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A REVIEW OF TAX INCENTIVES FOR RENEWABLE ENERGY PROJECTS IN NIGERIA

INTRODUCTION

Nigeria, rich in renewable energy resources like solar, wind, hydro, and biomass, continues to struggle with a significant energy deficit despite its vast potential.¹ With over 100 million people lacking access to reliable electricity, the country has increasingly turned to renewable energy as a sustainable solution to bridge this gap². To stimulate investment in this sector, the Nigerian government has introduced various tax incentives aimed at attracting both domestic and foreign investors. This briefing note provides an in-depth analysis of the various tax incentives currently available for renewable energy projects in Nigeria. It delves into how these incentives are structured, including tax holidays, investment tax credits, and import duty exemptions, and evaluates their effectiveness in promoting sustainable energy development.

OVERVIEW OF RENEWABLE ENERGY POTENTIAL IN NIGERIA

Nigeria's renewable energy potential is vast. The country receives an average of 6.25 hours of sunlight daily, translating to a solar energy potential of approximately 17,500 terawatt-hours annually.³ Additionally, its wind speeds in northern regions, ranging from 4 to 7 meters per second, make it viable for wind energy projects. Hydropower contributes about 12.5% of Nigeria's on-grid energy, while biomass from agricultural waste remains largely untapped. Despite this potential, renewable energy accounts for a small fraction of the national energy mix, overshadowed by fossil fuels, particularly oil and gas.⁴ The government's National Renewable Energy and Energy Efficiency Policy (NREEEP) aims to

¹ (IRENA, "Renewable Energy Market Analysis: Africa and Its Regions," 2021)

² World Bank, Nigeria Energy Access Report 2023(Washington, DC: World Bank, 2023), 14.

³ Federal Republic of Nigeria, Nigeria Renewable Energy Master Plan (Abuja: Energy Commission of Nigeria, 2005, revised 2013), 22-25

⁴ Renewable energy contributes approximately 10-15% to Nigeria's total energy mix- IRENA's "Renewable Energy Roadmap: Nigeria" (2023) and Statista's "Renewable energy share in electricity capacity in Nigeria from 2011 to 2023" (2024)

increase renewable energy's share to 30% by 2030, necessitating significant investment and policy support.⁵

TAX INCENTIVES FOR RENEWABLE ENERGY PROJECTS

The Nigerian government has implemented several fiscal incentives to encourage renewable energy development. These incentives are embedded in various legislative frameworks, including the Electricity Act of 2023, the Industrial Development (Income Tax Relief) Act⁶, and the Value Added Tax (VAT) Act⁷.

Below is a review of key tax incentives:

1. Pioneer Status Incentive

Under the Industrial Development (Income Tax Relief) Act⁸, companies that are pioneering the renewable energy sector, particularly those dedicated to manufacturing solar equipment, can attain pioneer status. This designation offers a generous tax holiday lasting three years, with the potential for an extension of up to two additional years. This initiative is crafted to alleviate the burden of initial capital expenditures and to foster a robust, long-term investment landscape in renewable energy infrastructure. During this advantageous period, these forward-thinking companies enjoy a complete exemption from corporate income tax, allowing them to reinvest their savings into innovative projects that contribute to a sustainable future.⁹

Similarly, the NREEEP outlines additional incentives to stimulate investment in the renewable energy sector. These incentives include:

- A five-year tax holiday for manufacturers commencing renewable energy production
- Tax exemptions on dividend income derived from domestic renewable energy investments

Access to soft loans and low-interest financing from the Power Sector Development Fund, aimed at mitigating the financial burden on developers.¹⁰

These incentives are designed to promote the growth and development of Nigeria's renewable energy sector, while encouraging investment and innovation in the industry.

⁵ Federal Republic of Nigeria, National Renewable Energy and Energy Efficiency Policy (NREEEP) (Abuja: Energy Commission of Nigeria 2015) 12-15

⁶ Industrial Development (Income Tax Relief) Act (Cap. 17, LFN 2004)

⁷ Federal Republic of Nigeria, Electricity Act 2023, Section 165(2), Official Gazette No. 102, Vol. 110 (June 8, 2023)

⁸ Federal Republic of Nigeria, Industrial Development (Income Tax Relief) Act, Cap 17, Laws of the Federation of Nigeria, 2004, Section 10(1).

⁹ Nigerian Investment Promotion Commission (NIPC). (2021). "Pioneer Status Incentive Guidelines."

¹⁰ National Renewable Energy and Energy Efficiency Policy (NREEEP) (Abuja: Energy Commission of Nigeria 2015)

2. VAT Exemptions¹¹

The VAT (Modification) Order 2021 introduces a significant exemption from the standard 7.5% VAT rate for transactions involving renewable energy equipment, marking a pivotal step towards promoting sustainable energy solutions. This exemption encompasses a diverse range of cutting-edge technologies, including solar panels capturing sunlight's power, wind turbines harnessing the force of nature, and off-grid power systems that empower remote communities. Additionally, the exemption applies to green electricity supplied to the national grid by pioneering renewable energy companies.

