

TR 2001/6 - Income tax: deductibility of commercial website expenditure

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⚠ This document has changed over time. This is a consolidated version of the ruling which was published on *25 July 2001*



Taxation Ruling

Income tax: deductibility of commercial website expenditure

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Preamble

*The number, subject heading (the title), **Class of person/arrangement**, **Date of effect** and **Ruling** parts of this document are a 'public ruling' for the purposes of Part IVAAA of the **Taxation Administration Act 1953** and are legally binding on the Commissioner. The remainder of the document is administratively binding on the Commissioner.*

Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.

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 application which enables a user to locate and view Hyper Text Markup Language (html) documents (for example Netscape and Explorer);
- 'Content' is the description given to information on the site. Examples of such information are graphics, sound, video files, a current catalogue of goods for sale or a complete inventory of stock which can be searched and ordered by an online customer;
- 'Domain Name' means a unique name registered by a domain name registrar in the register of names in a domain, for example .com or .com.au, and listed or capable of being listed on domain nameservers as being associated with a particular Internet address, to enable the owner to establish a webserver to utilise other Internet protocols, for example file transfer or mail;

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- ‘Establishing’ a website includes the expenses incurred in designing, planning, testing, up-loading of content, and making the site suitable to be ‘loaded’ onto a server;
- ‘Hardware’ means the physical components of a computer system;
- ‘Hyper Text Markup Language’ or ‘html’ is a language used to format the documents on the web. Its commands or ‘tags’ (hidden from the viewer) are embedded in the web document so that browsers will give the document the required appearance e.g., bold, italics etc;
- ‘Internet Address’ or ‘IP address’ is a unique number used to identify servers and clients connected to the Internet. In Internet Protocol version 4 (IPv4) it means a 32 bit number separated into 4 bytes or octets by periods. This is usually expressed in decimal format as four numbers from 0 to 255. Operating domain names are linked to IP addresses through domain nameservers. Internet Protocol version 6 uses 128 bit IP addresses;
- ‘Internet Service Provider’ means someone who provides access to the Internet by enabling the user to join the network;
- ‘Links’ are hyper text 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’ is generally described as computer programs consisting of encoded instructions designed to cause a computer to perform a particular task or to produce a particular result;
- ‘The Internet’ is a network of networks, or an ‘internetwork’, linking computers world-wide. In its physical form, the Internet is composed of wires, routers and communication links;
- ‘Uniform Resource Locater’ (URL) means a file name used to identify a file on the Internet;
- ‘Website’ means a document or series of 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* (ITAA 1936) should be read as applying equally to section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997).

4. A reference to section 8-1 of the ITAA 1997 should be read as applying equally to subsection 51(1) of the ITAA 1936.

Background

The range of websites

5. Building a website 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 website consists of little more than the 'marking up' of text and the use of links to other web pages as provided for by basic html. More sophisticated websites often require design, text authoring or transformation, image and graphics acquisition/capture, manipulation and html coding or generation.

7. The larger/complex websites require a wider range of expenses, including: planning, strategy, production, design, back-end integration, content management, marketing, building and managing customer relations, and obtaining, training and retaining suitably qualified people. The requirements of each business will determine the range of features contained within the site.

8. The purpose of websites will vary, and will include providing or capturing information, marketing, delivery of digital products, buying and selling, banking, customer to business (C2B) e-commerce, or 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 personalisation, and all the facets of e-commerce. Some of the functions of a website may include:

- Publication of electronic catalogues;
- Registration and processing of enquiries;
- Acceptance of orders to purchase;
- Acceptance of applications for payment and processing;
- Access to shipment tracking records.

Ruling

9. In determining the tax treatment of the costs of acquiring, developing or constructing a website it is necessary to identify expenditure on computer hardware, software and content.

Expenditure on hardware

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

Expenditure on software

11. Expenditure on software will be deductible over a period of 2½ years (under Division 46 of the ITAA 1997) where the website is used for the purpose of earning assessable income. Section 46-25 applies to units of software on which expenditure is incurred as if they were units of plant. Under section 42-15 a deduction is allowed for a unit of plant that is used or ready for use, for the purpose of producing assessable income.

