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Ivar Kreuger and IMCO: A case of taxation of fictitious income

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Abstract

This paper relates an episode of epic capital market fraud that previous research has linked to major twentieth-century legislative reforms of U.S. capital markets. In 1932, following the suicide of Ivar Kreuger, the companies representing two of the most popular and arguably the most widely distributed securities in the world, the Swedish holding company Kreuger & Toll AB and its U.S. subsidiary, International Match Company (IMCO), filed for bankruptcy. IMCO, the focus of this study, was alleged by bondholders' legal counsel to have overstated financial income and substantially overpaid federal income taxes. IMCO paid nearly $6 million in income taxes, the current equivalent of over $85 million.

Using previously unexplored primary documents from the accountant hired by the bankruptcy trustees for IMCO, this paper investigates the effort to substantiate the claim for and to recover the federal income taxes paid because the payments were based on fictitious income.

Keywords: Kreuger; Fraud; Income tax refund

1. Introduction

Having occurred over 80 years ago, the International Match Company's (IMCO) overpayment of taxes seems now a prototype for the collapse of Enron, MCI-WorldCom,

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HealthSouth, and Bernard Madoff.[1] Like these others, IMCO reported fictitious earnings for financial accounting purposes, paid substantial U.S. income taxes on that non-existent income, and then subsequently filed for a tax refund (Blumstein, Berman, & Perez, 2003). Using previously unexplored primary archival material, this study reports on IMCO's bankruptcy trustees' efforts to reclaim tax payments and provides details of a unique and previously unexplored episode in the Kreuger saga.

2. Ivar Kreuger's International Match Company

Ivar Kreuger and his partner, Paul Toll, began a highly successful construction business in Sweden in the years immediately before World War I. He entered the business of match manufacturing by acquiring his family's match business and began to focus his attention on that industry. By 1913, Ivar Kreuger had expanded his core match entity, the Swedish Match Company, through a series of mergers and acquisitions until he virtually controlled the Swedish match industry. In 1917, the Kreuger & Toll business operations were divided. Toll continued the construction business, Kreuger & Toll Construction AB, while Kreuger formed a separate company, Kreuger & Toll AB (K&T), to serve as a holding company. Immediately after World War I, Kreuger made large loans to European governments devastated by the war. Funds were needed to meet loan and or reparation payments, as well as for reconstruction. The loans were as much as $125 million to a single government and were made in exchange for the monopoly to make matches in their country. The match monopolies were expected either to produce sufficient funds for the government to repay the loans or to demonstrate sufficient profit that K&T would be willing to refinance the loans on their due dates. With its match monopoly model, K&T began an era of apparent rapid expansion. Ultimately, K&T involved more than four hundred subsidiaries in as many as 99 different nations. Perhaps the best known of the K&T subsidiaries was the Swedish Match Company, and one of the largest subsidiaries of the Swedish Match Company was its U.S. subsidiary, IMCO.[2]

Where did the money come from to expand rapidly and to make these loans? In the post-WWI financial community, the United States was the strongest and most robust economy. Much of the capital was raised by IMCO, formed in late 1923. Lee, Higginson & Co., a highly regarded private investment banking firm originating in Boston (1848), was the lead U.S. banker. Their English counterpart, Higginson & Co., handled 40% of the new common stock issue that doubled the amount of common stock in the Swedish Match

[1] The similarities have revived interest in the Ivar Kreuger story. Examples of recent recountings include an article in the December 17, 2007, *The Economist* (*"Fraud and financial…"*), a Harvard Business School case by Jones and Vargas (2004), and a 2009 book, *The Match King*, by Frank Partnoy, professor of law at the University of San Diego.

[2] According to an analysis prepared by Klein et al. (1924–1940), as of December 31, 1930, IMCO had two wholly owned US subsidiaries: Vulcan Match Co. and American Turkish Investment Corporation. In addition, IMCO directly owned 10 other subsidiaries—one in Mexico (100%), one in the Philippines (100%), one in Poland (unknown level of ownership), and seven European subs including two in Finland (99.7% and 90.135%), two in Yugoslavia (100%), one in Denmark (100%), one in Norway (100%), and the largest subsidiary, Continental Investments AG. Continental Investments AG was a 100% owned Swiss subsidiary, which itself had 14 subsidiaries varying in ownership levels from 50.5% to 100%. Nine of Continental Investments' subsidiaries were wholly owned. This glimpse into a part of the K&T organizational structure suggests it was incredibly complex.

Company (Shaplen, 1960, p. 69). Lee, Higginson & Co. had been involved in the capital formation activities of many railroad and industrial enterprises in the United States (Shaplen, 1960, p. 68).