However, this progressive move has not come without its complications. A cloud of controversy looms as the Federal Inland Revenue Service (FIRS) has issued conflicting notices.¹² creating ambiguity and uncertainty regarding the tax liability of specific renewable energy equipment, thereby casting doubt on the scope of the exemption.¹³ This ongoing ambiguity highlights the implementation challenges faced in transitioning to a greener economy and ensuring clarity in the tax framework for renewable energy initiatives.

3. Import Duty Exemptions¹⁴

In the dynamic landscape of the renewable energy sector, operators enjoy significant benefits through exemptions from customs and import duties on vital machinery, cutting-edge equipment, and indispensable accessories designed exclusively for off-grid renewable energy generation. This crucial advantage not only alleviates the financial burden associated with importing state-of-the-art technologies but also paves the way for innovative projects to flourish. By reducing costs, these exemptions empower stakeholders to embark on ambitious initiatives that contribute to a sustainable future, making renewable energy solutions more accessible and financially viable than ever before.

4. Capital Allowances¹⁵

Renewable energy investors can reap considerable benefits through capital allowances, a tax incentive in place of depreciation that permits the deduction of a portion of capital expenditures from taxable income, thereby providing substantial tax relief and enhancing project viability. This financial

¹¹ Federal Inland Revenue Service (FIRS). (2021). "Value Added Tax Act."

¹² FIRS VAT and Tax Compliance Notices (2022)- FIRS released several tax compliance notices in 2022, urging renewable energy companies to ensure correct VAT filing on sales of renewable energy products. The notices called for businesses to comply with VAT registration and payment requirements for sales involving energy equipment, which impacted both companies involved in the importation and local distribution of renewable energy systems. The implementation of these compliance notices sparked a debate, as businesses questioned the accuracy of VAT application in light of earlier VAT exemptions on renewable energy products. These notices led to debates within the industry over the interpretation of tax laws, especially when such taxes could undermine the affordability of renewable energy solutions.

¹³ Federal Republic of Nigeria, VAT (Modification) Order 2021, Official Gazette No. 147, Vol. 108 (October 2021) Schedule 1, Part II.

¹⁴ Federal Ministry of Finance. (2020). "Customs and Excise Tariff Act- Section 38

¹⁵ Companies Income Tax Act (CITA), 2004 – Sections 24, 32, 34(3), Second Schedule; amended by Finance Acts 2019 (Section 12) and 2021 (Section 16)

framework not only enhances the overall return on investment but also empowers investors to make a more impactful contribution to sustainable energy solutions, all while enjoying reduced tax burdens.

5. Investment Tax Credit¹⁶

Under the Companies Income Tax Act (CITA), an Investment Tax Credit (ITC) is available for companies that replace outdated equipment with energy-efficient or renewable energy alternatives. This credit directly reduces the company's tax liability, the tax credit offered is typically between 10% and 15% of the cost of acquiring energy-efficient equipment or renewable energy systems.¹⁷ The tax credit applies to businesses that replace old equipment with solar-powered systems, biomass generators, or other forms of renewable energy infrastructure. It applies to companies upgrading to renewable energy solutions like solar energy or biomass generators.

EFFECTIVENESS OF TAX INCENTIVES

While these incentives are well-meaning, their effectiveness has been decidedly mixed. The pioneer status and import duty exemptions have sparked interest and investment, particularly in the burgeoning field of solar mini-grid projects, nurtured by initiatives like the Nigeria Electrification Programme. For instance, from 2019 to 2024, over 200 solar mini-grids sprang to life in rural areas, fueled in part by these enticing fiscal benefits.¹⁸

Despite the promising prospects, the path to harnessing this potential is hindered by significant challenges. The lack of clear implementation guidelines and the protracted delays in accessing incentives have created barriers to entry, thereby stifling wider adoption and hindering the growth of Nigeria's renewable energy sector. The ongoing controversy surrounding VAT exemptions stands out as a glaring example, with conflicting regulatory signals casting shadows of uncertainty that deter investors seeking a stable and predictable environment.

Furthermore, these incentives tend to favor large-scale or foreign investors who possess the resources and know-how to navigate the complexities of the system, leaving small and medium enterprises (SMEs) vital players in the realm of decentralized renewable energy, underrepresented and underserved. The proposed Power Production Tax Credit, although filled with promise, remains an unfulfilled aspiration, underscoring the disconnection between ambitious policies and their real-world execution. Studies indicate that tax incentives, while beneficial, are only part of the equation; without complementary measures like robust infrastructure development, access to technical expertise, and a stable regulatory landscape, true progress will remain elusive.¹⁹

RECOMMENDATIONS FOR ENHANCING TAX INCENTIVES FOR RENEWABLE ENERGY PROJECTS IN NIGERIA

¹⁶ Companies Income Tax Act (CITA), Section 32, as amended by the Finance Act 2019, Section 12

¹⁷ *ibid*

¹⁸ Nigeria Electrification Programme, Progress Report 2024 (Abuja: Rural Electrification Agency, 2024), 8-10.

