TR 2016/D1 - Income tax: deductibility of expenditure on a commercial website

Draft Taxation Ruling

Income tax: deductibility of expenditure on a commercial website

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What this draft Ruling is about

1. This draft Ruling sets out the Commissioner's preliminary views on the deductibility of expenditure incurred in acquiring, developing, maintaining or modifying a website for use in carrying on a business, including expenditure relating to domain names.

2. This draft Ruling:

covers	does not cover
• section 8-1[1] • Division 40 (capital allowances) • Division 328 (small business entities) • Parts 3.1 and 3.3 (capital gains tax) • section 40-880 (black-hole expenditure) • the definition of 'in-house software'	• expenditure on computer hardware • cross-border issues where a business is carried on outside Australia • when software is trading stock[2] • research and development (R&D) concessions

[1] All legislative references are to the *Income Tax Assessment Act 1997* unless otherwise indicated.
[2] This is addressed in Taxation Ruling TR 93/12 *Income tax: computer software*, see paragraphs 6 and 7.

Previous rulings

3. The deductibility of website development expenditure under former Division 46 (capital allowances for software) was addressed in TR 2001/6[3] (now withdrawn). Division 46 was repealed with effect from 1 July 2001.

4. TR 2001/6 is not relevant to the application of Division 40.

Ruling

5. A taxpayer that is carrying on a business will often incur expenditure that is related to a website that it uses in that business (called a **commercial website** in this Ruling).

6. In this Ruling, a website is an intangible asset consisting of software, and includes software integrated into the website for online use by a website user. However, it does not include software provided on the website for installation on the user's device. (See Example 1)

7. The deductibility of expenditure on a commercial website under section 8-1 depends upon whether the expenditure is of a capital or revenue nature.

8. The following assets can be separately identified and are not considered part of a commercial website:

- hardware
- the right to use the domain name (see paragraphs 47 to 49 of this draft Ruling)
- content available on or incorporated into a website that has independent value to the business.

9. Expenditure on a commercial website that is not deductible under section 8-1 (or any other provision outside Divisions 40 and 328) may be 'in-house software' and deductible under the capital allowances regime. (see paragraphs 37 to 44 of this draft Ruling)

10. Expenditure on a commercial website is not deductible to the extent that the website is used to produce exempt income or non-assessable non-exempt (NANE) income.

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[3] Taxation Ruling TR 2001/6 *Income tax: deductibility of commercial website expenditure.*

Expenditure on a website prior to its use in carrying on a business

11. Any website expenditure incurred, even as part of a hobby, will form part of the cost of the depreciating asset (the website).[4] The decline in value and adjustable value of the website is calculated from the time it is held, irrespective of the use of the website. Deductions for the decline in value are not available until the hobby becomes a business. (See Example 2)

Commercial website expenditure: capital/revenue distinction

Types of Expenditure

12. Expenditure in relation to commercial websites is commonly for:

- labour – including contractor expenses and employee expenses
- off-the-shelf software products, or
- registration, licensing and other periodic usage fees.

These expenses can be incurred at any stage of the lifecycle of a commercial website.

Nature of expenditure generally

Labour

13. Labour costs are ordinarily a recurrent business expense and deductible. However, labour costs that are directly referable to the enhancement of the profit-yielding structure of the business are capital in nature and not deductible.

14. Where labour costs are partly on revenue account and partly capital in nature, the expenditure is to be apportioned on a reasonable basis.[5]

Off-the-shelf products and periodic usage fees

15. Expenditure on 'off-the-shelf' software products is of a capital nature where the product provides an enhancement of the profit-yielding structure of the business. Where this is the case, a deduction may be available under Division 40 where the off-the-shelf product constitutes 'in-house software' (see paragraphs 38 to 44 of this draft Ruling).

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[4] See paragraph 13 of TR 97/11 which provides indicators for determining whether an activity is a hobby or amounts to the carrying on of a business.
[5] *Ronpibon Tin NL and Tongkah Compound NL v. Federal Commissioner of Taxation* (1949) 78 CLR 47; [1949] HCA 15.

16. Expenditure on 'off-the-shelf' software product that is licensed periodically is a revenue expense.

17. Where a commercial website is leased from a web developer by a business owner, periodic lease payments made under the arrangement are deductible as incurred, provided the business does not also have a right to become the owner of the website. (See Example 3)

18. Periodic operating, registration or licensing fees are revenue expenses.

Acquiring or developing a website

19. Expenditure incurred in acquiring or developing a commercial website for a new or existing business is capital expenditure. The expenditure is treated as expenditure on 'in-house software' to the extent the expenditure relates directly to the commercial website and is not deductible under a provision outside Divisions 40 and 328. (See Examples 4 & 5)

Maintaining a website

20. Expenditure incurred in maintaining a website is a revenue expense.

21. Whether a modification to a website is properly considered to be maintenance is a matter of fact and degree. Generally, maintenance activity on a website is routine and expected, but can involve responding to an unexpected event affecting the operation of the website. Remedying software faults is regarded as maintenance.

22. A modification to a website that preserves but does not:

- alter the functionality of the website
- improve the efficiency of function of the website, or
- extend the useful life of the website

has the character of maintenance.

23. A modification to a website that adds minor functionality or makes minor enhancements to existing functionality is also of a revenue character. However, a modification that adds new functionality or materially expands existing functionality is not in the nature of maintenance and is capital.

24. Functionality can be back-end or front-end. Front-end functionality refers to interactivity available directly to the website user. Back-end functionality manages the website, connecting front-end functionality with required resources and running background operations.

Modifying a website

25. The character of expenditure incurred on modifications to a website is a matter of fact and degree. The more significant the change or improvement is to the profit-yielding structure of the business, the more likely the expenditure is capital in nature.

26. The purpose and significance of the website modification and the associated expenditure is to be judged from a practical and business perspective. Factors to be taken into account in determining the character of expenditure incurred in modifying a website include:

- the role of the website in the business
- the nature of the modification to the website
- the size and extent of the modification
- the degree of planning and level of resources employed in effecting the modification
- the level of approval required for the modification
- the expected useful life of the modification. (See Examples 6, 7 & 8)

27. The addition of new functionality to a website, or the upgrading of existing functionality in a website, may add to or enhance the profit-yielding structure of the business rather than being a day-to-day operational cost. Expenditure on a modification that represents a structural advantage to the business is capital expenditure. (See Examples 9 & 10)

28. Similarly, expenditure to facilitate a replacement of a material part of the commercial website is a structural advantage and capital in nature. (See Examples 11 & 12)

29. Expenditure on regularly upgrading existing website software to allow webpages to appear correctly with new mobile devices, browsers or operating systems, is normally directed at facilitating continued access to the website by browsers. It is generally an operational and not a structural expense and is deductible. However, where that expenditure extends functionality, replaces a material part or creates a business asset or advantage which is distinct from the website, the expenditure will be of a capital nature where that advantage is significant to the business. (See Examples 13 & 14)

Piecemeal modifications and minor enhancement

30. Piecemeal modifications can result in a website becoming significantly changed over time.

31. Piecemeal or routine modifications are to be contrasted with modifications that are part of a program of work to upgrade and improve the website significantly. Each situation must be judged on its own circumstances, although a routine modification resulting in minor enhancement will be of a revenue nature; expenditure on the latter will usually be of a capital nature.

32. Whether expenditure on a modification is part of a program of work for improving the website is determined by reference to the purpose of the program of work in the context of the business. Indicators that a modification is part of a program of work for improving the website include:

- inclusion of the modification in planning, approval or other documentation for a program of work
- extent to which a particular end-state is planned and the importance of those incremental enhancements in achieving that end-state
- causal or temporal links with other modifications. (See Example 15)

Content migration

33. The character of expenditure incurred in migrating website content follows that of the activity requiring the content migration.

34. Content is digital information in a website that can be displayed in the form of text, graphics, sound or video (for example, a catalogue of goods for sale) or not displayed but available to the administrator (for example, a client email list).

35. If content is migrated as part of establishing a new website, the cost is a capital expense. If content is migrated as a result of an upgrade to an existing website that does not significantly enhance or replace the website, the cost is a revenue expense.

Social media

36. Businesses will often establish and maintain a profile on social media websites. Because the business will be using the platform of the social media site, it is expected that establishment costs will be minimal. However, any such costs in establishing the presence on a social media site will be capital in nature. Expenditure incurred in maintaining that social media presence and updating content is akin to advertising or marketing expenditure and is of a revenue nature. (See Example 16)

Capital allowances – where expenditure is not otherwise deductible

37. A website is not a depreciating asset under Divisions 40 and 328, except to the extent it can be classified as 'in-house software'.

In-house software

38. Software is 'in-house software' where it is:

> computer software, or a right to use computer software, that you acquire, develop or have another entity develop:
>
> (a) that is mainly for you to use in performing the functions for which the software was developed; and
>
> (b) for which you cannot deduct amounts other than under Divisions 40 and 328.[6]

39. The term 'software' takes its ordinary meaning for the purposes of Divisions 40 and 328, and may include data and content.