12. The extent to which (if at all) a website is made up of software must be determined on a case by case basis. However, as a general proposition, where the website is nothing more than a document or series of documents which have been converted to html or 'marked up' and linked in a language similar to html, there will be no software created. In setting up the website referred to at paragraph 6, i.e., a simple website, it is unlikely that software will be created.

13. However, greater levels of sophistication show that software is present.

Indicators of software

14. Indicators of the presence of software (described as 'software indicators') in a website are:

- (i) The website allows interaction with individual users who have been identified through some form of authentication process;
or
- (ii) The website underwent a validation process that necessitated the testing and debugging of design errors;
or
- (iii) The architecture of the website has been specifically designed to ensure it can meet a range of operational

criteria;

or

- (iv) Supportive documentation is necessary to assist with the various phases in the lifecycle of the website.

15. If any of the 'software indicators' show the presence of software then you need to identify that part of your expenditure on the website that relates to software and claim a deduction for that cost under Division 46, and that part, if any, of your website expenditure which is deductible under other provisions of the Act (and make appropriate claims under those provisions). In apportioning expenditure on websites between software and other matters (such as content or hardware) what is required is an apportionment made on a reasonable basis.

Purchase of software package

16. The cost of acquiring a software package which is used to create a website will represent 'expenditure on software'.

Costs which are not expenditure on software

17. Website costs which are not 'expenditure on software' will be considered according to normal principles. The costs including content may be deductible outright or may represent capital expenditure. Some kinds of capital expenditure can be deducted under other provisions of the ITAA 1936 or the ITAA 1997 such as section 73B of the ITAA 1936, Division 40 of the ITAA 1997 and Division 373 of the ITAA 1997.

Preliminary to business

18. Costs incurred preliminary to the commencement of business are not deductible prior to commencement. Some website expenditure may fall within this principle. In some cases an amount incurred before commencement of business may be deductible for depreciation of a unit of plant or software used in producing the assessable income or installed ready for use after the business has commenced.

Existing business

19. Costs incurred by an existing business when setting up a website that establishes, replaces or significantly extends the 'profit yielding structure' are considered to be of a capital nature. Some kinds of capital expenditure can be deducted under other provisions of the ITAA 1936 or the ITAA 1997 (refer paragraph 17).

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Alterations to the website

20. Most websites are regularly updated with new content or design changes. Those costs which are attributable to the modifications of a site to provide additional functionality 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 functionality are considered to be in the nature of on-going operation of the site.

Operating and maintaining the website

21. Ongoing operating expenses of commercial websites that are not expenditure on software are allowable as a recurrent cost of the business.

Date of effect

22. 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

Expenditure on hardware

23. Website hosting requires server hardware, server software, the applications servers necessary to support software elements of the website, and a connection to the Internet.

24. Server hardware generally comprises physical goods, including computers, peripheral equipment (e.g., screens, backup drives etc), and routers (for connection to the Internet).

25. The cost of acquiring computer hardware represents the acquisition of a unit of plant depreciable under Division 42 of the ITAA 1997. The depreciation deduction is based on the cost and calculated at a rate dependent on the effective life of the computer hardware.

Expenditure on software

26. The expenditure incurred in developing and maintaining a website can include both software and content in variable amounts.
27. In determining the tax treatment of the costs of acquiring, developing or constructing a website it is necessary to identify expenditure on software.
28. Expenditure on software is deductible over a period of 2½ years (under Division 46 of the ITAA 1997) where the website is used for the purpose of earning assessable income. Division 46 of the ITAA 1997 applies to expenditure in 'acquiring or developing' units of software as if they were units of plant and includes the payment of salaries or wages to a person involved in the development of the software.

