Taxation Ruling

Income tax: deductibility of expenditure on a commercial website

Contents **Para**

This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling sets out the Commissioner's 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 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software) was addressed in Taxation Ruling TR 2001/6 *Income tax: deductibility of commercial website expenditure* (now withdrawn). Division 46 was repealed with effect from 1 July 2001.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.[3]

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 of this Ruling). The term 'website' includes content available on that website, but only to the extent that the content has no independent identity or value. (See Examples 2, 3 and 4 of this Ruling).

7. 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 53 to 55 of this Ruling), and
- content available on or incorporated into a website that has independent value to the business.

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

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 41 to 46 of this 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] In this Ruling, a website used in a business is referred to as a 'commercial website', or simply a 'website' unless the context requires otherwise.

Commercial website expenditure: capital/revenue distinction

Types of Expenditure

11. 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

12. 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.

13. Where labour costs are partly on revenue account and partly capital in nature, the expenditure must be apportioned on a reasonable basis.[4]

Off-the-shelf products and periodic usage fees

14. 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 41 to 46 of this Ruling).

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

16. 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 5 of this Ruling).

17. Periodic operating, registration, web hosting and licensing fees are revenue expenses deductible over the period to which the expense relates.

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

Acquiring or developing a website

18. Expenditure incurred in acquiring or developing a commercial website for a new or existing business is capital expenditure. (See Examples 6 and 7 of this Ruling). The expenditure is treated as expenditure on 'in-house software' if:

- the expenditure relates directly to the commercial website
- the commercial website is mainly used by the business for interaction with customers (that is, any copyright in the website is not itself exploited for profit), and
- the expenditure is not deductible under a provision outside Divisions 40 and 328.

Microsites

19. The same principles apply to expenditure incurred in acquiring or developing a microsite, that is, a subsidiary commercial website with its own domain name that is typically used for promoting or marketing a particular product or service within a business. Where the microsite represents a permanent improvement to the business structure, the expenditure on the microsite will be of a capital nature. (See Example 8 of this Ruling). However, expenditure on a temporary microsite will tend to be of a revenue nature where it is set up for a transient marketing purpose.

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. (See Example 9 of this Ruling).

23. A modification to a website that adds minor functionality or makes minor enhancements to existing functionality is also of a revenue character. (See Example 10 of this Ruling). However, a modification that adds significant new functionality or materially expands existing functionality is not in the nature of maintenance and is capital (see paragraphs 25 to 32 of this Ruling).

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 and its significance to the business
- 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, and
- the expected useful life of the modification.

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 an operational cost. Expenditure on a modification that represents a structural advantage to the business is capital expenditure. (See Examples 10, 11, 12, 13, 14 and 15 of this Ruling)

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 16 and 17 of this Ruling).

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. (See Examples 18 and 19 of this Ruling).

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 substantial modifications or modifications that are part of a program of work to upgrade and improve the website significantly. Whilst each situation must be judged on its own circumstances, a routine modification resulting in minor enhancement will be of a revenue nature and a modification that is substantial or part of a program of work 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, and
- causal or temporal links with other modifications. (See Example 20 of this Ruling).

Content migration

33. 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).

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

35. 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.

36. 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.

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

Social media

38. A social media presence is a capital asset of a business separate from its website. Member profile information and content entered onto social media is not 'in-house software' as it resides on the social media platform.

39. Expenditure incurred on a social media profile is appropriately treated as revenue expenditure where the cost of setting up the profile is trivial and the profile is maintained mainly for marketing purposes. (See Example 21 of this Ruling).

Capital allowances – where expenditure is not otherwise deductible

40. A website is not a depreciating asset under Divisions 40 and 328, except to the extent it can be classified as 'in-house software'.[5]

In-house software

41. 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]

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

Software that is 'in-house software'

43. In-house software includes:

(a) software in a commercial website that enables the website owner to interact with the user, where any independent benefit to the user is no more than incidental to the interaction (See Examples 22 & 23)

(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, and

(c) content on a website which is incidental to the website and not an asset having value separate from the website. (See Example 2 of this Ruling).

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[5] Note that if the website owner holds copyright in component parts of the website, that copyright may be a depreciating asset.
[6] As defined in section 995-1.