The Swedish Match Company held all of IMCO's common stock, but IMCO preferred stocks, and bonds were popular with U.S. investors as the purchase price was low and dividends and interest were high. After the 1929 market crash, Kreuger still paid high dividends and interest. In 1932, K&T securities were more widely distributed than any other stock in the world (Shaplen, 1960, p. 128). Then, on March 12, 1932, Ivar Kreuger was found dead under circumstances determined to be suicide (Ivar Kreuger Kills Self, 1932).

Within one month of his demise, a forensic audit by Price, Waterhouse & Co. began to report details of apparent fraud throughout the K&T firm. Ultimately it was asserted that many reported assets never existed, and that the operations of the match monopolies were neither sufficient to maintain the liquidity to service interest or debt, nor sufficiently profitable to cover more than a fraction of the amounts that had been paid out as dividends to investors. By January 1933, before the U.S. Senate Banking Committee, George O. May, representing Price, Waterhouse & Co., affirmed in his testimony that there had been widespread fraud in the K&T companies, characterized by the payment of dividends and interest out of contributed capital. Thus funded, Kreuger's firms serviced their debt and interest and paid substantial dividends in order to continue to attract new flows of investment from fresh offerings.[3] While K&T may have started as a legitimate business, it had devolved into a so-called Ponzi or pyramid scheme.

2.1. Practice environment: taxation

The modern corporate income tax in the United States began with the Revenue Act of 1913.[4] In that tax law, corporate tax was levied on income as defined "under general accounting principles." However, this expression lacked meaning because it predated authoritative financial accounting standards by more than two decades. Tax law began by using general financial accounting rules, but it soon became obvious that this would not be sufficient. While Congress began to write tax rules to minimize opportunities for understating income, the federal income tax rules of Kreuger's time remained much simpler than the thousands of pages of code, regulations, and case law that define the rules under which corporate taxable income is calculated today.[5] In the years when IMCO existed and paid taxes, federal income tax rates varied between 11% and 13.5% (U.S. Department of the Treasury Fact Sheet, 2003).

[3] George O. May of Price, Waterhouse & Co. distilled an essential aspect of the concerns relating to K&T, in responding to an inquiry by the Chairman of the subcommittee, as follows: "The Chairman: And they (Kreuger & Toll as a group) paid in dividends more than four times what they earned. Mr. May: Exactly. …"—p. 1268, Stock Exchange Practices: Hearings before a Subcommittee of the Committee on Banking and Currency, United States Senate. Part 4, (Kreuger & Toll) January 11 and 12, 1933, GPO: Washington 1933. www.fraser.stlouisfed.org. Search term: Kreuger.

[4] While there were several earlier corporate-level taxes, including a 1909 excise tax, the Revenue Act of 1913 is widely considered the beginning of the modern federal corporate income tax.

[5] For example, *USA Today* reported that the U.S. income tax code and regulations totaled 400 pages in 1913; 14,000 pages in 1954; and 74,608 pages in 2014 ("Total pages of," 2014).

Perhaps the most challenging difference for modern accountants to understand is the difference in the tax information disclosure atmosphere of the 1920s. Beginning with the Civil War Income Tax of 1862, government officials routinely posted lists of taxpayers and the amounts of taxes they paid on courthouse doors (Cummings, 2000). The philosophy of the day was that informed citizens should police their neighbors' tax bills since all had to share the burden of financing government. In the 1910 Revenue Act, while Congress provided that corporate tax return information was public data, it could only be inspected upon order of the President under rules to be determined by the Secretary of the Treasury together with the President.

Passage of the Revenue Act of 1924 signaled a return to the earlier era of public disclosure of tax payment data. The Revenue Act of 1924 required the Commissioner of Internal Revenue to have "prepared and available to public inspection… lists containing the name and address of each person making an income tax return together with the amount of income tax paid by such person" (U.S. Congress, 1924). In both 1924 and 1925, the Commissioner of Internal Revenue made available to the public unsorted lists of individual and corporate taxpayers, their addresses, and the full amount of federal income taxes paid. However, newspapers of the day published alphabetized lists of both individual and corporate taxpayers and the full amount of federal income taxes each paid.

The move toward disclosure was once again reversed in the Revenue Act of 1926, which reduced the published information to the name and address of all taxpayers with no mention of the amount of taxes paid (U.S. Congress, 1926). Later tax laws returned to the nondisclosure laws that existed prior to 1924. Throughout the remaining years of the 1920s, discussions continued as to whether public disclosure of taxes paid was useful to discourage tax evasion.

IMCO was formed in 1923, so the first full year of operations coincided with the first year that the amount of taxes paid was public information. The company allegedly overstated taxable income and overpaid income taxes in the two years when corporate tax payments were public knowledge and in the five years when it was realistic to believe that taxpayer lists might again become public information.

