

THE FOOD CORPORATION OF INDIA
HEAD QUARTERS : NEW DELHI

No. Accts/14(1)/92-93

DT : 9.2.1994

CIRCULAR NO. 649/ACCTS

Sub.: Capital or Revenue expenditure – clarification thereof – Reg.

It has been noticed that every year Statutory Auditors/Government Audit are raising observations in regard to accountal of expenditure incurred on repairs, renewals and replacements. Allocation of expenditure on this item between capital and revenue become disputed. The field units also are not following uniform procedure in this regard.

As per general principles of accounting, expenditure incurred on repairs, renewals and replacement are charged to revenue only. In this regard extract of Institute of Chartered Accountants of India guidelines on accounting standards on fixed assets is reproduced below :

IMPROVEMENT & REPAIRS

“Frequently it is difficult to determine whether subsequent expenditure related to fixed asset represents, improvements that ought to be added to the gross book value or repairs that ought to be charged to P&L account statement. Only expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance is included in the gross book value e.g., an increase in capacity”.

The cost of an addition or extension to an existing asset which is of a capital nature and which becomes an integral part of the existing asset is usually added to its gross value. Any addition or extension which has a separate identify and is capable of being used after the existing asset is disposed off is accounted for separately”.

The expenditure incurred in repairs, renewals and replacements is not a permanent character and if there is no improvement in the capacity strength and there is no future benefit to the existing asset beyond what was accounted for a capital the same should be considered as revenue. As per decision arrived in the case of CIT versus Udaipur Mineral development Syndicate Pvt. Ltd. (1993) 203 ITR 556 (Raj) “Repair” means” restore (building, machine, garment tissue, strength etc.) to good condition, renovate or mend by replacing or refixing parts or compensating loss or exhaustion”. Incurring of expenditure on repairs could not be enduring benefit. The expenditure incurred in repairing the Kucha roads and keeping them in good condition is not expenditure of a permanent character.

In another case of CIT versus Cominco Binani Zinc Ltd. (1993) 204 ITR 56 (Cal.). The assessee company carried on the business of manufacture of zinc slabs with sulphur and cadmium as by products. The company included certain sum under the head "Repairs and Maintenance and Others" towards certain expenditure incurred for water pipeline including cost of pipeline, labour charges and electrical inspecting charges. The Assessing Officer disallowed the said expenditure as capital expenditure. The Tribunal found that there already existed a pipeline for bringing saline free water from the river to the factory of the assessee. In the relevant year, the salinity problem was acute and therefore, it became necessary to reroute the pipeline connection and to take the pipeline further upstream for getting saline free water for operation. The Tribunal further found that re-routing of the pipeline was not a new feature. The company had done so in the past also. Hence the tribunal held that expenditure was revenue expenditure.

In the light of above decisions and clarifications issued from time to time, field units are advised to follow the instructions carefully for correct accountal of expenditure on this account.

Sd/-
(M.V. AVADHANI)
JOINT MANAGER (ACCTS.)