HOW AI AND AUTOMATION ARE CHANGING INCOME TAX FILING IN INDIA

Authored by Adv. Ankita Shailendra Pradhan.

Direct Tax Litigation Lawyer.

INTRODUCTION:

"Operation Sindoor" has marked India's pioneering step into AI powered defense. This operation has redefined modern warfare by making AI the driving force, using autonomous drones and real time decision making for precision strikes. This offers a glimpse into the future where wars will no longer be fought by weapons and military might but with intelligent machines and data driven strategies. AI is also the silent brain behind Elon Musk's "Starlink" space network which has transformed thousands of orbiting satellites into a dynamic, self-optimizing web of global connectivity.

In a period characterized by fast technological advancements and constant connectivity, Artificial Intelligence (AI) has emerged as a vital force driving change across the economy. Right from healthcare to education, AI is becoming an integral part of every industry.AI is not merely a tool but a transformative revolution. It's ability to process vast amounts of data, learn from patterns, and make informed decisions is enhancing effectiveness, fostering invention and addressing complex global challenges.AI has seamlessly integrated into nearly every facet of our life, transforming how industries work and making it an indispensable part of today's fast paced world.

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As India ascends to the position of world's 4th largest economy, AI and technological advancement has become indispensable to sustain the momentum in an increasingly digital world. As AI accelerates India's progress in various sectors, the Income Tax department is actively embracing this technology to revolutionize its functions. The number of ITRs filed in the financial year 2023-24 were 8.09 crore, an increase from 7.40 crore filed in financial year 2022-23. In financial year 2021-22, this number was over 6.96 crore[1]. Traditionally, tax filing has been a cumbersome and time-consuming process, often prone to errors and delays which would lead to fines and inquiries for the tax payer. By deploying advanced AI systems, the department is improving accuracy in identifying tax evasion and offering better services to tax

[1] https://m.economictimes.com/industry/banking/finance/only-6-68-of-population-filed-income-tax-return-in-2023-24-fiscal/amp_articleshow/116400121.cms?

payers. This intelligent integration not only boosts efficiency but also enhances transparency and compliance, helping to build a fairer tax ecosystem that supports India's growing economy.

AI'S IMPACT ON INDIA'S INCOME TAX LANDSCAPE

The Union Budget 2025 marks a significant step in integrating AI into India's Income Tax system reflecting the Government's commitment to modernizing tax administration and enhancing tax payer services. The new Income Tax Act, 2025 has been designed to be more concise, user friendly and also facilitates integration of AI tools for better tax compliance and administration. Thus, the application of AI in income tax filing is no longer conceptual, it is being incorporated into key touchpoints in the tax payer experience and administration.

1. PRE- FILLED INCOME TAX RETURNS (ITRs) –

   Gone are the days of sifting through stacks of documents and manually filling out every line of the ITR. The Income Tax department has introduced AI powered prefilled ITRs which has made the entire process faster, smarter and less stressful. It is a game changer for millions of tax payers who can now simply review the auto populated ITR forms, add any missing information and submit without any hassle.

   The Income Tax department relies on cutting edge AI technologies like Optical Character Recognition (OCR), Natural Language Processing (NLP) and machine learning to gather, validate and auto populate data into ITR forms. This not only speeds up the filing process but also reduces mistakes.

   AI collects and integrates data from multiple reliable sources to pre-fill tax payer details accurately. With the linkage of PAN and Aadhar, the Income Tax Department is able to consolidate a greater amount of tax payer's data from various sources. These sources[2] are as follows –

   - Form 26AS – It is a consolidated annual tax statement issued by the Income Tax Department through the TRACES Portal. It contains crucial details such as tax deducted at source (TDS), tax collected at source (TCS), advance tax payments, refunds received. It also records high value transactions like property purchases and investments.
   - Form 16 – This form contains employee's salary details along with TDS during the year. The Income Tax Department uses Form 16 submitted by employers as a key source

[2] https://www.incometax.gov.in/iec/foportal/

for prefilling ITRs. AI powered OCR technology can extract data from multiple Form 16 documents, even in varied formats. Machine learning models validate and map the salary and TDS details accurately into the appropriate fields in the ITR, reducing manual errors.

- Banks and other financial institutions – They report the interest income earned by the tax payers, often in diverse formats. AI driven data parsing and NLP techniques enable automated extraction and categorization of interest income details, which are then reliably populated in the pre- filled forms.
- Dividend income data – This data is submitted by companies and mutual fund houses. AI tools scan dividend statements and align the income with tax payer's profile to prefill the ITR.
- Capital Gains data – The sale of listed equity shares, mutual funds and property is recorded in the Annual Information Statement (AIS) which is further used to prefill the ITR of the taxpayer.
- Other income – Income from insurance maturities, National Savings Certificate, government bonds is processed by AI and incorporated into the ITR comprehensively.

For businesses and professionals juggling multiple incomes and expenses, AI tools streamline the process by automatically pulling and organizing data from various sources such as accounting software, GST returns, Form 26AS, bank statements and payroll systems. This automation facilitates the generation of pre-filled ITRs for companies, partnership firms and professionals, significantly cutting down on manual data entry and minimizing the risk of errors.

