

THIRD DIVISION

[G.R. No. 143672, April 24, 2003]

COMMISSIONER OF INTERNAL REVENUE, PETITIONER, VS. GENERAL FOODS (PHILS.), INC., RESPONDENT.

DECISION

CORONA, J.:

Petitioner Commissioner of Internal Revenue (Commissioner) assails the resolution^[1] of the Court of Appeals reversing the decision^[2] of the Court of Tax Appeals which in turn denied the protest filed by respondent General Foods (Phils.), Inc., regarding the assessment made against the latter for deficiency taxes.

The records reveal that, on June 14, 1985, respondent corporation, which is engaged in the manufacture of beverages such as "Tang," "Calumet" and "Kool-Aid," filed its income tax return for the fiscal year ending February 28, 1985. In said tax return, respondent corporation claimed as deduction, among other business expenses, the amount of P9,461,246 for media advertising for "Tang."

On May 31, 1988, the Commissioner disallowed 50% or P4,730,623 of the deduction claimed by respondent corporation. Consequently, respondent corporation was assessed deficiency income taxes in the amount of P2,635, 141.42. The latter filed a motion for reconsideration but the same was denied.

On September 29, 1989, respondent corporation appealed to the Court of Tax Appeals but the appeal was dismissed:

With such a gargantuan expense for the advertisement of a singular product, which even excludes "other advertising and promotions" expenses, we are not prepared to accept that such amount is reasonable "to stimulate the current sale of merchandise" regardless of Petitioner's explanation that such expense "does not connote unreasonableness considering the grave economic situation taking place after the Aquino assassination characterized by capital fight, strong deterioration of the purchasing power of the Philippine peso and the slacking demand for consumer products" (Petitioner's Memorandum, CTA Records, p. 273). We are not convinced with such an explanation. The staggering expense led us to believe that such expenditure was incurred "to create or maintain some form of good will for the taxpayer's trade or business or for the industry or profession of which the taxpayer is a member." The term "good will" can hardly be said to have any precise signification; it is generally used to denote the benefit arising from connection and reputation (Words and Phrases, Vol. 18, p. 556 citing *Douhart vs. Loagan*, 86 III. App. 294). As held in the case of *Welch vs. Helvering*, efforts to establish reputation are akin to acquisition of capital assets

and, therefore, expenses related thereto are not business expenses but capital expenditures. (Atlas Mining and Development Corp. vs. Commissioner of Internal Revenue, *supra*). For sure such expenditure was meant not only to generate present sales but more for future and prospective benefits. Hence, "abnormally large expenditures for advertising are usually to be spread over the period of years during which the benefits of the expenditures are received" (Mertens, *supra*, citing Colonial Ice Cream Co., 7 BTA 154).

WHEREFORE, in all the foregoing, and finding no error in the case appealed from, we hereby RESOLVE to DISMISS the instant petition for lack of merit and ORDER the Petitioner to pay the respondent Commissioner the assessed amount of P2,635,141.42 representing its deficiency income tax liability for the fiscal year ended February 28, 1985."^[3]

Aggrieved, respondent corporation filed a petition for review at the Court of Appeals which rendered a decision reversing and setting aside the decision of the Court of Tax Appeals:

Since it has not been sufficiently established that the item it claimed as a deduction is excessive, the same should be allowed.

WHEREFORE, the petition of petitioner General Foods (Philippines), Inc. is hereby GRANTED. Accordingly, the Decision, dated 8 February 1994 of respondent Court of Tax Appeals is REVERSED and SET ASIDE and the letter, dated 31 May 1988 of respondent Commissioner of Internal Revenue is CANCELLED.

SO ORDERED.^[4]

Thus, the instant petition, wherein the Commissioner presents for the Court's consideration a lone issue: whether or not the subject media advertising expense for "Tang" incurred by respondent corporation was an ordinary and necessary expense fully deductible under the National Internal Revenue Code (NIRC).

It is a governing principle in taxation that tax exemptions must be construed *in strictissimi juris* against the taxpayer and liberally in favor of the taxing authority;^[5] and he who claims an exemption must be able to justify his claim by the clearest grant of organic or statute law. An exemption from the common burden cannot be permitted to exist upon vague implications.^[6]

Deductions for income tax purposes partake of the nature of tax exemptions; hence, if tax exemptions are strictly construed, then deductions must also be strictly construed.

We then proceed to resolve the singular issue in the case at bar. Was the media advertising expense for "Tang" paid or incurred by respondent corporation for the fiscal year ending February 28, 1985 "necessary and ordinary," hence, fully deductible under the NIRC? Or was it a capital expenditure, paid in order to create "goodwill and reputation" for respondent corporation and/or its products, which should have been amortized over a reasonable period?

Section 34 (A) (1), formerly Section 29 (a) (1) (A), of the NIRC provides:

(A) Expenses.-

(1) Ordinary and necessary trade, business or professional expenses.-

(a) *In general.*- There shall be allowed as deduction from gross income all ordinary and necessary expenses paid or incurred during the taxable year in carrying on, or which are directly attributable to, the development, management, operation and/or conduct of the trade, business or exercise of a profession.

Simply put, to be deductible from gross income, the subject advertising expense must comply with the following requisites: (a) the expense must be ordinary and necessary; (b) it must have been paid or incurred during the taxable year; (c) it must have been paid or incurred in carrying on the trade or business of the taxpayer; and (d) it must be supported by receipts, records or other pertinent papers.^[7]

The parties are in agreement that the subject advertising expense was paid or incurred within the corresponding taxable year and was incurred in carrying on a trade or business. Hence, it was necessary. However, their views conflict as to whether or not it was ordinary. To be deductible, an advertising expense should not only be necessary but also ordinary. These two requirements must be met.

The Commissioner maintains that the subject advertising expense was not ordinary on the ground that it failed the two conditions set by U.S. jurisprudence: first, "reasonableness" of the amount incurred and second, the amount incurred must not be a capital outlay to create "goodwill" for the product and/or private respondent's business. Otherwise, the expense must be considered a capital expenditure to be spread out over a reasonable time.

We agree.

There is yet to be a clear-cut criteria or fixed test for determining the reasonableness of an advertising expense. There being no hard and fast rule on the matter, the right to a deduction depends on a number of factors such as but not limited to: the type and size of business in which the taxpayer is engaged; the volume and amount of its net earnings; the nature of the expenditure itself; the intention of the taxpayer and the general economic conditions. It is the interplay of these, among other factors and properly weighed, that will yield a proper evaluation.

In the case at bar, the P9,461,246 claimed as media advertising expense for "Tang" alone was almost one-half of its total claim for "marketing expenses." Aside from that, respondent-corporation also claimed P2,678,328 as "other advertising and