Software that is not 'in-house software'

44. 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 of this Ruling).

45. Application software made available through a commercial website for online use and provided by the website owner for a main purpose other than enabling the website owner to further interact with the user is a separate asset from the website and is not 'in-house software'. (See Example 24 of this Ruling).

46. 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 allowances (in relation to copyright) or capital gains tax, is determined according to the nature of the asset. (See Example 4 of this Ruling).

Capital allowances for in-house software

47. 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
  - (ii) otherwise, in accordance with the general small business pool rules.

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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 subsection 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 228 of the Explanation of this Ruling.

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

Expenditure incurred on in-house software prior to a website being used in carrying on a business

48. Capital expenditure incurred, even as part of a hobby[10], on in-house software in a website will form part of its cost.[11] The decline in value of the in-house software is calculated from the time it starts to be held, irrespective of its use. Deductions for decline in value can be claimed once the in-house software starts to be used for a taxable purpose, as when the hobby becomes a business.[12] (See Example 25 of this Ruling).

Copyright

49. Copyright can subsist in parts of a website but not in a website as a whole. Where the website owner holds copyright in a component of the website held for a taxable purpose, the website owner may deduct the decline in value of the copyright. Where that component is also part of an in-house software asset, the most appropriate treatment will be to deduct the decline in value of the in-house software asset.[13]

50. A business may also own the copyright in software or content that is available on the website but is not considered part of the website. Whether the copyright in these items is able to be depreciated will not depend on whether the commercial website expenditure is able to be depreciated.

Capital gains tax (CGT)

51. 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 not constitute the cost of 'in-house software' or of copyright, the CGT regime will recognise the expenditure as part of the cost base of a CGT asset.

Section 40-880

52. Section 40-880 is a provision of last resort. Section 40-880 will generally not apply to commercial websites because capital expenditure

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[10] 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.
[11] See the discussion commencing paragraph 40 in relation to whether capital expenditure on a website can be deducted.
[12] Non-capital expenditure incurred prior to the commencement of business is not deductible.
[13] Section 8-10

on commercial websites will usually be 'in-house software' and, if not, is likely to be part of the cost base of a CGT asset.[14]

Domain names

53. A domain name is a unique name registered with a domain name registrar (for example, www.ato.gov.au). Periodic registration fees for a domain name, including the initial registration fee, are revenue expenses and deductible when paid. This is the case unless the fees relate to a period greater than 13 months, in which case the fee is deductible over the period to which the fee relates.

54. 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.

55. 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. (See Example 26 of this Ruling).

Examples

Example 1 – software not part of website

56. *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.*

57. *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 paragraph 6 or 44 of this Ruling).

Example 2 – content part of website

58. *Ratna retails environmentally-friendly household cleaning products through a commercial website. The website includes tips and short articles promoting environmentally-friendly cleaning methods. The articles are mostly written by or for Ratna and are turned over frequently. They have no commercial value to Ratna apart from their function on the website.*

59. *As the tips and articles have no independent value, they are part of the website.*

[14] 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*.

60. *The website also contains analytic software which collects and applies customer data. The data is used to tailor the web experience for the user as well as providing Ratna with information about general user habits and trends for the purposes of her business strategy.*

61. *The customer data has no value to Ratna apart from its function in the website. It is considered to be part of the website software.* (Return to paragraph 6 or 43 of this Ruling).

Example 3 – content not part of website

62. *Meg is a professional photographer who specialises in corporate photography.*

63. *Meg has a website on which she displays a portfolio of her work to attract clients. Meg owns copyright in the digital images which has significant, and not token, value to Meg independent of her use of the images for the website.*

64. *The digital images are considered to be separate assets from the website and not in-house software. The intellectual property (copyright) in the images is a separate depreciating asset held by Meg.*

65. *Meg updates her displayed portfolio frequently to maintain the search profile of her website. Expenditure incurred in initially uploading the portfolio is a capital cost. The cost of subsequent updates is deductible as a cost of maintaining the website.* (Return to paragraph 6 of this Ruling).

