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TAXATION OF DIGITAL HUMANS AND AI – GENERATED WORK: RETHINKING FISCAL LIABILITY IN THE AGE OF AUTONOMOUS INTELLIGENCE

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ABSTRACT

The fast growth of artificial intelligence has given rise to digital humans, virtual influencers, and autonomous AI systems that can generate significant income through creative, commercial, and algorithmic activities. This new development challenges the basic principles of current tax laws, which focus on human authorship, residence, and identifiable income sources. This study aims to explore how tax laws can change to keep pace with this digital landscape, where non-human entities can generate and earn revenue independently. It looks into the main question of who should be taxed for AI-generated work. Should it be the developer, the user, the platform, or the AI itself? The study also addresses the complexities of jurisdiction, valuation challenges, and income classification in international AI operations. By examining international approaches such as the OECD's digital economy initiatives and the European Union's proposals, the research aims to identify gaps in policy and suggest a framework for India and other regions. Ultimately, this paper emphasizes the urgent need to redefine taxable personhood, income classification, and liability in the age of artificial intelligence to promote fairness, responsibility, and legal certainty in global tax systems.

KEYWORDS: artificial intelligence taxation, digital humans and virtual influencers, AI-generated income, taxable personhood, jurisdiction and source of income, international tax frameworks, OECD digital economy model, and legal reform for AI-driven work.

INTRODUCTION

In the twenty-first century, artificial intelligence (AI) has changed the global economy by creating new forms of digital work, creative expression, and automated business. The rise of digital humans—virtual influencers, AI artists, automated content creators, and algorithmic traders—has reshaped the traditional ideas of work and production. These AI entities can earn money independently through online interactions, digital art, software creation, and entertainment, often without direct human input. This technological change challenges the foundations of traditional tax

systems, which were designed for human taxpayers and tangible economic activities.

Tax laws worldwide are based on well-established principles like personhood, residence, income sources, and territorial jurisdiction. However, the income generated by autonomous AI systems and digital humans does not fit neatly into these traditional legal frameworks. For example, when an AI model creates music, produces art, or engages with users as a virtual influencer, a key question arises: Who should be taxed? Should it be the programmer who wrote the code, the company that owns it, or the AI itself? This confusion has created a significant policy gap that

governments and international organizations are trying to address. Additionally, as AI systems often operate across multiple jurisdictions using cloud computing and decentralized platforms, pinpointing the source and residence of such income becomes more complicated. The borderless nature of digital economies makes it hard for tax authorities to identify where value is created and who is responsible for tax payments. The challenge isn't just administrative; it's conceptual. Existing tax laws weren't created to handle entities that don't have a physical presence or human identity. Meanwhile, AI-driven economic activities have started to generate substantial income, affecting the global flow of wealth and innovation. The absence of a clear tax framework for AI-generated work poses two major risks: under-taxation can lead to lost revenue for governments, while overlapping taxation can create legal uncertainty and disputes among multiple jurisdictions. These challenges affect global fairness, compliance, and economic equity.

This research aims to examine whether current tax laws are adequate for addressing income generated by AI systems and digital humans. It seeks to find out if the current ideas about taxpayer identity and liability are sufficient, or if a new legal definition of "taxable personhood" is needed for AI entities. The study also looks at international tax frameworks, such as the OECD's Pillar One and Pillar Two proposals and the European Union's digital services tax, and how they can help create a consistent approach to taxing AI-generated income. In India, this issue is particularly important as the country transitions to a more digital economy. India's Income Tax Act, 1961, and related international tax principles currently lack clear rules for income from AI or digital avatars. As India embraces digital progress under initiatives like Digital India and AI for All, an updated approach to tax law is essential to prevent tax base erosion and ensure that technological advances align with fiscal responsibility.

RESEARCH OBJECTIVES

- To examine the adequacy of existing tax frameworks in addressing income generated by digital humans and AI systems that operate independently without human creators.
- To identify the right taxable person or entity responsible for income from AI-generated work, considering the roles of developers, users, and platform operators.
- To analyze the challenges in determining the source, residence, and jurisdiction of AI-generated income in cross-border digital activities and transactions.
- To assess methods for valuing and classifying AI-generated income within current tax laws, distinguishing between business income, royalties, and capital gains.
- To evaluate international tax approaches, including OECD and EU frameworks, and suggest policy recommendations for developing a new legal model to effectively tax AI-driven and digital human activities in India and globally.

