25 Years of Initiatives to Tax Advertising

1986 — Treasury Department provides Senate Finance Committee with revenue estimate for disallowance of 20 percent of advertising costs.

1986 — Senators Bill Bradley (D-NJ) and John Chafee (R-RI) and Rep. Pete Stark (D-CA) propose disallowance of cost of all tobacco advertising.

1986 — Rep. Brian Donnelly (D-MA) proposes disallowance of all alcohol beverage advertising costs.

1987 — Rep. Richard T. Schulze (R-PA) urged fellow Ways and Means Committee Members to restore investment incentives repealed by the 1986 Tax Reform Act and pay for the change with restrictions on the deduction of advertising costs. Rep. Schulze incorporated a summary of an article by University of Miami Law Professor George Mundstock in the University of Pennsylvania Law review, arguing that the deduction gives advertisers a tax preference that costs taxpayers billions of dollars a year.

1987 — Joint Committee on Taxation and Committee on Ways and Means included in Description of Possible Options to Increase Revenues proposals to raise $37.9 billion over three years by disallowing the deduction for 20 percent of advertising costs and amortizing the remainder over two years for firms with over $5 million in sales.

1987 — Harvard Economics Professor Lawrence H. Summers told the Senate Finance Committee that requiring firms to amortize advertising outlays would promote competitiveness and raise billions of dollars. A year later Professor Summers wrote in *The New Republic*, "The business community should be prepared to vigorously defend the important role of advertising in our economy against the destructive arguments of those who see it only as a ripe target." This could be described as the origins of "Etch-A-Sketch" public policy positions.

1987 — Executives of media and advertising agencies including ANA, NAB, AAAA, MPA and NAA testified before the House Ways and Means Subcommittee on Select Revenue to explain why the business deduction for the cost of advertising should not be reduced.

1988 — An AICPA task force recommended to the Accounting Standards Executive Committee (AcSEC) that certain advertising costs should be

capitalized for book income. TAC worked for three years with AcSEC which reversed the task force recommendation and voted that all advertising expenses should be "presumed" to be expensed for book income.

1989 Senator Joseph D. Biden (D-DE) told the Senate Democratic Drug Abuse Task Force to endorse limits on the deduction for the cost of advertising alcohol and tobacco products to fund federal drug prevention efforts.

1990 Congressional Budget Office lists deduction for advertising costs as a new revenue option in *Reducing The Deficit: Spending and Revenue Options*. The limit was estimated to generate $28 billion over five years if 20 percent of advertising costs were amortized over four years.

1991 Treasury Secretary Nicholas Brady offered conferees for the Omnibus Budget Reconciliation Act of 1991 (OBRA) to limit the deduction for advertising costs to raise $10 billion over five years.

1991 H.R. 3035, offered by Ways and Means Committee Chairman Dan Rostenkowski (D-IL), exempted from required amortization any costs that may *create* intangible asset value, such as the cost of advertising, as a way to pay for a 14-year amortization schedule for acquired intangible assets.

1991 Rep. Sam Gejdenson (D-CT) proposed to finance a federal campaign-matching fund of $200,000 per candidate for Congress with a 0.25 percent tax on all advertising.

1992 An amendment to the 1992 tax bill offered by Sen. Bill Bradley and Sen. Tom Harkin (D-IA) was defeated 56-38. It would have amortized 20 percent of the cost of advertising tobacco products over four years.

1993 TAC witnesses, including the publisher of the Albany *Times Union* and the president of the Association of National Advertisers, testified before the House Ways and Means Subcommittee on Select Revenue about the damage that would be done to the economy if the deduction for the cost of advertising were treated differently than other business deductions.

1993 Assistant Treasury Secretary for Tax Policy, Les Samuels, told the Ways and Means Committee that the Clinton Administration opposed limits on the deduction of advertising costs.

