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Battery Energy Storage Financing Structures and Revenue Strategies

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A Practice Note discussing financing structures and revenue strategies for battery energy storage systems (BESS). This Note explains how project sponsors can monetize BESS projects, which store electricity during periods of high supply and release it when demand is high. It examines various offtake structures, including fixed-price contracts like capacity or tolling agreements and resource adequacy contracts, which are often preferred by project finance lenders and investors for their stable cash flows. This Note also explores variable revenue sources such as energy price arbitrage, ancillary services, and state incentive programs, and how combining these streams through "value stacking" can improve project economics. The Note evaluates the federal tax credits available for BESS projects under Sections 48 and 48E of the Internal Revenue Code and discusses how monetization strategies, such as traditional tax equity financing or the direct sale of tax credits, impact a project's overall offtake and financing structure.

Battery energy storage systems (BESS) are devices that charge or store electricity during periods of high supply and low demand and then release that electricity when it is most needed (during periods of low supply and high demand). These systems enable project developers (also referred to as project sponsors) to exploit wind and sunlight while addressing the main criticisms of these energy sources, their seasonality and intermittency. For information on other electricity storage devices or technologies, see Practice Note, Understanding Energy Storage.

This Practice Note:

- Explains the key benefits BESS projects offer and how project sponsors can monetize these benefits.
- Discusses the fixed and variable offtake structures that project sponsors can use to earn revenue from these projects.
- Evaluates the federal tax credits available for BESS projects and how these tax credits impact offtake strategies and financing structures for BESS projects.

Basics of BESS Projects

A battery system may:

- Be built as a stand-alone project or may be co-located with another energy generation facility.
- Be installed onsite on a customer's property (behind-the-meter (BTM)) or offsite or grid-connected (front-of-the-meter). The customer in a BTM transaction may be residential or a commercial and industrial (C&I) entity. This Note focuses on transactions with commercial entities.
- Be controlled by the project company (a special purpose vehicle the project sponsor establishes to own the project assets and enter into the project and loan documents) or the offtaker or customer.
- Have its stored electricity and attributes sold:
  - to a utility;
  - into a deregulated electricity market managed by regional transmission organization (RTO) or independent system operator (ISO)(for example, the Pennsylvania New Jersey Maryland

Interconnection (PJM), Midcontinent Independent System Operator (MISO), or Electric Reliability Council of Texas (ERCOT)); or

- to a C&I entity.

- Each of the above factors impact the BESS project's revenue structures (see Battery Energy Storage Revenue Streams).

Benefits of Battery Energy Storage Projects

BESS projects serve a variety of purposes for utilities, grid operators, and consumers of electricity, including:

- Reducing total energy costs. Standalone BESS projects may be charged with electricity during times of low market prices and the stored electricity used at times of high market demand when electricity would otherwise be purchased at a higher market price.
- Providing back-up power for intermittent renewable energy sources. Most solar and wind energy projects include battery storage (co-located systems) to enable them to deliver electricity to the electric grid even in periods of low sunlight or wind.
- Playing a critical role in frequency regulation. BESS projects can be quickly dispatched (typically within a second) to provide power when demand exceeds generation. This is important because if there insufficient generation to meet demand, load is automatically removed from the electric grid in stages (meaning electricity delivery is temporarily interrupted to certain consumers) to prevent grid failures and extended outages until balance is restored. This is also referred to as load shedding.
- Balancing electricity supply with demand. Batteries can store excess clean energy generated at times of low market demand to inject energy into the grid at a later time, reducing the need for generation from other sources, including fossil fuel-powered plants. As a result, in addition to their other attributes, BESS projects are viewed as a key component in the clean energy transition.

Battery Energy Storage Revenue Streams

The varying uses of storage, along with differences in energy markets and regulations (BESS projects may be subject to regulations and market rules issued by the Federal Energy Regulatory Commission (FERC), state public utility commissions, and grid operators (whether a utility, ISO, or RTO) depending on where the system is located and its electricity is sold) create a range of revenue streams for BESS projects. In many locations, owners of batteries, including storage facilities that are co-located with solar or wind projects, can generate revenue under contracts from multiple sources based on the different benefits BESS provide to the grid and customers (utilities, grid operators, and C&I entities).