RESEARCH PROBLEM

The rise of digital humans and AI-generated work poses a significant challenge to existing tax frameworks traditionally built around human creators and legal entities. The central research question is how tax laws can adapt to an economy where artificial intelligence independently creates, performs, and generates income without human involvement. Current tax systems depend on clear definitions of personhood, residence, and income sources, but AI outputs disrupt these principles. When digital avatars or generative AI systems earn revenue through creative works, performances, or trading, it's uncertain who the rightful taxpayer is—the developer, the user, or the AI itself. Jurisdictional issues, valuation, and income classification complicate enforcement, as AI activities often operate beyond national boundaries and in decentralized digital spaces. This research aims to determine whether current tax laws can adequately address

income from AI and digital humans or if a new legal framework is needed to define taxable personhood, liability, and source rules in the evolving digital economy.

RESEARCH QUESTIONS

1. How can existing tax laws be adjusted to determine tax responsibility for income generated by digital humans and AI systems that operate without direct human input?
2. Who should be recognized as the "taxable person" when AI-generated content or digital human avatars earn income—the developer, the user, the platform owner, or the AI entity itself?
3. What legal and conceptual challenges arise from identifying the source and residence of AI-generated income in cross-border digital transactions?
4. How can tax authorities value and classify income produced by AI systems—as business income, royalties, or capital gains—within current tax laws?
5. Do existing international tax models, like the OECD's digital economy proposals, provide a solid basis for taxing AI-generated work, or is a new framework necessary to address emerging forms of digital personhood?

HYPOTHESIS

H₁ - Current tax laws are inadequate for addressing income from digital humans and AI systems. They do not define taxable personhood and liability for non-human entities.

H₂ - The lack of clear legal recognition for AI-generated income results in confusion over the source, valuation, and jurisdiction of this income, leading to potential revenue loss for tax authorities.

H₃ - Creating a special legal and policy framework that incorporates taxation for digital and AI-driven entities can ensure fairness,

prevent tax evasion, and promote responsibility in the digital economy.

RESEARCH METHODOLOGY

This study uses a doctrinal research approach, focusing on analyzing existing laws, legal principles, and academic writings related to the taxation of digital humans and AI-generated work. It relies on secondary sources, including statutes, case law, international conventions, academic journals, policy papers, and official reports from organizations like the OECD, IMF, and the European Union. The focus is on examining how current tax laws define personhood, income sources, and liability, and evaluating their adequacy in dealing with AI-driven economic activities. A comparative legal approach contrasts the taxation models of different jurisdictions, especially in India, the OECD framework, and the European Union's digital tax initiatives. This helps identify global best practices and potential reforms that could apply in India. The research also uses analytical and interpretative methods to identify gaps, inconsistencies, and possible reforms in existing income tax laws. The methodology is qualitative, aimed at developing clear concepts instead of measuring quantities. The study concludes with policy recommendations and legal proposals for reforming tax systems to include digital personhood and AI-generated income within a fair, transparent, and adaptable legal structure.

SCOPE OF THE STUDY

The scope of this study on "Taxation of Digital Humans and AI-Generated Work" includes examining the legal, fiscal, and policy aspects of taxing income generated from artificial intelligence and digital avatars, both locally and globally. The study aims to understand how current tax laws—especially income tax, international tax rules, and digital economy regulations—can be applied or changed to cover AI-generated activities that lack direct human authorship. It looks into issues like taxable personhood, income attribution, jurisdictional challenges, valuation

of AI outputs, and cross-border tax implications. While focusing mainly on the Indian legal context, the research also draws from OECD guidelines, EU proposals, and other global models to discover best practices. The study does not cover technical insights about AI development but focuses on legal recognition, tax implications, and policy responses to manage the economic contributions of AI and digital humans. Its goal is to offer a comprehensive understanding of how emerging technologies can fit into tax systems to ensure fairness, accountability, and adaptability in the changing digital economy.

LIMITATIONS OF THE STUDY

1. Limited Legal Precedents: The study faces challenges due to a lack of judicial precedents or specific laws addressing the taxation of AI-generated income or digital humans in India and worldwide.
2. Conceptual Uncertainty: The evolving landscape of artificial intelligence and digital personhood creates confusion about ownership, liability, and authorship, limiting the precision of legal analysis.
3. Data Availability: Reliable data on AI-generated revenues, digital human earnings, and their tax treatment are hard to find, leading the study to focus on doctrinal and conceptual analysis rather than quantitative assessment.
4. Jurisdictional Variation: The research encounters obstacles from differing international tax systems and policies, making uniform comparisons across countries challenging.
5. Technological Scope: The study centres on legal and fiscal implications rather than technical or programming details of artificial intelligence, which may limit the understanding of how AI systems generate taxable income.

CAN EXISTING LAWS CAN BE CAHNGED TO TAX THE INCOME OF DIGITAL HUMANS

The rapid growth of artificial intelligence has blurred the lines between economic value created by humans and machines. Digital humans, virtual influencers, algorithmic artists, and autonomous AI systems can now generate income independently through activities like digital performances, automated trading, and creative content creation. This presents a unique challenge to traditional tax systems designed under the assumption that only natural or legal persons can earn income. The lack of a physical actor or legal personality in AI-driven transactions raises questions about who is responsible for tax liability and how to value this income. Therefore, existing tax laws need to change both conceptually and structurally to address this modern economic reality.

