

TR 2000/D6 - Income tax: deductibility of commercial website expenditure

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This document has been finalised by TR 2001/6.



Draft Taxation Ruling

Income tax: deductibility of commercial website expenditure

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Preamble

Draft Taxation Rulings (DTRs) represent the preliminary, though considered, views of the Australian Taxation Office. DTRs may not be relied on by taxation officers, taxpayers and practitioners. It is only final Taxation Rulings that represent authoritative statements by the Australian Taxation Office of its stance on the particular matters covered in the Ruling.

What this Ruling is about

Class of person/arrangement

1. This Ruling deals with the deductibility of expenses incurred in establishing, constructing, acquiring and maintaining commercial websites.

Definitions

2. In this Ruling, a reference to:
- ‘Browser’ is a software program which enables a user to locate and view Hypertext Markup Language (HTML) documents (for example Netscape and Explorer).
 - ‘Domain Name’ or ‘Internet Address’ or ‘Uniform Resource Locator’ (URL) is a unique name assigned to a website (or e-mail address).
 - ‘Establishing’ a website includes the expenses incurred in designing, planning and making the site suitable to be ‘loaded’ onto a server.
 - ‘Hardware’ means the physical components of a computer system.
 - ‘HyperText Markup Language’ or ‘HTML’ is the programming language used to format the documents on the web. Its commands or ‘tags’ (invisible to the viewer) are embedded in the web document so that browsers will give the document the required appearance e.g., bold, italics etc.

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- ‘Internet Service Provider’ means someone who provides access to the Internet by enabling the user to join the network.
 - ‘Links’ are hypertext connections between Web pages. Links enable the user to navigate between the pages of a website and may also allow for a convenient transfer to another site.
 - ‘Server’ is a computer system which holds information capable of being accessed by other computers.
 - ‘Software’ means a set of instructions allowing a computer to perform specified operations, or a language allowing such instructions to be performed, and includes HyperText Markup Language (HTML).
 - ‘The Internet’ is a network of linked computers connected at Internet Protocol (IP) addresses.
 - ‘Website’ means a document or series of HTML coded documents (pages) linked together and operating from a server (computer) connected to the Internet.
3. A reference to subsection 51(1) of the *Income Tax Assessment Act 1936* should be read as applying equally to section 8-1 of the *Income Tax Assessment Act 1997*.
4. A reference to section 8-1 of the *Income Tax Assessment Act 1997* (ITAA) should be read as applying equally to section 51(1) of the ITAA 1936.

Background

The range of websites

5. Building a web site can be a simple or a complex activity ranging from the equivalent of designing a business card, a pamphlet or advertising material to the implementation of a large-scale corporate IT system.
6. The simplest websites require design, text authoring or transformation, image and graphics acquisition/capture, manipulation and HTML coding or generation. The larger/complex web sites require a wider range of expenses, including: planning, strategy, production, design, back-end integration, content management, marketing, building and managing customer relations, obtaining, training and retaining suitably qualified people. The requirements of each business will determine the range of features contained within the site.
7. The purpose and type of web sites will vary, and will include providing or capturing information, marketing, delivery of digital

products, buying and selling, banking, customer to business (C2B) e-commerce, business to business (B2B) e-commerce. The website may be the entire business, or merely part of an existing one. It may be designed for a very short life span, or be part of the ongoing business infrastructure. Websites have a constantly increasing range of features, including text, graphics, sound, animation, movies, interactivity, dynamic updating of information/pages, user customisation or personalization, and all the facets of e-commerce. Some of the capacities may include:

- Electronic catalogues
- Shopping carts
- Ordering facilities
- Payment and credit processing
- Shipping of the order
- Tracking of the order
- Integration with existing inventory database and order fulfilment systems.

Ruling

8. The cost of acquiring, developing or constructing a website is 'expenditure on software' (under Division 46 of the ITAA 1997), and is depreciable over a 2 ½ year period where the website is used as part of a commercial venture carried on for the purpose of earning assessable income.

9. The cost of acquiring computer hardware represents the acquisition of a unit of plant depreciable under Division 42 of the ITAA 1997.