BESS projects can derive revenue from a variety of sources, including:

- Fixed-price contracts for:
  - sales of capacity (capacity or tolling contracts);
  - rights to use the battery (battery use contracts); and
  - resource adequacy benefits (contracts for the sale of resource adequacy).
- Variable revenue contracts.
- Energy price arbitrage.

These projects are also eligible for investment tax credits (ITCs) in a base amount equal to 30% of eligible projects costs, subject to compliance with (or exemption from) prevailing wage and apprenticeship (PWA) requirements and bonus credits if they meet domestic content and other requirements (see Tax Credits for BESS Projects). These tax credits may also be sold and transferred to qualified third parties (see Sales of Tax Credits).

Combining (or value stacking) the different revenue sources available to storage projects enables project developers to improve the economics for their projects. They can seek tax equity and project financing based on anticipated cash flows from all or a portion of the components of the value stack.

Key Regulations

Many of the revenue streams on which battery storage projects now rely only became available in 2018 after FERC issued an order requiring RTOs and ISOs (except ERCOT) to revise their tariffs to establish a participation model for electric storage resources that recognize the physical and operational characteristics of these resources (including batteries, flywheels, compressed air energy storage, and thermal energy storages). (See Order No. 841,162 FERC ¶ 61,127 (Feb. 15, 2018), *affirmed on reh'g*, Order No. 841-A, 167 FERC ¶ 61,154 (May 16, 2019).)

Under the Federal Power Act (16 U.S.C. §§ 791a to 828c), FERC has jurisdiction over the wholesale electricity markets, the interstate transmission system, and the rules and procedures involved to interconnect generating and energy storage facilities to the transmission system (16 U.S.C. § 824(b)). ERCOT is not subject to FERC's regulations regarding rates and transmission because it does not engage in interstate sales of electricity. However, ERCOT has its own market rules that energy projects must comply with.

This order effectively removed barriers to the participation by energy storage projects in the capacity, energy, and ancillary services markets operated by RTOs and ISOs, allowing it to among other things enter into resource adequacy contracts and benefit from energy price arbitration opportunities.

Fixed Price Revenue Streams

BESS projects are typically financed on a limited recourse basis. Financing parties (whether project lenders or tax equity investors) traditionally prefer projects that have long term agreements with creditworthy counterparties to pay a fixed price for the project's output. Assuming the project operates as expected, the project can generate revenue that does not fluctuate with changes in market prices for the output.

With long-term agreements that ensure stable and reliable revenue streams, financing parties can size their loans or equity investments based on the following assumptions:

- The project can produce a minimum level of output.
- A creditworthy party can pay a fixed price for that output (on a per-unit, per-month basis, or a combination of those prices).
- The project's net cash flows are sufficient to repay the project debt (whether loans, bonds, or a both) and for equity investors to earn a return on their investment.

For more information on these issues, see Practice Notes, Project Finance: Overview: Bankability Analysis, Financial Covenants: Project Finance Transactions, and Project Finance: Sources of Available Financing.

Project companies may enter into:

- Capacity, tolling, or battery use contracts (see Capacity, Tolling, or Battery Use Contracts).
- Resource adequacy contracts (see Resource Adequacy Contracts).

Capacity, Tolling, or Battery Use Contracts

In capacity contracts, the offtaker or buyer (which could be a utility or a large end user of electricity) pays a fixed capacity payment or **battery-use payment** or **toll** for the right to charge and dispatch energy from the storage system, subject to compliance with negotiated operating procedures. Under this contract, the offtaker is in control on when and whether to charge the system or to dispatch stored electricity from the system.