2.2. Practice environment: financial reporting and auditing

Flesher and Flesher (1986), in their study of Kreuger, point out that, "Accounting and financial reporting as we know it today was then in its infancy." During the early 1920s in particular, audited financial accounting statements were not customarily provided. And, even as such reports became available, auditing procedures were varied among firms and circumstances, and authoritative standards were lacking (Flesher et al., 2005). In a letter written on April 6, 1926, by Ben Tomlinson, vice president and treasurer of IMCO, to Ernst Hoffman, secretary of IMCO, Tomlinson summarizes views expressed by Donald Durant, one of the Directors of IMCO and a banker at Lee, Higginson & Co.

> In giving the banker's point of view he pointed out that IMCO stock has had a very successful career, but that it is regarded more or less as a 'mystery' stock, selling largely on the character of its backing and sponsorship rather than on any great amount of detailed information regarding earnings and growth; that there is good

> buying in it but that investors are always wanting to know why it has had such a rise and might therefore be inclined to be a bit nervous and easily affected by anything that could be construed as news of an adverse nature regarding it.
>
> [Klein, Hinds, & Finke, 1924–1940]

Tomlinson's observations are confirmed by Flesher and Flesher (1986): "Investors based their decisions solely on dividend payments, the personal reputation of Ivar Kreuger, and the prestige of the brokerage firm which had underwritten the American securities, Lee, Higginson & Company."

Annual earnings for IMCO were published each year in *The Wall Street Journal* (International match earned $6.20 per combined share, *The Wall Street Journal, 1927)*, (See Table 1).

The Board of Directors of IMCO saw this identical information in the annual report, but unlike modern reports, these annual reports presented no notes explaining the financial results. The audit report by Ernst & Ernst each year pointed out that they "examined the books of account and records of International Match Corporation and its American subsidiaries... and have received statements from abroad with respect to the foreign constituent companies." The numbers for all the foreign subsidiaries were supplied to Ernst & Ernst. Apparently, many of management's representations were taken at face value.

2.3. The aftermath of Kreuger's death

The event of Kreuger's death precipitated what the press termed, in 1932, "the Kreuger crash" (Kreuger's deficit put at $191,762,730: The New York Times, 1932). In the months following Kreuger's suicide, there was a groundswell of outrage in newspapers and magazines about the scandal at K&T. There is also persuasive evidence of a linkage between the Kreuger scandal and the passage of the U.S. Securities Act of 1933 that established mandated financial reporting requirements for existing publicly traded companies (Flesher & Flesher, 1986).

When IMCO declared bankruptcy, Irving Trust was named trustee for the bondholders. Acting on the orders of the Federal District Court for the Southern District of New York, Irving Trust hired New York attorneys Rosenberg, Goldmark and Colin, who hired the New York CPA firm of Klein, Hinds & Finke to conduct a thorough investigation into and audit of IMCO.

3. Joseph J. Klein

Dr. Joseph J. Klein headed this investigation into IMCO's financial position as well as the tax refund filing and resultant negotiations. Dr. Klein was a CPA, an attorney, a professor of accounting, and the author of a financial accounting textbook. He was also the lead partner in the New York accounting firm that would assist the bankruptcy trustees in unraveling the financial details of IMCO and its convoluted dealings with K&T, its countless subsidiaries, and Ivar Kreuger. Klein's family donated voluminous papers related to his examination of the IMCO records to the University of Florida George A. Smathers Library Special Collection in 1972. The correspondence and documents provide information about the accounting underlying the reported financial and taxable income as well as the costs to the bondholders from both the overpayment of taxes and the effort to recover it.

4. Klein's evidence that IMCO's income was fictitious

Within two months of Kreuger's suicide, the accountants at Klein, Hinds & Finke recommended to the bankruptcy trustees that a tax refund request should be filed immediately with the Bureau of Internal Revenue (Bureau) to recover all taxes paid by IMCO for all open tax years—1929, 1930, and 1931. The grounds of the request for refund were unusual if not unique for the time, namely since there was no income, there could be no taxes owed. IMCO had reported enough income to the Bureau that they had paid more than $5.8 million in income taxes over the 8-year life of the corporation, with federal income taxes of $2,291,843.89 paid during the open tax years.

Klein maintained that there had been little or no net income generated by IMCO so that all taxes paid were overpayments. Most of the income that IMCO reported came from interest accrued and dividends received by IMCO from other firms within K&T. Most of the money raised in the United States was sent to other K&T entities so that it was reasonable to believe that these entities either owed IMCO interest on loans or that IMCO held an equity position in these firms that could generate dividends. Because Kreuger exercised total control over all the entities, he alone determined where the funds went and what interest or dividends would be paid to IMCO.

Documentation was informal. A memo written by Mr. Tomlinson, vice president and treasurer of IMCO, about a conversation held with Kreuger appears typical.