Redefining Taxable Personhood in the Age of AI

Current tax laws recognize only natural and legal persons, such as individuals, firms, or corporations, as taxable entities. However, when an autonomous AI system generates value without human input, these categories do not capture the true economic contributor. One possible change is to create a framework for “electronic personhood” or “AI-associated taxable identity.” This would not grant AI systems full legal rights but would ensure their economic actions are legally recognized for tax purposes. In this model, AI entities could be treated like dependent agents, with tax liability assigned to the human or corporate controller who benefits from or manages the system. This approach would foster accountability while acknowledging AI's independent role in the economy.

Attribution of Income to Beneficial Ownership

Another important reform involves determining to whom AI-generated income should be attributed. Current laws could be expanded to recognize “beneficial ownership of

AI systems,” assigning tax liability to the party controlling, owning, or profiting from the AI’s output. For example, if a company uses an AI influencer that earns advertising revenue, the firm would be seen as the beneficial owner of that income. Similarly, if an individual licenses an AI program for automated trading, that person would be taxed on the resulting gains. This strategy builds on established principles of ownership, agency, and control under income tax laws while adapting them to the digital landscape.

Determining Jurisdiction and Source of Income

AI systems often operate globally through cloud infrastructure, complicating the determination of “source of income.” Traditional rules based on physical presence or territorial ties do not suffice for digital activities. Thus, existing laws must broaden source-based taxation to include income generated through significant digital interactions. India’s “Significant Economic Presence (SEP)” provision under the Income Tax Act, 1961, is a useful starting point. By recognizing digital engagement—such as transactions, user data collection, or virtual performances—as establishing taxable presence, the law could account for AI-generated income coming from the Indian market even without physical operations. Internationally, the OECD’s proposals under Pillar One could be adapted to distribute AI-driven income based on value creation.⁵⁴

Characterization and Valuation of AI-Generated Income

AI outputs do not fit neatly into traditional income categories like royalties, business income, or capital gains. For example, when AI software generates artwork or music, it remains unclear whether this counts as royalty income or creative production. Tax authorities can update frameworks by creating a separate category for “AI-derived income” and

developing valuation methods similar to transfer pricing principles. This would ensure AI-generated outputs are valued fairly, preventing both over-taxation and under-reporting. Establishing standardized valuation criteria would also help harmonize AI income taxation globally.

Integration of International Tax Norms

Because AI systems operate across borders, unilateral tax measures could lead to double taxation or legal conflicts. Adjusting existing laws thus needs to align with international guidelines such as the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS). These models could be expanded to include AI-generated income through shared definitions of digital presence, profit attribution, and tax nexus. Collaborative efforts like the automatic exchange of information and joint audits could enhance transparency and reduce disputes over AI-related income across jurisdictions.

Ethical and Policy Considerations

Updating tax laws for AI systems must balance two competing goals: promoting technological innovation and ensuring fairness in taxation. Over-taxing could deter investment in AI research, while not taxing could lead to unfair advantages and revenue loss. Therefore, a tax policy that is neutral and friendly toward innovation should be adopted. Governments could implement a gradual framework where AI-generated income is taxed proportionally through its human or corporate controllers until the concept of digital personhood is more clearly defined. Moreover, ethical considerations such as privacy, accountability, and transparency must guide tax policy to avoid misuse or evasion disguised as autonomous AI operations.⁵⁵

⁵⁴ Xavier Oberson, *Taxing Robots: Helping the Economy to Adapt to the Use of Artificial Intelligence* 12 (Edward Elgar Publ’g 2019).

⁵⁵ Jinyan Li, *Rethinking the Taxation of the Digital Economy*, 74 Bull. for Int’l Tax’n 122 (2020).

WHO SHOULD BE RECOGNIZED AS TAXABLE PERSONS FOR AI GENERATED INCOME

The rise of AI-generated content and digital human avatars has fundamentally changed the concept of authorship and ownership in the global economy. Virtual influencers, AI musicians, automated traders, and generative content platforms create substantial value without constant human involvement. Yet, current tax systems, designed for natural and legal persons, struggle with determining who should be taxed on this income. Identifying the taxable person in such cases is central to digital taxation policy and requires re-evaluating legal concepts of ownership, control, and benefit.

Absence of Legal Personhood in Artificial Intelligence

Under existing legal frameworks, AI systems and digital humans are not recognized as “persons.” They cannot own property, enter contracts, or bear tax liability. Taxation assumes there is a legally accountable entity. Therefore, until AI becomes a formal legal person, it cannot be taxed on its own. This limitation means that a human or corporate proxy must be found to take responsibility for the income generated by AI systems. Consequently, the taxable person must be identified based on principles of ownership, control, and benefit already present in tax law.