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2. INTELLIGENT COMPLIANCE MONITORING AND ALERTS

Tax compliance for businesses and professionals can be intricate and time consuming. While human oversight brings important contextual awareness, manual processes are often more vulnerable to mistakes and inefficiencies. AI driven platforms address this challenge by continuously monitoring compliance activities and issuing real time alerts for upcoming deadlines, missing documentation and possible filing discrepancies. These intelligent tools offer a reliable way for busy professionals and businesses to stay on track and avoid late submissions and penalties.

3. VIRTUAL ASSISTANTS AND CHATBOTS

To enhance tax payer services, the Income Tax department has introduced virtual digital assistants on its upgraded e-filing portal 2.0[3]. Available round the clock, this virtual assistant helps users with a variety of tasks , right from choosing the correct ITR form and interpreting notices, to tracking refund status and navigating through complex sections of the Income Tax Act. It offers support in multiple Indian languages and provides step by step, personalized guidance as per the user's profile. Located at the bottom right corner of the portal after login, it is integrated with services such as the AIS and Compliance portal. If a query goes beyond the bot's scope, it automatically escalates the query to a human support agent during business hours, ensuring uninterrupted and continuous assistance throughout the filing process.

The tax payers have been completely dependent on tax return preparers or Chartered Accountants for filing their return. However, with these AI assisted tools, the tax payers can independently file their return.

4. E- VERIFICATION AND AUTHENTICATION

The Income Tax department notified the E-verification scheme, 2021 on 13th December 2021[4]. This scheme is the Income Tax department's most ambitious scheme in which advanced AI algorithms have been used to find out those financial transactions which may have been under reported or have not been reported in the ITR filed by the tax payer. The details of these transactions are then shared with the concerned tax payer who is asked to either accept or reject the information and provide a clarification for the same, thereby facilitating a streamlined and effective income tax assessment process. Since the introduction of e-verification, compliance levels have significantly increased, from 13% in 2014-15 to 93% in 2022-23. The average processing time of ITR has reduced from 84 days in 2019-20 to 10 days in 2023-24.[5]

5. FRAUD DETECTION AND DATA VAILDATION

The Income Tax department is increasingly turning to AI to strengthen fraud detection and improve overall tax compliance. By processing massive amounts of data from

[3] https://www.incometax.gov.in/iec/foportal/help/assissted-filing

[4] https://government.economictimes.indiatimes.com/news/governance/using-ai-algorithms-cbdt-completes-35000-cases-out-of-68000-taxpayers-selected-for-e-verification/98635205

[5] OECD (2024), *Tax Administration 2024: Comparative Information on OECD and other Advanced and Emerging Economies*, OECD Publishing, Paris, https://doi.org/10.1787/2d5fba9c-en

sources like bank transactions, property records, GST filing, AI can uncover discrepancies between reported income and actual income. This intelligent validation not only accelerates assessment but also enhances accuracy, allowing the department to tackle evasion while simplifying compliance for honest tax payers. Machine learning models are used to identify suspicious patterns such as sudden unusual income spikes, underreported assets, high value transactions, often triggering scrutiny and notices. A cornerstone of this effort is the "Project Insight", an advanced data analytics platform that compiles a 360-degree tax payer profile by integrating information from multiple sources. It uses AI and big data analytics to detect signs of tax evasion, track shell companies and identify benami transactions, significantly boosting the department's ability to carry out focused investigations and ensure stricter compliance. Thus, AI now plays a critical role in automated case selection based on risk parameters, spotting hidden anomalies in financial records and assisting the Assessing Officers to make informed and unbiased decisions. The introduction of Faceless Assessment Scheme in 2019 marked a major milestone towards achieving a fair and transparent assessment. Using AI for generating notices and ensuring case allocation anonymously, the system ensures greater transparency and fairness by reducing opportunities for corruption and human bias. This AI powered shift not only strengthens accountability and enforcement but also builds a more reliable and trustworthy tax system.

Though AI can assist in the assessment proceedings, it lacks the ability to interpret laws with the nuance and fairness that human judges provide. The judiciary depends on human judgement, empathy and ethical considerations; elements that AI cannot be a substitute for. Thus, AI serves as a tool to support, but not replace the crucial roles of the Courts and Tribunals.

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THE DARK SIDE OF AI IN INDIA'S INCOME TAX FILING: WHAT EVERY TAX PAYER SHOULD KNOW

AI is reshaping India's Income Tax system by enabling quicker processing, improved fraud detection and enhanced transparency. However, beneath this cutting-edge innovation lie important challenges that could impact many tax payers. While AI dazzles with efficiency and precision, it is equally important to recognize the downsides of this digital transition.

