The Difference Between Capital Expenditure & Capitalized Expenditure

by Linda Richard

A small business distinguishes between items purchased for the short term and long-term expenditures, both in accounting and in taxes. Capital expenditures are business improvements, upgrades or expansions. A capitalized expenditure is primarily a tax term, reflecting depreciation for loss of value over a period of years. Confusion arises when capital expenditures become capitalized expenditures for tax purposes, as these are long-term business improvements requiring depreciation over several years.

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Capitalized or Expensed

The business owner must choose to capitalize or expense business costs each tax year. "Expensing" costs allows you as owner to take the entire purchase off your current business tax return. You can claim as expenses those purchases that last only for the year or that do not improve the business for the future. The Internal Revenue Service requires you to capitalize expenditures or depreciate expenses that have business benefits for the future. Property with a useful life greater than a year is depreciated for federal tax purposes over the life expectancy of the property, with a percentage of depreciation allowed each year.

Expenses

The business owner deducts low-value items or items with a year or less of useful life as a business expense in the year of purchase. These items are "expensed" or written off in the year you incur the expense with no depreciation allowed for future years. Books updated annually are expenses; reference books usable over a period of years may be depreciated.

Capital Expenditure

A capital expenditure is money spent on buildings, machinery or equipment as an investment to increase efficiency or production. Capital expenditures are items purchased that will have future benefits for the business and that add value to the business for future years. The IRS requires that the business tax return reflect depreciation of capital expenditures, with distribution of the tax write-off over a period of years. You "capitalize" capital expenditures when you list them on your tax return and depreciate them.

Capitalized Expenditure

The IRS requires the business owner to delay the tax deduction on some items, filing for depreciation of large expenses as a capitalized expenditure. You may claim three, five or seven years and deduct 33 percent, 20 percent or 14 percent each year until your item is fully depreciated. You capitalize the expenditure in journal entries as well, and each tax year, adjust the journal entry to reflect the depreciation for the year. Repairs may be capitalized expenses in 2011 as the IRS has modified the rules for expensing and capitalizing repairs. Required capitalized expenditures for repairs now include upgrades, improvements, enhanced value, betterment or repairs that extend the useful life or adapt the property to a new use.

References (4)

- IRS.gov: Publication 946 -- How to Depreciate Property
- Nolo: Capitalized Expenditure
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- CPA2biz: IRS Issues New Guidance on Capitalized Expenditures

About the Author

Linda Richard has been a legal writer and antiques appraiser for more than 25 years, and has been writing online for more than 12 years. Richard holds a bachelor's degree in English and business administration. She has operated a small business for more than 20 years. She and her husband enjoy remodeling old houses and are currently working on a 1970s home.

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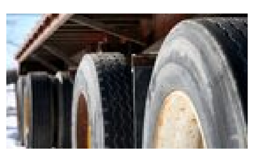
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