter dichotomy, viewing reasonableness as fundamentally distinct from legality and considering judicial intervention on reasonableness grounds (like “obviously improper”) as specific, limited exceptions to the

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<sup>17</sup> See He Haibo (何海波), *Lun Xingzheng Xingwei “Mingxian Budang”* (论行政行为“明显不当”) [*On “Obviously Improper” Administrative Acts*], 3 FAXUE YANJIU (法学研究) [LEGAL RSCH.] 70 (2016).

general principle of legality review.<sup>18</sup> Others argue for a more integrated view, contending that legality itself possesses a substantive dimension. From this perspective, serious or manifest unreasonableness constitutes a form of substantive illegality, meaning that an administrative action that is grossly disproportionate, arbitrary, or contrary to fundamental legal principles implicitly violates the requirements of the law itself, even if it formally complies with explicit rules.<sup>19</sup>

#### B. DE FACTO DEFERENCE IN THE PRC JUDICIAL PRACTICE

Although the PRC laws and regulations do not explicitly stipulate judicial deference, a pattern has formed in specific cases. The Nantong Intermediate People's Court of Jiangsu Province noted in a hazardous chemicals administrative licensing case<sup>20</sup> that People's Courts should balance necessary respect with limited correction, stating, "from the perspective of judicial review technical strategy, three basic standards are whether the administrative professional determination meets procedural regularity requirements, whether it is manifestly unreasonable, and whether it constitutes an abuse of power." In a government information disclosure case<sup>21</sup> in Beijing, the Beijing High People's Court held that "whether government information can be disclosed often involves highly specialized knowledge. Administrative agencies, in the process of decision-making and supervision, often accumulate a wealth of professional knowledge." Therefore, "the first-instance court's view that the information requested by the plaintiff still required administrative investigation and discretion, from the perspective of respecting the Dongcheng District Government's right of first judgment and professional judgment, was not improper."

<sup>18</sup> See Xue Gangling (薛刚凌) & Yang Xin (杨欣), *Lun Woguo Xingzheng Susong Gouzao: "Zhuguan Susong" Yihuo "Keguan Susong"?* (论我国行政诉讼构造: "主观诉讼"抑或"客观诉讼"?) [On the Structure of Administrative Litigation in China: "Subjective Litigation" or "Objective Litigation"?, 4 XINGZHENG FAXUE YANJIU (行政法学研究) [ADMIN. L. RSCH.] 29 (2013).

<sup>19</sup> See Wang Kai (王锴), *Hexianxing, Hefaxing, Shidangxing Shencha de Qubie yu Lianxi* (合宪性、合法性、适当性审查的区别与联系) [The Distinction and Connection Among Constitutionality Review, Legality Review, and Appropriateness Review], 1 ZHONGGUO FAXUE (中国法学) [CHINA LEGAL SCI.] 5 (2019); Zhou Youyong (周佑勇), *Sifa Shencha Zhong de Xingzheng Xingwei "Mingxian Budang" Biaozhun* (司法审查中的行政行为"明显不当"标准) [The Standard of "Obviously Improper" Administrative Acts in Judicial Review], 3 HUANQIU FALÜ PINGLUN (环球法律评论) [GLOB. L. REV.] 23 (2021).

<sup>20</sup> *X Gongsì su Rudong Xian Xingzheng Shenpi Ju Weixian Huaxuepin Xingzheng Xuke An* (某公司诉如东县行政审批局危险化学品行政许可案) [A Certain Co. v. Rudong Cnty. Admin. Approval Bureau Hazardous Chems. Admin. License Case] (Nantong Interm. People's Ct.) (China).

<sup>21</sup> *Beijing Shi Dongcheng Qu Renmin Zhengfu Deng Xinxi Gongkai An* (北京市东城区人民政府等信息公开案) [Beijing Dongcheng Dist. People's Gov't et al. Gov't Info. Disclosure Case], No. 1807 (Beijing High People's Ct. 2018) (China).

In the field of tax adjudication, the *Defa* case<sup>22</sup> is a typical example of this discretionary space. The case involved the judgment of indeterminate legal concepts such as “taxable basis is obviously low without just cause,” and the court ultimately deferred to the tax authority’s determination. The Supreme People’s Court concluded that courts should “respect the professional judgment and administrative customs formed by administrative agencies during long-term enforcement activities. By way of judicial confirmation, recognizing customs formed by tax bureaus below the provincial level and their inspection bureaus in the specific enforcement process that do not violate legal principles and spirit and are consistent with the rules and characteristics of specific enforcement, provides a reference method for People’s Courts in handling similar issues in the future.” This confirms that when facing indeterminate legal concepts and professional judgments, courts have discretionary space to exercise their review power and can choose the depth of their intervention into the substance of the administrative action. This establishes the normative foundation for this study to explore how courts exercise economic rationality within this space.

### C. COMPARATIVE NORMATIVE PERSPECTIVES

To further contextualize this *de facto* judicial deference, it is instructive to examine normative standards in comparative jurisdictions.

In the United States, the *Chevron* doctrine<sup>23</sup> establishes a normative baseline where courts defer to an agency’s reasonable interpretation of ambiguous statutes. However, this deference is not absolute. As Thomas W. Merrill (1992) argues, judicial deference should be best understood through an “executive precedent model,” where agency interpretations are treated as *prima facie* correct but subject to judicial discretion based on the consistency and reasoning of the agency’s decision.<sup>24</sup> This is particularly relevant in tax law, where the Internal Revenue Service possesses significant rulemaking authority. Andrew Pruitt (2011) highlights a critical nuance in this context: while courts often defer to the IRS on technical interpretations, the “institutional-expertise rationale” faces challenges when the agency issues retroactive regulations to overturn unfavorable court decisions. Pruitt argues that in such cases, the judiciary must balance the agency’s enforcement prerogative against the

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<sup>22</sup> *Guangzhou Defa Fangchan Jianshe Youxian Gongsi su Guangzhou Shi Difang Shuiwu Ju Diyi Jicha Ju Shuiwu Chuli Jueding* (广州德发房产建设有限公司诉广州市地方税务局第一稽查局税务处理决定) [Guangzhou Defa Real Estate Constr. Co. v. First Inspection Bureau of Guangzhou Local Tax'n Bureau, Tax Treatment Decision] (Sup. People's Ct.2017) (China).

<sup>23</sup> *Chevron U.S.A., Inc. v. NRDC*, 467 U.S. 837 (1984).

<sup>24</sup> See Thomas W. Merrill, *Judicial Deference to Executive Precedent*, YALE L.J., Mar. 1, 1992, at 969.

taxpayer's reliance interests and the integrity of judicial decision-making.<sup>25</sup> This suggests that the normative basis for deference in tax cases is contingent on the agency acting within the bounds of fair play and procedural justice.

Similarly, in the United Kingdom, modern developments under the Human Rights Act have introduced a more sophisticated discretionary area of judgment. Richard Clayton (2006) posits that deference should not be viewed as judicial abdication, but rather as part of a "democratic dialogue" between the courts and the executive.<sup>26</sup> In this view, courts respect the expertise gap regarding technical matters but retain strict scrutiny over fundamental rights.

Applying this comparative perspective to the Chinese context clarifies the boundaries of Article 70 of the ALL. It suggests that while courts must retain full authority over questions of law and procedural justice, they should accord a degree of deference to the tax authority's fact-finding and technical discretion. As Merrill and Pruitt suggest, such discretion is exercised consistently and does not retroactively infringe on taxpayer rights. In this way, the PRC courts can fulfill their supervisory role without paralyzing the efficiency of tax collection.

