



# TECHNICAL ASSISTANCE REPORT

## LIBYA

### Redesign of Income Tax Forms

**AUGUST 2024**

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# Contents

<b>Acronyms</b>	<b>5</b>
<b>Preface</b>	<b>6</b>
<b>Executive Summary</b>	<b>7</b>
<b>Recommendations</b>	<b>8</b>
<b>I. Key Findings</b>	<b>9</b>
A. Status of LTA Income Tax Operations	9
B. Taxpayer Registration	10
C. Annual Income Tax Declarations	12
<b>II. Technical Assistance Provided</b>	<b>14</b>
A. Taxpayer Registration	14
B. Annual Tax Declaration Forms 4 and 5	14
C. Annual Corporate Income Tax (CIT) Declaration Form 9	16
<b>Boxes</b>	
1. Application for Registration	11
2. Annual Income Tax Declarations	13
3. A Merged Declaration for Unincorporated Taxpayers (Forms 4 and 5)	15
4. Declaration for Incorporated Taxpayers (Form 9)	15
<b>Annexes</b>	
1. Application Form 1 Tax Identification Number	18
2. Personal Income Tax Annual Declaration	19
3. Corporate Income Tax Return	20
4. Current Tax Forms 1, 4, 5 and 9	21

# Acronyms

CD	Capacity Development
CIT	Corporate Income Tax
FAD	Fiscal Affairs Department (IMF)
ISIC	International Standard Industrial Classification
IT	Information Technology
LTA	Libyan Tax Authority
METAC	Middle East Regional Technical Assistance Center
PIT	Personal Income Tax

# Preface

At the request of the Libyan Tax Authority (LTA), a capacity development (CD) assignment was conducted through remote assistance during the period April 22 to May 2, 2024, by Mr. Thomas Story, External Advisor, IMF Fiscal Affairs Department (FAD). Mrs. Sabine Corm, Regional Tax Administration Advisor for fragile and conflict-affected states (FCS) at the Middle East Regional Technical Assistance Center (METAC) also participated in the remote assistance.

The purpose of the assignment was to support LTA in the identification of data and reporting requirements for the administration of income taxes, and in developing initial high-level proposals for the re-design of tax forms.

Between April 22 and 25, 2024, virtual workshops using the Zoom platform were attended by senior LTA staff in which detailed discussions took place to clarify current approaches for income tax administration, including processes for registration, declaration, payment, and verification of liabilities. This report presents some suggestions from the workshops for improvements to income tax registration, and annual tax declaration reporting.

# Executive Summary

**LTA initiated a wide-ranging transformation program for tax administration with a central focus on digitalization of paper-based systems.** METAC provided a road map for implementation of an integrated tax administration system (ITAS) as well as advice on digitization preparedness<sup>1</sup>. A key observation was that LTA tax forms were poorly defined and unable to support data capture and processing.

**Without sufficient information on registered taxpayers and their tax filings, there is very limited risk assessment.** Tax forms for registration and annual declaration filing contain no structured data fields. Information is in free text. The amount of information being requested in annual declarations is too little and for CIT there is total reliance on annexures in unspecified formats. Officials acknowledge that analytical capacity for monitoring and management of tax compliance is most difficult.

**The proposed taxpayer registration application form will allow LTA to compile and maintain a complete database of businesses and individuals required by law to register.** It retains the existing approach for a single application form across all forms of entity, both incorporated and unincorporated. It expands the application form to include additional data fields consistent with international standards for taxpayer registration, particularly for companies. It also provides advance information on expected numbers of employees and projected annual gross income.

**The mission team advised on the data fields for an annual tax declaration for unincorporated entities which merge the reporting of trade, industry, craft, and liberal professionals (Forms 4 and 5).** The new form provides for a large amount of additional data; it is more data demanding than the current approaches, and the proposals should be considered for taxpayers who are over a total income threshold and who can be reasonably expected to have some books and records. The form maintains a separation of net income from industry and handicraft, reflecting the reduced tax rate for this cohort. It fully itemizes the gross profit calculation for each class of taxpayer to facilitate comparative ratio analyses for risk assessment. It suggests a very small number of end-of-year balance sheet items corresponding to cash at bank, total assets, and total debts.

**Because the declaration is reasonably comprehensive, the need for a formal profit and loss statement as an annexure to the declaration may be re-considered.** The medium-term approach would be to remove the need for a separate profit and loss statement.

**The mission team revised the CIT declaration and proposed a preliminary set of data.** The new declaration would expand considerably the information within the existing form 9. The requirement for a profit and loss and balance sheet would be retained for company taxpayers.

