LEADERSHIP AND
MARKETING EXCELLENCE

April 15, 2015

The Honorable John Thune
The Honorable Benjamin Cardin
Co-Chairs of the Business Income Tax Working Group
United States Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510

RE: Comments for Business Income Tax Working Group

Dear Senators Thune and Cardin:

I am writing on behalf of the Association of National Advertisers (ANA) to express our strong opposition to any change in the current full deductibility of all advertising costs.

In a radical deviation from over 100 years of corporate tax policy, draft tax reform bills introduced in the last Congress by former Senate Finance Committee Chairman Max Baucus and former House Ways and Means Committee Chairman Dave Camp would have allowed marketers to deduct only 50 percent of their advertising costs each year. The proposals required the remaining 50 percent to be amortized over a period of five years in the Senate draft and ten years in the House draft.

Advertising is a driving force in the U.S. economy and such a restriction on the full deductibility of all advertising costs would be extremely counterproductive and bad tax policy. It could seriously undermine the ability of American companies to market their goods and services efficiently and effectively.

Founded in 1910, ANA's membership includes more than 640 companies with 10,000 brands that collectively spend more than $250 billion annually in marketing and advertising. More information is available at www.ana.net

ANA supports tax reform and the lowering of corporate tax rates to guarantee U.S. competitiveness, but we believe it is counterproductive and unsound public policy to impose a tax on the business efforts to sell their goods and services in order to fund other changes to the tax code. Advertising is extremely valuable to the U.S. economy, both as an economic driver of sales and as a consumer resource. It is part of the lifeblood of the economy, not a special interest exemption to be used to make up for shortfalls elsewhere. While there are some exceptions, the vast majority of our major economic competitors do not place these types of burdens on advertising by businesses. We see no reason why the United States should put its businesses at a serious disadvantage by requiring that half of all advertising costs be amortized.

Advertising Provides Tremendous Value to Our Economy

ANA and The Advertising Coalition (TAC), of which ANA was a founding member, have just released a new study which provides a comprehensive assessment of the total economic impact of advertising expenditures across the country. The study, conducted by IHS Global Insight, Inc., is based on an econometric model of the U.S. economy that was originally created by the late Dr. Lawrence R. Klein, a Nobel Laureate in Economics.

The IHS Global Insight study found the following:

- **Advertising supports 18.7 percent of U.S. GDP and 20.8 million of the 147.5 million jobs in the country**

- **Each dollar spent on advertising expenses generates nearly $19 of economic output**

- **Every $1 million spent annually on advertising supports 28 American jobs**

More information about the IHS Global Insight report is available at: www.ana.net/content/show/id/adtax.

The study found that the impact of advertising is surprisingly consistent across the country regardless of the location or population of a state. Advertising, for example, generates 16% of economic impact in both South Dakota and Maryland. Advertising also supports 15% of the jobs in Maryland and 14% of the jobs in South Dakota. In fact, there is no congressional district or state in this country where advertising does not play a major beneficial and productive role both in regard to job creation and generation of business activity.

The Advertising Deduction Provides Tax Fairness

Advertising has been recognized and treated as an ordinary and necessary business expense since the federal tax code was adopted in 1913. From the time the tax code was enacted, the Internal Revenue Service has, by regulation, provided for the current deduction of advertising costs. The deduction for advertising costs promotes tax fairness because it is central to allowing a business to properly calculate its net income and ultimately the amount of tax it must pay, just the same as the deduction for employee salaries, rent, utilities and the other ongoing costs of businesses. Amortizing the deduction for half of all advertising costs would be arbitrary and inconsistent with rules for financial accounting rules. Advertising, like any other ordinary and necessary deduction, is dependent for its impact and success on multiple repeated expenditures each year.

In addition to driving economic growth and promoting tax equity, advertising helps the economy work more efficiently. According to Nobel Laureates in Economics, Dr. Kenneth Arrow and Dr. George Stigler, advertising provides valuable information to consumers about products and services in an efficient and cost-effective manner. In this way, advertising helps the economy to function smoothly; it keeps prices low and facilitates the entry of new products and new companies into the market. Advertising benefits all levels of our economy, from national marketers to local businesses, and is the most efficient way to communicate with consumers.