#### D. FROM NORMATIVE JUSTIFICATIONS TO POSITIVE ECONOMIC ANALYSIS

To clarify the operational logic of judicial deference in the PRC, this study distinguishes normative theories of deference from a positive economic model. Normative theories, such as those derived from the *Chevron* doctrine in the U.S., typically argue that courts should defer for two primary reasons: 1) Agency Expertise: The belief that administrative agencies (like the tax authority) possess superior technical, scientific, or specialized knowledge that courts lack, making the agency better equipped to make complex factual determinations and policy judgments; or 2) Democratic Accountability & Legislative Delegation: The principle that the legislature (e.g., Congress or the National People's Congress) has implicitly or explicitly delegated interpretative power and discretionary authority to the administrative agency, which is considered more politically accountable (directly or indirectly) than the unelected judiciary.<sup>27</sup>

Rather than prescribing how courts ought to behave, this paper's positive economic model explains how courts actually operate within a complex doctrinal environment, particularly *why* and *under what conditions* they move beyond formal legality review to engage in substantive scrutiny.

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<sup>25</sup> See Andrew Pruitt, *Judicial Deference to Retroactive Interpretative Treasury Regulations*, GEO. WASH. L. REV., Sep. 1, 2011, at 1558.

<sup>26</sup> See Richard Clayton, *Principles for Judicial Deference*, JUD. REV., Jul. 26, 2006, at 109.

<sup>27</sup> See Matthew C. Stephenson, *Legal Realism for Economists*, J. ECON. PERSP., 2009, at 191.

At the core of the model is a distinction between two modes of review with different institutional costs. Formal legality review, which focuses on procedural compliance and clear violations of explicit legal rules, represents the judiciary's low-cost option. It requires limited technical expertise, entails modest information acquisition, and avoids deep intrusion into administrative discretion. Substantive review, by contrast, imposes significantly higher decision costs, as courts must assess complex factual records, evaluate discretionary reasoning, balance competing interests, and examine proportionality and fairness.

Courts are therefore modeled as rational decision-makers who implicitly weigh the costs and benefits of intervention. Intensive substantive review is undertaken only when the expected benefits of intervention are sufficiently high, such as in cases involving major economic interests, salient public concerns, serious rights infringements, or the articulation of authoritative legal standards. Absent such conditions, courts tend to adhere to formal legality review and uphold administrative decisions, even where their substantive reasonableness may be contestable.

This approach draws on comparative institutional analysis, particularly Neil Komesar's insight that institutional choice must be based on relative institutional limitations rather than abstract normative ideals.<sup>28</sup> Adjudication is constrained by limited scale and expertise, while political processes face participation biases. Judicial deference thus reflects a rational response to institutional constraints: when judicial decision costs exceed the expected error costs of administrative action, non-intervention becomes the rational outcome. Adrian Vermeule's theory of *judging under uncertainty* further sharpens this account. As rational actors operating under informational constraints, judges often rely on strategies such as formalism or deference to manage uncertainty and reduce error variance. In the tax context, formal legality review functions as a practical heuristic for coping with technical complexity by reallocating fact-finding responsibilities to specialized administrative bodies.<sup>29</sup> The dynamic between courts and agencies also involves strategic considerations. As Matthew Stephenson notes, procedural rigor can act as a substitute for substantive review. Agencies that demonstrate thorough procedures signal competence and careful deliberation, which encourages judicial deference. Courts, in turn, may treat procedural regularity as an indicator of decision quality. As a result, the depth of judicial review is shaped by the behavior of the administrative body itself.<sup>30</sup>

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<sup>28</sup> See NEIL K. KOMESAR, *IMPERFECT ALTERNATIVES: CHOOSING INSTITUTIONS IN LAW, ECONOMICS, AND PUBLIC POLICY* 3–13 (Univ. of Chi. Press 1994).

<sup>29</sup> See Matthew C. Stephenson, *The Strategic Substitution Effect: Textual Plausibility, Procedural Formality, and Judicial Review of Agency Statutory Interpretations*, HARV. L. REV., Dec. 1, 2006, at 528.

<sup>30</sup> See *id.*, at 563–64.

To sum up, the economic rationality model conceptualizes judicial review as a trade-off between decision costs and error costs. This provides the analytical foundation for the Utility Function Model developed in Chapter III, in which judicial choice is formalized as an optimization problem involving legality, institutional effort, and systemic stability.

## II. UTILITY FUNCTION MODEL FOR TAX ADMINISTRATIVE ADJUDICATION

Rather than conceiving judges as mechanical enforcers of legality standards, this chapter models judicial behavior as utility-maximizing decision-making under conditions of informational asymmetry, cognitive limitation, and institutional constraint.

At the core of this analysis is a Utility Function Model, which formalizes the intuition that judicial intervention in tax cases varies systematically with case stakes, technical complexity, and fiscal sensitivity. This model integrates and extends the traditional cost-benefit framework by embedding it within a broader utility-maximization structure.

### A. ANALYTICAL FRAMEWORK AND MODEL ASSUMPTIONS

Tax administrative adjudication is an interaction among three strategic actors: the Taxpayer (plaintiff), the Tax Authority (defendant), and the Judge. The Taxpayer decides whether to initiate litigation, the Tax Authority defends the challenged administrative act, and the Judge renders a decision subject to legal, informational, and institutional constraints.

The model rests on three core assumptions.

First, all actors are rational in the economic sense. For judges, utility does not consist of monetary gain, but of non-pecuniary benefits such as professional reputation, career advancement, psychological satisfaction derived from issuing a legally sound decision, and the preservation of leisure by avoiding excessive cognitive effort.

Second, information asymmetry is structural and persistent. Consistent with Vermeule's view of "epistemic competence," tax authorities possess superior technical information concerning tax bases, valuation methods, and enforcement practices. Judges, as generalists, face a systematic disadvantage when reviewing complex tax determinations, particularly those involving factual reconstruction or discretionary judgment.

Third, judicial decision-making is cost-sensitive. Judicial resources such as time, attention, and cognitive capacity are finite. As Posner observes, judges, like other workers, dislike effort and value leisure. Consequently, adjudication costs increase sharply as disputes become more technically complex, rendering intensive substantive review expensive.

### B. THE JUDGE'S UTILITY FUNCTION

The judge's utility in a tax administrative case ( $U_j$ ) is modeled as a function of three variables: Legality Accuracy ( $L$ ), Adjudication Cost ( $C$ ), and Political/Fiscal Stability ( $P$ ).

$$U_j = \alpha L - \beta C + \gamma P$$

Legality Accuracy reflects the professional satisfaction and reputational benefits associated with issuing a legally sound judgment. Decisions that withstand appellate review enhance this component of utility, whereas reversals impose reputational and career-related costs.

Adjudication Cost captures the time, cognitive effort, and informational investment required to ascertain facts and apply the law. In technically complex tax cases, determining the correct tax outcome requires specialized expertise, causing  $C$  to rise sharply. Rational judges therefore have a structural incentive to minimize this cost.

Political/Fiscal Stability represents the alignment of judicial outcomes with broader state interests, particularly the maintenance of fiscal revenue and social stability. The PRC courts are institutionally embedded in a governance framework that places weight on fiscal order and policy continuity. Judicial decisions that significantly disrupt revenue collection or undermine major policy initiatives may therefore generate negative institutional externalities. Drawing on Gambitta's insight that litigation performs functions beyond dispute resolution, this model suggests that judges may maximize stability by deferring in individual cases while allowing the litigation process itself to transmit reform signals to the legislative or administrative system.

