

# Power Sector Article

Power Sector Watch

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## Distributed Generation and Tax Credit Scheme – A Pathway to Reliable Power in Nigeria?

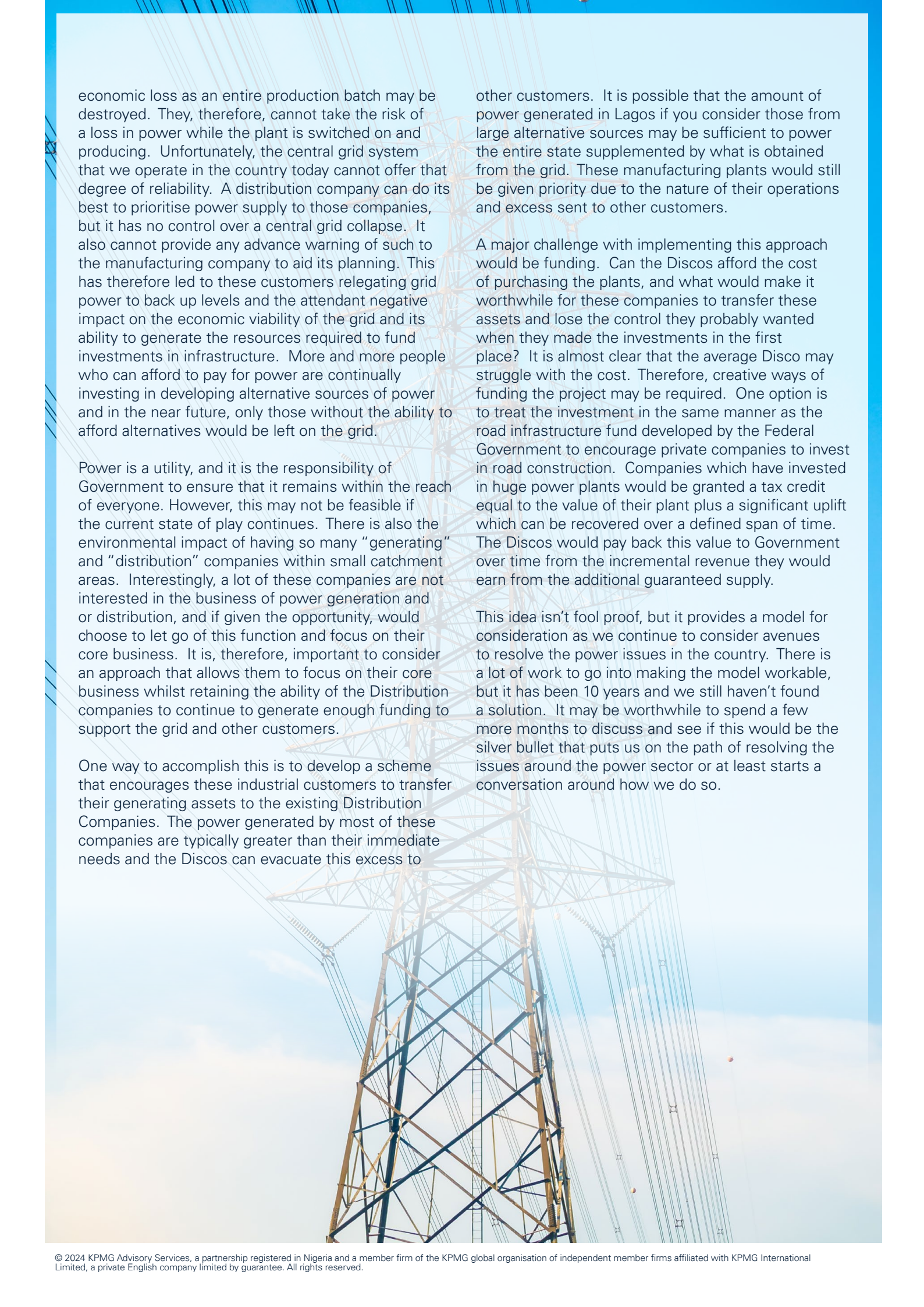
It has been almost a decade since the erstwhile, wholly Government owned, utility monopoly was handed over to private sector players. It may be considered sufficient time for the country's power issues to be confined to history, though quite several people will argue that this isn't the case yet. Power supply, though having improved since then, still appears erratic. Popular opinion may lay the blame across the entire value chain from Government to the private sector players now in charge of the successor companies. However, the focus should always remain on how we can continue to improve the operations of these Companies and consequently power supply to industries and individuals.

