



When is the cost of software development tax deductible?

There was once a time where the mention of inhouse software development seemed only relevant to the big end of town. But now so many businesses are looking to sell online it is important to understand how these costs are treated for tax purposes. After all if there is no tax deduction they are effectively going to be a lot more expensive.

Maintenance, Hosting, Annual Domain Fees etc:

These sorts of regular expenses are just tax deductible as incurred. In the case of subscriptions over \$1,000 be careful that the subscription period does not exceed 13 months. In the case of maintenance make sure this is not a major upgrade but part of the normal ongoing oversight of a website. The line in the sand drawn by the ruling appears to be, that it is still considered just maintenance to update the web site to adapt for use on mobile phones. That is just an issue of functionality as opposed to a significant advancement in what the site does.

Starting a Web Site From Scratch or Major Developments:

This would normally be considered capital in nature. That is that you are developing an asset, no deduction, even if it is wages to your own employees. Though, having said that, outsourcing the development will not change, whether it is considered an inhouse software or not. If this asset is considered inhouse software then it does qualify to be depreciated and the best thing about this now days is that means immediate write off assuming you qualify otherwise, which most businesses do. <https://bantacs.com.au/Jblog/the-25k-immediate-writeoff-clever-trick/#more-201>

What is Inhouse Software?:

Section 995-1 1997 ITAA defines this as mainly used by you in performing the functions for which the software was developed. Note inhouse software does not necessarily have to be a web site, it is software developed for use in your business.

Developing software to sell on your web site or building subscription products for your customers on your web site will not count as inhouse software because it is for your customers to use not you.

If the development is just a shopping page that your customers use or some other means of collecting data on your customers, then it is okay to be classed as in-house software. This software is really for your purposes to either enhance the customers' website experience or increase your sales.

The line between inhouse software that can be deducted and that which has to remain in the balance sheet as a capital asset is whether you developed it as a tool to use in your business or as a tool that your customers will buy off you or subscribe to use.

If you are unsure refer to paragraphs 214 to 218 of TR 2016/3. In particular paragraph 218 looks at the situation where you develop software for inhouse use but it has such generic application that you also sell it to the public. In this case you have to look at the main purpose for which the software was developed.

What Happens to Expenditure on Software that does Not meet the Definition of Inhouse?:

This expenditure is an asset, subject to CGT. It just sits there in your balance sheet until you scrap the software completely, at which time you recognise a capital loss or you sell the software and recognise a capital gain or loss.

For this reason if you ever sell your web site it is important to get the majority of the sale proceeds as a right to the domain name or stuff that you are selling on the web site, not for the website itself. Assets that are entitled to be depreciated are not caught in the CGT net. Profits on their sale are normal income. Where as, assets that can't be depreciated such as the right to use that domain name or intellectual property are subject to CGT which can mean all the small business CGT concessions and discounts. Maybe even no tax on the gain!

The ATO ruling on this matter is TR2016/3

<https://www.ato.gov.au/law/view/document?DocID=TXR/TR20163/NAT/ATO/00001&PiT=99991231235958>