Submission 60
VAL Inquiry

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THE TREASURY

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File:

Mr Paul McMahon 7/8/07
Committee Secretary
House of Representatives Standing Committee
on Industry, Science and Resources
Parliament House
CANBERRA ACT 2600

Dear Mr McMahon

INQUIRY INTO INCREASING VALUE-ADDING TO AUSTRALIAN RAW MATERIALS

I refer to two questions that the Department of Treasury took on notice during the Industry Science and Resources Committee's round table hearing on 28 June 2001, namely:

- the deductibility of website costs (page 390 of the transcript); and
- the feasibility/desirability of an insurance arrangement for high risk value-added projects of the type used by EFIC (page 399 of the transcript).

Our replies are attached for the Committee's consideration. I hope that this information will assist the Committee in its deliberations.

Yours sincerely

David Tune
General Manager
Business Income and Industry Policy Division

DEDUCTIBILITY OF WEBSITE COSTS

Question: Would the deductibility of website development costs depend on whether it was (created?) in-house or out-of-house?

According to Tax Ruling TR2001/6, purchases of software, developing software and having another person develop software represents expenditure on software. There is no difference in treatment between 'in-house' and 'out-of-house' software.

- Purchased software represents an asset and is depreciated over two and a half years.
- The STS taxpayers get an immediate deduction for purchased software costing less than $1,000.
- Expenditure on software, other than purchased software can be allocated to a software development pool and is deductible over four years. This concession allows businesses with a number of software projects to have their expenditure on such software recognised in the tax system as it is incurred rather than waiting until the software project itself is finalised.

Question: Are website developments costs regarded as capital costs (non-deductible) rather than running costs (deductible)?

Tax Ruling TR2001/6 provides the following clarification in relation to the taxation treatment of website development costs.

- Expenditure on hardware for running a website (servers, peripherals and routers) is depreciable over its effective life.
- Expenditure on software is deductible over a period of two and a half years.
- Some expenditure that is neither hardware or software (that can include content) may be deductible outright — ongoing operating expenses of commercial websites that are not expenditure on software are allowable as recurrent cost of the business.
- Some expenditure that is neither hardware or software may be deductible outright — ongoing operating expenses of commercial websites are allowable as recurrent cost of the business.
    - Costs incurred by an existing business when setting up a website that establishes, replaces or significantly extends the 'profit yielding structure' of the business are considered to be capital expenditure. Such capital expenditure is part of the cost of establishing the website; to the extent that this cost represents the cost base of a CGT asset, there would be no costs that could be considered as a 'blackhole'. The ATO ruling does not discuss capital gains tax (CGT) treatment, and does not refer to the Capital Allowance provisions effective from 1 July 2001.

FEASIBILITY/DESIRABILITY OF AN INSURANCE ARRANGEMENT FOR HIGH RISK VALUE-ADDED PROJECTS OF THE TYPE USED BY EFIC

The Export Finance and Insurance Corporation (EFIC) is a self-funding corporation wholly owned by the Commonwealth that offers a number of insurance products and financial services to Australian businesses that undertake offshore activities. Essentially, EFIC assists exporters, investors and banks to manage risks they face internationally, particularly risks that the private market is not willing or able to cover. EFIC's insurance products provide a coverage mainly against the risk of not getting paid for exports because of possible commercial, political or economic problems overseas (the 'payment risk'); and the risk of a reduction in a value of overseas investment, resulting from such events as currency inconvertibility, blockage, expropriation, confiscation, war or political violence. The above risks are outside business's control and thus they are difficult for business to manage by itself. Importantly, businesses are unable to purchase an appropriate insurance cover from a private insurer, as the private insurance market does not offer such products. This justifies the Government intervention, through ownership of EFIC, in this particular area of the insurance market.

The EFIC-based rationale does not carry over to assisting high risk value-added projects. The nature of risk in value-added projects (regardless whether it is a high or low risk project) is essentially commercial, that is mostly within the control of investors and business. While certain elements of the commercial risk may relate to the technology applied, such a risk is usually well understood and can be compensated through the market mechanism. Consequently, the EFIC type of arrangement would not be appropriate for high risk value-added projects. It should also be recognised that businesses and their investors engage in high risk value-added projects in expectation of gaining above normal returns that compensate them for bearing the higher risk of those projects.