Indicators of software

29. The presence of any one of the software indicators shows that the site contains some software such that there is 'expenditure on software' (under Division 46 of the ITAA 1997).
30. A website contains a degree of software if:
- i) The website allows interaction with individual users who have been identified through some form of authentication process.*** Such a site would normally have both public and private areas such that the private areas are only accessible to authorised users. Sites that permit general access for multiple-users through a simple gateway by means of common access codes and/or passwords are not considered to have an authentication process.

or
- ii) The website underwent a validation process that necessitated the testing and debugging of design errors.*** Such errors may be a result of implementation faults in the logic or failures to meet the specified requirements. Simple checks for accessing web pages, for example, testing out the hyperlinks and visual checks on the final layout and appearance of web pages, would not constitute a validation or debugging process.

or
- iii) The architecture of the website has been specifically designed to ensure it can meet a range of operational criteria.*** That is, the software architecture of the site

was designed to meet, for example, performance, reliability, capacity and security requirements.

or

iv) Supportive documentation is necessary to assist with the various phases in the lifecycle of the website.

These will include, for example, a written functional specification, test and debug procedures, documented code listings, maintenance notes and detailed user notes. Simple documents on how to access web pages or any specifications relating to the dimensions, location and layout of a web page are not considered to constitute supportive documentation.

31. The following steps can be used by a business to determine the tax treatment of their website expenditure:

STEP 1

The first step is to determine whether some software is present in the website. The 'software indicators' have been developed to assist you in making this determination. They are based on tests used in software development projects.

STEP 2

If you have determined that there is no software present, the expenditure should be considered under other taxation provisions as Division 46 is not applicable. If so, go to STEP 5 .

STEP 3

You need to determine the proportion of the costs that is for software and the proportion that is not for software. For example, a single payment to a website designer might be for both content and software (refer to paragraph 51).

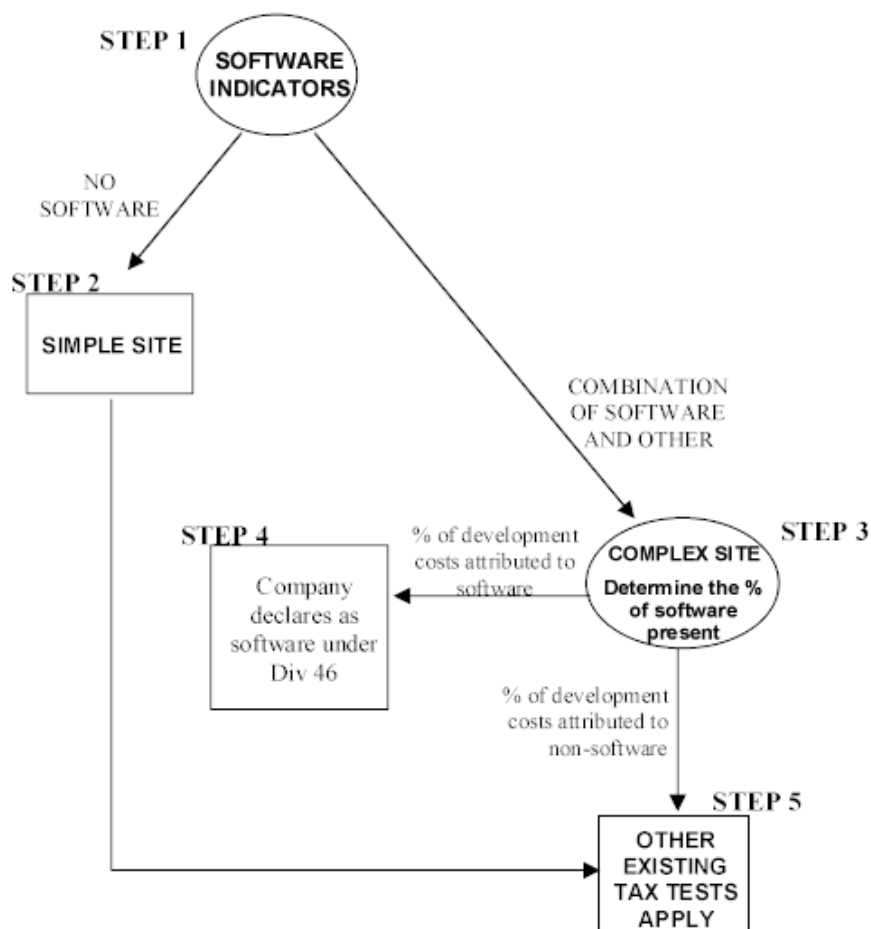
STEP 4

Costs identified as expenditure on software should be claimed as a deduction under Division 46.