1. Privacy on the edge: Who is watching your data?

   The Income Tax department's AI system captures a large volume of personal data, ranging from bank account details and transactions, property records to everyday business transactions. While this data driven approach enhances security, it also raises serious concerns around privacy and security. The risk of data breaches or misuse, whether due to weak cyber security measures or insider threats, could expose sensitive financial information, leaving tax payers vulnerable to identity theft or fraud. In a country where digital literacy is still developing and data protection laws are evolving; the potential consequences of such vulnerabilities are significant. Ensuring robust safeguards and responsible data handling is important.

2. Lost in translation: When AI misses the human story

   AI may be brilliant at spotting similar patterns, but it often falls short when it comes to understanding the actual context. Take for example, a freelancer who lands a major contract in one financial year resulting in an income surge in that corresponding year. AI system which lacks insight into the actual situation, might interpret this spike as a suspicious. Unlike humans, AI cannot grasp the nuances behind such financial events or extraordinary income. This limitation can lead to unfair notices, creating unnecessary stress for honest and law-abiding tax payers.

3. Automation overload: When machines take over

   With the Government increasingly embracing automation, many tax assessments today are largely driven by AI. But placing too much reliance on AI can have unintended consequences and can backfire. AI systems operate based on predefined rules and historical data, making them less adaptable to emerging or complex tax evasion strategies. When human oversight is minimized, mistakes or oversights may go unnoticed, potentially leading to wrongful assessments, delays or even heavy penalties. For tax payers caught in this cycle, the appeal process can feel like battling a faceless, impersonal system where navigating through the appeal process becomes frustrating. There must be a redressal mechanism in place for the tax payers affected by such notices. Even after the introduction of the Faceless Assessment Scheme, certain complex assessments still demand in person presence, like for voluminous books of accounts scrutiny in front of the Assessing Officer. This defeats the very moto of the scheme which is an unbiased, corruption free assessment where the identity of the officer and the tax payer are not known to each other. Thus, AI has not been able to take over the tax assessment procedure completely and is not a substitute for assessments by the Assessing Officers. Moreover, the Income Tax department

needs to ensure it has enough workforce and other resources to handle the rapid increase in assessment proceedings generated by AI.

4. False alarms: When AI sounds the wrong alarm

   Even a small data discrepancy or an uncommon transaction can sometimes prompt an automatic scrutiny or issue a notice, despite the tax payer disclosing the income as per the Income Tax Act. These false alarms create unnecessary stress, costing honest tax payers time, money and peace of mind. On the flip side, Assessing Officers may find themselves diverting valuable resources towards investigating compliant tax payers, rather than focusing on actual cases of tax evasion.

5. Digital Divide: Who is being left behind?

   AI driven tax portals and automated processes often assume that all taxpayers have strong digital skills and easy, stable internet access; an assumption that does not hold true in a diverse country like India. Many tax payers in rural regions, senior citizens or those not comfortable with technology may struggle to navigate these digital systems. This gap in digital access, literacy risks and the fairness in the tax systems will ultimately create unequal opportunities for tax compliance.

6. Algorithmic bias: When AI unfairly targets you.

   AI relies on historical data to make decisions, which itself contains a built-in bias. As a result, certain groups may be unfairly flagged for assessment. The opaque nature of AI's decision making makes it difficult for tax payers to challenge or understand why they were singled out for scrutiny. These biases can erode the trust in the tax system and may lead to perception of unfair treatment or discrimination.

7. Legal and ethical gray areas.

   The swift adoption of AI in tax administration has outpaced the existing legal frameworks. Important issues around due process, tax payer rights and informed consent remain unresolved. How can tax payers challenge automated decisions? Are they adequately informed about ways in which their personal data is being collected and used? Navigating the fine line between robust enforcement and ethical treatment is a complex challenge that the Income Tax department must address with caution and transparency.

CONCLUSION

The increasing use of AI and automation in India's income tax filing is truly transformative. Technologies like automated data extraction, predictive analytics, instant assistance and easy,

streamlined e-verification, have boosted efficiency, reduced human errors and made compliance process convenient for millions. Yet, this transformation comes with its challenges. Relying more on AI raises serious concerns around data privacy, safeguarding against cyber security threats and the lack of clarity in how AI algorithms reach a decision. Further, while tax payers in the urban areas are more likely to benefit from these advancements, many people in rural areas still face digital literacy challenges and poor access to the infrastructure which is needed to benefit fully from these innovations.

Despite AI's advancements, it cannot replace the expertise and judgement of professionals like the Chartered Accountants and lawyers. Their deep understanding and interpretations of the changing tax laws and their ability to handle complex, nuanced situations remain essential for accurate tax filing and to navigate through the assessment proceedings.

For tax filing to be genuinely transformed, technological progress must go hand in hand with inclusivity, transparency and ethical oversight. Policies should be adapted to safeguard tax payer's rights while ensuring that AI system operates without bias and mistakes. When used thoughtfully and responsibly, AI and automation have the potential to broaden access to tax services, build stronger trust in the system and reinforce India's financial framework. Moving forward, the focus should not only be on adopting advanced technology but also on designing a fairer and more equitable system for all.

As it is wisely said by Dr. A.P.J Abdul Kalam, "India's strength lies in her ability to blend technology with human values"

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