> Debit… N.V. Financiele Maatschappij Garanta (author's note: Garanta) $17,000,000 as of October 1, 1925 and credit STAB (author's note: a subsidiary of the Swedish Match Company). For this amount IMCO will receive promissory notes. Interest is to be charged on this amount at the rate of 24% per annum, compounded semiannually on June 30th and December 31st and Dutch company should be advised of charge and interest when charged and added to principal amount. IMCO will first receive 8% p.a. on this loan as a return on invested capital and the balance of interest received will then be divided equally between STAB and IMCO…Send statement of account after making above entries to Mr. Henning of STAB with the information that it is sent at the request of I.K.[6]

Klein supported his assertion that income was fictitious by supplying countless similar documents and summaries of details from the financial accounting records. Two such summaries are considered as examples of the work he did to establish that the income was fictitious:

1. Table 2 is an analysis of the shrinkage of net worth in IMCO from its 1924 first full year of operations to the end of the quarter in which Kreuger died.

[6] In Irving Trust's final report to the court, they discussed Garanta as follows, "The Trustee discovered almost immediately that this company was a mere shell having no assets and no earnings capacity of any kind. The sums supposedly advanced to it had been fraudulently diverted by the late Ivar Kreuger to other channels. . ." (page 21).

Table 1
IMCO financial data published in *The Wall Street Journal*—1925 and 1926.

	1926	1925
Total income	$46,240,688	$34,916,152
Expenses & taxes	29,803,233	22,487,832
Depreciation	1,851,183	1,731,717
Net profit	$14,586,272	$10,696,603
Participating preferred dividends	3,240,000	2,023,713
Surplus	$11,346,272	$8,672,890
P&L surplus	$35,651,900*	$18,231,261
• Includes $6,071,366 premium on preferred stock		
Earnings per share	$6.20	$5.62

On combined $35 par value participating preferred stock and no par common stock.
International Match earns $6.20 per share, The Wall Street Journal, June 2, 1927, p. 5.

2. Table 3 is an analysis of reported income of the parent IMCO compared to the amount of income needed to pay dividends on preferred stocks and highlighting the interest rate paid to IMCO by its Continental subsidiary.

Table 2 was sent to the Trustee's attorneys in the fall of 1933. Klein stated that the assets were valued at cost, but he cautioned that some might have been recorded at inflated values. This analysis indicates that only $27 million of the more than $175 million invested in IMCO remained on March 31, 1932. The $8,158,769.59 in income that Klein estimates for IMCO and Continental compares to the approximately $120,926,000 in income reported by IMCO and subsidiaries during this same period.

One reason that Klein believed that transactions recorded on IMCO's books were fictitious was that interest rates on loans made by IMCO to other Kreuger subsidiaries varied widely with no apparent link to any factor except IMCO's need for income to pay dividends and bond interest.

Table 2
Analysis of the shrinkage of net worth of IMCO—1924 to March 31, 1932.
Prepared by Joseph J. Klein and reported to Rosenberg, Goldmark and Colin (Klein, Hinds, & Finke, 1924–1940).

Net proceeds of stock and debenture issues, including	
Premiums and discounts on issuance and retirement of securities	$175,467,534.53
Balance of net assets remaining at March 31, 1932	27,831,623.10
Shrinkage in net worth	$147,635,911.43
Deficit in payment for initial issue of IMCO common stock	$10,046,431.66
Losses through misappropriations	93,562,042.17
Payment of dividends on common & participating preferred	46,302,623.00
Payment of FIT (probably on fictitious income)	5,883,583.19
	$155,794,680.02
Less consolidated "real" net income, before FIT [a]	8,158,768.59
	$147,635,911.43

[a] $4,691,002.45 for Continental Investment A.G. and $3,467,766.14 for IMCO.

Table 3
International match corporation (not including subsidiaries).
Excerpts from "statement comparing net income for the quarterly periods noted, with dividends paid and indicating the charge as per books, for interest from the Continental Investment A/G" prepared by Joseph J. Klein (Klein, Hinds, & Finke, 1924–1940).

Quarter	Net income	Dividends	Interest charged to Continental A/G	Ann. interest rate
31-Mar-25	$433,837	$291,857	$522,337	13%
30-Jun-25	581,940	291,857	582,559	14
30-Sep-25	912,386	720,000	947,682	22
31-Dec-25	843,252	720,000	578,047	12
"1925 numbers include interest, commissions and financing charges"				
31-Mar-26	$1,157,143	$720,000	$581,983	12%
30-Jun-26	1,287,954	720,000	580,417	12
30-Sep-26	1,206,657	720,000	611,855	12
31-Dec-26	1,519,133	1,080,000	633,855	12
31-Mar-27	$1,916,443	$1,080,000	$1,467,421	15
30-Jun-27	1,988,892	1,880,792	1,493,124	15
30-Sep-27	2,213,639	1,880,792	1,167,145	11
31-Dec-27	1,941,958	1,880,792	1,223,615	12
31-Mar-28	$1,952,171	1,880,792	1,445,378	14
30-Jun-28	1,982,875	1,880,792	1,300,095	12.5
30-Sep-28	2,083,532	1,880,792	1,501,741	14
31-Dec-28	2,193,955	1,880,792	1,673,744	15
31-Mar-29	$2,021,863	$1,880,792	$1,498,705	13%
30-Jun-29	2,002,466	1,880,792	1,097,155	10
30-Sep-29	2,431,184	1,880,792	2,009,727	17.5
31-Dec-29	2,413,687	2,350,990	1,709,574	19
31-Mar-30	$2,392,254	$2,350,000	$1,777,742	16.5%
30-Jun-30	2,396,270	2,350,000	0	0
30-Sep-30	2,397,486	2,350,000	0	0
31-Dec-30	2,402,765	2,350,000	603,692	3 3/4 [a]

[a] Klein calculated that the two interest payments made during the year equaled 3 3/4% interest on the outstanding loan balance.

