October 24, 2001

Sarah Hall Ingram, Esq.
Division Counsel
Associate Chief Counsel of Tax Exempt and
Government Entities
Internal Revenue Service
Attn: CC:TEGE
1111 Constitution Avenue, Room 5214
Washington, DC 20224

Re: Solid Waste Regulations Under Code Section 142

Dear Ms. Ingram:

On behalf of NABL's Task Force on Solid Waste Financing (the "Task Force") I am enclosing proposed regulatory language relating to the question of whether recycling facilities constitute solid waste disposal facilities for purposes of section 142(a)(6) of the Internal Revenue Code of 1986. This material is being submitted pursuant to your request that we supplement the regulatory proposal we provided as part of the Report on Solid Waste Regulations (the "Report") prepared by the Task Force and submitted to Treasury and the IRS on March 22, 2001.

The proposal we made in the Report was to modify section 1.103-8(f) of the Regulations to clarify that waste material would not be treated as having value if that value were attributable to its usefulness in a solid waste recycling process. That proposal was modeled on the recycling facility definition contained in section 1.48-9(g) of the Regulations relating to the energy tax credit. We continue to believe that our original proposed language would deal simply, effectively and appropriately with the inconsistencies and ambiguities that were described in the Report. For that reason, in responding to your request for further input we have prepared revised draft language that continues to follow the approach suggested in the Report, with additional language to address the concerns and questions expressed at our meeting last summer.

The changes and additions to our original proposal are described below:

1. The new language includes a detailed definition of the term "recycling." As in our original proposal the language and basic concept in this regard are similar to those contained in section 1.48-9(g) of the energy credit regulations. They are not identical, however, because some of the concepts addressed in section 1.48-9(g) are dealt with separately in other provisions of the exempt facility regulations (e.g., the functionally related and subordinate concept) or are based on specific statutory rules not applicable to the tax-exempt financing area.

2. We have included several examples to illustrate the rules set forth in the draft.

3. The specific legal issues addressed in the examples include two issues that were not specifically addressed in the Report: (i) the application of the allocation rule of section 17.1 of the Regulations in the context of recycling facilities, and (ii) the application of the value rules where a portion of the waste has a market value, but the rest must be disposed of as waste. In each case the example reaches the conclusion we believe is mandated under current law. However, because this draft is much more extensive than our original proposal we were concerned that a failure to address these issues could be viewed as having substantive significance.

4. As in the case of our original proposal we have structured the draft regulations as a modification to existing section 1.103-8(f) of the Regulations. We believe this is a simpler approach than trying to structure the regulation as a new section 142 regulation, although we believe a new section 142 regulation could be developed along the same lines if necessary.

We hope this material will be helpful. Of course, if you would like to discuss this draft, the Report or any other aspect of this issue we would be happy to do so at your convenience.

Sincerely,

Charles S. Henck
Chair
Task Force on Solid Waste Financing

Enclosure

cc: Rebecca Harrigal, Esq.
Bruce Serchuk, Esq.
Mark Scott, Esq.
Stephen Watson, Esq.

Suggested Regulatory Language – Revised

Section 1.

Treas. Reg. §1.103-8(f)(2)(ii)(*b*) is amended by inserting the following sentence before the sentence beginning "Section 203(4) of the Solid Waste Disposal Act provides . . .":

> For purposes of applying this subparagraph material that has a market or other value at the place it is located only by reason of its value for recycling is not considered to have a market or other value.

Treas. Reg. §1.103-8(f)(2)(ii) is amended by redesignating subparagraph (*d*) as subparagraph (*e*) and inserting the following new paragraph (*d*):

(*d*) *Recycling*. (1) *In general*. The term "recycling" means a solid waste disposal process whereby solid waste is converted to material that is not waste or is burned or otherwise processed to produce useful forms of energy. Recycling facilities include facilities used to sort or otherwise prepare, and recycle, solid waste ("recovery facilities") or to convert solid waste into steam or other useful forms of energy ("conversion facilities").

(2) Recovery facilities. Recovery facilities include facilities that --

(i) Separate solid waste into a mixture of waste,

(ii) Apply a thermal, mechanical, or chemical treatment to ensure the waste will properly respond to recycling, or

(iii)) Recycle solid waste to recover usable raw materials, but not beyond occurrence of the first of the following:

(A) The point at which a material has been created that can be used in beginning the fabrication of an end-product in the same way as materials from a virgin substance. Examples are the fiber stage in textile recycling, the newsprint or paper board stage in paper recycling, and the ingot stage for metals.

(B) The point at which the material is actually sold or used under § 17.1. For this purpose material is actually sold or used when it has been converted to a marketable product (*i.e.*, has value other than for recycling) even if the material is not marketed at that point.

(3) Conversion facilities. Conversion facilities include facilities that convert solid waste into fuel or other usable form of energy such as steam, electricity, or hot water. Examples include solid waste-fired boilers and solid waste gasification facilities.

