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Regulating Artificial Intelligence in Indian Tax Administration: Lessons from Algorithmic Risk Profiling in GST Enforcement

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The tax regulatory landscape has been evolving due to Artificial Intelligence (AI), all over the world, facilitating predictive analytics, real-time fraud detection, and focusing on implementation. An innovative example of the Goods and Services Tax (GST) regime is the spread of algorithmic risk profiling systems. That counts taxpayers and activates audits, terminates registration, and blocks input tax credit (ITC). Though many constitutional and statutory blind spots have been detected throughout the operation of such systems, various observations have also reflected a decrease in fraudulent claims. The behavioural-economic analysis of taxpayer trust, empirical results of fraud-detection, and jurisprudence of reviewing the evidence provided by algorithms are, as of now, examined in the emerging scholarly literature. Providing quantitative evidence and comparative jurisprudence that both suggest efficiency benefits and invoke due-process issues. This paper aims to put forward that, using the GST risk-profiling model as a base, there arises a need for India to have its own comprehensive laws for AI amongst all sectors, like indirect, direct, and customs tax regulations. The paper lays down a tiered approach model combining constitutional grants of high-risk tax AI, requiring human supervision, algorithmic auditing, and a taxpayer's right to explanation based on the constitutional Articles 19(1)(g), 21, and 14, comparative regulations like the EU Artificial Intelligence Act and the Digital Personal Data Protection Act (DPDP). By implementing AI, revenue would be protected, voluntary compliance would be facilitated, and fundamental rights would be upheld as India's digital tax system evolves.

Keywords: *artificial intelligence, gst, algorithmic risk profiling, indian tax administration, personal data.*

INTRODUCTION

In the tax regulatory landscape, artificial intelligence (AI) has evolved as a revolutionary tool, ensuring enhanced fraud detection, efficiency, and compliance. For the effective assignment of compliance scores to taxpayers, in the country's complicated GST framework, AI-based risk-profiling tools are used to examine massive filing and invoice datasets. For example, by using the Business Intelligence and Fraud Analyst website, suspicious behaviours and fake registrations are flagged by GSTN using advanced data analytics. These systems can prioritise audits of high-risk bodies via the processing of both structured and unstructured data, like invoices and communications. Italy, Australia, and the UK are currently shifting to use AI to identify tax evasion patterns, therefore, reflecting a shift from reactive audits to predictive policing. Although cautious administration is required to answer legal and ethical questions that are raised by the implementation of AI in GST. Various concerns include data privacy, transparency, algorithmic bias, accountability, and due process. A breach can take place when AI systems operate on sensitive data like transaction histories, invoices, and communications, which can lead to loss of public trust or identity theft. As such, models can inherit biases that are trained on previous GST data. Small businesses or certain regions can be unfairly scrutinised due to this inaccuracy, which can result in misidentification of complaints as high-risk.

According to the observations made by Sharma and Garg[1], without orderly and measurable audits, bias can be developed in AI systems, thus compromising on fairness and diminishing taxpayer confidence. The outputs, such as risk scores and anomaly flags, can also have transparency or clarity issues due to many machine-learning algorithms, specifically the neural nets, acting as black boxes, which leaves taxpayers unable to understand or contest their unjustified actions. In the case of M/s ASP Traders v Uttar Pradesh,[2] the Supreme Court held that the authorities must issue a reasonable order, even when the tax demands are paid, so that taxpayers can appeal. The Supreme Court has directed tax authorities to improve software errors that issued incorrect surcharge notices and criticised that technological errors cannot be a basis for bothering assesses every year. The Court also upheld that the

[1] Sachin Mishra and Mahi Agrawal, 'Artificial Intelligence (AI) in Taxation: Enhancing Compliance, Efficiency And Policy in India' (*TAXMANN,* 14 January 2025) <https://www.taxmann.com/research/income-tax/top-story/105010000000026002/artificial-intelligence-ai-in-taxation-enhancing-compliance-efficiency-and-policy-in-india-experts-opinion> accessed 18 October 2025

[2] *M/s ASP Traders v State of U P & Ors* (2025) SCC OnLine SC 322

requirement for a well-reasoned order can't be extinguished, as the order is their path towards appeal. Both these decisions underscore the importance of appeal rights, transparency, and reasoned orders in digital taxation procedures.[3] Therefore, there must be compulsory compliance with legal safeguards for any AI-based risk profiling or auditing systems. Like manual assessments, taxpayers should have the right to know the standard of facilitating an audit and a system to question AI results, like manual assessments.[4]