One major challenge to improve supply that has been identified by players in the industry as significant is funding. Tariffs prior to privatisation was reflective of most Government run businesses without much consideration for economic sustainability. It was widely accepted by all parties that it would take time for Nigerians to get use to paying value for power, given the number of decades that had passed where they had enjoyed highly subsidised power. Furthermore, it was acknowledged that any conversation about cost reflective tariff can only be had under a climate where power had improved significantly, and people could

better understand why they had to pay more and for what. It is debatable if the actual cost of investments in power infrastructure required to achieve this degree of improvement was ever considered viz the ability of the private players to raise the money from internal and external sources whilst running huge loss-making ventures and huge cash collection issues.

One option to address this issue at the time was the concept of cross subsidy; where customers within a specific catchment area with the capacity to pay would be charged a higher tariff to cover partly for those unable to pay, at least until they had seen the expected improvement. There was also the assumption that collection losses from these paying customers would be at a minimum, and so cash would not necessarily be an issue. This soon turned into a mirage.

Most industrial customers currently pay far more for running their own distributed generation systems than the cost for obtaining power from the grid today. However, they are reluctant to rely on the grid for their primary source of power. The reason for this isn't also far-fetched. A lot of manufacturing plants run continuous production systems, wherein a loss of power for a brief second may result in significant



economic loss as an entire production batch may be destroyed. They, therefore, cannot take the risk of a loss in power while the plant is switched on and producing. Unfortunately, the central grid system that we operate in the country today cannot offer that degree of reliability. A distribution company can do its best to prioritise power supply to those companies, but it has no control over a central grid collapse. It also cannot provide any advance warning of such to the manufacturing company to aid its planning. This has therefore led to these customers relegating grid power to back up levels and the attendant negative impact on the economic viability of the grid and its ability to generate the resources required to fund investments in infrastructure. More and more people who can afford to pay for power are continually investing in developing alternative sources of power and in the near future, only those without the ability to afford alternatives would be left on the grid.

Power is a utility, and it is the responsibility of Government to ensure that it remains within the reach of everyone. However, this may not be feasible if the current state of play continues. There is also the environmental impact of having so many “generating” and “distribution” companies within small catchment areas. Interestingly, a lot of these companies are not interested in the business of power generation and or distribution, and if given the opportunity, would choose to let go of this function and focus on their core business. It is, therefore, important to consider an approach that allows them to focus on their core business whilst retaining the ability of the Distribution companies to continue to generate enough funding to support the grid and other customers.

One way to accomplish this is to develop a scheme that encourages these industrial customers to transfer their generating assets to the existing Distribution Companies. The power generated by most of these companies are typically greater than their immediate needs and the Discos can evacuate this excess to

other customers. It is possible that the amount of power generated in Lagos if you consider those from large alternative sources may be sufficient to power the entire state supplemented by what is obtained from the grid. These manufacturing plants would still be given priority due to the nature of their operations and excess sent to other customers.

A major challenge with implementing this approach would be funding. Can the Discos afford the cost of purchasing the plants, and what would make it worthwhile for these companies to transfer these assets and lose the control they probably wanted when they made the investments in the first place? It is almost clear that the average Disco may struggle with the cost. Therefore, creative ways of funding the project may be required. One option is to treat the investment in the same manner as the road infrastructure fund developed by the Federal Government to encourage private companies to invest in road construction. Companies which have invested in huge power plants would be granted a tax credit equal to the value of their plant plus a significant uplift which can be recovered over a defined span of time. The Discos would pay back this value to Government over time from the incremental revenue they would earn from the additional guaranteed supply.

This idea isn't fool proof, but it provides a model for consideration as we continue to consider avenues to resolve the power issues in the country. There is a lot of work to go into making the model workable, but it has been 10 years and we still haven't found a solution. It may be worthwhile to spend a few more months to discuss and see if this would be the silver bullet that puts us on the path of resolving the issues around the power sector or at least starts a conversation around how we do so.

# For further enquiries on the above and information on how KPMG can assist you, please contact:

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