***Enterprise Theatre Co. v. Commissioner, 1948 Tax Ct. Memo LEXIS 144 (1948)***

Legal expenses incurred by a corporation to resist jurisdiction in a lawsuit, primarily for its own benefit to avoid significant business disruption, are deductible as ordinary and necessary business expenses, even if the suit involves a stockholder's personal interests.

**Summary**

Enterprise Theatre Co. sought to deduct legal expenses incurred while resisting jurisdiction in a New York lawsuit. The Tax Court held that these expenses were deductible as ordinary and necessary business expenses. The court reasoned that although the lawsuit concerned the ownership of stock held by a major stockholder, Cooper, the corporation's resistance to jurisdiction was primarily to protect its own business interests from potential disruption and expense, not merely to benefit Cooper. The court also addressed the Commissioner's argument that the expenses should be apportioned among related companies, finding that Enterprise reasonably bore the entire cost due to its primary operational role and the potential impact on its business.

**Facts**

Cooper, a major stockholder of Enterprise Theatre Co., Interstate, and Rialto, was sued by Paramount in New York concerning the title to the stock in those three corporations. The corporations were named as nominal defendants. Enterprise paid legal expenses to resist the jurisdiction of the New York court over itself, Interstate, and Rialto. Enterprise was the principal operating company of the Colorado theaters and argued that defending the suit in New York would significantly interfere with its business operations.

**Procedural History**

Enterprise Theatre Co. sought to deduct the full amount of the legal fees on its federal income tax return. The Commissioner disallowed the deduction, arguing that the expenses were either capital expenditures related to defending title to stock or should be apportioned among the related companies. The Tax Court reviewed the Commissioner's determination.

**Issue(s)**

1. Whether legal expenses paid by Enterprise in resisting jurisdiction in the New York lawsuit were ordinary and necessary business expenses deductible under Section 23(a)(1)(A) of the Internal Revenue Code?

2. If the legal expenses are deductible, whether the entire amount is deductible by Enterprise, or if the expenses should be apportioned among Enterprise, Interstate,

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and Rialto?

## Holding

1. Yes, because the expenses were incurred primarily for Enterprise's own benefit to avoid potential disruption and expense to its business, and not solely to defend title to stock or benefit a shareholder.

2. The entire amount is deductible by Enterprise because Enterprise was the principal operating company, and it reasonably bore the full expense considering the potential impact on its business.

## Court's Reasoning

The court distinguished between expenses incurred to defend or protect title to property, which are generally capital expenditures, and expenses incurred to defend a business from attack. The court found that Enterprise had no direct title or interest to defend in the stock involved in the suit; Cooper owned the stock personally. The court emphasized that Enterprise's primary motivation in resisting jurisdiction was to avoid significant interference with its business operations. The court cited *Welch v. Helvering*, 290 U.S. 111, noting that legal expenses in defense of suits attacking a taxpayer may be unique in the life of the taxpayer, and are accepted as the ordinary and necessary means of defense against attack. The court further cited *Kornhauser v. United States*, 276 U.S. 145, supporting the deduction of legal expenses under these circumstances. Regarding apportionment, the court found that Enterprise reasonably paid the entire amount given its role as the principal operating company and the disproportionate impact the lawsuit would have had on its operations.

## Practical Implications

This case provides guidance on when legal expenses can be deducted as ordinary and necessary business expenses, even if they relate to a shareholder's personal interests. The key factor is whether the primary purpose of incurring the expense is to protect the corporation's own business interests. This case informs how similar situations should be analyzed. Attorneys should focus on documenting the potential business disruption that justifies the corporation's legal actions. In cases involving related companies, this case suggests that expenses can be disproportionately borne by the entity most directly affected, provided there is a reasonable basis for doing so. Later cases might cite this case to support the deductibility of legal expenses where a clear business purpose is demonstrated.

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