

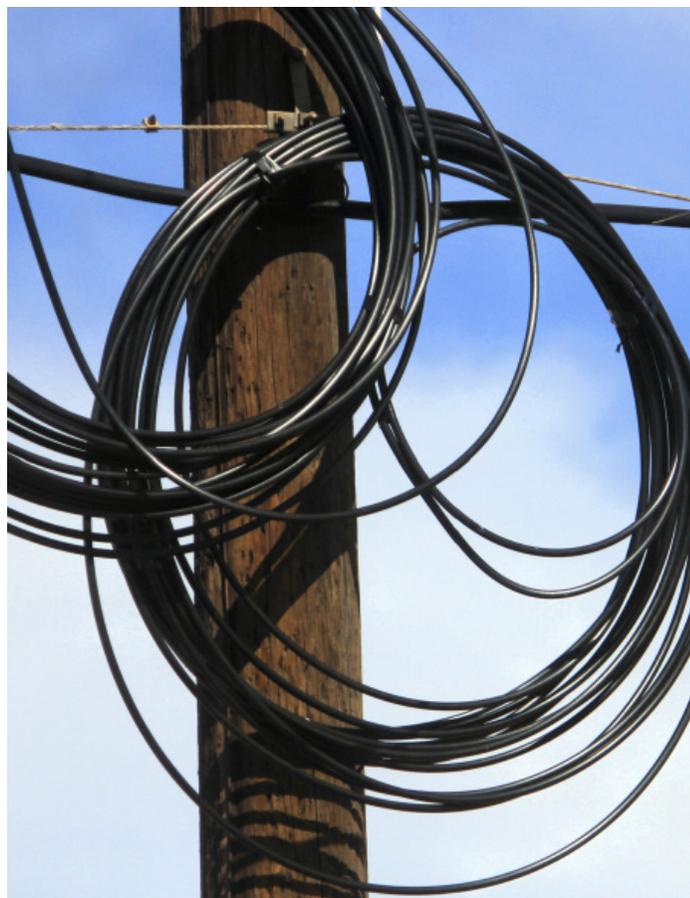
Value added tax compliance - Any respite for Nigeria Electricity Supply Industry operators?

Value added tax (VAT) is a multistage consumption tax, which is charged and payable on the supply of all goods and services. VAT is payable by individuals, body corporates, and organisations that buy, procure or import taxable goods and services. VAT applies on all goods and services except those specifically listed as exempt in the law. The First Schedule to Value Added Tax Act, Cap V1, LFN 2007 (as amended) (VATA) contains the list of exempted items. Goods exempted include basic food items, baby products, all exports, books and educational materials.

In addition to VATA, which is the core legal framework for the administration of VAT, the Federal Inland Revenue Service (FIRS) which administers VAT, has in the past released 'Information Circulars' which have assisted in the effective administration of VAT.

Since the introduction of VAT in 1993, it has become an important source of revenue to the country and the proceeds are distributed amongst the federating units. VAT also accounts for a significant percentage of the total tax revenue generated in the country. The Revenue Authority's approach in the administration of VAT is that, what is not specifically exempted in Schedule 1 of the Act is taxable. This has been their mantra. To give effect to this understanding and interpretation of Schedule 1 of the Act, FIRS released an information circular 2007/02 "Detailed list of items exempted from VAT".

One of the many grey issues associated with VAT is the uncertainty in its application for companies operating in the Nigeria Electricity Supply Industry (NESI) and more specifically, those engaged in electricity generation, with many questions remaining unanswered. Some of the recurring questions confronting the industry are: whether VAT is chargeable by transmission companies and the bulk purchasers? At which point in the value chain should VAT be charged? Was VAT envisaged at the point the Multi-Year Tariff Order pricing was fixed?



