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INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

District Director

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's EIN:

Conference of right held:

LEGEND:

City =

Authority =

Operator =

State =

Parent =

Amount One =

Amount Two =

Amount Three =

Amount Four =

Amount Five =

Series A Revenue Bonds =

Series A G.O. Bonds =

Series B Revenue Bonds =

Series C Revenue Bonds =

Series C G.O. Bonds =

Area One =

Area Two =

W =

X =

Y =

Z =

Date One =

Date Two =

Date Three =

Date Four =

Date Five =

Date Six =

Date Seven =

Date Eight =

Date Nine =

ISSUE

Whether the permanent bonds issued by City to fund the construction by Operator of a facility (the "Facility") to recycle into qualify as exempt facility bonds under § 142(a) of the Internal Revenue Code.

CONCLUSION

The permanent bonds issued by City to fund the construction by Operator of Facility do not qualify as exempt facility bonds under § 142(a).

FACTS

This transaction involves the following parties: (1) City; (2) Authority; and (3) Operator, a corporation under State law and a wholly owned subsidiary of Parent.

On Date One the City entered into a non-recourse loan agreement with the Authority in which the City agreed to issue revenue and general obligation tax increment bonds and loan the proceeds thereof to the Authority to finance the construction of a facility for the recycling of into .

Simultaneously, the City and Authority entered into a lease agreement, with an option to purchase, with Operator under which Operator was granted the right to possess and use the Facility. In return, Operator agreed to construct the Facility on land that the City had deeded to the Authority. The lease agreement provided that the Authority would loan the bond proceeds to Operator for payment or reimbursement of Facility construction costs. Operator agreed to make lease payments in an amount sufficient to pay all principal, interest and premium due at redemption or maturity of any bonds used to finance the Facility. Furthermore, Operator agreed to pay all taxes due, including any special assessment taxes. The lease agreement also served as a security agreement under which Operator pledged all project equipment, contract rights and certain secured sums as security for all lease payments.

Also on Date One, in a separate mortgage and security agreement, the Authority granted the City a mortgage in the Authority's land, a security interest in the Facility's buildings, machinery and equipment and assigned all leases, profits and rents of the Facility to the City. The Authority, in a separate document, also pledged to the City all Facility related tax increments as security for the general obligation bonds.

Also on Date One, the City, the Authority and Parent entered into a guaranty as to completion of the debt service for the Facility. The guaranty sets forth a financing plan in which the City would presently issue temporary bonds with the intention of refunding the temporary bonds with permanent bonds at a later date.

Operator entered into a contract with a builder on Date One to construct the Facility.

On Date Two the City issued temporary solid waste facility revenue bonds, the Series A Revenue Bonds, and temporary solid

waste facility general obligation bonds, the Series A G.O. Bonds, in the amounts of Amount One and Amount Two, respectively (collectively the "Series A temporary bonds"). The Series A temporary bonds had a stated maturity date of Date Eight. The City timely filed a Form 8038 which identified the Series A temporary bonds as solid waste disposal bonds pursuant to § 142(a)(6) of the Internal Revenue Code.

At the time of issue of the Series A temporary bonds, Operator and the builder were in the process of finalizing the design of the Facility. Construction of the Facility began on Date Four.

On Date Three the City, Authority, Operator and Parent amended the bond transcripts, lease agreement and related documents in anticipation of issuing additional temporary bonds. Under the amended security agreements, all Facility assets were cross-collateralized to secure the Series A temporary bonds and the additional temporary bonds. On Date Five the City issued temporary solid waste disposal facility revenue bonds, the Series B Revenue Bonds, in the amount of Amount Three (the "Series B temporary bonds"). The Series B temporary bonds had a stated maturity of Date Eight. The City timely filed a Form 8038 which identified the Series B temporary bonds as solid waste disposal bonds pursuant to § 142(a)(6).