¹⁹ International Renewable Energy Agency (IRENA), Renewable Energy Market Analysis: Africa and Its Regions (Abu Dhabi: IRENA, 2022), 45-47.

To fully capitalize on the tax incentives available for renewable energy projects in Nigeria, several key measures need to be taken to improve both the regulatory environment and the overall investment climate. Below are our recommendations, which, if implemented, could maximize the impact of these incentives and promote sustainable development in Nigeria's renewable energy sector.

1. Clarify and Streamline Regulations

One of the primary obstacles facing investors in Nigeria's renewable energy sector is regulatory uncertainty. Despite the existence of several tax incentives, the lack of clear, consistent application leads to confusion and delays in the approval process. The government should work to harmonize and clarify conflicting regulations, especially concerning the VAT exemptions for renewable energy equipment and import duty exemptions. The government can establish a one-stop-shop for renewable energy investors, where all regulatory requirements and procedures can be accessed and managed in a streamlined process. This central agency should provide clear guidelines, timelines, and support to navigate the application process for tax incentives. By reducing the bureaucratic complexity, the government can create a more predictable and investor-friendly environment.

2. Increase Awareness of Tax Incentives

A significant barrier to the full utilization of tax incentives is the low level of awareness among key stakeholders, especially SMEs. Many local developers and potential investors are either unaware of the specific tax incentives available to them or lack the resources to access and apply for these benefits. Without adequate outreach, these incentives fail to reach their target audience, particularly local businesses that could benefit the most from tax relief and financial support. The Nigerian government should launch comprehensive awareness campaigns aimed at educating SMEs, local investors, and industry stakeholders about the renewable energy tax incentives available. These campaigns could include workshops, seminars, online resources, and partnerships with industry associations to provide information on the processes for accessing tax holidays, import duty exemptions, and VAT exemptions. Additionally, partnerships with business incubators and accelerators could help bridge the knowledge gap for emerging players in the renewable energy space.

3. Improve Financing Mechanisms for Renewable Energy Projects

While tax incentives are critical in reducing the tax burden on renewable energy projects, they do not address the financing gap that many developers face. The high upfront capital required for renewable energy projects, particularly in off-grid and rural areas, remains a significant challenge. In addition to tax incentives, access to affordable financing is crucial to encourage investment in renewable energy. It would be useful for the Nigerian government to create an enabling environment under which investors can explore innovative financing mechanisms to support renewable energy projects. This could include establishing a dedicated renewable energy financing facility that offers concessionary loans with lower interest rates and longer repayment periods. Additionally, the government should work with international development partners, commercial banks, and impact

investors to create blended financing models that reduce risks and attract more capital. There is also an opportunity to develop green bonds, which would allow investors to raise capital specifically for renewable energy projects.

4. Strengthen Infrastructure Support for Renewable Energy Projects

In addition to financial and tax incentives, the success of renewable energy projects heavily depends on the underlying infrastructure to support these investments. The lack of reliable energy transmission and distribution networks poses a significant barrier to the successful deployment of renewable energy systems. Without the necessary infrastructure, even the most well-funded renewable energy projects cannot effectively reach consumers or contribute meaningfully to the grid. The Nigerian government should prioritize investment in renewable energy infrastructure, particularly in transmission and distribution systems, to enable the efficient integration of renewable energy into the national grid. This should include the construction of new transmission lines to connect renewable energy projects, as well as upgrades to existing infrastructure to accommodate the integration of variable renewable energy sources, such as wind and solar power. Additionally, microgrid and off-grid solutions should be supported to provide energy access to underserved areas, particularly in rural and remote locations.

CONCLUSION

Tax incentives for renewable energy projects in Nigeria are pivotal in driving the nation's ambitious energy transition. Initiatives such as pioneer status, VAT exemptions, and relief from import duties have catalyzed progress, igniting a spark of innovation and investment in the sector. Nigeria's renewable energy sector holds immense potential, but its growth is hampered by regulatory uncertainty, limited access to financing, and inadequate infrastructure. While the tax incentives currently in place have spurred some development, further reforms and targeted initiatives are necessary to fully unlock their potential. By clarifying regulations, increasing awareness, improving financing mechanisms, strengthening infrastructure, and decentralizing energy governance, Nigeria can accelerate its transition to renewable energy and meet its sustainable development goals. These reforms will also help in establishing Nigeria as a leader in renewable energy in Africa, providing a sustainable energy future for its citizens while contributing to global efforts to combat climate change.