There is no specified AI regulatory framework for tax administration in India. There is a lack of specific laws that limit the automatic profiling system or mandate algorithmic transparency. The Digital Personal Data Protection Act (DPDPA) 2023,[5] which mentions data protection, is silent on the automated decision process. There is no guarantee of appeal, explanation, or non-discrimination in the 'accuracy, consistency, and completeness' aspect of Section 8(3) of the DPDPA[6] regarding data. The laws are silent on automatic decision-making, which leaves a regulatory blind spot for AI-based processing. India's law gives no absolute solution for citizens who are facing poor algorithmic outcomes, far from the EU's GDPR,[7] which allows a certain 'right to explanation' under Article 22. The recent DPDPA thus put forth privacy protections, but does not have any regulations on mandating AI accountability. Also, India has issued various high-level AI policy guidelines, such as the NITI Aayog's AI for all strategy of 2018[8] and follow-on papers of 2021, which describe principles of accountability, inclusion, and fairness, including ideas of accountability of AI decisions and rightful inclusion of beneficiaries. The Digital India Act and draft of AI governance directions for public comment have also been proposed and published by the Ministry of Electronics and IT (MeitY). The Baker McKenzie directs no data-regulator guidance or implementation considering AI/profiling in 2024, which makes it aspirational, with no solid enforceable AI regulation in force. Relating it to the use of AI in tax, it relies on general administrative law, which specifies Article 14's prohibition on arbitrariness and Article 21's fair procedure specifics,[9] which should apply to digital profiling as it applies to

[3] *E P Royappa v State of Tamil Nadu & Anr* (1974) AIR 555
[4] *Justice K S Puttaswamy (Retd) & Anr v Union of India & Ors* (2017) 10 SCC 1
[5] Digital Personal Data Protection Act 2023
[6] Digital Personal Data Protection Act 2023, s 8(3)
[7] General Data Protection Regulation 2016, art 22
[8] 'NATIONAL STRATEGY FOR ARTIFICIAL INTELLIGENCE: #AIFORALL' (*NITI Aayog*, June 2018) <https://www.niti.gov.in/sites/default/files/2023-03/National-Strategy-for-Artificial-Intelligence.pdf> accessed 18 October 2025
[9] Constitution of Indian 1950, arts 14, 21

human decisions. Similarly, citizens should also be able to demand disclosure of algorithmic criteria in e-government projects by using the Right to Information Act.[10] The recent requirement on software upgrades and the procedural fairness in the ASP Traders case by the Supreme Court points out that the court is trying to fill the bridge. Yet, a gradual judicial approach would not cover a comprehensive policy.

PRIMARY CHALLENGES

For the proper implementation of algorithmic risk-profiling systems in India's Goods and Services Tax (GST), there exist a lot of regulatory, statutory, and joint constitutional concerns. These concerns are not just technical; the core questions about legality, fairness, and the allowed functions of state power are raised through them. The administrative regulatory system for AI in the taxation regime should be examined with the core ethical standards and legal requirements, such as:

Explainability & Transparency: The evaluation criteria for a risk score must be understood by the taxpayers. AI decisions must be explicitly explainable, fair & transparent, with direct communication to affected individuals as clearly mentioned as a demand by Singapore's Model AI governance framework.[11] Likewise, Article 22 of Europe's GDPR provides the right to challenge important automated decisions to its citizens. Without these rights, the vague AI system introduces issues related to due process.

Non-Discrimination and Fairness: Small firms or specific industries can have reinforced systemic biases. As observed earlier, there is a risk of miscategorising compliant taxpayers as high-risk by the biased training data models, which can further prolong gaps. Administrative approaches that resemble NASSCOM's shot for fairness and accountability in government AI can be implemented, which require regular bias audits and measures. Therefore, it is demanded that no class of taxpayer should be unfairly targeted by an algorithm that upholds human rights.

