

Tax Treatment of Advertising Costs Under Current Code

Assume:

- 1) A company begins with \$1 million in taxable income each year, prior to deductions for advertising
- 2) Other business expenses total \$750,000
- 3) Advertising expenses (fully deductible) total \$200,000
- 4) Tax rate: 35%

Current Tax Treatment: Fully Deductible

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Revenue	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000
Other Expenses	\$750,000	\$750,000	\$750,000	\$750,000	\$750,000	\$750,000	\$750,000	\$750,000	\$750,000	\$750,000
Advertising Expenses	\$200,000	\$200,000	\$200,000	\$200,000	\$200,000	\$200,000	\$200,000	\$200,000	\$200,000	\$200,000
Taxable Income	\$50,000	\$50,000	\$50,000	\$50,000	\$50,000	\$50,000	\$50,000	\$50,000	\$50,000	\$50,000
Taxes (35% rate)	\$17,500	\$17,500	\$17,500	\$17,500	\$17,500	\$17,500	\$17,500	\$17,500	\$17,500	\$17,500
Total Taxes Paid = \$175,000										

Amortization Schedule Proposed by House Ways and Means Committee: 50% Deductible + 50% Amortized Over 10 Years

Note: As you study the chart below, keep in mind that amortization is simply spreading out a deduction over time.

Assume:

- 1) A company begins with \$1 million in taxable income each year, prior to deductions for advertising
- 2) Other business expenses total \$750,000
- 3) Advertising expenses total \$200,000
- 4) Amortization will increase the tax burden in each year that a new round of advertising is purchased. Advertisers concurrently will be forced to pay off the previous year's advertising, as well as begin payment on new advertising.

Under Proposed Amortization Schedule

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Revenue	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000
Other Expenses	\$750,000	\$750,000	\$750,000	\$750,000	\$750,000	\$750,000	\$750,000	\$750,000	\$750,000	\$750,000
Advertising Expenses	\$200,000	\$200,000	\$200,000	\$200,000	\$200,000	\$200,000	\$200,000	\$200,000	\$200,000	\$200,000
Deductible Advertising Costs (50%)	\$100,000	\$100,000	\$100,000	\$100,000	\$100,000	\$100,000	\$100,000	\$100,000	\$100,000	\$100,000
10% of Deferred Ad Costs	\$10,000	\$20,000	\$30,000	\$40,000	\$50,000	\$60,000	\$70,000	\$80,000	\$90,000	\$100,000
Taxable Income	\$140,000	\$130,000	\$120,000	\$110,000	\$100,000	\$90,000	\$80,000	\$70,000	\$60,000	\$50,000
Taxes (25% rate)	\$35,000	\$32,500	\$30,000	\$27,500	\$25,000	\$22,500	\$20,000	\$17,500	\$15,000	\$12,500
Total Taxes Paid = \$237,500 Tax Increase Due to Amortization: \$62,500										