The background to the introduction of income tax on employee share options

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Case: Abbott v Philbin (Inspector of Taxes) [1961] A.C. 352 (HL)

*B.T.R. 117 Abstract

Using Treasury and Inland Revenue files from the National Archives, this article traces the developments leading to the introduction of the first set of UK provisions specifically designed to charge profits from the exercise of employee share options as income. It examines how the Revenue discovered a potential problem in their interpretation of existing general legislation and their reaction to the loss of a test case in the House of Lords. It gives an insight into how policy in the area was formulated and into the relationship between the Revenue and Treasury Ministers who, even though knowledgeable on the subject, found themselves persuaded to act almost completely in accordance with the Revenue's views.

Introduction

BEFORE the 1960s there was little use of share option schemes by UK companies for rewarding their employees. This was partly because the Revenue charged the excess of the market value over the cost of acquisition to income tax and surtax on exercise of the option. However in the late 1950s some taxpayers began to challenge the Revenue interpretation and took cases before the courts claiming that the measure of income had to be determined at the time the option was granted rather than at the time of its exercise. There was some disagreement between judges in different cases as they struggled to distinguish one fact pattern from another and this led to a short period of confusion until the matter was settled in favour of the taxpayer by the House of Lords in June 1960 in Abbott v Philbin. This decision created potential for a considerable tax advantage in rewarding employees by the use of share options, particularly as there was at that time no capital gains tax when the shares acquired were eventually sold. Although capital gains tax was introduced in 1965, the differential between its maximum rate of 30 per cent and the maximum combined rate of income tax and surtax (91 and a quarter per cent) meant that share options were still an attractive proposition. Eventually, in 1966, the Revenue persuaded the Labour Government to reinstate the position to that which had operated prior to Abbott v Philbin. This article examines the 10-year build up towards this legislative action.
*B.T.R. 118 Reports of an incipient problem*

At the beginning of 1958 the head of each specialist area within the Revenue made a report to the Chief Inspector of Taxes in respect of the previous year. One such report drew attention to the growing attraction of share option schemes in providing an inducement for senior executives in the form of a potential future tax-free capital gain, despite the immediate benefit charge arising at the point of exercise of the option. However, it also referred to:

"a stiffening and increasing resistance, stimulated by the opinion of eminent counsel, to the official view that tax liability arises by reference to the value of the shares at the date a share option is exercised."

The report also indicated that some cases had been referred to the Board’s Solicitor to defend assessments based on the Revenue's view and that an impending case before the Court of Session would soon provide guidance on the issue. A few days later in *Forbes's Executors v CIR* all three judges concluded that the Revenue's interpretation was correct.

**The problem grows**

Despite the Revenue's success in *Forbes's Executors*, the report of the Revenue's specialist for 1958 indicated that agents were still ready to assert that the case was of limited application (but gives no reason why this is so). The decision was not followed by the General Commissioners in a subsequent case where, on the facts, they decided that the income arose when the option was granted. Although the report indicated that the Revenue were prepared to appeal, they chose to rely instead on *Abbott v Philbin* which came before the Special Commissioners in February 1958. Giving their decision in early April that year, they concluded that the *Forbes* case was binding upon them and that the facts were indistinguishable, despite Forbes being given his option while Abbott was required to pay a small sum for its grant. However, in March of the following year Abbott won his appeal as the High Court decided that payment for the grant of the option enabled his case to be distinguished. By October 1959 the Crown had obtained a unanimous decision of the Court of Appeal that the principles in *Forbes* applied to Abbott as the two cases were indistinguishable. However, in June 1960 the House of Lords decided on a 3:2 majority to overrule the *Forbes* case and concluded that the only benefit which could arise was at the time the option was granted. Thus, any increase in value of an option between grant and exercise was a capital profit derived from that asset and not from services; so the profit was not liable to income tax whether the grant was gratuitous or not. As a result, the uncertainty surrounding the tax treatment of employee share options (following eminent counsel's opinion contrary to the then Revenue practice) was removed. The driving force for a great increase in companies using options over their shares to reward employees had been created. Perhaps not
surprisingly, the Revenue saw an immediate increase in the number of companies granting share options following the House of Lords decision.\textsuperscript{6}