Software that is 'in-house software'

40. In-house software includes:

(a) Software integrated into a commercial website that the website owner uses mainly to enable further interaction with the user, rather than providing it mainly for the user's own benefit. (See Examples 17 & 18)

(b) Software provided on a commercial website for installation on the user's device if its purpose is solely to provide a user interface for interacting with the business. (See Example 19)

(c) Content on a website which is incidental to the website and not an asset having value separate from the website.

Software that is not 'in-house software'

41. Application software made available through a commercial website for installation on the user's device for offline use is a separate asset from the website, and is not 'in-house software'. This includes downloadable software provided on a website for profit-making by sale or licence. (See Example 1)

42. Application software made available through a commercial website for online use and provided by the website owner mainly for the user's own benefit and not to enable further interactions with the user, is a separate asset from the website and is not 'in-house software'. (See Example 20)

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[6] As defined in section 995-1.

43. Software associated with a website that does not meet the requirements of the definition of 'in-house software' is an asset separate from the website. The tax treatment of expenditure on such software, whether Capital Gains Tax (CGT) or section 40-880 (which deals with black-hole expenditure) is determined according to the nature of the asset.

Capital allowances for in-house software

44. Where expenditure is incurred on 'in-house software', the following capital allowances are available:

(a) the expenditure may be deducted over 5 years[7] from the time the in-house software is first used or installed ready for use

(b) if the expenditure on in-house software is incurred on developing computer software, the expenditure may alternatively be allocated to a software development pool and deducted in accordance with the pool rules[8]

(c) if the entity incurring the expenditure is a small business entity, has chosen to use the simplified depreciation rules in Subdivision 328-D and has not allocated the expenditure to a software development pool, the expenditure is deductible:

  (i) immediately where the asset costs less than the instant asset write-off threshold[9], and

  (j) otherwise, in accordance with the general small business pool rules.

CGT

45. The CGT provisions (Part 3-1 to Part 3-3) have residual application to items of expenditure related to commercial websites. To the extent relevant expenditure is not a revenue expense and does constitute cost of 'in-house software', the CGT regime will recognise the expenditure as part of the cost base of a CGT asset.

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[7] For in-house software expenditure whose start time is on or after 1 July 2015. See Item 8 of the table at section 40-95(7).

[8] Section 40-455. For expenditure allocated to the pool from 1 July 2015, the deductions are available in accordance with the table set out at paragraph 202 of the Explanation of this draft Ruling.

[9] For expenditure between 12 May 2015 and 30 June 2017, the threshold is $20,000.

Section 40-880

46. Section 40-880 is a provision of last resort. Section 40-880 will generally not apply to commercial websites because capital expenditure on software development can usually be allocated to a software development pool under Division 40.[10]

Domain names

47. A domain name is a unique name registered with a domain name registrar (for example, ato.gov.au). Periodic registration fees for a domain name are a revenue expense.

48. An amount paid once-and-for-all to secure the right to use a domain name is capital expenditure. Such an amount would be nil where the right is secured solely by registering the domain name. (See Example 21)

49. The right to use a domain name is a CGT asset. As such, expenditure incurred in acquiring the right to use a domain name forms part of the cost base of that asset.

Examples

Example 1 – software – not part of website

50. *Teddy Pty Ltd is a software company specialising in innovative software for primary producers. Teddy licenses and sells software products from its website. Customers download products from links provided on Teddy's website.*

51. *Although the software is accessed from Teddy's website, the software products are not part of Teddy's website and cannot be depreciated as part of the costs of the commercial website.* (Return to paragraphs 6 or 41 of this draft Ruling)

Example 2 – business from hobby

52. *Abishek has a full time job and earns a salary. In his spare time, Abishek is a keen home-handyman and he decides to set-up a home-handyman advice website on which he will post articles and demonstration videos, and host an online forum.*

53. *If the website proves to be popular, Abishek sees an opportunity to make money through advertising and commissions from sales.*

54. *Abishek engages a web developer to design and create the website. He develops the initial content which the developer will upload. Once the website goes live, he continues to produce and publish content, paying periodic hosting and web maintenance fees.*

[10] The Commissioner's view on the application of section 40-880 is set out in Taxation Ruling TR 2011/6 *Income tax: business related capital expenditure - section 40-880 of the Income Tax Assessment Act 1997 core issues*.

55. *After the website has been operational for several months, Abishek decides that his website is receiving sufficient traffic to generate income. He establishes formal relationships with other businesses to provide links and advertising, and devotes significant time to developing content.*

56. *Applying the principles in paragraph 13 of TR 97/11, Abishek is carrying on business from the time he decides to commercialise his website. From that time, Abishek's hosting and maintenance fees will be deductible.*

57. *Although the initial website expenditure forms part of the cost of an 'in-house software' asset, Abishek was not carrying on a business at that time. It is only now that the website is being used for a taxable purpose that the website's cost is depreciable as in-house software under the capital allowances provisions .*

58. *The periodic hosting and maintenance fees that Abishek incurred prior to the commencement of business are private expenses and not deductible.* (Return to paragraph 11 of this draft Ruling)

Example 3 – leased website – lease payments

59. *SolderOn Pty Ltd leases a website to support its appliance repair business. The website provides the address and phone contact details of the business premises, location on a map, a description of the range and brands of appliances repaired and images of appliances. It has a webmail facility as an alternative point of contact for members of the public.*

60. *The terms of the lease do not give SolderOn Pty Ltd economic ownership of the website, nor is it the registrant of the domain name. After an initial term of one year, the company or the lessor may terminate the lease at one month's notice. The company pays monthly lease payments which cover all costs, including six content updates per year. A fee is payable for additional content updates.*

61. *The lease payments are an operating cost to the company and are deductible as incurred.* (Return to paragraph 17 of this draft Ruling)

Example 4 – existing business establishes a basic website

62. *Eve has owned Fashion from Eden, a suburban boutique for many years. She decides to establish a website and engages a web developer. The developer sources the domain name, designs the website and arranges hosting. The total establishment cost is $2,500. Eve makes a series of progress payments while the website is being constructed. Additionally, the web developer agrees to make content updates as needed. Eve's regular ongoing costs are domain name registration and server hosting.*

63. *The website is a single page, containing:*

- *the business name and contact details,*
- *opening hours,*
- *some promotional text identifying clothing brands sold,*
- *a subscription facility for promotion and sales emails, and*
- *links to the business's social media pages.*

64. *There is no online sales facility. The website requires updating only when the business's details change. In 2015, the business wins a local business award and has the website content updated to display this.*

65. *The website is an enduring feature of the business, established to promote the business in new markets and attract new customers. It is more than a transitory advertisement; it is a modern equivalent of a hoarding. The expenditure incurred to create the website is a capital expense. The progress payments retain their capital nature despite the payments being made by instalments. However, any developer fees for content updates with transitory benefit, such as the reference to the local business award, are of a revenue nature.*

66. *The website is a depreciating asset; it is software used by the business in the business to perform the function of increasing brand awareness. It is 'in-house software' and depreciable under the capital allowances provisions.* (Return to paragraph 19 of this draft Ruling)

Example 5 – acquisition of investment website – carrying on a business

67. *Cindy is a solicitor and supplements her salary income by purchasing an income-producing commercial website as a going concern. The acquisition included the website content, which had no independent value, and the domain name. The website, which carries articles about pets and pet care, produces income of approximately $200 a month from commission on sales as a registered advertising site for a large online retailer.*

68. *To maintain the income-earning capacity of the website, Cindy must update the content frequently to attract website traffic, actively monitor its performance and keep the software up-to-date. In addition, she researches new developments in website technology and website commerce. Cindy engages a web developer, to maintain the currency of the software and install content updates which she provides.*

69. *Cindy has an intention to make a profit and performs regular activities in a business-like manner to keep the website operational and productive. Applying the factors at paragraph 13 of TR 97/11, Cindy carries on a business. Her business will be treated as a small business entity.*

70. *The cost of acquiring the pre-existing commercial website is capital in nature and forms part of the depreciable cost of in-house software. Cindy may choose to apply the small business capital allowances rules.*[11]

71. *The cost of acquiring the right to use the domain name also forms part of the cost base of the domain name, but any annual registration and/or hosting fees will be revenue expenditure. The fees paid to the developer are akin to operational or maintenance costs and are therefore of a revenue nature.* (Return to paragraph 19 of this draft Ruling)

Example 6 – business adds online sales function

72. *Continuing from Example 4, Eve decides to expand the website to include online sales.*

73. *The developer adds a product catalogue, shopping cart, payment facility, back-end stock database and a back-end customer database. The web developer provides technical support on an on-call basis and ensures functionality and security is kept up-to-date, in exchange for a monthly fee. The owner updates stock information.*

74. *This additional functionality introduces a new kind of activity to Eve's business and improves her competitiveness and market reach. It enlarges the profit-yielding structure of the business. The cost of the upgrade is a capital expense and is expenditure on in-house software. The ongoing maintenance costs, including technical support, are of a revenue nature.* (Return to paragraph 26 of this draft Ruling)

Example 7 – e-business promotional activity – temporary change to website appearance

75. *Indigo Zephyr conducts an online voucher business. It sells promotional vouchers from its website to members of the public who redeem the vouchers with client businesses. The company earns income from fees and commissions on voucher sales. For a special promotion, the company changes the visual appearance of its website for two weeks.*

76. *Indigo Zephyr incurs expenditure, mainly salary and wages for its staff, in generating ideas for the promotion, liaising with marketing teams, designing the website promotion, developing code for functionality, testing, deployment, measuring and monitoring, and removal and monitoring when the promotion finishes.*

77. *The expenditure incurred is an operational cost of the business. The alteration of the website's appearance is designed to increase voucher sales and raise the profile of the business in the short term. While the website's visual appearance is changed temporarily to draw users' attention to a particular offer, there is no structural change from a practical, business perspective.*

[11] Subdivision 328-D.