STEP 5

Expenditure on websites for items other than software may only be claimed as a deduction if they fall within other provisions of the ITAA 1997.

The diagram below sets out the steps detailed above.



32. In identifying what expenditure is expenditure on software, sometimes it will be possible to dissect compound expenditure into a number of outgoings, each of which wholly relates to software (or content or hardware or other matters). However, sometimes a single outgoing may relate both to software and to other objects. For example, a single payment to a website designer might be for both content and software. In a case where expenditure has to be apportioned between several objects, including software, the apportionment is to be made on a reasonable basis, which is not necessarily a mathematically exact calculation: See *Ronpibon Tin* (1949) 78 CLR 47. In particular, small amounts of expenditure do not require mathematically exact apportionments.

33. However, care must be taken to ensure that a claim for software does not include amounts relating to hardware, or non-deductible capital costs (such as costs incurred preliminary to the commencement of a business).

Purchase of software package

34. The cost of acquiring a software package which is used to create a website is 'expenditure on software'.

Costs which are not expenditure on software

Preliminary to business

35. Costs incurred preliminary to the commencement of business are not deductible prior to commencement. Some website expenditure may fall within this principle. In some cases an amount incurred before the commencement of business may be deductible for depreciation of a unit of plant or software used in producing the assessable income or installed ready for use after the business has commenced.

36. In *Sun Newspapers Ltd v FC of T* (1938) 61 CLR 337 at p360-361 Dixon J acknowledged the distinction:

'For example, a profitable enterprise such as the sale of a patent medicine may depend almost entirely on advertisement. In the beginning the goodwill may have been established by a great outlay upon a widespread advertising campaign carried out on upon a scale which it was not intended to maintain or repeat. The outlay might properly be considered to be of a capital nature. On the other hand, the goodwill may have been gradually established by continual advertisement over a period of years growing in extent as it proved successful. In that case, the expenditure upon advertising might be regarded as an ordinary business outgoing on account of revenue.'

and further at page 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.'

Existing business

37. Costs incurred by an existing business when setting up a website that establishes, replaces or significantly extends the profit yielding structure are considered to be of a capital nature. Where the

expenditure results in a different stream of income from the existing business the expenditure is likely to be of a capital nature. In *Sun Newspapers* Dixon J adopted a conceptual approach and formulated the test based on the distinction between the business structure and the process of operating it stating at p 359 stated:

'The distinction between expenditure and outgoings on revenue account and on capital account corresponds with the distinction between the business entity, structure, or organisation set up or established for the earning of profit and the process by which such an organisation operates to obtain regular returns by means of regular outlay, the difference between the outlay and returns representing profit or loss.... As general conceptions it may not be difficult to distinguish between the profit-yielding subject and the process of operating it. In the same way expenditure and outlay upon establishing, replacing and enlarging the profit-yielding subject may in a general way appear to be of a nature entirely different from the continual flow of working expenses which are or ought to be supplied continually out of the returns or revenue....'

Alterations to the website

38. Most websites are regularly updated with new content or design changes. Those costs which modify the site structure so as to provide additional functionality 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 functionalities are considered to be in the nature of on-going operation of the site.

39. 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 2½ years of depreciation and you do not need to wait for the 2½ years to elapse.

40. Where the software which is no longer installed 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 component which has ceased to be installed relative to the total cost incurred at the time the software was acquired.

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41. 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 remove 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 2½ years.

Operating and maintaining the website

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

43. 'Content' is the description given to information on the site. Examples of such information are graphics, sound, video files, 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. However, the acquisition of a database to be loaded onto a website may not be a deductible expense. For the purpose of this ruling 'content' is not a word synonymous with 'revenue expense'.

44. 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.

Examples

45. Joe operates a suburban plumbing service. He arranges to have a website constructed with the following features. It will have his name and address and a description of the nature of work he will perform. The site also contains an email address which can be 'clicked' on so that potential customers can contact him directly. As the designer advised Joe that his simple site involves no software, has no sophisticated functionality and is used merely to advertise his business, the cost of constructing the site will be deductible under section 8-1 of the ITAA 1997.