The coefficients  $\alpha$ ,  $\beta$ , and  $\gamma$  represent the relative weight assigned to each variable, reflecting both individual judicial preferences and local institutional conditions.

### C. COMPLEXITY, COST, AND JUDICIAL DEFERENCE

The utility function model explains judicial deference as the product of a rational trade-off between maximizing legality accuracy and minimizing adjudication costs, subject to the constraint of fiscal and political stability. When disputes concern clear procedural violations, such as failures of notice or breaches of statutory time limits, adjudication costs are low, as legality can be assessed without specialized expertise. In such cases, judges can enhance legality accuracy at minimal cost, leading to stricter scrutiny and a higher likelihood of rulings in favor of taxpayers.

By contrast, disputes involving complex technical determinations substantially increase adjudication costs. Attempting a *de novo* review of valuation or discretionary judgments requires extensive information processing and carries a heightened risk of error. Faced with high cognitive burdens and uncertain outcomes, rational judges adopt deference as a

cost-reducing strategy, accepting administrative determinations so long as they do not appear manifestly unreasonable. This approach preserves an acceptable level of legality while avoiding the prohibitive costs of full substantive reassessment.

Fiscal stakes further reinforce this tendency. Where invalidating a tax decision would entail significant revenue loss or destabilize fiscal planning, stability considerations become decisive. From the judge's perspective, it represents a rational accommodation of institutional constraints, prioritizing systemic stability and cost control over marginal gains in substantive accuracy.

Taken together, the model offers a coherent positive explanation for a recurring pattern in Chinese tax administrative adjudication: rigorous judicial control over procedural legality, coupled with systematic restraint in reviewing technically complex or fiscally sensitive administrative determinations.

#### IV. HYPOTHESES, DATA, AND METHODS

##### A. HYPOTHESES

To test the explanatory power of the above framework, this paper uses quantitative analysis of batch judgments to explore the key factors affecting judicial decision-making. The hypotheses are directly derived from the cost-benefit calculus of the judge's utility function.

**H1: The Complexity-Deference Hypothesis.** In the utility function,  $\beta C$  captures the disutility associated with adjudication effort. Consistent with theories of bounded rationality and judicial behavior, judges operate under severe constraints of time, cognitive capacity, and institutional resources. As a result, they are systematically motivated to minimize adjudication cost, particularly in cases that require intensive factual verification or technical assessment.

In tax administrative litigation, adjudication cost varies significantly with the *Nature of Dispute*. Cases classified as *Factual Dispute* or *Mixed Dispute* require the court to evaluate the tax authority's fact-finding process, including the collection, interpretation, and weighing of evidence. Given the technical complexity of tax administration, courts face a pronounced informational disadvantage in such cases. Independent verification of factual determinations demands substantial cognitive effort and increases the risk of error, thereby raising adjudication cost. By contrast, cases categorized as *Legal Dispute* primarily concern the interpretation and application of legal norms. These disputes are relatively less dependent on technical expertise and can be resolved through conventional legal reasoning, resulting in comparatively lower adjudication costs. From a rational choice perspective, when adjudication cost is high, the marginal utility gained from correcting a potential error in fact-finding may be outweighed by the effort required to do so. Under such conditions,

judges are incentivized to adopt a deferential posture towards the tax authority's determinations, particularly in relation to factual issues. Deference allows the court to conserve scarce judicial resources while maintaining an acceptable level of legality by avoiding full-scale substantive review. Conversely, when the dispute is purely legal in nature and adjudication cost is relatively low, judges can afford closer scrutiny and are more willing to intervene.

Accordingly, this hypothesis predicts that judicial deference is positively correlated with the factual complexity of the dispute. Specifically, compared with cases classified as *Legal Dispute*, cases involving *Factual Dispute* or *Mixed Dispute* are associated with a higher probability of the court *Upholding* the administrative act (1). In other words, as the *Nature of Dispute* shifts from legal to factual or mixed, the likelihood that the court upholds the administrative act increases. Consistent patterns are also expected in the court's Attitude towards Fact-finding, with higher probabilities of (1) *Approve* in fact-intensive cases.

**H2: The High-Stakes Scrutiny Hypothesis.** This hypothesis advances a refinement of the conventional "fiscal deference" intuition by arguing that *Amount in Dispute (D)* exerts a structural influence on judicial decision-making, not merely as a measure of fiscal magnitude, but as a variable that reshapes the internal parameters of the judge's utility function. Specifically, this paper posits that *Amount in Dispute* enters the utility function  $U_j = \alpha L - \beta C + \gamma P$  by modifying both the weight assigned to Legality Accuracy (  $L$  ) and the substantive meaning of Political/Fiscal Stability (  $P$  ). Formally, this can be expressed as  $U_j = \alpha(D)L - \beta C + \gamma(D)P$ .

As *Amount in Dispute* increases, the legal and social salience of the case correspondingly intensifies. High-value tax disputes are more likely to attract scrutiny from higher courts, supervisory bodies, and the public, thereby amplifying the reputational consequences of judicial error. In particular, the cost of upholding an unlawful tax assessment escalates sharply with the size of the disputed amount. Under such conditions, the reputational risk borne by the judge transforms Legality Accuracy (  $L$  ) from a routine adjudicative objective into a dominant concern. Consequently, the coefficient  $\alpha$  becomes an increasing function of *Amount in Dispute* (  $\alpha(D)$  ), such that the marginal utility of achieving a legally correct outcome justifies the incurrence of higher Adjudication Cost (  $C$  ), including more intensive fact review and legal reasoning.

The influence of *Amount in Dispute* on  $P$  is similarly non-linear. When the disputed amount is relatively small,  $P$  is closely associated with short-term fiscal considerations, and judicial restraint may serve the goal of revenue stability. However, as *Amount in Dispute* reaches a substantial scale, the content of  $P$  shifts qualitatively. Large-scale tax enforcement actions, if legally

flawed, risk undermining market confidence, distorting the business environment, and eroding the credibility of tax administration. In this high-stakes context, safeguarding institutional legitimacy and the rule of law becomes integral to maintaining long-term fiscal and economic stability. Accordingly, strict adherence to legality ( $L$ ) no longer conflicts with  $P$ , but instead becomes its necessary precondition.

Based on the foregoing analysis, this paper predicts that judicial scrutiny intensifies as *Amount in Dispute* increases. Empirically, this implies a positive relationship between *Amount in Dispute* and the likelihood of a taxpayer-favorable outcome, operationalized as *Court Judgment Outcome = 0 (Revoke/Modify)*. As the disputed amount grows, the enhanced weight of Legality Accuracy ( $L$ ) outweighs both the incentive to economize on adjudicative effort ( $C$ ) and the preference for protecting short-term fiscal interests, thereby increasing the probability of judicial intervention against the tax authority.

## B. CALCULATIONS

A binary logistic regression model is used to quantify the impact of independent variables on the probability of the court's final judgment choice (upholding the administrative action). The core of this model is to convert the results of linear regression into probabilities, suitable for analyzing how a set of independent variables  $X$  affects the likelihood of a binary dependent variable  $Y$  occurring.

