

Client Alert

Public Finance Practice Group

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Solid Waste Disposal Facilities Regulations

1. Overview

The Internal Revenue Service recently released final regulations for determining whether a facility is a solid waste disposal facility under section 142(a)(6) of the Internal Revenue Code. When fully effective, the regulations will replace existing regulations that date back to 1972. The publication of the new rules brings to a close a decade-long process that began in large part as a result of controversy relating to audits of bonds issued to finance solid waste disposal facilities, particularly bonds issued to finance recycling facilities. The regulations explicitly state that they are implementing “a policy in favor of recycling through the use of solid waste disposal facilities.”

2. Definition of Solid Waste Disposal Facility

A “solid waste disposal facility” is a facility that processes solid waste in a qualified solid waste disposal process, performs a preliminary function, or is a functionally related and subordinate facility. A “preliminary function” is 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. The inclusion of this concept addresses concerns that the process of collecting and sorting solid waste might cause it to become a material that is not waste.

3. Definition of Solid Waste

a) General

“Solid waste” means garbage, refuse, and other solid material derived from any agricultural, commercial, consumer, governmental, or industrial operation or activity if the material is either “used material” or “residual material.” Material is solid only if it is solid at ambient temperature and pressure. The definition of solid waste no longer includes the controversial “no value” test, which provided that material is not solid waste if it has any market or other value on the date the bonds were issued. This new definition of solid waste reflects two helpful changes. First, the reference to governmental operations was added. Second, the ambient temperature and pressure language was added for purposes of determining whether material is solid.

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Client Alert

Public Finance Practice Group

b) Used Material

“Used material” is any material that has been used previously as an agricultural, commercial, consumer, governmental, or industrial product, or a component of any such product. Used material also includes animal wastes.

c) Residual Material

“Residual material” is any residual byproduct or excess unused raw material that results from or remains after completion of any agricultural, commercial, consumer, governmental or industrial production process or activity or from the provision of any service. In the case of an integrated manufacturing or industrial process consisting of multiple processes, the material must result from or remain after the completion of the entire integrated process. As of the bond issuance date, the material must have a fair market value that is reasonably expected to be lower than the value of all of the products made in the production process, or lower than the value of the service that produces such residual material. Note that this language eliminates a proposal that residual material could not exceed 5% of the material entering the production process.

The definitions of both “used material” and “residual material” now include a reference to government activities, in response to comments that the absence of such a reference might suggest that wastes generated as a result of government operations (*e.g.*, debris from road maintenance) were not intended to be included in the definition of solid waste.

The language relating to integrated facilities may prove troublesome. Rather than allowing the determination of whether a material is residual material to be made separately for each process, the definition of residual material covers “only residual material that remains at the end of the integrated processes that are fundamentally interconnected or interdependent, based on all the facts and circumstances.”

d) Introduction to a Qualified Solid Waste Process

Material is not used material or residual material unless the person who generates, purchases or otherwise acquires the material reasonably expects the material to be introduced into a qualified solid waste disposal process within a reasonable time after its production, acquisition, or purchase.

e) Exclusions from Solid Waste

The definition of solid waste specifically excludes (1) virgin material, (2) solid or dissolved material in domestic sewage or other significant pollutant in water resources, (3) certain specified precious metals, (4) hazardous material, and (5) radioactive material.

Client Alert

Public Finance Practice Group

4. Qualified Solid Waste Disposal Process

a) General

The regulations designate three types of solid waste disposal processes: (1) a final disposal process (such as a landfill, incineration, containment), (2) an energy conversion process (for example, a waste-to-energy facility), and (3) a recycling process (such as a waste paper recycling facility).

b) First Useful Product

The regulations provide guidance, including some helpful examples, for determining the “first useful product” of a recycling process for purposes of establishing the end point of that process. A useful product includes a product useful for consumption either as an ultimate end-use product or as an input to some stage of a manufacturing or production process, and that could be sold for such use, whether or not actually sold. The regulations make clear that geographic location and certain operational and cost factors may be taken into account for purposes of determining whether a useful product has been produced.

c) Mixed-use Facilities

i) General

The regulations have rules for assessing the qualified cost of mixed use facilities; that is, facilities that perform both a qualified solid waste disposal function and some other non-qualified process. Mixed use facilities could be facilities used to dispose of both solid waste material and other material, or could be recycling or energy conversion facilities that require both waste material and virgin material to produce a usable product or usable energy. In either case, the regulations follow the existing approach of allocating the costs of the facility between the qualifying and non-qualifying functions on a basis that “reasonably reflects” a separation of the costs of the two functions (*e.g.*, on the basis of the percentage of solid waste processed in the facility), although the basis for the allocation is spelled out more directly.

ii) 65 Percent Test

Many recycling facilities and waste-to-energy facilities require a mixed input (*i.e.*, both waste and non-waste input) in order to operate efficiently or on an economically viable basis. Under the general rule described above, the introduction of non-waste material into the process would require an allocation to determine the qualifying cost of the facility. The existing rules have long provided that no such allocation was required if at least 65% of the input to a recycling facility, determined on either a weight or volume basis, consisted of solid waste. The regulations retain this 65% rule, and also address certain other areas of uncertainty. First, the regulations provided specifically that the test is to be applied on an annual basis, with failure in any year to be treated as a disqualifying change in use requiring remediation. In response to concerns about the harshness of this one-year rule, they provide a method for curing a shortfall in any year by taking into account the excess waste (*i.e.*, the amounts in excess of 65%) introduced into the facility in the next two years. Additionally, the annual testing period does not commence until the facility is through its ramp up period; that is, it is in operation at substantially the level for which it was designed. Second, they clarified that the 65% rule provided a way to avoid an allocation under the mixed use rule, but that absent meeting this benchmark the facility could be financed in

Client Alert

Public Finance Practice Group

part under the mixed input standard. Finally, the regulations made the 65% rule applicable to solid waste disposal facilities in general, not just recycling facilities.

5. Transition Rule and Effective Date

The regulations apply to private activity bonds that are sold on or after October 18, 2011, the date 60 days after the date of publication of the regulations in the Federal Register (August 18, 2011). The regulations provide a transition rule that permits current refundings of bonds that are subject to section 142 of the Code but are sold before the effective date of the regulations.

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