Advertising Does Not Create an Asset

The explanation of proposed Section 177 in last year's House Ways and Means Discussion Draft offered by the Joint Committee on Taxation (JCT) stated, "Business expenses associated with the development or creation of an asset having a useful life extending beyond the current year generally must be capitalized and recovered over such useful life." The JCT did not provide any tax or economic research to link that statement to advertising or to demonstrate the durability of advertising in a way that would support such a radical change in the law.

There is virtually no empirical evidence to support the concept that an investment in advertising is long-lived or comparable to the purchase of an asset. Does anyone really believe that an ad is similar to a business expense that must be amortized under the current tax code, such as an office building (40 years) a business vehicle (5 years) or an office laptop (5 years)?

Almost 30 years ago, several economic studies were cited in an article in the University of Pennsylvania Law Review that attempted to establish the longevity of advertising expenditures and argued for amortizing these costs. We asked two of this nation's leading economists – Dr. Kenneth Arrow and Dr. George Stigler – to evaluate these economic studies. These eminent scholars were particularly well suited for this task. Dr. Arrow received the Nobel Memorial Prize for Economics based on his theories of social choice. Dr. Stigler received the Nobel Prize for his work on the role of information in market decisions.

Drs. Arrow and Stigler wrote, "We believe that support for the proposed change in the tax treatment of advertising is based on two mistaken views of advertising: (1) that advertising is "bad" or "wasteful" and (2) that advertising (whether it is bad or good) is inherently long-lived and therefore should be treated under the tax code as other investments with long lives." Drs. Arrow and Stigler then emphatically emphasized that "there are a number of studies… that suggest that advertising depreciates so rapidly that virtually all of its effects are gone within a year. **In short the economic evidence does not support the view that advertising is long-lived.**" (emphasis added) The Lexecon Study is available at www.ana.net/content/show/id/adtax-lexecon

Drs. Arrow and Stigler also demonstrated that the studies cited in the University of Pennsylvania Law Review to support the amortization of advertising were severely flawed in their analysis.

This conclusion was true when Drs. Arrow and Stigler wrote their critique, and it is far more true today. In the past 20 years, advertising has undergone a dramatic transformation. For much of the 20th century, the advertising business was oriented to the dominance of three television networks, a large number of highly recognizable national magazines, and daily and weekly newspapers serving communities and metropolitan areas. Today, marketing experts must find ways to reach consumers through a highly fragmented traditional media marketplace substantially augmented and transformed by the Internet, Twitter, Facebook, mobile media, and other applications.

This transformation has created an environment in which news and entertainment messages are changing constantly not over years but often on an ongoing basis. The advertising business continually employs real time data analysis (not available until recently) to monitor and respond quickly to changes in consumer behavior. Marketing directors regularly adjust messages to present a product or service in the context of changing current events and consumer preferences. Most company's competitors are also altering their campaigns in a 24/7 thrust and parry of dueling marketing efforts.

The dynamics of the online marketplace have tended to greatly shorten the time during which an ad is effective. Online ads are delivered electronically to the computer or web device of a consumer based on a wide range of factors. Companies can change their online ads hourly or daily or weekly to respond to the intense battle in the marketplace. It makes no sense to require the cost of today's ads, which are often intended to generate an immediate response, to be amortized over a period of years.

There are numerous other examples of time-sensitive ads, such as retailer ads for a Halloween costume, a Memorial Day sale or ads for a new movie release. These ads are clearly intended to have an immediate impact and it makes absolutely no sense to treat them as having a useful life or value of five or ten years.

Some time ago, George Ditomassi, the former CEO of Hasbro Toy Company, in a meeting with a member of Congress, provided an important real life example concerning the perceived "longevity" of advertising. As the then new CEO at Hasbro, Mr. Ditomassi suggested that the company shift marketing spending from two renowned brands to lesser known products that he felt could benefit from a boost in promotion. Mr.

Ditomassi noted that within a few months it became evident his strategy was allowing the market share for Scrabble and Monopoly to erode. After reviewing the results, he directed the marketing department to restore ad spending to those brands. He concluded that in a competitive environment, continuous advertising effort is essential to the generation of sales, whatever the category, product, or service.

The Creation of Intangible Value

Drs. Arrow and Stigler noted that confusion often exists about whether the value that attracts a consumer exists within the advertising itself or is due to the product or service involved. They concluded that the intangible value is not in the means chosen to communicate the attributes of a product, but in the product or service itself. They noted that when Apple, for example, developed the "Finder" for its Macintosh computers, the advertising introduced the revolutionary tool for navigating online to the public. Public acceptance of the Macintosh was not grounded in the advertising but in the consumer-friendly features of the finder itself. The advertising simply was a mechanism to communicate those features to consumers.