The fixed capacity payment the offtaker pays under this contract is often conditioned on the project continuing to meet specific operating and performance metrics, such as:

- Demonstrating an ability to hold an output at the delivery point (typically the point of interconnection with the grid or utility). This is a performance test that assesses the system's ability to maintain continuous discharge at an agreed level and for an agreed period at the delivery point without material degradation or interruption.
- Maintaining a guaranteed level of availability during a given measurement period (for example, 95% availability for a given month, quarter, or year).
- Round-trip efficiency. This refers to the amount of stored electricity that can be dispatched. The higher the round-trip efficiency, the less energy is lost in the storage process.
- Compliance with grid interconnection standards established by the applicable grid operator (whether a utility or RTO/ISO) (see Practice Notes, Interconnection: Connecting Generation Resources and Energy Storage Systems to the Electric Grid and Understanding FERC Order No. 2023: Framework for Connecting to the Electric Grid).

If the storage system does not achieve agreed operating metrics, then the contract price is often subject to adjustment. For example, many contracts provide that if the system is not available for a guaranteed percentage of hours during a contract year, then the contract price is reduced. The contract price may be reduced:

- In proportion to the period of unavailability.
- According to a formula set out in the agreement.

- Using a tiered structure based the percentage of the project's actual availability.

Sharing of Energy Cost Savings

In addition to paying the fixed capacity payment to the project company, some contracts for standalone BESS projects require the offtaker to share with the project company the benefits of any energy price arbitrage. These are gains that accrue to, or money saved by, the offtaker as a result of charging the system with electricity it purchases during periods of relatively low market prices and then using the electricity from the system at a time when the offtaker would otherwise pay a higher price for electricity.

Benefits to the Offtaker

In exchange for the fixed capacity payment, the buyer or offtaker receives the benefits of operating the battery. These benefits include the ability to:

- Save on total electricity costs by charging the battery during times of low market prices for electricity and then drawing on the stored electricity during times of peak market prices for electricity (for example, in the late afternoon when demand for electricity is high). This is a major benefit for C&I customers that enter into these agreements. C&I customers often pay:
  - for their retail electricity based on time-of-use (TOU) arrangements in which the price of electricity changes based on the time of day. BESS projects allow these customers to pay for retail electricity when TOU rates are low, and then use electricity discharged from the battery (rather than electricity from the grid) when TOU rates are high; and
  - a surcharge (a demand charge) to their utility based on the highest level of electricity they use in a given period (usually 15-to-30-minute intervals). Battery storage allows these customers to draw power from the battery instead of from the electric grid during these periods.
- Access stored electricity when electricity from the grid is otherwise unavailable due to grid outages.
- In the case of offtakers that are utilities and other grid operators:
  - regulate frequency levels on the grid by charging or discharging the battery when there is an imbalance between supply and demand for electricity on the grid; or
  - inject reactive power into the grid, which maintains the force (voltage) needed to move electrons through the grid ensuring its stability.

Resource Adequacy Contracts

Resource adequacy is the ability of the electricity system to supply electric power and energy to meet electricity demand at all times, taking into account scheduled and unscheduled outages. This requires management of energy supply (the construction of new generation facilities) and demand.

Many states have resource adequacy programs which require utilities and other load serving entities to ensure they have sufficient generation capacity to meet customer demand. To meet this obligation, these entities must procure certain attributes (that is technical and operational characteristics of electricity resources that contribute to system reliability). These attributes include:

- Dispatchability. This is the ability to:
  - dispatch energy resources when demand is high and reduce the electricity flowing to the grid when demand is low; and
  - sustain the output needed during the peak or higher demand periods.
- Fuel security. Resources with supply chains that are not subject to commodity price volatility, international trade issues, and other issues that may disrupt generation and availability may be viewed as more resilient and reliable.

Depending on the regulatory environment where the project is located, the project company can sell and transfer these attributes under long-term resource adequacy contracts to utilities or other load serving entities. For example:

- The California ISO (CAISO) operates a resource adequacy program that allows utility-scale battery storage projects to be eligible for resource adequacy attributes.
- The PJM operates a Reliability Pricing Model that allow battery systems to sell these attributes if they meet certain performance and reliability standards.

