APR - 8 1971

Dear Ben:

Thank you for your letter of February 16, 1971, concerning the issuance of industrial development bonds and their impact on the issuance of other tax-exempt bonds by the State or its political subdivisions. You are well-advised to proceed with the degree of care that your questions suggest.

In 1968 Congress decided that interest on industrial development bonds -- that is, bonds issued by a state or its political subdivisions for use by private business -- should no longer enjoy the tax exemption privilege except in certain clearly specified areas. While these bonds are issued by the state or political subdivision, it is in reality the credit of the private business which is pledged. Congress apparently felt that this was extending the tax exemption privilege beyond its purpose of providing financing for governmental functions.

The specific areas carved out, for which such bonds may still be issued, even though the proceeds are to be used in the business of a private company, include the financing of quasi-public facilities. These are such facilities as airports, docks, wharves, mass commuting facilities, parking facilities, residential real property for family units, sports facilities, convention or trade show facilities, air or water pollution control facilities, sewage or solid waste disposal facilities, and facilities for the local furnishing of electric energy, water, or gas. There are also small issue exemptions for issues up to $1 million each and in some cases $5 million. Further, the interest on the bonds remains exempt if the proceeds are to be used for the activities of certain charitable organizations, such as building a non-profit hospital.

These exemptions leave a considerable area for issuance of tax-exempt bonds quite apart from their use to finance governmental facilities and functions such as the building of schools, roads, or bridges. It probably was a wise Congressional decision to restrict their use in financing private business facilities because of the extraordinary competition that developed between states in the 1960's to attract industry in this manner and the resulting flood of tax-exempt issues that were being placed on the market. In effect, widespread use by the states of industrial development bonds was self-defeating. The value of the tax-exempt interest privilege depends on the supply of tax-exempt issues as there is a limited market for this kind of advantage. If the supply is too great, it forces the interest rate up quickly toward the surplus rates on taxable issues. This was clearly ________________ in the 1963-1968 period.

It seems to me that Texas might well use industrial development bonds to finance at low interest cost the kind of facilities presently carved out of the Congressional legislation. The small issue exemptions may also prove useful, as may the use of tax-exempt financing to support construction of hospitals, university facilities (for universities other than state-owned), and similar charitable activities. However, other kinds of assistance would seem to be best to attract businesses or activities not operating within these areas.

With best wishes,

Sincerely,

/s/ John Connally

The Honorable
Ben Barnes
Lieutenant Governor of Texas
Austin, Texas 78711