

## Chapter 20 Capital and Revenue

### Question 1

What is Capital Expenditure?

**Answer:** Any expenditure which is incurred in obtaining or increasing the value of a fixed asset is known as capital expenditure. Similarly, the total amount spent on the Plant and Machinery, Land and Building, Furniture and fixtures etc., Such expenditure yields benefit over a long period.

### Question 2

What is Revenue Expenditure?

**Answer:** Any expenditure, the benefit of which is received during the current year itself is termed as revenue expenditure. Similarly, all the revenue expenditures are debited to the Trading and Profit and Loss a/c.

### Question 3

State the difference between Capital Expenditure and Revenue Expenditure.

**Answer:**

Capital Expenditure	Revenue Expenditure
Any expenditure which is incurred in obtaining or increasing the value of a fixed asset is known as capital expenditure.	Any expenditure, the benefit of which is received during the current year itself is termed as revenue expenditure.
The total amount spent on the Plant and Machinery, Land and Building, Furniture and fixtures etc.,	All the revenue expenditures are debited to the Trading and Profit and Loss a/c.
Capital expenditure is incurred for the purpose of increasing the capacity of the trading concern.	Revenue expenditure is incurred for the purpose of maintenance of earning capacity.

## Practical Questions

### Question 1

State with reasons whether the following are capital or revenue expenditures:

- (i) A new machine is purchased for ₹ 60,000, ₹ 800 were spent on its carriage and ₹ 1,500 were paid as wages for its installation.
- (ii) A sum of ₹ 10,000 was spent on painting the new factory.
- (iii) ₹ 5,000 paid for the erection of a new machine.

(iv) ₹ 2,000 were spent on repairs before using a second-hand generator purchased recently.

(v) ₹ 1,500 were spent on the repair of machinery.

(vi) ₹ 10,000 was paid as brokerage on the issue of shares and other expenses of the issue were ₹ 25,000.

**Solution:** The reasons are.

(i) New machinery purchase is a capital expenditure that increases the earning function of a firm. Here, the installation cost is capitalized as it is used before the machine is put into operation.

(ii) As the new factory is painted it is categorised as a capital expenditure.

(iii) New machine erection cost will be capitalized as it is used before equipment is put into operation.

(iv) As 2nd hand generator are repaired before it is put into function, so it is a capital expenditure

(v) Since, repairs are done regularly, therefore, it is considered as revenue expenditure.

(vi) Brokerage and other expenses issue are capital in nature, therefore, it is a capital expenditure.

## **Question 2**

State whether the following expenditure are Capital, Revenue or Deferred Revenue. Give reasons:

(i) Furniture of the book value of ₹ 10,000 was sold off at ₹ 2,500 and new furniture of the value of ₹ 6,000 was acquired, cartage on purchase ₹ 50.

(ii) Temporary was constructed costing ₹25,000. These are necessary for the construction of the new building and were demolished when the buildings were ready.

(iii) Replacement of old machine by a new one.

(iv) Damages paid by a transport company to its passengers injured in an accident.

(v) ₹40,000 was spent is dismantling the removing the machinery from old sites to a more suitable site.

(vi) Removal of stock from the old site to new site cost 420,000. The new site is more favourably located.

**Solution:**

(i) ₹7,500 loss in the furniture sale is revenue expenditure and ₹ 6,050 purchase + cartage will be capital expenditure.

(ii) It is considered as capital expenditure as registration and a legal fee is given to obtain the asset.

(iii) A purchase of a new machine is a capital expenditure which will enhance the firm's earning space.

(iv) Since accidents and damages payments do not increase the earning size of a business, so it is a revenue expenditure.

(v) The new construction will increase the earning capacity of a firm. So, it is a capital expenditure,

(vi) It is a deferred expenditure.

### Question 3

Classify the following into Capital, Revenue and Deferred Revenue expenditure, stating reasons in each case:

(a) A sum of ₹ 32,000 has been spent on a machine as follows: (i) ₹ 20,000 for addition to double the output, (ii) ₹ 5,000 for repairs necessitated by negligence and (iii) ₹ 7,000 for replacement of worn-out parts.

(b) Total expenditure on a cinema building during the year was ₹ 2,00,000 out of which 20% related to repairs and 80% represented improvements and additions.

(c) Compensation paid to a retrenched employee for the loss of employment.

(d) Second-hand furniture worth ₹ 40,000 was purchased and repairing of this furniture cost ₹ 15,000. The furniture was installed by own workmen-wages for this being ₹ 5,000.

(e) A person was injured by the motor car of the company. ₹ 10,000 was paid to him by way of compensation.

(f) Advertisement expenditure in special advertisement drive.

### Solution:

(a) ₹ 20,000 is a capital expenditure as it will increase the output of a firm. ₹ 12,000 are revenue expenditure as replacements and repairs are done on a regular basis.

(b) ₹ 40,000 for repairs is considered as revenue expenditure as it is performed regularly and ₹ 1,60,000 on improvements will give benefits in future, so, it's a capital expenditure.

(c) Remuneration and compensation are fixed in any company, so, it will be considered as revenue expenditure.

(d) Any cost acquired on the asset used in the firm's performance is considered as capital expenditure.

(e) Compensation are fixed, so, it is considered as revenue expenditure.

(f) Advertisement is a deferred expenditure as its benefit are gained after many years.

### Question 4

State with reasons whether the following receipts would be treated as Capital or Revenue:-

(a) ₹ 5,000 received from a customer whose account was previously written off as bad.

(b) ₹ 20,000 received from the sale of an old machine.

(c) ₹ 2,60,000 received from the sale of stock-in-trade.

(d) ₹ 5,00,000 is contributed by a partner as capital.

(e) Took a loan of ₹ 10 Lac from Punjab National Bank.

(f) Received ₹ 4 Lac as subsidy from State Government.

(g) Received ₹ 8 Lac as a grant from State Government for the construction of quarters for the staff.

**Solution:**

(a) The account previously written off as bad is a revenue receipt as it is the normal function of a business.

(b) Sale of an old machine is considered as a capital receipt as by selling the machine it will gain the capital.

(c) Sale of a stock is termed as revenue receipt as the company will receive the capital over an exchange of goods.

(d) Contribution as a partner is a capital receipt because it will enhance the financial status of a firm.

(e) A loan is a capital receipt as it will intensify the production of a business.

(f) A subsidy is a revenue receipt because it is received on a regular basis from the government.

(g) Grants received for construction is a capital receipt as it will increase the firm's earning capacity.