On Date Six the City, Authority, Operator and Parent amended the bond transcripts, lease agreement and related documents in anticipation of issuing permanent bonds. On Date Seven the City issued solid waste disposal facility revenue refunding bonds, the Series C Revenue Bonds, and solid waste disposal facility general obligation tax increment revenue refunding bonds, the Series C G.O. Bonds, in the amounts of Amount Four and Amount Five, respectively (collectively the "permanent bonds"), to refund the Series A temporary bonds and Series B temporary bonds. The City timely filed a Form 8038 which identified the permanent bonds as solid waste disposal bonds pursuant to § 142(a)(6). The Series A temporary bonds and Series B temporary bonds were defeased on or before Date Eight. The Facility was placed in service on Date Nine.

is generated as a byproduct of the operations and activities of commercial, industrial, and residential entities ("generators"). Traditionally, this has been intermixed with discarded material and either placed in a landfill or incinerated. With the advent of recycling technologies, however, increasingly is being separated from waste material and recovered. Generally, the separation and sorting is done by generators or by commercial waste collectors ("collectors"). One

or the other of these parties often bales the separated to facilitate handling. The is transported by the collector to either an end-user (like Facility), a consolidator, or to a landfill or incinerator. Consolidators gather and further process for resale to end-users. Transfers of between generators, collectors or consolidators and end-users may in some cases be facilitated for an additional fee by a broker.

The prices (positive or negative) at which baled changes hands in different regions is tracked by various national publications. The price paid at the generator's dock is listed in "Board Converting News" (also known as the "White Sheet"), while the price paid by end-users at the broker's dock is published in "Official Board Markets" (also known as the "Yellow Sheet"). A third publication, "Recycling Times," reports prices paid to various sources by end-users.

The "White Sheet" price listed for baled in Area One on the date of issue of the Series A temporary bonds is W, and on the date of issue of the Series B temporary bonds is X. The "Yellow Sheet" price for baled in Area Two on the date of issue of the Series A temporary bonds is Y, and on the date of issue of the Series B temporary bonds is Z. While the exact price published in the "Recycling Times" for these dates could not be established on the basis of the submission, these prices were positive amounts for both dates. The prices at which is sold generally vary as a function of the current market price of the products of recycling.

Operator has always acquired all of its from collectors, consolidators, and brokers, paying spot market prices for the material.

LAW AND ANALYSIS

Generally, interest on a private activity bond is not excludable from gross income under § 103(a) of the Code unless the bond is a qualified bond. Section 141(e)(1)(A) provides that a qualified bond includes any private activity bond that is an "exempt facility bond." Section 142(a) provides that the term "exempt facility bond" means any bond issued as part of an issue 95 percent or more of the net proceeds of which are used to provide certain exempt facilities. Section 142(a)(6) describes "solid waste disposal facilities" as exempt facilities.

The above statutory scheme was enacted by the Tax Reform Act of 1986. See sections 1301 et seq. of Pub L. No. 99-514, 1986-3 C.B. (Vol. 1) 519-527. The legislative history accompanying the 1986 Act imports the definitions of the terms "solid waste" and

"solid waste disposal facility" from the regulations promulgated under the predecessor Code provision (§ 103(b)(4)(E)). The House Report incorporated all of the present law to the extent not amended and the present law characterization of "solid waste disposal facilities" expressly referred to the regulatory rules found in § 1.103-8(f)(2)(ii). H.R. Rep No. 426, 99th Cong., 1st Sess. 497, 518 (1985), 1986-3 C.B. (Vol. 2) 497, 518. The Conference Report stated that "solid waste disposal facilities" is defined, with exceptions not relevant to the present inquiry, as under present law. H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-704 (1986), 1986-3 C.B. (Vol. 4) 704.

Generally, § 1.103-8(f)(2)(ii)(a) of the regulations defines the term "solid waste disposal facilities" as meaning any property or portion thereof used for the collection, storage, treatment, utilization, processing, or final disposal of solid waste. Section 1.103-8(f)(2)(ii)(b) provides that:

[T]he term "solid waste" shall have the same meaning as in section 203(4) of the Solid Waste Disposal Act (42 U.S.C. § 3252(4)), except that for purposes of this paragraph, material will not qualify as solid waste unless, on the date of issue of the obligations issued to provide the facility to dispose of such waste material, it is property which is useless, unused, unwanted, or discarded solid material, which has no market value at the place where it is located. Thus, where any person is willing to purchase such property at any price, such material is not waste. Where any person is willing to remove such property at his own expense but is not willing to purchase such property at any price, such material is waste. Section 203(4) of the Solid Waste Disposal Act provides that:

The term 'solid waste' means garbage, refuse, and other discarded solid materials, including solid-waste materials resulting from industrial, commercial, and agricultural operations, and from community activities, but does not include solids or dissolved material in domestic sewage or other significant pollutants in water resources, such as silt, dissolved or suspended solids in industrial waste water effluents,

dissolved materials in irrigation return flows or other common water pollutants.

