AMERICAN ADVERTISING FEDERATION®
THE UNIFYING VOICE FOR ADVERTISING®

Advertising Should Remain Fully Deductible as an Ordinary and Necessary Business Expense

Advertising supports 20 million U.S. jobs. Advertising is a major economic engine driving growth in the U.S. economy. Advertising expenditures account for $5.8 trillion in U.S. economic output – that is 20 percent of the total national economic output. Advertising also helps support 20 million jobs, or 15 percent of all jobs in the country. This stimulus creates sales and jobs throughout the economy and in every congressional district.

The deduction for advertising costs is the correct tax policy. A business may deduct the cost of advertising pursuant to Section 162(a) of the Tax Code which permits a business to deduct the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. The expense must be ordinary – that is, it must occur as part of the routine operation of the business – and it must be necessary to the operation of the business. The Internal Revenue Service and the U.S. Tax Court have determined that the cost of business advertising meets these criteria. Most critically, this deduction assures that businesses are only paying taxes on net income or profits. When advocates of reform say every tax provision must be on the table, this should not include ordinary and necessary expenses – otherwise businesses would pay taxes on their costs of doing business and not on net income or profits.

Advertising deduction is not a tax expenditure. The commitment to tax reform expressed by leaders in Congress can bring productive changes to the Tax Code, including a reevaluation of "tax expenditures" that are not consistent with sound tax policy. However, it is essential to distinguish between tax expenditures and ordinary and necessary business expenses. Tax expenditures are defined under the Congressional Budget Act as "revenue losses [to the government] caused by provisions of the tax laws that allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability." In other words, a tax expenditure is a form of federal spending that is designed to encourage specific behavior. These measures are not ordinary and necessary to business activity and therefore are treated as exceptions to sound tax policy. The principle of Section 162(a) was part of the Tax Code adopted 100 years ago, and advertising has been treated as a currently deductible expense since that time.

Proposals constitute a tax on advertising. The federal income tax on businesses is a tax on profits or net income – that is gross income less current expenses and other deductible costs. If you are allowed to deduct all of your costs, except your advertising costs, it is a tax on part of your income that includes the nondeductible advertising. For example, if your business had total income of $100 last year, and all of your expenses including advertising and other ordinary expenses were $80, you would pay taxes on net income (profit) of $20. Under a corporate tax rate of 35 percent you would pay $7. However, if $20 of your $80 was for advertising, and the government disallowed that cost deduction, it would mean you have taxable income of $40 and would have to pay a federal income tax of $14. In this example, the loss of the advertising deduction would double the federal income tax liability of the business.

Most countries permit advertising cost deduction. Advertising is integral to the ability of companies to provide information to their business and consumer markets about their goods and services. U.S. advertisers have been world leaders for innovative developments in marketing and advertising, and most western economy tax systems, as well as China, have followed the U.S. example and permit the current deduction of advertising as an ordinary and necessary business expense.

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