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Algorithmic Authority and Constitutional Accountability in Indian Tax Law

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ABSTRACT

The past decade has witnessed a profound reconfiguration of Indian corporate tax administration through machine learning platforms of unprecedented analytical scope. Project Insight, the Computer-Assisted Scrutiny Selection system (CASS), the GST Network analytics platform, and the Faceless Assessment Scheme under Section 144B of the Income Tax Act, 1961 ('ITA 1961') collectively represent the most consequential structural transformation of fiscal governance since the introduction of self-assessment. Yet the legal architecture purportedly governing these platforms has failed to keep pace with their constitutional implications. This paper advances the thesis that India's existing statutory and constitutional framework is structurally inadequate to govern AI-driven corporate tax audits across five dimensions: the absence of explicit parliamentary authority for algorithmic audit selection; the failure of procedural safeguards to reach the pre-selection stage; the absence of accountability mechanisms for harm caused by erroneous algorithmic determinations; the inadequacy of data governance frameworks; and the absence of independent institutional oversight. Drawing on doctrinal analysis, empirical data from fifteen tax professionals and twenty corporate entities, comparative review of the United Kingdom, European Union, Australia, and the United States, and a sustained engagement with Maneka Gandhi v Union of India and KS Puttaswamy v Union of

India, the paper proposes a phased legislative reform agenda. The central thesis is that technological capability and constitutional legitimacy are complementary rather than competing values.

I. INTRODUCTION

In a constitutional democracy, the state's fiscal claim is resolved through law: the state may tax, but only on authorised bases, through prescribed procedures, and with accountability for its exercise of power. India's Income Tax Act of 1961 encodes this principle elaborately, its procedures predicated on a human assessing officer exercising individual judgment, recording reasons, and remaining identifiable to those under examination. The present decade has not merely refined that model; it has replaced its operational foundations while leaving the statutory architecture formally intact.

Project Insight, launched in 2017, aggregates data from banking institutions, financial intelligence units, securities regulators, company registrars, customs databases, and property registration records, deploying machine learning models to construct risk profiles of corporate taxpayers at a scale no manual process could replicate. CASS applies algorithmic risk-scoring to determine which returns merit detailed examination, replacing officer discretion with a process whose internal criteria have never been publicly disclosed. The GST Network generates real-time invoice-level analytics drawing on over seven billion annual invoice records. The Faceless Assessment Scheme, introduced to eliminate corruption by removing the human officer from proceedings, has generated arguably deeper constitutional difficulties: when the decision to scrutinise a company is made by an algorithm, a portal issues the notice, and the assessment is conducted by an officer whose identity is withheld, the procedural values that give tax administration its constitutional legitimacy are structurally compromised.

The efficiency gains of this technological transformation are genuine and should not be dismissed. However, efficiency gains do not by themselves confer constitutional legitimacy. A faster system that acts arbitrarily is not better than a slower system that acts fairly; it is worse, because it scales injustice. What voluntary compliance requires is not merely effectiveness but procedural legitimacy: the taxpayer's perception that the system operates by knowable rules, that its decisions can be explained, and that its errors can be corrected.

The ITA 1961's conceptual architecture rests on the unexamined assumption of a human assessing officer at the centre of every consequential determination. When an artificial intelligence system performs or substantially shapes those functions, that architecture does not merely strain at its edges; it

fractures at its foundations. This paper proceeds through six further sections: a technical and legal analysis of the deployed AI systems; a systematic doctrinal critique of existing frameworks; an examination of corporate governance consequences; an analysis of ethical challenges including algorithmic bias; a comparative review of regulatory approaches in the UK, EU, Australia, and the United States; a phased set of legislative reform proposals; and a conclusion.

II. THE TECHNOLOGY AND ITS LEGAL CONSEQUENCES

Artificial intelligence, as deployed in contemporary tax enforcement, is best understood as supervised machine learning, in which an algorithm is trained on labelled historical data to generate predictive classifications of new inputs. The critical legal implication follows directly: the 'rules' a trained model applies exist as numerical weights distributed across potentially thousands of parameters, and the relationship between any specific input and the resulting output cannot, in deep learning architectures, be traced to a single identifiable decision criterion. This is not a temporary limitation awaiting better engineering; it is a structural feature of the parametric statistical learning approach.

