Guide to

Tax Credit Insurance

after the Inflation Reduction Act

The Inflation Reduction Act ("IRA") was recently signed into law by President Biden, becoming one of the largest federal investments in incentive programs of this type in recent years. As a result, Aon expects investments in renewable energy projects to continue to grow as tax credits continue to be used as a primary federal incentive to encourage investment in solar, wind and other renewable energy projects.

Tax Credits are relied upon by institutional tax equity investors to support funding for these projects and these investors remain passive participants, subject to numerous insurable tax risks.

Key tax credit provisions in the IRA include:

1. a ten year tax credit extension;
2. new qualification matters to allow for the tax credit percentage to increase (i.e., wage standards and location);
3. a Production Tax Credit ("PTC") option for solar projects;
4. a tax credit for standalone storage;
5. the ability to sell tax credits rather than using tax equity structures; and
6. tax credits available for other technologies including standalone energy storage, clean hydrogen and Section 45Q carbon sequestration.

As a result of these key tax credit provisions, as well as other provisions of the IRA, we anticipate tax credit insurance will continue to be used as an opportunity to provide risk management to sponsors, developers, lenders, tax equity investors, and tax credit purchasers. The tax credit insurance concepts traditionally applied to wind and solar financings can be used to facilitate tax equity financings in these other technologies as well.

Start of Construction

As a result of the passage of the IRA, we anticipate a number of projects seeking certainty around when the project is considered to have started or begun construction. This start of construction risk is a popular tax insurance policy that is sought by sponsors, developers, lenders and investors in both wind and solar projects as the year a project has begun construction has determined what percentage of credit the project qualifies for. Some of the new provisions of the IRA, including the Prevailing Wage and Apprenticeship Standards, will affect projects that begin construction 60 days after guidance is issued. We anticipate that some projects will want to have been considered to have started construction **before** the 60 days are up (so that the prevailing wage and apprenticeship standards **do not** apply) and that other projects will want to have been considered to have started construction **after** the 60-day period (so that the prevailing wage and apprenticeship standards **do** apply).

Bonus Tax Credit Amounts

Projects which meet the Prevailing Wage and Apprenticeship Standards will be entitled to a bonus credit (above a reduced base) once regulations are issued. We expect to be able to place tax insurance that a Project has and/or will meet the Prevailing Wage and Apprenticeship Standards.

In addition, there are a number of new 'bonus' tax credit provisions that allow for a project to qualify for a higher tax credit percentage than before. This includes that the project uses domestic content (products produced in the United States), the project is located in an "energy community" (i.e., an area with significant employment related to coal, oil, or natural gas), and/or that the project is in a low-income community. We anticipate that each of these 'bonus' tax credit provisions will be covered under a tax insurance policy, providing additional opportunity for the project to qualify for the higher tax credit.

Direct Pay

Although the direct pay option did not turn out to be as broad as once proposed and is focused on specified governmental and tax-exempt entities with some exceptions, there certainly will be a category of transactions that would benefit from the direct pay option. However, for developers seeking to monetize credits to finance construction through direct pay, there will be timing differences they need to address. There will be a lag between the construction timeline (and when traditional tax equity would invest) before the placement in service date and the actual receipt of cash from the US Treasury sometime down the road. We can envision the potential development of a bridge loan product and the need to backstop that loan with tax credit insurance, in efforts to arrange coverage for the lender against disallowance of the tax credit.

Transferability; Structural tax risks

Often, structural tax risks are covered under tax insurance policies when there is a tax equity investment structure in place. The exact risks covered under the tax policy depend upon whether a partnership flip structure, inverted lease structure or some other structure is chosen as the tax equity investment structure. Broadly, these risks include that the partnership will be respected and that the allocations of the tax credits will be respected, among other specific tax risks.

