were a handful of insiders to be permitted to rig the game for their own ends.

But all of this was done nearly twenty-five years ago. And while a great part of the protective ramparts then erected still stands, careless administration and a lack of legislative vigilance has permitted some serious erosion of this structure.

One of the most serious of the erosion points lies in the area of corporate management and stock manipulation. In spite of corrective legislation, those who place their own interests above the interests of stockholders, customers and the nation at large still exercise excessive control over the affairs of many great corporations, and still represent a challenge to the well-being of all Americans.

Stock Options Create New Millionaires

As a result of such control, a special, new crop of millionaires has arisen in recent years. Aided immeasurably by a revision of the tax laws covering stock option plans, droves of corporate executives have made fortunes overnight with virtually no risk involved. Hundreds of them have managed in a few short years to realize an ambition which ordinarily takes a lifetime by old fashioned methods. And in the wake of their success, they have left a trail marked by special privilege, hypocrisy, tax avoidance, inflationary pressure and stock market abuse.

Essentially this is how corporate executives have made fantastic sums by betting on the winning horse after the race has ended. The management of company "Y," including President Smith, of course, decides that President Smith, who is earning only $100,000 in direct compensation, needs an additional incentive to put forth his best efforts. Consequently, it grants him the right to buy 5,000 shares of "Y" stock at $95 per share.

The market value of the stock was only $100 at the time of the grant. However Smith can wait for as long as 10 years before buying any or all of the 5,000 shares. This gives him an opportunity to see where "Y" stock values are heading. While he waits, the stock may double, triple or quadruple in value, but the price Smith pays the company for each share he decides to purchase remains fixed. Regardless of when he exercises his option, he will pay no more than $95 per share.

A few years after the option is granted, the market value of "Y" stock rises to $250. Smith decides to take up his option; he invests $475,000 and obtains assets worth $1,250,000, thus making an immediate paper profit of $775,000.[1]

[1] Had the company sold the 5,000 shares at the current market value instead of the option price, the $775,000 would have gone into the company's treasury. It would have become the property of existing shareholders rather than Mr. Smith.

A few more years elapse and the market value of "Y" stock climbs to $400. Smith sells his 5,000 shares for $2,000,000, realizing an actual profit of $1,525,000 in all. ($2,000,000 — $475,000).

Smith now is in a position to enjoy an additional privilege. Under the law which prevailed prior to 1950, the profit he made the moment he purchased the stock ($775,000) would have been treated as part of his income for the year in which the purchase occurred and taxed at ordinary income tax rates (which now run as high as 91 percent). The remaining part of his profit ($750,000), which resulted from a rise in value after he purchased the stock, would have been taxed at a maximum rate of 25 percent (like all other gains from the sale of property which has been held for at least six months). However, thanks to the generosity of Congress in 1950, *all* of Smith's profits will now be subject only to the 25 percent capital gains tax. As a result, he will realize a profit after taxes of $1,143,750 instead of the far smaller sum which he would have netted under the old law, and not one penny of the tax on the entire transaction will be paid until he relinquishes his ownership of the stock in question. (See Appendix, Table I, for illustration of tax calculations.)

Of course, "Y" stock could conceivably have declined in value. However, if the decline occurred before Smith purchased his 5,000 shares, he could have simply declined to exercise his option. If the value of the stock dropped after he purchased it, Smith would have a substantial cushion to fall back on since he paid only $95 per share at a time when the stock was selling for $250 per share. He could stand by while the price dropped $155 and still recoup his entire investment.[2]

Some plans require no waiting period before options can be exercised. If this were true of company "Y's" plan, Smith could have purchased the 5,000 shares on the day the option was granted, resold them the same day, and made a profit of $25,000.

Even if a waiting period were required, as is commonly the case, once such a period had elapsed, Smith could still have bought and sold his option shares on the same day and obtained a substantial profit without investing a penny of his own. In a recent article in *Harpers Magazine* (July 1959), Bernard Nossiter poses a similar situation. "For example," Nossiter writes, "U. S. Steel last year gave 120 of its executives options on 151,100 shares at $55. This spring, the stock had risen $40 a share above this. Any time a top Steel executive needed cash, he picked up his telephone, told the company treasurer to issue him a few thousand of his optioned shares, and told

[2] As a matter of fact, Smith could have protected himself against the drop in the value of the stock even after he purchased it by entering into an agreement called a "put," giving him the option to sell the shares at the then current market price. Eventually, if he decided to exercise this option to sell he could still pocket the difference between the $95 and the $250 (except for the cost of the "put") regardless of how low "Y" shares had dropped in the interim.