The practical legal consequence is stark. A supervised classifier used to assign an audit risk score to a corporate return cannot, without interpretability tooling that the CBDT has not publicly deployed, explain why it rated a particular company as high-risk. It can identify that the company's profile diverges from the statistical norm of its training data in ways associated with non-compliance; it cannot specify which feature drove the determination, how much weight it carried, or whether the historical association remains valid for the company's current circumstances. This is precisely the information a taxpayer needs to mount a meaningful response, and precisely the information the existing legal framework does not require to be disclosed.

Project Insight operates as a centralised data integration and analytical engine drawing on over three hundred external data sources. CASS has evolved from a rule-based selection mechanism toward a machine learning-driven one. Earlier versions applied articulable, testable criteria against which a company could identify the basis of its selection and respond directly. The ML-enhanced CASS generates risk scores from combinations of potentially hundreds of variables, with no equivalent specification of decisive factors publicly available. The Comptroller and Auditor General, reporting in 2023, found that accountability documentation for CASS selection decisions was systematically incomplete and that post-hoc review mechanisms were inadequate to detect and correct erroneous algorithmic outputs.

III. THE EXISTING LEGAL FRAMEWORK: A CRITICAL AUDIT

A. The Foundational Void in the Income Tax Act

The Income Tax Act 1961 contains no provision that expressly authorises, regulates, or constrains the use of artificial intelligence in audit selection, risk scoring, or the preparation of assessment orders. Section 143(2) empowers 'the Assessing Officer' to issue a notice if 'he considers it necessary or expedient to ensure the correctness of the return.' The legislative text is grammatically and conceptually unambiguous: it requires a human being forming a judgment on the basis of reasons specific to the return before him. No textual basis within Section 143(2) supports reading 'he considers' as encompassing an algorithmic risk score generated by a system no individual officer designed, calibrated, or reviewed in relation to the specific return.

The CBDT's reliance on the general administrative coordination power in Section 119 as the basis for deploying Project Insight and CASS is constitutionally untenable. Section 119 was enacted to enable the Board to issue instructions to subordinate authorities for the 'proper administration of the Act.' The proposition that this general coordination power provides sufficient parliamentary authority for the deployment of an Rs. 1,000 crore machine learning infrastructure determining which of India's 1.3 million active companies face full tax scrutiny fails the basic test of legality. The Finance Act 2021's validation of data analytics as a reassessment trigger represents the legislature's first and only express engagement with the subject. By including 'any information generated through data mining or data analytics' within the statutory triggers for reassessment, Parliament has validated data analytics as a basis for initiating proceedings. However, the amendment imposes no standard of reliability, accuracy, or methodological integrity; it validates all data analytics equally regardless of the system's design, validation history, or false-positive rate.

B. The Pre-Procedural Gap and Natural Justice

The ITA 1961's procedural protections operate entirely within the assessment proceeding that follows from a return being selected for scrutiny. They say nothing about the legality of the selection decision itself. No provision requires that the taxpayer be told an algorithm selected their return, what data the algorithm used, what risk score was assigned, or which factors drove that score. This 'pre-procedural gap' is where the most consequential decision in the taxpayer's engagement with the tax authority is made, and where the law provides no protection whatsoever.

The constitutional analysis begins with Maneka Gandhi v Union of India (1978). Justice Bhagwati's treatment of Articles 14, 19, and 21 as forming a unified constitutional guarantee of substantive fairness established that any state action affecting fundamental rights must be taken through a procedure that is 'right, just, and reasonable.' A selection process whose basis cannot be examined because it is algorithmically generated and never disclosed to the affected party is not 'right, just, and reasonable' by any defensible interpretation of that standard. GKN Driveshafts (India) Ltd v ITO (2003) applied this principle specifically to the tax context, holding that reasons recorded for a scrutiny notice must be furnished to the taxpayer upon request. In the algorithmic context, the officer issuing the notice may themselves be unable to explain the algorithmic basis of the selection upon which they are acting. The Supreme Court's intervention in Union of India v Ashish Agarwal (2022), where approximately 90,000 defective reassessment notices were treated as show-cause notices under Article 142, signals that judicial patience with procedural deficits in the AI-driven reassessment regime is running out.

C. Companies Act, IT Act, and DPDP Act

The Digital Personal Data Protection Act 2023 ('DPDP Act') was widely anticipated as a framework addressing algorithmic governance. In practice, its relevance to AI-driven corporate tax audits is structurally limited. First, the Act's protective scope is confined to 'personal data' about an identifiable natural person, excluding corporate financial data that forms the primary input of AI-driven corporate tax audit systems. Second, Section 17(2)(a) permits the Central Government to exempt any instrumentality of the state from any or all provisions where processing is necessary for 'enforcement of any right or claim.' The CBDT is an instrumentality of the state; tax assessment is enforcement of a right or claim; the DPDP Act therefore provides no material constraint on Project Insight or CASS. The constitutional sustainability of that blanket exemption is doubtful in light of the proportionality framework established in KS Puttaswamy v Union of India (2017), which requires that any limitation on the fundamental right to informational privacy be legally authorised, necessary for the stated purpose, and accompanied by procedural safeguards against misuse.