Example 4 – software not part of website

66. *Wattso Pty Ltd provides estimating services for electrical installation work. The company has developed a software estimating tool for component inputs and labour which it uses in its estimating work but also licenses to electrical contractors. Under the terms of the licence, Wattso provides periodic upgrades and retains copyright in the software. The company also provides user access to the estimating tool as a web-based application on its website for a fee.*

67. *Since developing the software tool, Wattso's income is mainly derived from licence and access fees, in accordance with its business plan. The software tool, both as a product for sale and as a web-based application, is not part of Wattso's website. It is not in-house software.* (Return to paragraph 6 or 46 of this Ruling).

Example 5 – leased website – lease payments

68. *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.*

69. *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.*

70. *The lease payments are an operating cost to the company and are deductible as incurred.* (Return to paragraph 16 of this Ruling).

Example 6 – existing business establishes a basic website

71. *Eve has owned Fashion from Eden, a suburban boutique for many years. She engages a web developer to establish a website. 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.*

72. *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.*

73. *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.*

74. *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 the digital equivalent of a permanent 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.*

75. *The website is a depreciating asset; it is software used by the business in the business to establish an online profile for the business and increase brand awareness. It is 'in-house software' and depreciable under the capital allowances provisions.* (Return to paragraph 18 or Example 11 of this Ruling).

Example 7 – acquisition of investment website – carrying on a business

76. *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.*

77. *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.*

78. *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 Taxation Ruling TR 97/11 Income tax: am I carrying on a business of primary production?, Cindy carries on a business. Her business will be treated as a small business entity.*

79. *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.*[15]

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[15] Subdivision 328-D.

80. *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 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 18 of this Ruling).

Example 8 – business sets up microsite

81. *BrixtonBaker is an on-line bakery that delivers to suburban retail customers. It has a very successful website with an on-line shop offering a vast array of freshly baked goods.*

82. *BrixtonBaker has recently developed a gluten-free pizza dough which it sells in frozen pizza base form, retailed under the name Pizza Fre-o-gee, mostly to commercial customers. BrixtonBaker has added the product to its on-line shop but has had little success in the way of sales.*

83. *BrixtonBaker commissions a web designer to develop a 'microsite' focused exclusively on the sale of the gluten-free pizza dough to commercial kitchens and pizza retailers. The visual appearance of the website is entirely different to BrixtonBaker's main website, exclusively promoting Pizza Fre-o-gee. However, by clicking 'order' on the Pizza Fre-o-gee website, the customer is redirected to BrixtonBaker's web checkout.*

84. *The microsite is a capital asset separate from BrixtonBaker's website and is 'in-house software'.* (Return to paragraph 19 of this Ruling).

Example 9 – online business – maintenance of website

85. *Shayvoo Pty Ltd conducts an online business that provides advice on home decorating and enables users to source products from home decorating suppliers. Shayvoo derives commission income on sales as well as advertising fees from miscellaneous advertising. The success of Shayvoo's website business depends on a constant turnover of interest-catching articles and graphics within a flexible search function that enables users to explore a wide variety of home decorating themes and ideas.*

86. *The cost of uploading new articles, refreshing graphics and advertising, and of updating product supplier links as suppliers and products change, are maintenance expenses deductible under section 8-1.* (Return to paragraph 22 of this Ruling).

Example 10 – minor modification to website functionality

87. *Venda Pty Ltd has a website with online sales capability that only accepts 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.*

88. *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.*

89. *From a practical business perspective, the addition of a payment option 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 23 or 27 of this Ruling).

Example 11 – business adds online sales function

90. *Continuing from Example 6, Eve decides to expand the website to include online sales.*

91. *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.*

92. *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 27 of this Ruling).

Example 12 – e-business promotional activity – temporary change to website appearance

93. *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.*

94. *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.*

95. *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.*

96. *The expenditure is of a revenue nature.* (Return to paragraph 27 of this Ruling).

Example 13 – non-sales website modification

97. *Mining Limited does not carry on business online but has a website that publishes information about the company, which includes history, management, business activities, community engagement, recruitment and careers, investor information and company documents. The company enhances 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 Mining Ltd does not expect to modify the system again for at least 12 to 18 months.*

98. *The website plays an important publicity role in Mining Ltd's business. Whilst the website itself is a capital asset, the additional functionality represented by the modification 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.*

99. *Expenditure on the modification is of a revenue nature.* (Return to paragraph 27 of this Ruling).