\textbf{*B.T.R. 119* A proposed legislative solution}

It appears that immediately after their final defeat in \textit{Abbott v Philbin}, the Revenue decided not to press for corrective legislation as there was insufficient tax at stake.\textsuperscript{7} The specialists' reports to the Chief Inspector make no further mention of the matter. There is no evidence of any attempt to have the law altered until a Labour Government was installed in October 1964 and the Chancellor (James Callaghan) asked for a note about possible anti-avoidance measures for the forthcoming Finance Bill. The Revenue suggested four topics for consideration: a general anti-avoidance measure; covenanted transfers of income; business expenses; and share options.\textsuperscript{8} This was followed up by a detailed memorandum for the Chancellor copied to both the Chief Secretary and the Financial Secretary to the Treasury. It explained the history of the Revenue treatment of share options, the position following the final decision in \textit{Abbott v Philbin} and the fact that they “only rarely succeeded in establishing that such options have more than a nominal value.”\textsuperscript{9} It pointed out that “the option… gives the taxpayer the right to take advantage of a rise on the cheap, without exposing him to the risk of a fall.”\textsuperscript{10} In the previous four years, the Revenue had found that well over 100 companies had granted options to directors and employees and expected there to be more which had yet to be reported to them. They argued that, although at that time there was not a great amount of tax at stake, the ultimate tax-free gains would often be very substantial and would be subject to much adverse public comment. Accordingly, it was urged that action be taken sooner rather than later.

Having explained the nature of the problem, the memorandum turned to the implications of restoring the position to that which had existed before the House of Lords judgment and warned that the legislation would have to be “somewhat complex to stop all possible ways of getting round the charge.”\textsuperscript{11} It also warned of arguments from some quarters that the increase in value between grant and exercise should only be liable to capital gains tax--the introduction of which had already been decided. The contrary argument was felt to be stronger in that those supporting the use of options did so “on the grounds that they provided an incentive to those who received them” and that to tax any gain as emoluments “would, we think, reflect more accurately the truth of the matter.”\textsuperscript{12}

The memorandum moved on to the tricky question of whether the new legislation should only apply to options granted after it was introduced or to all options exercised, no matter when the option was granted. As the Revenue had seen many options granted for a 10-year period, and some for even longer, they thought it unjustifiable to exclude these merely on the grounds that they were granted prior to 1965/66 and again argued that on taking up the shares an employee was actually receiving remuneration. They believed that taking such an
approach was not truly retrospective because “the granting of the option merely set the stage for the avoidance”. 13

After a brief diversion into the merits or otherwise of share options for the company and its shareholders and the potential for conflicts of interest that they created, the *B.T.R. 120* memorandum turned to international comparisons. Canada and West Germany already operated a scheme similar to that which the Revenue were proposing and in the United States a similar position applied unless the shares acquired were held for at least three years and certain other conditions were met, in which case the profit was taxable as a capital gain. The United Kingdom was therefore said to be out of line with other industrial countries.

**Ministerial reaction**

The Chief Secretary to the Treasury (John Diamond, a chartered accountant) took the lead in responding to the Revenue's memorandum. Although accepting the tax avoidance aspect of options, he rejected taking any action on four grounds:

1) the existing position was covered in a House of Lords judgment;

2) retrospection would create difficulties not worth facing on a minor issue;

3) the growth in value between grant and exercise was capital not income; and

4) the benefit to the option-holder caused a corresponding loss to other shareholders which was not an allowable deduction for income tax purposes.