Table 3 is derived from a similar table Klein created to highlight the wide variance in interest rates charged by IMCO to Continental, IMCO's largest subsidiary. In the first year the loans were outstanding, interest rates varied from 12% to 22% per year. The lowest interest rate was in 1930 when high interest was paid in the first quarter, no interest was paid in the second and third quarters, and just enough interest was paid in the fourth quarter to bring interest for the year to 3 3/4%. As a basis for comparison, short-term business loan rates varied between 4.3% and 6% in New York during this period of time, while Aaa corporate bond yields varied from 4.55% to 6.01% (U.S. Department of Commerce, 1976).

In addition, Klein bolstered his contention that the income was fictitious with evidence from the contents of more than 130 separate letters and radiograms between Kreuger, the IMCO Treasurer Ben Tomlinson, A.D. Berning IMCO's Ernst & Ernst account representative,[7] and

[7] In 2013, Ernst & Young, whose predecessor firm had served as the auditor of IMCO, established an archive of materials relating to the early years of the firm, founded in Cleveland. Now available at Case Western Reserve University, this founder's archive includes unexplored files regarding the firm's financial activities with IMCO.

various IMCO officials. These communications matter-of-factly discuss determining the level of earnings to be reported by IMCO. In later communications, it is less clear that any economic transactions underlie the reported accounting results.

A copy of a March 16, 1925 letter from Ivar Kreuger to Berning of Ernst & Ernst sheds light on the early discussions about earnings for K&T's U.S. subsidiary. The excerpt from Kreuger's following letter regards the 1925 earnings of IMCO, mostly from commissions to be paid by the largest IMCO subsidiary, Continental.

> I note with interest your observations regarding this matter. When suggesting a quarterly commission of $200,000, I was quite aware that in this way International would get a somewhat larger income than strictly necessary to pay the stipulated dividend, but I had in mind to create a little surplus for International Match Corporation so as to make us freer in our dividend policy than we are at present. I quite agree with you, however, that it is very important to keep down the taxes as much as possible, and perhaps we shall later find it desirable to reduce the income of International Match Corporation somewhat. Considering, however, that we have already put on record the agreement between International Match Corporation and Continental Investment Aktiengesellschaft regarding the commission, I would be inclined to let the commission remain as it is until we get an opportunity to discuss the matter further orally. This would probably mean that we should proceed with paying the commission for the first two quarters of this year, as I hope we shall meet at least before the third quarterly payment is due.
>
> [Klein, Hinds and Finke, 1924–1940]

In a letter sent to Rosenberg, Goldmark and Colin on May 3, 1932, Klein provided two additional examples of manipulation of earnings from the IMCO files. "We herewith hand you an interesting memorandum summarizing a conversation between Mr. Kreuger and Mr. Tomlinson, in 1926, and presumably prepared by the latter." The memo that Klein quotes is actually dated December 26, 1925, and covers many details about loans between the K&T companies. Near the end of the memo is the single line, "Vulcan should show a profit of $20,000 to $25,000 for the year 1925" (Klein, Hinds and Finke, 1924–1940). The memo refers to Kreuger's plan for the profits of Vulcan Match Company, another IMCO subsidiary.

Klein's May 3, 1932, memo continues. "We also hand you a memorandum dealing with the procedure whereby Vulcan Match Co., Inc. eliminated 1929 and 1930 operating losses." The transaction he lays out for the attorneys is an example of the confounding complexities of the analysis Klein undertook to determine IMCO's real income. Klein quotes a radiogram sent by Mr. Tomlinson to Kreuger, "In order that Vulcan may show small net profits for 1930 it is necessary STAB (author's note: a Swedish Match Company subsidiary) credit or pay Vulcan dollars 325,000 as at December 31, 1930 stop Kindly advise how you wish matter arranged."

