Tax Reform and the Power Sector

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Introduction

Nigeria recently introduced four key tax reform Acts (The Acts) which are scheduled to come into effect on 1 January 2026. They have led to several conversations across various sectors with the focus on its potential impact on businesses. The Power sector in Nigeria has been challenged over the years with several initiatives introduced to kickstart growth with varying impact. Players in the sector are therefore keen to understand how the Acts will impact them and whether it may finally be one of the silver bullets that leads to genuine growth in the sector.

This newsletter analyses some of the key changes introduced by the Acts and how it may impact players in the sector.

From Exempt to Zero Rated

Nigeria's Value Added Tax (VAT) system was in essence a modified sales tax due to the inability of companies to recover all the input tax incurred while generating taxable revenue. Input VAT that could be recovered, was limited to those incurred on goods purchased for resale or used in the direct manufacture of goods on which the tax is charged. The Acts seek to change that with the expansion of the items on which input VAT can be recovered to all taxable supplies including services and fixed assets, provided that the tax was incurred for the purpose of consumption, use or supply while making taxable supplies. This should have been exciting news for Distribution companies (Discos) as only them, under the existing tax framework, makes taxable supplies out of the players involved in the national grid. Supply of electricity by the Generating companies (Gencos) through the Nigerian Bulk Electricity Trading Company (NBET) and the Transmission Company of Nigeria Limited (TCN) are currently not taxable supplies as they are exempt from VAT and so would not be able to claim any input VAT.

Fortunately, the Acts recognised this issue and moved power supplied by Gencos to NBET as well as power supplied by TCN to the Discos from exempt to zero rated. This slight change, ensures that these supplies now count as taxable supplies albeit at a rate of zero and so eligible for the claim of input VAT. Gencos can now claim input VAT on all taxable supplies it receives. The same applies to TCN.

It is however instructive to note that the classification of zero exempt status does not extend to bilateral contracts between Gencos and Discos. It may however not have any long-term effect on cost for those contracts as VAT is supposed to be borne by the final consumer whose status has not changed under the Acts.

Pioneer to Priority

Power was viewed as a pioneer industry due to the state of the sector and the need to continue to encourage investments in it. However, the entire pioneer status program which was governed by the Industrial Development Act has now been scraped and replaced with the priority sector program. The intention is the same, which is to encourage growth in sectors so classified, though the means has fundamentally changed. Companies which were granted pioneer status in the past were entitled to a 3 - 5 year tax holiday amongst others. However, companies which have priority sector status would no longer enjoy the 3 - 5 year holiday but would instead be eligible for a tax credit which amounts to about 5% of the value of their investments. There is also a minimum investment and a sunset timeline with the expectation that the industry would have developed sufficiently that it should no longer be a priority sector. The minimum investment amount and sunset time for the supply of electricity is N100b and 20 years respectively.

It is instructive that the Act did not seek to create a lower minimum investment threshold for renewables. Nigeria does not have a grid level renewable energy generation plant other than the Hydro plants. The bulk of investments in renewable energy generation have been in mini-grids in underserved and unserved areas. These projects will struggle to meet the minimum investment threshold and so may not be able to claim the priority sector incentive. It is also debatable whether 20 years is a reasonable sunset period given that Nigeria transitioned from a Government monopoly run power sector to a private led sector about 12 years ago with limited success. Given that the power sector gap has continued to grow in that time, will 20 years be sufficient to close the gap to a reasonable extent that power no longer becomes priority?

Exempt to Chargeable but Suspended

Renewable energy equipment is currently exempt from the application of VAT today. This will no longer be the case once the Acts become effective. However, this does not mean that VAT will begin to apply on their sale. The Acts introduced a new category of items on which VAT is chargeable but suspended pending the lifting of the suspension through an Order issued by the Minister of Finance. It is not clear how long this suspension will stand and this may impact the ability of players to engage in long term planning.

Minimum Tax

Every Nigerian company with an aggregate turnover of N50b as well as subsidiaries of multinational enterprises with a group revenue of 750m Euros would be subject to a 15% minimum tax on net profit less franked investment and unrealised exchange gains. This may negatively impact Discos who currently make profits on an annual basis but still have significant accumulated losses from prior period. This also brings to light the treatment of the subsidy shortfall which the Discos report in their financial statements. There is strong argument that this should not form part of the net profit of a Disco as it is only serving as a pass through for the amount to NBET. The price of power to end users as well as the price at which NBET sells the power to the Discos is fixed by Government. The inherent subsidy is also Government's decision. The Government has the right to reflect the subsidy in the price at which NBET is expected to sell to the Discos rather than the current method where it is reflected in the price to end users. Government can then transfer the subsidy directly to NBET which it does anyway, only that in the current case, it treats it as a payment on behalf of the Disco. This therefore increases Disco revenue and subsequently its net profit with the attendant minimum tax exposure. It may therefore be in the best interest of the Discos to collectively argue for a different treatment. The potential minimum tax may be invested in network development and so assist in ensuring that in 20 years time, power supply is no longer a priority sector.

No Charge to Surcharge

A 5% surcharge on chargeable fossil fuel products, provided and produced in Nigeria, has been introduced by the Acts. It appears to be part of the Government's broader push toward environmental sustainability. However, its practical implications (if any) on the power sector, warrants consideration as Gencos still rely on fossil fuel such as piped natural gas for electricity generation.

The application of the surcharge may lead to higher costs for the Gencos though the Act also states that the surcharge is to be computed based on the retail price of all chargeable fossil fuel products. GenCos typically procure gas directly from producing companies at wholesale prices, not retail, which raises the question of whether the surcharge would, in fact, apply to them.

From Conditional to Accessible

The ongoing transfer of regulatory authority from the Federal to the State had created some tax concerns. KPMG had, in a previous publication, raised the issue of potential transfer taxes that may arise, when the Discos transfer assets and liabilities to their newly created subsidiaries in the various States which had exerted regulatory control over their domain. The current tax framework exempts such transfers from transaction tax provided that the subsidiary had existed for at least one year prior to the transfer. Discos and the State Regulators therefore had the option to delay the transfer or pay the taxes.

Fortunately, this issue may now be put to rest with the changes contained under the Acts. There is no longer any minimum time required for the subsidiary to be in existence before you can enjoy the transaction tax exemption. The only criteria is that the transfer occurs from an entity which intends to continue to do business after the transaction. The parent company Discos should be able to meet this criterion as they will not be wound up but will continue to operate in other jurisdiction as well as oversee the operations of the newly created subsidiary.

Conclusion

These tax reform Acts present certain opportunities for the Nigerian power sector; however, the sector must also navigate emerging fiscal pressures carefully. Ultimately, the true impact of the reform Acts will unfold as players in the sector implement the changes and adapt to the new tax environment.

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