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subject: Treatment of Costs to Acquire Internet Domain Names for Use in Taxpayer's Trade or
Business
POSTN-119841-15

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

<u>A</u>	=	
<u>B</u>	=	

ISSUES

- (1) Whether costs incurred by a taxpayer to acquire a generic internet domain name (generic domain name) or a non-generic internet domain name (non-generic domain name) from the secondary market for use in the taxpayer's trade or business are deductible under § 162 of the Internal Revenue Code or are required to be capitalized under § 263(a)?

- (2) If costs incurred by a taxpayer to acquire a non-generic domain name from the secondary market for use in the taxpayer's trade or business are required to be capitalized under § 263(a), are these capitalized costs amortized under § 197?
- (3) If costs incurred by a taxpayer to acquire a generic domain name from the secondary market for use in the taxpayer's trade or business are required to be capitalized under § 263(a), are these capitalized costs amortized under § 197?

CONCLUSIONS

- (1) Costs incurred by a taxpayer to acquire a generic domain name or a non-generic domain name from the secondary market for use in the taxpayer's trade or business must be capitalized under § 263(a) as an intangible asset pursuant to § 1.263(a)-4(b)(1)(i) and § 1.263(a)-4(c)(1) of the Income Tax Regulations.
- (2) If the non-generic domain name is registered as a trademark or functions as a trademark, the capitalized costs of acquiring such a non-generic domain name from the secondary market for use in the acquiring taxpayer's trade or business meets the definition of a trademark in § 1.197-2(b)(10) and constitutes an amortizable § 197 intangible. Alternatively, if the non-generic domain name does not meet the definition of a trademark in § 1.197-2(b)(10) but will be used by the acquiring taxpayer in its trade or business to provide goods or services through a website that is already constructed and will be maintained by the acquiring taxpayer, the capitalized costs of acquiring such a non-generic domain name from the secondary market meets the definition of a customer-based intangible in § 1.197-2(b)(6) and constitutes an amortizable § 197 intangible.
- (3) If the generic domain name is associated with a website that is already constructed and will be maintained by the acquiring taxpayer, and such taxpayer acquired the generic domain name for use in its trade or business 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, the capitalized costs of acquiring such a generic domain name from the secondary market for use in the acquiring taxpayer's trade or business meets the definition of a customer-based intangible in § 1.197-2(b)(6) and constitutes an amortizable § 197 intangible.

FACTS

Situation 1

In 2013, a company purchases two internet domain names (domain name(s)) 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. The company will use the domain names in its trade or business. One domain name is a generic domain name and the other domain name is a non-generic domain name.

Situation 2

In 2014, the same company purchases two domain names from existing holders of such domain names. This acquisition is not part of an acquisition of a trade or business. The company will use the domain names in its trade or business. One domain name is a generic domain name and the other domain name is a non-generic domain name.

For both situations, a non-generic domain name is usually a company or product name (e.g., A). 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 (e.g., B).

No facts were provided as to how the company will use the domain names in its trade or business. Further, with respect to the generic domain names, no facts were provided as to whether such domain names are associated with a website already constructed and maintained. Also, with respect to non-generic domain names, no facts were provided as to whether these domain names are registered as trademarks or function as trademarks.

This Chief Counsel Advice only addresses the federal tax treatment of domain names acquired from the secondary market for use in the taxpayer's trade or business. Therefore, for example, this Chief Counsel Advice does not address the federal tax treatment of a domain name acquired for resale or for investment by a taxpayer.

LAW AND ANALYSIS

Issue 1

Section 263(a) provides that no deduction is allowed for any amount paid out for new buildings or for permanent improvements or betterments to increase the value of any property or estate or any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made.

Section 1.263(a)-4(b)(1)(i) generally provides that a taxpayer must capitalize an amount paid to acquire an intangible. Section 1.263(a)-4(c)(1) provides that a taxpayer must capitalize amounts paid to another party to acquire an intangible from that party in a purchase or similar transaction. Section 1.263(a)-4(c)(1) also provides examples of intangibles requiring capitalization under this rule. One such example is a trademark (as defined in § 1.197-2(b)(10)). Thus, capitalization is required for an amount paid to another party to acquire a domain name that meets the definition of a trademark under § 1.197-2(b)(10), but is also required for an amount that is paid to acquire a domain name simply because the domain name is an intangible asset. See Kremen v. Cohen, 337 F.3d 1024, 1029 (9th Cir. 2003) (domain name is a form of intangible property).

Capitalization is required regardless of whether the acquired domain name is a generic or non-generic domain name.

Issue 2

Section 197(a) provides that a taxpayer shall be entitled to an amortization deduction with respect to any amortizable § 197 intangible. The amount of the deduction under § 197(a) is determined by amortizing the adjusted basis (for purposes of determining gain) of such intangible ratably over the 15-year period beginning with the month in which the intangible was acquired.

