

OFFICE OF THE SECRETARY OF THE TREASURY
WASHINGTON, D.C. 20220

Dear Mr. Stone:

Your letters of September 14 and 15, 1971, to the Commissioner of Internal Revenue have been forwarded to this office, which has primary responsibility for matters of federal income tax policy.

Your letters enclosed copies of resolutions of the City of Tulsa, the Economic Development Commission of the City of Tulsa, the Tulsa Industrial Authority and the City of Tulsa - Rogers County Port Authority, in support of S. 1644, introduced by Senator Dole. S. 1644 would amend section 103(c)(6)(D) of the Internal Revenue Code by increasing the so-called "small issue exemption" from the industrial development bond provisions from \$5 million to \$10 million. The effect would be to double the amount of tax-exempt industrial bonds that could be issued by a state or local governmental unit for the benefit of private companies.

We will oppose enactment of S. 1644. Its effect would be a further expansion of the use of tax-exempt financing for private industrial development. When Congress enacted section 103(c), it did so in order to put a halt to the practice which threatened to seriously disrupt municipal financing. During the 1960s, a large number of state and local governments authorized the issuance of industrial development bonds. The practice was initially developed as a means to attract new industry to underdeveloped areas by offering business the use of the issuer's tax exemption. As more states authorized these bonds, the competitive advantage in luring industry to a particular area was largely neutralized. By that time, no one state could halt the trend, so Congress stepped in in 1968 and declared that with certain limited exceptions industrial development bonds would no longer be accorded tax-exempt status. This decision was based in large part on the fact that large numbers of industrial development bond issues were competing with school bonds, sanitary bonds, etc. While the industrial users were saving money through the use of local tax-exempt issuers, there was a corresponding increase in the interest paid on traditional municipal financings.

While the debates in 1968 focused on several huge issues of \$20 million to \$80 million, the bulk of industrial development bonds represented less than \$10 million. It was for this reason that the Treasury Department strongly opposed the \$5 million small exemption in 1968, and why we would be even more strongly opposed to an increase to \$10 million.

Expanding the small issue exemption would actually be of little advantage to state and local governments. Since virtually all states now authorize some form of industrial development bonds, no one area would receive any competitive advantage from the use of its tax exemption. The only beneficiary would be the industry itself, whose financing costs are reduced by the savings between taxable and tax-exempt interest. Moreover, the eventual effect of increased industrial development financing would be an increase in the cost of financing for traditional governmental projects, such as schools, bridges, police and fire protection. Financing for these activities would be forced to compete with larger industrial development bond issues which often provide greater security and a higher premium to the investor. The net effect would be that local

taxpayers would pay a higher rate for school bonds so that a manufacturing company can pay a lower rate on its factory bonds.

Your letter also asked for the results of the public hearing on the proposed industrial development bond regulations, which was held on September 16. We are now reviewing the transcript of that hearing as well as the written comments which have previously been submitted. When final decisions have been made on the regulations, they will be reflected in a Treasury Decision published in the Federal Register.

Sincerely,

John E. Chapoton
Tax Legislative Counsel

Mr. Samuel C. Stone
Assistant City Attorney
200 Civic Center
Tulsa, Oklahoma 74103