Developer or Programmer as Taxable Person

The developer or programmer of an AI system might be considered the initial taxpayer if they retain ownership rights or continue to earn income from the AI’s operations. For instance, if a software developer creates an AI tool that autonomously generates and sells digital art, the developer remains the economic beneficiary, and the revenue should be taxed in their name. This aligns with the principle that income goes to the person who creates or benefits from the source of that income. However, if the developer transfers ownership or licenses the AI, tax liability could shift to the

licensee or the entity controlling the commercial use.

Corporate Owner or Platform Operator

In many situations, the corporate owner or platform operator utilizing AI systems for business becomes the de facto taxpayer. For example, when a company operates a digital human avatar that earns money through brand partnerships or advertisements, the company, as the legal entity controlling the AI’s actions, should bear tax responsibility. This attribution reflects the principle of beneficial ownership, where income is taxed based on who enjoys the benefits, not just who facilitates the income-generating process. This treatment aligns with existing corporate tax structures and prevents creating tax-neutral zones around AI entities.

User or Licensee of the AI System

When individuals or businesses use licensed AI tools to create content or perform automated tasks, the user or licensee becomes the primary taxpayer. For instance, if a marketing professional uses an AI content generator to produce and sell digital advertisements, the income from that use goes to the human user rather than the AI or its developer. This mirrors the current taxation of tools and equipment used for business, where the taxpayer is the individual profiting from the tool’s output. Therefore, tax liability should go to the economic beneficiary, regardless of whether the work was automated or done by a human.

Shared or Distributed Tax Liability

Sometimes, multiple parties—developers, owners, and users—share control and profit from AI-generated activities. For such complex arrangements, a shared liability or split-income approach could be used. This method divides taxable income proportionately among all stakeholders based on contractual rights, data ownership, and profit distribution. Such models exist in joint venture and partnership taxation and could be applied to AI ecosystems to avoid double taxation and tax avoidance.

Need for a Legal Proxy Framework

To clarify responsibilities, tax laws might introduce a “legal proxy” mechanism to assign a human or corporate intermediary as the accountable entity for AI-generated income. This can be formalized through amendments that recognize “controllers of AI systems” as responsible taxpayers. The proxy system ensures that while AI operates independently, a clear individual or company is responsible for compliance, reporting, and tax payment. This model is similar to how trustees or agents are held liable for income generated from assets managed for others.

Policy and Ethical Considerations

Determining the taxable person in AI-related activities also raises ethical issues. Over-assigning tax liability to developers or users could stifle innovation, while complete exemption for AI-generated income might enable tax evasion. Hence, a balanced approach is needed—one that acknowledges AI as an income-generating entity while keeping human or corporate controllers legally and fiscally responsible. As AI evolves and legal frameworks develop, limited recognition of AI personhood for tax purposes might emerge, especially for autonomous systems capable of continuous self-management and income generation.⁵⁶

HOW CAN THE EXISTING TAX LAWS CAN BE AMENED

In the digital economy, artificial intelligence (AI) and digital humans are no longer just tools—they are becoming independent economic actors. AI-generated art, automated trading bots, and virtual influencers can earn significant revenue without direct human control or creative input. However, the current tax systems worldwide are based on the assumption that only natural or legal persons can earn income. This creates a serious gap: when AI generates revenue on its own, it is

unclear who is legally responsible for paying taxes. Addressing this challenge requires reassessing existing income tax frameworks and developing new principles that acknowledge the changing nature of digital economic participation.

Redefining Taxable Entities and Digital Personhood

Traditional tax laws recognize individuals and corporations as taxable entities, both of which possess legal personhood. In contrast, AI and digital humans lack this legal identity, making it impossible to assign tax liability directly to them. To adapt tax systems, the concept of “digital personhood” should be explored—a legal status granting limited recognition to AI entities for tax purposes. While full legal personhood may raise ethical and accountability concerns, some recognition—similar to corporate personhood—could enable taxing AI systems as independent entities or as extensions of their owners or developers. This would create a structured way to tax autonomous digital activity while ensuring that liability cannot be avoided through technological advancement.

Establishing Ownership and Beneficial Control

Determining who “owns” the income produced by AI is essential. In cases without human involvement, tax authorities can attribute income based on beneficial ownership, meaning the individual or entity that ultimately controls or benefits from the AI system. For instance, if a company deploys a generative AI model that produces and sells digital art, the income should be taxed under that company’s name, even if no employee directly facilitated the output. Legal reforms could require businesses using autonomous AI systems to register them under a taxable identity, connecting the system’s earnings to the human or corporate controller. This approach would align with established frameworks like the OECD’s Base Erosion and Profit Shifting (BEPS) guidelines and India’s

⁵⁶ Kimberly A. Houser & David Sanderson, *The Ethical Implications of AI Taxation and Personhood*, 37 Yale J. on Reg. 225 (2020).

