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**DAILY EDITORIAL
ANALYSIS**

TOPIC

**AI IN TAX ADMINISTRATION:
OPPORTUNITIES AND CHALLENGES
FOR INDIA**

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AI IN TAX ADMINISTRATION: OPPORTUNITIES AND CHALLENGES FOR INDIA

Context

- India has begun leveraging technology to improve tax compliance and governance, as it faces a persistent fiscal challenge in the form of a **low tax-to-GDP ratio (16.36% during 2001–22)** and **significant tax evasion (≈4.3% revenue loss annually)**.

AI in Tax Administration

- AI in taxation refers to the use of **machine learning algorithms, big data analytics, and predictive modelling** to improve tax administration functions such as **compliance management, fraud detection, and taxpayer services**.
- It enables **real-time monitoring of transactions**, facilitates **risk-based compliance systems**, and promotes **'smarter tax administrations'** through automation and data integration.

India's Approach: Project Insight (PI)

- It is a **Data Warehousing & Business Intelligence project** of the Income Tax Department, **launched** in 2017 and was fully operational by 2019.
- It aims to strengthen the non-intrusive information driven administration for improving voluntary compliance and enhanced taxpayer services.
- Key Components of PI:**
 - INTRAC (Income Tax Transaction Analysis Centre):** AI-based analytical engine, builds **360° financial profiles** using multi-source data (banking, GST, property, securities).
 - Compliance Management Centralized Processing Centre (CMCPC):** Uses analytics outputs to ensure compliance.
 - NUDGE Strategy (Non-intrusive Usage of Data):** Behavioral nudging via SMS/email that encourages voluntary correction of tax returns.

Opportunities of AI in Tax Administration

- Enhanced Compliance and Revenue Mobilisation:** AI detects mismatches between **declared and actual income**.
 - India has seen **1 crore+ revised returns**, and **₹11,000 crore additional revenue**.
 - According to the IMF, **data-driven compliance systems significantly improve tax buoyancy**.
- Risk-Based and Targeted Enforcement:** AI helps classify taxpayers based on **risk profiles**, enables focus on **high-value evasion cases**, and reduces arbitrary or excessive scrutiny.
- Improved Efficiency and Cost Reduction:** Automation of return processing, refunds (93 → 17 days in India), and frees human resources for complex decision-making.
 - EY highlights that AI reduces **administrative costs and manual errors**.
- Behavioral Compliance:** Non-intrusive reminders improve voluntary compliance. Example: 62% compliance in foreign asset disclosures.
 - It aligns with the global shift from **coercive to cooperative tax regimes**.
- Better Taxpayer Services:** AI-powered chatbots and assistance; faster grievance redressal; and reduced interface with officials (less corruption).
- Detection of Complex Evasion Networks:** AI uncovers sophisticated fraud patterns.
 - IMF emphasizes AI's role in tackling **cross-border and digital economy taxation**.

Challenges and Risks

- **Data Quality and Reliability:** AI systems depend on **accurate and comprehensive data**. Risk of **false positives** in variable incomes, and joint family finances.
- **Algorithmic Bias:** Models trained on historical data may reinforce socio-economic biases, and target specific regions or groups.
 - ◆ Global example: Dutch childcare benefits scandal.
- **Lack of Transparency and Explainability:** AI decisions often function as **'black boxes'**, leading to concerns like violation of **natural justice**, and difficulty in challenging decisions.
- **Privacy and Data Security:** Massive collection of financial data increases risk of cyberattacks, and potential misuse of personal information.
 - ◆ IMF stresses the need for **robust data governance frameworks**.
- **Institutional and Legal Gaps:** Absence of AI ombudsperson, algorithmic audits, and public accountability mechanisms.
- **Risk of Surveillance State:** Excessive data tracking may erode trust, and discourage voluntary compliance.

Global Best Practices

- Countries like the **USA, UK, Australia, and Italy** have implemented AI-driven tax systems and used predictive analytics for fraud detection.
- They achieved **higher compliance and revenue mobilisation**.

Way Forward

- **Ethical AI Framework:** Ensure **fairness, accountability, and transparency**.
- **Human-in-the-Loop Systems:** Critical decisions need to involve **human oversight**.
- **Strengthen Data Protection:** Effective implementation of **Digital Personal Data Protection Act (DPPA, 2023)**.
- **Algorithmic Transparency:** Provide clear explanations, and appeal mechanisms.
- **Institutional Reforms:** Establish **AI Ombudsperson**, independent audits, and public reporting systems.
- **Capacity Building:** Train tax officials in **data science and AI governance**.

Conclusion

- AI offers India a transformative opportunity to **modernize tax administration, improve compliance, and enhance revenue mobilisation**.
 - ◆ However, without robust safeguards, it risks undermining **privacy, fairness, and trust**.
- The key lies in balancing **technological efficiency with democratic accountability**, ensuring that AI becomes a tool for **good governance rather than surveillance**.

Daily Mains Practice Question

[Q] Artificial Intelligence is transforming tax administration by improving efficiency and compliance, but it also raises serious concerns regarding privacy, fairness, and accountability. Discuss in the context of India's tax administration.

Source: TH