Example 14 – addition to functionality of website

100. *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.*

101. *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.*

102. *Ordering plays an integral role in the efficiency and success of Tony's business. The website upgrade cost is significant, exceeding the annual cost of maintaining the website.*

103. *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 Ruling).

Example 15 – online business – maintenance and upgrade

104. *Compinsur Pty Ltd carries on its business online. The company's website provides a facility for potential insurance customers to compare insurance products. Website users can apply for an insurance product by following a link to the insurance provider. Compinsur derives fees from client insurance providers for successful referrals as well as revenue from website advertising.*

105. *Compinsur updates the software comparison tool for new insurance provider clients and when its current clients introduce new products or alter existing products. Costs incurred by Compinsur in updating the insurance products maintain the currency of the website and are maintenance costs on revenue account.*

106. *To maintain its market edge, Compinsur undertakes a redesign of its website to enhance both front-end and back-end functionality, providing an improved user interface and results that can be customised to a user profile. The upgrade involves significant planning and expenditure, including establishing a beta site. The website is central to Compinsur's business structure and the upgrade strengthens that income-producing structure. Expenditure incurred in upgrading the website is capital expenditure.* (Return to paragraph 27 of this Ruling).

Example 16 – online business – back-end upgrades

107. *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 several years. The appearance and functionality of the website for users will not change.*

108. *The upgrade is a planned and budgeted program of work, 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.*

109. *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 Ruling).

Example 17 – managed website – expenditure on in-house software

110. *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.*

111. *HL engages an IT company to provide all of its computer support, hardware and software, including managing its website. The IT company periodically invoices HL for its services. HL receives an invoice with an item for 'website development' being an upgrade of its 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. Upgrades of this kind are infrequent, usually happening several years apart. IT company received approval from HL's management before undertaking the upgrade.*

112. *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.*

113. *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 Ruling).

Example 18 – existing website modified for mobile devices

114. *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.*

115. *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:*

- *alter the existing website software to enable it to adapt 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).*

116. *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.*

117. *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 Ruling).

Example 19 – online business – ongoing compatibility updates

118. *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, including expenditure 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.*

119. *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 Ruling).

Example 20 – online business – incremental changes

120. *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.*

121. *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'.*

122. *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.*

123. *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 Ruling).

Example 21 – business with social media presence

124. *Mayfair Textiles is a suburban fabric retailer that has a commercial website.*

125. *To advertise its products and sales promotion events and to encourage website traffic, Mayfair establishes a small profile on Facade, a popular social media site. Facade charges no membership fee.*

126. *Mayfair incurs labour costs in signing up for membership and setting up its Facade profile and ongoing costs in posting new content. The employees who set up and maintain the profile work in Mayfair's marketing department.*

127. *The Facade profile is a capital asset of the business separate to the commercial website and is not in-house software of Mayfair.*

128. *Although the Facade profile is a capital asset, the labour costs incurred in establishing the profile itself are trivial and cannot be distinguished for practical purposes from the labour costs incurred in updating and monitoring the profile, which are deductible marketing expenses.* (Return to paragraph 39 of this Ruling).

Example 22 – off-the-shelf software – part of a website

129. *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.*

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

131. *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.*

132. *The ISP hosting fees are an expense of a revenue nature.* (Return to paragraph 43 of this Ruling).

Example 23 – definition of 'in-house software' – do-it-yourself website-building application

133. *Sites@Work operates a commercial website which incorporates application software for customers to construct their own websites. Sites@Work 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 Sites@Work as a yearly subscription service. A customer who constructs a website on Sites@Work will face obstacles in trying to migrate it to another hosting service.*

134. *The website-building application (basic and fully featured versions) integrated into Sites@Work website, is solely for use online and is not marketed as a download. Sites@Work's use of the website-building software is integral to a business model of providing a comprehensive website service. The application is not exploited separately for profit.*

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

136. *The website-building application is part of Sites@Work's website and is 'in-house software'.*

137. *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 Sites@Work will be on revenue account.* (Return to paragraph 43 of this Ruling).