78. *The expenditure is of a revenue nature. The alteration to the website is comparable to advertising or window-dressing of physical premises.* (Return to paragraph 26 of this draft Ruling)

Example 8 – non-sales website modification

79. *Big Smiles Limited has a website that publishes information about the company, including its history, management, business activities, contributions to the community, recruitment and careers, investor information and other company documents. The company upgrades the user monitoring software to better understand the visitor profile and use of its website. The expenditure is minor compared with the annual website spend and Big Smiles expects to upgrade the system again in 12-18 months.*

80. *The website has an important publicity role in Big Smiles's business. Whilst the website itself is a capital asset, the additional functionality represented by the upgrade of the user monitoring software is not sufficiently significant to represent a long-term structural advantage to the company's business. It enables the company to critically analyse and assess the effectiveness of its website, which will be relevant to future modification decisions. It will assist in the making of decisions in relation to publicity and promotion of the business.*

81. *Expenditure on the upgrade is of a revenue nature.* (Return to paragraph 26 of this draft Ruling)

Example 9 – significant improvement to functionality of website

82. *Tony's suburban pizza business has had a website since 2005 which has developed over time. Currently, customers can browse the menu and order food by phone for pickup or delivery. Tony wants to increase the popularity and competitiveness of his business by establishing an online ordering system, allowing customers to customise their pizza orders, save their customised preferences and track the progress of their order.*

83. *Tony engages his web developer to design the ordering system which includes user interfaces for customers and for pizza-making staff. As no off-the-shelf software is suitable, the web developer designs and encodes the software and installs it for $5,000.*

84. *Ordering plays an integral role in the efficiency and success of Tony's business. The website upgrade cost is significant, approximating annual expenditure on the website in recent years.*

85. *While the nature of Tony's business does not change, these factors point to the upgrade as providing a structural advantage to the business. On balance, the expenditure is of a capital nature and will be expenditure on in-house software for the purpose of the capital allowances regime.* (Return to paragraph 27 of this draft Ruling)

Example 10 – minor modification to website functionality

86. *Venda Pty Ltd has a website with online sales capability that accepts only credit cards. Venda Pty Ltd asks their website developer to establish an additional payment option, a 'PayCobber' account and payment facility to enable payment options, for a fee of $500.*

87. *The addition of a PayCobber payment method does not add new functionality to the website. It extends the existing functionality, marginally increasing convenience for customers and Venda's competitiveness with other similar businesses. It is not expected to have a significant impact on sales or the customer base.*

88. *From a practical business perspective, the addition of payment options does not represent an enhancement to the profit-yielding structure of the business. The web developer's fees are a revenue expense.* (Return to paragraph 27 of this draft Ruling)

Example 11 – business website – back-end upgrades

89. *TBug Limited carries on a business of on-line travel bookings. The company upgrades its website architecture to increase its business efficiency. The upgrade is expected to reduce response times for users, enhance the efficiency of storage, enable future functionality improvements and reduce maintenance costs. It is expected not to need further major upgrade for at least two years. The appearance and functionality of the website for users will not change.*

90. *The upgrade is specifically planned and budgeted, including:*

- *engaging IT staff and consultants to present options to the Board*
- *constructing a beta (parallel) website for testing*
- *release and troubleshooting, and*
- *post-deployment monitoring, analysis and reporting.*

91. *The website is integral to the income-earning operations of the business. The improvement of the website's efficiency through the back-end upgrade goes beyond the ordinary operation of the business. The project planning, specific provisioning in the budget and involvement of the Executive indicate this project is to provide significant structural enhancement to the business. Expenditure on the upgrade is capital expenditure, and deductibility is worked out under Division 40 because the upgrade is part of the cost of 'in-house software'.* (Return to paragraph 28 of this draft Ruling)

Example 12 – managed website –expenditure on in-house software

92. *HL Pty Ltd provides employee assistance services for large businesses and government agencies. HL's website provides information and links to a number of services, including a secure portal through which employees from client organisations can discuss issues with a counsellor in an online 'chat' facility.*

93. *HL engages an IT company to provide all of its computer support, both hardware and software. HL receives invoices with an item for 'website development', being an 'upgrade' of the existing website. The portal software was upgraded to enhance the user interface, stability and security. The cost of the upgrade exceeds the ordinary annual budget for software support by over 30% . Upgrades of this kind are infrequent, usually happening several years apart. IT company consulted with HL's management before undertaking the upgrade.*

94. *The website portal plays a significant role in the services HL provides. While the enhancement of the user interface improved rather than expanded its functionality, the upgrade is significant in terms of resources and the back-end upgrade increases the useful life of the portal.*

95. *The 'website development' expenditure represents an improvement of the structure of HL's business and is a capital outgoing. Deductibility for this expenditure is worked out under Division 40 because the upgrade is part of the cost of 'in-house software'.* (Return to paragraph 28 of this draft Ruling)

Example 13 – existing website modified for mobile devices

96. *Pierre runs a restaurant, and maintains a website which displays the name and address of the restaurant, its location linked to an online map, opening hours, contact details, a menu and photos of popular dishes and the premises.*

97. *Pierre decides to upgrade the restaurant's existing website so that it is compatible with mobile devices. He engages a developer, who suggests that he could either:*

- *create website software that adapts the existing website to display its content in a smart phone friendly layout when a user accesses the website from a mobile device (Option 1), or*
- *create a separate website exclusively for mobile device access, to which mobile device browsers will be redirected when they connect with the website (Option 2).*

98. *Expenditure on Option 1 is an ordinary business expense, and not capital. Expenditure on his existing website, designed to ensure it is compatible with emerging technology and new browser software over time, is expenditure to maintain existing functionality rather than expand the profit-yielding structure of the business.*

99. *By contrast, expenditure on Option 2 is of a capital nature because it results in a new and separate commercial website exclusively for mobile device access.* (Return to paragraph 29 of this draft Ruling)

Example 14 – online business – ongoing compatibility updates

100. *Jade Sheets operates a large online business that lists advertisements through a commercial website. As functionality and currency of its website is integral to its operations, Jade Sheets employs a team who work exclusively on its website. To ensure its website and content appear correctly on all devices as new mobile devices, computer operating systems and browser software are released, the company incurs expenditure on an ongoing basis in acquiring newly released handsets and operating systems and on labour for testing and updating its website software as necessary. Labour costs are incurred in identifying, logging and designing fixes for bugs; and in testing and monitoring the effectiveness of updates.*

101. *While the updates enhance the functionality of the company's website, from a practical, business perspective this does not represent an expansion of the profit-yielding structure. The commercial purpose of the updates is to maintain end-user functionality and appearance of the website in a constantly changing environment. The labour costs are of an operational nature and are therefore deductible.* (Return to paragraph 29 of this draft Ruling)

Example 15 – online business – incremental changes

102. *Finery Limited is an Australian company that operates a business selling luxury products through a commercial website. The company employs a team of web professionals that is responsible for:*

- *constantly monitoring the website,*
- *identifying customers' usage patterns,*
- *identifying areas for improvement in both the front-end and back-end functionality of the website, and*
- *responding to feedback from customers and staff.*

103. *Sometimes consultants are engaged to provide additional expertise. Finery's management regularly consults with key members of the team for technical input into strategic decision-making. The team is involved in costing and recommending software solutions – some directed to solving operational problems, and others at achieving longer term efficiency and productivity goals or business innovation. The team regularly rolls out 'releases' which modify the website, some modifications being invisible to website users and some visible. Significant analysis and forward planning can go into making some of the changes included in the regular 'releases'.*