These resource adequacy contracts (whether for standalone storage projects or solar or wind projects paired or co-located with storage) typically include a fixed-price payment for the attributes.

Sales of resource adequacy attributes alone may not be sufficient to enable tax equity investors to meet target returns for investment or for project lenders to finance projects on a limited recourse basis. However, these sales provide a degree of fixed, stable cash flows for projects that these parties include in their analyses of the project.

Operational Control and Energy Price Arbitrage

Under many of these contracts, the project company retains:

- Operational control of the BESS facility (that is, the ability to control when the system is charged or stored electricity is discharged).
- The right to receive revenue from sales of electricity discharged from the battery.

When the project company retains operational control and the right to receive revenue from sales of discharged electricity, the project company may share the price arbitrage gains with the utility through an adjustment to the monthly price the utility pays under the contract.

In other cases, a utility offtaker may enter into a capacity or tolling contract that includes a transfer of resource adequacy benefits (see Capacity, Tolling, or Battery Use Contracts). For these contracts, the utility offtaker (rather than the project company) has control over the BESS project's operations and, depending on the terms of the contract, may be required to share with the project company any arbitrage gains (Sharing of Energy Cost Savings).

Virtual Arbitrage

Sharing of gains may also be based on virtual arbitrage. In this case, the project company transfers the gains to the offtaker by reducing the fixed price the offtaker must pay under the contract by the gains that would be realized if both of the following apply:

- The system is charged with electricity that is purchased during the four hours with the lowest market prices.
- The electricity is discharged and sold during the four hours with the highest market prices.

This is known as a "TB4" or top-bottom four hours model.

By transferring virtual arbitrage gains to the offtaker, the offtaker receives some of the arbitrage benefits from the BESS project, while the project company controls charging and discharging and captures the actual gains from arbitrage in the market, along with other gains from sales of ancillary services.

Variable Revenue Streams

Tax equity investors and lenders generally favor projects with fixed-price contracts that mitigate market price risk. However, project owners can also adopt strategies that entail exposure to market prices but may increase overall project revenues, such as:

- Energy price arbitrage, often with forms of price hedging (see Price Arbitrage with Hedging).
- Shifting time for delivery of electricity from co-located energy projects (see Shifting Time of Delivery of Electricity from Co-Located Projects).
- Sales of ancillary services (see Ancillary Services).
- Taking advantage of state incentive programs (see State-Level Credits and Incentive Programs).

Price Arbitrage with Hedging

In some transactions, rather than transferring or sharing the price arbitrage gains with the offtakers, the project owner keeps the potential upside in revenue from procuring electricity at their expense during times of low market prices and then selling the stored electricity at times of high market prices. In this case, the project owner assumes the risk that these gains may not be realized because there is little difference between the low and high market prices for electricity in a particular day.

The project company may mitigate this market price risk by entering into hedging agreements, such as put options with a third party under which the project company pays the hedge provider an upfront premium payment. During the term of the put agreement, the hedge provider pays the project company an agreed amount if the arbitrage gains (that is, the difference between the low market purchase price and the high market sale price) for any period are below an agreed level. This guarantees a minimum arbitrage payment, while allowing the project company to obtain higher actual revenue in the market. For more information on put options,

see Practice Note, Commodity Derivatives: Overview (US): OTC Commodity Option Contracts.

Shifting Time of Delivery of Electricity from Co-Located Projects

Pairing a BESS project with a solar or wind power generation project allows the project company to charge the battery system and store the electricity generated by a solar or wind project rather than deliver power to the grid when either:

- Market prices for electricity are low or negative.
- The electricity that would otherwise be delivered to the interconnection point by the project is curtailed. Grid operators often reduce power from renewable energy sources to maintain the balance of power supply and demand when there is insufficient demand.

The battery system can then discharge the stored electricity during times of high market prices or when the electricity is not curtailed at the interconnection point.

