

IRAS CIRCULAR

Tax Treatment for E-Commerce Start-up Costs (Revised Edition)



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1 Introduction

- 1.1 The purpose of this guide is to state the tax treatment for costs incurred by businesses on or after 3 May 2002 in developing their Internet platforms for business use. It encompasses the treatment for costs relating to the development and purchase of websites.

2 Principles Governing Deductibility of Expenses

- 2.1 Generally, only expenses wholly and exclusively incurred in the production of income would be deductible under Section 14(1) of the Income Tax Act. This would preclude claims for expenses incurred prior to the commencement of business since they are not related to the income-producing activities. Expenses are not deductible where they are specifically prohibited from deduction under Section 15. For instance, expenditure incurred to acquire a new source of income or new plant and machinery would be deemed to be capital in nature and prohibited from deduction under Section 15(1)(c).

3 Expenditure qualifying for Capital Allowances

- 3.1 Capital expenditure incurred in the acquisition of assets such as machinery and plant or approved know-how or patent rights can be written off as capital allowances in accordance with the relevant provisions of the Income Tax Act. While Section 14(1) does not provide for the deduction of pre-commencement expenses, Section 19(1B) and Section 19B(3) allow capital expenditure incurred prior to commencement of business to be treated as if it was incurred on the first day the trade or business commenced and hence admissible to claim for capital allowances.

4 Costs incurred to get started on E-Commerce

- 4.1 The common expenditure incurred to prepare for e-commerce activities would be one or more of the following items:
- (1) Fees for registration of domain name;
 - (2) Cost of purchase of domain name;

- (3) Cost of developing or purchasing the website¹;
- (4) Installation expenses, design fees for website;
- (5) Cost of server²;
- (6) Payment for intellectual property rights;
- (7) Internet Service Provider (ISP) fees, technical and training assistance fees etc.

4.2 The costs would have to satisfy the principles of deductibility set out in paragraph 2 or be incurred in the acquisition of machinery and plant or approved patent rights and know-how (paragraph 3) in order for businesses to be given some offsets against taxable income.

4.3 Expenditure covered under S14(1)

4.3.1 Expenses incurred in the production of income, such as renewal fees for business licences, rental and utilities would be deductible. In the context of E-businesses, expenses such as the ISP fees, technical and training assistance fees incurred by an on-going business concern can be treated as operating expenses incurred in the production of income and hence be deductible. On the other hand, the same expenses incurred prior to commencement of any form of business activities cannot be considered for deduction, being expenses not incurred in the production of income.

4.4 Capital Expenditure

4.4.1 Capital expenditure includes the cost to acquire an asset or a new plant and machinery. This would include the fee paid to register the domain name, which would not be deductible since it is incurred to acquire a new right. However, renewal fees for the continued use of the domain name can be deducted as a business expense.

¹ "website" (including mirror sites) comprising a collection of programs, data and images which is accessible over the Internet using a browser or some other form of access.

² "server" is considered to be a device upon which EC applications may be sited or run from to allow EC activities to take place. A server would usually include the computer hardware and its operating and basic application software.

4.4.2 Capital expenditure may qualify for writing down allowances under the Income Tax Act. In the case of a new E-business or an existing business embarking on E-business, the server and the website, for instance, can be treated as its plant and machinery. Thus, the installation and purchase costs of the server and the costs of development or purchase of the website will qualify for writing down allowances. Since these assets are acquired with the intention of automating the functions or services in the business, 100% write-off can be given on the capital expenditure, if claimed.

4.4.3 If a company acquires an approved³ intellectual property right (IPR) on or after 23 Feb 2001, the acquisition cost of the IPR, excluding incidental costs such as legal fees and registration fees will be eligible for writing down allowances over a period of 5 years under Section 19B. For any year of assessment, the writing down allowances would be an amount equal to 20% of the expenditure incurred.

4.5 Prior to 3 May 2002, the Income Tax Act did not explicitly state whether a website can qualify as a plant and machinery or prescribed office automation equipment etc. As such, capital expenses incurred before 3 May 2002 for the purchase or development of websites did not qualify for capital allowances. However, the Government has decided that all capital expenditure incurred on and after 3 May 2002, on the purchase or development of websites can qualify for 100% capital expenditure write-off for businesses embarking on E-commerce or new E-businesses, e.g. installation and purchase costs of the website.

4.6 With effect from 3 May 2002, a new Section 19A(1J)⁴ has been introduced in the Income Tax Act to allow all capital expenditure incurred on and after 3 May 2002 on the purchase or development of websites to qualify for 100%

³ "approved" means approved by the Minister or such persons as he may appoint. Application for approval should be made in writing to EDB or IDA.

⁴Section 19A(1J) Notwithstanding section 19, where a person proves to the satisfaction of the Comptroller that he has incurred capital expenditure on the provision of a website for the purposes of a trade, business or profession carried on by him, he shall be entitled to an allowance of 100% in respect of the capital expenditure incurred on the provision of that website, and for this purpose, a website is deemed to be machinery or plant.

write-off in the year when such expenditures are incurred.

- 4.7 As businesses are increasingly leveraging on information technology to expand their reach or offer new electronic services, this new provision aims to help lower the costs of businesses that are embarking on E-commerce or new E-businesses.

5 Conclusion

- 5.1 The tax treatment on costs incurred to engage in E-commerce activities on or after 3 May 2002 is summarised in the diagram in Appendix 1.

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Appendix 1