104. *Finery has recently upgraded the platform for its user interface and functionality substantially. In opting for early release with basic functionality rather than a later release with full functionality, Finery seeks to gain a market advantage. Over the following months, Finery's website is gradually upgraded to bring the new platform up to full functionality through items included in its regular 'releases'. Documentation for the upgrade and the causal relationship of the new platform with the later 'release' items shows clear links between those items and the upgrade.*

105. *The character of expenditure on these items is determined by reference to the upgrade as a whole, and is capital in nature. If any labour expenditure on the releases is not clearly related to the 'substantial upgrade' the labour costs of the release should be apportioned on a reasonable basis.* (Return to paragraph 32 of this draft Ruling)

Example 16 – business with social media presence

106. *Mayfair Textiles is a suburban fabric retailer.*

107. *To advertise its products and sales promotion events, Mayfair establishes a profile on Facade, a popular social media site. Facade charges no fees for subscribing.*

108. *Mayfair incurs expenditure on salary and wages in providing and updating the content on its Facade profile and in otherwise maintaining the profile.*

109. *The expenditure is on revenue account.* (Return to paragraph 36 of this draft Ruling)

Example 17 – off-the-shelf software – part of a website

110. *Ritsuko runs a printing business. Ritsuko purchases a $1,000 off-the-shelf computer program designed to allow her to develop her commercial website using its base functionality. The program, Webmeister, enables her to design and customise her webpage, translates that into html, creates the dynamic content (fetching and searching functions), helps her organise the content and provides a basic, customisable client login function, which customers can use to sign in then upload and personalise their print jobs. The Webmeister software is fully integrated into Ritsuko's commercial website.*

111. *Ritsuko uses the program herself and designs a website which is then hosted for a fee by her Internet Service Provider (ISP).*

112. *The cost of acquiring Webmeister is expenditure of a capital nature as it augments the profit-yielding structure of Ritsuko's business. Because the Webmeister software is an integral part of the website, the expenditure will be part of the cost of the commercial website asset, which will be in-house software for the purpose of the capital allowances regime.*

113. *The ISP hosting fees are an expense of a revenue nature.* (Return to paragraph 40 of this draft Ruling)

Example 18 – definition of 'in-house software' – do-it-yourself website-building application

114. *SitesAtWork operates a commercial website which incorporates application software for customers to construct their own websites. SitesAtWork provides the basic version of the website-building tool for free but charges for the use of fully featured versions. The use of the tool is packaged with ongoing web-hosting services provided by SitesAtWork as a yearly subscription service. A customer who constructs a website on SitesAtWork will face obstacles in trying to migrate it to another hosting service.*

115. *The website-building application is integrated into SitesAtWork website, is solely for use online and is not marketed as a download. SitesAtWork's use of the software is integral to a business model of providing a comprehensive website service. The application is not exploited separately for profit.*

116. *SitesAtWork mainly provides the website-building application for the purpose of engaging the user as a customer for its comprehensive website service, and not mainly for the user to have use of it independent of that objective.*

117. *The website-building application is part of SitesAtWork's website and is in-house software.*

118. *For the customer, any fee incurred to use the website-building application will be capital in nature and the resulting website will be in-house software. Hosting and maintenance fees paid to SitesAtWork will be on revenue account.* (Return to paragraph 40 of this draft Ruling)

Example 19 – mobile app – in-house software

119. *Argent Bank Limited provides an online banking app download on its website for its customers free of charge. The app is not part of the Argent Bank's website. The app is designed solely to allow Argent Bank customers to conduct online banking on their mobile devices. The app provides a customised interface (a mini front-end) between the particular customer and data drawn from the bank's web servers, as an alternative to using a browser and logging into the bank's website.*

120. *Argent Bank's use of the software falls within the purpose for which it was developed. The online banking app is in-house software of Argent Bank Limited.* (Return to paragraph 40 of this draft Ruling)

Example 20 – software – not part of a website

121. *BigSystems Ltd owns the rights to a popular operating system and associated suite of software applications. Historically, BigSystems has exploited these products for profit by licensing their installation on customer devices but more recently has introduced a subscription service. BigSystems markets the applications both as a suite and individually, releases new versions of the products from time to time and provides regular security, debugging and minor enhancement updates online.*

122. *BigSystems introduces Nebula, a browser-based service containing light versions of some of its more widely-used applications. Users sign in to Nebula on the BigSystems website and use the applications online through BigSystems' servers. Fully functional versions of these applications are available by subscription or as one-time purchases. Nebula is provided free of charge.*

123. *BigSystems provides Nebula mainly to users to use for their own benefit and not as a means of further interaction with users. The character of the software is indistinguishable from the versions that BigSystems exploits for profit by subscription or sale.*

124. *Nebula is not part of BigSystems' website and is not 'in-house software'.* (Return to paragraph 42 of this draft Ruling)

Example 21 – domain name

125. *Largesse Pty Ltd procures an existing domain name at auction for $25,000 and registers the domain name with a domain name registrar. It uses the domain name for a new website to carry on its business.*

126. *The right to use the domain name continues indefinitely, provided Largesse Pty Ltd maintains its registration with an accredited registrar. It is expected that the company will retain the domain name for the foreseeable future. The right is an advantage of an enduring nature that is part of the profit-yielding structure of the business. The amount paid at auction is capital expenditure and is not deductible.*

127. *Registration fees for the domain name are deductible as incurred.*

128. *If the domain name is later disposed of, the cost base of the right for CGT purposes will be the purchase price of $25,000 and other expenditure incurred in securing or disposing of the domain name, for example, brokerage fees.* (Return to paragraph 48 of this draft Ruling)

Date of effect

129. When the final Ruling is issued, it is proposed to apply both before and after its date of issue. However, the Ruling will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 75 to 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation
6 April 2016

Appendix 1 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached. It does not form part of the proposed binding public ruling.

Commercial websites

130. A website used in the course of a business is a commercial website irrespective of whether it is used directly to produce income. Websites can have a variety of functions within the business, some integral and others ancillary.

131. A website is an intangible asset of a business, consisting of software installed on a server or servers and connected to the internet.

132. For income tax purposes, the following assets are distinguished from a website:

- hardware
- the domain name, and
- content available on or incorporated into a website that has independent value to the business.

133. The deductibility of expenditure on a website depends upon whether the expenditure is of a revenue or capital nature. If not deductible under section 8-1, expenditure would generally be deductible under the capital allowances provisions as expenditure on 'in-house software'. In-house software is discussed in more detail below.

Expenditure prior to becoming a commercial website

134. Where a website has been established for a hobby which subsequently becomes a business, capital expenditure incurred in the hobby phase will form part of the cost of the depreciating asset. The asset's decline in value starts when you commence to hold the asset, including the years it was used for a private purpose. Deductions for decline in value of the asset commence once it is used for a taxable purpose (determined objectively). Other expenses (non-capital) incurred in the hobby phase will be private and non-deductible.

Commercial website expenditure: capital/revenue distinction

135. While it may be useful to draw analogies between website expenditure and more traditional items of business expenditure, analogy cannot displace established principles. In the course of summarising the task of determining the revenue or capital character of expenditure, Gageler J stated in *AusNet Transmission Group*[12] at [74]:

> To characterise expenditure from a practical and business perspective is not to… inquire into whether the expenditure is similar or economically equivalent to expenditure that might have been incurred in some other transaction. It is to have regard to the 'whole picture' of the commercial context within which the particular expenditure is made, including most importantly the commercial purpose of the taxpayer in having become subjected to any liability that is discharged by the making of that expenditure. It is, where necessary, to 'make both a wide survey and an exact scrutiny of the taxpayer's activities'.
>
> [*footnotes omitted*]

136. The capital/revenue distinction was explained by Dixon J in *Sun Newspapers*[13] at CLR 359:

> The distinction between expenditure and outgoings on revenue account and on capital account corresponds with the distinction between the business entity, structure, or organization set up or established for the earning of profit and the process by which such an organization operates to obtain regular returns by means of regular outlay, the difference between the outlay and returns representing profit or loss.

137. His Honour went on to identify the following considerations relevant to the capital/revenue characterisation of expenditure in *Sun Newspapers* at CLR 363:

> There are, I think, three matters to be considered, (a) the character of the advantage sought, and in this its lasting qualities may play a part, (b) the manner in which it is to be used, relied upon or enjoyed, and in this and under the former head recurrence may play its part, and (c) the means adopted to obtain it; that is, by providing a periodical reward or outlay to cover its use or enjoyment for periods commensurate with the payment or by making a final provision or payment so as to secure future use or enjoyment.'

In the subsequent case of *Hallstroms*[14] at CLR 647, Dixon J stated:

> … the contrast between the two forms of expenditure corresponds to the distinction between the acquisition of the means of production and the use of them; between establishing or extending a business organization and carrying on the business; between the implements employed in work and the regular performance of the work in which they are employed; between an enterprise itself and the sustained effort of those engaged in it.

