

INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

March 15, 2010

Third Party Communication: None
Date of Communication: Not Applicable

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CASE-MIS No.: TAM-141891-09

Director

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's Identification No
Year(s) Involved:
Date of Conference:

LEGEND:

Issuer

State

Company

Bonds

Municipality

Date 1

Date 2

a

b

ISSUE:

Whether the Facility (as described below), or any portion thereof, constitutes a sewage facility within the meaning of § 142(a)(5) of the Internal Revenue Code and § 1.142(a)(5)-1 of the Income Tax Regulations.

CONCLUSION:

The Facility is a sewage facility under § 142(a)(5) because it consists of (a) property used for the collection, storage, and processing of wastewater, which property is necessary for secondary treatment under § 1.142(a)(5)-1(b)(1)(iv)(A), and (b) property that is functionally related and subordinate to such property under § 1.142(a)(5)-1(b)(1)(vi).

FACTS:

Issuer is a public instrumentality and body corporate and politic of State. Issuer was created pursuant to state law to provide financing for qualifying projects (including, without limitation, industrial facilities, commercial facilities, pollution control facilities, and public facilities) located in State.

On Date 1, Company and Issuer entered into an agreement (Agreement) whereby Issuer would issue Bonds and loan the proceeds to Company to finance the construction and acquisition of the Facility. On Date 2, Issuer issued Bonds to finance the Facility as a sewage facility within the meaning of § 142(a)(5) and § 1.142(a)(5)-1(b). Bonds are payable from and secured by loan payments to be made by Company to Issuer under the Agreement.

Company is a pharmaceutical company that discovers, develops, manufactures, and markets a range of products used to improve human and animal health. Company owns and operates a research and manufacturing facility (Plant) in State. The Plant generates wastewater that contains organic pollutants having a raw biochemical oxygen demand of less than 350 milligrams per liter. This wastewater is discharged to Municipality's publicly owned treatment works (POTW) under a permit (Permit) issued by the POTW to Company. The POTW performs secondary treatment of wastewater from the Plant and from other sources. The POTW is located approximately a miles away from the Plant.

Using Bond proceeds, Company financed the construction of a wastewater equalization and neutralization facility (Facility) located adjacent to the Plant and owned and

operated by Company. The Facility is comprised of equalization tanks, a concrete containment dike, piping and associated platforms, a pH neutralization system, mixing equipment, an air scrubber, an approximately b square foot building (Building), and miscellaneous related site work (e.g., utilities and roadways). The Building houses two laboratories, office space, a control room, a mechanical room, an emergency generator room, restrooms, a garage, and a loading dock. The office space is directly related to the day-to-day operations of the Facility.

The Facility performs two functions. First, it collects the Plant wastewater in the equalization tanks and equalizes the pressure of the wastewater. This pressure equalization reduces the impact of the Plant wastewater on the POTW by controlling peak discharge flow rates. Second, the equalized wastewater is neutralized and adjusted to a pH level that is acceptable to the POTW under the Permit. Such neutralization is required for the proper operation of the POTW's wastewater treatment methods because the POTW treats wastewater by using biological methods to remove solids and nutrients, breakdown organic matter, and destroy pathogens. Wastewater with pH outside the acceptable range can be harmful to the bacteria that digest organic material. Once the wastewater is collected, equalized, and neutralized, it is discharged from the Facility to the POTW.

No "preliminary treatment," "primary treatment," "secondary treatment," "advanced or tertiary treatment", or "pretreatment" of the wastewater is conducted at the Facility, and no "septage" is processed at the Facility, as those terms are used in § 1.142(a)(5)-1.

LAW AND ANALYSIS:

Section 103(a) provides that, except as provided in § 103(b), gross income does not include interest on any state or local bond. Section 103(b)(1) provides that § 103(a) shall not apply to any private activity bond which is not a qualified bond within the meaning of § 141.

Section 141(e) provides, in part, that the term "qualified bond" means any private activity bond that is an exempt facility bond issued as part of an issue which meets the applicable requirements of §§ 146 and 147.

Section 142(a)(5) provides, in pertinent part, 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 sewage facilities.

Section 142(b)(2) provides that an office shall not be treated as an exempt facility under § 142(a) unless the office is located on the premises of the facility, and not more than a de minimis amount of the functions to be performed at such office is not directly related to the day-to-day operations of the facility.

Section 1.103-8(a)(3) provides that an exempt facility includes any land, building, or other property functionally related and subordinate to such facility. Property is not functionally related and subordinate to a facility if it is not of a character and size commensurate with the character and size of such facility.

Section 1.142(a)(5)-1 defines the term “sewage facility” for purposes of § 142(a)(5). Section 1.142(a)(5)-1(b)(1) provides that a sewage facility is property —