Relevant Date(s)

To determine whether material is waste, § 1.103-8(f)(2)(b) of the regulations requires the material to be valueless on the date of issue of the bonds issued to provide the facility to dispose of the material. Thus, it must be determined which of the three dates on which bonds were issued by City are relevant for this requirement.

Section 1.150-1 of the regulations provides that issue date means:

[I]n reference to an issue, the first date on which the issuer receives the purchase price in exchange for delivery of the evidence of indebtedness representing any bond included in the issue. Issue date means, in reference to a bond, the date on which the issuer receives the purchase price in exchange for that bond. In no event is the issue date earlier than the first day on which interest begins to accrue on the bond or bonds for Federal income tax purposes.

Section 1.103-7(d) of the regulations provides that:

[I]n the case of an issue of obligations issued to refund the outstanding face amount of an issue of obligations, the proceeds of the refunding issue will be considered to be used for the purposes for which the proceeds of the issue to be refunded were used. The rules of this subparagraph shall apply regardless of the date of issuance of the issue to be refunded and shall apply to refunding issues to be issued to refund prior refunding issues.

Pursuant to § 1.150-1(d)(1) of the regulations the term "refunding issue" means an issue of obligations the proceeds of which are used to pay principal, interest, or redemption price of another issue, including the issuance costs, accrued interest, capitalized interest on the refunding issue, a reserve or replacement fund, or similar costs, if any, properly allocable to that refunding issue. Section 1.150-1(d)(3) provides that a

current refunding issue means a refunding issue that is issued not more than 90 days before the last expenditure of any proceeds of the refunding issue for the payment of principal or interest on the prior issue.

Based on the known facts in this transaction, the relevant dates of issue for purposes of § 1.103-8(f)(2)(ii)(b) of the regulations are the dates of issue for the Series A temporary bonds and Series B temporary bonds, which are Date Two and Date Five, respectively. The best interpretation of the bond transcript and related documents is that, as of the issue date of each issue of bonds, the City intended to expend 95% of the bond proceeds on the Facility as required by § 142(a) and § 1.103-8(f)(1). No facts indicate that the bonds are hedge bonds under § 149.

Moreover, the Series A temporary bonds and Series B temporary bonds were not issued on a contingent basis. As documented in the lease and loan agreements, the City had agreed, on or before the issue date of the temporary bonds, to loan the bond proceeds to the Authority for use in financing the construction of the Facility. Likewise, the Authority had also agreed to loan the bond proceeds to Operator for use in financing the construction of the Facility. No facts indicate that the temporary bonds were anything but valid, short-term obligations issued by the City the interest from which was purportedly excludable from income under § 103.

Pursuant to § 1.103-7(d) of the regulations, the date of issue of the permanent bonds is not the relevant "date of issue of the obligations" for purposes of § 1.103-8(f)(2)(ii)(b) because the permanent bonds were used to currently refund the Series A temporary bonds and the Series B temporary bonds and did not provide any new construction funds for the Facility.

Since the Series A temporary bonds and the Series B temporary bonds are separate new money issues, each issue must individually meet § 141(e) to be considered an issue of qualified private activity bonds. Also, all bond proceeds are subject to the arbitrage rules of § 148 prior to expenditure by Operator.

The proper "date of issue of the obligations" refers to the dates of issue of all new money bonds issued to finance the construction of the Facility. Accordingly, for this transaction, there are two relevant dates of issue for purposes of § 1.103-8(f)(2)(ii)(b) of the regulations: Date Two and Date Five.

Do the Bonds Qualify as Exempt Facility Bonds?

As stated above, material is not waste for purposes of § 1.103-8(f)(2)(ii)(b) unless, on the relevant date(s) of issue, it is property which is useless, unused, unwanted, or discarded solid material, which has no market value at the place where it is located. Where any person is willing to purchase the property at any price, the material is not waste. Where any person is willing to remove the property at his own expense but is not willing to purchase the property at any price, the material is waste.