Equalization Levy, which target profits from digital operations.

Attribution of Income in Autonomous Operations

AI systems can operate continuously across different countries, generating income from multiple locations at once. This raises complicated questions about tax residence and income sources. Tax laws may need to redefine “permanent establishment (PE)” to include virtual or algorithmic establishments, which are digital presences that consistently generate revenue within a jurisdiction. The OECD has started to explore this through the “Significant Economic Presence (SEP)” principle. This principle allows taxation based on digital engagement instead of physical presence. Extending these ideas to AI-driven income would help countries claim their fair share of taxes from autonomous operations without relying on outdated notions of territorial rights.

Technological Transparency and Record-Keeping

To assess tax liability correctly, authorities need insight into how AI systems generate revenue. Introducing transparency and audit obligations for AI requires companies to keep algorithmic logs, digital transaction records, and AI performance data. This would help trace the flow of income and prevent tax evasion. Blockchain-based recording systems could ensure accountability by connecting each AI-generated output to its origin and related tax records. This would modernize compliance systems and bring accountability into fiscal governance.

Legal and Policy Reforms

Changing tax laws for AI-generated income requires proactive legal reforms. Governments could:

- Amend Income Tax Acts to explicitly include income generated by autonomous digital systems.

- Introduce a “Digital Activity Tax” aimed at AI-driven revenue streams.

- Encourage international cooperation to prevent double taxation or profit shifting by multinational AI corporations.

- Establish ethical AI taxation guidelines that promote responsible AI innovation while ensuring fairness. Such reforms must balance innovation and equity, preventing corporations from exploiting legal grey areas to avoid tax obligations under the guise of automation.⁵⁷

COMPARATIVE ANALYSIS IN DIFFERENT JURISDICTIONS (India, EU, OECD, and USA)

The taxation of AI-generated income has become a significant issue for global tax authorities. As artificial intelligence and digital humans take part in economic activities—including automated financial trading and content creation—governments around the world are considering new ways to tax these non-human sources of revenue. This analysis looks at how different jurisdictions, such as India, the European Union (EU), the Organisation for Economic Co-operation and Development (OECD), and the United States (USA), are dealing with the fiscal implications of digital and AI-driven economies. Each jurisdiction has a unique approach, balancing innovation with fair taxation and administrative practicality.

India: Towards Recognition of Digital Economic Presence

India has taken the lead in taxing digital transactions with measures like the Equalization Levy (2016) and the Significant Economic Presence (SEP) principle under the Income Tax Act, 1961. These measures aim to tax non-resident digital entities that earn from Indian users without a physical presence.

The Equalization Levy, currently at 2% for online advertising and e-commerce operators, indirectly includes AI-driven businesses like

⁵⁷ Ruth Mason, *The Taxation of Digital Businesses in the Global Economy*, 72 Tax L. Rev. 69 (2019).
Klaus Vogel, *Klaus Vogel on Double Taxation Conventions* 145 (4th ed. Kluwer Law Int'l 2021).

automated advertising platforms or virtual influencer marketing. Similarly, the SEP provision expands the idea of “business connection” to cover digital operations earning income from Indian customers through digital means.

However, India’s framework does not yet specifically recognize AI-generated or autonomous income. While the SEP model provides a foundation for taxing virtual activities, it assumes human or corporate control. Therefore, Indian law needs to adapt to include autonomous AI systems and digital humans as taxable entities under a “digital entity framework” or through updates acknowledging algorithmic income. This would ensure tax accountability, even when the creator or controller of the AI is far away or legally unclear.

European Union: Regulating Digital Economy with Ethical Accountability

The European Union (EU) takes a more comprehensive and rights-based approach, linking AI regulation with fiscal accountability. With the Digital Services Act (DSA), the Digital Markets Act (DMA), and plans for a Digital Levy, the EU aims to ensure that large tech companies, including AI platforms, pay their fair share of taxes. While the Digital Levy was initially designed to target digital giants, it indirectly includes AI systems that earn significant income from European markets. The EU Artificial Intelligence Act (2024) brings forth the idea of AI system accountability, laying groundwork for tax responsibility.

The EU model stresses ethical taxation, where fiscal obligations come with transparency, traceability, and human oversight. If a digital human or autonomous system earns from user engagement, data collection, or virtual content, the operator must disclose the income source and comply with tax reporting standards. This approach combines AI

governance with fiscal rules, ensuring that digital autonomy doesn’t lead to tax evasion.⁵⁸

OECD: Global Coordination Through the Pillar One and Two Frameworks

The OECD plays a key role in harmonizing global tax policies with its Base Erosion and Profit Shifting (BEPS) initiatives and the Two-Pillar Framework.