10. Alterations to a website represent the acquisition of additional software only if new functions are introduced.

11. Ongoing operating expenses of commercial websites are allowable as a recurrent cost of the business.

Date of effect

12. This Ruling applies to years commencing both before and after its date of issue. However, the Ruling does 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 the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Explanations

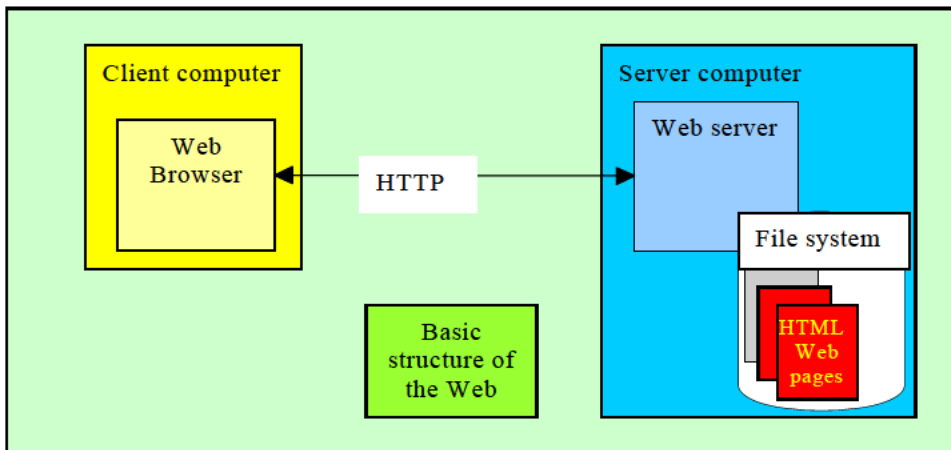
Hypertext Markup Language

13. Hypertext Markup Language (HTML) is the language of the World Wide Web. In order to be read on the web a document needs to be ‘marked up’ or programmed using HTML. Consequently the transformation of material into a form capable of being read on the web represents the creation of software. HTML is a specific-purpose programming language, it is a set of instructions for telling browsers how to display, structure and link information. HTML gives instructions to the browser about the meaning, structure or appearance of the document, and connections (links) to other web pages. It has a syntax like a programming language and can be either coded by hand, produced by an authoring tool, or dynamically generated by other programs.

14. Web pages constructed in HTML with embedded scripts, Dynamic HTML, Common Gateway Interface (CGI) scripts or dynamically generated from applications servers are software from a theoretical, user and developer perspective. Web pages require significant programming effort to develop, and are interactive (ie they can execute on both the client and server computers, and communicate with other software systems).

15. A user types in a URL such as <http://www.ato.gov.au>, the browser on a user’s computer sends a HTTP request to the web server holding the desired web page. The web server then finds the page, and sends it back to the browser. The browser interprets the HTML code and displays the web page on the user’s computer screen.

16. The following diagram illustrates the most basic connection between the viewer and the website.



17. The Web was designed to be a universal umbrella over the

infrastructure of the internet (computers communicating with each other using TCP/IP (Transmission Control Protocol/Internet Protocol) using five features:

- A data format (HTML) in which Web pages are written,
- a transfer protocol (HTTP, HyperText Transfer Protocol) for distributing HTML documents between computers,
- a distributed addressing mechanism for linking web pages and other resources (URLs- Uniform Resource Locators or web address),
- browsers which find and interpret the HTML pages and display them, and
- Web servers on a host computer which respond to requests for web pages from Browsers (or other programs) on remote computers.

Functions performed by websites

18. The traditional method of organising web pages has been to store them as files managed by the operating system. In order to present a web page that has database content, the owner would need to extract information to integrate with HTML stored in the file system. (This model requires a chain of software with links that can include middleware such as drivers, and a servlet or an application built with CGI, Netscape Application Programming Interface (NSAPI), or Internet Server API (ISAPI)). More recently databases have been developed which can store all types of content, including HTML documents, images, audio, maps, video, etc.