Treas. Reg. §1.103-8(f)(2)(ii) is amended by adding at the end thereof the following new subparagraph (*f*):

(f) Examples. The principles of this paragraph (f)(2)(ii) and § 17.1 may be illustrated by the following examples:

Example (1).

Facts. Company proposes to build a new paper mill in County. When the mill is operational logs from nearby timber operations first will be processed through a machine which removes the bark. The stripped logs are then sent to a chipper and the chips are used to make paper stock. The bark from the bark removal process will fall onto a conveyor which takes it to a storage pile. A portion of the bark (up to 20%) can and will be sold to nearby landscaping operations and garden supply stores for use as mulch. The remainder of the bark will be fed into a boiler which provides process steam and steam for production of electricity. The bark to be burned in the boiler has no market or other value except for its value as input to the boiler. Company proposes to use the proceeds of bonds issued by County to finance eligible costs of solid waste disposal facilities to be constructed at the mill.

Analysis. The bark to be burned in the boiler is solid waste. The conveyor system, which is used for processing the bark, and the boiler and related facilities, which are used to convert the bark into steam, are conversion facilities and thus are solid waste disposal facilities. Before it has been removed and separated from the logs the bark is not a discarded material or material otherwise described in paragraph (f)(2)(ii)(*b*) and therefore is not solid waste. Thus, the facilities for removing the bark from the logs are not solid waste disposal facilities.

Example 2.

Facts. City operates a residential waste paper recycling program. City enters into a contract with Company, an integrated waste management company, under which Company will collect and recycle waste paper deposited at curbside under City's program. At the curbside the material has no market or other value except for its value as input to a recycling process. City will pay Company to use Company trucks and employees to collect the material at curbside. Company employees will then transport the waste to an integrated sorting and processing facility to be constructed and owned by Company. At the sorting and processing facility Company's employees will hand sort the collected material using a conveyor belt "picking line" to remove non-conforming material that is mixed in with the waste paper. The non-conforming material will be segregated and sent to a landfill. The waste paper will continue along the conveyor to a facility where it is repulped, cleaned and then fed into a paper machine that produces large rolls of paper toweling that are approximately 14 feet in length and 10 feet in diameter. In order to assure the quality of the paper toweling Company will add virgin pulp to the waste paper pulp entering the paper machine, with the resulting pulp blend being approximately 80% recycled material. The Company sells the large toweling rolls to converters who further process the toweling by taking it off the large rolls and producing individually wrapped consumer packages. The Company proposes to finance the sorting facility, the repulping and pulp cleaning facilities and the paper production facility with proceeds of bonds issued by City.

<u>Analysis</u>: The waste paper has no market or other value at the place it is located (*i.e.*, at the curbside), other than value it may have as input to a recycling facility. Accordingly, the waste paper collected at curbside is solid waste. Under paragraph (f)(2)(ii)(*d*)(*2*) the sorting facility, the repulping and pulp cleaning facilities and the paper machine are recovery facilities. Under §17.1 and paragraph (f)(2)(ii)(*e*) the waste disposal function includes the processing of the waste paper to the point where the material produced by the recycling process is actually sold or used; that is, the point where the large rolls of paper toweling are produced. Because at least 65% of the material entering the recycling process is solid waste the entire facility qualifies as a solid waste disposal facility.

Example 3.

<u>Facts</u>: The facts are the same as example 2 except that Company also operates a converting facility at the site that is used to prepare some of the toweling for retail sale under Company's brand name. It continues to sell some of the rolls to third party converters.

<u>Analysis</u>: The solid waste recycling process ends at the point the waste paper has been processed into a new marketable product. This occurs when the waste paper has been converted into the large rolls of toweling. Under paragraph (f)(2)(ii)(*d*)(2)(B) the converting facilities are not solid waste disposal facilities. The result would be the same if Company did not, in fact, sell any of the rolls to third party converters.

Example 4.

<u>Facts</u>: The facts are the same as example 2 except that City contracts for the collection and hauling services and the operation of the sorting facility with Service Co., which is not related to Company. After Service Co. completes the sorting operation it bales the waste paper and ships it to Company which will pay Service Co. a fixed amount per ton for supplying the waste paper. Company will recycle the waste in its repulping, pulp cleaning and papermaking operation.

<u>Analysis</u>: The Company's facility is a solid waste recycling facility. The fact that the entity performing the collection, transportation and sorting services is different from the entity carrying out the recycling does not affect the analysis of the Company's facility; nor does the fact that Service Co. makes a profit on the performance of the services. The baled waste paper has no value apart from its value as input to a recycling facility. Thus, under paragraph (f)(2)(ii)(*b*) the baled waste paper is solid waste when Company obtains it and the paper machine qualifies as recovery equipment.

Example 5.

