Why save records?

Once you file a tax return, there is no need to keep the records, right? Unfortunately, that's a misconception.

The main reason for saving tax records is to substantiate the information reported on your tax return. The statute of limitations for most federal tax returns is three years. This is extended to six years if you under-stated your income by more than 25 percent. No statute of limitations exists if you do not file a return or file a fraudulent return in order to evade taxes.

How long should you keep records?

Prior year income tax returns

Keep prior year returns for a minimum of three years from the later of the date you filed or the due date of the return. Example: Bill and Sheryl filed their 2011 tax return on June 13, 2012. They had filed an extension, which made their tax return due on October 15, 2012. They need to keep their return until at least October 17, 2015, because that date is later than the date they filed. If Bill and Sheryl had filed their 2011 return by March 15, 2012, they would keep their return until at least April 15, 2015.

The conservative approach would be to keep tax returns for at least seven years. It's best to keep returns longer if there are items that affect future years. Common items that might affect future years include:

- Net operating losses.
- Capital losses.
- Charitable contributions.

Tax receipts

Most audits occur within three years of the filing of the tax return. Keep receipts used to document expenses through the statute of limitations for that return. After the statute has expired, examine receipts to see if they fall into another area that would require you to save them for a longer period of time. Discard any receipts that will not affect future transactions.

Retain closing papers from the sale or purchase of a home for a minimum of three years after the sale. If building a home or making improvements, keep careful records of all expenditures, including amounts paid to outside contractors. Keep these records for at least three years after the sale.

Investment records

Keep retirement plan statements [e.g., 401(k), IRA, Roth] until the account is closed.

Retain year-end brokerage statements from the purchase of stocks, bonds and mutual funds for three years after you sell the investment. These statements show the reinvestment of dividends, the purchase of shares and the redemption of shares.

IRA contribution and distribution records

Keep IRA contribution and distribution records indefinitely. Records of nondeductible contributions are particularly important.

Business records

You can discard most receipts dealing with operational expenses if they do not fall within the statute of limitations.

For cost basis purposes, retain receipts that relate to the property you still own.

Keep payroll records for a minimum of four years.

If a business has an overall loss on the tax return, the loss could create a net operating loss and is either carried backward or forward. Save the tax return and records of the calculation creating the net operating loss carryover or carryback (and the tax return for any year in which part of the carryover loss is absorbed) for three years following the last year the loss is used.

Employee business expenses

The most common employee business expenses are transportation and travel expenses. Save mileage logs, motel bills and meal receipts for the three-year limitation period. Truckers who claim the standard meal allowance should keep logbooks for three years.

Gifts

For gifts received, it's important to know the cost to the donor and to obtain receipts for gifts of property other than cash. This becomes the donee's basis in the property for future sales consequences. This is extremely important when gifting stock among family members such as grandparents to grandchildren. The grandparent's cost becomes the grandchild's basis. If you report anything on a gift tax return (Form 709), keep a copy of the form indefinitely.

Inheritances

If you inherit property, you need to keep records that establish the fair market value on the date of death. These records usually come from the fiduciary's (executor or trustee) records. Keep them for three years after the property is sold.

Summary

While the most common statute of limitations period is three years from the filing of the return, a return that was never filed has no statute of limitations.

The statute of limitations is six years for returns where income has been understated by more than 25 percent.

Saving tax returns indefinitely may provide good historical information in addition to providing substantiation.

Other personal documents

Wills, living wills, healthcare powers of attorney, trust documents, powers of attorney, divorce decrees, military records, adoption documents, citizenship and/or naturalization documents, prenuptial agreements and birth, marriage and death certificates should be kept indefinitely.

Keep passports, alimony and custody agreements, insurance policies, employment contracts and deeds until no longer current.

Bills or receipts for other major purchases such as vehicles, collectibles or jewelry should be kept for cost documentation purposes.

Pay stubs, cancelled checks, general bills and receipts and credit card receipts should be shredded when monthly statements are received, unless the item is needed for tax purposes. Monthly statements can be shredded after one year.

Document security

Consider fire and flood-proof storage for important papers. A bank safe deposit box provides added safety. Shred all personal documents before discarding.

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