He recommended to the Chancellor that no action be taken as the existing short-term gains tax and the proposed capital gains tax would satisfy all the Revenue's arguments and avoid all the difficulties. 14

However, the Revenue were not prepared to give up and rebutted each of his objections. First, they suggested that it was not uncommon for defects in the law to be revealed by decisions of the courts and that these were quite frequently dealt with by corrective legislation. Rather perversely, they then stated that on a count of heads in all three courts the majority favoured the Revenue's view. As regards retrospection, they argued that there was none “in the full sense, i.e. changing the law for transactions already carried out” 15 and warned that to allow options granted before Budget day to escape would be regarded in some quarters as over-generous. As regards growth in value being a capital matter, their view was that there was no reason why the provision of actual shares at an undervalue should be taxable as income whereas the growth in value between grant and exercise of an option over those shares should only be liable to capital gains tax on the subsequent disposal of the shares, possibly many years later. Finally, the Revenue could see no grounds for other shareholders getting any corresponding relief for reductions in value of their shares as this related to their capital.
Mr Diamond responded by politely but robustly rejecting each of the first three Revenue rebuttals and ignoring the last one. After dismissing the head count argument as irrelevant, he went on to disagree that full retrospection was not involved in the Revenue's proposals. Although not wholly against retrospection, he thought:

"that politically speaking a Labour Government has to be even more careful than a Conservative one on this issue: rightly or wrongly an unsatisfactory image has been created in this respect".16

*B.T.R. 121* He did, however, agree that it would be over-generous to allow all options granted before Budget day to escape liability. It is quite clear that Mr Diamond thoroughly understood how share options operated and was not going to be fobbed off by the Revenue's comparison between shares issued cheaply and the grant of an option and took issue with their statement that the option gave the right "to take up the shares cheap at a future date".17 As he rightly pointed out, the price may or may not be cheap and there is no exact parallel between the issue of shares and the grant of an option over shares.

The Chief Secretary made it clear to the Revenue that he regarded a share option as an asset which should be liable to capital gains tax on the difference between the market value of the shares acquired on exercise and the total cost of acquiring them and that this should be charged on exercise with further capital gains tax payable on the eventual disposal of those shares. By this means, combined with any existing options being revalued on Budget day, he believed his proposals would meet with little resistance.

Feeling as though they were being pushed towards a capital gains solution, the Revenue responded that they wished to examine in greater detail "why the United States (which have of course great experience in share options) have felt obliged to tighten up on the capital gains treatment of options".18 Although ostensibly they had the relevant US material in their office, unusually for them, it took just over two weeks to get back to Mr Diamond.

The Chancellor's only input at this stage was to request an explanation of how share options worked and clarification of when any gain was obtained.19 This enabled the Revenue to give him a very straightforward and brief account of the tax-free benefit employees were obtaining and to emphasise that this was at variance with the general principle that where an employee obtained something saleable from his employer at less than market price the difference was pay even though no cash was received.20

The only contribution to the debate by the Financial Secretary (Niall MacDermot QC) was to support Mr Diamond's view that the legislation should not reverse the effect of *Abbott v Philbin* and that the increase in value of options should only be charged to capital gains tax or short-term gains tax.21 At this stage it therefore looked very much as if the Revenue were not going to get their way. However, they still had not apprised ministers of the United States' experience of taxing share options.
Clinching the argument

Given the difficulty in persuading the Revenue to agree with his views, it is not surprising that Mr Diamond suggested a round table discussion to resolve matters. Prior to that meeting the Revenue submitted an eight page memorandum which, besides quibbling over Mr Diamond’s earlier arguments, raised many new and persuasive matters to consider. First, they pointed out that their practice prior to the decision in Abbott v Philbin had not created any significant problems. Secondly, they suggested that industrial opinion was *B.T.R. 122* deeply divided on the desirability of providing share options to directors and employees. Thirdly, it was submitted that in the context of an incomes policy:

“this is one of these perquisites given to the higher salaried staff that can cause irritation lower down … [and] many of the best industrialists dislike the practice on other grounds as well.”