Vulcan sold matches to STAB at a below-market price during the year, and Kreuger had STAB transfer enough money at year-end to have Vulcan Match report a small profit. In earlier years, a transfer of cash followed this adjustment on the books. However, the 1930 transaction was different. The radiogram response from Kreuger dated February 25, 1931, says, "Please have Vulmatch debit Exportaktiebolaget Norden with Three hundred Twenty five Thousand Dollars as at December 31, 1930 Stop Will Arrange to Have Norden Pay

You the Amount Before April First." This year's transaction was different because Norden had never before provided the payment to make Vulcan Match profitable. In addition, this transaction was different because there never would be a payment of $325,000. Instead, K&T sent a radiogram to Vulmatch (author's note: Vulcan Match, an IMCO subsidiary), "We credit you April Third with Higginson New York Four Hundred Thirty Thousand Dollars." Klein's report to the attorneys indicates that the $430,000 was then transferred to IMCO. This resulted in money being shifted from K & T instead of Norden, and the amount transferred was larger than the expected $325,000.

The only relationship between Vulcan Match and Norden that Klein could find was that Norden purchased some chemicals from Vulcan Match. In 1929, Norden made purchases that totaled $52,267.40, and in 1930, purchases by Norden totaled $226.50. In spite of the relatively modest business dealings between Norden and Vulcan Match, on the books of Vulcan Match the $430,000 amount was credited to Norden for the 1929 purchases of chemicals.

Klein could not find any listing of Norden among the hundreds of subsidiaries of K&T or the Swedish Match Company. The Trustee's final report (p. 57) indicates that Norden was not a member of the K&T group. Further, they say "For the year 1930 the operating loss (author's note: of Vulcan Match) was charged to a Swedish company which subsequently denied all knowledge of the transaction." It appears that this transaction was fictional.

5. The efforts to recover overpaid U.S. income taxes

Klein, Hinds and Finke began working for the attorneys hired by the bankruptcy trustees soon after Kreuger's death. On May 3, 1932, the first letter from the accounting firm to the attorneys included a list of items for immediate attention. Dr. Klein's Daily Report for August 2, 1932, states, "Mr. Rosenberg (author's note, one of the attorneys) and I also discussed questions of tax refunds. He appears to be somewhat skeptical of the ability of anyone to demonstrate to the satisfaction of Treasury that IMCO had paid taxes on non-existent profits and that on this basis it is entitled to a refund".

The bondholders' trustee, Irving Trust, had no such hesitation. In its first report to the bankruptcy court filed only 3 days after Klein reported this conversation, Irving Trust reported claims against the U.S. government for approximately $2,250,000 in tax refunds.

In its February 8, 1933 report to the bankruptcy court, Irving Trust reported that a request for a tax refund was filed for the full federal income taxes paid in 1929 ($1,091,108.37),[8] 1930 ($1,198,235.52), and 1931 ($2,500). In this report, Irving Trust also told the court that the Bureau might assert a claim for an additional $1,000,000 in taxes due from IMCO for 1931 income. IMCO reported $7,123,650 in income for the first three quarters of 1931 but paid only $2,500 in taxes. Treasury did file a notice of unpaid 1931 taxes. The Trustees reported in their December 1933 report to the bankruptcy court that the Trustees had "also filed claim for abatement of unpaid income taxes claimed by the United States Treasury Department for the year 1931 totaling $1,043,455.83."

[8] The request for refund for 1929 was later reduced to $818,331.28 when it was determined that the payment of taxes for the first quarter of 1929 was beyond the statute of limitation.

5.1. Meetings and discussions

The Bureau was skeptical of claims that IMCO had earned no income. In August 1932, Revenue Agent Max Steinberg began a field examination of IMCO's books. Based on Steinberg's early work, the assessment of additional taxes due for 1931 was made in February 1933. In March 1933, two attorneys from the Bureau's General Counsel's office came to a meeting in New York with the attorneys and accountants for the bondholders' trustees. The purpose of the meeting, according to Klein, was to determine whether or not there were assets to be used to pay the 1931 tax assessment.

On October 26, 1933, the first of several meetings between IMCO's lawyers and accountants and personnel from the Bureau was held in Washington, D.C. Attendance at this first meeting was typical of all the discussions in Washington. The Bureau's personnel in attendance at this conference included an acting Deputy Commissioner, an auditor, and a staff attorney from the General Counsel's office, while two attorneys plus Klein and another accountant represented the Trustees. From Klein's perspective, these conferences accomplished little and often were largely devoted to providing an overview of the IMCO facts to Bureau personnel. The meetings took place from their beginnings in 1933 until late 1937.

However, the February 1935 Washington conference between the Trustees' attorneys and accountants and Bureau personnel appears relevant. From this meeting, two facts are learned that suggest that the Bureau's position was evolving as it attempted to untangle the complex issues arising from the tax refund request from this unwieldy corporate organization. First, Klein notes that this meeting is attended by a Mr. Thurman Hill, whom Klein describes as head of a new Bureau division "dealing with reorganizations and receiverships." Also during this meeting, the Bureau suggested that they needed to go to Europe to study financial records there, but they were uncertain as to how to pay for the trip.

In spite of the great effort involved, little progress was achieved in reaching an agreement until the spring of 1937.