Data for this study were sourced from the PKULaw database, using "Tax Administrative Management (Taxation)" as the cause of action (i.e., administrative litigation cases with tax authorities at various levels as defendants) and "judgment" as the document type, with the closing date limited from January 1, 2020, to May 31, 2025. To ensure the validity and representativeness of the study, the sample selection followed these criteria: (1) The document type is a first-instance, second-instance, or retrial administrative judgment; (2) The core dispute of the case is a specific administrative action taken by a tax authority at any level; (3) The judgment content is complete and allows for the clear extraction of all variable information set in this study. After the removal of incomplete, duplicate, or irrelevant documents, a database of 391 effective judgments was constructed. These judgments effectively reflect the practical status of tax administrative adjudication in China. Let  $P$  be the probability that the court chooses to "uphold the original administrative action" ( $Y = 1$ ). This probability is determined by the following logistic function:

$$P(\text{Uphold}) = P(Y = 1|\mathbf{X}) = \frac{1}{1 + e^{-(\beta_0 + \sum_{k=1}^m \beta_k X_k)}}$$

For ease of interpretation, we typically examine the log-odds ratio, which is the natural logarithm of the ratio of the probability of “upholding” to “revoking/modifying”:

$$\ln\left(\frac{P}{1-P}\right) = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \dots + \beta_m X_m$$

Where: (1) The dependent variable  $Y$  is the court’s final judgment (1=Uphold; 0=Revoke/Modify); (2)  $\mathbf{X} = \{X_1, X_2, \dots, X_m\}$  is the vector of independent variables, representing factors affecting Cost  $C$  or Benefit  $B$  (e.g., nature of dispute, amount in controversy); (3)  $\beta_0$  is the intercept term; (4)  $\beta_k$  is the regression coefficient for the  $k$ -th independent variable, with its sign and magnitude reflecting the direction and degree of that factor’s influence on the probability of the court upholding the administrative action; (5)  $e$  is the base of the natural logarithm.

**Table 1: Coding Manual for Dependent and Independent Variables**

Type	Variable Name	Variable Definition	Variable Coding
<b>Dependent Variable</b>	Court Judgment Outcome	The final judgment of the court on the administrative act.	(1) Uphold (0) Revoke/Modify
	Attitude towards Fact-finding	The court’s attitude in the reasoning of the judgment towards the tax authority’s fact-finding.	(1) Approve (0) Disapprove
	Attitude towards Legal Application	The court’s attitude in the reasoning of the judgment towards the tax authority’s application of law.	(1) Approve (0) Disapprove
<b>Independent Variable</b>	Nature of Dispute	The type of dispute involved in the case, whether it is fact-finding, legal application, or both.	(1) Factual Dispute (2) Legal Dispute (3) Mixed Dispute
	Tax Authority Level	The administrative level of the tax authority involved. If the case involves administrative reconsideration with two levels of tax authorities as co-defendants, the higher-level authority is taken as the standard.	(1) District/County Level (2) Municipal Level (3) Provincial Level (4) National Level
	Administrative Reconsideration Outcome	The outcome of the administrative reconsideration (if any) in the case.	(1) Reconsideration Upheld (2) Reconsideration Revoked (3) No Reconsideration Involved
	Amount in	The amount of tax	Continuous Variable

Type	Variable Name	Variable Definition	Variable Coding
	Dispute	involved in the case.	(in RMB Yuan)
	Nature of Taxpayer	Whether the taxpayer is a natural person or a legal person.	(1) Natural Person (0) Legal Person
	Court Level	The level of the court that issued the judgment.	(1) District Court (2) Intermediate (3) High
	Type of Tax Authority Duty	Whether the duty of the tax authority involved is related to tax revenue or other administrative duties such as information disclosure, medical insurance, social insurance, etc.	(1) Tax-related Duty (0) Other Duty

This study uses statistical analysis software to construct three independent binary logistic regression models to test the differential impacts of the seven independent variables on the three dependent variables.

However, it should be noted that the sample period examined in this study coincides with the post-pandemic economic recovery phase (2020–2025). During this interval, the government implemented a series of large-scale tax relief measures to mitigate economic downturns and stabilize market expectations. This macroeconomic and policy backdrop likely strengthened the judiciary’s “economic guardianship” function in tax adjudication, structurally predisposing judges to shield market entities from excessive taxation in order to align judicial outcomes with the national policy objectives. As a result, the observed positive correlation between higher amounts in dispute and taxpayer win rates may be partially amplified by this specific historical context rather than reflecting a fully time-invariant judicial pattern. Future research should therefore extend the temporal scope of analysis to assess whether this relationship persists under more normalized economic conditions.

Additionally, the analysis is limited to the paper language presented in the judgments. Therefore, the conclusions drawn are not a direct judgment of the intensity of judicial review during the court’s trial process or the judge’s drafting process. In fact, researchers cannot fully reconstruct the specific review process and judgment basis from publicly available judgment texts alone. Thus, this study focuses on correlation rather than causation. It aims to infer the degree of review in tax adjudication by using the judgment outcome and the court’s resulting attitude towards the administrative action as a proxy. In other words, the core of the research is to identify the circumstances under which courts tend

to uphold or negate the administrative actions of tax authorities and, using this as a clue, to deduce the economic rationality of tax administrative adjudication.

#### V. DATA ANALYSIS: INFLUENCING FACTORS OF THE ECONOMIC RATIONALITY IN TAX ADJUDICATION

The analysis is structured to test the validity of the Utility Function Model ( $U_j = \alpha L - \beta C + \gamma P$ ), examining how the observable proxies for Adjudication Cost and Political/Fiscal Stability correlate with the probability of judicial deference. While this statistical analysis provides robust evidence of correlation, it is important to note the boundaries of the model: it offers a descriptive account of judicial tendencies rather than a definitive proof of the internal psychological calculations of individual judges.

At the macro level, the probability that a tax authority's administrative action is upheld is high. Regarding the final judgment result, 265 cases were upheld and 126 were revoked/modified, for a maintenance rate of 67.8%. In terms of the attitude on fact-finding, 282 were recognized and 109 were negated, for a recognition rate of 72.1%. Regarding the attitude on law application, 273 were recognized and 118 were negated, for a recognition rate of 69.8%. From the taxpayer's perspective, the proportion of winning a favorable judgment (i.e., the court revokes, modifies, or confirms illegality) is about one-third. From the court's perspective, courts may be more deferential on factual issues during the review process. This provides a preliminary confirmation of the common perception that tax authorities have a high success rate in tax administrative adjudication. However, this aggregate data does not reveal the internal structure of adjudicative behavior; further cross-analysis with independent variables is required.

This study incorporates all seven independent variables into the model, running regressions on the three dependent variables respectively. The overall model significance (Omnibus Test) and goodness-of-fit (Hosmer-Lemeshow Test) for all models were good, indicating the results are statistically significant.<sup>31</sup> The following regression analysis results were obtained, corresponding to the three models: Final Judgment Result, Attitude on Fact-Finding, and Attitude on Law Application.

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<sup>31</sup> This study conducted statistical tests on the three constructed binary logistic regression models. The results showed that for the three models (final judgment outcome, fact-finding attitude, and legal application attitude), the likelihood ratio p-values of the Omnibus Test were 0.0001, 0.0005, and 0.0028, respectively, all far less than the 0.05 significance level, suggesting the models are statistically significant overall. Concurrently, the Hosmer-Lemeshow Test p-values for the three models were 0.5847, 0.2045, and 0.8647, respectively, all far greater than the 0.05 critical value, suggesting the models fit the data well.

