WHEN THE ALGORITHM AUDITS YOU: HUMAN RIGHTS IMPLICATIONS OF ARTIFICIAL INTELLIGENCE IN TAXATION WITH SPECIAL REFERENCE TO INDIA AND COMPARATIVE PERSPECTIVES FROM THE EU AND US

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ABSTRACT

The world is racing to adopt artificial intelligence (AI) in taxation to combat evasion, automate tax assessments, identify anomalies and develop tax profiles. India is not immune - the Income Tax Department's use of AI-based risk profiling, the Faceless Assessment Scheme and data analytics (Project Insight) are a major expansion of the state's revenue powers. This increase in algorithmic power in taxation not only has implications for administrative efficiency, but also for the right to equality, the right against arbitrary state action, the right to privacy, the right to a fair hearing, and the prohibition on discriminatory enforcement. This article explores these human rights concerns in detail, with reference to the Indian Constitution and some comparative case studies in the European Union and US. It concludes that the use of AI in taxation, although legitimate in principle, necessitates robust legal protections that are not yet in place - particularly in India.

Keywords: Artificial Intelligence, Taxation, Human Rights, Right to Privacy, Algorithmic Decision-Making, Faceless Assessment, Article 14, Due Process, India, EU, United States.

INTRODUCTION

In 2021, the Dutch Supreme Court found that the Netherlands' tax benefit fraud prevention system (or SyRI) was in breach of the European Convention on Human Rights. It was used to target low-income families in certain postal codes for tax and social benefit fraud, using data from seventeen state databases. It breached citizens' right to privacy (Article 8 of the ECHR), the court found, due to a lack of transparency, lack of effective judicial oversight, and reliance on a mysterious algorithm over which citizens had no access or redress. The case of SyRI is not just a European one. It is a metaphor for the problem with rights that occurs where a state uses AI to exercise its coercive tax power - and it is a metaphor that India ought to consider with care.

India's tax system has transformed in the last ten years. Project Insight, introduced in 2014, uses data from banks, registrars, stock exchanges and other sources to create risk profiles of taxpayers and detect inconsistencies between their reported income and lifestyle indicators. The Faceless Assessment Scheme, launched in 2020, eliminates the need for human tax officers in assessment, and substitutes in-person proceedings with a centralised, algorithmically assisted assessment. The Annual Information Statement brings together information about taxpayers' financial transactions from various sources into a unified profile available to the department. These are important administrative changes. They are also, from a human rights perspective, major enhancements of state monitoring and machine-based state decision-making over individuals.

This article is in seven sections. In sections II to VI, I explore particular human rights issues: privacy, equality and non-discrimination, due process and the right to a hearing, the right against arbitrary state action, and data rights. Section VII contains observations from the EU and US. Section VIII provides some suggestions for reform.

AI IN INDIAN TAXATION: THE OPERATIONAL LANDSCAPE

To understand the human rights issues, it's useful to understand what AI systems are being used in the Indian tax system. AI is used by the Income Tax and data analytics in a number of different ways. The most significant is risk profiling for scrutiny. The The department's Computer Assisted Scrutiny Selection system incorporates an algorithm to select returns for detailed examination.

The inputs to this algorithm - what triggers selection, what thresholds are used, how data from different sources are weighted - are not publicly available. Taxpayers whose returns are flagged for review don't know of knowing what suspicion or profile led to their selection, or if their perceived risk under the algorithm is based on correct information. The Faceless Assessment Scheme goes even further. Under the scheme, assessment is undertaken by a National Faceless Assessment Centre where the taxpayer or their neither taxpayer nor their lawyer know who is working on their case, and AI -ready tools are used to prepare assessment orders. The scheme was touted as a reform that will minimise corruption and harassment - good objectives - but it has also taken away the interpersonal element of the process that gave taxpayers the opportunity to explain, clarify and engage in participatory democracy.