5.2. Travel to Europe

Because so much of IMCO's income appeared to originate from K&T, the Bureau felt that they needed to examine the European records and interview witnesses before determining whether IMCO's income was fictitious. Apparently, European travel was difficult for the government to justify during the financial strictures of the Great Depression. Mr. Hill stated that he would talk to Bureau personnel as to the value of the trip and about how to finance it. Mr. Hill asked if the IMCO Trustees would be willing to ask the bankruptcy court for permission to finance the trip for the Bureau employees. "There is a Bureau rule that says taxpayers cannot finance government examination, so it is mandatory from the official viewpoint to secure an appropriate court order." Apparently, this request was made, and there was a letter to creditors issued on April 17, 1935, notifying them about the financing of the European trip.

On August 14, 1935, in New York, an agreement was finally reached that the trip to Europe was necessary to determine whether or not the reported income was fictitious. Even at this point in time, the financing of the government employees' trip to Europe was not resolved. On September 5, Mr. Homer R. Miller of the Bureau's General Counsel's office called the trustee attorneys to request that the trustees pay the expenses for a man from the Department of Justice and a representative of the U.S. Attorney's office to make the European trip, but not for Bureau employees. The trustees agreed. The trustees reported on this trip as follows:

> Subsequently representatives of the U.S. Treasury Department and the Department of Justice, and accounting, legal and business representatives of the Trustees, proceeded to Europe for the purpose of collecting testimony. Such testimony was taken in Sweden, Switzerland, France and Spain, some representatives of the Treasury Department also making an additional investigation in Germany. The testimony of many witnesses was taken…

5.3. The settlement offer

On March 19, 1937, Klein's office received a proposed settlement offer from the Bureau of $745,316.27 (tax refund) plus an interest of $259,097.24. In addition, the government withdrew all claims for the assessment of taxes for the 1931 tax year. This offer was accompanied by a thinly veiled threat. According to Dr. Klein's notes,

> Mr. Hill stated that there was a decided inclination on the part of responsible Government officials to have the case go to court, even if the result might be a larger refund, because of the public good which would result from the complete airing of the Kreuger frauds…Further the General Counsel's office thought that the Court might not allow interest to be paid on the overpayment because of the fraud in the accounting.

A member of Klein's partnership found an error in the government's calculations that increased their settlement offer to approximately $1,200,000. In April 1937, the trustees brought the proposed settlement to the creditors of IMCO and received their approval to accept the offered settlement.

In a May 20, 1937, a letter to the Commissioner of Internal Revenue and Irving Trust as the trustee in bankruptcy for IMCO detailed the offer from the Bureau accepted by the Trustees:

1. The parties agreed that the 1929 income was $6,582,579 and that the income was made up largely of interest, fees, and other payments from Continental Investment AG to IMCO. Accordingly, the tax refund due was $369,600 plus interest. The agreement stated that all income received by IMCO from Garanta was excluded because it was fictitious.
2. The parties agreed that the 1930 income was $7,413,563.66 and that the income came largely from Continental Investment AG to IMCO. The tax refund due from 1930 was $544,456.99 plus interest due. The letter stated that the 1930 income from both Garanta and Norden was fictitious.

3 The parties agreed that the 1931 income was $8,216,542.19, but that the entire amount of income was eliminated by the loss on German bonds embezzled by Kreuger of $26,970,000.

While the Trustees and creditors had officially agreed to the $914,057 ($369,600 for 1929 and $544,457 for 1930) tax refund plus interest offered by the Bureau in the Spring of 1937, the process was far from complete.

The Department of Justice received the files and approved them in early June 1938. From the Department of Justice, the files were forwarded to the Joint Congressional Committee on Taxation (JCC) for their approval. On August 24, 1938, Mr. Miller said that the JCC objected to the terms of the settlement. They questioned the running of the statute of limitation based upon the "insufficiency of the original refund claims filed." Further, they refused to allow the Trustees to see a copy of the memo related to their discussions. Klein apparently questioned the right of the JCC to have any say in the matter. However, the requirement that refunds greater than $75,000 be approved by the JCC had been added by the Revenue Act of 1928 (IRC Sec 710) (U.S. Congress, 1928).

On November 21, 1938, Klein received a letter from the Chief Counsel of the Bureau with a draft closing agreement enclosed. The accountants and attorneys for IMCO's trustees made some revisions to that agreement and returned the papers the same day. For the next several weeks, the Bureau and the IMCO accountants and attorneys honed the final details.

It was not until February 24, 1939—almost 2 years after the first agreement was reached—that Klein received word that the Secretary of the Treasury had signed the agreement and the checks could be written. The Trustees received two checks on May 3, 1939, in the amounts of $557,023.81 for overpayment in taxes in 1929 including interest on the overpayment and $788,268.79 for the overpayment and interest related to the 1930 tax year. The total settlement proceeds from the open years for refunded tax payments and interest represent nearly $19 million in current purchasing power terms (U.S. Bureau of Labor Statistics).

