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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.