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[12] *AusNet Transmission Group Pty Ltd v. Federal Commissioner of Taxation* [2015] HCA 25; 2015 ATC 20-521

[13] *Sun Newspapers Ltd. and Associated Newspapers Ltd. v. Federal Commissioner of Taxation* (1938) 61 CLR 337; (1938) 5 ATD 23; (1938) 1 AITR 403.

[14] *Hallstroms Pty Ltd v. Federal Commissioner of Taxation* (1946) 72 CLR 634; [1946] HCA 34.

138. Whilst the lasting quality of an advantage is often an indicator of an affair of capital, it is just one factor to be considered under the tests set out by Dixon J in *Sun Newspapers* at CLR 362 and is not necessarily determinative of whether expenditure is of a capital nature. As the High Court stated in *Mount Isa Mines*[15] at CLR 147-8:

> The fact that no tangible asset or benefit of an enduring kind is acquired as result of the expenditure does not of itself preclude a finding that expenditure is on capital account. It certainly points the way but it is not determinative. Likewise, the recurrence of a specific item of expenditure is not a test; it is a relevant consideration the weight of which depends upon the nature of the expenditure.

and at CLR 153:

> While it is certainly true that in some cases the revenue-capital classification has been seen to depend on the nature of the asset or intangible benefit acquired or protected, as we have pointed out, the primary focus of the inquiry has been and must be on the expenditure itself and what it is intended to secure to the business.

139. In *Citylink Melbourne*[16], the majority stated (citing *Hallstroms* and *GP International Pipecoaters*[17]) at CLR 43:

> The characterisation of an outgoing depends on what it 'is calculated to effect', to be judged from 'a practical and business point of view'. The character of the advantage sought by the making of the expenditure is critical.

140. The test is not so much whether the expenditure itself provides an enduring benefit, but whether the expenditure enhances or augments the profit-yielding structure of the business or, on the other hand, whether the expenditure is incurred as a cost of operating the business.

141. In a commercial environment where technology and associated business strategy is constantly evolving, the profit-yielding structure of the business may be subject to continual adjustment. It is a question of judgment whether a particular expenditure on a commercial website relates to the profit-yielding structure or is incurred as part of the process of operating the business.

142. To the extent that the operation of a business is dependent on the operation of a website, the website is part of the profit-yielding structure of the business. If the website must continue to evolve for the business to remain competitive and productive, expenditure incurred on that evolution can be seen to relate to the profit-yielding structure rather than to its day-to-day operation.

143. It is the character of the expenditure at the time it is incurred that is relevant.

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[15] *Mount Isa Mines Limited v. Federal Commissioner of Taxation* (1992) 176 CLR 141; [1992] HCA 62; 92 ATC 4755; (1992) 24 ATR 261.
[16] *Federal Commissioner of Taxation v. Citylink Melbourne Ltd* (2006) 228 CLR 1; [2006] HCA 35; 2006 ATC 4404; (2006) 62 ATR 648.
[17] *GP International Pipecoaters Pty Ltd v. Federal Commissioner of Taxation* (1990) 170 CLR 124; [1990] HCA 25; (1990) 90 ATC 4413; (1990) 21 ATR 1.

Nature of expenditure generally

Labour

144. Expenditure incurred on developing, maintaining or changing a website will predominantly consist of labour costs. Labour costs are expended initially in planning, designing, programming, testing, bug fixing, deployment and monitoring of a website. All or some of these activities may be necessary when a website is modified.

145. The characterisation of expenditure on salary and wages is a question of fact to be determined objectively based on the circumstances of each particular case. While labour costs are ordinarily a revenue expense, in those cases where a direct link may be established between the employee or contractor and a capital asset, the expenditure may be of a capital nature.[18]

146. In *Goodman Fielder Wattie*[19], Hill J stated at ATC 4453-4454:

> Where a person is employed for the specific purpose of carrying out an affair of capital, the mere fact that that person is remunerated by a form of periodical outgoing would not make the salary or wages on revenue account. On the other hand, where an employee is employed and engaged in activities which are part of the recurring business of a company, the fact that he may, on a particular day, be engaged in an activity which viewed alone would be of a capital kind, does not operate to convert the periodical outgoing for salary and wages into an outgoing of a capital nature. In between, there will be cases where it may be difficult to determine whether the expenditure should properly be regarded as on capital account or as on revenue account.

Similarly, in *Star City*[20], Jessup J stated at [263]:

> Likewise, while wages are ordinarily a revenue expense, wages paid to employees engaged wholly upon the installation of new capital equipment should not be so regarded. Merely to look at the legal rights and obligations which existed as between the payer and the payee (ie the employer and the employee) would be of no assistance in the task of characterisation.

147. Labour costs incurred on website construction or modification that gives rise to a structural advantage to the business – an 'affair of capital' – are considered to be capital expenditure. The fact that expenditure on salary or wages may be incurred periodically is not determinative; recurrence is indicative but not a test of whether expenditure is on revenue account.[21]

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[18] For examples of the application of this principle see ATO ID 2011/42 and ATO ID 2011/43.

[19] *Goodman Fielder Wattie Ltd v. Federal Commissioner of Taxation* (1991) 29 FCR 376; 91 ATC 4438; (1991) 22 ATR 26

[20] *Federal Commissioner of Taxation v. Star City Pty Limited* (2009) 175 FCR 39; [2009] FCAFC 19; 2009 ATC 20-093; (2009) 72 ATR 431

[21] *Sun Newspapers*, Dixon J at CLR 362.

148. Where a business incurs website-related labour costs to secure the performance of a range of tasks, some of which are routine or operational and others directed to the enlargement of the profit-yielding structure of the business, expenditure may have to be apportioned. Any apportionment must be made on a reasonable basis.[22]

149. Similar to employee expenditure, costs incurred in engaging a contractor will be characterised by the nature of the business advantage to be secured by the expense. If the cost secures a material enhancement to the website, it will be of a capital nature. This is so irrespective of whether it is remitted as periodic payments, such as progress payments made to a web developer during the construction of a website, or paid as a lump sum.

Off-the-shelf products and periodic usage fees

150. In determining whether expenditure on off-the-shelf products is of a revenue or capital nature, the same criteria apply as for software developed in-house. Where off-the-shelf software replaces or enlarges an element of the profit-yielding structure of the business, the expenditure is on capital account.

151. A business owner may opt to rent or lease a website from a website provider. Such an arrangement may include an option to purchase after a specified period.

152. Under an ordinary lease arrangement, payments made by the business owner for the use of the asset are deductible as incurred. However, if the terms of a website lease arrangement mean that the business owner has a right to use the website software that falls within table items 5 or 6 of section 40-40, the business owner will be the economic owner of the right to use the website in-house software. In such a case the business owner may incur a capital cost in securing the right and is required to apply Divisions 40 or 328, as appropriate to their circumstances.

Acquiring or developing a website

153. A website can be acquired from a website developer or developed in-house. In some cases, a website is acquired as part of a business purchased as a going concern or as a discrete business asset.

154. Generally, a website represents a capital advantage to a business. In the ordinary case, it provides the business with a fixed online presence, which is increasingly considered to be an ordinary business requirement. Not having a website means that the business lacks visibility to users of electronic devices and may be less competitive.

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[22] *Ronpibon Tin NL and Tongkah Compound NL v. Federal Commissioner of Taxation* (1949) 78 CLR 47; [1949] HCA 15.

155. Even a simple website containing no more than basic information about the business and directing customers to physical premises has a permanent quality unlike traditional advertising. It exhibits the quality of providing the business with a profile in a popular location, advertising its existence and providing information about it, much like a fixed hoarding.

156. A business website has an obvious and real relationship to the income-producing activities of the business. In some cases, a website may be the primary or sole means of earning income.

157. A business may set up a website temporarily for a particular commercial objective, such as a special promotion of goods or services. Such a website may not represent a structural advantage to the business and accordingly related expenditure would have the character of a revenue expense.

Maintaining a website

158. Expenditure is required to keep a website up-to-date and fully operational. This kind of expenditure is comparable to expenditure on ongoing maintenance of a physical asset or, where made in response to an event disrupting the operation of a website, to the repair of a physical asset.

159. The cost of remedying a software fault is not deductible under section 25-10 (Repairs) as that section does not apply to intangible assets.[23] The concept of repair generally implies a notion of remedying the effects of 'wear and tear' or 'deterioration arising from the use of property' and is not apt for software.[24] Expenditure incurred in remedying software faults in a website is therefore regarded as a matter of maintenance.

160. While some website maintenance activity, such as monitoring, requires no modifications to be made to the website, other maintenance activity may require modifications; for example, updates to user content, embedded applications (plug-ins) and security software, as well as bug fixes, search engine optimisation and data restoration after an incident such as a power surge.

161. Modifications to a website that are routine and expected, or are made in response to an incident affecting the operation of the website, are regarded as maintenance. These modifications preserve or restore the existing functionality of the website.