Project Insight's data matching capability is a holistic financial surveillance architecture. Data from banks, mutual funds, registrars of property, regulators, foreign exchange brokers, credit card providers and other sources is brought together the Annual Information Statement. The system can automatically detect anomalies - a inconsistent with returns, bank deposit inconsistent with returns inconsistent with your tax return, for example, and these are triggers for notices which are sent automatically. examination of the facts of a case. The magnitude of this surveillance state has been unprecedented in Indian tax administration.

THE RIGHT TO PRIVACY: SURVEILLANCE, DATA AGGREGATION, AND PROPORTIONALITY

The Supreme Court's landmark ruling in K.S. Puttaswamy v. Union of India (2017) confirmed the right to privacy as a fundamental right under Article 21 of Constitution. The case confirmed that any breach of privacy be satisfied by a three-part test: it must be lawful, it must serve a legitimate aim of the state and it must be proportionate - the means must be necessary and the least intrusive option available. This is relevant for AI-based data collection and profiling in taxation. The state purpose is not seriously questionable: tax evasion and avoidance correct assessment are significant public interests. The The question of proportionality is more difficult.

Project Insight's collection of information from 17 or more sources is far broader than is needed to support verification of a taxpayer's income in most instances. The system collects comprehensively and filters selectively - a model of surveillance that turns upside down the conventional approach in investigative model, in which the state gathers information to check for a particular suspicion. The 'lawed' requirement is also imperfectly satisfied. The Income Tax 1961 contains authorisations for the collection of information and investigation, but none expressly authorise the mass algorithmic profiling of Project Insight involves. The programme is reliant on administrative circulars and rather than statutory mandate - a problem that becomes important when considering the principle, enunciated in Puttaswamy, that privacy infringing conduct, a law of adequate quality: clear, intelligible and foreseeable in its application.

The Personal Data Protection laws in India (the Digital Personal Data Act, 2023 - is the most pertinent law, but it has a notable exemption: the government can notify any government agency exempt from the Act for national security, sovereignty or "prevention of offences". offences.' Tax could conceivably be exempted under this provision, meaning that meaning the data practices of the Income Tax Department will be exempt from the protections of the Act. Whether such an exemption is constitutional in light of Puttaswamy is unclear and important question.

EQUALITY AND NON-DISCRIMINATION: THE ALGORITHMIC BIAS PROBLEM

The Constitution provides for equality before law and equal protection of laws in Article 14. Article 15 bars discrimination on the basis of religion, race, caste, sex or place of birth. There are two aspects to equality concerns with the use of AI systems in taxation: differential treatment of comparable taxpayers, and the potential for systemic inequality in AI systems themselves.

The differential treatment issue is systemic. An unknown weighing of variables in a scrutiny selection algorithm results in no way to determine whether it operates to treat like taxpayers in like circumstances equally. If two people report the same income, claim the same deductions, and have the same financial circumstances, they may be treated differently because of data weighted by the algorithm that they - and a court - don't know about. The doctrine of arbitrariness under Article 14 - articulated through cases such as E.P. Royappa v. State of Tamil Nadu and Maneka Gandhi v. Union of India - demands that the classification by the state must be based on intelligible differentia with a rational nexus to the object sought to be achieved. An algorithm with undisclosed differentiation criteria can't be scrutinised against this benchmark.

The systemic bias aspect is less obvious but potentially more insidious. AI algorithms that use these data for tax enforcement will reflect the biases of past enforcement. If in the past certain regions, certain professions or certain income levels were disproportionately scrutinised (whether on the basis of legitimate risk factors or on the basis of other priorities in the enforcement of the law), an algorithm based on this data is likely to replicate and perhaps even reinforce these patterns. There are particular challenges associated with the informal economy, which correlates with lower income and marginalised communities: taxpayers whose data is less accessible to the government (because they don't have the same documentation as taxpayers in the formal economy) may be identified as higher-risk profiles in a data-driven system, not because they are actually evading more tax but simply because their compliance profile is not the same as the average taxpayer.

The Dutch SyRI case is highly pertinent here: the court concluded that profiling postal code areas with lower income and greater numbers of minorities constituted a form of discrimination that breached the right to privacy and the prohibition on discrimination. While there is no such judicial pronouncement of algorithmic bias in tax collection in India, there is adequate constitutional ground for it.

