



TECHNICAL UPDATE

COMMERCIAL WEBSITE EXPENDITURE – DRAFT TAXATION RULING

DRAFT TAXATION RULING TR 2016/D1 REGARDING THE DEDUCTIBILITY OF EXPENDITURE ON A COMMERCIAL WEBSITE WAS RELEASED FOR COMMENT ON WEDNESDAY, 6 APRIL 2016. THE RULING HAS WIDESPREAD APPLICATION FOR EVERY BUSINESS WHICH HAS A WEBSITE WHETHER IT IS USED PASSIVELY OR IS INTERACTIVE WITH ITS CUSTOMERS.

Application

This draft ruling sets out the Commissioner's preliminary views on the deductibility of expenditure incurred in acquiring, developing, maintaining or modifying a website for use in carrying on a business, including expenditure relating to domain names. The deductibility of website development expenditure was previously considered in TR 2001/6, which was withdrawn in August 2009. The ruling is proposed to apply both before and after its date of issue.

What's considered in this ruling?

For the purposes of this ruling, the Commissioner considers a website to be an intangible asset consisting of software, and includes software integrated into the website for online use by users. The Commissioner has stated this does not include software provided on the website for installation on the user's device. Similarly, the following assets can be separately identified and are not considered part of a commercial website under the ruling:

- Hardware
- The right to use a domain name
- Content available on, or incorporated into, a website that has independent value to the business.

Capital versus revenue

This ruling confirms that the deductibility of expenditure on a commercial website will depend upon whether the expense is capital or revenue in nature. Where the expense is not immediately deductible, it will likely fall under the definition of 'in-house software' and be deductible under the capital allowance provisions.

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In making the determination, the Commissioner has expressed the following preliminary views regarding the treatment of certain expenses:

TYPE OF EXPENDITURE	TREATMENT
Labour – including contractor expenses and employee expenses	Ordinarily a recurrent business expense, and therefore deductible. However, where such costs are directly referable to the enhancement of the profit-yielding structure of the business, they will be deemed capital in nature, and therefore not deductible. Labour costs that are partly on revenue account and partly capital can be apportioned on a reasonable basis.
Off-the-shelf software products	Expenditure on such products will be considered capital where the product provides an enhancement of the profit-yielding structure of the business. A deduction may be available under the capital allowance provisions if the product constitutes in-house software. Expenditure on such products will only be considered a revenue expense where the software product is licensed periodically.
Registration, licensing and other periodic usage fees	Such expenditure is considered a revenue expense.
Acquiring or developing a website	Where expenditure is incurred in the acquisition or development of a website, the expenditure is deemed capital in nature. This expenditure may be treated as 'in-house software' to the extent the expenditure relates directly to a commercial website, and is not deductible outside of the in-house software provisions.
Maintaining a website	<p>Expenditure incurred in maintaining a website will generally be considered revenue in nature. The Commissioner has provided guidance on when a website modification will be considered maintenance. This is a question of fact and degree. Generally, maintenance activity 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.</p> <p>A modification will have the character of maintenance if it preserves, but does not:</p> <ul style="list-style-type: none"> • Alter the functionality of the website • Improve the efficiency or function of the website, or • Extend the useful life of the website. <p>Modifications that add minor functionality or makes minor enhancements to existing functionality are also of a revenue character. Alternatively, where a modification adds new functionality or materially expands existing functionality, this expenditure is likely to be considered capital in nature.</p>

TYPE OF EXPENDITURE	TREATMENT
Modifying a website	<p>The character of such expenditure is a question of fact and degree. The Commissioner has stated that, where the more significant the change or improvement is to the profit yielding-structure of the business, the more likely the expenditure is considered capital.</p> <p>The Commissioner has provided the following factors to take into account when determining the character of expenditure incurred in modifying a website:</p> <ul style="list-style-type: none"> • The role of the website in the business • The nature of the modification to the website • The size and extent of the modification • The degree of planning and level of resources employed in effecting the modification • The level of approval required for the modification • The expected useful life of the modification. <p>The Commissioner has stated that the following is capital expenditure:</p> <ul style="list-style-type: none"> • Expenditure on a modification that represents a structural advantage to the business • Expenditure to facilitate a replacement of a material part of the commercial website.
Piecemeal modifications and minor enhancements	<p>A routine modification resulting in minor enhancement is likely to be considered revenue expenditure; whereas, modifications which are considered to be part of a program of work to upgrade and improve a website significantly are likely to be of a capital nature. Each situation must be judged on its own circumstances.</p>
Content migration	<p>The character of expenditure incurred in migrating website content will follow the purpose of the migration. Namely, if the content is migrated for the purposes of establishing a new website, then the cost is likely to be capital. Whereas, if the content is migrated as part of an upgrade to an existing website that does not significantly enhance or replace the website, the cost is likely to be a revenue expense.</p>
Social media	<p>Any costs associated in establishing a business's presence on a social media site will be capital in nature; whereas costs incurred in maintaining such a presence and updating content are revenue in nature.</p>

The draft ruling contains various practical examples which assist in determining whether the expenses would be considered capital or revenue in nature.

In-house software

The Commissioner has confirmed that a website is not considered a depreciating asset, except to the extent it can be classified as in-house software. In-house software includes:

- Software integrated into a commercial website that the website owner uses mainly to enable further interaction with the user,
- 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
- Incidental website content which is not an asset with separate value from the website.

To the extent expenditure can be considered in-house software, capital allowances are available as follows:

- Expenditure can be deducted over a period of five years, from the date the in-house software is first used or installed ready for use.

- Where expenditure is incurred on developing software, the expenditure may be allocated to a software development pool and deducted in accordance with the relevant pooling rules.

We note that if the current draft legislation on Intangible Asset Depreciation, which proposes to allow taxpayers to self-assess the effective life of certain intangible assets including in-house software becomes law, expenditure on such software acquired on or after 1 July 2016 may be deducted over a period of less than five years, where a taxpayer chooses to self-assess the effective life.

- Small business entities (aggregated turnover less than \$2 million) who have chosen to apply the small business simplified depreciation rules may be able to immediately deduct the expenditure if it is below the instant asset write-off threshold (\$1,000 if acquired between 1 January 2014 and 12 May 2015, or \$20,000 if acquired between 12 May and 30 June 2017). Alternatively, they may allocate the expenditure to a small business pool.

We note that if the current draft legislation which proposes to allow taxpayers to self-assess the effective life of in-house software is passed, expenditure on such software on or after 1 July 2016 may have been deducted over a period of less than five years, where a taxpayer chooses to self-assess the effective life.

Residual Expenditure

Where software expenditure associated with a website does not fall within the definition of in-house software and is not a revenue deduction, the tax treatment may be determined under the capital gains tax (CGT) provisions, whereby any residual expenditure will form part of the cost base of the CGT asset. Alternatively, the blackhole expenditure provisions may apply as a last resort. However, the Commissioner considers it unlikely the blackhole provisions will apply to commercial websites because capital expenditure on software development can usually be allocated to a software development pool.

BDO comment

The draft ruling has application to all businesses which use a website to advertise or interact with customers. The draft ruling applies the general principles of capital versus revenue expenditure which should be applied when considering the deductibility of all expenses. The more interactive the website, the more this ruling with its examples will be useful in determining the point at which expenses relating to the website change from being maintenance/updates to changing the profit yielding structure of the business. Where the expense is considered capital, although not immediately deductible, the expense is likely to be deducted on a straight line basis over five years.

As this ruling has potential retrospective application, businesses may need to reconsider how they have treated such expenses in the past.

If you have any comments or concerns regarding this ruling, please do not hesitate to contact us.

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