162. Modifications made to add new functionality or extend existing functionality are not regarded as maintenance.

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[23] See paragraph 12 of Taxation Ruling TR 93/17 *Income tax: income tax deductions available to superannuation funds*.

[24] This issue is discussed in more detail in Taxation Ruling TR 98/13 *Income tax: deductibility of year 2000 (millennium bug) expenses* at paragraphs 27 to 34 (withdrawn as no longer necessary on 9 March 2005).

Modifying a website

163. Modifications that add new functionality or extend the existing functionality of a website from a business perspective may amount to a structural advantage to the business. If so, expenditure incurred in making the modifications is capital expenditure. Such modifications may or may not be apparent to website users.

164. The purpose and significance of the modification of a website, and thus the character of the associated expenditure, is to be judged from a practical, business perspective. Factors relevant in determining whether a modification represents a structural advantage to a business include:

- the role of the website in the business
- the nature of the modification to the website
- the degree of planning and level of resources employed in effecting the modification
- the level of approval required for the modification
- the expected useful life of the modification.

Role of the website in the business

165. The nature of the business and the role of the website in its operations are relevant in assessing the significance of a modification to the website within the profit-yielding structure of the business. For example, a modification may be highly significant to the profit-yielding structure of a trading entity selling goods from its website, whereas a similar modification may have little significance to the profit-yielding structure of a business using its website primarily as a public relations tool.

Nature of the modification

166. A modification to a website that is more closely connected to the process of income generation from the website or to the saving of expenditure on the website is more likely to relate to the profit-yielding structure of the business than a modification that is less closely connected.

Planning and resources

167. The planning and resources should be assessed in the context of the nature of the business. The greater the degree of planning and resources required to implement a modification (relative to the size and scale of the business), the more likely it is that the modification relates to the profit-yielding structure of the business.

Level of approval

168. A modification that requires approval at a senior level is likely to be more significant to the business than one that does not. This fact may point to the presence of a structural advantage to the business.

Expected useful life of the modification

169. As noted at paragraph 140 of this draft Ruling, the test is not so much whether the expenditure itself provides an enduring benefit, but whether the expenditure enhances the asset itself so as to add to the profit-yielding structure of the business. Whilst not determinative, the expected useful life of a website modification may often indicate its significance to the profit-yielding structure of the business.

Practical application

Mobile compatibility

170. When new mobile devices and user operating systems are released, modifications may be required to website software to maintain the correct appearance of webpages and operation of user functionality on the user device. For websites with more complex user functionality, this process can require extensive testing, bug fixing and monitoring.

171. Whilst such modifications add to the software capability of the website, they are made in response to external events and merely enable the website to continue functioning effectively in the changing digital environment. From a business perspective, the enhancement maintains but does not extend the efficiency of the website. Expenditure on such modifications is therefore on revenue account.

Front-end upgrades

172. Front-end modifications can either modify the way that the business interacts online with clients or enhance user experience with existing functionality.

173. A modification serving either of these purposes (judged objectively) can represent a structural advantage for a business.

Back-end upgrades

174. Back-end modifications may be made to increase the overall efficiency of a website; for example, by enhancing user response times, increasing the website's capacity for user traffic; improving the efficiency of data storage, reducing future maintenance and update costs, or enabling the easier integration of upgraded or new functionality. The significance of the modification to the profit-yielding structure of the business is determined principally by reference to its objective purpose.

175. The fact that a back-end modification may have little discernible effect on the user experience does not prevent it from being a structural advantage for the business.

Piecemeal modifications and incremental enhancement

176. It has become industry practice to prioritise speed-to-market over full functionality of product, meaning that incremental modifications and feature releases are increasingly common. Incremental modifications to a website may result in its gradual enhancement, resulting in significant change in capability over time.

177. In determining whether expenditure on a particular modification is an operating expense or results in an accretion to the profit-yielding structure of the business, the purpose of the modification must be considered in its context.

178. Piecemeal modifications are to be distinguished from modifications that are part of a program of work for improving a website.

179. The character of expenditure on a modification that is part of such a program is determined by reference to the purpose of the program in the context of the business. If the purpose of the program is to improve the profit-yielding structure of the business, expenditure on the modification is a capital expense.

180. Where a commercial website constitutes the business and is subject to constant oversight and work by a team of employees, modifications directed to improving the website are more likely to be integrated into a program of work.

Content migration costs

181. The character of expenditure on migrating website content to a website follows the character of the expenditure which prompted the migration of the content.

182. Where content is migrated from an old website to a new website, the cost of migrating the content will be capital as a cost of establishing the new website.

183. If content is migrated to a new platform as part of a website upgrade, the cost of doing so is capital if the upgrade itself is of a capital nature. Otherwise it is a revenue expense.

184. The migration of content due to the replacement of hardware without a material change to the commercial website is a revenue expense.

Social media

185. Many businesses establish and maintain a profile on one or more social media sites and use the profile for promoting the business's products or services. Typically, no fee is charged by the social media site owner for establishing a profile and the business entity incurs expenditure only in maintaining its profile and updating content.

186. Such expenditure is on revenue account. However, any costs incurred to establish such a presence are of a capital nature.

Capital allowances – where expenditure is not otherwise deductible

In-house software

187. In-house software is one of a limited number of intangible depreciating assets. As defined in section 995-1, 'in-house software' is computer software, or a right to use computer software, that you acquire, develop or have another entity develop:

(a) that is mainly for you to use in performing the functions for which the software was developed, and

(b) for which you cannot deduct amounts under a provision of the Act outside Divisions 40 and 328.

188. Software for which the cost is deductible under any other provision of the Act, such as section 8-1, is not in-house software. This includes modifications to in-house software that have the character of website maintenance.

189. The expression 'for you to use in performing the functions for which the software was developed' in paragraph (a) of the definition excludes software that is developed for the purpose of exploitation for profit. It does not exclude software provided by the website owner for use by clients as a means of interacting with the business or to enable the business to transact further with the client. Client use in those circumstances falls within the 'use' of the software by the website owner for the purposes for which it was developed. The website owner mainly uses the software to generate client interactions that serve the broader (profit-making) purposes of the business.

190. Application software made available through a website to users mainly for their own benefit, and not for engaging with the user as a customer, is not regarded as software that the website owner uses in performing the functions for which it was developed. It is not in-house software and could be said to have a functional identity that is independent of the website. Typically, a website owner provides such application software for the purpose of deriving income from fees or generating other revenue.

191. Where a website provides access to software that is installed on a user device for offline use independent of the operation of the business, the software is not used by the website owner for the purposes for which it was developed, and is not in-house software.

192. On the other hand, software installed on the user's device solely to provide a user interface with the website, may be in-house software. Whilst it is not part of the website, its use by business clients has the character of broader use by the website owner.

193. The qualification 'mainly [for you to use]' is intended to cover situations where software is developed for dual purposes of in-house use and exploitation for profit. For example, a business may develop a new software application for its own use but also license other businesses to use it. In such situations the reason for the expenditure is a question of fact to be determined according its main intended use.

Meaning of 'software'

194. 'Software' is not defined in the income tax legislation and takes its ordinary meaning in the absence of contrary intent. Nothing in section 8-1 or Divisions 40 and 328 requires 'software' to take other than its general meaning in ordinary usage. This is its meaning for the purposes of the defined term 'in-house software'.[25] Software is, functionally, anything that instructs another part of the computer system; more generally, it is a digital system made up of programs, data and associated documentation. It may include data and website content.

In-house software core provisions

195. 'Depreciating asset' is a defined term and intangible assets are excluded from being a depreciating asset. A website is an intangible asset as it does not have a physical existence.

196. However, 'in-house software' is specifically included as a depreciating asset (to the extent that it is not trading stock). Therefore, a website can only be a 'depreciating asset' if it can be classified as in-house software.

197. Optional pooling provisions for expenditure incurred on software development are set out in Subdivision 40-E. This pooling option does not apply to or include acquisition costs.[26]

198. As a depreciating asset, in-house software starts to decline in value from when it is first used, or is installed ready for use. In-house software may only be depreciated using the prime cost method; a straight line depreciation method.[27] The effective life of in-house software is specified in the table at subsection 40-95(7). For assets first used or installed ready for use on or after 1 July 2015, the effective life of in-house software is five years.

[25] TR 2001/6 (withdrawn) applied 'indicators of software' to website expenditure to determine if it was 'expenditure on software' for the purposes of former Division 46. The 'indicators of software' are no longer current.
[26] See Note to subsection 40-450(1).
[27] Subsection 40-72(2).

199. The option to self-assess an effective life for in-house software is removed by subsection 40-105(4) and the option to recalculate the effective life of in-house software has been removed by subsection 40-110(5).[28]

200. Where the development of in-house software is abandoned, the expenditure already incurred may be deductible in the year that decision is made, if:

- the software was intended for a taxable purpose
- the software has not been used or installed ready for use, and
- the expenditure has not been allocated to a software development pool.[29]

Software development pools

201. The option to pool expenditure on software development is established by Subdivision 40-E. Pooling may be preferred because it enables access to the deductions without requiring the software to be ready for use or because it reduces the compliance and administration burden. Once the choice is made to pool, it is irrevocable; all expenditure on development of software for a taxable purpose incurred in that year and subsequent years must be pooled. A new pool is created for each year in which in-house software development expenditure is incurred.