Section 197(b) provides that no other depreciation or amortization deduction shall be allowable with respect to any amortizable § 197 intangible.

Section 197(c) defines the term “amortizable section 197 intangible.” Pursuant to § 197(c)(1), the term “amortizable section 197 intangible” means any § 197 intangible that is acquired by the taxpayer after August 10, 1993, and that is held in connection with the conduct of a trade or business or an activity described in § 212. However, § 197(c)(2) provides that the term “amortizable section 197 intangible” does not include any § 197 intangible that is not described in § 197(d)(1)(D), (E), or (F), and that is created by the taxpayer. Section 197(c)(2) does not apply if the intangible is created in connection with a transaction (or series of related transactions) involving the acquisition of assets constituting a trade or business or substantial portion thereof. *See also* § 1.197-2(d).

The term “section 197 intangible” is defined in §§ 197(d) and (e) and the regulations thereunder. An intangible asset not described as a § 197 intangible may not be amortized under § 197.

Section 197(d)(1)(C)(iv) provides that customer-based intangibles are a § 197 intangible. Section 197(d)(2) defines the term “customer-based intangibles” as meaning (i) composition of market, (ii) market share, and (iii) any other value resulting from future provision of goods or services pursuant to relationships (contractual or otherwise) in the ordinary course of business with customers. Section 1.197-2(b)(6) further provides that the amount paid or incurred for customer-based intangibles includes, for example, any portion of the purchase price of an acquired trade or business attributable to the existence of a customer base, a circulation base, an undeveloped market or market growth, insurance in force, the existence of a qualification to supply goods or services to a particular customer, a mortgage servicing contract, an investment management contract, or other relationship with customers involving the future provision of goods or services.

Section 197(d)(1)(F) provides that any franchise, trademark, or trade name is a § 197 intangible. Section 1.197-2(b)(10) provides in pertinent part that the term “trademark” includes any word, name, symbol, or device, or any combination thereof,

adopted and used to identify goods or services and distinguish them from those provided by others. A trademark includes any trademark arising under statute or applicable common law, and any similar right granted by contract. The renewal of a trademark is treated as an acquisition of the trademark.

Section 1.197-2(e)(2)(i) provides that the acquisition of a franchise, trademark, or trade name constitutes the acquisition of a trade or business or a substantial portion thereof unless one of the exceptions in § 1.197-2(e)(2)(ii) applies.

Section 197(e)(4) provides exceptions to the definition of a § 197 intangible when the asset is acquired in a transaction (or series of related transactions) that does not involve the acquisition of assets constituting a trade or business or a substantial portion of it. One such exception is described in § 197(e)(4)(D) and § 1.197-2(c)(13) which provide that a § 197 intangible does not include any right under a contract if the right: (a) is acquired in the ordinary course of a trade or business and not as part of a purchase of a trade or business; (b) is not described in § 197(d)(1)(A), (B), (E), or (F); (c) is not a customer-based intangible, a customer-related information base, or any other similar item; and (d) has either a fixed duration of less than 15 years, or is fixed as to the amount and the adjusted basis is properly recoverable under a method similar to the unit-of-production method.

Certain domain names may be registered as trademarks. A domain name that is registered as a trademark clearly meets the definition of a trademark under § 1.197-2(b)(10). Because none of the exceptions in § 197(e) and § 1.197-2(c) apply, 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, is a § 197 intangible. Further, such capitalized costs are not within the exception in § 197(c)(2) and § 1.197-2(d)(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, is an amortizable § 197 intangible under § 197(c). Accordingly, these capitalized costs must be amortized ratably over a 15-year period, beginning on the first day of the month in which the intangible was acquired.

But most domain names are not registered as trademarks. These domain names are the focus of this Chief Counsel Advice.

For both Situation 1 and Situation 2, no facts were provided as to how the taxpayer will use the domain names in its trade or business. Further, with respect to the generic domain names, no facts were provided as to whether such domain names are associated with a website already constructed and maintained. Accordingly, for purposes of this Chief Counsel Advice, our analysis of whether purchased domain names are amortizable § 197 intangibles is based on the following assumptions: (a) each purchased domain name is associated with a website already constructed and will be maintained by the acquiring taxpayer; and (b) the taxpayer purchased the generic

domain names for use in its trade or business 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.

Non-generic domain names

A non-generic domain name is usually a company or product name. Besides providing the domain name holder's internet address, a non-generic domain name actually is used to identify the particular good, service, and/or business that is associated with the website. But that identification alone is not enough to meet the definition a trademark under § 1.197-2(b)(10). The non-generic domain name must be used to identify goods or services *and* to distinguish them from those provided by others (emphasis added).