Similarly, the price that offtakers pay for electricity is often higher during late afternoon periods. A BESS project enables the project company to deliver electricity to the offtaker during these peak pricing periods, even if the renewable project cannot generate electricity because of adverse conditions (for example, rain, low sunlight, or low wind).

Pairing a battery system with a renewable project also enables project sponsors to manage risks associated with financial hedge contracts that contemplate delivery of fixed volumes of energy during specified periods.

Ancillary Services

In many electricity markets, BESS projects can sell ancillary services in addition to energy or capacity either to transmission owners or to regional grid operators (for example, PJM and MISO).

Ancillary services include:

- Various forms of frequency regulation and operating reserves products that may be sold in market-based clearing price auctions.
- Certain voltage control and reactive power management services that are sold at cost-based rates that may be established in a utility or grid operator's tariff or in a project's own rate schedule.

Although revenue from these sources is often infrequent or unpredictable, it may spike at certain times of the year, such as during heat waves that strain the local electric grid, resulting in large windfalls to project owners.

State-Level Credits and Incentive Programs

Various state-level programs provide credits or other incentive payments for distributed generation solar and BESS projects. These programs compensate projects based on when and where they provide electricity to the grid.

In New York, for example, standalone and co-located battery storage projects may be eligible for the value of distributed energy resources (VDER) credit, which is a per-kilowatt credit that includes fixed-rate (a market transition credit (or a community credit) and variable-rate components (for example, energy value, capacity value, and environmental value). Under community energy programs, the project company can sell those credits to electricity customers (or subscribers) who use these credits to reduce their utility bills by the amount of these credits.

Implications for Financing Structures

Variable payments related to BESS facilities provide potential increased revenues to project sponsors and financing parties. However, lenders and tax equity investors do not typically account for these variable revenue sources in their upfront sizing of a project loan or equity investment because they are subject to potentially volatile swings in market prices for project output.

When a BESS project includes variable and unpredictable revenue sources, third party financiers and project sponsors often negotiate how these cash flows are to be allocated when received by the project. Depending on the project and the negotiating strength of the parties, these additional cash flows may be addressed in one of the following ways:

- Allocated to the project lenders as a prepayment of the loans.
- Distributed entirely to the project sponsors.
- Shared between project lenders and the project sponsor depending on the overall financing structure.

Depending on analyses of the relevant energy markets, some tax equity investors are also unwilling to take variable revenue sources into account in the sizing of their investments. In these cases, the tax equity investor may only receive a share of net cash flow that is attributable to fixed price contracts, and the project sponsors receive a special distribution of cash from riskier revenue sources.

For more information on these issues, see Practice Notes:

- Project Finance: Overview: Bankability Analysis.
- Financial Covenants: Project Finance Transactions.
- Project Finance: Sources of Available Financing.

Hybrid Revenue Models

Standalone storage projects and co-located solar and storage projects usually feature a mix of the fixed and variable revenue sources, which continue to evolve as changes occur in regional energy regulations and markets. Fixed-price contracts allow a project to generate a relatively predictable and stable amount of revenue, subject to the project meeting technical operating assumptions. These contracts also allow project owners to achieve higher total returns by retaining the benefits of price arbitrage.

Project developers piece together a variety of contracts and market participation plans to generate revenue, setting up a negotiation with financing parties (for example, project lenders, hedge providers, and tax equity investors) regarding the treatment of the revenue streams under financing documents and the project developer's plans for maximizing the value of a storage project.

Tax Credits for BESS Projects

BESS projects may qualify for an ITC under Section 48 or Section 48E of the Internal Revenue Code (Code) depending on the date the project began construction (within the meaning of the Code and accompanying Internal Revenue Service (IRS) regulations) (see Notice 2013-29; *clarified by* Notice 2013-60, 2013-44 I.R.B. 431; *clarified and modified by* Notice 2014-46, 2014-36 I.R.B. 520; *updated by* Notice 2015-25, 2015-13 I.R.B. 814; *clarified and modified by* Notice 2016-31, 2016-23 I.R.B. 1025; updated, clarified, and *modified by* Notice 2017-04, 2017-4 I.R.B. 541; Notice 2018-59, 2018-28 I.R.B. 196; *modified by* Notice 2019-43, 2019-31 I.R.B. 487; *modified* by Notice 2020-41, 2020-25 I.R.B. 954; *clarified and modified* by Notice 2021-5, 2021-3 I.R.B. 479; *clarified and modified* by Notice 2021-41, 2021-29 I.R.B. 17; and Notice 2025-42).