**All these proposals should be examined for their legislative impact as well as their short-term technical feasibility.** An interim but limited computer system for income taxes is anticipated for a mid-

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<sup>1</sup> See METAC, Libya, Digitization Preparedness and Planning; March 2023, Peter Poulin.

year commencement. The ideal approach is to incorporate these forms within the scope of the new computer platform.

**A program of consultation with business groups and taxpayer representatives on the new forms is suggested.**

### Recommendations

<b>Taxpayer Registration</b>	
<b>1</b>	Adopt the revised format for a taxpayer registration application form.
<b>2</b>	Conduct consultations with the business community on the changes to tax forms.
<b>Data Items for Income Tax Declarations</b>	
<b>3</b>	Review the preliminary data items proposed for a single annual income tax declaration for unincorporated entities (merged forms 4 and 5) and a revised form 9 for companies.
<b>4</b>	As a medium-term measure, (e.g., after two years of implementation of the revised form), remove a requirement for a profit and loss account to accompany the revised forms 4 and 5.
<b>5</b>	Examine the legislative impacts arising from the new tax forms.
<b>6</b>	Confirm the technical feasibility of all new forms for short term implementation in the interim LTA computer platform.
<b>7</b>	Maintain the requirement for a profit and loss statement and balance sheet to accompany annual tax declarations for all CIT payers.
<b>8</b>	Maintain the availability of the existing Forms 4 and 5 for use by the smallest taxpayers where there are very limited books and records and who are below a pre-determined total income threshold.
<b>9</b>	Adopt a standardized approach for industry classification based upon the United Nations ISIC.



# I. Key Findings

## Background

1. **In 2021, the Libyan Tax Authority (LTA) proposed a strategy for the transformation of income tax administration.** A wide-ranging set of modernization initiatives for income taxes were put forward that envisaged digitalization as well as reforms in parallel to legislation, organization, infrastructure, and human resources. As these measures are a long-term program with uncertain timing, LTA also wishes to take more immediate steps to improve the income tax administration. This report is concerned with one near-term measure - a re-design of tax declarations.

## A. Status of LTA Income Tax Operations

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2. **Libya's administration of income taxes remains within its traditional paper-based environment.** Income tax administration is very decentralized across a network of 39 executive administrations (regional offices) and 60 smaller offices. There is administrative support from a small headquarters.

3. **There are no enterprise-level computer systems to support the core functions of tax administration.** Office automation tools (word processing, scanning, and printing) are available, and work stations were being replaced at LTA's five largest offices as a precursor for digitalization.<sup>2</sup> There can be local information technology (IT) and spread sheet applications for some tax administration functions, though their functional capabilities are not clear, and there are no systems for a central and standardized data capture of income tax information.<sup>3</sup> Taxpayer registration, filing, and assessment, and their recording, are reduced to very restricted and manual processes.

4. **As a next step, LTA is progressing an in-house small IT system development for roll-out from mid-2024.** A total tax administration IT solution covering all core functions and integrated across the personal income taxes (PIT), corporate income tax (CIT), and the Defense ("Jehad") tax is at a very early stage of technical specification. A small system development for tax administration is an interim measure, to be piloted in a few offices, though officials emphasize that it represents a partial step covering a few functions. The details of the tax administration functions to be supported under this small system were not confirmed.

5. **Tax forms are very outdated and cannot support data capture.** Tax forms for registration and annual declaration filing contain no structured data fields. Information is in free text. The amount of information being requested in annual declarations is too little and for CIT there is total reliance on annexures (e.g., financial accounting reports) in unspecified formats. Without a data resource to provide information on registered taxpayers and tax filings, there are few internal controls. Officials acknowledge that analytical capacity for monitoring and management of an income tax system is lacking.

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<sup>2</sup> See P. Poulin, Digitization Preparedness and Planning, METAC, March 2023.

<sup>3</sup> Poulin, (METAC) loc.cit

## B. Taxpayer Registration

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**6. A single registration application (“Form 1”) applies to all income tax entities including companies.** Individuals apply to register with LTA upon commencing business in trade (retail and wholesale), industry (manufacturing), or as a liberal professional (such as lawyers, doctors, accountants, architects). Before registering with LTA, every entity must obtain a business license from the Ministry of Economy. Legal persons (companies) register with LTA following their entry into the Commercial Register.

**7. Registration information requested within Form 1 is narrowly prescribed.** There are proof of identity requirements for registration.<sup>4</sup> Other information items that are part of modern tax registration processes are not collected.