19. All the activities required to build a web site can be viewed as software costs because software is the substantial output product. Web sites are software systems which deliver various sorts of content, services and information. Division 46 of the ITAA 1997 applies to expenditure on ‘acquiring or developing’ software and includes the payment of salaries or wages to a person involved in the development of the software. That Division allows the cost of software to be depreciated over 2 ½ years. The Explanatory Memorandum to the legislation describes software as ‘computer programs consisting of encoded instructions designed to cause a computer to perform a particular task or produce a particular result’. The programming associated with the creation of a website comes within that description.

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Hardware

20. A website is ‘hosted’ or held on a computer server at a particular physical location. Often a fee is charged by the owner of the ‘host’ system for the service of hosting the site. Such a fee, if paid on a regular basis, is deductible as an expense incurred in operating the website. The cost incurred in purchasing a host computer or any related hardware is subject to depreciation as a unit of plant under Division 42.

Alterations to the website

21. Most websites are regularly updated with new content or design changes. The cost of those changes which result in the addition of new functions will be ‘expenditure on software’ within the meaning of that expression in section 46-10 of the ITAA 1997. Changes which do not create new functions are considered to be in the nature of maintenance of the site.

22. Whenever some part of the website is replaced or removed it will be necessary to determine if a deduction is available as a balancing adjustment (section 46-50 of the ITAA 1997). If you permanently cease to use a unit of software and it is no longer installed and ready for use, then under subsection 46-50(1) (subject to an additional requirement relevant only to ‘rights to use’ software) you are entitled to an immediate deduction for the balance of the unclaimed cost of that unit of software. In other words you can claim a deduction for the balance of the 2 ½ years of depreciation and you do not need to wait for the 2 ½ years to elapse.

23. Where the uninstalled software is only a part of the website it will be necessary to identify the cost of that part. A reasonable estimate of the cost will be accepted where that estimate is based on a knowledge of the approximate cost of the uninstalled component relative to the total cost incurred at the time the software was acquired.

24. Some websites are intended to have only a limited life. Those sites may promote a particular event, such as a week-long festival, and are intended to be active for the time leading up to, during and shortly after that event. Notwithstanding that the operators intend to keep the website active and online for only a limited period of time, it will be necessary to ‘uninstall’ the site in order to satisfy section 46-50 of the ITAA 1997 and obtain an immediate deduction for the cost of the site which would otherwise be depreciable over the balance of 2 ½ years.

Operating expenses

25. A website requires ongoing maintenance to ensure that it is operating in the intended manner. The content of the site needs to be updated, dates on the site may need to be changed, fees paid to the site host and other administrative matters attended to. These costs are part of the regular maintenance of the site and are deductible when incurred.

26. ‘Website content’ is the description given to data or information used on the site. It may include a current catalogue of goods for sale or a complete inventory of stock which can be searched and ordered by an online customer. Where this database is developed as part of the ongoing operations of the business the cost of its creation as a collection of data will be deductible as an expense incurred in operating the business. Content can also refer to any factual information or other material loaded into the various pages which make up the website.

27. Annual registration costs, the fees of Internet Service Providers and regular Domain Name registration costs are also deductible when incurred as part of the ongoing and regular expense of operating a website.

Example

28. A website was developed at a cost of \$4000. It contained a shopping cart facility, which allowed on line customers to order stock as they moved through the site. The inclusion of the cart formed approx. 25% of the site development cost. After 12 months the WDV of the website is \$2400, consequently the cart has a WDV of \$600. The shopping cart is uninstalled and an immediate deduction for \$600 is available. A replacement and more sophisticated ordering and stock management function is added at a cost of \$6000. The 2½ year depreciation period for that software commences at the time of installation.

The monthly upload of the stock database is an operational expense and is deductible when incurred.

Detailed contents list

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Your comments

30. If you wish to comment on this Ruling, please send your comments by 21 May 2000 to:

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Commissioner of Taxation
10 May 2000

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Not previously issued in draft form.

Related Rulings/Determinations:
TR 92/20;

Subject references:
- computer software
- function
- improvements

- website

Legislative references:

- ITAA 1936 51(1)
- ITAA 1997 8-1
- ITAA 1997 Div 42
- ITAA 1997 Div 46
- ITAA 1997 46-10
- ITAA 1997 46-50
- ITAA 1997 46-50(1)

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