KPMG

Power Sector Watch

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A summary of available incentives for players in the power sector

Nigeria's power sector has continued to grow even though some may argue that the rate of growth is still below the required level. The commercial framework for the sector has however remained an issue. The power sector is highly capital intensive as large amounts of investment are required for acquisition and installation of equipment and machinery, construction of power plants and transmission lines, as well as regular maintenance and upgrades of the equipment and machines to ensure that they meet increasing demands. Therefore, players in the sector continue to advocate for more incentives which they believe may impact the commercial framework and aid growth. Notwithstanding, there are already some incentives available to players in the sector and this newsletter seeks to introduce a few of them for consideration.

1. VAT exemptions on goods and importation of equipment

The Federal Government of Nigeria published the Value Added Tax (Modification Order) in its Official Gazette No. 167, Vol.108 of 21 September 2021 ('the Order). The 2021 Order, which had a commencement date of 30 July 2022, was issued by the Honourable Minister of Finance, Budget and National Planning (HMoFBNP), Mrs. Zainab Shamsuna Ahmed, pursuant to her powers under Section 38 of the Value Added Tax (VAT) Act, Cap. V1, Laws of the Federation of Nigeria, 2004 (as amended).

The Order introduced exemption for various products and goods relating to the power sector. These include:

- Gas supplied by gas producing companies to electricity generating companies (GENCOs),
- Electricity generated by GENCOs and supplied to the national grid or Nigeria Bulk Electricity Trading Company (NBET) and
- Electricity transmitted by Transmission Company of Nigeria (TCN) to electricity distribution companies (DISCOs)
- Importation of renewable energy equipment (REE).

The savings from the VAT exemption granted is expected to improve the cashflow of these companies, provide additional fund for investment in key infrastructures and improve their overall operational efficiency. The exemption of REE from VAT particularly demonstrates Nigeria's commitment to its pledge to attain net zero emissions by the year 2060. The exemption will also help the FGN towards achieving its goal of raising Nigeria's electricity supply from renewable sources from its current 13% to 23% by 2025 and 36% by 2030.

There are however concerns with the implementation of the VAT exemption granted to REE especially at the port of entry where unless certain CET codes are used when importing REE, the exemption may not apply. There are also issues around the lease of REE to indigent customers and whether the exemption would also apply to such leases.

It is important that these issues are addressed so that the sector can fully reap the benefits of the exemption.

2. Withholding tax exemption on foreign loans

The CIT Act specifies some WHT reliefs available on interest on foreign loans, depending on the loan term and grace period for repayment of principal and interest. This incentive, which is focused on the loan provider as a means of encouraging foreign lenders to provide funds to local businesses, exempts a portion of interest income accruing to the lender from income tax. Under the Nigerian tax laws, WHT on interest income is the final tax on interest earned by a foreign lender.

The following are the income tax exemption on interest income earned by foreign lenders in Nigeria:

Duration of Loan	Grace Period	Percentage of Interest Exempted
7 years and more	2 years	70 %
5-7 years	18 months	40 %
4 years	12 months	10 %

There are concerns though as to whether the exemptions alone are sufficient to convince foreign lenders to do business with players in Nigeria's power sector. The issues around foreign exchange (rates and availability) may also need to be addressed given that players in the sector earn predominantly in Naira and would therefore need help to obtain the required foreign currency to settle any foreign debt.

3. Pioneer Status Incentive (PSI)

The PSI is another incentive aimed at promoting investment and development of sectors that are deemed critical to economic development in Nigeria. It is a profit-based tax incentive, governed by the Industrial Development (Income Tax Relief) Act, Cap. 17 Laws of the Federation of Nigeria, 2004.

The incentive grants qualifying businesses in pioneer industries, income tax holiday for a maximum period of 5 years, an initial 3 years which can be extended for another 2 years based on performance and compliance with key business case strategies. This allows beneficiary companies to reinvest monies that may have been applied towards the payment of income tax during the holiday period to growing the size of their business and improving operational efficiency.

Other benefits conferred by PSI include exemption from WHT on dividends paid out to shareholders from the pioneer profit, WHT exemption on pioneer income, amongst others. Currently, 71 industries including power and gas supply are eligible for PSI.

Several players have also argued that the nature of the PSI may not be best suited for the power sector. Under current rules, any company looking to benefit from the PSI must apply within 18 months from commencement of business. Power as we already pointed out is highly capital intensive and a lot of times, the players may not break even and make profit for a few years. A tax holiday is of no real benefit to a company which isn't profitable, and it is possible that a power company may not make profits for a significant portion of its first five years of operations. It may therefore be necessary to reconsider how this applies to the power sector.

4. Gas Utilization Incentive (GUI)

Section 39(1)(a) of the CIT Act grants tax incentives to companies engaged in the trade or business of gas utilization in downstream operations. The Act defines gas utilization as the marketing and distribution of natural gas for commercial purposes, and it includes power plants, fertilizer plants, gas transmission, and distribution pipelines.

GUI grants qualifying companies an initial tax-free period of 3 years which may, subject to satisfactory performance, be renewed for an additional period of 2 years. Given the similarities with the PSI, Finance Act, 2021 introduced amendments that precludes companies that benefit from the downstream gas utilization incentives from applying for PSI. While PSI requires applicants to have a non-current asset investment of at least ₦100 million and must make an application in the first year of production of the pioneer product or service, the GUI does not have any investment threshold nor timeframe for application.

The GUI also provides for additional incentives, other than the tax holiday period of five (5) years.

The primary concern with the GUI is the lack of a clear operational process for obtaining and renewing the incentives.

Conclusion

The benefits of tax incentives can never be overemphasized given their ability to revive, rehabilitate and stabilize key sectors of the economy. However, the success of these incentives lies in their adaptation for the peculiarities of the industries for which they are targeted and in their implementation.

The power sector may require more than what is available to achieve its growth potential, but more focused understanding and implementation of the available incentives will go a long way in driving the growth and development required in the sector.

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

Ayo Luqman Salami
Partner and Head,
Energy Line of Business (Tax)
KPMG in Nigeria
T: +234 803 402 1015
E: ayo.salami@ng.kpmg.com

Martins Arogie
Partner,
Tax, Regulatory & People Services
KPMG in Nigeria
T: +234 703 403 6318
E: martins.arogie@ng.kpmg.com

Ayodele Soyinka
Partner and Head,
Energy Line of Business (Audit)
KPMG in Nigeria
T: +234 803 402 0949
E: ayodele.soyinka@ng.kpmg.com

Ikechukwu Odoh
Senior Manager,
Tax, Regulatory & People Services
KPMG in Nigeria
T: +234 806 689 8804
E: ikechukwu.odoh@ng.kpmg.com

home.kpmg/ng
home.kpmg/socialmedia

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