

Deducting Business Website Costs

The business use of websites is widespread, but IRS has not yet issued formal guidance on when Internet website costs can be deducted.

Fortunately, established rules that apply to the deductibility of business costs in general, and formal IRS guidance that applies to software costs in particular (the “software guidelines”), provide a taxpayer launching a business website with some guidance as to the proper treatment of the costs. Here is a brief discussion of some relevant principles:

The time for deducting website design costs (i.e., costs of the website's overall structure, functionality and appearance) depends on whether the costs are costs of “software” within the meaning of the “software guidelines.” Generally, the portions of the website's design that are produced from sophisticated programming languages (for example, the “C++” language widely used in website design) will qualify as “software.” On the other hand, there is some doubt as to the extent to which the portions of a design produced from HTML (hypertext markup language) will qualify as “software.”

Website design costs that are “software” costs are deductible under “safe-harbor” rules. The deductibility of website design costs that are “software” costs is governed by the following “safe-harbor” rules.

Generally, if the individual or company launching the website “purchases” the design (i.e., acquires the design from a contractor who is at economic risk should the software not perform), the design costs are amortized (ratably deducted) by that individual or company over the three-year period beginning with the month in which the website is placed in service. Also, non-customized computer software placed in service in tax years beginning before 2013 qualifies as “section 179 property,” and is thus eligible for the [Code Sec. 179](#) elective expensing deduction that is generally available only for machinery and equipment. For tax years beginning in 2011, the deduction is limited to \$500,000. For tax years beginning in 2012, the deduction is limited to \$139,000. The limits are reduced by the cost of other section 179 property for which the election is made. Also, the election is phased out for taxpayers placing more than \$2,000,000 of section 179 property into service during a tax year beginning in 2011 (more than \$560,000 for a tax year beginning in 2012). Non-customized software acquired and placed in service in 2011 is also eligible for a 100%-of-cost depreciation deduction in the year that the software is placed in service (100% bonus depreciation). The bonus depreciation for an item of software is reduced to take into account any portion of the item's cost for which a [Code Sec. 179](#) election is made, and regular depreciation deductions are reduced to take into account both the bonus depreciation and any [Code Sec. 179](#) election.

If, instead of being purchased, the website design is “developed” (designed in-house by the individual or company launching the website or designed by an independent contractor who is not at risk should the software not perform), the individual or company launching the website

can choose among alternative treatments, including, but not limited to, “currently deducting” the costs (deducting the costs in the year that the costs are paid, or accrued, depending on the taxpayer's overall accounting method) or amortizing the costs under the three-year rule, discussed above, for a “purchased” design.

Website design costs that aren't costs of “software” are deductible in accordance with useful life. The time for deducting website design costs that are costs of portions of the design that aren't “software” depends on the expected “useful life” of these non-software portions of the design. Thus, these costs must be amortized over the number of years that it is expected that the non-software portions of the design will be used in the business (except if it is expected that these non-software portions of the design will have a useful life of no more than a year, in which case the costs can be currently deducted.)

Website content that is advertising is generally currently deductible; the treatment of other content costs will vary. Advertising costs are, generally, currently deductible. Thus, the costs of website content that is advertising are, generally, currently deductible. Website content that isn't advertising will be currently deductible, or amortized over a multi-tax year period, depending on its useful life.

The deductibility of some website costs that are business start-up costs is limited. Where website costs that would otherwise be currently deductible are paid or accrued before a business begins, the costs are deductible only upon the termination or disposition of the business, unless the individual or company launching the website elects to amortize these costs over a period of 60 months or more beginning with the actual start of the business.

The above principles, and others that effect the deductibility of website costs, suggest ways in which the individual or company launching the website can “take charge” of the treatment of website costs. For instance, an individual or company who contracts for a website design that qualifies as software, and who seeks the favorable tax treatment that applies to the costs of “developed” software, can, if acceptable as a business matter, include, in its written agreement with the developer/contractor, terms that will put the risk that the software won't perform on the individual or company. Another example of a way to manage the tax treatment of website costs is detailed, descriptive allocations of costs, both in contracts and in internal records.