Their final, and perhaps most persuasive, new argument concerned the situation in the United States where in 1950 a special relieving provision had been introduced to charge profits on share options as capital gains if certain conditions were satisfied, so overturning their prior treatment as income. According to the Revenue, this had led to such an enormous increase in the granting of employee share options that in 1963 the President’s tax message to Congress proposed the withdrawal of capital gains treatment. The content of the President’s message must have created concern in the minds of Labour ministers. It pointed out that two out of three corporations listed on the New York Stock Exchange had option plans and that the benefits, measured by the spread between the exercise price and the market price, often far exceeded any other part of the executive compensation. Three hundred and fifty large companies had provided their executives with option benefits totalling $200 million in 1959, $164 million in 1960, and even more in 1961 as a result of the marked rise in stock prices that year. The President’s main arguments for eliminating preferential treatment are set out below:

-- stock options were a reward for services so paying tax at capital gains rates was inconsistent with accepted principles of tax fairness;

-- a contemporary study of 166 top executives in 31 of the 50 largest industrial corporations had shown average option benefits of $83,000 a year, with almost 40 per cent of them having after-tax benefits exceeding their after-tax salaries and bonuses;

-- some individuals had option benefits of millions of dollars;

-- treatment of stock option profits as capital gains was based on the belief that they would provide an incentive to recruit and retain executives and stimulate them to greater effort but “the advantages claimed do not appear to be substantiated by experience”
-- the evidence suggested that options were used almost entirely to reward present management rather than to attract new executives and that they often tended to impede rather than to improve executive mobility as they were set up in a manner to tie executives to their present jobs;

-- in many cases, the executives already had such large shareholdings in the company that further incentives were almost irrelevant;

-- Treasury studies had shown that about two thirds of the employees exercising their options disposed of all or part of the shares within three years and this was inconsistent with the objective of creating a proprietary interest in the business for executives;

*B.T.R. 123* -- the awards conferred were more related to changes in investor outlook and stock prices generally than to the efforts of executives.

Despite the above-mentioned arguments and the President's recommendation that profits on share options should be charged at ordinary income tax rates, he only succeeded in getting more stringent conditions for option gains to qualify as capital gains, i.e. the exercise price had to be no less than the share price at the time of grant; the exercise period could not exceed five years; the shares acquired would have to be held for at least three years; and the individual could not hold more than five per cent of the ordinary stock. As the Revenue pointed out, many existing UK options would not have qualified for capital gains treatment under the above rules.

Clearly, some of the practices which had developed in the United States, and the President's difficulty in removing capital gains treatment, must have had a severe impact on ministerial thinking. The Revenue forced home the point by arguing that although granting options:

“has not so far spread here to anything like the extent that it has in the USA, the American experience is, however, some indication of how things can develop where option profits are taxed as capital gains”.  

It is suggested that other matters raised by the Revenue, including the need for special capital gains legislation to achieve Mr Diamond's preferred approach, were relatively trivial in comparison to the impact of the detailed description of the US experience of taxing option profits as capital gains. Perhaps it is not surprising therefore that at the subsequent meeting with the Chief Secretary and the Financial Secretary it was agreed that the Revenue's approach was the right one. Thus, there was to be a Schedule E charge on the exercise of an option but limited for existing options to the increase in value between Budget day and the exercise. The latter point had been forced on the Revenue to minimise any criticism on the score of retrospection.

All that was left to do was to obtain agreement from the Chancellor. In a brief note the Revenue informed him that a clause had already been drafted and that with little additional
work it could be included in the Finance Bill and "would probably make some appeal to the unions in connection with an incomes policy". Although the Revenue made it clear that this matter was less important than dealing with business expenses and deeds of covenant, the Chancellor had already decided that share options had to be left to next year "purely [as] a matter of lack of legislative time [as] the Lord President and PM are already pressing me about the length of the Finance Bill".

A second and successful attempt

In late December 1965, the Chairman of the Board of Inland Revenue wrote to the Chancellor about the agreed proposals deferred from the previous Finance Bill and set out a broad outline of the arguments which had been rehearsed previously. He warned that "the longer legislation is deferred the more difficult it will be to tackle this avoidance *B.T.R. 124 device* and reminded him that the United Kingdom was out of line with most other industrial nations. The difficulties faced in the United States were also resurrected. The Revenue had been keeping an eye on the growth in companies using option schemes and advised that they had not only discovered almost 60 new cases in the previous 12 months but were also aware that many more companies were thinking of introducing them. They warned that such schemes would soon become an accepted feature of executive remuneration, as they already were in the United States, with the potential for substantial profit which would inevitably be the subject of much adverse public comment. As the length of the previous Finance Bill had been the stumbling block for earlier action, the Revenue concluded their submission by stating that the matter could be dealt with in one clause in just over two pages, even though it would be "somewhat complex to stop all possible ways of getting round the charge". The Chancellor agreed that legislation should be introduced in the 1966 Finance Bill but only if there was room. Nevertheless, he requested that the necessary work be put in hand.

