

Pricey Domain Names: To Deduct or Capitalize

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It is not uncommon today for businesses to spend liberally on domain names. There is a kind of urban myth about people grabbing up domain names on the cheap that later somehow tie in to a major revenue stream. Just consider the following meant-to-be-famous examples of big domain-name spending:

- VacationRentals.com—is said to have been purchased in 2007 for \$35 million.
- PrivateJet.com—was reportedly purchased in 2012 for \$30.18 million.
- Insure.com—commanded a reported \$16 million price tag in 2009.

- Sex.com—was a big winner in 2010, worth a reported price of \$14 million.
- Hotels.com—reportedly sold for \$11 million in 2001.
- Fund.com—commanded a price of \$9.9 million in 2008.
- Porn.com—reportedly traded for \$9.5 million in 2007.
- Fb.com—Facebook needed this one from American Farm Bureau Federation and was willing to shell out \$8.5 million in 2010.

IRS Too

As one piece of evidence that this topic is on the IRS radar, consider the IRS announcement in CCA 201543014 [Sep. 10, 2015; released Oct. 23, 2015]. The IRS considered several fact patterns involving purchased Internet domain names.

One question the IRS addressed is when the costs of those domain names must be capitalized under Code Sec. 263. Another is whether they can be amortized under Code Sec. 197. The IRS considers both generic and nongeneric domain names.

A generic domain name is not a company or product name, but typically describes a product or service using generic terms people associate with the topic. Examples would be pizza.com or cleaning.com. A nongeneric domain name is usually a company or product name.

The Regulations under Code Sec. 263(a) include examples of intangibles requiring capitalization. One is a trademark (as defined in Reg. §1.197-2(b)(10)). But there is always amortization to consider. Code Sec. 197(a) provides that a taxpayer is entitled to an amortization deduction with respect to any amortizable “Code Sec. 197 intangible.”

An amortizable Code Sec. 197 intangible is any “Code Sec. 197 intangible” acquired after August 10, 1993, and held in connection with the conduct of a trade or business or an activity. However, there are exclusions from this concept. Several are included in Code Sec. 197(d)(1)(D), (E) and (F).

Code Sec. 197(d)(1)(F) provides that any franchise, trademark or trade name is a Code Sec. 197 intangible. A trademark includes any word, name, symbol or device, or any combination thereof, adopted and used to

identify goods or services and to distinguish them from those provided by others. [Reg. §1.197-2(b)(10).] A trademark includes any trademark arising under statute or applicable common law and any similar right granted by contract.

Two Cases

In both of the situations, the IRS considered: (a) each purchased domain name is associated with a website that is already constructed and that will be maintained by the acquiring taxpayer; and (b) the taxpayer purchased the generic domain names for use in its trade or business. It did so either to generate advertising revenue by selling space on the website or to increase its market share by providing goods or services through the website.

In Situation 1, a company purchased two domain names as part of an asset acquisition of a trade or business. A portion of the purchase price is allocated to each of the domain names. One is a generic domain name. The other is a nongeneric domain name.

In Situation 2, the same company purchases two domain names from existing holders of the domain names. This acquisition is not part of an acquisition of a trade or business. One is a generic domain name; the other is nongeneric.

Not surprisingly, in both cases, the IRS says that the cost of the domain names must be capitalized. And the IRS takes this view for both the generic and the nongeneric domain names in both cases.

Trademarks

Much of the IRS view seems to come from the trademark example in Reg. §1.263(a)-4(c)(1). The IRS says capitalization is required for an amount paid to another party to acquire a domain name that meets the definition of a trademark under Reg. §1.197-2(b)(10). Moreover, you must also capitalize an amount paid to acquire a domain name alone because a domain name is an intangible asset.

It does not matter if the acquired domain name is a generic or nongeneric domain name. You may be able to amortize the cost, but that depends on several factors. Capitalized costs are not within the exception in Code Sec. 197(c)(2) for self-created intangibles. Consequently, the taxpayer’s capitalized

costs of acquiring a domain name that is registered as a trademark, whether acquired as a separate asset or as part of the acquisition of a trade or business, are an amortizable Code Sec. 197 intangible. Accordingly, these capitalized costs may be amortized.

No Trademark

Nongeneric domain names are a little different. Besides providing the domain name holder's Internet address, a nongeneric domain name identifies the particular good, service and/or business associated with the website. The IRS says that such an identification alone is not enough to meet the definition of a trademark under Reg. §1.197-2(b)(10).

The nongeneric domain name must be used to identify goods or services and distinguish them from those provided by others. If a nongeneric domain name meets the definition of trademark in Reg. §1.197-2(b)(10) (functions as a trademark), the capitalized costs of such a domain name are a Code Sec. 197 intangible unless an exception in Code Sec. 197(e) and Reg. §1.197-2(c) applies. None of these exceptions are applicable.

The IRS notes that the taxpayer's capitalized costs of acquiring a nongeneric domain name that functions as a trademark are an amortizable Code Sec. 197 intangible. This is so whether the nongeneric domain name is acquired as a separate asset or as part of the acquisition of a trade or business. Accordingly, under both Situation 1 and Situation 2, the company can amortize the capitalized costs.

Alternatively, if a purchased nongeneric domain name does not function as a trademark, the capitalized costs of acquiring such a nongeneric domain name may also meet the definition of a customer-based intangible in Reg. §1.197-2(b)(6). It would qualify if the acquiring taxpayer uses the nongeneric domain name in its trade or business to provide goods or services through a website that is already constructed and that will be maintained by the acquiring taxpayer.

This is the result whether acquired as a separate asset or as part of the acquisition of a trade or business. Accordingly, under both Situation 1 and Situation 2, the company may amortize the capitalized costs.

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