

CHAPTER-20

CAPITAL AND REVENUE

(Classification of Expenditure and Classification of Receipts)

(A) Capital Expenditure and Revenue Expenditure:

Capital Expenditure:- Any expenditure which is incurred in acquiring or increasing the value of a fixed asset is termed as capital expenditure. As such, the amount spent on the purchase of Land and Building, Plant and Machinery, Furniture etc. is capital expenditure. Such expenditure yields benefit over a long period and hence is written in Assets. Following are the examples of capital expenditure:-

- I. Expenditure which results in the acquisition of a fixed asset such as land, building, plant, motor vehicles, trade marks, etc. Such asset would be used in the business for a number of years.
- II. Expenditure in connection with the purchase or erection of a fixed asset such as wages paid to workers for erecting machines, cartage paid on acquiring plant and machinery, overhauling of second-hand machines etc.

Revenue Expenditure Any expenditure, the benefit of which is received during the current year itself is termed as revenue expenditure. As such, all the revenue expenditures are debited to Trading and Profit & Loss Account. Such expenditure does not result in an increase in the earning capacity of the business but only helps in maintaining the existing earning capacity. Examples are :

- i. Expenses incurred for the purpose of day to day running of business such as manufacturing expenses, office expenses, selling expenses etc.
- ii. Expenses incurred on the ordinary repairs and maintenance of fixed assets, white-washing of building etc.
- iii. Payment for goods purchased for resale.
- iv. Depreciation on fixed assets.
- v. Purchase of raw materials for converting it into finished goods.
- vi. Interest on loan and interest on capital for the period after the asset is put to use.
- vii. Replacement of worn-out part of an existing machine.
- viii. Loss from sale of fixed assets.

Distinction between Capital Expenditure and Revenue Expenditure:

Basis of Distinction	Capital Expenditure	Revenue Expenditure
1. Purpose	It is incurred for the acquisition or erection of a fixed asset for use in business.	It is incurred for the day-to-day running of the business.

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2. Earning capacity	It increases the earning capacity of the business.	It is incurred for maintaining the earning capacity.
3. Period	Its benefit extends to more than one year.	Its benefit is exhausted within maximum period of one year
4. Accounting Treatment	It is debited to related Asset Account.	It is debited to related Expenses Account.
5. Nature of Account	It is a real account.	It is a nominal account.
6. Presentation	It is shown in the Balance Sheet.	It is shown in the Trading or Profit and Loss Account.
7. Examples	Purchase of fixed assets like plant and machinery, land and building, furniture etc.	Rent, salaries, repairs, depreciation etc.

“Revenue Expense relates to the operations of the business of an accounting period or to the revenue earned during the period or the items of expenditure, benefits of which do not extend beyond that period. capital Expenditure, on the other hand, generates enduring benefits and helps in revenue generation over more than one Accounting period.”

“Capital expenditure contributes to the revenue earning capacity of a business over more than one accounting period whereas revenue expense is incurred to generate revenue for a particular accounting period. The revenue expenses either occur in direct relation with the revenue or in relation with accounting periods.”

“Deferred revenue expenditure is that expenditure for which payment has been made or a liability incurred but which is carried forward on the presumption that it will be of benefit over a subsequent period or periods. Deferred revenue expenditure should be revenue expenditure by nature in the first instance. But its matching with revenue may be deferred considering the benefits to be accrued in future.”

“Receipts which are obtained in course of normal business activities are revenue receipts (e.g. receipts from sale of goods or services, interest income etc.) Revenue and capital receipts are recognised on accrual basis as soon as the right of receipt is established. Revenue receipts should not be equated with the actual cash receipts. Revenue receipts are credited to the Profit and Loss Account.”

Capital Receipts and Revenue Receipts

It is also necessary to make a proper distinction between capital receipts and revenue receipts because the revenue receipts are shown on the credit side of Trading and Profit & Loss Account whereas the capital receipts are shown in the Balance Sheet either as increase in liabilities or as reduction in the value of the assets.

Capital Receipts:

Examples of capital receipts are:

- (i) Amount received from the sale of fixed assets or investments.

(ii) Capital contributed by proprietors, partners or money obtained from issue of shares and debentures in case of company.

(iii) Amount received by way of loans.

Revenue Receipts:

- (1) Money obtained from sale of goods.
- (2) Commission and fees received for services rendered.
- (3) Interest and dividend received on investments.

SHORT ANSWER QUESTIONS

1. What is Capital Expenditure? Give six examples of Capital Expenditure.
2. Explain Revenue Expenditure with examples.
3. Give three points of distinction between Capital Receipt and Revenue Receipts.

LONG ANSWER QUESTIONS

1. State the meaning of capital expenditure and revenue expenditure. What is the difference between them?
2. "Capital expenditure is different from Revenue Expenditure." Explain by giving suitable examples.
3. Distinguish between: -
 - (i) Capital Expenditure and Revenue Expenditure
 - (ii) Capital Receipt and Revenue Receipts
4. (i) Classify the following as capital expenditure, revenue expenditure and deferred revenue expenditure for a cloth merchant?
 - (a) Preliminary Expenses
 - (b) Purchase of Furniture
 - (c) Payment of Salary
 - (d) Expenses paid for constructions of building.

Ans. (i) (a) Preliminary Expenses: Deferred Revenue Expenditure;
(b) Purchase of Furniture: Capital Expenditure;
(c) Payment of Salary: Revenue Expenditure;
(d) Expenses paid for constructions of building: Capital Expenditure.