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Tax Exempt Financing of Solid Waste Disposal Facilities

On September 16, 2009 the Internal Revenue Service (IRS) published notice in the Federal Register of proposed regulations (the proposed regulations) defining the term "solid waste disposal facility" for tax-exempt bond purposes. The proposed regulations provide guidance as to what constitutes a solid waste disposal facility (an exempt facility) and thus eligible to be financed with tax exempt bonds under Section 142 (a) of the Internal Revenue Code. In that notice the IRS also withdrew its prior proposed regulations in this area published in 2004.

The proposed regulations, in a significant change in approach from the withdrawn 2004 regulations, generally encourage the use of solid waste disposal financing. For example, the preamble to the proposed regulations states that the definition of used material is to "be interpreted broadly" and that the definition of residual material "is intended to further encourage innovation in the full use of all resources."

As described in further detail below, the proposed regulations:

- Eliminate the "no value test" from the definition of solid waste.
- Expressly exclude radioactive materials from qualifying as solid waste.
- Add definitions of final disposal process, energy

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conversion process and recycling process.

- Retain the special rule allowing 100 percent of the costs of a mixed-input facility to be financed as a solid waste disposal facility if at least 65 percent of the materials processed are solid waste.

Before the proposed regulations are adopted as final, public comments may be submitted to the IRS by December 15, 2009. A public hearing has been scheduled for January 5, 2010.

In general, the proposed regulations will apply to bonds that are sold on or after the date that is 60 days after publication of final regulations in the Federal Register, although depending on the circumstances, issuers may be able to apply the proposed regulations prior to their effective date.

Our Alert highlights certain provisions of the proposed regulations.

What Is a Solid Waste Disposal Facility?

A solid waste disposal facility means a facility that:

- Processes solid waste in a qualified solid waste disposal process;
- Performs a preliminary function; or
- Is functionally related and subordinate to either of the above functions.

What Is Solid Waste?

It is important to note that the proposed regulations eliminate the "No Value Test," the IRS determined that such a test is unadministrable and that the definition of solid waste needs to take into account both the material itself as well as the process by which such material is to be disposed of or recycled.

Solid waste is garbage, refuse and other solid material derived from any agricultural, commercial, consumer or industrial operation or activity if it is both:

1. Used material ¹ or residual material ², and
2. Reasonably expected to be introduced into a qualified solid waste disposal process within a reasonable time after such purchase or acquisition.

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Specifically excluded from the definition of solid waste are: virgin material (except to the extent that it is a residual material), solids within liquids and liquid waste, precious metals, hazardous material and radioactive material.

The proposed regulations state that this definition of solid waste is intended to encompass a wide range of products from waste coal to byproducts of typical agricultural operations, and is intended to further encourage innovation in the full use of all resources.

What Is a Qualified Solid Waste Disposal Process?

A qualified solid waste disposal process may employ any biological, engineering, industrial or technological method. The proposed regulations provide for three eligible types of solid waste disposal processes including a final disposal process, an energy conversion process and a recycling process.

1. **Final Disposal Process** – Either the placement of solid waste in a landfill, the incineration of solid waste without capturing any useful energy, or the containment of solid waste with a reasonable expectation that the containment will continue indefinitely and that the solid waste has no current or future beneficial use.
2. **Energy Conversion Process** – A thermal, chemical or other process that is applied to solid waste to create and capture synthesis gas, heat, hot water, steam or other useful energy. The energy conversion process begins at the point of the first application of such process. The energy conversion process ends at the point at which the useful energy is first created or captured in the form of a first useful product, provided that, in all events, the energy conversion process ends before any transfer or distribution of synthesis gas, heat, hot water, steam or other useful energy.
3. **Recycling Process** – A process reconstituting, transforming or otherwise processing solid waste into a useful product. The recycling process begins at the point of the first application of a process to reconstitute or transform the solid waste into a useful product, such as decontamination, melting, re-pulping, shredding or other processing of the solid waste to accomplish this purpose. The recycling process ends at the point of completion of production of the first useful product³ from the solid waste. The term "recycling process" does not include

refurbishment, repair or similar activities.

What Is a Preliminary Function?

The proposed regulations define a preliminary function as a function to collect, separate, sort, store, treat, process, disassemble or handle solid waste that is preliminary to and directly related to a qualified solid waste disposal process. A function qualifies as a preliminary function only if more than 50 percent of the total materials that result from the function are solid waste in each year that the issue is outstanding.

Considerations for Mixed-Use Facilities

In general, if a facility is used for both a qualified solid waste disposal function (including a qualified solid waste disposal process or a preliminary function) and a nonqualified function, then the costs of the facility allocable to the qualified solid waste disposal function are determined using any reasonable method, based on all the facts and circumstances, using existing allocation rules for determining amounts properly allocable to an exempt facility.

Except as provided in the paragraph below, for each qualified solid waste disposal process, the percentage of the costs of the property used for such process that are allocable to a qualified solid waste disposal process equals the average annual percentage of solid waste processed in that process while the issue is outstanding. The average percentage of solid waste processed in such process for any year is the average percentage, by weight or volume, of the total materials processed in that process that constitute solid waste for that year.

There is a special rule for mixed-input processes if at least 65 percent of the materials processed are solid waste. For each qualified solid waste disposal process, if the annual percentage of solid waste used in that process for each year that the issue is outstanding equals at least 65 percent of the materials used in that process, then all of the costs of the property used for such process are treated as allocable to a qualified solid waste disposal process. The percentage of solid waste used in such process for any year is the percentage, by weight or volume, of the total materials used in that process that constitute solid waste for that year.

Examples

The IRS provided a number of examples to illustrate the application of these proposed regulations including residual material from oil refining, waste coal, tire

recycling, paper recycling, energy conversion, mixed-input facilities, mixed-function facilities and landfills. The full text of the proposed regulations including the IRS' examples, is [available here](#). For further information relating to the proposed regulations, please contact your principal Squire Sanders lawyer.

¹ "Used material" means any material that has been used previously as an agricultural, commercial, consumer or industrial product or as a component of any such product.

² "Residual material" means any residual byproduct or excess unused raw material that remains from the production of any agricultural, commercial, consumer or industrial product, provided that material qualifies as residual material only to the extent that it constitutes less than 5 percent of the total material introduced into the production process and it has a fair market value that is reasonably expected to be lower than that of any product made in that production process.

³ "First useful product" means the first product produced from solid waste that is useful for consumption in agricultural, consumer, commercial or industrial operation or activity and that could be sold for such use, whether or not actually sold. In the case of a continuous or integrated production process, the determination of when a useful product may result from such an integrated process may take into account operational constraints that affect the point in production when a useful product reasonably can be extracted and isolated and sold independently.

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