202. The software development pool allocates expenditure over five years. The rates of depreciation are provided in section 40-455:

Deductions allowed for software development pool		
	Column 1	**Column 2**
Item	**Income year**	**Amount of expenditure you can deduct for that year**
1	Year 1	Nil
2	Year 2	30%
3	Year 3	30%
4	Year 4	30%
5	Year 5	10%

203. The expenditure incurred on software development projects commenced before the income year in which the choice to pool is made must continue to be capitalised until the particular item of software is used or installed for use.

[28] On 7 December 2015 the Government announced a new measure to allow businesses to self-assess the effective life of acquired intangible depreciating assets, including in-house software, from 1 July 2016: http://www.treasury.gov.au/Policy-Topics/Taxation/NISA/Intangible-asset-depreciation.

[29] Section 40-335.

Small business entities

204. Expenditure on in-house software that has been allocated to a software development pool must be depreciated under Division 40. Other expenditure incurred on depreciating assets by eligible small business entities[30] may be depreciated using the simplified depreciation rules of Subdivision 328-D.

205. The simplified depreciation rules set an instant asset write-off threshold and provide a general small business pooling option. The former may allow the taxable purpose proportions of the adjustable values and second element of cost amounts of most depreciating assets to be written off immediately if their cost is below the applicable threshold. For amounts greater than the threshold, the latter enables a choice to allocate depreciating assets into a general pool and treat the pool as a single asset (irrespective of their effective life).

Date asset purchased and first installed ready for use	Applicable threshold
1 July 2012 – 31 December 2013	$6,500
1 January 2014 – before 7.30pm (AEST) 12 May 2015	$1,000
From 7.30pm (AEST) 12 May 2015 – 30 June 2017	$20,000

206. Eligible small business entities may therefore apply the instant asset write-off threshold and general small business pooling to capital expenditure they incur in developing or acquiring in-house software.

207. For more information, see Appendix 1A (flowchart), the Guide to Depreciating Assets or *Small business entity concessions* at ato.gov.au.

CGT

208. The CGT provisions have residual application to websites. 'CGT asset' includes any kind of property, or legal or equitable right that is not property.[31] A website is a CGT asset.

209. Amounts will not form part of the cost base of a CGT asset where the amount is otherwise deductible. To the extent that website expenditure is not deductible under section 8-1, Division 40 or Division 328, amounts will ordinarily form part of the cost base of the relevant CGT asset.

210. The cost base of a CGT asset consists of five elements. Where the CGT regime applies, commercial website expenditure is most likely to fall within the first element (which relates to acquisition costs), and the fourth element (expenditure incurred to increase or preserve the value of the asset after its creation or acquisition, or to install or move the asset).

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[30] Subdivision 328-C. For more information see Eligibility Rules in *Small business entity concessions* on ato.gov.au.
[31] Section 108-5.

Section 40-880

211. It would be very unusual for commercial website development expenditure to be deductible under section 40-880, especially given the broad definition of 'CGT asset' (discussed above). TR 2011/6 sets out the ATO view of business-related capital expenditure.

212. Section 40-880 is a provision of last resort and can apply only where no other provision allows or denies a deduction, or includes the cost in a CGT cost base or depreciable asset cost. Additionally, to fall within section 40-880 the expenditure must be capital expenditure, business-related and the business must be carried on for a 'taxable purpose'.

213. Eligibility for deduction under section 40-880 is determined at the time the expenditure is incurred. If eligible under section 40-880, the expenditure may be depreciated over five years in equal proportions.[32]

Domain names

214. The right to use a domain name is held by the registered user and can lapse if registration is not maintained. A domain name itself cannot be owned; it is not property. However, the right to use a domain name is exclusive to the registrant and is a CGT asset.

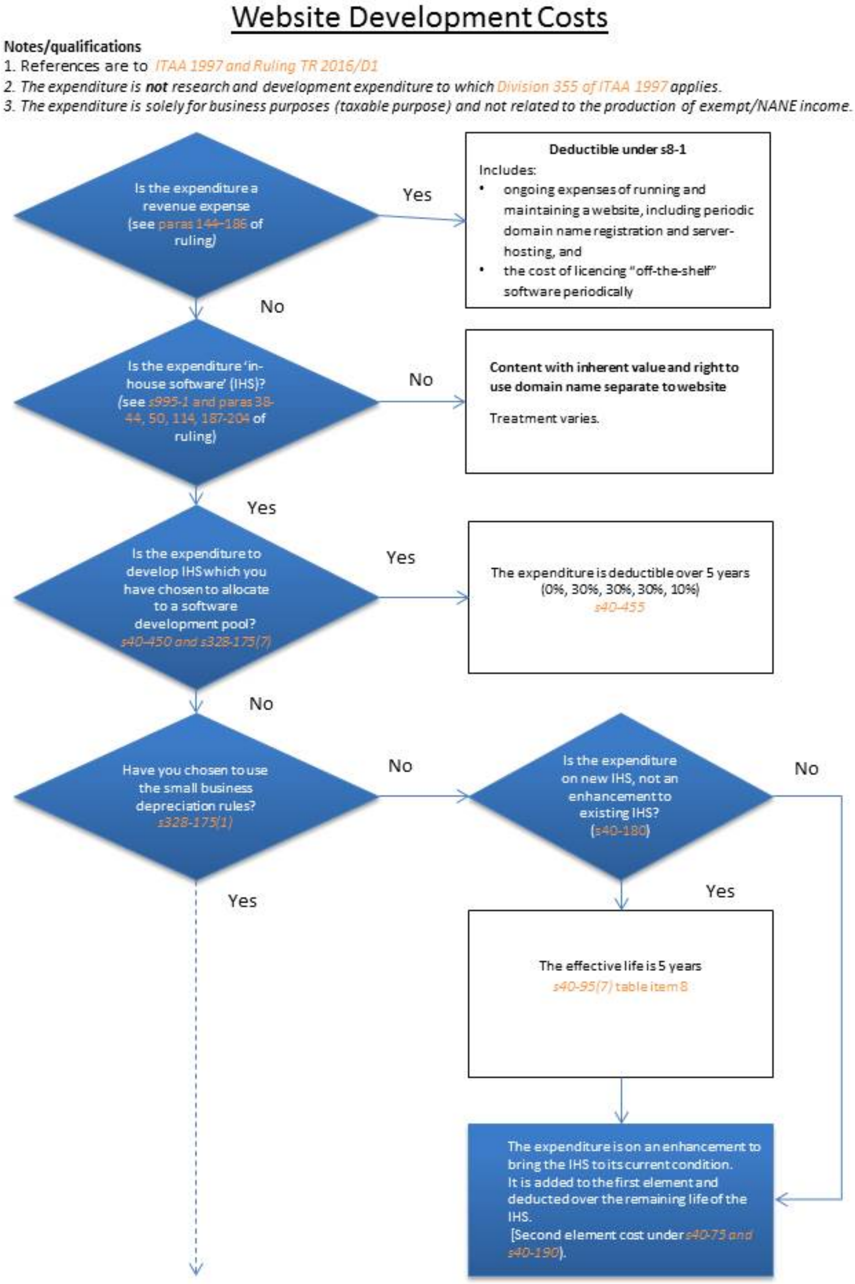
215. The right to use a domain name is considered to be a separate asset from the website. It is an asset of a different nature to software and can be bought and sold separately from the website software.

