

Tax and Business Alert – April 2024

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Abstract: Generally, the IRS has three years to audit a tax return, from the later of the due date of the return, or the date the return is filed. But many exceptions exist that make it prudent to keep financial records even longer. Some states also have different records retention requirements. Here's the lowdown on records retention, broken down by various types of documentation.

Tax records: What can you toss and what should you keep?

Generally, the IRS has three years to audit a tax return, from the later of the due date of the return, or the date you file. You can also file an amended return within this time frame if you overlooked something. Here's what you need to know about keeping financial records involved in your tax returns.

Federal tax records

Despite the three-year guideline, many tax advisors recommend retaining copies of your finished tax returns *indefinitely* to prove that you filed. Even if you don't keep returns indefinitely, at least keep them for six years after the returns are due or filed, whichever is later. It's a good idea to keep the records that support items on your individual tax return until the three-year statute of limitations runs out. Supporting records include canceled checks, charitable contributions receipts, mortgage interest payments and retirement plan contributions. These documents may also support an amended tax return if you find you overlooked something.

So which records can you throw away today? Based on the three-year rule, generally you'll soon be able to throw out most records associated with your 2020 return if you filed by the 2020 due date (which was extended to May due to the pandemic). Extended 2020 returns could still be vulnerable to audit until October of 2024.

Also, some tax issues are still subject to scrutiny after the three years. If the IRS suspects that income has been understated by 25% or more, the statute of limitations for audit rises to six years. If no return was filed or if fraud is suspected, there's no limit of time for the IRS to launch an inquiry.

Certain records that support figures that may affect multiple years, such as carryovers of charitable deductions, should be saved until the deductions no longer have effect. Also, don't toss out records that support deductions for bad debts or worthless securities that could result in refund claims, because you have up to seven years to claim them.

State tax records

The previous guidelines are geared toward complying with federal tax obligations. We can instruct you regarding your state's statute of limitations.

Plus, states generally have the right to resolve their own issues related to federal tax returns that have been audited. So, hold on to records related to an IRS audit for a year after it's completed.

Real estate records

Retain real estate records for as long as you own a property, plus three years after you dispose of it and report the transaction on your tax return. Throughout ownership, keep records of the purchase, home improvements, relevant insurance claims and refinancing documents.

These documents help prove your adjusted basis in the home, which is needed to figure any taxable gain at the time of sale. They can also support rental property or home office deductions.

Investment account statements

To accurately report taxable events involving stocks and bonds, you must maintain detailed records of purchases and sales. Records should include dates, quantities, prices, dividend reinvestment and related expenses. Keep these records for as long as you own the investments — plus additional time until the statute of limitations for the relevant tax returns expires.

The IRS requires you to keep copies of Forms 8606, 5498 and 1099-R until all the money is withdrawn from your IRAs. It's even more important to retain records of all transactions relating to Roth IRAs, in case you're ever questioned.

Purge with caution

Old tax records take up space and could lead to stolen identities if not properly disposed of. But purging too soon may leave you without a defense if the IRS has questions. When in doubt, hang on to records a little longer than you think is necessary. Contact us with questions.

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