## Model Data Results for the Judicial Deference Mechanism

Independent Variable		Final Judgment Outcome	Attitude towards Fact-finding	Attitude towards Legal Application
		Exp(B) (OR)	Exp(B) (OR)	Exp(B) (OR)
<b>Nature of Dispute</b> (Ref: Mixed Dispute)	<b>Factual Dispute</b>	3.051 (.026)*	4.254 (.004)*	2.146 (.134)
	<b>Legal Dispute</b>	1.155 (.621)	1.143 (.660)	1.002 (.995)
<b>Tax Authority Level</b> (Ordinal)		1.638 (.045)*	1.803 (.018)*	1.492 (.102)
<b>Admin. Reconsideration Outcome</b> (Ref: No Reconsideration)	<b>Reconsideration Upheld</b>	2.224 (.005)*	1.636 (.112)	2.029 (.013)*
	<b>Recon. Revoked/Modified</b>	0.350 (.191)	0.342 (.201)	0.444 (.331)
<b>Amount in Dispute</b> (Log)		0.829 (.006)*	0.902 (.120)	0.871 (.033)*
<b>Nature of Taxpayer</b> (Ref: Legal Person)		2.067 (.055)	1.611 (.221)	1.839 (.098)
<b>Court Level</b> (Ordinal)		0.617 (.062)	0.692 (.168)	0.669 (.130)
<b>Type of Tax Authority Duty</b> (Ref: Other Duty)		0.778 (.465)	0.603 (.214)	0.706 (.326)
<b>Model Pseudo R-Square</b> (Nagelkerke R Square)		0.156	0.137	0.12

Note: p-values are in parentheses.

\* indicates significance at the  $p < 0.05$  level. To handle outliers and skewed distribution of the amount in dispute, its natural logarithm was used in the regression analysis.

## Interpretation of Model Data for the Judicial Deference Mechanism

Independent Variable	Direction of Influence*	p-value	Interpretation
<b>Nature of Dispute</b> (Factual)	Significantly Positive (++)	0.026	Courts tend to trust the professional advantage of tax authorities in fact-finding. <b><u>(Strong correlation)</u></b>
<b>Tax Authority Level</b>	Significantly Positive (+)	0.045	Courts tend to trust the legality and reasonableness of decisions from higher-level authorities. <b><u>(Weaker correlation)</u></b>
<b>Reconsideration Outcome</b> (Upheld)	Significantly Positive (++)	0.005	Courts tend to recognize the legality and reasonableness of the internal administrative reconsideration system. <b><u>(Very</u></b>

			<b><i>strong correlation</i></b>
<b>Amount in Dispute</b>	Significantly Negative (--)	0.006	The larger the amount in dispute, the more likely the court is to rule in favor of the taxpayer. <b><i>(Very strong correlation)</i></b>
<b>Nature of Taxpayer</b> <i>(Individual)</i>	Positive Trend (+)	0.055	Individual taxpayers may be at a disadvantage in tax administrative litigation. <b><i>(Weaker correlation)</i></b>
<b>Court Level</b>	Negative Trend (-)	0.061	The higher the court level, the more likely the court is to revoke/modify the tax authority's administrative act. <b><i>(Weaker correlation)</i></b>
<b>Type of Tax Authority Duty</b>	No Significant Influence	0.465	Different duties of the tax authority may not affect the judgment outcome. <b><i>(Very weak correlation)</i></b>

*\*Note: The "Direction of Influence" is based on the dependent variable "Final Judgment Outcome," referring to the influence on the tax authority winning, i.e., the court upholding the original administrative act. This table does not cover the data analysis for the dependent variables "Attitude towards Fact-finding" and "Attitude towards Legal Application."*

#### A. COST: FACTORS DRIVING "RATIONAL NON-INTERVENTION"

The regression results provide evidence supporting **H1: The Complexity-Deference Hypothesis**. Specifically, when cost-increasing factors are present, the probability of the tax authority winning the suit increases significantly.

First, high information and risk costs. Controlling for all other variables, when a case involves a factual dispute, the odds of the court upholding the tax authority's action are 3.05 times higher than in mixed-dispute cases ( $p=0.026$ ). This reveals the court's deference to the professional judgment of the tax authority: on the factual level involving complex tax issues, the court, as the party with professional and informational disadvantages, acknowledges that the tax authority, as the frontline enforcement body, possesses superior professional and informational advantages. Unless the taxpayer can provide clear contrary evidence, the court tends to respect the tax authority's factual conclusions. The context for this trend is that administrative power has broadly penetrated many aspects of social life, exhibiting high professional thresholds and strong technical attributes, forming specialized administrative domains. As argued in *Chevron*, an agency's interpretation is worthy of deference because the daily experience in enforcing the

statute makes the agency more familiar with the circumstances.<sup>32</sup> The observed patterns of deference are consistent with this study's hypothesis, suggesting that such judicial behavior aligns with a rational choice framework regarding the scarcity of judicial resources and the professional division of labor.<sup>33</sup> The information courts receive is mostly from the case file (second-hand information), whereas the agency's information comes from administrative investigation (first-hand information).<sup>34</sup> Although the *Administrative Litigation Law* provides for the court's power of clarification, allowing it to complete fact-finding by urging evidence submission, questioning expert witnesses, or inquiring, its fact-finding ability is still inferior to that of the administrative agency.<sup>35</sup> Therefore, by deferring to the tax authority's professional judgment in fact-finding, the court achieves an optimal allocation of judicial resources.

Second, all else being equal, for each one-level increase in the administrative rank of the tax authority, the probability of the court upholding the decision increases by 63.8% (OR=1.638, p=0.045). This sends an institutional signal of lowering cost. It indicates that, in judicial cognition, courts tend to believe that higher-level tax authorities (e.g., municipal, provincial) possess stronger legal and operational teams, more standardized administrative procedures, and more prudent decision-making processes. Administrative actions taken by higher-level authorities are afforded greater credibility, reflecting *institutional trust* functioning as a cost-saving method.

This finding fills a gap in existing academic research. Scholars have previously proposed that "deference should be limited, especially for administrative regulations from lower-level agencies."<sup>36</sup> Others, analyzing judicial deference in the US, have noted that the institutional separation between administrative courts and agencies is limited to higher levels; at lower levels, administrative procedures and dispute resolution often remain entangled, with administrative officials concurrently serving as administrative law judges in smaller states.<sup>37</sup> The data presented here confirms a linear relationship between administrative rank and judicial deference in China. By upholding decisions from

<sup>32</sup> See *Chevron*, 467 U.S. at 837.

<sup>33</sup> No. 174 (Guizhou High People's Ct. 2015), cited in Dai Jiajia (戴加佳), *Woguo Sifa Zunzhong De Xianzhuang Yu Jiantao — Yi Panduan Yudi Lilun Wei Fenxi Gongju* (我国司法尊重的现状与检讨——以判断余地理论为分析工具) [The Current Situation and Review of Judicial Deference in Our Country—Using the Judgment Margin Theory as an Analytical Tool], 2019 J.FUJIAN JINGCHA XUEYUAN XUEBAO [FUJIAN POLICE ACAD.] 50, 55 (2019).

<sup>34</sup> See Cheng Haonan (程皓楠), *Lun Xingzheng De Shouci Panduan Quan* (论行政的首次判断权) [On the Administration's Right of First Judgment], 2024J. Caijing Faxue (财经法学) [FIN. & L.] 111 (2024).

<sup>35</sup> See ZHANG LI (张力), CHANMING QUAN YANJIU (阐明权研究) [A STUDY ON THE RIGHT TO CLARIFICATION] 16–28 (China Univ. of Pol. Sci. & L. Press 2006).

<sup>36</sup> Dai Jiajia, *supra* note 34, at 55.

<sup>37</sup> Cheng Haonan, *supra* note 35, at 102.

higher-level bodies, courts align themselves with the hierarchical structure of the administration, reducing the potential friction (C) and political risk (P) associated with overturning a high-ranking defendant.