Section 48 ITC

Energy storage projects that begin construction before January 1, 2025 may qualify for a tax credit equal to 30% of eligible costs under Section 48 of the Code, if they:

- Pay contractors engaged in construction and (during the five-year period after the project is placed in service) alteration or repair of the project, wages that are not less than prevailing rates, as determined by the Secretary of Labor.
- Maintain a minimum number of qualified apprentices during construction of the project.

(Together, the Prevailing Wage and Apprenticeship Requirements.)

Projects that began construction before January 29, 2023, are exempt these requirements.

Section 48E ITC

Energy storage projects that begin construction after December 31, 2024 may qualify for an ITC equal to 30% of eligible costs under Section 48E of the Code, subject to compliance with the Prevailing Wage and Apprenticeship Requirements.

These projects are eligible for the full amount of the ITC under Section 48E of the Code so long as construction begins before the end of 2033. This is different from wind and solar projects which must begin construction by July 4, 2026 or be placed in service by December 31, 2027 to qualify for the Section 48E ITC.

For more information on these credits and the Prevailing Wage and Apprenticeship Requirements, see Practice Notes, Financing Clean Energy or Zero Carbon Projects: Federal Tax Credits and Financing Clean Energy or Zero Carbon Projects: Prevailing Wage and Apprenticeship Requirements and Bonus Credits.

Bonus Credits

Qualifying energy storage projects may also receive an additional:

- 10% tax credit if the project is located within an "energy community" as defined in Section 45(b)(11)(B) of the Code.
- 10% domestic content bonus credit if structural iron and steel components used in the project are produced in the US and certain minimum percentage (adjusted percentage) of the costs of manufactured products and their components used in the project are mined, produced, or manufactured in the US. The adjusted percentage is:
  - 40% if construction begins before June 16, 2025;
  - 45% if construction begins after June 16, 2025 and before January 1, 2026;
  - 50% if construction begins in 2026; and
  - 55% if construction begins after December 31, 2026.

For more information on these credits, see Practice Note, Financing Clean Energy or Zero Carbon Projects: Prevailing Wage and Apprenticeship Requirements and Bonus Credits: Bonuses or Adders.

Foreign Entity of Concern (FEOC) Requirements

To claim a tax credit under Section 48E of the Code, the project must satisfy following foreign entity of concern requirements:

- If the project is placed in service after December 31, 2025, then the taxpayer claiming the credit cannot be a prohibited foreign entity (PFE) (as defined in Section 7701(a)(51)(A) of the Code). A PFE is either:
  - a specified foreign entity (as defined in Section 7701(a)(51)(B) of the Code); or
  - a foreign-influenced entity (as defined in Section 7701(a)(51)(D) of the Code, subject to a limited exception).
- If the storage project begins construction after December 31, 2025, then the construction of the project cannot have received any material assistance from a prohibited foreign entity (as defined in Section 7701(a)(52)(A) of the Code).

To determine whether a storage project has received material assistance from a prohibited foreign entity for any year for which the tax credit is being claimed, its "material assistance cost ratio" cannot exceed the cap for that year. The material assistance cost ratio is equal to:

The total direct costs for all manufactured products, *minus* the total direct costs for all manufactured products mined, produced, or manufactured by a prohibited foreign entity.

divided by

The total direct costs for all manufactured products.

A battery project is treated as receiving material assistance from a prohibited foreign entity if the percentage or ratio of non-PFE costs is less than:

- 55% for projects that begin construction in 2026.
- 60% for projects that begin construction in 2027.
- 65% for projects that begin construction in 2028.
- 70% for projects that begin construction in 2029,
- 75% for projects that begin construction after December 31, 2029.