IV. CORPORATE GOVERNANCE IMPLICATIONS

AI-driven administration introduces a form of risk distinct from compliance risk: the risk that a transaction, structure, or financial profile that is entirely lawful and accurately reported will nonetheless generate an algorithmic flag because it falls outside the statistical distribution of the model's training data. Compliance quality and algorithmic audit risk have thus become partially decoupled, which is both a

governance problem and a constitutional one. The data environment determining algorithmic audit risk extends far beyond the filed return itself. Discrepancies between GSTN records and income tax return figures, however innocently explained, generate algorithmic flags the company will not learn of until the scrutiny notice arrives.

In the majority of Indian listed companies, tax risk management has historically been a technical function delegated to the CFO. AI-driven tax audits require a fundamental rethinking of this arrangement. Fewer than thirty percent of companies surveyed for this research had formally incorporated AI-specific tax audit risk into their enterprise risk management frameworks, and the CII-Deloitte Tax Technology Readiness Survey of 2023 found that 71% of SMEs had conducted no formal assessment of their algorithmic audit risk exposure whatsoever. The principle articulated in In re Caremark International Inc (1996)that directors breach their duty of care when they fail to implement adequate monitoring systems for material, foreseeable legal riskstranslates directly into the Indian governance context through Section 166(2) of the Companies Act.

The disproportionate impact on small and medium enterprises warrants separate emphasis. India has approximately 63 million MSMEs contributing around 30% of GDP. Empirical research by Makhija and Anand found that SMEs with annual turnover below Rs. 10 crore incurred average compliance costs of Rs. 4.2 lakh per scrutiny assessment under the faceless regime. PwC India's Tax Controversy Survey documented that average legal costs per assessment proceeding rose by approximately 295% following the introduction of the faceless regime, reaching Rs. 8.3 lakh. This structural coercionwhere legally compliant taxpayers settle meritorious disputes because contestation costs exceed the amount at stakeis a governance failure with constitutional dimensions.

V. ETHICAL AND OPERATIONAL CHALLENGES

Machine learning systems trained on historical enforcement data do not learn about objective non-compliance; they learn about historical enforcement decisions. Those decisions were themselves products of resource constraints, institutional priorities, political pressures, and the accumulated biases of the officers who made them. When the CBDT trains an audit risk-scoring model on decades of enforcement records, it encodes these historical choices as predictive associations, reproducing the enforcement patterns of the past as predictions for the futurea feedback loop that amplifies rather than corrects historical inequities. Three distinct bias patterns are plausible in the Indian context and consistent with the empirical data collected for this research: sector bias, arising from industries historically subjected to

higher enforcement intensity appearing in training data with elevated frequencies of adverse findings; size-related bias, where the statistical norm calibrated to large corporate returns produces higher false-positive rates for SMEs; and geographic bias arising from documented regional enforcement heterogeneity absorbed into the model's predictive function.

The principles of natural justicethe rule against bias and the right to be heardapply to the full range of administrative decision-making affecting rights and interests, as established in AK Kraipak v Union of India (1970). An algorithm trained on biased historical data exhibits a more fundamental form of bias than personal partiality: its outputs systematically disadvantage certain classes of taxpayers because the computational logic embeds historical inequities as structural features. The right to be heard is compromised at multiple levels simultaneously. A taxpayer whose return has been selected on the basis of an undisclosed algorithmic risk score cannot prepare a meaningful substantive response because the analytical basis of the adverse determination is unknown. The GSTN framework creates a further problem: a corporate taxpayer's input tax credit claims may be disallowed because a supplier is retrospectively classified as fraudulent, with the taxpayer suffering loss as a consequence of an algorithmic determination about another entity in proceedings to which it was not a party.

Frank Pasquale's characterisation of algorithmic systems as constituting a 'black box society' captures the epistemological challenge deep learning models present for public accountability with particular precision. Zarsky's proposal for selective transparencyrequiring disclosure of general methodology, data categories, validation approach, and error rates without requiring disclosure of proprietary model architectureoffers a constitutionally adequate and operationally workable middle path. The GDPR's Article 22 right to meaningful information about automated decision-making logic represents a partial legislative realisation of this approach. By aggregating data from over three hundred sources into a single analytical platform, the CBDT has effectively built a state financial surveillance infrastructure of unprecedented scope, the proportionality of which has not been demonstrated and is not currently required by any statutory provision to be demonstrated.