Section 17.1 of the temporary regulations provides that a facility which otherwise qualifies as a solid waste disposal facility will not be treated as having a function other than solid waste disposal merely because material which has utility or value is recovered or results from the disposal process. Where materials are recovered, the waste disposal function includes the processing of such materials which occurs in order to put them into the form in which the materials are in fact sold or used, but does not include further processing which converts the materials into other products. An example in the regulation describes a situation in which a taxpayer proposes to build a facility that will separate metals, glass, and similar materials from discarded waste. As separated, some of such materials are commercially saleable, but the taxpayer does not intend to sell the metals and glass until the metals are further separated, sorted, sized and cleaned and the glass is pulverized. The example states that the waste disposal function includes such processing of the metals and glass, but no further processing is included.

Rev.Rul. 76-222, 1976-1 C.B. 26, involves the proposed issuance of solid waste disposal bonds to finance construction of and acquisition of a facility designed to separate garbage into combustible and noncombustible fractions. The garbage will be collected by independent collectors and dumped at collection stations operated by the operator of the facility. The operator pays nothing for the material, and the ruling cites as a fact that the garbage is useless, unwanted material for which no person would pay any amount. The combustible fraction is fed directly from the operator's classifiers to a surge bin from which it is blown into the boilers of the purchaser, a public utility. The ruling concludes that the operator's waste disposal function includes the processing of the waste into the form that is subsequently sold, but does not include further processing because once the material is in the form in which it can be sold, it is no longer useless and unwanted.

Rev. Rul. 75-184, 1975-1 C.B. 41, involves an recycler that prior to issuance of bonds entered into a long-term contract with a waste collector to purchase at a set price that has been separated from the refuse stream, sorted, baled and loaded for transportation. The revenue ruling states that since the containers will have value at the waste collector's location and the recycler is willing to purchase the property at a stated price, the material will not qualify as solid waste under § 1.103-8(f)(2)(ii)(b). The revenue ruling is consistent with the underlying PLR 7405290400A, in which the taxpayer's facility would not dispose of "solid waste" because the collector charged the end-user an amount for separating from the waste stream and sorting the (designated as "cost to seller") in addition to transportation and handling expenses (designated as "processing charge").

In the present case, Operator has always purchased its in a form (separated, sorted, and baled) that is sold on an open market. On the dates of issue of the Series A temporary bonds and the Series B temporary bonds, in the area where Operator obtains its , persons were willing to purchase at a price at the locations at which Operator customarily acquires its . Consequently, on the date of issue of the Series A temporary bonds and the Series B temporary bonds, did not qualify as solid waste for purposes of § 1.103-8(f)(2)(ii)(b) in the area in which Operator purchases its . As a result, the Series A temporary bonds and the Series B temporary bonds issued to fund a facility for the disposal of the fail to meet the requirement under § 142(a)(6) that 95 percent or more of the net proceeds thereof are to be used to provide solid waste disposal facilities and will not be treated as having been issued to provide an exempt facility. Accordingly, under § 1.103-7(d) the permanent bonds also will fail to meet the requirements of § 142(a)(6) and will not be treated as having been issued to provide an exempt facility.

The taxpayers urge the Service to equate the phrase "at the place where it is located" with the generator's dock in all circumstances. Under this interpretation, if the material is valueless prior to any processing, none of the value added to the material as a result of further processing (e.g., separation and baling) may be considered for purposes of determining whether the material is waste under § 1.103-8(f)(2)(ii)(b) even if an amount is charged for the material after such processing.

Operator has always purchased its from various entities, including collectors, consolidators, and brokers, on the spot market after the has been separated, sorted, and baled. Accordingly, it is at this point of purchase that the regulatory

definition of solid waste must be applied. Moreover, even if the taxpayer's argument of measuring value at the generator's dock in all circumstances is applied, the "White Sheet" publication shows as having value at the generator's dock on the date of issue of the Series B temporary bonds. Accordingly, would not qualify as solid waste on the date of issue of the Series B temporary bonds even if valued solely at the generator's dock. Under the facts in this case, because the proceeds of the Series B temporary bonds are in excess of five percent of the proceeds of the permanent bonds, disqualification of only the Series B temporary bonds would cause the permanent bonds to fail to meet the 95-percent requirement of section 142(a)(6) and thus not be treated as having been issued to provide an exempt facility.

CONCLUSION

The permanent bonds issued by City to fund the construction by Operator of Facility do not qualify as exempt facility bonds under § 142(a).

A copy of this technical advice memorandum is to be given to the taxpayer. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.