If a non-generic domain name functions as a trademark as defined in § 1.197-2(b)(10), then the capitalized costs of such a domain name is a § 197 intangible unless an exception in § 197(e) and § 1.197-2(c) is applicable. None of these exceptions are applicable. Further, such capitalized costs are not within the exception in § 197(c)(2) and § 1.197-2(d)(2) for self-created intangibles. Consequently, the taxpayer's capitalized costs of acquiring a non-generic domain name that functions as a trademark, whether acquired as a separate asset or as part of the acquisition of a trade or business, is an amortizable § 197 intangible under § 197(c). Accordingly, under both Situation 1 and Situation 2, the company is required to amortize these capitalized costs ratably over a 15-year period, beginning on the first day of the month in which the intangible was acquired.

Alternatively, if a purchased non-generic domain name does not function as a trademark, we believe that the capitalized costs of acquiring such a non-generic domain name meets the definition of a customer-based intangible in § 1.197-2(b)(6) if the acquiring taxpayer uses the non-generic domain name in its trade or business to provide goods or services through a website that is already constructed and will be maintained by the acquiring taxpayer. Consequently, the capitalized costs of such a domain name used in that manner is a § 197 intangible unless an exception in § 197(e) and § 1.197-2(c) is applicable. The only possible exception is in § 1.197-2(c)(13) but it is inapplicable because the non-generic domain name described in this paragraph is a customer-based intangible. See § 1.197-2(c)(13)(i)(C). No other exceptions in § 197(e) and § 1.197-2(c) are applicable. Further, the capitalized costs of such a domain name are not within the exception in § 197(c)(2) and § 1.197-2(d)(2) for self-created intangibles. Consequently, the taxpayer's capitalized costs of acquiring a non-generic domain name used in the manner described in this paragraph, whether acquired as a separate asset or as part of the acquisition of a trade or business, is an amortizable § 197 intangible under § 197(c). Accordingly, under both Situation 1 and Situation 2, the company is required to amortize these capitalized costs ratably over a 15-year period, beginning on the first day of the month in which the intangible was acquired.

Generic domain names

A generic domain name is not a company or product name, but rather describes a product or service using generic terms people associate with the topic. Accordingly, we believe that a generic domain name does not meet the definition of a trademark under § 1.197-2(b)(10).

However, a purchased generic domain name is a customer-based intangible as defined in § 1.197-2(b)(6) if (a) the generic domain name is associated with a website that is already constructed and will be maintained by the acquiring taxpayer, and (b) such taxpayer acquired the generic domain name for use in its trade or business 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. Accordingly, such a generic domain name is a § 197 intangible unless an exception in § 197(e) and § 1.197-2(c) is applicable.

The only possible exception is in § 1.197-2(c)(13) but it is inapplicable because the generic domain name described in the preceding paragraph is a customer-based intangible. See § 1.197-2(c)(13)(i)(C). No other exceptions in § 197(e) and § 1.197-2(c) are applicable. Further, the capitalized costs of such a generic domain name are not within the exception in § 197(c)(2) and § 1.197-2(d)(2) for self-created intangibles. Consequently, the taxpayer's capitalized costs of acquiring a generic domain name described in the preceding paragraph, whether acquired as a separate asset or as part of the acquisition of a trade or business, is an amortizable § 197 intangible under § 197(c). Accordingly, under both Situation 1 and Situation 2, the company is required to amortize these capitalized costs ratably over a 15-year period, beginning on the first day of the month in which the intangible was acquired.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

Further factual development is needed to determine if the domain names meet the assumptions stated on page 5 or if the non-generic domain name functions as a trademark as defined in § 1.197-2(b)(10).

We are aware that a taxpayer may purchase a domain name outside of the secondary market or for reasons other than those discussed in this Chief Counsel Advice. In such cases, our analysis may be different.

We also are aware that a taxpayer may purchase a generic domain name even though a website has not been constructed and no goods or services have been offered. In this case, we believe that the inherent value of the generic domain name does not meet the definition of goodwill in § 1.197-2(b)(1).

If a purchased domain name is not an amortizable § 197 intangible, then the domain name is an intangible asset subject to § 167. The 15-year safe harbor provided

in § 1.167(a)-3(b) does not apply because the acquired domain name is an intangible described in § 1.263(a)-4(c). See § 1.167(a)-3(b)(1)(ii). Therefore, such domain name is amortized under § 167 only if the taxpayer can show a limited useful life pursuant to § 1.167(a)-3(a). For purposes of § 167, the estimated useful life of an asset is not necessarily the useful life inherent in the asset but is the period over which the asset may reasonably be expected to be useful to the taxpayer in its trade or business or in the production of its income. See § 1.167(a)-1(b). Because a business usually intends to use a domain name for an indeterminable period of time, we believe that the registration period of a domain name subject to § 167 is not its useful life for purposes of § 167.

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Please call (202) 317-7005 if you have any further questions.