**8. The current registration form is reproduced at Annex 4.** A summary of some information gaps within Form 1 is in Box 1.

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<sup>4</sup> These are for individuals: a national identity card for a resident of Libya, a foreign passport for non-residents and for legal persons: entry into the Commercial Register

### Box 1. Application for Registration

Form 1 provides some identity information to tax administration but omits or only indirectly references information recognized to represent an adequate standard of information on registered taxpayers.<sup>5</sup>

For individuals the registration application form omits or indirectly references:

- Date of Birth
- Contact information (e.g., cell and other telephone contact)
- Taxpayer segment
- Economic / industry sectors by code
- Contact information for tax agents or intermediaries
- Nature on filing and payment obligations

For companies, the registration application form also omits or indirectly references:

- Identity of associated entities
- Identity information for company office holders (directors)
- Contact information (cell and other telephone contacts) for company office holders
- Identity of related parties, e.g. shareholders and subsidiary companies
- Other taxpayer roles within the tax system (e.g., as an employer)

Form 1 does not provide additional information to support the application, such as:

- An estimate of annual gross income
- The number of paid employees
- The accounting period to be applied

**9. Employees are not required to register with LTA.** However, employees of non-profit entities may be obliged to file a declaration and pay taxes on annual assessment.

**10. A critical gap is that there is no coding system for classification of business activity.** There is a single line in Form 1 for a description of the main purpose of a business. The absence of an activity coding system severely limits the analysis of tax compliance and the capacity to compare taxpayer's compliance across a taxpayer segment or activity. The authorities should adopt an industry classification system that is based upon the United Nations International Standard Industrial Classification (ISIC).

**11. An individual may have multiple tax numbers.** If the individual has more than one class of income identified under the income tax law, for example (e.g.,) there is income from industrial or handicraft activity, as well as from commercial (retail) activity or rental activity, then the taxpayer will be issued with separate tax numbers.<sup>6</sup> A tax number is six digits, which officials advise is sequential.

**12. The number of taxpayers cannot be accurately determined.** Officials advise that there are 45,000 income taxpayers, but this includes unknown numbers of ceased businesses, bankrupts, and liquidated entities.

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<sup>5</sup> See TADAT Secretariat, Field Guide for Tax Administration Diagnostic Assessment Tool (2019)

<sup>6</sup> This is in order to file tax declarations for each activity. The authorities note this is a requirement under Law No.7 of the year 1378 on Income Taxes (2010).

## C. Annual Income Tax Declarations

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**13. Tax forms for individuals require a minimal set of data to determine a taxable income.**

There are separate forms for partnerships and individuals engaged in trade, industry, and handicraft (Form 4) and for liberal professionals (Form 5). Both specify some expense items to be included within a statement of taxable profit (form 4) or net taxable income (form 5) though the lists of expenses are not extensive and there are significant omissions. Where available, a profit and loss statement is to be annexed to the forms together with a certification from the registered accountant and legal auditor.

**14. Tax forms for companies (form 9) are restricted to identification and address information, including that of branches.** There are high level tables to provide a reconciliation between accounting and taxable profit, and a CIT calculation against taxable income. A certification by a registered accountant completes the declaration. There are no other data fields prescribed within the tax form relating to the determination of net income, taxable income, tax credits or balance sheet items. The current annual tax declaration forms are at Annex 4.

**15. There is a full reliance on the external accounting reports for determination of an income tax assessment.** Administrative assessments are based upon the information provided by the taxpayer. There is no authority for adjustment to primary assessment information without conducting a tax audit.

**16. Risk assessment to inform audit case selection is not assisted by internal data resources within LTA.** Risk assessment for tax audit is largely based upon formal accounting reports. Without a store of key taxpayer data extracted from those reports, such as for gross and net income, assets and liabilities, there are no automated benchmarks of income tax information that must be manually compiled across comparator taxpayer groups — such as industry sectors. Nevertheless, officials advise that risk assessment is attempted to guide audit selection.