Example 24 – software – not part of a website

138. *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.*

139. *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.*

140. *BigSystems provides Nebula mainly to users to use for their independent 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.*

141. *Nebula is not part of BigSystems' website and is not 'in-house software'.* (Return to paragraph 45 of this Ruling)

Example 25 – business from hobby

142. *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.*

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

144. *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.*

145. *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.*

146. *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, as Abishek uses his website for a taxable purpose, his hosting and maintenance fees are deductible.*

147. *Although the initial website expenditure forms part of the cost of an 'in-house software' asset, Abishek was only carrying on a hobby at that time. It is only when he begins to carry on a business that the website is used for a taxable purpose and its decline in value as in-house software is deductible under the capital allowances provisions.*

148. *The periodic hosting and maintenance fees that Abishek incurred that relate to the period prior to the commencement of business are private expenses and not deductible.* (Return to paragraph 48 of this Ruling).

Example 26 – domain name

149. *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.*

150. *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.*

151. *Registration fees for the domain name (including the initial registration fee) are deductible over the period to which they relate.*

152. *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 55 of this Ruling).

Date of effect

153. This Ruling applies to income years commencing both before and after its date of issue. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation
14 December 2016

Appendix 1 – Explanation

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

Commercial websites

154. 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.

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

156. 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.

157. 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.

Commercial website expenditure: capital/revenue distinction

158. 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*[16] 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*]

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

159. The capital/revenue distinction was explained by Dixon J in *Sun Newspapers*[17] 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.

160. 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*[18] 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.

161. 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*[19] 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.

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

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

[19] *Mount Isa Mines Limited v. Federal Commissioner of Taxation* (1992) 176 CLR 141; [1992] HCA 62; 92 ATC 4755; (1992) 24 ATR 261.

162. In *Citylink Melbourne*[20], the majority stated (citing *Hallstroms* and *GP International Pipecoaters*[21]) 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.

163. 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.

164. 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.

165. 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.

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

Nature of expenditure generally

Labour

167. 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, and deployment and monitoring of a website. All or some of these activities may be necessary when a website is modified.

168. 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.[22]

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[20] *Federal Commissioner of Taxation v. Citylink Melbourne Ltd* (2006) 228 CLR 1; [2006] HCA 35; 2006 ATC 4404; (2006) 62 ATR 648.

[21] *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.

[22] Note also Kirby J's discussion of authorities in *Steele v. Deputy Federal Commissioner of Taxation* (1999) 197 CLR 459; [1999] HCA 7; (1999) 41 ATR 139; 99 ATC 4242 at paragraphs [76] and [83].

169. In *Goodman Fielder Wattie*[23], 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*[24], 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.

170. 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.[25]

171. 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.[26]

172. 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.

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[23] *Goodman Fielder Wattie Ltd v. Federal Commissioner of Taxation* (1991) 29 FCR 376; 91 ATC 4438; (1991) 22 ATR 26
[24] *Federal Commissioner of Taxation v. Star City Pty Limited* (2009) 175 FCR 39; [2009] FCAFC 19; 2009 ATC 20-093; (2009) 72 ATR 431
[25] *Sun Newspapers*, Dixon J at CLR 362.
[26] *Ronpibon Tin NL and Tongkah Compound NL v. Federal Commissioner of Taxation* (1949) 78 CLR 47; [1949] HCA 15.

Off-the-shelf products and periodic usage fees

173. 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.

174. 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.

175. 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

176. 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.

177. 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.

178. 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.

179. 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.

180. 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.

Microsites

181. A business may establish a secondary website with a distinct identity and domain name. Typically, such a site, known as a 'microsite' and associated with one or a sub-set of the products or services of a business, will often have a different 'look and feel' and different search engine parameters.

182. A microsite will be treated separately but consistently with the treatment of the expenditure on a commercial website. A microsite will often augment the business structure. If so, the expenditure will be of a capital nature. However, a temporary microsite set up for a transient marketing purpose may not represent an expansion of the business structure. Such expenditure will be of a revenue nature. The nature of expenditure on a microsite is determined having regard to all of the circumstances.

Maintaining a website

183. 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.

184. The cost of remedying a software fault is not deductible under section 25-10 (Repairs) as that section does not apply to intangible assets.[27] 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.[28] Expenditure incurred in remedying software faults in a website is therefore regarded as a matter of maintenance.