Appeal & Accountability: There arises a definite need for contesting AI decisions. Courts have recommended appeal processes for algorithmic results, where e-governance can administer welfare cases. In taxation, this can mean a specific tribunal or compulsory human

[10] Right to Information Act 2005
[11] *Model Artificial Intelligence Governance Framework* (2nd edn, PDPC 2020)

supervision of AI suggestions. A concept that is lacking during implementation in India's current landscape is the AI principle asserted by OECD, that AI actors must be held accountable.

Data Protection & Privacy: Huge sets of data are used in AI profiling. The DPDPA does not address AI-specific concerns and only focuses on consent and security. The AI use in GST should match the data protection regulations, such as protecting storage, limiting purpose, and anonymisation, also, which duly respects taxpayer privacy, beyond what the DPDPA requires.

Evidentiary and Legal Validity: There is a crucial question regarding the admissibility of AI-generated evidence, which is surfacing, and the court should consider whether the flags and risk scores can be admitted. There is little precedent on machine-generated evidence in Indian evidence law. Therefore, there arises the need for future regulations to allow the documentation of algorithmic ways, like audited logs, for judicial supervision.

Equality and Arbitration under Article 14: The right to equality of the Constitution limits the state from behaving arbitrarily and mandates that there be a rational link to a legitimate concern. The Supreme Court, famously, equalised arbitrariness with inequality itself in the case of E.P. Royappa v State of Tamil Nadu.[12] The GST risk-profiling systems result in high-risk flags by analysing huge datasets of returns, e-way bills, and invoices. Taxpayers cannot understand whether the algorithmic divide matches the Royappa case standard, due to the confidential nature of factors such as network linkages, turnover volatility, or filing frequency, which help in computing it. If past implementation unfairly targets small traders or certain geographic regions, the results will produce indirect discrimination, and the model will continue to flag these groups. It was upheld by the Hague Courts as well that the Dutch SyRI welfare-fraud system has been unauthorised for the same reasons that unrevealed risk factors have continued in breaching the European Convention on Human Rights by authorising unjust profiling.

Freedom of Trade and Proportionality under Article 19(1)(g): According to Article 19(1)(g), an individual holds the right to pursue any profession or engage in any trade, and this may be subject only to reasonable restrictions. GST registration is the lawful beginning of a taxable

[12] *E P Royappa v State of Tamil Nadu & Anr* (1974) AIR 555

business. Under Rule 86A of the CGST Rules,[13] tax officers may restrict input-tax credit (ITC) if they have 'reason to believe' the ITC is fraudulent. This restriction has the risk of disabling a business from operating, perhaps with an overnight effect when the 'reason' is established without any human evaluation, solely as the result of an AI system. In Modern Dental College v State of Madhya Pradesh,[14] the Supreme Court introduced a four-prong proportionality test, which includes: legitimate goal, rational connection, necessity, and balancing of interest. If a tax officer relies solely on the 'reason' as the result of an algorithmic output, it may fall short under the necessity prong, because alternatives to using the AI-generated 'reason' may achieve the same restrictions without the risk to business continuity.

Privacy and Informational Self-Determination under Article 21: The historic privacy ruling in K.S. Puttaswamy v Union of India[15] mandates any state action relevant to personal data to undergo a three-part test, including legality, legitimate aim, and proportionality. GST risk engines take on massive amounts of taxpayer information, including invoices, bank account information, transport documentation, and so forth. The risk engines routinely combine these large-scale taxpayer datasets with other third-party datasets. Data collected by the CRA for the purposes of filing returns is now being used to form machine-learning predictive models to estimate the risk of future fraud. The state has not satisfied the public impact assessments, which demonstrate that intrusiveness in its analytics is the least intrusive way to deal with GST fraud.

COMPARATIVE LESSONS INTEGRATED INTO THE INDIAN LAW LANDSCAPE

India participates in the OECD's Global Partnership on AI (GPAI),[16] which endorses the principles of the OECD AI Principles: human-centred values, transparency, and robustness. These principles are non-binding and are intended to advance the use of inclusive, ethical AI, while UNESCO's 2021 Recommendation on AI Ethics adopts a similar spirit to advance fairness and accountability in the use of AI. While these will provide helpful guidance, international recommendations do not come with enforcement mechanisms. India may adopt some of the same themes, for example, AI systems should be transparent and enable

