MAR 10 1965

Dear Tom:

This is with further reference to your inquiry regarding my comments before the House Committee on Banking and Currency on the growing practice of financing industrial plants through issuance of tax-exempt municipal bonds.

Municipal industrial development bonds are being used to finance the construction of industrial facilities which are then leased to private industry at rentals sufficient to meet interest and principal payments on the bonds. The lower interest costs attributable to the tax exemption of interest on State and local bonds are thus passed on to the private lessees in the form of lower rental payments. Although municipal industrial financing accounts for only a small proportion of the total State and local bonds outstanding, the practice is becoming widespread, and the propriety of using the tax exemption privilege for this purpose is being questioned by a number of groups, including many State and local officials.

As you know, the Ways and Means Committee considered this matter in connection with enactment of the 1954 Code. The House approved a provision which disallowed the deduction to private business for rental payments made to State and local governments on real property used for manufacturing which had been acquired or improved by the issuance of revenue bonds. In a favorable report on this legislation the Ways and Means Committee referred to the growing abuse of the tax-exempt privilege through the diversion to private business of the benefits of Federal tax exemption. This provision was not, however, enacted.

Bills now pending in the 89th Congress would deny a deduction for any amounts (including rent, interest, and taxes) paid by the lessee for the use of facilities constructed with the proceeds of State and local revenue bonds.

The Advisory Commission on Intergovernmental Relations, composed of representatives of Federal, State and local governments, made an extensive study of this problem and in a report published in June 1963 concluded that “the industrial development bond tends to impair tax equities, competitive business relationships, and conventional financing institutions out of proportion to its contribution to economic development and employment. It is therefore, a device which the Commission does not endorse or recommend.” As a member of the Advisory Commission I concurred in this finding. The Commission recommended denial of the rental deduction although limited to those situations in which the lessee purchases the bonds.

In my remarks before the House Banking and Currency Committee I stated that I have great sympathy with municipalities and States in less developed areas which have adopted this device as a means of attracting industry. I believe it is necessary to help these areas, but this should be done through measures such as the Administration's proposed program for development of the Appalachian region and an improved area redevelopment program, rather than through the use of tax-exempt industrial bonds. A transcript of my remarks is enclosed.

With best wishes,

Sincerely,

Douglas Dillon

The Honorable
Thomas B. Curtis
House of Representatives
Washington, D. C.

Enclosure