Tax Tips You Can Use

How long to keep tax records
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Many people ask how long to keep their tax records. If you would like to read the IRS rules, it is all in Publication 552. This article will give practical advice on record retention and several surprising points that few people know.

Most of us need to keep our records for three years. If you are audited, you need to be able to substantiate the items on your return. Generally, the IRS will only audit returns filed in the last three years. If you ask the person next to you what the last three years are, that person would logically say that since it is April of 2010, the last three years are 2009, 2008 and 2007. But that person is not the IRS. Since the "filing season" is not yet closed, 2009 is not yet open to audit. The three "open audit years" for timely filed returns are 2006, 2007 and 2008 until after April 15. The filing date of your return is April 15 or the actual date that you file, whichever is later. Even if you filed your 2009 return in February, it is considered to be filed on April 15, 2010. Also, if you filed your 2001 return in June of 2008, your return can be audited until June of 2011. I tell my clients to keep their information for four years so that they will always have the appropriate years.

If the IRS audits you and finds significant underreporting of income, they can audit 6 years. If the IRS finds fraud, they can go back 10 years- think of Al Capone. A little-known fact is that an auditor needs managerial approval to go back more than three years. So, in most cases, the auditor won't go back more than three years, even if she finds new tax due. I once had an audit client who had "maximized his refund" by having his consumer software put the same expenses in three places. Even though he owed at least $10,000.00 of additional tax for each year, the auditor only looked at two years, not three, and not six. She was going for maximum impact, then on to the next.

There are two other things to consider when deciding how long to keep your records. The first is that capital items may need to be substantiated at audit. This means that if you have a business or rentals and have assets that are depreciated, the IRS may ask to see the original purchase documents to justify the depreciation. Taxpayers should keep capital asset receipts in a separate file for this reason. Rental houses are depreciated for 27.5 years. That is long after the tax return papers are gone.

The last thing to consider when deciding how long to keep records is substantiation for Social Security. Each of us who has worked long enough to qualify for Social Security, but who has not yet filed for Social Security, has a work history. Taxpayers used to get annual statements. Now one must check the work history at the Social Security Website. A taxpayer should check it periodically to insure it is accurate. From personal experience, I know that errors can occur. My story is that I looked at the statement and found that where I had wages listed for 1983 in the previous year's statement, the new statement listed zero income. Some computer glitch has erased my 1983 earnings. I took my 1983 tax return and faded W-2 to the local Social Security office. (Remember I am a tax preparer- I DO have all those returns.) The young man was quite impressed and said that with a tax return and W-2's, it takes about 5 minutes to fix an error. If the Social Security people have to go back through 25 years of records it can take six months, if ever. Your tax return and W-2's can be helpful to fix some errors in the Social Security records, if they occur. Certainly before one files to receive social security benefits, she should check that the work history is accurate and complete.

So keep your capital asset receipts, old returns and W-2's in a binder or file, but after four years the medical, business and other receipts can be shredded. Never just throw them away. The identity thieves are out there.

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The fine print: This article is for information only. Please see your tax professional for questions about your individual tax situation.