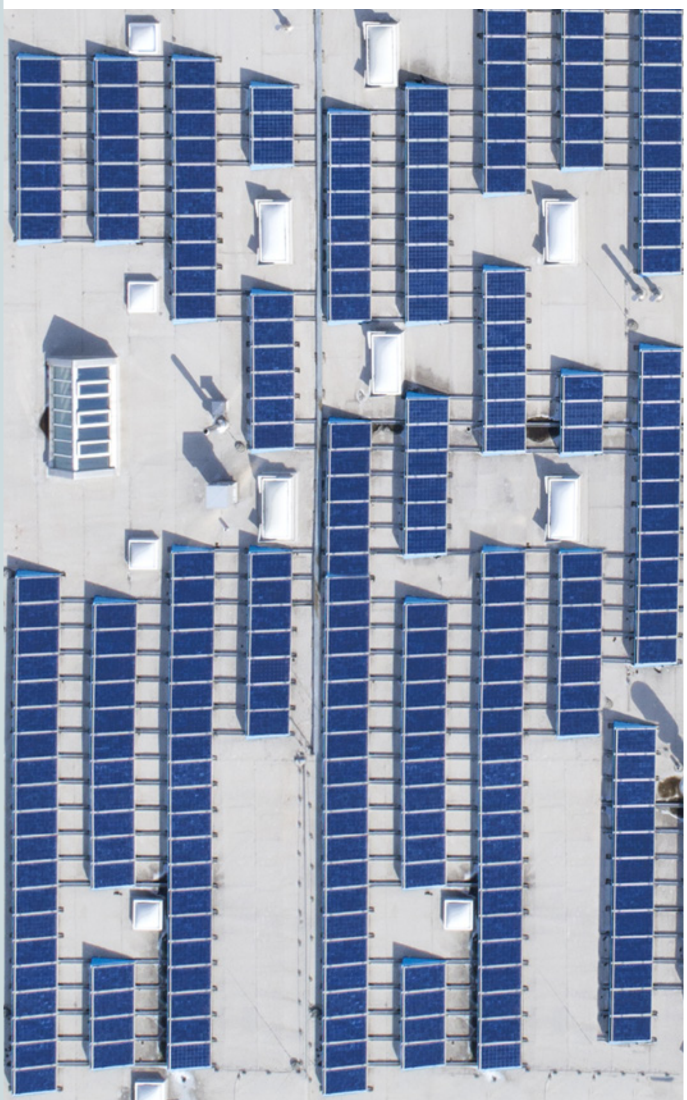
Under the IRA, tax credits can now be transferred, i.e., sold to a third party. While this will eliminate the structural risk that the investment entity is respected as a passthrough, we would anticipate that the seller of the tax credits is still going to have to provide a typical tax indemnity to the purchaser of the tax credits. This indemnity is designed to protect the tax credit buyer against a subsequent IRS determination that projects did not qualify for the tax benefits and/or that the amount of the tax credits, which often is based on an appraisal, was incorrect or recapture. This scenario would present insurable risks to the developer/seller. In addition, like many tax equity investors, tax credit buyers have concerns around the financial strength of the developer's/seller's balance sheet for their indemnity/guaranty to stand behind. Tax credit insurance can operate as a means to credit enhance these balance sheets (taking advantage of the A rated or stronger balance sheets that many of the tax insurance markets provide) or to shift the primary responsibility for any lost tax credits away from the buyer and seller to the tax insurance markets.

Qualified Basis, Recapture Risks

Of course, risks which are frequently insured pre-IRA will continue to face tax equity investors. The tax credit insurance markets are poised to continue to provide coverage that the project will qualify for the credit, that the fair market value of the project would be respected, and that there would not be a tax loss due to recapture.

Applicability to Real Estate Investment Trusts (“REITs”)

The transferability rules noted above also now permit REITs to own renewable projects and transfer the tax credits to a buyer. This of course is interesting because it expands the universe of renewable energy investors but could also present additional challenges and complexities navigating the rules for REIT qualification. However, there is already an established market for “hybrid” tax and representations and warranties policies which are frequently used to facilitate acquisitions involving REITs. This coverage allows buyers to look to third party insurance where there is loss due to breach by seller of its representations and warranties, including the REIT qualification representations, thereby offering the seller with a clean exit.



The Aon Advantage

Aon Transaction Solutions is the leader in placing tax insurance in renewable energy transactions with over $16 billion of limits placed since 2013 insuring over 17 gigawatts of solar and wind projects. We expect tax credit insurance to continue to grow as a key solution to help support sponsor and developer tax indemnities, bringing additional certainty to renewable energy transactions.

As the leading global tax insurance broker, Aon delivers an unparalleled depth of knowledge and experience to effectively guide clients in helping protect against an adverse tax ruling that can compromise the value of a transaction or corporate earnings. Our team has been instrumental in the growth of tax insurance globally, and we pride ourselves on being both pioneers in this industry and continual innovators. Our broad range of tax insurance solutions addresses many tax risks faced by deal teams and corporate tax professionals across many jurisdictions. When working with Aon, our clients are confident that their investments are secure and the uncertainty around their tax positions is managed.

Aon was among the first to participate in this specialty market and we have worked closely with our clients to manage a wide range of tax risks. A global team comprised of tax attorneys and tax accounting professionals, Aon brings a depth of knowledge and passion needed to develop tailored solutions to your complex tax risks.

We offer experienced guidance to help ensure that your investments are secured, and that value is enhanced.

Since 2013, Aon’s global tax practice has placed hundreds of policies transferring more than $35 billion of risk. Programs over $500 million are more frequent occurrences and, with the entrance of additional A-rated or better insurers to the market, our ability to place programs over $1.5 billion per risk has been enhanced. Additionally, since 2013, over 450 transaction liability claims were made, and with the assistance of our dedicated claims team over $425 million was paid by insurers to Aon clients in amounts ranging from $400,000 to over $50 million.

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If you have questions about your coverage or are interested in obtaining coverage, contact your Aon broker.

About Aon

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