TR 2016/3EC - Compendium

Public advice and guidance compendium – TR 2016/3

This is a compendium of responses to the issues raised by external parties to draft Taxation Ruling TR 2016/D1 *Income tax: deductibility of expenditure on a commercial website*

This compendium of comments has been edited to maintain the anonymity of entities that have commented.

Summary of issues raised and responses

Issue No.	Issue raised	ATO Response/Action taken
1	**Copyright**	
1.1	Copyright is specifically recognised under Division 40 of the *Income Tax Assessment Act 1997* (ITAA 1997) as a depreciable intangible asset. If developed software is not 'mainly for the taxpayer's use in performing the functions for which the software was developed' (definition of 'in-house software') but is developed for profit exploitation via commercial licencing or sale, then deductions for the decline in value of copyright in the underlying software code is the relevant tax treatment.	We agree that, where the business owner is the owner of copyright in software it develops and the software does not fall within the definition of 'in-house software' and is not held as trading stock, capital expenditure on the software may be deductible under Division 40 of the ITAA 1997 as the decline in value of intellectual property (being copyright in the software). Recognition that capital expenditure may be incurred in creating copyright in software, and that copyright may be the relevant intangible depreciating asset, is now included at paragraphs 49 and 50. Copyright is also referred to in paragraphs 18, 46 and 51 and in Examples 3 and 4.
1.2	Paragraph 43 flags potential capital gains tax (CGT) or section 40-880 of the ITAA 1997 treatment. However, potential treatment as copyright (as an item of intellectual property) under Division 40 is not discussed. We suggest that paragraph 43 include reference to software being potentially copyright if it is not 'in-house software'. The income tax treatment of	See 1.1 above.

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	copyright should then be covered in the Ruling (for example, between paragraphs 207 and 208) unless scoped out.	
1.3	In relation to paragraph 45, if the software is not in-house software it falls within table item 5, subsection 40-95(7) of the ITAA 1997 as copyright.	See 1.1 above.
1.4	The Ruling does not refer to copyright. The Ruling should provide guidance on when the relevant depreciating asset is copyright in software.	See 1.1 above.
2	**In-house software**	
2.1	Any software acquired or developed for the purpose of providing services to customers should be treated as in-house software as long as there is no right provided to the customer to modify the source code or to reproduce the software for further distribution and sale. If the customer is not granted any rights to the source code of the software or any rights to reproduce and distribute, then the customer has not paid for anything more than simple use. If the customer is paying for simple use, it is appropriate to treat the software as in-house software. This would be consistent with the ATO's views regarding royalty withholding tax and what it refers to as simple use.	The definition of 'in-house software' is based on the use of the software by the entity that holds the software for Division 40 of the ITAA 1997 purposes. This is a different test to whether software is subject to 'simple use' by a purchaser or licensee. It would be inconsistent with the definition of 'in-house software' to include all software that is exploited for profit by sale or licence to a customer on the basis that no rights are granted over the source code. As a depreciating asset, the meaning of 'in-house software' must be consistent with a capital asset used within the operation of a business and would exclude software that is exploited for profit by sale or licence. While the structure of former Division 46 of the ITAA 1997 differs from the current provisions of Division 40 of the ITAA 1997 for in-house software, the intention is the same. The Explanatory Memorandum to the Taxation Laws Amendment (Software

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		Depreciation) Bill 1999 which accompanied the introduction of former Division 46 explained that the new provisions were intended to apply to software acquired or developed for use within a business and not where the exploitation of the software was the business. Where there was a dual purpose, the principal reason for the acquisition or development was a question of fact (see paragraphs 31 and 32). The terms of the definition of 'in-house software' indicate that the same legislative intent applies in the application of Division 40 of the ITAA 1997 to in-house software, which superseded former Division 46 of the ITAA 1997 with effect from 1 July 2001. In the Ruling we have taken the position that some degree of exploitation of software for profit (that is, its use by a customer to obtain an independent benefit) can be consistent with in-house software. This is where the use of the software by the business is 'mainly for performing the functions for which the software has been developed' notwithstanding that it is incidentally provided to customers for a fee. See Example 23 'Sites@Work'. Typically this will occur where the customer has access to the software only online and in the context of an ongoing engagement with the business.
3	**Mobile apps**	
3.1	The proliferation of mobile apps in the age of technology and e-commerce warrants our recommendation to the Commissioner to provide more guidance on the deductibility of costs relating to mobile apps and 'in-apps', which are installed on	While the nature of expenditure on mobile apps may in many cases be similar to that of expenditure on websites, it is considered that there are sufficient differences to warrant consideration of mobile apps in a separate ATO product. A decision has been made to develop and issue a product to