1994	A policy report entitled "Cut-and-Invest to Compete and Win: A Budget Strategy for American Growth," issued by the Progressive Policy Institute, a think tank close to the Clinton Administration, advocated the amortization of 20 percent of advertising cost as a capital cost to build brand recognition.
1994	Sen. Paul Wellstone (D-MN) and Rep. Jim McDermott (D-WA) were joined by 89 Representatives and five Senators to capitalize 20 percent of all advertising costs to fund a single payer health care reform proposal.
1995	House Budget Committee Chairman John Kasich (R-OH) launched a major challenge to the deduction for advertising costs. He incorporated a $10 billion tax on advertising in a draft Congressional Budget Resolution as part of a $25 billion GOP corporate welfare package. A Ways and Means member, with whom we discussed advertising in a grassroots meeting, alerted us to the proposal and allowed time for hundreds of Ohio publishers and broadcasters to let the Chairman know about our concerns.
1998	House Speaker Newt Gingrich sought to respond to teenage smoking by directing his GOP leadership task force to come back with elimination of the deduction for tobacco advertising costs to raise $1.7 billion over five years. Even CRS opined that it would not violate the First Amendment. TAC met with a group of House GOP leaders coordinated by Conference Chairman John Boehner and the proposal lost 8 to 9 on a GOP leadership vote.
1998	An amendment by Sen. Jack Reed (D-RI) was approved by voice vote after surviving a 47-47 tabling motion. The amendment would have authorized the FDA Commissioner to certify to the Treasury Secretary that a tobacco company had violated regulations on advertising to children which would provide the basis for denying a deduction for the company's advertising costs.
1999	TAC was invited to join the Steering Committee of a historic Tax Council conference on taxation of intangible assets following the U.S. Supreme Court decision in *Indopco v. Commissioner*, 503 U.S. 79 (1992). The Committee surveyed 334 companies and found 34 had undergone audits challenging their deduction for advertising costs, notwithstanding a 1992 Revenue Ruling in which the IRS said "advertising costs generally are deductible." *Indopco* represents a shift from *Commissioner v. Lincoln Savings Assn.*, 403 U.S. 345 (1971), that said an expenditure must "create an asset" to be capitalized. *Indopco*

dictated that the expenditure need only create long-term revenue and not a separate asset. This case continues to provide concern.

1998 *RJR Nabisco v. Commissioner of IRS* represented the first potential test of *Indopco*. The IRS disallowed the current deduction of $1.8 million for graphic designs of cigarette product packaging and advertising. The U.S. Tax Court overturned the IRS decision. A critical element of the case came from a Tax Court judge's affirmation of an opinion by an IRS advertising expert that the expenditures on the development of an advertising campaign created intangible assets that are inseparable from brand equity and goodwill. The IRS did not expect the judge to conclude these expenditures should be expensed. TAC was prepared to file an amicus brief with the U.S. Court of Appeals for the District of Columbia, but the IRS elected not to appeal.

2001 The trend continued to use limitations on the deduction for certain advertising costs to help achieve various social policy goals. Proposals have been offered to address teenage smoking, drunk driving, alcohol abuse, and violent television programming by restricting deductions for advertising costs. For nearly 15 years, a debate has been underway in the Congress and in the Executive Branch over the appropriate treatment of advertising costs as a business expense. While these costs generally are treated as ordinary and necessary business expenses, academic studies and a 1992 U.S. Supreme Court decision (*Indopco v. Commissioner*) have raised serious questions about whether certain types of advertising – particularly that which helps create intangible value in a company or brand, should be expensed or amortized over a period of time. The Department of the Treasury conducted a review of *Indopco* related issues and their impact on capitalization rules.

2002 House Ways and Means Committee Chairman William M. Thomas (R-CA) told the *New York Times*, "The decision to advertise or not advertise would be left completely up to the company. But the idea that you are going to drive up market share by advertising on a product that isn't medically necessary ought not to be in anyone's mind." The *Times* reported, "A bill introduced by Rep. Pete Stark, Democrat of California, would deny tax deductions for consumer advertising that presents the benefits of a drug without accurately describing the risks."

2005 *Markets and Childhood Obesity Policy*. John Cawley, Associate Professor of Policy Analysis and Management at Cornell University, contends in an article in *Future of Children* published by Princeton University, that

"The government can easily disseminate information to consumers directly, but formulating policies to address the other two rationales is more difficult. In the absence of ideal policies to combat obesity, the government must turn to "second-best" policies. For example, it could protect children from advertisements for "junk food." It could implement taxes and subsidies that discourage the consumption of unhealthful foods or encourage physical activity."

2008 Rep. Rahm Emanuel (D-IL) told a joint meeting of the American Association of Advertising Agencies Board of Directors and its Government Affairs Committee that the first order of business in the new Congress would be shoring up the economy and bringing the deficit under control. He volunteered that this would cause the advertising industry some pain. When pressed to elaborate, he said that, in Congress' quest for new revenue, one likely possibility would be telling PhRMA that they could keep the write-off for R&D or DTC, but not both. At the time, Emanuel was speaking as a member of the Committee on Ways and Means and Chairman of the Democratic Congressional Campaign Committee. Soon thereafter, he was named by President-elect Obama to be the White House Chief of Staff.