[13] Central Goods and Services Tax Rules 2017, r 86A
[14] *Modern Dental College & Research Centre & Ors v State of Madhya Pradesh & Ors* (2016) 7 SCC 353
[15] General Data Protection Regulation 2016, art 22
[16] 'Recommendation of the Council on Artificial Intelligence' (*Organisation for Economic Co-operation & Development,* 22 May 2019) <https://legalinstruments.oecd.org/en/instruments/oecd-legal-0449> accessed 25 October 2025

users to challenge AI processes or outcomes, but these principles must be operationalised in domestic law or policy. The government of Singapore launched a voluntary framework for organisations using AI. The principles of the framework include human-centric AI, explainability, and governance structures. For example, the guidance states that the human would have to determine the appropriate degree of human involvement in AI-augmented decision-making. Additionally, it recommends checking the outcomes for bias. Repurposing this model, India could require that GST officers review the AI risk scores, which means humans would remain in the loop, and that AI tools would be subject to external audits. These recommendations were also put forth in the study by Sharma & Garg.

The European Union's GDPR has established a right to explanation and bans completely automated decision-making with legal effect. The EU's predicted AI Act, coming into effect in 2024, categorises tax enforcement programs as 'high-risk' and will introduce enhanced transparency obligations and risk assessments. If India were to consider similar powers, it would put obligations on tax AI systems to undertake pre-implementation impact assessments and certification. Though this may protect citizens, it could slow down rollout and lead to substantial compliance costs. Moreover, India has more of an agile environment for innovation and may not tolerate excessively bureaucratic laws.

Other Countries, like Canada[17] and the Netherlands, have established a law to hold automated decision-making accountable that includes an obligation to undertake impact assessments. A country could adopt another model like Germany, which has incorporated algorithmic fairness into existing anti-discrimination law. India could study these models and apply them to the local context. For example, Germany's Federal Administrative Court has established that an automated algorithm used to profile welfare recipients was caught under Article 3 (equality) protections, and India could develop a similar approach in relation to constitutional equality under Article 14[18] to regulate profiling.

ANALYSIS

Literature Gaps and Implementation Deficit: Current literature on taxation and AI discusses AI capabilities and efficiency advantages, and rightly so, they take the position that

[17] *Ewert v Canada* [2018] 2 SCR 165
[18] Constitution of India 1950, art 14

AI can substantially improve efficiency and detect new fraud patterns. But there is a serious gap; governance and legal enforceability are neutralised as themes. For example, Sharma & Garg[19] and NASSCOM propose ethical audits and explainable frameworks. But there is little analysis of how or if those would ever be built into law or a governance institution. In the same vein, comparative articles might mention HMRC's Connect system or reference GDPR rights, but they fall short in proposing Indian legal/regulatory changes to put those options in play. There must be assessment frameworks against the preceding criteria. India's non-prescriptive stance, NITI guidelines under review, and the Digital India Act still pending would be low on the enforceability scale. It is to be noted here that India needs to legislate some explicit AI safeguards, for example, require reasoned orders for AI-based action, and integrate appeal rights into the CGST Act. Voluntary guidelines, like those in Singapore, are commendable but ultimately rely on regulation to ensure enforceability. OECD and UNESCO principles provide good principles to reference, but again, they still require a local anchoring. Silence in the DPDPA about automated decisions is another failure; if rights to explanations or a challenge to automated decisions aren't unambiguously established, then citizens are left with very few avenues for the erroneous effects of profiling.

Risks of Algorithmic Bias and Need for Independent Audits: In addition, discussions around literature are often rooted in the presumption that AI outputs are objective, despite literature suggesting algorithms can reproduce human biases. This risk is even more acute in a diverse socio-economic context like India. As observed in various articles, errors in AI outputs within relief benefit scenarios in two states,[20] Telangana and Odisha, resulted in mass denial of family tax benefits and are a cautionary tale for tax thinking.[21] To mitigate this risk, tax AI systems should be independently auditing the platform. These audits are essential for good governance, just as the ordinary audit of tax returns is a basis of tax compliance. Reducing AI to an assistive tool for inspectors, versus a black box decider, aligns with Canada's constitutional obligation to provide administrative decision-making.