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	portable user devices such as smartphones and tablets. In-apps (apps within apps that provide access to premium content or other benefits) should be treated as second element cost base to any original app asset, even where the original app was developed for free to customers with only in-apps being charged for a fee. Of course, the assessment of the original app must be made on a case-by-case basis as to whether the app was developed for commercial distribution/exploitation or to enable customer transactions to be completed (such as Example 19 the Argent Bank app). The point here is that in many cases, the original app is free for customers to download and the app is likely to be treated as in-house software (like the Argent Bank app). However, where in-apps require customers to pay for a premium service or bolt-on, if this was considered a separate asset, then the fact that customers now need to pay to access the in-app may be considered copyright and not in-house software, which we believe would be the wrong conclusion.	address issues specific to mobile apps. The nature of apps and 'in-apps' can vary significantly. An app may be provided free of charge as a shell to support further software additions (in-apps) which are intended to be a source of revenue to the app provider. This may result in an in-app having a different character to one provided as a basic service supporting advertising and where the user may choose to purchase the 'no ads' version or premium content. See item 8.8 below regarding the removal of former Example 19 'Argent Bank'.
3.2	Example 19 addresses whether a mobile app is in-house software. It would be preferable if the scope of the Ruling were broadened to expressly address expenditure on apps due to their increasing commercial significance.	See 3.1 above.
4	**Data and content**	

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4.1	The Ruling is inconsistent in referring to 'content' and 'data and content'. References should be consistent. We understand the distinction to be that 'data' refers to things like names and numbers whereas 'content' refers to contextualised data, such as customer lists and product codes.	We consider that the distinction between 'data' and 'content' is not significant for the purposes of the Ruling. To avoid referring to 'data and content' throughout the Ruling, we have used the term 'content' to refer to all digital content (including data) that is not part of a program being executable code.
5	**Software transactions**	
5.1	There are a lot of uncertainties related to transactions involving software, which, in my view, the Ruling should be expanded to address. For example, if software is sold, it can be characterized in the following ways: 1. sale of goods – that is the CD or DVD containing the program 2. the copyright is sold, or 3. merely the provision of services.	It is considered that more general guidance on transactions involving software is beyond the scope of the Ruling. Note that TR 93/12 *Computer software* addresses the income tax implications arising from the development and marketing of computer software, including when computer software is trading stock. Note that TR 93/12 is currently under review.
6	**Labour on-costs**	
6.1	We query whether the ATO considers that on-costs are part of employee expenses, in the context of the first dot point of paragraph 12 and coverage of 'salary and wages' in paragraphs 144 to 148. If so, we suggest that: a) 'including on-costs' be appended to the first dot point of paragraph 12, and b) the meaning of 'on-costs', including examples, be covered in paragraph	It is not intended that the Ruling provide broad interpretative guidance on capitalised labour. As such, it is considered that on-costs are beyond the scope of the Ruling.

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	145 and/or 147.	
7	**Microsites**	
7.1	We suggest the ATO includes commentary in relation to micro-sites that have a related but distinct identity and domain name from the main business website. For example, a business may create a microsite dedicated to a new product, rather than simply uploading a webpage with the details of the product amongst all of its other product description pages. While website updates relating to routine product changes and announcements are likely to be maintenance, would the creation of a separate microsite be considered to be a modification of a capital nature?	It is considered that the principles set out in the Ruling would apply equally to a microsite as to a business' main website. Microsites are now covered under new subheadings at paragraph 19 of the Ruling and paragraphs 182 and 183 of the Explanation. Example 8 illustrates the tax treatment of expenditure on a microsite of significance to the business structure.
8	**Examples**	
8.1	We recommend the Ruling include further examples: • in relation to the criteria at paragraph 22 • in relation to whether content has independent value to the business and is not part of the website and not in-house software, and • illustrating the capital-revenue distinction in the context of businesses that operate only online.	New Examples 2, 3 and 4 have been included to address these aspects. Example 9 relates to former paragraph 22. **Note:** the repositioning of paragraphs and addition of new examples has resulted in the reordering and renumbering of Examples in the final Ruling.