2008 *Fast-Food Restaurant Advertising on Television and Its Influence on Childhood Obesity*, a National Bureau of Economic Research Working Paper by Shin-Yi Chou, Inas Rashad, and Michael Grossman. The study was overseen by Dr. Zeke Emanuel, brother of former White House Chief of Staff Rahm Emanuel. The authors discuss several policy options for limiting fast food advertising including banning it and eliminating it as a tax-deductible business expense. Based on their results, eliminating deductibility would increase advertising costs by 54 percent and reduce the number of overweight children and adolescents by 5 and 3 percent respectively.

2009 The House Ways and Means Committee voted to approve a measure to disallow the ability of a pharmaceutical company to deduct its marketing costs, including the cost of advertising prescription medicines. The measure was estimated to generate $37 billion toward the cost of the Patient Protection and Affordable Care Act. The measure was removed from the bill four days after objections were raised by media and advertising companies.

2009 Rep. Dennis Kucinich (D-OH) introduced H.R. 4310, a bill to amend the Internal Revenue Code to protect children's health by denying any deduction for advertising and marketing directed at children to

promote the consumption of food at fast food restaurants or of food of poor nutritional quality.

2011 The Joint Select Committee on Deficit Reduction actively deliberated placing limits on the amount of the cost of advertising that a business could deduct as one strategy for generating additional tax revenues. The Pharmaceutical Care Management Association wrote to the "Super Committee" recommending that it adopt a bar on the ability of a company to deduct the cost of advertising prescription medicines.

2011 In a grassroots meeting in the midwest conducted by The Advertising Coalition, a highly regarded Republican "rising star" who is a member of the Committee on Ways and Means, cautioned the advertising and media executives to have in their back pocket the amount of advertising costs they would be willing to trade for lower tax rates.

Lexecon Inc. The debate over capitalizing all or part of the cost of business advertising was accelerated by the release the 1980s and 1990s of economic research papers that contend that a significant portion of advertising goes toward building brands and intangible value for businesses. Additional momentum was provided by the Supreme Court decision in *Indopco v. Commissioner*, 503 U.S. 79 (1992) said capitalization does not depend upon creation of a separate asset and only a future revenue stream needs to be shown. The economic consulting firm of Lexecon, Inc., and its affiliates, Nobel Laureates Dr. Kenneth Arrow of Stanford University and the late Dr. George Stigler of the University of Chicago, researched and wrote a paper entitled *Economic Analysis of Proposed Changes in the Tax Treatment of Advertising Expenditures.*

The Lexecon Study observed that the tax law permits businesses to deduct the cost of advertising as a current expense. It has been suggested that some portion of advertising costs be amortized and deducted over several years. This concept appears to be based on the view that advertising is either wasteful and should be discouraged, or that current advertising expenses generally produce long-term benefits or create intangible value that lasts for more than one year. The Lexecon study states:

"Advertising is a powerful tool of competition. Advertising keeps prices low and facilitates the entry of new products and new firms into the market. It provides valuable information about products and services in a cost-effective manner and helps the economy to function smoothly.

"Based on an analysis of the issues and a comprehensive review of the existing literature in the field, ***Lexecon concludes that proposals to change the tax treatment of advertising are not supported by the economic evidence."***

IHS/Global Insight

In a landmark economic study entitled *The Economic Impact of Advertising Expenditures in the United States* IHS/Global Insight found in 2010:

- Businesses spend $279 billion on advertising
- Every dollar of ad spending generates just under $20 of economic output
- Every million dollars of ad spending supports 69 American jobs
- Advertising accounts for $5.8 trillion of the $29.6 trillion in U.S. output
- Advertising supports 19.8 million or 15 percent of the 133.4 million jobs in America

The Economic Impact of Advertising Expenditures in the United States also measures the extent to which advertising expenditures contribute to the creation of jobs and the generation of substantial economic activity in each state and congressional district in the country. For example, in the 4th Congressional District of Michigan, advertising supports 36,728 jobs and generates $9.1 billion in economic output. in the State of Montana, advertising supports 64,257 jobs and generates $12.2 billion in economic output.

IHS/Global Insight is one of the nation's premier econometric modeling firms, and they score consistently as one of the most accurate economic forecasting organizations in the world. The study was prepared for The Advertising Coalition under the direction of Michael J. Raimondi, Executive Managing Director, IT & Telecom Custom Solutions, IHS/Global Insight, and Dr. Lawrence R. Klein, who was awarded the Nobel Prize in Economics in 1980.