

Tax Recordkeeping Demystified

By Bonnie J. Orr, CPA

Gathering together all of the pertinent information and records that are needed to prepare a tax return can be quite annoying and boring. But it is essential that you compile the right information so that your return can be prepared properly. Maintaining records also is critical so that if the IRS later audits the return, you will be able to withstand the challenge. Sometimes, you even need to retain records to fend off potential challenges on returns for years subsequent to the year of the return to which the records directly relate. And records are a first line of defense against many penalties.

What are the basics? While your records must be accurate, the Internal Revenue Service generally does not require any particular form of recordkeeping (although they do urge taxpayers to kept records in an “orderly” fashion).

One of the best records of having paid a particular expense is a cancelled check (or the scanned image provided by the bank with your bank statement). Keep cancelled checks that relate to any items that you need or even only think will be needed to prepare any tax return that you may have to file.

You should also retain receipts, sales slips, and invoices referring to items that might be included on a return. Of course, once your return has been prepared and items have, in fact, been included in the return as deductions you must keep records supporting the claimed tax treatment.

In addition to keeping records to support deductions, you will also need to keep records to keep track of what income you will need to report on your tax return. These include Forms W-2 showing wages from employment and Forms 1099 showing compensation from any independent contracting work you performed. Apart from Forms 1099, separate accounting books and records are needed for independent contracting jobs. There are a whole series of other Forms 1099 showing interest, dividends and other types of income, which you should keep, along with financial statements from brokerage houses. Of course, you should also keep copies of your tax returns. Also, keep copies of related schedules and attachments with the returns. **Table 1** lists some key records to keep and **Table 2** provides IRS rules on how long to keep those documents. See IRS Publication 552, *Recordkeeping for Individuals* for more information (www.irs.gov).

Table 1—Basic Records To Keep

- Form(s) W-2, 1099, 2439, and K-1
- Bank statements
- Brokerage & Mutual Funds statements
- Home closing statements
- Sales invoices, receipts, and cancelled checks for all deductions claimed on your return
- Insurance records
- Form(s) 2439

Table 2—How Long To Keep

*Years noted below is years from the date you file your income tax return or, if later, years from the time you pay the tax. If you file your return before the due date, the IRS gets to measure the period from the actual due date. Note that there is no limit for the IRS to bring an action against someone who has filed a false or fraudulent return.

Years*	Provided you...
3	According to the IRS, provided none of the following situations apply to you.
6	You failed to report income and it is 25% or more of the gross income shown on your return.
No limit	Filed a fraudulent return.
No limit	Failed to file a return.
Later of 3 years or 2 years after tax paid	Filed an amended return for a refund or credit.
7	Filed an amended return for loss from worthless security.

We advise clients to keep copies of filed tax returns indefinitely—they are a good source of financial information even beyond the needs of IRS. Estate & Gift Tax returns should be kept as basis until property is sold and then for years as per **Table 2**, until statute passes.

All tax records for properties such as homes, businesses, and investments should be kept until you dispose of them and report the disposition on your tax return, in addition to the time limits in **Table 2**. You also should permanently retain certain documents such as trust documents, wills, partnership agreements, business contracts, divorce decrees, leases and the like. If in doubt, consult with your CPA.

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