185. 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.

186. 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.

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

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

[28] 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

188. 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.

189. 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. Paragraph 26 of this Ruling identifies the following factors to consider in order to determine whether a modification represents a structural advantage to a business.

Role of the website in the business

190. 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 and its significance to the business

191. 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.

Size and extent of the modification

192. The greater the extent of the modification to the existing website and its functionality, the more likely it is that the expenditure will be of a capital nature.

Planning and resources

193. 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

194. 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

195. As noted at paragraph 163 of this 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

196. 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.

197. 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

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

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

Back-end upgrades

200. 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.

201. 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

202. 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.

203. 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.

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

205. 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.

206. Where a commercial website constitutes the business and is subject to constant oversight and work by a team of employees, successive minor modifications that collectively modify the website significantly are more likely to form part of a program of work. Factors to be taken into account are listed in paragraph 32 of this Ruling.

Content migration costs

207. If content is migrated as part of establishing a new commercial website or an upgrade that significantly enhances or replaces a commercial website, the cost is a capital expense, being a second element cost of 'in-house software'.

208. If content is migrated as a result of an upgrade to an existing website that does not significantly enhance or replace the website or as a result of relocation of the same website code onto a new server, the cost is a revenue expense as the expenditure is directed to maintaining the operation and functionality of the existing website.

Social media

209. 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 as part of their ongoing business strategy. A social media presence is separate from any website that the business operates, though links may be provided for users.

210. 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.

211. While the social media profile is a capital asset of the business due to its function and permanence, it is considered that all expenditure incurred on a social media profile is appropriately treated as revenue expenditure. Social media profiles can be set up in minutes and the medium does not require any significant threshold expenditure. The medium operates on single, concise posts made periodically and a business will look to generate a transient benefit from each post.

Capital allowances – where expenditure is not otherwise deductible

In-house software

212. '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.

213. 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.

214. 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.

215. Application software made available through a website to users mainly for their independent 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.

216. 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.

217. 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.

218. 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 to its main intended use.

Meaning of 'software'

219. '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'.[29] Software is, functionally, anything that instructs another part of the computer system; more generally, it is a digital system made up of programs and associated documentation. It may include website content.

Capital allowances for in-house software

220. A website is an intangible asset as it does not have a physical existence. In accordance with paragraph 40-30(1)(c), intangible assets are not depreciating assets unless they are of a type mentioned in s 40-30(2).

221. Paragraph 40-30(2)(d) lists 'in-house software' as an intangible depreciating asset (to the extent that it is not trading stock). Therefore, a website can be a 'depreciating asset' if it is classified as in-house software.

222. 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.[30]

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[29] 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.
[30] See Note to subsection 40-450(1).

223. 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.[31] 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.

224. 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).[32]

225. 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.[33]

Expenditure incurred on in-house software prior to a website being used in carrying on a business

226. 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 in-house software. The decline in value starts when you commence to hold the in-house software, including the years it was used for a private purpose. However, you cannot deduct the decline in value until you start to use the in-house software for a taxable purpose (determined objectively). Other expenses (non-capital) incurred in the hobby phase will be private and non-deductible.

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[31] Subsection 40-72(2).
[32] 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.
[33] Section 40-335.

Software development pools

227. 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 to pool is made, 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.

228. 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%

229. 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.

Small business entities

230. 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[34] may be depreciated using the simplified depreciation rules of Subdivision 328-D.

231. 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).

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[34] Subdivision 328-C. For more information see Eligibility Rules in *Small business entity concessions* on www.ato.gov.au.

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

232. 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.

233. For more information, see Appendix 2 (flowchart) and the *Guide to Depreciating Assets* or *Small business entity concessions* at www.ato.gov.au.

Copyright

234. The Australian Copyright Council states:[35]

> Whole websites are not protected by copyright. However, component parts of a website, such as text, artworks, logos and the underlying source code and files, may be protected.

235. As intellectual property in a thing is a separate asset to the thing itself, an entity can hold in-house software and also own copyright in the in-house software. However, the entity cannot deduct the same expenditure twice: it will need to determine which provision is the most appropriate in deciding how to deduct the expenditure (section 8-10).