The Electric Power Sector Reform Act (EPRA) created opportunities for private companies to engage in these three segments; electricity generation, transmission, and distribution. The Act birthed the Nigerian Electricity Regulatory Commission (NERC), as an independent regulator of the electric power sector. As a result of the reform, Power Holding Company of Nigeria (PHCN) was unbundled into six generating companies (GenCos), one transmission company and eleven electricity distribution companies (DisCos). After the privatisation of the power sector, GenCos now sell power to Nigeria Bulk Electricity Trading Plc (NBET) at agreed prices stated in the Power Purchase Agreements (PPA) while NBET resells to the DisCos, who in turn deliver to the final consumers.

The tariff system used in the Nigeria power sector, which is regulated by NERC, is known as the Multi-Year Tariff Order (MYTO). The MYTO is used to set the prices for electricity throughout the value chain (wholesale and retail prices). The tariff system determines all the industry's cost and the revenue requirement aimed at performance improvement. MYTO adopts the building block's approach shown in figure 1.

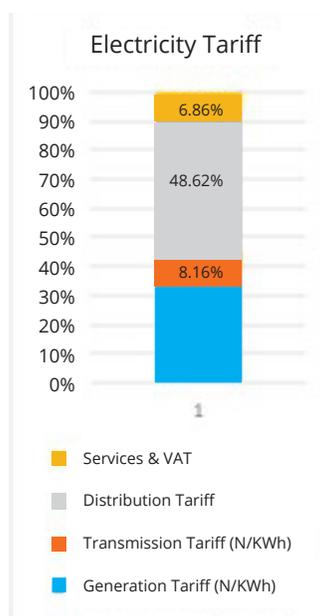


Fig 1
Source: NERC official site

An understanding of how MYTO determines electricity sales price is very important in understanding the issues around VAT as it affects NESI. In a nutshell, MYTO takes into consideration certain assumptions and factors before fixing prices. However, there is every indication that VAT was not factored in at the point of concluding the fixed tariffs which formed the price of electricity consumption in Nigeria.

Operators in NESI are aware of the conflicts around VAT as it affects the sector and

have taken various measures in resolving the issues. The major issue has been determining the level at which VAT is to be charged upon supply of electricity especially as the prices of electricity distribution at both wholesale and retail levels have been fixed based on MYTO.

The stakeholders in the sector having identified that the issue of VAT requires clarity, engaged the Revenue Authority to ensure that the grey areas are resolved so that they could have unhindered operations and achieve the overall objective of the reform in the sector. This, among others, led to several meetings by stakeholders such as the NERC, FIRS, and participants from NESI. During one of such meetings held on 24 June 2014 at Transcorp Hilton Abuja, FIRS and NERC held a workshop tagged 'promoting voluntary value added tax compliance in the new power sector automation'. At the workshop, the applicability of VAT at various stages in the value chains of the industry was extensively discussed. At the end of the session, a communique was issued. One of the key issues in the communique is that there will be a single point of collection of VAT in the value chain. The implication is that GenCos would not charge output VAT upon supply of electricity where such GenCo is not an electricity distribution company (DisCo). The output VAT was only required to be charged at the level of the DisCos.

It is now about four years since the agreement was reached that VAT should be charged at one point in the value chain. Has this agreement been given any effect in the law? Does the agreement in itself constitute the law? Can the Revenue Authority renege on the gentleman's agreement in the absence of any legal backing? What efforts have the stakeholders put in to ensure that the agreement has a legal basis?

One of the fundamental features of the Nigerian tax system, as documented in the National Tax Policy, is flexibility and dynamism in response to changing business and

economic environment that does not deter economic activities. In response to this, the Revenue Authority should be proactive in tackling any tax issues that would truncate the objective of government in repositioning the power sector which is critical in national development and industrialization. Where necessary, electricity may be considered a necessity and consequently exempted from imposition of VAT throughout the value chain.

Where clarity is not timeously provided, the tax risk for the operators will remain high. There may be risk of exposures in terms of penalties, interests and other risks associated with potential allegation of non-compliance with the VAT Act. Going forward, it is important that all ministries, departments and agencies of government that would be involved in the implementation of a policy be carried along from the planning stage so that its implications would be thoroughly reviewed for goal congruence.

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