6. Costs of U.S. income tax overpayment to IMCO investors

In agreeing to refunds for some taxes paid in 1929 and 1930, the Treasury acknowledged that portions of income reported in the open years were fictitious. However, the IRS maintained that there was some income in the open years and some taxes were owed. The total unrecovered overpayment of U.S. income taxes was as much as $4,968,943. While much of the unrecovered taxes relate to closed tax years, about 22% of this represents amounts from the open tax years that were not refunded. These unrefunded amounts represented taxes Treasury believed were due on real income from the open tax years.

There likely was tax paid on fictitious income in closed tax years and perhaps some fictitious income in the open years not recognized by Treasury. However, the cost to the bondholders was not limited to unrecovered tax paid on fictitious income. The actual recovery fees also were a 'transaction' cost born by the bondholders. The donated papers do not provide direct evidence on the fees Klein's firm was paid for the tax refund work, but there is information about total fees paid by the trustees.

The Trustee's final report includes an accounting of all disbursements from 1932 to 1939. Disbursements directly linked to the tax refund suit included $50,000 paid to the trustee's tax counsel (Dr. Klein) and $16,889 for expenses (other than professional fees) directly allocable to preparation of the federal income tax refund suit. Other disbursements to the trustee's accountants Klein, Hinds and Finke totaled $140,429, but this represented billings for both tax refund work by the accounting firm and work related to the forensic examination of financial accounts of IMCO. In addition to Dr. Klein's hours on the tax project, we know that a second partner in his firm, Mr. Maurice Austin, worked long hours on the tax aspects of this engagement. Several others, employees of Klein, Hinds and Finke as well as law firm personnel, were also mentioned throughout the tax refund work.

Throughout Dr. Klein's daily reports on his work on the tax refund case, we find mention of two partners in the law firm of Rosenberg, Goldmark, and Colin working many hours. In total, the lawyers were paid $490,000 that included work for the tax refund case as well as all of the other work for the bankruptcy. Unfortunately, we have no basis for dividing the lawyers' payment between the tax refund case and the remaining bankruptcy issues.

The final category of disbursements that relate in part to the tax refund suit is the travel for lawyers and accountants totaling $147,520.87. The travel expense represents extensive European travel at the beginning of the IMCO project to find and understand the financial accounting records. In addition to the European travel, there were seven conferences between the IMCO accountants and lawyers and the employees of the Bureau that took place in Washington. All of the travel costs related to these seven conferences were tax related.

Total federal income tax paid by IMCO were more than $5.8 million, some of which represented overpayment. Of the $2,019,066 paid in the last three quarters of 1929, 1930, and 1931, the tax refund was $914,057. direct costs of Klein's service on the tax refund case were $66,889. In addition, a portion of the $140,429 paid to the accounting firm, a portion of the $490,000 paid to the law firm, and perhaps most of the $147,520 in travel costs also were related to the tax refund effort. Ivar Kreuger's decision to overpay federal income taxes resulted in substantial cost to investors in IMCO securities.

7. Summary and future research

This paper contributes to our understanding of a complex, important, historical incident, employing new information from archival sources and studying principal tax accounting outcomes of that episode. It further details archival records studied to understand the costs and processes required to be successful in receiving a refund. A caveat regarding Klein's materials is warranted. As an advocate of the bondholders, his interpretation of information is assumed to reflect that role. Kreuger, on the other hand, was not available to explain his actions.

Klein's engagement included a forensic review and was broader than the taxation claim that is the subject of this paper. Future research into other archival data and aspects of Klein's activities involving Kreuger may benefit those evaluating Kreuger's impact on

U.S. capital markets. There are thousands of pages of data in the Klein files that may be of interest. For example, there is an exhibit that Klein created to estimate the overall loss to American investors in IMCO by comparing their investment in IMCO bonds with the total assets remaining in IMCO when bankruptcy was declared. By making other researchers aware of the scope and richness of the material in the Klein collection, this paper makes an additional contribution to the literature.

Set in an earlier era, the lessons from this case are also relevant to contemporary[9] as well as historical research because the paper provides an example of one of the earliest known successful appeals for the refund of taxes paid on fictitious income. It also contributes to our understanding of a motivation for a management to willingly pay taxes on fictitious income.

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[9] Such as Erickson, Hanlon, & Maydew, 2004 and Lisowsky, 2009.

Archival and Online Resources

U.S. Bureau of Labor Statistics, U.S. Department of Labor, CPI Calculator, www.bls.gov.

www.fraser.stlouisfed.org Use search term "Kreuger." Locate in findings therein the George O. May's testimony before Senate Stock Exchange Practices, hearings before a subcommittee of the Committee on Banking and Currency, Seventy Second Congress Second Session hearings on S, Res 239, January 11 and 12, 1933.

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