RECORD AND DOCUMENT RETENTION

Perhaps, you were hoping to contribute in a mild way to the waste pollution by discarding old financial records. Sorry, you may need to hang on even longer. This can easily cause problems for mobile Americans.

Those who may be selling their homes soon, especially older couples, and moving to a retirement community will be trading spacious storage for what to them will seem like no room at all. They are busily getting rid of clothes, books, tools, scrapbooks and all the other belongings that people tend to acquire over many years.

Along with old theater programs and bronzed baby shoes, they have folders of canceled checks, bank statements and income tax records going back perhaps as far as the 1940's.

SHOULD WE KEEP EVERYTHING?

If you are one of those keeping every single bill, tax return, medical contract and even the 10 year old warranty for the toaster oven you sold at the garage sale last year – you are not alone. And with the increasing prevalence of identity theft, proper destruction of records becomes critical, too.

The traditional answer has been that "virtually everything except tax records for the past three years may be discarded." Taxpayers are required to retain documentation supporting claims on tax returns only until the statute of limitations has passed, a period of three years.

Do you have the 10 year old warranty for the toaster oven you sold at the garage sale last year?

However, the catch is that the three-year rule does not apply if the IRS claims your return has been false or fraudulent. It also does not apply if a prior year's return is in question, such as for the prior purchase of a "tax shelter."

In addition, documents supporting a tax-loss carry forward, charitable carry forward, or depreciation schedule should be kept until they are no longer relevant.

NEW RETENTION RULES

Because of the rules on the retention of certain tax records, in years to come many taxpayers will have to save more papers for longer periods. For example, anyone with passive losses that cannot be written off in the current year will have to retain the documentation until at least three years after the losses have been used. Taxpayers with non-deductible IRAs will have to hold on to all records pertaining to those accounts as long as the IRAs are in force, including tax returns and/or IRS Forms 5498, 1099-R and W-2P. This could be twenty to forty years.

To make matters worse, if all this record keeping requires you to rent a U-Haul or a storage facility, the cost is generally not deductible.

DOCUMENT RETENTION SCHEDULE

Unless you operate a business, the required record keeping can be relatively simple. Because the burden of proof rests with the taxpayer, it is to your advantage to retain accurate and complete records, especially for deductions. The IRS generally will disallow deductions that cannot be adequately substantiated. This can often result in a 5% negligence penalty in addition to the tax and interest.

For many years, the primary information returns (IRS forms reporting amounts distributed to taxpayers that by law must be completed by banks, companies, etc.) that needed to be retained were merely those for interest or dividend income (Form 1099), and wages or salaries (W-2 Forms).

With computers and advanced technology, it is easy for the IRS to crosscheck additional income sources; such as state and local tax refunds, social security benefits, IRA contributions and IRA and pension disbursements. The IRS can easily match information on alimony payments and mortgage interest deductions.

In addition to information returns, certain personal records should be retained, such as canceled checks, bank statements and receipts. These records are necessary to substantiate medical expenses, interest and taxes paid, charitable contributions and other deductible items.

It is also important to maintain investment information, such as stockbrokers' advice and real estate records, showing purchase price, proceeds from sales and investment-related deductions. If you own securities, it is important that you maintain a record of each security owned, including stock splits and stock dividends, to help determine your cost basis. Certificate numbers, number of shares and sales prices should be maintained.

BUSINESS RECORDS

The IRS requires substantiation to support business deductions, especially automobile expenses. In addition, documentation should be retained to support the business or investment write-off of a personal computer. Other deductible business expenses should be substantiated as well.

Besides receipts, an appointment book - listing meeting places, dates and times, business contacts and business purpose of the expense - is useful. For entertainment expenses exceeding $75, the IRS requires that receipts be retained – and notes, not just of the expense, but the business-related aspects of the activity.

STORAGE LOCATION

Once it has been determined which records to retain, they should be stored in the proper place. An ordinary cabinet or desk drawer may be sufficient for the less important records, but all valuable or irreplaceable documents should be stored in a fireproof lockbox or safe, file cabinet or safe deposit box.

Records for insured items should be stored apart from the insured property to prevent the concurrent loss or destruction of both the records and the property.

TAX RECORDS

There is no specific time requirement for personal record retention set forth by law.

However, a good general rule to follow is that prior years' tax returns, bank statements and canceled checks should be retained for at least six years.

Records supporting the accuracy of the income tax return should be kept for as long as they may be material in determining the tax liability. This is generally three years (the number of years the IRS has to audit a return) after the return is filed or two years after the tax was paid, whichever occurs later.

However, a six-year period applies if there has been at least a 25% understatement of income.

Furthermore, if the IRS claims a taxpayer has submitted a fraudulent return or failed to file a return altogether, there is no limit on how many years the IRS has for assessment.

The following describes the type of document or record and the recommended period that each document should be held.

As a general "rule of thumb", one should save a record if it may be used for legal or tax oriented purposes or if the cost or ownership of an item may be questioned in the future.

The basic guideline is the "statute of limitations" but the more conservative approach is "If in doubt - keep it!"

TWO YEARS

Bank Reconciliations
Duplicate Deposit Slips
Routine Correspondence

MINIMUM THREE YEARS RETENTION

Appliance Warranties (or until expired)
New & Used Car Warranties
Appliance Purchase Agreements
Insurance Policies (expired)
Employee Applications
Employee Records (after termination)

FIVE YEARS RETENTION

Sales Commission Report
Employee Business Expenses
Medical Insurance Policies
Hospital Bills

SEVEN YEARS RETENTION

Federal Tax Returns
State & Local Tax Returns
Items to Support Tax Returns
Vendor Contracts
Employee Contracts
Options records (expired)
Inventory Records
Expense Analysis Records
Invoices and Cash Receipts
Payroll & Social Security Tax Returns
W-2 Forms
Mortgage Records
Leases (expired)
Personal Bank Statements
Personal Canceled Checks*
Property Damage Reports
Accident Records
Accident Release Forms

* *Only as relating to taxes, purchases, special contracts, etc. should be filed with papers pertaining to the transaction*

TEN YEARS RETENTION

Business Contracts
Business Check Registers
Business Accounting Journals
Worker's Compensation Report

PERMANENT RETENTION

Deeds & Titles
Divorce Papers
Mortgage Documents
Marital Agreements
Social Security Audits
Parents' Wills
Military Service Records
Civil Service Records
Corporate Tax Returns
Adoption Papers
Corporate Pension Records
Patent Records / Trade Marks
Corporate Labor Contracts
Stock & Bond Certificates
Articles of Incorporation
Partnership or Corporate
Tax Exemption Certificate
Annual Financial Statements
Audit Report of Accountants
Depreciation Schedules
Current Contracts & Leases
Property Records

The retention-holding period normally commences at the end of the fiscal year in which the paper was created. For contracts, employment records, etc. the holding period commences after termination or disposal of the underlying asset.

DESTRUCTION

Now that you have separated the wheat from the chaff, it is probably wise to invest in a paper shredder. Any documents that show your personal information should not be discarded until you are sure the information cannot be used against your interests by someone else. Paper shredders are now relatively inexpensive and start from as little as $25. Pay more if you value speed and quiet operation.

Source: Financial Planning Consultants, Inc.