**17. Box 2 summarizes some limitations in annual income tax declarations.**

## Box 2. Annual Income Tax Declarations

### Income tax declarations omit information on:

- Opening stock, closing stock, purchases and cost of goods sold for trade (retail and whole sale)
- Opening and closing inventories of raw materials, finished goods and cost of goods manufactured and sold for an industry (manufacturer)
- Common expense items: e.g., depreciation, repairs and maintenance, leasing expenses
- Credits and income tax offsets – e.g., for income tax withheld on payments
- Identification of exempt income (for Jihad tax)
- Summary balance sheet items (e.g., cash at bank, total assets, total debt)
- Provision of bank account information for payment of taxes and refund of overpayments

### Income tax declarations provide limited information for partial coverage of:

- A dissection of total income from all sources – e.g., commissions, rents,
- A calculation of gross profit.
- A schedule of common expense items
- A calculation of a tax liability

### Income tax declarations are unable to support:

- Calculation of common financial ratios for comparison to prior years and like taxpayers:
  - Profitability: Gross Profit/Gross Business Income
  - Profitability: Sales/Purchases
  - Working capital: Current Assets/Current liabilities
  - Financial stability: Debt/Total Assets
  - Efficiency: Total Business Income/Total Assets
  - Other comparator ratios for a potential understatement of income: Debtors/Total Business Income, Creditors/Cost of Goods Sold, Business Income/Fixed Assets
- Cross-matching of income and expense items between contracted parties (e.g., sales to purchases, rents paid to rents received, legal expenses paid, and professional fees received).

## II. Technical Assistance Provided

### A. Taxpayer Registration

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**18. Annex 1 presents an example of a revised taxpayer registration application.** The application form is for illustrative purposes, but it has several features to address the shortcomings of Form 1. Specifically, the revised format:

- Separates a trading name from any other business name.
- Separates a business address from a mailing address.
- Provides full contact information.
- Separates trading location information that is from other than the main business.
- Separates a description of the type of operation (e.g., trade, industry craft, and professional services) from the nature of the business ownership.
- Seeks an indication of annual gross income as well as the number of paid employees.
- Seeks information on associated persons, directors, shareholders and subsidiaries.
- Requests information on the accounting period.

**19. The form also includes rental information.** Although optional, the purpose is to permit a crossmatch with information that is provided under current Form 2.

**20. The form also indicates tax obligations for the newly registered taxpayer.** Under the heading for “Office Use Only”, there are information fields to indicate any existing local office references, a business activity code should a coding system be established and the separate tax accounts for which the taxpayer will have a liability.

### B. Annual Tax Declaration Forms 4 and 5

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**21. Because there is a considerable overlap between the information items in Forms 4 and 5, these forms could be merged.** The purpose is to have a single annual tax declaration for unincorporated taxpayers that are carrying on a business. LTA indicated in principle support for Forms 4 and 5 to be merged but noted that a legislative change will be needed.

**22. Annex 2 presents an example of the data fields for a revised personal income tax declaration.** The form provides for a large amount of additional data. The form is more complex than the current forms 4 and 5, and LTA should retain the existing declarations for the smallest taxpayers. A test based upon level of turnover is the usual approach for defining eligibility for a simplified declaration.

**23. LTA should consider the approaches and the proposals at Annex 2 for taxpayers where there is a reasonable expectation that there is some record keeping.** As noted previously, the common approach would be to adopt a test based upon the level of turnover, e.g., a total revenue that is greater than (say) Dinar 50,000 though the determination of a turnover threshold will need analysis by the authorities on impact of the change. Annex 2 would apply to these larger taxpayers. The data to be

collected at Annex 2 should be considered a preliminary compilation that would be subject to the authorities' review, testing against the existing laws and subsequent modification.

**24. The proposals have some important features that represent a significant departure from the existing abridged formats (see Box 3).**

### **Box 3. A Merged Declaration for Unincorporated Taxpayers (Forms 4 and 5)**

- **The declaration would annually update the taxpayers' identity information.** The declaration would expand identity information and contact details that are consistent with the proposals for an expanded revised registration form at Annex 1. The declaration also includes details of the bank account.
- **The financial components of the declaration are in five sections and with item codes within each section.** To identify an item code in any explanatory material concerning the declaration, the reference would be to a section number with the alpha item code corresponding to the specific data label field (e.g., item 2A is Sales for a trade and commerce entity).
- **The income tax declaration distinguishes domestic purchases and sales from imported sales and exports.** Although officials advise that export volumes remain low, this information will provide a crossmatch to information collected by Customs as a future compliance management measure.
- **The form requires a separation of net income from industry and handicraft.** This is in order to allow a calculation of tax payable at the ten percent rate.
- **Industry net income data fields include a cost of goods manufactured and goods sold.** This is to fully itemize the gross profit and allow comparative ratio analyses. Net income from trade and commerce incorporates data for the itemization of items to calculate the cost of goods sold.
- **Income from E Commerce is included.** This is also within section 2 of the declaration (item 2K) for taxpayers with trade and commerce income or income from professional services.
- **There is a minor expansion of expense items.** In addition to the standard items, there are some new expense categories for legal and accounting and other professional fees (for cross-matching to income declared by legal professionals. Travel, motor vehicle and transport and telecommunications costs have been added.
- **An extract of items from the balance sheet is shown as a minimum set for unincorporated entities – cash at bank, total assets and total debts.** If a taxpayer has elected an accruals basis for revenue recognition, the taxpayer should also provide information on accounts receivable and payable.