A dramatic further illustration of this point can be found in a review of two of the most successful advertising campaigns in the history of the automotive industry. Success of an advertising campaign for this category often can be measured by the number of consumers prompted to visit a dealership to view a new car model. In the first ad campaign, record numbers of prospective buyers turned out to Ford dealerships around the country, but disappointingly, small numbers drove away with the new Edsel. Years later, Ford had similar success in a subsequent advertising campaign, but this time consumer acceptance made the Taurus the most popular car in America.

Using the automobile industry as a further example, the concept of amortizing 50% of all advertising costs over 10 years is impractical on its face. Consider the automobile dealer who this year plans to spend $5 million to advertise a new 2015 model. That dealer will not be able to fully recover the cost of this year's advertising for the 2015 model until the 2025 models are on the showroom floor. This situation repeats each year thereafter. A 5-year amortization period would be little better. This approach would not make any sense and cannot be justified for any product or service category.

Some have argued that advertising creates long-term intangible value in a company (brand awareness and company loyalty) which generates ongoing revenue, and thus the ads should be amortized over time. However, history is full of innumerable once famous brands and companies that have died in the marketplace because they failed to keep abreast of consumer needs or became obsolete; companies such as Borders, Radio Shack, Circuit City, Polaroid and Blockbuster, to name just a few. Some companies, such as Lehman Brothers, were suddenly laid low by serious buffeting in the marketplace. Clearly, once these companies went under, the value of their advertising immediately dramatically plummeted. Further, in a Revenue Ruling regarding the U.S. Supreme Court's decision in the *Indopco* case, even the Internal Revenue Service declared that advertising did not create generally amortizable value.

Amortization of Advertising Costs is Bad Economic Policy

The amortization proposal would have the net effect of increasing a company's taxable income for every year in which new advertising is purchased. This would cost marketers multi-billions of dollars in increased taxes.
The amortization proposal is counterproductive. It would stifle creativity and innovation. Most new products are introduced to the market with a relatively high advertising spend, often with failure rates as high as 70% in the first couple of years of introduction.

The amortization proposal is not based on any accepted economic or tax policy theory – just on the need for more tax revenue to pay for reducing the tax rates.

Some defenders of the amortization proposal claim that advertisers would be "made whole" after five or ten years, when a company completes the initial amortization cycle. However, this suggestion fails to take into account the time value of money and lost investment opportunity costs. By being forced to wait for five or ten years, companies would be foregoing the ability to spend or invest that money due to their inability to fully deduct advertising costs. In light of the constant erosion of spending power, generated by annual rates of inflation, a dollar available to an advertiser today is far more valuable than one that will only become available five or ten years from now.

While inflation rates have been historically low recently, there is no reason to believe that this situation will continue indefinitely in the future, and this creates a potential threat for even greater erosion of advertising spending power. In addition, the extra dollars that are available to advertisers as a result of immediate deductibility, if invested or spent wisely, can be applied to further economic growth of a company.

In a perverse way, the amortization proposals simultaneously both under-values and over-values advertising. Given the negative impact amortization would have on jobs and economic activity, it dramatically under-values the critical role that advertising plays in our economy. If amortization is based on the belief that advertising has a shelf-life of five or ten years, it over-values the impact that any ad has to generate continuing sales over time.

Conclusion

There are those who argue that despite all of these concerns, we should still amortize advertising to provide funding to allow for a lower U.S. corporate tax rate. As we have stated, ANA believes that a more competitive corporate tax rate is a very valuable goal.

However, there is absolutely no reason to believe that we need to saddle the ability to sell with heavy tax burdens to reach this goal. The vast majority of free market economic competitors realizing the enormous economic value of advertising have not imposed these types of burdens on their advertising efforts to reach their lower tax rates.

It would be extremely counterproductive for Congress to impose an increased tax burden on advertising, particularly during a period when the nation is still struggling to recover from the recent staggering recession. Because of the immense value it brings to both consumers and the marketplace throughout the country, advertising should remain a fully deductible ordinary and necessary business expense.

Thank you for your consideration.

Sincerely,

Daniel Jaffe
Group Executive VP