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[19] Mishra (n 1)

[20] Sameet Panda & Chakradhar Buddha, 'Fraud risk, boat journeys, biometric errors: Digital pension payments leave many behind in Odisha' *Scroll* (09 January 2024) <https://scroll.in/article/1061209/fraud-risk-boat-journeys-biometric-errors-digital-pension-payments-leave-many-behind-in-odisha> accessed 27 October 2025

[21] Tapasya et al., 'How an algorithm denied food to thousands of poor in India's Telangana' *Al Jazeera* (24 January 2024) <https://www.aljazeera.com/economy/2024/1/24/how-an-algorithm-denied-food-to-thousands-of-poor-in-indias-telangana> accessed 27 October 2025

Towards a Proportionate and Legally Anchored Framework: Finally, a critique of regulations assessing AI systems should support a principle of proportionality. Putting forth barriers to innovation will hinder efficiencies for governments. India has an opportunity to provide a different take versus the EU's prescriptive bans and disclosures on foundational models. A risk-based framework to support tax AI could allow some tax AI models to be categorised as moderate risk AI tax models, whilst requiring baseline controls, accuracy of categorising taxpayers, audit trails, an explicit boundary of consent, and human oversight, which justifies a balance between innovation and citizen rights. Previous research on AI and taxation emphasises its technical skill and efficiency gains. They noted, correctly, that AI can greatly enhance efficiency and identify new fraud schemes. While they address ethics in the context of AI development, there is a clear lacuna regarding governance frameworks and legal enforceability.

The research by NITI Aayog suggests ethical audits and explores explainable frameworks, but does not speculate on how they might be enforced through laws or institutions. Similarly, instead of suggesting the application of analogous laws and frameworks that exist in international settings, for example, the HMRC Connect system or GDPR Rights, comparative studies of AI in tax contexts often pragmatically abstract the complications of relying on other systems in India.

India is unable to achieve or provide specifics for a non-prescriptive model, such as NITI guidelines, and is still pending the Digital India Act governance setup; thus, this method scores poorly on enforceability. India should develop explicit laws providing safeguards around the use of AI in taxation, for example, require a well-reasoned order to be recorded for any AI-based action, and integrate appeal rights into the CGST Act, etc. Mandatory guidelines like the Singapore approach, while commendable, are compliance-based on legal enforcement, an accountability lacking in their voluntary culture. OECD and UNESCO principles provide principles of good governance, but again lack local contextualization. Finally, the non-accountability of the DPDPA concerning automated decision-making remains a notable weakness, as without affirmative rights to explanation or challenge, a citizen's recourse against erroneous profiling remains scant.

Judicial and Institutional Framework: Even though the lack of legislative action is the main issue of the discussion on AI in taxation, the fact that the Indian institutional structure, like

courts, tribunals, and tax authorities, is well-prepared to examine AI-driven enforcement is also a question of vital importance. Algorithm risk profiling, unlike the conventional types of tax disputes, brings new technical evidence that is challenging the current judicial review mechanisms. The judicial review of a tax administrative action normally considers the actions of an authority, whether an action has taken place within the bounds of the statute, followed the principles of natural justice, and gave a reasoned order. Nevertheless, on the issue of a GST registration suspension by an opaque algorithm by the taxpayer, the courts are confronted with an evidentiary gap. The rationale behind the model is either proprietary or too complex to be explained by the Supreme Court in the proportionality analysis of Modern Dental College v State of Madhya Pradesh,[22] and the condition of the speaking orders supported in M/s Sahil Enterprises v Union of India.[23] A judge can then be obliged to either indulge himself inappropriately in administrative assertions of truthfulness or to invalidate acts based on procedural factors without examining the underlying risk model. The high courts and GST appellate tribunals did not intend to decipher machine-learning models. Training data, false-positive rates, or metrics of bias are complex algorithmic evidence that needs expertise in a domain. One approach can be the establishment of specialised technical benches in tax tribunals or the institutionalisation of the deployment of independent experts or amicus curiae, in cases involving algorithmic decision-making, and a practice like that in other areas of the law, like competition law or environmental litigation. The use of ex post litigation is inefficient and uneven, relying solely on it. A dedicated committee of impact assessment, auditing of algorithms, and complaints by taxpayers may be offered by an independent Tax AI Oversight Board. The Competition Commission of India, or the Adjudicating Authority under the Prevention of Money Laundering Act, may be the model of such a body due to the legal and technical ability to assess AI systems before their harmful consequences. The open algorithms regime in Chile mandates that audit-selection criteria should be publicly disclosed and that a regular audit of auditors should be conducted, which reduces the burden of proof on the courts. Though Singapore has voluntary audits (not binding), the documented technical findings provided through the audits will help in making an informed judicial review in the event of conflicts. India may require that GST algorithms be subject to impact analysis and periodic audits, with reports being included in the