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8.2	Example 2 – clarify that the relevant test for the deductibility of decline in value is taxable use, not whether a business is carried on per se.	Former Example 2 (now 25) has been amended accordingly.
8.3	Example 9 – clarify what is meant by 'annual expenditure'.	Former Example 9 (now 14) has been amended to clarify that the reference is to the annual cost of maintaining the website.
8.4	Example 13 – clarify at the first dot point of paragraph 97 whether the website software is in-house software.	(Now Example 18) The words 'create website software' have been changed to 'alter the existing website software' at the first dot point. As the software modification is treated as a revenue expense, no expenditure is incurred on in-house software (which is necessarily capital).
8.5	Example 14 –clarify tax treatment of handsets.	Reference to 'handsets and operating systems' removed, as the tax treatment of hardware is out of scope. (Example 19)
8.6	Example 16 (social media) – expand to cover costs of establishing a presence in order to show how they differ from maintenance of a profile.	Former Example 16 (now 21) has been revised to specify set-up costs and their treatment.
8.7	Example 18 – clarify: • what is meant by 'providing it mainly for the user's own benefit' • why the example refers to two versions of the website-building tool, and • references to 'application' software in paragraphs 115 and 118.	• (now Example 23 'Sites@Work')) The expression 'user's own benefit' has been changed to 'user's independent benefit'. Example 24 'BigSystems' provides further clarification of the principle. • Free 'basic' and paid 'fully featured' versions reflect a common business model which make web-based DIY application software available to users. • Words have been added to clarify that the same tax treatment applies to the application

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		software in its basic and fully featured versions.
8.8	In relation to Example 19 'Argent Bank', Telstra raised the issue of 'in-apps', posing several hypothetical scenarios and providing its view that 'in-apps' form part of the cost base (second element) of the original app, which in accordance with Example 19 is regarded as in-house software.	We have removed former Example 19 as a decision has been made to develop a separate public advice product for mobile apps (see item 3 above). As noted at item 3.1, mobile apps raise a number of different issues from websites.
8.9	Example 20 – clarify treatment of costs of developing Nebula software – is it 'in-house software' but separate from the website software?	Former Example 20 (now 24) specified at former paragraph 122 that Nebula is not part of BigSystems' website and is not in-house software. The treatment of the costs of developing products made available through a website and that are not in-house software is beyond the scope of the Ruling.
9	**Editorial suggestions**	
9.1	Reverse order of paragraphs 5 and 6 to define website first and then specify the business nexus.	We consider the current order preferable as it provides the context for what follows.
9.2	References to 'commercial website' (see paragraph 5) are not consistent.	We note the inconsistency and have included a footnote to clarify the use of the bare term 'website'. Due to the numerous occurrences of 'website', we prefer not to use 'commercial website' in every instance.
9.3	The definition of 'website' at paragraph 6 should refer to associated content on the website, for consistency with paragraph 40(c).	Accepted.
9.4	Example 21 is better referenced to paragraph 49 as it does not contain a nil amount scenario.	Reference altered (now Example 26 and paragraph 55).

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9.5	Reverse order of paragraphs 7 and 8.	Accepted.
9.6	Paragraph 11 would be better placed between paragraphs 43 and 44 to link with the treatment of deprecating assets. Clarify that the test is 'taxable use'.	Accepted. This section is now placed at paragraph 48 after the section 'Capital allowances for in-house software'.
9.7	Include web hosting fees at paragraph 18.	Accepted.
9.8	Example 8 is better referenced to the first sentence of paragraph 23.	Reference added (now Example 13 and paragraph 27).
9.9	At paragraph 23, second sentence, add 'significant' before 'new functionality'. Cross-reference to paragraphs 25 to 32.	Accepted.
9.10	Remove the words 'day to day' at paragraph 27, as this narrows the catchment of operational cost.	Accepted.
9.11	Clarify at paragraph 40(a) that software that is used to further interaction with the user may be in-house software but is separate from the commercial website in-house software.	The intention at former paragraph 40(a) was that software 'integrated into a commercial website' is part of the website and therefore part of the website in-house software. We have amended the wording (now paragraph 43) to clarify the ATO position.
9.12	Clarify at paragraph 40(c) whether capital expenditure incurred in migrating data or content is included in the cost of in-house software.	This matter is now specifically addressed under the heading 'Content migration' in the Explanation at paragraph 208.
9.13	We consider that paragraph 46 misleadingly suggests the two alternatives are section 40-880 of the ITAA 1997 and software development pool. We recommend replacing the second sentence with:	Accepted.

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	'Section 40-880 will generally not apply to commercial websites because capital expenditure on software development will usually be 'in-house software' and, if not, it would likely in any case be part of the cost base of a CGT asset.'	
9.14	In paragraph 47, clarify whether two years is 'periodic', given that this seems to be the common domain name renewal requirement.	Domain names: the text of Example 26 has been amended to clarify that a registration fee is deductible over the period to which it relates.
9.15	In paragraph 48, first sentence, clarify whether 'An amount paid once-and-for-all to secure the right to use a domain name' refers to the initial registration of the domain name, which is when the first two-yearly fee is paid.	Words have been added to this paragraph and to former Example 21 (now 26) to clarify that all fees for domain name registration, including initial registration, are a revenue expense. This Example illustrates a once-and-for-all payment at auction to secure rights over an existing domain name as a payment independent of domain name registration fees.