DUE PROCESS AND THE RIGHT TO A HEARING: AUDI ALTERAM PARTEM IN THE ALGORITHMIC AGE

India's principles of natural justice - audi alteram partem, or the right to be heard - have constitutional standing and apply in all state decisions that impact individual rights. In tax law, they have been acknowledged and applied by the courts in numerous cases that hold that a taxpayer has to be afforded reasonable opportunity for response before an order of assessment is passed against them.

The Faceless Assessment Scheme formally retains a hearing process - taxpayers can respond to notices, and to draft orders if they are issued. What the scheme eliminates is the substance of the hearing. With an AI-assisted assessment and no knowing who prepared the assessment order, a taxpayer response to a notice can't know what factors the algorithm highlighted, what information was given more or less weight, or how to effectively respond to the assessment. This is a hearing in name only - equivalent to a form of notice and response.

The Supreme Court has held (for example, in Maneka Gandhi v. Union of India) that the right to a hearing must be effective, not merely procedural. This is not discharged by a response opportunity that fails to disclose the case against the taxpayer (that is, the risk score) in sufficient detail to permit an effective response. Where the "case" against a taxpayer is partly constituted by the algorithm's risk determination (which is based on data that is not available to the taxpayer) the disclosure requirement is necessarily unmet.

The explainability problem compounds this. Even where provided access to the output of the algorithm, a risk score or anomaly flag does not explain why the algorithm made a

taxpayer guilty of something. The black-box nature of AI-based decision-making means that the right to a reasoned decision - recognised under Indian administrative law as an aspect of the right to a fair hearing - cannot be fully discharged by an assessment order that relies on AI-based analysis unless the explanation of the basis of the analysis is framed in terms that are intelligible to the taxpayer.

ARBITRARY STATE ACTION, ARTICLE 21, AND THE PROBLEM OF AUTOMATED NOTICES

India's tax administration has a notorious problem with robot notices - system-generated notices and demands that are factually inaccurate, based on a mismatch of data, or that have not been satisfactorily scrutinised by human analysts. It's not uncommon. An analysis of income tax notices issued under Section 148 (notices for income escaping assessment) and Section 143(2) by the Income Tax Department reveals that a large percentage of these are either withdrawn on objection, or do not lead to additional demand. A significant number are triggered by data mismatches in the Annual Information Statement which would have been detected by a human.

An automatic notice that serves as the trigger for a formal legal process - in which a taxpayer must act within a statutory period or suffer consequences - is state action that impairs the person's liberty and property. The protection of life and liberty under Article 21, as widened by Maneka Gandhi and Puttaswamy, requires this action not be arbitrary. A notice that is generated without human oversight of the veracity of the information on which it is based, or the effectiveness of the algorithm that triggered the notice, is hard to categorise except as arbitrary.

The harm is more than dignitary. An Income Tax Department notice requires interaction with a tax advisor, compliance costs, reputational risk and anxiety, and can impact creditworthiness and business relationships. The compliance costs to small taxpayers and non-professional taxpayers in responding to an automated notice, even one that is clearly wrong, can be significant. The harms of incorrect algorithmic action are borne unequally.

COMPARATIVE PERSPECTIVES: EU AND UNITED STATES

A. **The European Union**

The European Union General Data Protection Regulation (GDPR) offers the most advanced protection for rights addressing algorithmic decision-making. Article 22 of the GDPR provides for a person's right not to be subject to a decision based exclusively on automated processing and which has legal or other significant effects - unless certain requirements are satisfied (such as explicit consent or a decision being necessary to perform a task carried out in the public interest under EU law with certain safeguards). Decisions about tax assessments are typical of those covered.

Automated processing is permitted where the data subject is informed, they have the right to get a human to review the decision, and they can state their own perspective and challenge the decision. These provisions formalise some of the principles of natural justice that Indian constitutional law recognises in a more abstract way. The EU AI Act, which comes into force in 2024, adds the following: AI systems used for applications by public authorities that affect the rights of individuals are deemed to be high risk, with transparency, conformity, and human oversight being mandatory.