Pillar One aims to assign taxing rights to jurisdictions where digital services create value without requiring a physical presence by introducing the idea of “significant user participation.”

Pillar Two establishes a global minimum tax of 15% to address tax avoidance by multinational digital companies.

Although these frameworks primarily target large corporations such as Google, Meta, and Amazon, they are also relevant to the growing concern of AI-generated income. Under Pillar One, if an AI system autonomously offers digital services or content in a jurisdiction, that jurisdiction may claim taxation based on value creation instead of physical operations. However, the OECD framework has not yet directly addressed non-human entities. Future revisions could expand BEPS principles to include “AI-driven profit allocation,” where algorithmic value creation incurs taxation even with minimal human involvement.⁵⁹

United States: Capitalism, Innovation, and Deferred Regulation

The United States, home to major AI developers like OpenAI, Google, and NVIDIA, approaches digital taxation with a market-driven and innovation-focused mindset. The U.S. tax system currently lacks a specific provision for taxing AI-generated income separately. Instead, income from AI systems goes to the legal owner or controller of the software or platform. For example, if an AI model

⁵⁸ European Commission, *Proposal for a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services* (COM/2018/148 final).

⁵⁹ Organisation for Economic Co-operation and Development (OECD), *Tax Challenges Arising from Digitalisation – Report on Pillar One and Pillar Two* (2021)

autonomously creates digital art or makes trading profits, the IRS considers this income earned by the entity that owns or licenses the AI system. The U.S. approach focuses on ownership-based taxation rather than algorithmic or autonomous attribution.

However, some scholars and policymakers in the U.S. are starting to discuss the idea of “electronic personhood” for advanced AI entities, similar to corporate status. If accepted, this could lead to direct AI taxation, ensuring accountability without hindering innovation. For now, the U.S. relies on a flexible yet reactive framework, adapting existing corporate and intellectual property tax laws instead of creating a new category for AI-specific tax regulation.

The comparative study shows India and OECD frameworks emphasize digital presence. The EU focuses on ethical and transparent accountability, while the U.S. prioritizes ownership and innovation. None of these systems fully capture the fiscal implications of autonomous AI entities generating revenue without human oversight.⁶⁰

LEGAL AND ETHICAL IMPLICATIONS OF TAXING THE AI AND DIGITAL HUMANS

The rapid advancement of artificial intelligence and digital humans brings significant challenges not just to law and economics but also to ethics and values. When AI systems generate income on their own, traditional legal frameworks struggle to determine accountability, ownership, and liability. The question isn't whether to tax AI-generated income but how to do so without violating essential legal and ethical principles. This discussion sits at the intersection of technology, law, and morality, requiring a balance between innovation, fairness, and justice.

Legal Ambiguities in Defining the Taxpayer

A major legal issue in taxing AI comes from the lack of a recognized legal identity for non-human entities. In most jurisdictions, tax liability is attached to either natural or legal persons (like corporations). However, AI systems exist in a legal grey area. They can generate revenue, make decisions, and even hold digital assets, yet they lack a formal legal identity for taxation. Legal experts suggest granting “electronic personhood” to advanced AI systems, similar to corporate legal status. This would allow AI entities to have rights and obligations, including tax responsibilities. Critics warn that this could create moral and accountability gaps, allowing human owners to escape responsibility by hiding behind algorithmic “agents.” So, while granting AI personhood may simplify tax management, it risks undermining the human-centric nature of law and justice.

Ownership and Attribution: The Core Legal Dilemma

Taxation hinges on identifying who owns the income and who benefits from it. With AI-generated work, ownership becomes unclear. Should income belong to the programmer, the corporation that deployed it, or the user who prompted it? For instance, if a digital human influencer autonomously creates sponsored content and earns money through social media, determining ownership is complex. Most legal systems apply the “beneficial ownership” principle, meaning tax liability falls on the party that ultimately controls or enjoys the economic benefits. This helps maintain continuity with existing frameworks, but as AI becomes more self-learning and decentralized (like in blockchain-based DAOs), even beneficial ownership may become hard to trace. Therefore, new regulations on digital accountability and AI registration may be necessary to maintain tax integrity while protecting ownership rights.

⁶⁰ Brian J. Arnold, *International Tax Rules and the Digital Economy: The Road Ahead*, 46 *Intertax* 493 (2018).

Ethical Concerns: Fairness, Autonomy, and Human Dignity

Taxing AI raises serious ethical questions about fairness and human dignity. Should artificial entities that lack consciousness or social needs contribute to society? From a utilitarian viewpoint, the answer is yes—AI-generated income should help with social needs to counter job loss and economic inequality caused by automation.