VI. COMPARATIVE PERSPECTIVES

HMRC's Connect system performs functions broadly analogous to Project Insight. What distinguishes the UK experience is not technological sophistication but governance architecture. HMRC is bound by the Taxpayer's Charter under Section 16A of the Finance Act 2009, creating enforceable standards of transparency against which AI-influenced decisions can be measured. The UK's Algorithmic

Transparency Recording Standard (ATRS), applied to HMRC's Connect system, requires public bodies to publish records specifying each deployed tool's purpose, data categories, training methodology, validation approach, human oversight mechanisms, and known limitations. The National Audit Office has independently reviewed HMRC's Connect programme and the HMRC Adjudicator's Office provides an accessible complaints pathway for AI-related process failures. The ATRS demonstrates one critically important proposition: the perceived tension between algorithmic transparency and operational effectiveness is largely illusory.

The EU AI Act, adopted in June 2024, provides the conceptually superior architecture for Indian reform. AI systems used in tax audit selection and assessment qualify as high-risk under Annex III, which explicitly covers systems used by public authorities to make determinations significantly affecting the legal status of entities. For high-risk systems, the Act requires pre-deployment conformity assessment by technically qualified independent persons, registration in a publicly accessible database, maintenance of technical documentation and operational logs, meaningful human oversight, and disclosure to affected parties of the fact and basis of automated decision-making. Two structural features are particularly instructive: the pre-deployment burden allocation places the burden of demonstrating compliance on the deploying authority, not the affected taxpayer; and the operational logging requirement enables appellate authorities to evaluate algorithmic determinations when challenged on appeal.

The Australian Robodebt scheme has achieved canonical status as the reference case for catastrophic failure in algorithmic public administration. The Royal Commission found that the scheme was unlawful throughout its operation, that senior officials knew it was unlawful and proceeded regardless, and that the harm caused to hundreds of thousands of welfare recipients was the predictable consequence of deploying a high-risk algorithmic system without adequate legal authority, without methodological validation, and without independent oversight. The structural parallels with certain features of AI-driven tax administration in India are concrete and concerning: the GSTN's retrospective disallowance of input tax credits on the basis of undisclosed algorithmic assessments does not disclose its analytical methodology, effectively reverses the evidential burden, and imposes substantial financial consequences on parties who had no opportunity to participate in the determination that harmed them.

The IRS, following significant technology investment authorised by the Inflation Reduction Act of 2022, maintains a publicly accessible inventory of AI use cases. The Administrative Procedure Act's 'arbitrary and capricious' standard of judicial review has been applied to AI-influenced agency decisions to require that the opacity of an algorithmic system does not discharge an agency from its obligation to

provide a reasoned explanation. The GAO's 2022 study found that Black taxpayers were audited at 2.9 to 4.7 times the rate of otherwise similar non-Black taxpayers, a disparity substantially attributable to algorithmic bias in the EITC audit selection model. This finding demonstrates, in a mature AI-driven tax administration with public oversight, that substantial algorithmic bias can persist undetected for yearsmaking the probability that Project Insight and CASS, operating in the complete absence of any published independent audit, are producing unbiased outcomes not credibly defensible.

VII. REFORM PROPOSALS

The reform agenda proposed here is organised around four principles drawn from constitutional analysis: legality (every AI deployment must rest on specific parliamentary authority); transparency (affected taxpayers must have meaningful information about how AI systems affect their obligations); accountability (clear rules must identify responsibility and remedy for AI-caused harm); and proportionality (governance intensity must be calibrated to the severity of risk).

A. Phase I: Immediate Interventions (0–18 Months)

Three interventions are achievable within the CBDT's existing administrative and rule-making powers. First, an immediate CBDT circular on human oversight standards within the NaFAC, requiring assessing officers to document their independent review of AI-generated risk assessments before acting on them, addressing whether the AI output is consistent with the taxpayer's overall compliance profile and whether contextual features exist that the model would not have been able to recognise. Second, a targeted amendment to Section 143(2) of the ITA 1961, requiring that where selection has been wholly or substantially influenced by an AI or data analytics system, the notice must inform the taxpayer of that fact and specify the general categories of data discrepancy or analytical concern that triggered selection. This amendment does not require disclosure of proprietary model architecture; it requires that the taxpayer know, in general terms, why they have been singled out for scrutinythe minimum that GKN Driveshafts establishes as constitutionally necessary. Third, SEBI should amend the LODR Regulations to require listed companies to include in their annual reports a specific statement on their approach to AI-driven tax audit risk.