Third, compared to cases directly litigated without prior review, cases that underwent administrative review and were upheld by the review body are 2.22 times more likely to be upheld by the court (OR=2.224,  $p=0.005$ ). Administrative review, as a *quasi-judicial* self-correction mechanism within the administrative system, involves a higher-level agency reviewing the legality and reasonableness of a lower-level agency's specific administrative action.<sup>38</sup> It has advantages such as strong professionalism, relatively simple procedures, and low cost. When an administrative review upholds the original action, it signifies that the action has already passed one professional examination. This greatly reduces the court's information cost, making repetitive review unnecessary and thus alleviating the judicial burden and improving judicial efficiency.

#### B. BENEFIT: FACTORS DRIVING “RATIONAL INTERVENTION”

In contrast to the cost-driven deference observed earlier, the regression results for *Amount in Dispute* provide empirical support for **H2: The High-Stakes Scrutiny Hypothesis**. The coefficient for the logarithm of *Amount in Dispute* is negative and statistically significant ( $p=0.006$ ), indicating that as the disputed tax amount increases, the probability of judicial deference decreases, or equivalently, the likelihood of taxpayer success increases. This finding carries theoretical implications, as it challenges the simplistic “fiscal maximization” hypothesis and instead supports the dynamic weighting mechanism embedded in this paper's utility function.

Two mechanisms help explain this pattern: First, the Reputational Mechanism ( $\alpha L$ ). High-value cases serve as alarms, attracting heightened public and political scrutiny. The statistical significance suggests that in such cases, the potential reputational cost of judicial errors exceeds the Adjudication Cost. Judges are effectively compelled by these elevated stakes to invest greater effort in rigorous review. The benefit they seek is not mere efficiency, but the avoidance of catastrophic reputational harm. Second, the Stability Mechanism (P). The negative relationship between amount and deference reveals that judicial conceptions of stability are context-dependent and evolve with case stakes. In low-value disputes, stability may align with efficient revenue collection and administrative finality. However, in high-stakes

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<sup>38</sup> See Li Xiaowu (黎晓武) & Liu Hongmei (刘红梅), *Shixi Woguo Xingzheng Fuyi Zhidu De Chonggou* (试析我国行政复议制度的重构) [Analysis on the Reconstruction of China's Administrative Reconsideration System], 2011 JIANGXI SHEHUI KEXUE (江西社会科学) [JIANGXI SOC. SCI.] 170 (2011).

cases, the evidence suggests judges prioritize long-term institutional legitimacy and economic order over immediate fiscal interests. By ruling for taxpayers when substantial amounts are at stake, courts likely function as a constraint against extractive taxation, thereby safeguarding the broader tax base and maintaining market confidence in the rule of law.

### C. MARGINALLY SIGNIFICANT OR NON-SIGNIFICANT FACTORS

In addition to the factors with significant statistical effects, the model also reveals variables that are statistically marginal or do not reach significance. While these factors do not constitute independent decisive influences, their potential trends are worthy of attention and may show stronger explanatory power in a larger sample or a more refined model.

First, the *Nature of Taxpayer* variable has a p-value of 0.055, approaching the significance threshold ( $p < 0.05$ ). The direction of this variable is positive, meaning that when the plaintiff is an individual taxpayer, the odds of the tax authority winning are 2.07 times higher than in cases with legal person taxpayers. Although not meeting the strict standard of statistical significance, this trend reflects the real-world problem of litigation resource disparity. This finding resonates with classic theories in legal sociology and law and economics. Marc Galanter argued that the litigation system systematically favors “Repeat Players” (such as the tax authorities and large corporations in this study) over “One-Shotters” (such as the individual taxpayers here).<sup>39</sup> “Repeat Players” possess more litigation experience, specialized legal and financial teams, greater resource mobilization capacity, and longer-term strategic perspectives. Corporations, especially medium and large legal entities, typically have professional legal and financial teams, enabling them to organize evidence and construct legal arguments more effectively, thereby proactively lowering the court’s information costs and creating a more balanced adversarial relationship with the tax authority. Interpreted through this paper’s model, the advantage of these “Repeat Players” lies in their ability to effectively help the court reduce the Adjudication Cost, making it easier for the court to conduct a more in-depth substantive review, and potentially overturn the administrative decision. In contrast, individual taxpayers, often constrained by resources, find it difficult to provide counter-evidence sufficient to overturn the tax authority’s judgment. For individual taxpayers, who act as “One-Shotters,” their lack of resources to organize effective counter-evidence means that if the court were to overturn the administrative decision, it would face extremely high information costs and potential risks of erroneous judgment. Although the social benefit of protecting the weaker party is high,

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<sup>39</sup> See Marc Galanter, *Why the “Haves” Come Out Ahead: Speculations on the Limits of Legal Change*, 9 LAW & SOC’Y REV., 1974, at 95.

if clear evidence is lacking, the expected benefit of active judicial intervention remains low, and the court is thus more inclined to uphold the original administrative action.

Second, the *Court Level* variable has a p-value of 0.061, also approaching statistical significance. The data show that for each one-level increase in the court level, the probability of the tax authority losing increases by approximately 62%. This trend aligns with theoretical expectations: higher courts bear a stronger review function, and their willingness and ability to correct the judgments of lower courts or administrative agencies are stronger, with higher review standards. From the perspective of judge selection, higher courts typically have judges with richer judicial experience and higher qualifications, and their trial style tends to be more standardized and prudent.<sup>40</sup> This effectively lowers their marginal information cost and risk cost for review, making it easier for the benefits of correction to surpass the cost threshold. It is worth noting that the *Court Level* variable may be influenced by the *Amount in Dispute* variable. According to Article 15 of the ALL, intermediate courts have jurisdiction over “major and complex” first-instance administrative cases within their territory. In practice, cases with large amounts in controversy are often deemed “major and complex” and are thus more likely to be heard by an intermediate court at first instance and a high court on appeal. This suggests that the *Court Level* and *Amount in Dispute* variables are not entirely independent and may have a potential interaction effect. Although the statistical significance of *Court Level* in this sample is insufficient, its explanatory power may be limited by the small number of high court samples (only 21 cases) and interference from other variables, but the existing data still suggest it has institutional explanatory power.

Finally, the type of tax authority duty variable has a p-value of 0.465, far from statistical significance. This indicates that after controlling for substantive variables like the nature of the dispute and the amount in controversy, whether the case involves tax collection itself, or other duties like taxpayer status confirmation or social security, does not significantly affect the court’s judgment tendency.

#### D. SUMMARY: UTILITY FUNCTION CONSIDERATIONS AT DIFFERENT REVIEW LEVELS

Synthesizing the empirical findings, it can be concluded that the variation in judicial outcomes observed in the PRC tax adjudication reflects a conditional equilibrium shaped by judicial utility maximization. The data expose two distinct pathways of

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<sup>40</sup> See Weimin Zuo (左卫民), *An Empirical Study on the Reform of the Judge Quota Selection Mechanism: Taking Province A as a Sample* (员额法官遴选机制改革实证研究: 以A省为样板) [ *Yuane Faguan Linxuan Jizhi Gaige Shizheng Yanjiu: Yi A Sheng Wei Yangban* ], ZHONGGUO FAXUE (中国法学) [CHINA LEGAL SCIENCE] (2020).

judicial review, each governed by a different configuration of the utility function. In cases marked by high factual complexity (*Factual Disputes*) but moderate financial stakes, Adjudication Cost emerges as the dominant factor. Judges rationally conserve limited cognitive and institutional resources by deferring to administrative expertise, producing consistently high rates of deference. Here, efficiency trumps scrutiny. By contrast, in high-stakes cases, elevated error costs and reputational risks ( $\alpha L$ ) compel judges to abandon the deference posture. The observed negative correlation between dispute amount and uphold rates indicates that judges function as rational guardians of economic order when the stakes justify the investment of adjudicative effort. In this track, self-preservation drives rigor.

