RETAINING TAX RECORDS

Taxpayers considering disposing of some past years' tax returns and records will want to remember the rules for retaining relevant tax records in the event that the IRS — or another taxing authority — wants those records as part of an audit.

Individual Taxpayers

Keep at Least Three Years — The following records are commonly used to substantiate a taxpayer's income and expense items:

- Form(s) W-2
- Form(s) 1099
- Form(s) K-1
- Bank and brokerage statements
- Canceled checks or other proof of payment of deductible expenses
- For charitable contributions of $250 or more, canceled checks are not sufficient. Receipts with statements affirming that no goods or services were received for the contribution are required by law.

At a minimum, the above tax records should be kept for a three-year period following the date that you file your return (or its due date, if later).

***But, Six Years is Better* —** The IRS's time limit for initiating an audit asserting that income was grossly understated, without fraud (for which there is no statute of limitation), is six years. Accordingly, you should retain all of the above documents for at least six years.

Investment Records — Similarly, you will want to keep investment sales records after you liquidate an investment. Documentation that substantiates the gain or loss on an investment should be kept for the period that you retain other tax documents supporting the return on which you report the sale. You should keep investment purchase records for as long as you own the investment plus at least four years.

Prior Years' Tax Returns — It is a good idea to maintain one or more permanent files with important legal and personal documents, including those relating to taxes. Specifically, as a general rule, you should retain copies of your federal and state income tax returns (and any tax payments) *indefinitely*.

For instance, the IRS (or another taxing authority) could claim that you never filed a particular year's return. If that occurs, the IRS could assess tax and penalties relating to the return in question. You will need a copy of your return to bolster your position that you actually filed the return.

Pass-through Business Entities — If you are an owner in an S corporation, LLC, or partnership, you should retain a copy of the annual Schedule K-1 for as long as you own an interest in the entity *plus four additional years*. Also, keep any paperwork related to the sale or other disposition of your interest for at least four years after the disposition.

Business Taxpayers

It is an employer's responsibility to keep accurate, up-to-date records. Similar to the concern of an individual taxpayer, businesses need to be prepared for the possibility of an audit.

Employment Tax Records — Employment tax records must be maintained for at least four years after the later of the due date of the tax return for the period to which the records relate or the date the tax is paid. The penalties for noncompliance can be harsh. These records should include the following information:

- Employer identification number (EIN);
- Amounts and dates of all wage, annuity, and pension payments;
- Amounts of tips reported;
- The fair market value of in-kind wages paid;
- Names, addresses, Social Security numbers, and occupations of employees and recipients;
- Employee copies of Forms W-2 that were returned as undeliverable;
- Employees' dates of employment;
- Periods for which employees and recipients were paid while absent due to sickness or injury, and the amount and weekly rate of payments made to them by the employer or third-party payers;
- Copies of employees' and recipients' income tax withholding allowance certificates (Forms W-4, W-4P, W-4S, and W-4V);
- Dates and amounts of tax deposits;
- Copies of returns filed;
- Documentation for allocated tips;
- Documentation for fringe benefits provided, including appropriate substantiation; and
- Forms I-9 and supporting documentation must be retained as long as the person is employed and after termination, for three years after date of hire or one year after termination, whichever is later.

Corporate and Partnership Income Tax Returns — It is highly advisable that you retain copies of all entity (limited liability company, partnership, or corporation) income tax returns *indefinitely*.

Other Business Records — In addition, you should keep the following business records indefinitely:

- Board minutes
- Bylaws
- Business licenses
- Contracts, leases, and mortgages
- Patents/Trademarks
- Shareholder records
- Stock registers/transactions
- Employee benefit plans, including pension/profit sharing plans
- Real estate purchases
- Construction records

- Leasehold improvements
- Annual financial statements
- Fixed asset purchases
- Depreciation schedules

The following business records should be retained for at least seven years:

- Accounts Payable/Receivable
- Inventory records
- Loan payment schedules
- Expense records
- Sales records
- Purchase orders
- Bank statements
- Canceled checks
- Loan records
- Electronic payment records
- Payroll records

Filing your tax returns is the first step in properly handling your taxes. However, making sure you can defend yourself in event of an audit is also important.

***Electronic Storage* —** Taxpayers who utilize computers with scanners and with confidence in their backup procedures might want to consider using electronic storage for some of their records. Nonetheless, we encourage retention of the hard copies of income tax returns.

Tax Preparers' Records – While you will want to keep your records as discussed above, you probably realize that most CPA tax return preparers keep electronic copies of returns they prepare for at least six years. Most preparers also retain electronic imaging copies of the support furnished with the preparation information for at least six years.

We will be pleased to discuss your record retention questions at your convenience.