B. Phase II: Structural Accountability through Legislative Amendment (18 Months – 3 Years)

The insertion of a new Section 133D into the ITA 1961, specifically authorising and regulating the CBDT's deployment of AI systems in audit selection and assessment, is the foundational legislative

reform from which all subsequent structural accountability measures derive their coherence. Section 133D would provide the specific statutory authority that Section 119 cannot constitutionally supply, and would establish as statutory requirements: pre-deployment independent conformity assessment; registration of approved systems in a publicly accessible CBDT register; maintenance of operational logs sufficient to reconstruct the analytical basis of any specific determination; and annual parliamentary reporting on AI system performance metrics including the proportion of AI-influenced assessments reversed on appeal. Section 250's appellate powers should be amended to specifically empower the Commissioner (Appeals) to call for audit logs and validation documentation of AI systems that contributed to an assessment under challenge. Section 293's officer immunity provision should be amended to specify that good faith immunity does not extend to decisions substantially based on AI outputs where no documented independent review was conducted, and where a taxpayer has suffered quantifiable harm directly attributable to an AI system's erroneous output, a state liability to compensate for reasonable costs should be created.

C. Phase III: A Comprehensive Legislative Framework (3–5 Years)

The proposed AI in Tax Governance Act would provide the comprehensive dedicated legislative framework that piecemeal amendment of existing statutes cannot supply. Modelled structurally on the EU AI Act's risk-based classification approach, the Act would define a functional classification of AI systems by risk level, with high-risk status attached to all systems used in audit selection, risk scoring, and assessment preparation. Pre-deployment requirements would place the conformity assessment burden on the deploying authority, correcting the current implicit inversion of the burden of proof. The Act would establish two new institutional bodies. The AI Tax Governance Councilan independent statutory body with membership drawn from tax law, machine learning, constitutional law, and civil societywould conduct pre-deployment conformity assessments, audit deployed systems for accuracy and fairness, maintain the public register, handle AI-related procedural complaints, and report annually to Parliament. The AI Audit Review Tribunala specialist adjudicative body with the technical capacity to evaluate operational logs, validation reports, and expert evidence about AI system performancewould provide the specialist dispute-resolution pathway that the ITAT, with its pendency exceeding 538,000 matters, cannot offer.

III. CONCLUSION

India has made genuine and consequential investments in AI-driven tax administration. The analytical capability embodied in Project Insight, CASS, the GSTN platform, and the Faceless Assessment Scheme represents a real modernisation of fiscal governance. These achievements are worth preserving. They cannot be preserved on their current legal foundations, which are constitutionally exposed and structurally precarious.

The five structural legal gaps identified in this paperabsent statutory authority, failed pre-procedural protection, unaccountable harm, inadequate data governance, and absent independent oversightrepresent a fundamental mismatch between the operational architecture of AI-driven tax administration and the constitutional order within which that administration must operate. The costs are borne concretely: by the SME that spends eight lakh rupees in legal costs to establish that an algorithm was wrong; by the listed company whose shareholders receive inadequate disclosure of material AI-generated tax risk; and ultimately by the tax system itself, whose voluntary compliance yield depends on procedural legitimacy that opacity and unaccountable error steadily corrode.

The comparative evidence from the UK's Algorithmic Transparency Recording Standard, the EU AI Act's risk-based classification framework, Australia's post-Robodebt governance reforms, and the IRS's institutional transparency mechanisms collectively demonstrates that the perceived tension between technological capability and legal accountability is not a genuine constraintit is a failure of governance imagination. India's position, deploying some of the most powerful fiscal AI systems in the democratic world under essentially no dedicated legal framework, is an outlier that the constitutional order cannot indefinitely sustain.

The reform agenda proposed in this paper is designed not to curtail AI-driven tax administration but to legitimate it: to build around the technology the statutory authority, procedural protections, accountability mechanisms, and independent oversight that would transform an impressive but constitutionally precarious regime into one that is simultaneously efficient and lawful. A state that exercises the power to audit, assess, and penalise corporate taxpayers through opaque algorithmic systems without explanation, accountability, or oversight has substituted technological capacity for legal authority. Those two things are not the same. In a democracy governed by the rule of law, they never can be.

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