

# Save \$871 on your new website

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Use this booklet to save yourself some money and work out the true cost of your website. In particular we are looking at the deductibility of expenses around the cost associated with website design and updating of websites generally.

Deductions for expenditure are covered by the Income Tax Act 2004.

Generally a person is allowed a deduction for an amount of expenditure or loss (including an amount of depreciation loss) to the extent to which the expenditure or loss is incurred in deriving assessable income or incurred by them in the course of carrying on a business for the purpose of deriving assessable income.

Like all legislation there are exemptions from a deduction for such things as Capital or Private expenses.

The IRD have put out a Tax Information Bulletin (TIB) to provide some guidance to businesses as to what they can claim in regard to the design and updating of websites. A copy of the TIB is included in this booklet .

Basically websites are seen as computer programs, new websites and the inclusion of new features or a reconstruction of a website is capital and the cost should be depreciated.

For example :

A company buys a new website . . .

Total cost of a new web site            5,500

Depreciation pa @ 48 % DV            2,640

Tax saving due to Depreciation of \$ 871.20. Therefore the real cost is (5500 – 871 = \$4,629). This assumes depreciation is for a full year and that the company tax rate is 33 cents per dollar.

The setting up of the Initial domain name is a capital item and depreciated.

Hosting fees are a revenue expense and written off each year as a normal business expense, as are the minor updates to the web site.

However, the terms used in the Tax Information Bulletin (TIB) are poorly defined and ambiguous it is recommended the advice of a suitably qualified person should be sought prior to any expenditure being incurred.



*Inland Revenue Department Tax Information Bulletin: Vol 12, No 8 (August 2000) 21*

## **WEBSITE EXPENDITURE - DEDUCTIBILITY**

### **Section BD 2, Income Tax Act 1994 – Allowable deductions**

A taxpayer has asked how he should treat expenditure incurred in creating a website to be used by him in deriving gross income. (The same considerations could also apply if the taxpayer had contracted another person to create the website for him.)

A website is a collection of web pages or web files. “Web” is an abbreviation for the “World Wide Web”, the graphical part of the Internet. A web page is created using different programming

languages (such as hypertext markup programming language (“HTML”)). The use of programming code such as HTML enables web pages to have a number of features, such as video files, sound files, and links to other sites. A web browser interprets the code for graphical interface with a user’s computer. A web page is transferred to a user’s computer via the hypertext transfer protocol (“HTTP”). A website resides on an HTTP server.

A website’s development has a number of steps (that can be undertaken in any order), including acquiring a domain name—the site’s Internet address. The site needs to be designed and programmed. A website owner may wish to register the site with different Internet search engines, and to embed search strings in the site. The owner will also need to rent space on a web server.

The domain name of the website is generally acquired for a modest sum (less than \$200). However, in some cases acquiring the domain name may require substantial expenditure. Expenditure incurred in acquiring a domain name is capital expenditure and non-deductible. In terms of the applicable capital/ revenue tests established by the courts, such expenditure is of a one-off nature, gives rise to an enduring benefit, gives rise to an identifiable asset, and is part of the business structure of a taxpayer.

A domain name is not “depreciable intangible property” as defined in section OB 1, and listed in Schedule 17, of the Act. As such, the expenditure incurred in acquiring the domain name is also not depreciable. The HTML or other programming that makes up the website is an asset, being a computer software program. The costs incurred in creating the website are appropriately categorised as capital expenditure.

In terms of the applicable capital/revenue tests established by the courts, such expenditure:

- is of a one-off nature
- gives rise to an enduring benefit
- is part of the business structure of a taxpayer.

As a capital asset, the costs of creating the website must be capitalised and may be depreciated. To be depreciable, the software must be used in deriving gross income. Consistent with other computer software, it may be depreciated at a rate of 40% diminishing value or 30% straight line. **(now 48% )**

This approach (of capitalising expenditure and depreciating it) is consistent with the views expressed by a number of commentators. In an accounting context the view that capitalisation and amortisation is appropriate has been expressed by Dr Rachel Baskerville in “Web Sites – Lame Ducks or Golden Geese” *Chartered Accountants Journal* (March 2000, page 62) and by Craig Fisher in “Accounting for Websites” *Accounting, Corporate and Tax Alert* (Issue 93, 5 June 2000, paragraph 200). The approach of capitalising and depreciating is also consistent with the draft Australian Tax Office ruling TR2000/D6.

Ongoing costs of updating or adding to the information on a website are of a revenue nature, and are deductible when incurred if they meet the general test of deductibility in section BD 2(1). It is a matter of degree as to whether expenditure is updating and maintaining a website, and hence revenue, or a reconstruction or functional improvement to a website, which would be capital. It is difficult to give general guidance on the distinction, as was noted (in a different context) by the Privy Council in *Auckland Gas Co Ltd v CIR* (unreported, PC Appeal 32 of 1999, judgment 14 June 2000). *Inland Revenue Department Tax Information Bulletin: Vol 12, No 8 (August 2000)*22

However, some examples can be given as to the distinction between the two categories in the context of websites. Maintenance of a website would include the following:

- updating the content of a web page
- adding content to a web page
- correcting minor errors or bugs in a website, and
- minor style or format changes relating to matters such as font types, font sizes, colours and so on.

An upgrade of a website would include the following:

- adding new features to a website, such as adding a sales capability with credit card processing features
- adding extra pages to the website
- upgrading the version of the software used in the website, and
- completely changing the layout and functions of the website sufficient to be a reconstruction.

These examples are consistent with the distinction between maintenance and upgrade in the Commissioner's existing computer software policy statement ("Income Tax Treatment of Computer Software" in *Tax Information Bulletin* Vol 4, No 10 (May 1993)).

The examples also reflect the fact that a website may start out as a very simple website with few features, and yet may be upgraded over time to be a complex e-commerce site with advanced features such as the ability to purchase goods and services online, with online credit card processing capability. Just as the general capital/revenue principles apply to the

original website (and the capital classification of that), any upgrade which adds new functions is also subject to those general principles and will also be on capital account.

The cost of renting space on an HTTP server is deductible, assuming the general test of deductibility is met. The annual renewal fee for registration of a domain name is also deductible. Such costs are of a revenue nature, because they are ongoing in the nature of a servicing charge, and are analogous to expenditure incurred in renting space in a building or in hiring goods.



This guide is provided by Spiral Web Design and O'Connell & Co to help you improve the return on your website investment.

O'Connell Accountants are an MYOB approved practice who help small to medium businesses grow and maintain their success.

Spiral is a web development company that will help you get your message out with simple, easy to use websites.

**Ask us about other ways to increase the return on your website investment.**

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