<u>Facts</u>: The facts are the same as example 4, except that that there are a number of companies involved in collecting waste paper from households and businesses and preparing it for recycling by sorting and baling it. In addition, there are a number of companies involved in recycling wastepaper into new toweling or other paper products. As a matter of industry practice the recyclers (including Company) generally do not

operate their own sorting and baling facilities or enter into long-term contracts with the collector/sorters for the provision of waste paper. Instead, they rely on the general availability of this material from the various potential suppliers. The recyclers generally pay the collector/sorters for providing the waste, and in some cases the collector/sorters make payments to businesses that gather the waste or to individuals who deliver their waste paper to centralized collection points. The amounts charged for the provision of services involved in collecting, sorting and baling the waste (*i.e.*, the "price" of the waste) are published in industry publications. In addition, these payments are expected to be sufficient to result in a profit to the collector/sorters.

<u>Analysis</u>. The waste paper is discarded material having no value at the point of its generation (e.g., at the location of the consumer). Any value that such material may have at any point prior to the completion of the recycling process, as evidenced by payments made by the recyclers, is attributable solely to its value as input to a recycling facility. Thus, the waste paper entering the Company's recycling facility is solid waste and the recycling facility is a solid waste disposal facility up to the point that the recycling process is complete.

Example 6.

<u>Facts</u>: Company operates an industrial plant in County. Production operations at the plant result in the generation of a waste byproduct. The solid waste, which has no market or other value, is a precipitate from production operations that is collected in water to form a sludge. For many years Company disposed of the waste sludge in a landfill, but that method of disposal has become prohibitively expensive. Company now proposes to construct facilities that will recycle the waste byproduct into commercially marketable products and to finance construction of the facilities with the proceeds of bonds issued by County. The recycling process will be a two-step operation. The first step dewaters the waste so that it can be introduced into the recycling facility. The second step converts the dewatered waste byproduct into a new product that will be sold to wholesalers and retailers. The waste byproduct constitutes at least 65% of the material processed in the facility.

<u>Analysis</u>: The waste byproduct has no market or other value at the point it is removed from the production process and therefore is solid waste. Because at least 65% of the material entering the facility is solid waste the facility qualifies as a solid waste disposal facility to the point where the waste byproduct has been converted to a marketable product.

Example 7.

<u>Facts</u>: The facts are the same as in example 6, except that the dewatered solid waste introduced into the recycling process will constitute only 50% of the material entering the recycling process. Company proposes to finance 50% of the cost of the facility with proceeds of bonds issued by County.

<u>Analysis</u>: Because the amount of waste introduced into the recycling facility is less than 65% the facility is not a recycling facility described in paragraph (2)(ii)(*c*). However, the facility does have a solid waste disposal function (recycling the solid waste byproduct) and a function other than the disposal of solid waste. Under § 17.1 the Company may reasonably allocate 50% of the cost of the facility to the solid waste disposal function.

Example 8.

Facts: The facts are the same as Example 6 except that Company contracts with Processor, an unrelated third party, to build and operate the facility that will carry out the second stage of the recycling operation and sell the resulting marketable products. The contract calls for Processor to make a payment to Company to partially offset the cost of the first step of the recycling process.

Analysis: The qualifying scope of the recycling facility is the same as in Example 6.

Example 9.

Facts: The facts are the same as Example 6 except that as of the issue date of the bonds there is a limited market for the waste byproduct, and Company is able to sell 50% of the material to users in County for use in agricultural operations. Such users are willing to pay Company $2 per ton for the material at the plant site. The Company must either dispose of the remainder of the material in a landfill or pay $10 per ton to ship the remainder of the material to another state where it is able to sell the byproduct for $2 per ton. In order to reduce its disposal costs Company proposes to use the recycling facility only to recycle the material it otherwise would be required to ship to another state or dispose of in a landfill. It will continue to sell the byproduct material in amounts sufficient to satisfy the existing local demand.

Analysis: The byproduct material that cannot be sold at the plant site has no market or other value at the place it is located, and thus is a solid waste under paragraph (f)(2)(ii)(*b*). Accordingly the facility is a solid waste recycling facility.

Section 2

Treas. Reg. §1.103-8(f)(2)(ii) is amended by adding at the end thereof the following new subparagraph (*g*):

> If a facility is financed with more than one issue of bonds (including refunding bonds), the determination as to whether a material is solid waste shall be made as of the date of issue of the first issue of obligations expected to finance qualifying costs of the facility in an amount that exceeds the greater of $50,000 or 5% of the total estimated qualifying cost of the facility.

Section 3. Effective date provision:

(a) In general.

The amendments made by sections 1 and 2 apply to bonds issued on or after [EFFECTIVE DATE].

(b) Elective retroactive application.

An issuer may apply the provisions of § 1.103-8(f)(2)(ii), as amended, to any issue outstanding on [EFFECTIVE DATE].