[22] Recommendation of the Council on Artificial Intelligence (n 16)
[23] *M/s Sahil Enterprises v Union of India* (2023) SCC OnLine Del 4512

administrative record, which may be subject to judicial review. Enhancing operational capacity is the means of making sure that the constitutional protections, namely, equality, proportionality, and due process, can be applicable in the age of AI-administered taxation. Courts and regulators should stop being spectators and become proactive examiners of algorithmic evidence to make sure that efficiency benefits do not overshadow the basic taxpayer rights.

In conclusion, while algorithmic risk profiling can be a valuable tool for combating fraud in GST enforcement, it raises significant legal and ethical questions. Policymakers in India can inform their approach based on comparative examples and design a governance regime for the use of algorithmic risk profiling tailored to Indian laws and context.

RECOMMENDATIONS AND CONCLUSION

There is a need to implement AI-specific norms in tax law by amending the CGST/IT Acts or rules that mandate any AI-generated assessment or notice, together with a statement of reasons. Therefore, clear that protecting taxpayer rights to appeal findings made using an AI model. This also requires algorithmic transparency by the GST Network/CBDT for IT to document the criteria used in the AI and allow for independent audit. A statutory right to explanation for taxpayers who are subject to automated fraud profiling can be considered. There is also a need to establish oversight mechanisms where an independent AI Ethics Board or appoint an existing body, for example, the ITAT or a wing of the CBIC, can oversee and review existing AI tools, and AI-related complaints, as well as certify algorithms and AI tools before implementation. Incorporating data protection into AI ethics by amending or creating subordinate rules related to the DPDPA to address AI risks, for example, a clear prohibition on using taxpayer information or data for purposes beyond compliance. Use existing privacy law to require the enforcement of data minimisation and security in any AI system and algorithms. Utilising constitutional doctrine and international best practices, India should create a governance framework that consists of four pillars of the taxation administration's AI applications. This proposal contextually weighs off administrative efficiency with safeguards in the constitution. It may be strapped on as amendments to the CGST Act or subordinate legislation. The CGST Act should clearly articulate ‘automated risk-profiling systems’ and characterise such systems as high-risk automated enforcement mechanisms. Modelled after the EU AI Act, any system that has a material impact on

taxpayer rights, such as blocking input tax credits (ITC) or suspending registrations, should require: a risk-impact assessment before implementation, registration with a central AI governance authority, and recertification periodically when models are modified. Drawing from Singapore's Model AI Governance Framework, Indian law should require a human-in-the-loop review of any coercive actions. Before an ITC block or a registration suspension takes effect, a trained officer should validate the AI recommendation and record independent grounds. Taxpayers should be entitled to a 'reasoned notice' that provides information that relates to the driving risk on their account, e.g., low credit in GSTR-2B, an abnormal transaction that deviates from network practices, that does not disclose proprietary algorithms. Modelling off CIAT[24] practice in Latin America, where an independent Tax AI Governance Board can conduct annual algorithm audits for testing: statistical accuracy, false-positive detection, disparate impact (small taxpayers or regions), and compliance with data-minimisation principles. Summarised reports should also be made publicly available to build trust in the department's methods while protecting any sensitive operational enforcement. The DPDPA should be amended to restrict tax enforcement exemptions and create purpose-limitation certifications. Before the GSTN links new datasets, e.g., bank feeds, telecom records, to its risk engine, it should provide a proportionality assessment showing the necessity and the least intrusive means. The GST Council can, using Section 164 of the CGST Act,[25] notify initial standards that impact assessments and human oversight, before the act is amended by Parliament. A pilot project may begin with voluntary disclosure of key risk factors to high-value taxpayers and grow once the audit function is mature.

[24] Cristina García-Herrera Blanco, 'The use of Artificial Intelligence by tax administrations, a matter of principles' (*CIAT*) <https://www.ciat.org/the-use-of-artificial-intelligence-by-tax-administrations-a-matter-of-principles/?lang=en> accessed 25 October 2025

[25] Central Goods and Services Tax Act 2017, s 164