The Chairman of the Board of Inland Revenue became aware from a conversation with the Permanent Secretary of the Board of Trade (Sir Richard Powell) that that department looked upon the use of share options in a fairly benevolent way. He therefore wrote to the Chancellor with a draft letter for him to send to the President of the Board of Trade to ensure there would be no disagreement between them concerning the need to introduce the tax provisions and to emphasise that the United Kingdom was out of line with other industrialised countries. The tone of the letter is reflected in the following extract:

"...industrialists are very divided in their views about share options. I am clear that, from our point of view, they are just one of those undesirable efforts to escape the taxes that other people must pay and that we ought to grasp the nettle now. The ordinary worker... is rightly irritated at the sight of executives getting the benefit of tax fiddles. This is a good time to act, as the values of many shares are stagnant and options are not a great attraction at present.
Nevertheless a number of firms are toying with them and we ought to act before any growth that makes action difficult.”

The President of the Board of Trade agreed to support the Chancellor’s action and the possibility of disagreement between the two departments was thus successfully averted.

**Closing a potential loophole**

Following publication of the Finance Bill there was comment in the press, including *The Economist* and the *Financial Times*, indicating that the clause could be circumvented by granting options in an investment company which held shares in the employing company or group, provided it was not controlled by that company or group. Although the Revenue had not come across options of this kind, they thought such arrangements were possible and so wrote to the Chancellor suggesting that:

* **B.T.R. 125** “it would be foolish to leave open [this] opportunity ... and it would be easy to ... catch options of this kind...by making the clause apply to the grant of options on the shares of any company”.

Although this would cast the net very wide, they could find no alternative which would catch all possible variants of the device. Having pointed out that the necessary amendment would be simple and would reduce the length of the clause, the Revenue probably expected straightforward agreement. However, there was to be none.

The Chief Secretary thought that the amendment was unnecessary and could not imagine circumstances where a company would be in a position to grant options over another’s shares and the Chancellor agreed with him. The Revenue were not prepared to give up and quickly responded by setting out three methods by which avoidance experts might contrive to sidestep the clause, two of which had appeared in *The Economist* of May 21, 1966. The first was “by putting an investment trust under the control of trustees who were formally, at any rate, independent of the company”. Secondly, a merchant bank might set up and own shares in an investment trust company which itself held shares in a few companies which had provided low interest loans to the investment trust. Options would then be granted to executives to buy shares at a discount in their employing companies held by the trust. A third method was a variation of the second and involved unrelated companies co-operating in setting up an investment trust with options being granted over its shares.

Despite stressing the fact that as these possibilities had been drawn to the attention of the public by the press and that it would be unwise to assume they would not be exploited, the Chief Secretary still resisted. He believed:

“that we would run the risk of creating an unfortunate image if we keep on having second thoughts about our own proposals before they have even been debated or enacted”.
He suggested two possible ways forward. First, was the rather impractical suggestion of awaiting the Committee Stage debates and, if an acceptable amendment was put forward, to incorporate the anti-avoidance alteration. Alternatively, "we could give warning of possible future retrospective legislation à la dividend-stripping warning, and leave it at that". 35

On the question of image, the Revenue accepted the point but suggested that, as these ideas had already been put forward "in responsible quarters as a serious proposition", there was a convincing excuse for reinforcing the defences of the clause.

"We have bitter experience over many years to show that avoidance experts are ready to exploit any gap, no matter how unusual; and we think that Ministers may well be sharply criticised if they close their eyes to one which has been widely advertised."36

As regards waiting for a related acceptable amendment, the Revenue thought it unlikely that there would be one to which an anti-avoidance change could be linked. The threat *B.T.R. 126 of retrospective legislation was also given short shrift. They argued that, although this method had been used to discourage devious and unforeseen ways around anti-avoidance provisions, it would be difficult to justify relying on such a warning on a matter which had been clearly described and could easily be met by an amendment to the current clause.