**25. Because the declaration is reasonably comprehensive, the need for a formal profit and loss statement as an annexure to the declaration will diminish.** In the first two years of implementation, the accounting reports should be retained as the declaration will need to be evaluated and modified. As a measure to reduce the costs to the business, the medium-term approach would be to remove the need for a separate profit and loss statement.

## C. Annual Corporate Income Tax (CIT) Declaration Form 9

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**26. Annex 3 suggests a tax declaration for companies (Form 9).** As for the proposals for unincorporated entities, Annex 3 shows the data items to be requested as a preliminary set of items for consideration, evaluation and testing against the existing law.

**27. The current Form 9 (Annex 4) does not request any financial data, but the proposed declaration is significantly expanded (see Box 4).** The revised CIT declaration collects financial data in four sections.

### Box 4. Declaration for Incorporated Taxpayers (Form 9)

- **One section is dedicated to net income of industry taxpayers.** This is because of the distinct information items to calculate a cost of goods manufactured within the cost of sales.
- **Gross income from all other sources is within section 2.** This includes trade and commercial taxpayers including *E* commerce income, professional fees, as well as income from rents, leasing, commissions, interest and capital gains.
- **CIT payers are subject to a standard tax rate for all income sources.** This means the declaration allows some simplifications. For example, there is less of a requirement to separate expense items for a particular class of income, beyond industrial companies.<sup>7</sup> It may be desired to separate expense items by the nature of activity for broader purposes – e.g. statistical or broader policy development needs.
- **In contrast to the declaration for unincorporated entities, the revised Form 9 would retain an ongoing requirement for accounting reports.** A profit and loss statement as well as a balance sheet to accompany the CIT declaration.
- **The revised Form 9 should therefore include exempt income categories (see item 2W).** This is because the Jehad tax is levied on profits *or* income exempt from taxation, excepting income from agricultural activities.

**28. A wider consultation with business and industry groups on the changes to tax forms would be appropriate.** Officials confirm that proposals for all form changes will require legislative changes. Because the annual income tax declarations are complex and represent a significant departure from existing approaches, the proposals need to be tested against the existing law and then evaluated for their impact on taxpayers, and their intermediaries (tax agents, and accountants) as well as the business community.

**29. All proposed forms are considered draft forms for further evaluation by LTA.** In particular, the LTA should quickly consider whether the proposals in this report are considered technically feasible for incorporation within the small system platform proposed for introduction in mid-2024.

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<sup>7</sup> For manufacturing, expenses are generally brought to account as a cost of manufacturing.



## Recommendations

30. Adopt the revised format for a taxpayer registration application form.
31. Review the preliminary data items proposed for a single annual income tax declaration for unincorporated entities (merged forms 4 and 5) and a revised form 9 for companies.
32. Maintain the availability of the existing Forms 4 and 5 for use by the smallest taxpayers where there are very limited books and records and who are below a pre-determined total income threshold.
33. Confirm the technical feasibility of all new forms for short term implementation in the interim LTA computer platform proposed for introduction from mid-2024.
34. Examine the legislative impacts arising from the new tax forms.
35. Conduct consultations with the business community on the changes to all tax forms.
36. As a medium term measure, (e.g., after two years of implementation of the revised form), remove a requirement for a profit and loss account to accompany the revised forms 4 and 5.
37. Maintain the requirement for a profit and loss statement and balance sheet to accompany annual tax declarations for all CIT payers.
38. Adopt a standardized approach for industry classification based upon the United Nations ISIC.

# Annex 1. Proposed Form 1 Application Tax Identification Number

[Sample TIN Application](#)

# Annex 2. Proposed Personal Income Tax Annual Declaration

[Example Personal Income Tax Forms](#)

# Annex 3. Proposed Corporate Income Tax Declaration

[Example Revised Corporate Income Tax Form](#)

# Annex 4. Current Tax Forms 1, 4, 5 and 9

[Current Tax Forms 1,4,5 and 9](#)