For more information on these requirements, see Article, One Big Beautiful Bill: Changes to Clean Energy Tax Credits and Implications for Clean Energy Project Developers and Investors: Foreign Entity Restrictions.

Tax Equity Financing and Sales of Tax Credits

Most project sponsors monetize tax credits that are available to their storage projects by either:

- Entering into a traditional tax equity transaction (for example, a partnership-flip transaction).
- Transferring the tax credits to a third party pursuant to Section 6418 of the Code.

Battery storage projects are often financed in a portfolio along with other solar or wind energy generation projects.

Traditional Tax Equity Financing

In a traditional tax equity partnership-flip structure, a holding company (a partnership) owns the project company, which is treated as a disregarded entity for federal income tax purposes. The partnership is owned by:

- One or more passive investors that seek to claim the benefits of the ITC and other tax benefits, including depreciation of the project (the tax equity investor).
- An affiliate of a project sponsor or project developer.

The tax equity investor typically receives an agreed percentage of project cash flows and generally 99% of tax benefits, including the ITC, until the point at which the tax equity investor has received an agreed target return (the "flip date'). After the flip date, the cash distributions and allocations of tax items "flip," with the project sponsor receiving the majority of project cash flows and generally 95% of tax items. The project sponsor also has the right to purchase the tax equity investor's interest in the partnership. For more information on this structure, see Practice Note, Financing Clean Energy or Zero Carbon Projects: Tax Equity: Tax Equity Structure: Partnership Flip.

Tax equity investors generally require fixed price contracts that limit their exposure to market price volatility and revenue risk and create more certainty regarding whether project cash flows can meet a target rate of return by a target flip date. These financing requirements may drive developers of battery storage projects to enter into long-term capacity or tolling contracts or hedging agreements to establish a floor on project cash flows. Project sponsors often prefer tax equity structures because, among other things, all tax benefits available to the project company can be allocated to tax equity investors, usually at full value.

Sales of Tax Credits

Another option for project sponsors is to cause the owner of the project to sell the ITC (but not other tax benefits, such as depreciation) to an unrelated person pursuant to Section 6418 of the Code. Purchasers of tax credits pay a discount to the face value of the ITC that can be claimed on their tax return.

Sales of tax credits (rather than partnership-flip transactions) may be suitable for projects that do not have an offtake agreement that provides stable, contracted cash flows. Unlike tax equity investors, tax credit buyers without an ownership interest in the project do not rely on project cash flows in purchasing credits because their purchase generally only depends on availability of the ITC. Without the need to pursue fixed, long-term sources of revenue to satisfy tax equity investor underwriting requirements, project developers have more flexibility to pursue offtake structures that provide less predictable or stable streams of cash flow but that may increase overall returns for sponsors.

For more information, see Practice Notes, Financing Clean Energy or Zero Carbon Projects: Transferability and Direct Pay Provisions and Buying and Selling Clean Energy Tax Credits: Key Issues and Risk Mitigation Strategies.

Tax Equity Financing Structures for Storage Projects Paired with Wind or Solar Projects

Storage projects without significant contracted cash flows can also be financed along with other projects in a traditional partnership-flip transaction. For example, a partnership that owns a solar project with a power purchase agreement that provides substantial contracted cash flows, along with a storage project with relatively low contracted cash flows, could attract tax equity financing if the total contracted cash flows of the portfolio satisfy tax equity and lender underwriting requirements.

Solar and wind projects that begin construction after July 4, 2026 will not be eligible for the ITC unless they are placed in service by December 31, 2027. Once the ITC is no longer available for solar or wind projects, owners of solar or wind projects may seek to finance such projects in a portfolio that includes storage projects that remain eligible for this credit. In such a portfolio, the tax equity investor could receive an allocation of the aggregate tax benefits (i.e., the investment tax credit for the BESS plus depreciation and other tax benefits attributable to all projects in the portfolio), plus the aggregate net cash flow from the projects in the portfolio.