Once he had seen the initial memorandum from the Revenue and the rejection of acting upon it by the Chief Secretary and the Chancellor, the Financial Secretary wrote to urge them to reconsider the matter as “we will look foolish if we fail to plug a hole to which attention has already been drawn in the press”. 37 This broke the deadlock. The three Ministers met to discuss the matter and agreed the Revenue's recommendation for a government amendment. 38 This episode seems to show how some Ministers were imagining difficulties where none existed and were dithering when the appropriate decision was obvious. In this case the civil servants were instrumental in protecting Ministers from adverse publicity. It is suggested that it should have been clear to the Chancellor that he was being provided with an opportunity to show himself to be well informed, proactive in blocking all loopholes and determined to attack the creators of tax avoidance schemes.

**Parliamentary opposition**

As a result of the general election in March 1966, the Budget Statement was delayed until May 3 and it only included a brief statement on the proposals for taxing share options. 39 There was no discussion of the matter in the Budget debates but four categories of Opposition amendment were put forward at the committee stage. First, to deal with supposed retrospective elements; secondly, to charge only capital gains tax; thirdly, to spread the tax charge over a number of years; and finally, to provide a let-out for option schemes applying to all a company's employees. The only government amendment was that referred to above, which extended the provisions to options granted in a company other than the employer, and this met with little resistance.
Although the clause excluded from charge any increase in value arising prior to Budget Day, the Opposition wanted all existing options excluded from any charge on the basis that to do otherwise was retrospectively interfering with an existing contract. Ministers dismissed this as a complete fallacy on the grounds that there was no amendment of the law applicable to events which had already taken place and no imposition of tax on completed transactions which were not taxable at that time. The position was said to be exactly comparable to what the Conservative Government had done in the Finance Act 1960 to restore the longstanding practice in connection with post-cessation receipts which had been found to be incorrect by the House of Lords. Furthermore, it was pointed out that there had been widespread speculation in the press on the question of how long it would be before the *Abbott v Philbin* position would be reversed. It was also argued that there were two distinct potential elements of profit, one on grant and one on exercise, so that the provision was not retrospective but was merely disappointing expectations of an exemption from future tax liabilities at the time of exercise. After much fruitless argument, the amendment was rejected.\(^4\)

\*\*\*B.T.R. 127\*\*

Given that the top rate of income tax was 91 and a quarter per cent, not surprisingly there was an attempt to water down the proposals so that only capital gains tax, with a maximum rate of 30 per cent, was chargeable. The supporting arguments were based upon the supposed disincentive on top executives, the improved profitability of companies with such schemes, and options being an efficient means for the capitalist to transfer some of his assets to managers. All of this was dismissed on the grounds that options were merely a reward for services and were regarded as such by the company, just like a cash bonus or like shares themselves being allotted to employees at an undervalue.\(^4\)

The amendments concerning spreading the tax charge involved two possible approaches: either spreading equally over the years from grant to exercise or spreading over the year of exercise and the following two tax years, in a manner similar to that which already applied to inventors and authors. Ministers could see no merit in either approach because, where shares themselves were given (instead of options) as a reward for many years of service, the benefit would nevertheless be wholly taxable in one year and, in any event, the option-holder could usually spread the exercise of his option and the resultant tax liability over a number of years. The spectre of bright young managers joining the “brain drain” to America was also brought up. This argument was repelled by quoting passages on the lack of evidence for share options improving recruitment and retention from President Kennedy's tax message to Congress referred to above.\(^4\)

The proposal for a let-out for all-employee schemes was put forward by the Liberals who, though supporting the Government on the clause, wished to encourage what they described as industrial co-ownership and partnership schemes. Their aim was to create a greater employee interest in the fortunes of their employing companies in order to create a less
confrontational manner of conducting industrial relations. The Financial Secretary resisted this proposal on the grounds that the Revenue had no knowledge of any such scheme being operated and that it would therefore be inappropriate to grant a special tax benefit in advance of anyone working out all its technicalities. More importantly, he could see no reason why employees of companies should be able to benefit while other workers would not, as this would depart from the principle that all forms of income should be liable to income tax whatever their source.\(^{43}\)