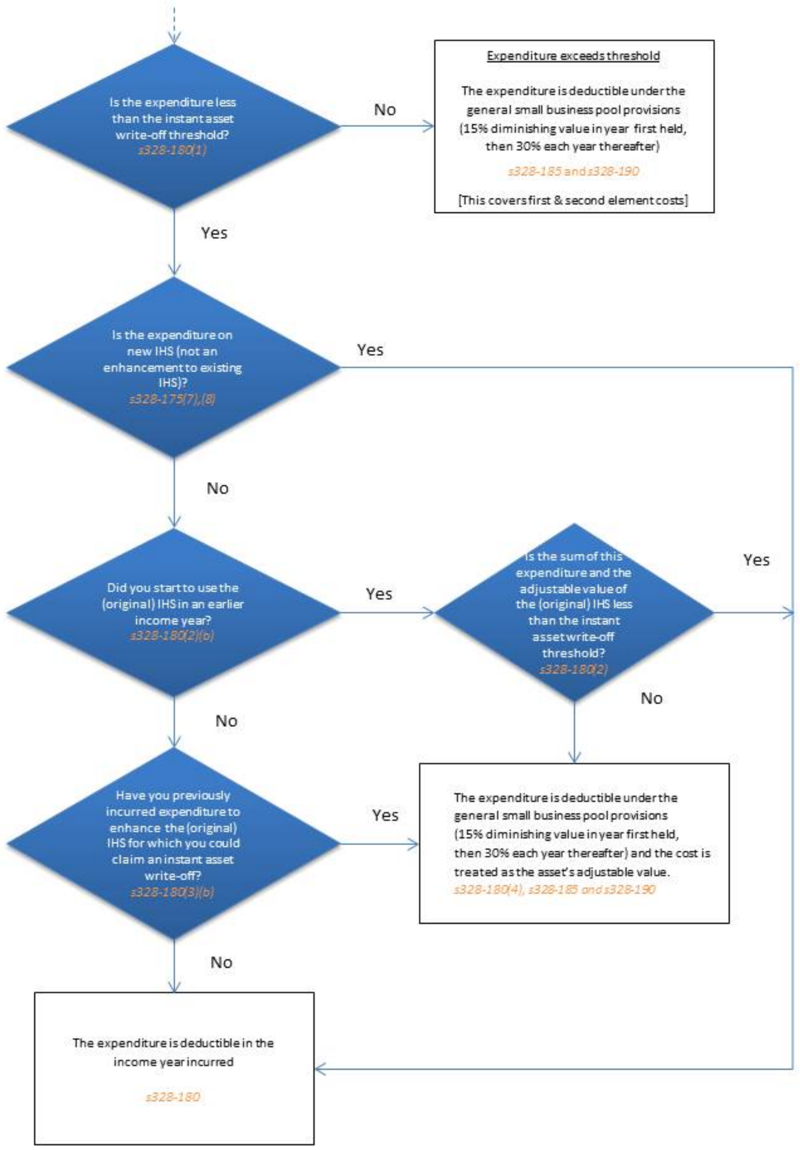
216. A business may register a new domain name when establishing a website. Where the right to use a new domain name is not secured by a payment and has no market value but is acquired only in conjunction with paying the registration fee for the initial registration period, its cost base for CGT purposes is nil.

217. However, a business may also source an existing domain name, such as through an online auction. The right to use a commercially desirable domain name can have considerable market value which does not diminish over time. The purchase price paid to acquire the right to use an existing domain name is the first element of its cost base for CGT purposes.

[32] Subsection 40-880(2).

Appendix 1A – Flowchart




Is the expenditure less than the instant asset write-off threshold?
s328-180(1)
No
Expenditure exceeds threshold
The expenditure is deductible under the general small business pool provisions (15% diminishing value in year first held, then 30% each year thereafter)
s328-185 and s328-190
[This covers first & second element costs]
Yes
Is the expenditure on new IHS (not an enhancement to existing IHS)?
s328-175(7),(8)
Yes
No
Did you start to use the (original) IHS in an earlier income year?
s328-180(2)(b)
Yes
Is the sum of this expenditure and the adjustable value of the (original) IHS less than the instant asset write-off threshold?
s328-180(2)
Yes
No
No
Have you previously incurred expenditure to enhance the (original) IHS for which you could claim an instant asset write-off?
s328-180(3)(b)
Yes
The expenditure is deductible under the general small business pool provisions (15% diminishing value in year first held, then 30% each year thereafter) and the cost is treated as the asset's adjustable value.
s328-180(4), s328-185 and s328-190
No
The expenditure is deductible in the income year incurred
s328-180

Appendix 2 – Alternative views

This Appendix sets out alternative views and explains why they are not supported by the Commissioner. It does not form part of the binding public ruling.

Marketing expenses

218. It has been argued that expenditure on establishing a simple website containing information about the business and minimal user functionality is comparable to an advertisement or a business card and therefore should be treated as a deductible marketing expense.

219. This view is not consistent with the consultation feedback we received about current usages of business websites. The internet serves more purposes than a directory. It enables interactions between people through the exchange of information in the digital medium in ways that can mimic other kinds of interactivity including physical presence, regardless of actual location. A business establishes a website as an ongoing part of its profit-yielding structure, usually to increase revenue (directly or indirectly) or increase efficiency of expenditure. The nature of the expenditure is better regarded as capital.

Labour deductions

220. It has been argued that all expenditure on salary and wages is revenue in nature and immediately deductible.

221. This view fails to take into account that the characterisation of expenditure on salary and wages is a question of fact. The surrounding circumstances must be considered. The case law instructs that, ordinarily, expenditure incurred for ongoing employees will be expenditure of a revenue nature, except to the extent that there is a direct link between what the employee does and the development of a capital asset.

'Maintenance'

222. It has been argued that all expenditure on a website following its initial construction should be classified as maintenance, and therefore deductible.

223. This view does not take into account the accepted distinction between 'maintenance' and 'improvements': see TR 97/23[33] (for tangible assets). Notwithstanding that section 25-10 does not apply to intangible assets, the 'repairs' and 'improvements' distinction is useful in applying the general capital/revenue distinction to website expenditure. Characterisation of expenditure on a website is a question of fact and degree having regard to the state of the website at the time of incurrence, the nature and extent of the work done, and the nature of the business.

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[33] Taxation Ruling TR 97/23 *Income tax: deductions for repairs*.

224. The rapidly changing environment in which commercial websites operate means that the benefit of website expenditure may not endure in the same way a tangible asset might. The transience of the benefit of the expenditure does not cause all expenditure to be deductible.

225. Where the benefit secured by the expenditure is of a structural nature to the business akin to an improvement, the mere fact that the benefit to the business might not last many years will not be enough to conclude the amount is of a revenue nature.

Appendix 3 – Your comments

226. You are invited to comment on this draft Ruling. Please forward your comments to the contact officer by the due date.

227. A compendium of comments is prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments, and
- be published on the ATO website at www.ato.gov.au.

Please advise if you do not want your comments included in the edited version of the compendium.

Due date:	**Friday, 20 May 2016**
Contact officer:	**John Wynter**
Email address:	**john.wynter@ato.gov.au**
Telephone:	**(08) 8208 1805**
Facsimile:	**(08) 7422 2202**
Address:	**Australian Taxation Office GPO Box 9977 ADELAIDE SA 5001**

Appendix 4 – Detailed contents list

228. The following is a detailed contents list for this Ruling:

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 93/12; TR 93/17; TR 97/11; TR 97/23; TR 98/13; TR 2001/6; TR 2006/10; TR 2011/6

Legislative references:

- ITAA 1997
- ITAA 1997 8-1
- ITAA 1997 25-10
- ITAA 1997 Div 40
- ITAA 1997 40-40
- ITAA 1997 40-72(2)
- ITAA 1997 40-95(7)
- ITAA 1997 40-105(4)
- ITAA 1997 40-110(5)
- ITAA 1997 40-335
- ITAA 1997 Subdiv 40-E
- ITAA 1997 40-450(1)
- ITAA 1997 40-455
- ITAA 1997 40-880
- ITAA 1997 40-880(2)
- ITAA 1997 Div 46
- ITAA 1997 Pt 3-1
- ITAA 1997 108-5
- ITAA 1997 Pt 3-3
- ITAA 1997 Div 328
- ITAA 1997 Subdiv 328-C
- ITAA 1997 Subdiv 328-D
- ITAA 1997 995-1

Cases relied on:

- AusNet Transmission Group Pty Ltd v. Federal Commissioner of Taxation [2015] HCA 25; 2015 ATC 20-521
- Federal Commissioner of Taxation v. CityLink Melbourne Ltd (2006) 228 CLR 1; [2006] HCA 35; 2006 ATC 4404; (2006) 62 ATR 648
- Federal Commissioner of Taxation v. Star City Pty Limited (2009) 175 FCR 39; [2009] FCAFC 19; 2009 ATC 20-093; (2009) 72 ATR 431
- Goodman Fielder Wattie Ltd v. Federal Commissioner of Taxation (1991) 29 FCR 376; 91 ATC 4438; (1991) 22 ATR 26
- GP International Pipecoaters Pty Ltd v. Federal Commissioner of Taxation (1990) 170 CLR 124; [1990] HCA 25; 90 ATC 4413; (1990) 21 ATR 1
- Hallstroms Pty Ltd v. Federal Commissioner of Taxation (1946) 72 CLR 634; [1946] HCA 34
- Mount Isa Mines Limited v. Federal Commissioner of Taxation (1992) 176 CLR 141; [1992] HCA 62; 92 ATC 4755; (1992) 24 ATR 261
- Ronpibon Tin NL and Tongkah Compound NL v. Federal Commissioner of Taxation (1949) 78 CLR 47; [1949] HCA 15
- Sun Newspapers Ltd. and Associated Newspapers Ltd. v. Federal Commissioner of Taxation (1938) 61 CLR 337; (1938) 5 ATD 23; (1938) 1 AITR 403

Other references:

- ATO ID 2011/42
- ATO ID 2011/43

ATO references

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