30 T.C. 635 (1958)

Legal fees paid by a corporation in connection with a shareholder suit, including fees of all parties as part of a settlement, are deductible as ordinary and necessary business expenses if the suit arises from the conduct of the corporation's business and benefits the corporation.

Summary

The United States Tax Court addressed whether a corporation could deduct legal fees paid in connection with a shareholder lawsuit. B.T. Harris Corporation (the corporation) paid legal fees for both sides in a suit brought by shareholders challenging actions by the corporation's directors. The court held that these fees, paid as part of a court-approved settlement, were deductible as ordinary and necessary business expenses because the underlying suit concerned the corporation's business and the settlement benefited the corporation. The court distinguished this from situations where fees are related to defending or perfecting title to property.

Facts

The B. T. Harris Corporation, a Delaware corporation, was sued by shareholders (Betty and Rosemary Harris) who sought to void the issuance of 20,000 shares of stock to a director, Bennett E. Glazer, and to cancel a debt entered on the corporation's books for Glazer's salary arrearages. The shareholders alleged that the transactions were fraudulent and a breach of the directors' fiduciary duty. The corporation's board authorized defense of the suit and agreed to pay all expenses. A settlement was reached, approved by the court, which included the return of the stock, payment of Glazer's back salary, and payment of legal fees for all parties. The corporation deducted the legal fees as business expenses on its tax return, which the Commissioner disallowed.

Procedural History

The Commissioner of Internal Revenue determined a tax deficiency, disallowing the corporation's deduction for legal fees. The corporation petitioned the United States Tax Court to challenge the disallowance. The Tax Court reviewed the facts and legal arguments to determine the deductibility of the legal fees.

Issue(s)

1. Whether the legal fees paid by the corporation to the plaintiff-shareholders' attorneys, as part of a settlement agreement approved by the court, constituted an ordinary and necessary business expense deductible under the Internal Revenue Code.

2. Whether the legal fees paid by the corporation in its own defense, and on behalf

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of its directors, constituted an ordinary and necessary business expense.

Holding

1. Yes, because the legal fees paid to the plaintiff-shareholders were considered an ordinary and necessary business expense as the shareholder suit resulted in a benefit to the corporation.

2. Yes, because the legal fees paid in defense of the corporation and its directors in the shareholder suit were considered an ordinary and necessary business expense, as the suit concerned the conduct of the corporation's business.

Court's Reasoning

The court relied on the principle that legal expenses arising from a corporation's business are generally deductible. The court cited the *Shoe Corporation of America* case as precedent. In that case, legal fees incurred in a shareholder derivative suit that benefited the corporation were deemed deductible. The court found the facts in the *B. T. Harris* case analogous. The lawsuit arose from director actions related to the corporation's business—Glazer's compensation and the issuance of stock. The settlement, which involved the return of stock, was deemed to benefit the corporation. The court rejected the Commissioner's argument that the fees were not

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