46. A website was developed at a cost of \$4,000. 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 Written Down Value (WDV) of the website is \$2,400, consequently the cart has a WDV of \$600. The shopping cart capability is completely removed and an immediate deduction for \$600 is available. A replacement and more sophisticated ordering and stock management function is added at a cost of \$6,000. 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.

47. Rebecca runs a small contract printing business. Rebecca purchases a \$1,200 computer program designed to allow her to develop a website. The program 'Webmeister' enables her to draft text in a particular format and translates that text into the common Internet 'mark up' language html. Rebecca uses the program herself and designs a website which is then hosted for a fee by her Internet Service Provider. The cost of the program is software and is depreciable over 2½ years. If Rebecca purchased a competing and cheaper program 'Spiderweb' for \$250 the total cost of the program would be deductible in the first year as it is less than \$300. As the website that Rebecca developed was no more than advertising her existing business (equivalent to an entry in the Yellow Pages telephone directory) any non software costs are considered to be of a revenue nature and deductible in the year the expenditure was incurred.

48. In the example above assume Rebecca decided to expand her printing business and start selling her own line of greeting cards that she had developed on her website. In that case the expenditure on items other than software in developing the website would be of a capital nature and not deductible as she would be adding to the structure of the business and creating a new revenue stream.

49. Clive operates a large wine outlet and manages a chain of 10 franchised wine retailers in various suburbs. He approaches a web designer and has a standard site developed for a fee of \$26,000. The standard site is in fact a package of modules which can be tailored to suit his business or any of the 10 wine outlets. As part of his management duties Clive provides that package to the 10 franchisees for free. Each of those 10 franchisees uses the package to develop its own website by selecting some of the capabilities of the package and having others altered according to preference, with each reflecting the particular interest and stock of the business. Clive has acquired software and will be eligible for a deduction over 2½ years. Each of the franchisees will need to determine whether the package is simply used to piece together modules which are suitable for their own

business in which case the cost of that process does not represent expenditure on the acquisition of software. If, however, the package is enhanced or significantly altered in producing the franchisee's website, then the expense incurred in that process is likely to satisfy one of the four 'software indicators' and will constitute software.

50. Academic Publishing Pty Ltd has operated for a number of years as a publisher and wholesaler of books which it distributes and sells to retailers. It then decided to establish a website for the purpose of retailing stock to the general public. Customers of its website are able to search a database of books and order online. The cost of the website represents a capital expense incurred in establishing a new arm of the business which is a structural addition to its existing operations. To the extent that the cost of developing the website is made up of non software costs they will be of a capital nature and not deductible. Software costs will be depreciable over 2½ years under Division 46.

51. Business Cards Online operates a business of producing business cards to order. It operates only through its website www.aussiebusinesscards.com.au. The site was developed by a webdesigner for a cost of \$8,000. The webdesigner has advised that 75% of the cost of the site represents the cost of acquiring software. In forming this view the webdesigner has taken into account the time taken to construct the functions of the site which required software. The balance of 25% of the site was made up of simple automated html coding and some design work. Those costs represent structural costs incurred in establishing the business and are non deductible capital expenditure.

52. 'Rainy Day Insurances' operates its business through a network of commission agents. It expands its business by setting up a website. To widen their customer base they purchase an 'electronic insurance register' containing a list of agents for a cost of \$15,000 which they load onto their website. The \$15,000 cost of acquiring the register is a capital expense notwithstanding that it may also be considered to be 'content' of the site.

Detailed contents list

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Related Rulings/Determinations:

TR 92/1; TR 92/20; TR 97/16

Subject references:

Legislative references:

- ITAA 1936 51(1)
- ITAA 1936 73B
- ITAA 1997 8-1
- ITAA 1997 Division 40
- ITAA 1997 Division 42
- ITAA 1997 42-15

- ITAA 1997 Division 46
- ITAA 1997 46-10
- ITAA 1997 46-25
- ITAA 1997 46-50
- ITAA 1997 46-50(1)
- ITAA 1997 Division 373

Case references:

- Ronipbon Tin (1949) 78 CLR 47
- Sun Newspapers Ltd v FC of T (1938) 61 CLR 337

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