

Title:

Commissioner of Internal Revenue vs. General Foods (Phils.), Inc.: A Case on Deductibility of Advertising Expenses

Facts:

General Foods (Phils.), Inc., a manufacturer of popular beverage brands, filed its income tax return on June 14, 1985, for the fiscal year ending February 28, 1985. This included a deduction claim for media advertising expenses amounting to P9,461,246 for “Tang.” On May 31, 1988, the Commissioner of Internal Revenue (Commissioner) disallowed half of the claimed deduction, leading to an assessed deficiency income tax of P2,635,141.42 against General Foods. The company’s motion for reconsideration was denied.

General Foods appealed to the Court of Tax Appeals (CTA), which dismissed the appeal, finding the advertising expense unreasonably large for a single product and construed it as an effort to create or maintain goodwill rather than an ordinary and necessary business expense. Unconvinced by General Foods’ justification, the CTA ordered the company to pay the assessed deficiency.

Aggrieved, General Foods sought recourse at the Court of Appeals, which reversed the CTA’s decision, allowing the deduction on the ground that it was not established the claim was excessive. The Commissioner then elevated the issue to the Supreme Court.

Issues:

1. Whether the subject media advertising expense for “Tang” was an ordinary and necessary expense fully deductible under the National Internal Revenue Code (NIRC).
2. Whether the advertising expense was a capital outlay intended to create goodwill, necessitating capitalization and amortization over a period.

Court’s Decision:

The Supreme Court granted the Commissioner’s petition, reversing the Court of Appeals’ decision. The main considerations were:

- The massive amount of advertising expense for a single product was deemed extraordinary and thus could not be considered an ordinary business expense.
- The expenditure was assessed to be aimed at creating or preserving brand franchise, which qualifies as a capital expenditure related to goodwill.
- The foremost principle in tax law is that deductions are to be strictly construed. General Foods failed to substantiate the necessity and ordinariness of the claimed expense

adequately.

Therefore, the Supreme Court ruled that the advertising expense was not wholly deductible as an ordinary and necessary business expense but was instead a capital expenditure that should be amortized over time.

Doctrine:

The Supreme Court reiterated the doctrine that tax exemptions or deductions are to be construed strictly against the taxpayer and liberally in favor of the taxing authority. Moreover, it established that for an expense to be deductible, it must be both ordinary and necessary within the context of the business, and that inordinately large expenditures for advertising intended to create or maintain goodwill are deemed capital expenditures that should be spread out over a reasonable period.

Class Notes:

- ****Deductions are construed strictly****: Taxpayers bear the burden of proof to establish the validity of claimed deductions.
- ****Ordinary and necessary expenses****: For an expense to be deductible, it must be both ordinary (common and accepted in the industry) and necessary (appropriate and helpful for the business), and not excessively large so as to suggest it's for goodwill.
- ****Capital Expenditures****: Expenses incurred to create or maintain goodwill are not immediately deductible business expenses but are capital outlays to be amortized.

Historical Background:

This case highlights the scrutinizing approach of the Philippine tax authorities and judiciary concerning large business expense deductions, especially in periods of economic uncertainty. It underscores the essentiality of distinguishing between ordinary business operations and strategic initiatives meant to foster long-term brand equity, particularly in the fiscal regime.