However, deontological ethics warn against equating AI with human taxpayers since this could blur moral lines between human creators and artificial tools. Moreover, ethical taxation requires transparency: if governments tax AI systems, they must also ensure algorithmic accountability and a fair application of tax laws. Ethical frameworks, such as the EU AI Ethics Guidelines (2019), stress that taxation and governance must uphold human oversight, accountability, and fairness, ensuring technology benefits humanity, not the other way around.

Data Ownership and Privacy Implications

AI-generated income typically comes from data-driven operations. Digital humans, chatbots, or recommendation systems earn through user interaction, data mining, and content creation, all of which rely on personal data. Taxing such entities might require detailed data tracking and audit trails, raising privacy concerns. For instance, linking AI income to human controllers could mean analysing transaction histories, behavioural algorithms, or even user-generated content. This may risk violating data protection principles like those under the General Data Protection Regulation (GDPR). Therefore, any tax framework for AI must ensure data minimalism—using only essential information for tax assessment—and maintain safeguards for the privacy of human users interacting with AI systems.

Jurisdictional Conflicts and International Legal Complexity

AI systems operate globally, often generating income across multiple jurisdictions. This creates confusion about which country has the right to tax that income. Traditional tax principles focus on residence and source, but AI systems can exist on a global cloud and operate in various countries at the same time.

The OECD's Pillar One and Pillar Two initiatives seek to clarify this issue by assigning taxing rights based on digital presence and user participation. However, ethical concerns remain: if taxation frameworks favor developed countries where AI companies are based, developing countries risk losing their share of tax revenues. Therefore, fair international cooperation is essential to prevent "digital colonialism," where AI-generated wealth is concentrated in advanced economies while developing nations remain consumers instead of beneficiaries.

Balancing Innovation and Regulation

A crucial ethical challenge lies in balancing innovation with regulation. Excessive taxation might hinder AI research and deter investment. Conversely, insufficient taxation could promote profit shifting and social inequity. Lawmakers thus need to create adaptable, innovation-friendly tax systems that encourage creativity while preventing evasion. Possible solutions include graduated AI taxation models, where tax rates correlate with the level of automation or market dominance, and incentive-based exemptions for ethical AI projects that contribute to education, healthcare, or environmental goals. Such balanced policies will ensure that taxation supports responsible innovation and technological inclusion.⁶¹

POLICY AND PROPOSED LEGAL FRAMEWORK

India is leading the way in digital transformation, with rapid growth in artificial

⁶¹ Ruth Mason, *The Taxation of Digital Businesses in the Global Economy*, 72 Tax L. Rev. 69 (2019).

intelligence (AI), machine learning, and virtual influencers affecting the digital economy. However, the Income Tax Act, 1961, and related fiscal frameworks are still based on a model focused on human efforts. This model assumes that income always comes from human or corporate work. As AI systems and digital humans can increasingly generate independent income streams—from automated trading and content creation to digital marketing and data analytics—India needs a new legal and policy framework that recognizes and regulates this emerging economic trend. Creating a strong AI taxation framework is essential for financial integrity and for ensuring India gets fair value from global digital activities in its market. The following recommendations outline how India can reform its laws to balance innovation, fairness, and accountability.

Defining “AI-Generated Income” and “Digital Human Activity”

The first step in reforming taxation is to set clear legal definitions. Current Indian law does not include terms for income generated from autonomous systems. Therefore, the Income Tax Act needs to define:

AI-Generated Income: Any income derived from operations conducted by artificial intelligence systems or digital avatars without direct human involvement.

Digital Human: A computer-generated human replica or virtual entity that interacts, performs, or creates value through digital means. These definitions would provide a legal basis for recognizing non-human economic participation, making it easier to identify, assess, and tax digital income streams.

Assigning Tax Liability: The Beneficial Ownership Model

Since AI does not possess consciousness or legal status, tax liability must ultimately rest with the beneficial owner or controller of the AI system. Under this model:

The entity or individual who owns, trains, deploys, or profits from an AI system shall be

considered the “taxable person” for income generated by its operations.

A “declaration of control” requirement could be introduced, obligating companies or individuals using AI systems to register them under their PAN (Permanent Account Number) or GST identification. This approach ensures accountability and prevents evasion by placing responsibility on the person who exercises ultimate control and receives economic benefit. This is similar to how Section 2(31) of the Income Tax Act defines a “person” to include groups and associations.

Expanding the Concept of Significant Economic Presence (SEP)

India’s Significant Economic Presence (SEP) principle under Section 9(1)(i) provides a good starting point for digital taxation. However, it currently focuses on human-led e-commerce or online services. The law could be expanded to include:

Algorithmic Presence: Income generated when AI systems or digital humans engage with Indian users.

