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Contact

Colette Gonsalves
Marketing Coordinator
Abbott, Stringham & Lynch
cgonsalves@aslcpa.com
408-377-8700

Contractors Likely to See Increased Tax Liability

New tax laws limit what can be expensed

San Jose, Calif. – June 4, 2012 – The IRS issued new temporary repair and maintenance regulations, Section 162 and Section 263(a), that will likely increase the tax liability of contractors on their 2012 tax returns, according to CPA Rob Trammell, a principal at the accounting firm of Abbott, Stringham & Lynch. “The new regulations fundamentally change the definition of a ‘unit of property’ in a way that significantly restricts the expenditures that can be expensed,” said Trammell.

Trammell said that these regulations quickly get technical, requiring the capitalization of many expenditures that contractors may be accustomed to expensing. “The bottom line is that contractors are likely to have fewer write-offs and this can affect profitability. Typically, capital expenditures are not costs that can be passed along to customers, so advance planning is critical to avoid a lower than expected profit margin for 2012.” Due to the tax implications and corresponding effects on profitability, Trammell advises contractors to consult with their CPAs now to understand the new regulations and to plan for major expenditures.

“The changes in these regulations are another development in the battle between the IRS and contractors over expensing versus capitalizing expenditures that has been going on for years,” said Trammell. According to Trammell, contractors may view the new regulations as an obstacle to the speed and vigor of their economic recovery. “We see a trend by the IRS to increase the stringency of regulations, likely in response to the so-called tax gap, so this regulatory direction is not surprising.”

According to Trammell, although the new regulations are described as temporary, they can stand indefinitely. “The IRS issues temporary regulations to signal regulatory direction and to solicit feedback. However, it is hard to know if the IRS will act on any feedback. If they don’t, the temporary regulations will likely stay in place.”

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