These findings invite a realistic interpretation of how tax justice operates within the system. The balance between state fiscal power and taxpayer property rights, often articulated as the normative aspiration of administrative law, appears not as the judiciary's primary, autonomous objective, but rather as an emergent property of judicial utility maximization. When error costs are substantial, judges' self-interest in avoiding reputational damage and preserving economic stability converges with taxpayers' interest in strict legal accountability. Conversely, when decision-making costs are high and stakes remain modest, judges' self-interest in minimizing effort aligns with administrative interests in efficient revenue collection and decisional finality. This interpretation suggests that taxpayer rights receive their protection not primarily through normative commitment, but when such protection coincides with the institutional incentives facing the judiciary.

Indeed, this offers practical guidance: if the aim is to strengthen judicial scrutiny in complex cases, reforms must address the structural drivers of adjudication costs. Likewise, to ensure consistent protection even in lower-stakes disputes, mechanisms should be designed to adjust the relevant variables within the judicial utility function.

#### VI. INSTITUTIONAL REFORM PATHS CENTERED ON OPTIMIZING JUDICIAL REVIEW

The overall maintenance rate of nearly 70% still reflects the relatively strong position of tax authorities in litigation. To optimize judicial review mechanisms and strengthen the protection of taxpayer rights, the focus should be on how to effectively break through the professional barriers in tax-related justice and, while respecting administrative professionalism, empower courts with a stronger capacity for substantive review. Therefore, the core task is to proactively utilize the cost-benefit structure of judicial review, primarily by lowering the total judicial cost while potentially enhancing the court's sensitivity to benefits.

### A. REDUCING TOTAL COST: IMPROVING SPECIALIZED TRIBUNALS

The court's rational non-intervention is most pronounced in factual dispute cases, directly reflecting the professional barriers judicial review faces against highly specialized tax collection and administration activities. Therefore, the solution lies in promoting judicial specialization by improving specialized tribunals.<sup>41</sup> Specialization serves as a fundamental cost-reduction strategy. By fostering expertise, it directly attacks the high cognitive and information costs that stem from bounded rationality and information asymmetry. Currently, the "Xiamen model" and the "Shanghai model" have emerged around specialized tax adjudication.<sup>42</sup> The Xiamen model refers to the establishment of a tax-related cases collegial panel in the Siming District People's Court of Xiamen, centralizing jurisdiction over first-instance civil, administrative, and criminal tax cases in Xiamen. The Shanghai model refers to the Shanghai Railway Transport Court's tax tribunal and the Shanghai Third Intermediate People's Court's administrative tribunal (tax tribunal) handling first- and second-instance tax administrative cases, respectively.<sup>43</sup> Although these two models represent significant innovations in the judicial system for tax adjudication, their specific institutional designs have room for improvement. For example, some scholars note that neither model's scope of accepted cases covers tax-related administrative promise or administrative agreement cases, nor do they respond to the fee-related duties undertaken by tax authorities.<sup>44</sup> Nonetheless, by establishing specialized tax collegial panels and tribunals, both models have effectively promoted the specialization of adjudicative bodies, fostered the professional

<sup>41</sup> Judicial specialization includes judicial institutional specialization, subject specialization, adjudicatory basis specialization, judicial professional ethics specialization, etc.; this paper refers to subject specialization. See Weifang He (贺卫方), *Sifa Gaige De Nanti Yu Chulu* (司法改革的难题与出路) [*The Dilemma and Way Out of Judicial Reform*], NANFANG ZHOUMO (南方周末) [SOUTHERN WEEKEND], Sept. 18, 2008, cited in Wei Deng (邓伟), *Lun Woguo Shuiwu Sifa Zhuanyehua* (论我国税务司法专业化) [*On the Specialization of Tax Judiciary in China*], in Dijiu Jie "Shuiwu Sifa Lilun Yu Shijian" Luntan Lunwenji (第九届“税务司法理论与实践”论坛文集) [Proceedings Of The 9th Forum On Tax Judicial Theory And Practice] 33.

<sup>42</sup> See Xiamen Shi Zhongji Renmin Fayuan Guanyu Mingque Sheshui Anjian Jizhong Guanxia Xiangguan Anyou De Tongzhi (厦门市中级人民法院关于明确涉税案件集中管辖相关案由的通知) [*Notice of the Xiamen Intermediate People's Court on Clarifying the Causes of Action for Centralized Jurisdiction over Tax-Related Cases*] (Xiamen Interm. People's Ct. 2023).

<sup>43</sup> See Shanghai Shi Gaoji Renmin Fayuan Guanyu Benshi Yi Shuiwu Bumen Wei Dangshiren De Xingzheng Anjian Jizhong Guanxia De Guiding (上海市高级人民法院关于本市以税务部门为当事人的行政案件集中管辖的规定) [*Shanghai High People's Court Provisions on the Centralized Jurisdiction of Administrative Cases Involving Tax Departments as Parties*] (Shanghai High People's Ct. n.d.).

<sup>44</sup> See Gang Li (李刚) & Yifeng Gu (谷一峰), *Sheshui Anjian Jizhong Guanxia Moshi Xia Shuiwu Xingzheng Anjian De Shouan Fanwei Chutan* (涉税案件集中管辖模式下税务行政案件的受案范围初探) [*A Preliminary Study on the Scope of Tax Administrative Cases under the Centralized Jurisdiction Model*], 2025 SHUIWU YANJIU (税务研究) [TAX'N RSCH] (2025).

development of judges,<sup>45</sup> and incentivized judges to actively learn finance, tax, and related knowledge. This enhances their independent review capabilities when facing complex tax issues and lowers their costs (including information, risk, and coordination costs) of reviewing cases.<sup>46</sup> Only in this way can judicial review transcend the formal review of administrative procedures and truly penetrate the substantive aspects of a case, rather than merely passively confirming the results of administrative investigations.

#### B. REDUCING INFORMATION COST: INTRODUCING THE PENETRATIVE REVIEW CONCEPT

Courts should be encouraged and empowered to innovate trial methods by introducing the penetrative review concept, granting them stronger fact-checking capabilities to achieve substantive review of cases and proactively lower information costs. Penetrative review can be viewed as a contextual tool for lowering information costs and simultaneously increasing the visibility of potential benefits. It is a direct institutional counter to the problem of information asymmetry, a core concept in agency theory and institutional economics.<sup>47</sup> In administrative litigation, the agency acts as the “agent,” holding private information that the court, as the “principal” in its review capacity, cannot easily observe. Penetrative review thus functions as a monitoring mechanism to reduce “information rent.” Conceptually, penetrative review refers to the court’s exercise of judicial power to go beyond the surface of a single administrative act, observe the entire administrative process, identify the plaintiff’s true rights status, and determine a judgment method that ensures gap-free protection of rights. This approach is particularly relevant in tax disputes, especially in complex cases involving VAT deduction chains or related-party transactions under enterprise income tax. For instance, in the *Shanghai Mou Shen Petrochemical Co. Ltd. v. Fifth Inspection Bureau of Shanghai Municipal Tax Service* case, the tax tribunal of the Shanghai Railway Transport Court adopted a penetrative review method to investigate the case facts.<sup>48</sup> The dispute centered on inconsistent factual findings by upstream and downstream tax authorities regarding the existence of fraudulent

<sup>45</sup> See Xiamen Siming Dist. People’s Ct. Rsch. Grp. (厦门思明区人民法院课题组), Shuiwu Sifa Zhuanyehua Gaige De Shixian Lujing (税务司法专业化改革的实现路径) [ *The Realization Path of Tax Judicial Specialization Reform*], 2025 JIMEI DAXUE XUEBAO (ZHE SHE BAN) (集美大学学报(哲社版)) [ J. JIMEI UNIV. (PHIL. & SOC. SCI.) ] 13 (2025).

