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A beginning guide to structure, basis and taxes

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The first thing to know about Leif Jensen is that he's a CPA -- president of Leif Jensen & Associates, an Elk Grove Village accounting and consulting firm.

Jensen's credentials give credence to his concern that most small business owners don't know enough about two tax-related business issues:

• The best legal structure for a business, at least from a tax basis. That's relatively simple.
• How basis dollars figure into an owner's ability to recognize losses or sell the business.

We'll start with corporate structure.

Back in the day, I was advised to go to an accountant when I wanted to give some structure to my initial business. That advice still makes sense; there are many corporate structure options with, depending on your situation, potentially significant differences in both personal liability and how dollars will flow from your business to your tax form.

A lawyer who knows tax law can help, too -- but, accountant or attorney, be aware that anything involving taxes can be complicated. Also be aware that how you and your business are taxed is an important decision.

"I've had arguments with my own attorney as to what entity makes the most sense for people" Jensen said in a recent email. Give thought to this issue.

Basis dollars may be more impactful. "No one seems to truly understand (basis) and why it is important," Jensen says. Basis, he explains, is the actual contribution the owner has in the business.

Here's an example Jensen uses:

• The owner puts $1,000 into his, or her, new business. That's the initial basis. $1,000.
• Then the owner puts in another $10,000 for computer equipment, cellphones and the like. The basis now is $11,000.
• The business loses $6,000 the first year, reducing the owner's basis to $5,000.
• The next year the business turns around and has a $20,000 profit. That raises the owner's basis to $25,000.
• But there's a $30,000 loss the following year. However, the owner can recognize only $25,000 of the loss because the owner's basis is $25,000. "You can't lose more than you have invested," Jensen says.

In a sense, the owner's basis is somewhat similar to the basis homeowners have when they sell their homes. Assume, for example, that you paid $200,000 for your house, then spent $50,000 on a heating system and new roof. For tax purposes, your basis is $250,000 -- dollars that basically escape being taxed as profit if you sell the house for, say, $400,000.

The homeowner example is greatly simplified, as is Jensen's example of how basis works. You should, of course, talk to your own tax adviser (or to Jensen) so you can ask questions and get specific answers.
But why care at all? "Because banks care," Jensen replies. "They want to know you have skin in the game," and your tax basis tells them that.

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