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Using Tax Insurance to Facilitate Renewable Energy Project Finance Transactions

The US federal government has historically encouraged the development and use of alternative energy sources through financial incentives such as grants and federal income tax credits. The Inflation Reduction Act of 2022 (the "IRA") sought to spend approximately $369 billion over a decade to promote the ongoing shift from fossil fuels to renewable energy sources. The expanded timeframe and broadened scope of the Investment Tax Credit ("ITC") and Production Tax Credit ("PTC") have encouraged developers and investors to build out clean energy projects faster than ever before and introduced many new participants into the world of renewable energy project finance.

One of the key financing methods used by renewable energy project developers and sponsors in the US is a tax equity investment. In a typical tax equity transaction, financial institutions like banks and insurance companies partner with a developer or sponsor to fund a project in exchange for a share of the project's tax benefits, primarily income tax credits and depreciation, as well as cash flows. Since the passage of the IRA, a project owner may also choose to sell the income tax credits generated by a project (but not the depreciation) to a third party for cash. The ability to transfer tax credits, or so-called "Transferability," has given developers an alternative path to monetizing tax benefits and spurred corporations to buy tens of billions in clean energy tax credits per year to reduce their federal income tax liabilities. A hybrid version of the partnership structures that use elements of tax equity and Transferability have also emerged as strategies for monetizing the anticipated tax benefits generated by a renewable energy project.

Several hurdles can hinder these transactions for tax equity investors and tax credit buyers alike. One issue can be the credit quality of a sponsor who typically provides various indemnities and guarantees to the investor or tax credit buyer, including for loss or disallowance of the tax credits. Another potential constraint for the investor/tax credit buyer are limits on the amount of concentrated counterparty risk that arises from taking on repeat sponsor indemnities from a preferred partner sponsor. Yet another simple concern that arises for tax credit buyers is operating in an unfamiliar landscape, particularly for new entrants into the renewable energy space, such as large corporations buying clean energy tax credits to reduce their federal income tax liability.

Tax Insurance for Renewable Energy Transactions

Over a decade ago, tax insurance companies stepped in to address the hurdles faced by tax equity investors while promoting the legislative goals of promoting clean energy. Since 2013, tens of billions of dollars in insurance capacity have been deployed to facilitate the financing of renewable energy projects in the United States, and significant resources have been allocated to increase tax expertise within the tax liability insurance industry. Tax liability insurance facilitates renewable energy finance transactions by providing A-rated capital to support or replace transaction indemnities and guarantees provided by sponsors and developers and mitigate non-indemnified tax risks.

Although much insurance capital has been deployed to support solar ITC and wind PTC tax equity transactions, the tax insurance market has adapted to underwrite new risks. Since the passage of the IRA, underwriters have moved quickly to facilitate transactions associated with newer technologies and initiatives, including standalone battery storage, carbon capture and sequestration, and credits related to the domestic production of clean energy components, as well as transferability, new and bonus tax credits, and alternative financing structures. The tax insurance underwriting process has also become more efficient as insurable risks are more readily measured and analyzed. As such, it is anticipated that tax insurance will continue to play a significant role in the financing of renewable energy projects in the US.

Tax insurance is a flexible tool that can be customized to each project and the commercial needs of the transaction parties. A policy can be written to directly benefit a tax equity investor or tax credit buyer or indirectly through a developer, sponsor, tax equity partnership, seller or project company. Loss under a tax liability insurance policy typically includes lost tax benefits (increased tax liability), applicable interest, penalties (if insurable under governing law), defense costs (above the retention), and a gross-up (for any taxes due on insurance proceeds). A tax credit insurance policy can be secured in as little as 10 – 15 business days and provides fulsome protection against a successful challenge by a tax authority to the insured risks, allowing transacting parties to move forward with certainty.

Commonly Insured Risks

Coverage under a tax credit policy is intended to address the specific needs of a transaction. Often, tax credit policies cover some or all of the following categories of risks:

1. **Structural Tax Risk**. With respect to a tax equity investment, covering that the structure of the transaction will be respected, whether the structure is a traditional partnership flip, sale-leaseback, or hybrid structure. For example, in the partnership flip scenario, a policy may cover that the partners' status, ownership, and allocations will be respected, among other things. In the context of a tax credit sale, a policy may specify that all aspects of the tax credit transfer structure will qualify as intended. For example, a seller is eligible to claim and transfer the credits, and the developer's structure did not result in a prior credit transfer.

2. **Qualification Risk.** A broad category covering that a solar, wind, battery energy standalone storage, geothermal, carbon capture/sequestration, biogas or another renewable energy project will qualify for the intended ITC or PTC, which may include the following tax risks: the eligible tax basis of energy property (including basis step-up), the start of construction, continuous efforts and placed in service dates, 80/20 repowering transactions, eligibility for each of the bonus incentive credits for energy projects in low-income or energy communities, and meeting domestic content or prevailing wage & apprenticeship requirements.

3. **Recapture Risk** (under Section 50 of the Internal Revenue Code). Covering that ITCs have not, and will not, be subject to a recapture event. For example, if the renewable energy project is sold, disposed of, or removed from service (e.g., suffers a casualty event) within the first five years of operation.

Premium Rates, Retentions, and Market Capacity

With more than 20 A-rated insurance carriers participating in the tax liability insurance market in 2025, there is an estimated $1 billion US dollars in market capacity available for tax insurance programs. Premiums for a tax insurance placement typically range from 1.5% to 3.5% of the limits purchased, depending on the scope of coverage, self-insured retentions, and coverage limits. Self-insured retentions can range from nil to a set amount for defense costs only or aggregate retention tied to a covered risk. The one-time premium is paid at binding and represents a multi-year policy that can range from 7 – 10 years. Additional one-time costs include carrier underwriting fees and applicable surplus lines taxes/fees imposed on the policies.

The passage of the IRA has supercharged tax equity investing in the US and ushered in a rapidly growing market for tax credit sales. Tax liability insurance is an established offering within the transactional risk segment of the broader property and casualty insurance marketplace. With significant capacity and a knowledgeable underwriting capability, this market stands ready to continue supporting all manner of renewable energy project finance transactions.

About Vanbridge, an EPIC company

Vanbridge is a fully diversified insurance and capital solutions firm that provides products and services at the intersection of the insurance, private equity and hedge fund industries. What makes us different is the strength and flexibility of our business model and our ability to provide a full range of insurance and alternative capital solutions without the limitations of a siloed approach.

Specializing in solving risk-related issues utilizing insurance and alternative capital, Vanbridge bridges the gap between the insurance and capital markets, allowing our clients to manage their risk, enhance their investment strategies, and strengthen their long-term financial performance. Our innovative approach includes expertise in tax liability insurance, supports renewable energy project finance and tax credit investments, and positions us at the forefront of emerging trends in the renewable energy sector.

For questions about tax liability insurance and how it can help facilitate your investments, transactions, and tax planning in 2025, contact a member of our team:

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