236. For the purposes of this Ruling, all software (including relevant content) associated with a commercial website that does not have independent value to the business is part of the website. Software that has independent value is not part of the website. In practice, the owner of a commercial website who owns copyright in parts of the website will not claim deductions for the decline in value of the copyright as the more appropriate treatment is to claim deductions for the decline in value of the in-house software in which the copyright subsists.

CGT

237. The CGT provisions have residual application to websites. 'CGT asset' includes any kind of property, or legal or equitable right that is not property.[36] A website is a CGT asset.

[35] Australian Copyright Council, 'Websites & Copyright' – Information Sheet G057v13, Strawberry Hills NSW, December 2014.
[36] Section 108-5.

238. 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.

239. 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).

Section 40-880

240. 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.

241. 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'.

242. 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.[37]

Domain names

243. 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.

244. 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.

245. 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.

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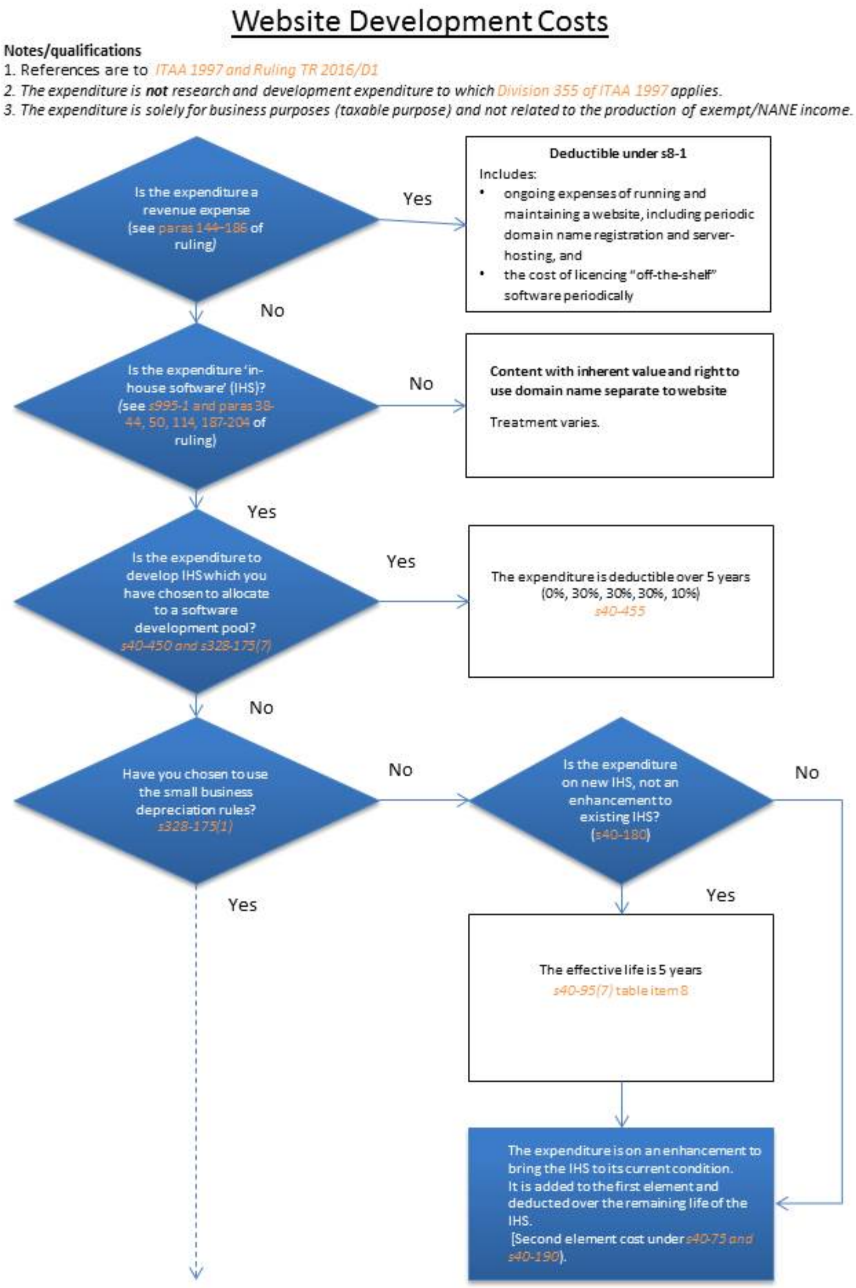
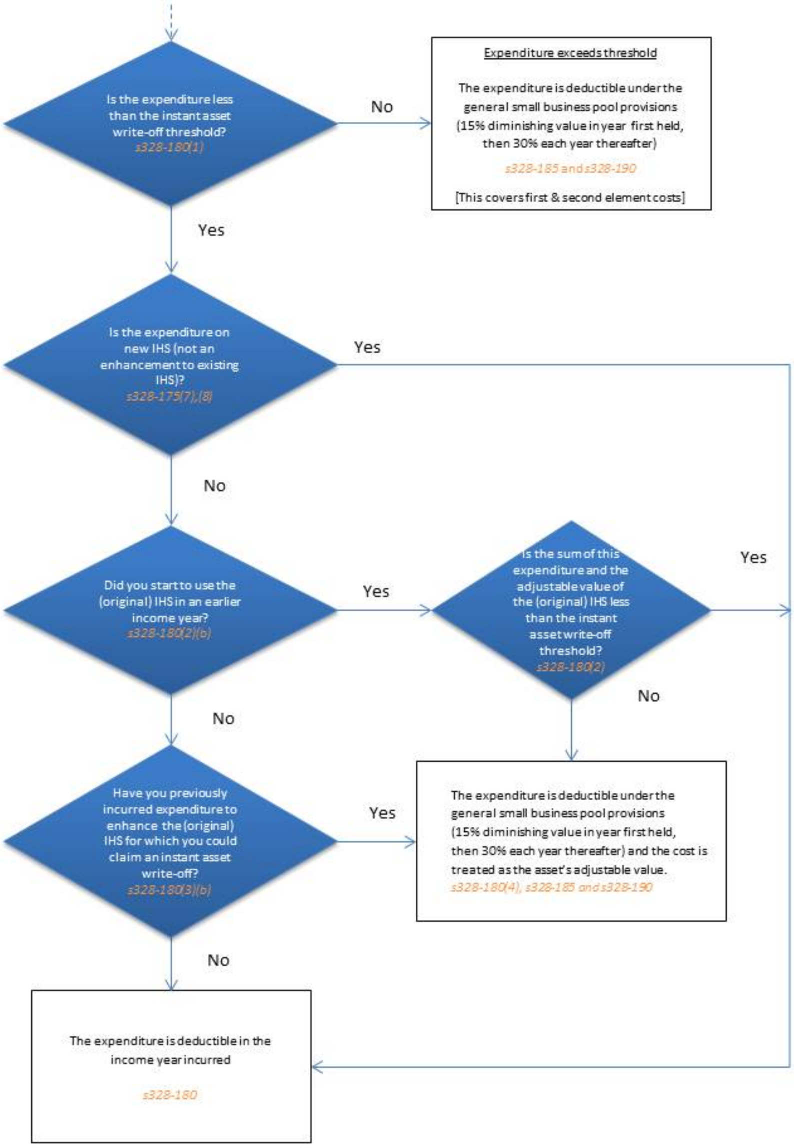
[37] Subsection 40-880(2).

246. 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.

Appendix 2 – 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 3 – Detailed contents list

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

References

Previous draft:

TR 2016/D1

Related Rulings/Determinations:

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

Previous Rulings/Determinations:

TR 2001/6 (withdrawn)

Legislative references:

- ITAA 1997
- ITAA 1997 8-1
- ITAA 1997 8-10
- ITAA 1997 25-10
- ITAA 1997 Div 40
- ITAA 1997 40-30(1)(c)
- ITAA 1997 40-30(2)
- ITAA 1997 40-30(2)(d)
- 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; (1946) 8 ATD 190; 3 AITR 436
- 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; (1949) 8 ATD 431
- Steele v. Deputy Federal Commissioner of Taxation (1999) 197 CLR 459; [1999] HCA 7; (1999) 41 ATR 139; 99 ATC 4242
- 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:

- Australian Copyright Council, ‘Websites & Copyright’ – Information Sheet G057v13, Strawberry Hills NSW, December 2014

ATO references

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