- (i) Except as provided in § 1.142(a)(5)-1(b)(2) and (d), used for the secondary treatment of wastewater; however, for property treating wastewater reasonably expected to have an average daily raw wasteload concentration of biochemical oxygen demand (BOD) that exceeds 350 milligrams per liter as oxygen (measured at the time the influent enters the facility) (the BOD limit), § 1.142(a)(5)-1(b)(1)(i) applies only to the extent the treatment is for wastewater having an average daily raw wasteload concentration of BOD that does not exceed the BOD limit;
- (ii) Used for the preliminary and/or primary treatment of wastewater but only to the extent used in connection with secondary treatment (without regard to the BOD limit described in § 1.142(a)(5)-1(b)(1)(i));
- (iii) Used for the advanced or tertiary treatment of wastewater but only to the extent used in connection with and after secondary treatment;
- (iv) Used for the collection, storage, use, processing, or final disposal of —
 - A. Wastewater, which property is necessary for such preliminary, primary, secondary, advanced, or tertiary treatment; or
 - B. Sewage sludge removed during such preliminary, primary, secondary, advanced, or tertiary treatment (without regard to the BOD limit described in § 1.142(a)(5)-1(b)(1)(i));
- (v) Used for the treatment, collection, storage, use, processing, or final disposal of septage (without regard to the BOD limit described in § 1.142(a)(5)-1(b)(1)(i)); and
- (vi) Functionally related and subordinate to property described in § 1.142(a)(5)-1(b)(1), such as sewage disinfection property.

Section 1.142(a)(5)-1(b)(3) provides definitions of certain terms used in § 1.142(a)(5)-1:

- (i) Advanced or tertiary treatment means the treatment of wastewater after secondary treatment. Advanced or tertiary treatment ranges from biological treatment

extensions to physical-chemical separation techniques such as denitrification, ammonia stripping, carbon adsorption, and chemical precipitation.

(ii) Nonconventional pollutants are any pollutants that are not listed in 40 C.F.R. 401.15, 401.16, or appendix A to part 423.

(iii) Preliminary treatment means treatment that removes large extraneous matter from incoming wastewater and renders the incoming wastewater more amenable to subsequent treatment and handling.

(iv) Pretreatment means a process that preconditions wastewater to neutralize or remove toxic, priority, or nonconventional pollutants that could adversely affect sewers or inhibit a preliminary, primary, secondary, advanced, or tertiary treatment operation.

(v) Primary treatment means treatment that removes material that floats or will settle, usually by screens or settling tanks.

(vi) Priority pollutants are those pollutants listed in appendix A to 40 CFR part 423.

(vii) Secondary treatment means the stage in sewage treatment in which a bacterial process (or an equivalent process) consumes the organic parts of wastes, usually by trickling filters or an activated sludge process.

(viii) Sewage sludge is defined in 40 CFR 122.2 and includes septage.

(ix) Toxic pollutants are those pollutants listed in 40 CFR 401.15.

40 C.F.R. 401.16 provides a list of conventional pollutants, which includes: (1) Biochemical oxygen demand (BOD), (2) Total suspended solids (nonfilterable) (TSS), (3) pH, (4) Fecal coliform, and (5) Oil and grease.

Section 1.142(a)(5)-1(c) provides that property other than property described in § 1.142(a)(5)-1(b)(1) is not a sewage facility. Thus, for example, property is not a sewage facility, or functionally related and subordinate property, if the property is used for pretreatment of wastewater (whether or not this treatment is necessary to perform preliminary, primary, secondary, advanced, or tertiary treatment), or the related collection, storage, use, processing, or final disposal of the wastewater.

The request for technical advice questions whether the functional relationship between the Facility property used to collect, store, equalize, and neutralize the Plant's wastewater and the secondary treatment of the wastewater performed by the POTW is sufficient for such property to be considered "necessary," as that term is used in

§ 1.142(a)(5)-1(b)(1)(iv)(A), or whether some additional relationship (e.g., common ownership or geographic proximity) must exist between the Facility and the POTW.

We conclude that the functional relationship between the property used to collect, store, equalize, and neutralize the Plant's wastewater, i.e., the Facility, and the secondary treatment performed by the POTW is sufficient for such property to be considered "necessary" under § 1.142(a)(5)-1(b)(1)(iv)(A). The secondary treatment of the Plant wastewater at the POTW involves biological methods in which bacteria remove solids and nutrients, breakdown organic matter, and destroy pathogens. The viability of this bacteria are necessary conditions for the proper operation of POTW's wastewater treatment methods. Anything introduced into the POTW that threatens the viability of this bacteria threatens the ability of the POTW to perform the secondary treatment of the Plant wastewater. The Facility neutralizes the Plant wastewater's pH level before the wastewater is discharged to the POTW because, without such neutralization, the pH of the wastewater can result in harm to the bacteria utilized by the POTW in the secondary treatment of the wastewater. In addition, the Facility controls the peak discharge flow rates to the POTW by equalizing the pressure of the Plant's wastewater. This pressure equalization reduces and controls the impact of the wastewater on the POTW by controlling the peak discharge flow rate from the Plant to the POTW.

The remainder of the Facility, including the air scrubber, the two laboratories, the office space, the restrooms, and the garage and loading dock constitute property functionally related and subordinate to property described in § 1.142(a)(5)-1(b)(1)(iv).

Nothing in § 142 or § 1.142(a)(5)-1 requires the existence of one or more specific relationships, such as common ownership or geographic proximity, between the Facility and the POTW in addition to the relationship described above when determining whether the Facility is a sewage facility under § 1.142(a)(5)-1(b)(1)(iv)(A). Accordingly, we conclude that the Facility is a sewage facility under § 142(a)(5) because it consists of (a) property used for the collection, storage, and processing of wastewater, which is necessary for the secondary treatment of the wastewater under § 1.142(a)(5)-1(B)(1)(iv)(A), and (b) property functionally related and subordinate to such property under § 1.142(a)(5)-1(b)(1)(vi) of the regulations.

CAVEAT(S):

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