**Conclusion**

Although it was an arduous process, the Revenue achieved almost exactly what they had set out to obtain. In order to do this, they showed extremely skilful management of ministers by taking account of their wider political and economic concerns. The Chancellor apparently had little understanding of share options and was fortunate to be able to leave matters in the hands of his two assistants, an accountant and a lawyer, both of whom had an in-depth knowledge of the relevant issues, and both of whom initially rejected most of the Revenue's advice. However, the Revenue persisted in pressing their views, and eventually achieved a breakthrough by intelligent use of evidence of public opinion gleaned from reports in the city pages of the newspapers and specialist financial magazines. Additionally, the ability to make international comparisons and access the *B.T.R. 128* practical experience of overseas tax authorities on similar issues was crucial to their success.

By the time the clause came to be debated in Parliament, ministers were therefore well versed in all the nuances of the subject as well as its fundamental policy objectives and this enabled them to deal easily with all Opposition objections, so that no changes were made. The resultant legislation remained virtually unaltered until major reconstruction of the legislation on employment-related securities took place in 2003. Even then, its fundamental principle (of making no tax charge on grant of an option but only on its exercise) and its approach to determining chargeable events and taxable amounts all survived this reconstruction. The fact that the old rules are at the heart of the new legislation on options\(^{44}\) is clear evidence of the success of the original provisions.

The Revenue's earlier fears of a rapid growth in the use of option schemes were soon allayed as they found a dearth of new schemes being launched in the few years after 1966 and discovered that some were even cancelled. Without the tax advantage, it seems that industry and commerce were no longer so convinced of the motivational effects of such schemes.

However, the Revenue's success was something of a Pyrrhic victory. Just over three years later, they had to return to the Chancellor to explain that a new version of the problem had emerged in the form of executive share incentive schemes.\(^{45}\) This time, ministers could not be persuaded to act.
Finally, it is interesting to contrast the relatively slow process of dealing with the loss of *Abbott v Philbin* in 1960 with the current speed of HMRC reaction when case law overturns a widely-held view and goes against their interests. Furthermore, the length of the Finance Bill 1965 would nowadays be considered short and so would not, as it did then, create any excuse for delaying an anti-avoidance provision.\textsuperscript{46}

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1. 39 TC 82.
2. TNA: PRO IR145/1 Bainey to Deputy Chief Inspector, January 10, 1958.
3. 38 TC 12.
4. TNA: PRO IR145/2 Bainey to Deputy Chief Inspector, January 8, 1959.
5. See fn.1.
6. TNA: PRO T171/808 M345 para.4.
7. See fn.6.
8. TNA: PRO T171/808 letter to the Chancellor, November 30, 1964.
9. TNA: PRO T171/808 M345 para.3.
10. See fn.9.
11. See fn.9.
12. See fn.9.
13. See fn.9.
15. TNA: PRO T171/808 January 1, 1965.
17. See fn.16.
18. TNA: PRO T171/808 Johnston to Diamond, January 5, 1965.
24. See fn.22 at 2 of the Appendix, para.3.
25. See fn.22.
26. TNA: PRO T171/808 memo to Bancroft, Private Secretary to the Chancellor, March 8, 1965.
27. TNA: PRO T171/808 memorandum to Bancroft March 3, 1965--handwritten note by the Chancellor dated March 5, 1965.
29. See fn.28.
32. TNA: PRO IR63/243 memo to Chancellor's PPS, Bancroft, June 7, 1966.
33. TNA: PRO IR63/243 memo to Chief Secretary, June 9, 1966.
34. TNA: PRO IR63/243 June 11, 1966.
35. See fn.34.
36. TNA: PRO IR63/243 memo to Chief Secretary June 14, 1966.
38. TNA: PRO IR63/243 June 14, 1966.
44. ITEPA, ss.475-480.
45. TNA: PRO T171/860 M475.
46. Employee share schemes; Income tax; Legal history

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