In the EU, there are multiple example of AI tax collection systems. As well as SyRI in the Netherlands, French social media analysis to reveal hidden income was challenged under GDPR laws, resulting in substantial changes to the system. These examples show that judicial oversight of algorithms for tax enforcement is not a theoretical concept - it is being litigated in jurisdictions with similar constitutional systems.

B. **The United States**

The US Internal Revenue Service (IRS) employs algorithms to select audits - the Discriminant Index Function system dates back to the 1960s, with periodic upgrades adding more complex analytics. The IRS does not release details of the audit algorithms, arguing this will lead to "gaming". This secrecy has led to ongoing complaints from tax professionals and civil rights groups.

In 2023, the Government Accountability Office released a report that found the IRS's audit selection algorithms audited black taxpayers at a far higher rate than white taxpayers with similar incomes, due in part to the weights that the algorithms assign to Earned Income Tax Credit (EITC) refund claims, which are more prevalent in black lower-income households. This is exactly the type of systemic disadvantage that algorithms can create when using historically inequitable data on enforcement to train its systems and demonstrates that the algorithmic bias issue in tax is real.

The US has no equivalent to the GDPR and constitutional due process in tax cases is less stringent in several ways than India's natural justice doctrine. Some reporting requirements are enshrined in the Administrative Procedure Act, but there are no reported cases of successful challenges to algorithm-based audit selection on grounds of arbitrariness and capriciousness, under the APA. The US experience indicates that absent targeted legislation, current administrative laws do not effectively control the use of algorithms in tax administration.

BRIEF REFORM OBSERVATIONS

A full reform plan for Indian tax administration using AI is beyond the scope of this discussion, but some general observations are in order.

First, the Income Tax Act should sanction (and control) AI-based assessment and profiling. The current regime is not authorised by a law of the parliament, but by administrative notifications. Puttaswamy's insistence that state surveillance encroaching on privacy be authorised by a law of sufficient quality requires better. The authorising law should identify the types of data that can be grouped together, the purposes for which AI analysis can be deployed, and required protections - such as a threshold for human review before taking adverse action.

Second, the government's exemption from the Digital Personal Data Protection Act should be limited to activities that do not cover the ordinary administration of tax. Tax administration is a coercive power of government - it is in this context that we expect data protection rights to apply, not be stripped away.

Third, the Faceless Assessment Scheme should be amended to ensure that any assessment order based on AI-based analysis should be disclosed, in taxpayer-friendly language, what the algorithm took to be anomalous, and how the anomaly was interpreted as demonstrating underreporting. Explainability is not an unachievable goal - it is a design choice and one that has been variously adopted by tax administrations in Germany and Canada.

Fourth, an independent audit function for the Income Tax Department's AI systems - akin to algorithmic audit provisions in the EU AI Act - should be designed to audit for systemic patterns in the scrutiny and enforcement of tax obligations. This will repeat the algorithmic bias problem seen in the US, invisibly and at scale, if not monitored.

CONCLUSION

The trend towards using AI in taxation is irreversible. The benefits in efficiency, revenue and political support for the systems are undeniable. It's not a question of whether AI will be deployed in Indian taxation but whether it will be deployed with a legal framework that is sensitive to the human rights consequences.

At the moment, it does not have this framework. The constitutional safeguards are certainly present - in Puttaswamy's interpretation of the right to privacy; in the doctrine of arbitrariness under Article 14; in the principles of natural justice under the doctrine of due process. But they have not been rendered as legal norms that limit the operations of AIbased tax administration. The Digital Personal Data Protection Act is part way, but it is crippled by the wide government exemptions. The Faceless Assessment Scheme was developed as a rights-protective measure, but has generated novel rights issues.

The Netherlands' SyRI ruling and the US' IRS racial discrimination report do not provide warnings from different cultures. They are empirical lessons about what will happen if there are no checks and balances of algorithmic tax systems. India can learn from its Constitution. It needs legislative support to expand on it.

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