<sup>46</sup> See Shimei Liao (廖仕梅), Sheli Shuiwu Fayuan De Biyaoxing He Kexingxing (设立税务法院的必要性和可行性) [ *The Necessity and Feasibility of Establishing a Tax Court*], DIFANG CAIZHENG YANJIU (地方财政研究) [LOCAL FIN. RSCH.] 98 (2017).

<sup>47</sup> George A. Akerlof, *The Market for “Lemons”: Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON., 1970, at 488.

<sup>48</sup> See SHANGHAI RAILWAY TRANSP. CT., Shuiwu Xingzheng Anjian Sifa Shencha Baipishu (税务行政案件司法审查白皮书) [WHITE PAPER ON JUDICIAL REVIEW OF TAX ADMINISTRATIVE CASES] 3 (n.d.).

VAT special invoices. Faced with this, the court innovatively joined the upstream tax authority as a third party to the litigation, effectively breaking down the information barriers caused by the tax system's segmented jurisdiction and enforcement.

This practice not only helps enhance the court's independent investigation capabilities and corrects rational non-intervention caused by insufficient capacity and high information costs, but also provides a path for the substantive resolution of administrative disputes, thereby enhancing the credibility of administrative adjudication. Through breaking down information barriers, it significantly reduces the information costs in adjudicating the specific case; at the same time, it makes the potential benefits of intervention (i.e., achieving substantive justice) more apparent and compelling to the court, thereby driving rational intervention.

### C. PROVIDING STABLE EXPECTATIONS FOR ECONOMIC RATIONALITY: CLARIFYING REVIEW RULES

While the court's economic rationality presents an internal structure at the macro level, in micro-level individual cases, it relies heavily on the judge's unstated discretion. If standards are not uniform, it is highly likely to lead to the risk of different judgments in similar cases. Therefore, transforming the discretionary logic that has spontaneously formed in judicial practice into external, clear review rules is the core path to standardizing discretionary power and ensuring the uniform application of the law. Its law and economics significance lies in providing a more stable and predictable baseline for the cost-benefit analysis.

In the short term, standards for the intensity of review can be refined by issuing guiding cases or judicial interpretations. As the data above show, the *Amount in Controversy* is highly correlated with the activation of intensified court review, while *Factual Dispute* is highly correlated with the inhibition of court review. This can be codified, for example, by specifying that in cases involving significant monetary amounts, complex facts, or a close relationship to taxpayer rights, courts should apply a stricter standard of review, adopt a more exacting attitude towards the tax authority's burden of proof, and scrutinize the authority's reasoning more rigorously. Correspondingly, in cases of pure fact-finding where administrative procedures are complete, a slightly lower standard centered on "reasonableness" could be applied, but it must be clear that if the taxpayer can provide preliminary counter-evidence, the court should initiate a more active review process. From a law and economics perspective, transitioning from implicit "standards" to clearer "rules" offers significant advantages by reducing uncertainty and transaction costs in the legal system. Explicit rules provide taxpayers and tax authorities with more stable expectations about how disputes will likely be resolved, potentially reducing the frequency of litigation

itself. Simultaneously, clearer rules reduce the decision costs for judges in individual cases, as they provide more direct guidance, lessening the need for extensive, ad-hoc balancing. This enhances judicial efficiency, promotes consistency across judgments, and ultimately lowers the overall societal costs associated with the judicial review system. By reducing ambiguity, clear rules also lower the institutional coordination costs between the judiciary and the administration, and between all parties and the legal system itself.

In the long term, a special procedural law for tax administrative litigation could be studied and formulated in future research. Drawing reference from the *Special Maritime Procedure Law*<sup>49</sup> and scholarly proposals for a Taxpayer Rights Advocate,<sup>50</sup> specialized rules and standards for judicial review intensity could be established to address the technical nature of tax litigation and the fundamental rights attributes of taxpayers, responding to the institutional design of specialized tribunals.

## VII. CONCLUSION

Tax administrative adjudication can be effectively understood as the result of economic rationality in operation. This paper has discussed the theoretical paths and appropriateness of the Utility Function Model ( $U_j = \alpha L - \beta C + \gamma P$ ), displayed the cost-benefit trade-off in the legal system in China, and made a systematic literature review regarding the institutional constraints on judicial decision-making. As a result, when the total cost of judicial intervention is high, courts tend to adopt a rational non-intervention stance. Specifically, variables representing high information and risk costs significantly increase the probability of the court upholding the original judgment, including *Factual Dispute* (OR=3.051), *Tax Authority Level* (OR=1.638), and *Administrative Review Uphold* (OR=2.224). Conversely, when potential benefits are high, courts are more inclined towards rational intervention. *Amount in Controversy* (OR=0.829) stands out as the only significant factor driving courts to rule in favor of the taxpayer, suggesting that high benefits may serve to offset the high costs of review.

The analysis suggests that the variance in judicial tendencies may not stem primarily from inconsistent judicial standards, but likely reflects the differentiated manifestation of economic

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<sup>49</sup> See Shengqing Chi (池生清), *Deguo Shuishou Jiuji Zhidu De Jiangou Yuanli Chutan* (德国税收救济制度的建构原理初探) [*A Preliminary Study on the Construction Principles of the German Tax Relief System*], 2017 SHUIWU YANJIU (税务研究) [TAX'N RSCH.] 81 (2017).

<sup>50</sup> See Duoqi Xu (许多奇), *Luoshi Shuishou Fading Yuanze De Youxiao Lujing* — Jianli Woguo Nashui ren Quanli Baohuguan Zhidu (落实税收法定原则的有效路径 — 建立我国纳税人权利保护官制度) [*An Effective Path to Implement the Principle of Tax Law Statutism: Establish a Taxpayer Rights Advocate System in China*], 2014 FAXUE LUNTAN (法学论坛) [LEGAL F.] (2014).

rationality under different cost-benefit constraints. In other words, the nearly 70% maintenance rate for tax authorities in litigation appears less likely to be a product of judicial bias, and more of a rational equilibrium resulting from the excessive costs of judicial review.

On this basis, if the system itself has an economic rationality foundation, then the key to achieving taxpayer rights protection lies in proactively reshaping the cost-benefit structure of judicial review. To this end, this paper proposes a three-pillar path to optimize the tax administrative litigation system: first, improve specialized adjudicative bodies to promote judicial specialization; second, introduce the penetrative review concept to strengthen the court's substantive review capabilities; and third, clarify judicial review standards to enhance the consistency and predictability of judgments. The first two aim to reduce the total cost of judicial intervention, while the latter intends to provide stable expectations for economic rationality, ultimately achieving the coordination and balance of state tax power and citizen rights on the track of the rule of law.

This study still has limitations. Due to the inadequacies in the quantity and informational detail of public judgments, the sample's representativeness needs further improvement. Concurrently, factors that are difficult to quantify, such as the court's actual scope of review, applicable standards, and the judge's internal deliberations, cannot be directly observed from the judgment texts and thus were not included in the empirical model. Future research can expand the sample size and introduce more control variables to further deepen the understanding of the economic rationality underlying tax administrative adjudication in the PRC.