Autonomous Digital Establishment: Recognition of AI-driven systems as “virtual establishments” for taxation. For example, if a virtual influencer or automated trading bot engages Indian users and earns revenue from advertising or digital transactions, it could be taxed under the extended SEP framework. This would ensure that AI activities that contribute to India’s economy are not left untaxed due to a lack of physical or human presence.

Introducing a “Digital Entity Tax” (DET)

A new Digital Entity Tax (DET) could be introduced under Indian law to specifically target revenue from AI-generated or digital human activities. Key features could include:

- i. A flat rate applicable to autonomous digital income exceeding a certain threshold.

- ii. Applicability to both resident and non-resident entities earning AI-based income in India.
- iii. Compliance through annual AI income disclosures and transaction logs verified via digital reporting systems.
- iv. The DET could function like the Equalization Levy but tailored specifically for AI-driven or autonomous systems, ensuring that India captures tax from non-traditional digital contributors.
- ii. Exempting small-scale AI startups from the DET for their first three years of operation.
- iii. Offering deductions under Section 35 of the Income Tax Act for spending on AI-driven innovation, similar to R&D incentives in biotechnology and IT sectors. These incentives would ensure that taxation encourages innovation rather than discouraging entrepreneurship in AI.

Regulatory Oversight and AI Transparency

To implement AI taxation effectively, transparency and traceability are critical. India could establish an AI Fiscal Governance Board (AIFGB) under the Ministry of Finance, responsible for:

- i. Certifying AI systems used for commercial activities.
- ii. Maintaining a national registry of digital humans and autonomous AI entities operating in India.
- iii. Ensuring algorithmic transparency by requiring AI developers to provide digital audit trails that show how income was generated.
- iv. These actions would align with global standards such as the EU AI Act (2024) and encourage responsible AI use while enabling tax compliance.

Encouraging Innovation Through Fiscal Incentives

While regulation is important, taxation should not hinder innovation. The government should adopt a balanced policy that offers incentives by:

- i. Providing tax credits for AI research, ethical AI development, and digital skill-building programs.

Ensuring Ethical and Equitable Taxation

Any new taxation model should also promote fairness, equity, and social responsibility. Revenue collected from AI taxation could be allocated for:

- i. AI Reskilling Funds to train workers impacted by automation.
- ii. Digital Literacy Programs to support inclusive technological growth.
- iii. Public AI Research Grants to expand access to emerging technologies.
- iv. By linking taxation to social reinvestment, India can ensure that AI-driven prosperity benefits society as a whole, not just businesses.

International Coordination and Double Taxation Avoidance

Given the global nature of AI operations, India should engage in international discussions through the OECD, G20, and UN Tax Committee to maintain consistency in taxing AI-generated income. Bilateral treaties should explicitly recognize AI-based income as taxable. Harmonizing digital taxes with global standards would help avoid double taxation or tax evasion by multinational AI companies. Such collaboration would help India maintain fiscal sovereignty while ensuring fairness in global digital taxation.

FINDINGS

- 1. Current tax frameworks do not adequately address income generated

by autonomous AI systems and digital humans.

2. Uncertainties in authorship, ownership, and control create challenges in assigning tax liability in AI transactions.
3. Most jurisdictions do not legally recognize AI entities, preventing direct taxation of their economic outputs.
4. The lack of clear global standards increases the risk of tax avoidance and double taxation conflicts.
5. Digital economy taxation models like “Significant Economic Presence” and “Digital Services Tax” offer partial but insufficient solutions.

CONCLUSION

Taxing digital humans and AI-generated work represents a significant challenge in the changing digital economy. As AI systems increasingly operate independently—creating art, software, and digital content that generate revenue—the traditional tax model focused on humans struggles to establish ownership and liability. Current tax laws depend on the existence of a natural or legal person, which fails to account for AI-driven income, leading to legal uncertainty and possible revenue loss for governments. To close these gaps, we need to rethink taxation principles in light of technological advancements. Recognizing AI as an economic actor—even if not a legal person—could establish a basis for attributing tax responsibility to the developer, owner, or operator. Moreover, harmonized global standards, inspired by the OECD’s digital tax framework, can ensure consistency and fairness across jurisdictions. In the end, the future of taxation lies in balancing innovation with accountability. A transparent, adaptable, and ethically grounded taxation system for AI-generated work will secure public revenue while promoting responsible development of AI technologies in line with legal and societal values.

RECOMMENDATIONS

1. Introduce a legal framework that recognizes AI-generated income and attributes it to human or corporate entities.
2. Develop a distinct tax category for autonomous AI systems to ensure financial accountability.
3. Encourage international cooperation through OECD or UN guidelines for AI taxation.
4. Implement digital transaction tracking systems to evaluate and monitor AI-based income streams.
5. Regularly update tax codes to reflect advancements in AI and new digital economy models.

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