Re: Recordkeeping for Individuals - General Requirements

Dear Client:

Gathering together all of the pertinent information and records that are needed to prepare a tax return can be quite annoying and boring. But it is essential that you compile the right information so that your return can be prepared properly. Maintaining records also is critical so that if the IRS later audits the return, you will be able to withstand the challenge. Sometimes, you even need to retain records to fend off potential challenges on returns for years subsequent to the year of the return to which the records directly relate. And records are a first line of defense against many penalties.

What are the basics? While your records must be accurate, the Internal Revenue Service generally does not require any particular form of recordkeeping. One of the best records of having paid a particular expense is a canceled check. Keep your canceled checks that relate to any items that you need or even only think will be needed to prepare any tax return that you may have to file.

You also should retain receipts, sales slips, and invoices referring to items that might be included on a return. Of course, once your return has been prepared and items have, in fact, been included in the return as deductions or in some form or another it is imperative that you keep records supporting the claimed tax treatment.

In addition to keeping records to support deductions, you will also need to keep records to keep track of what income you will need to report on your tax return. These include Forms W-2 showing wages from employment and Forms 1099 showing compensation from any independent contracting work you performed. Apart from Forms 1099, separate accounting books and records are needed for independent contracting jobs. There are a whole series of other Forms 1099 showing interest, dividends and other types of income, which you should keep, along with financial statements from brokerage houses. Of course, you should also keep copies of your tax returns. Also, keep copies of related schedules and attachments with the returns.

Another question that arises with respect to recordkeeping is how long you need to keep the records. The short answer is you need to keep them for as long as the IRS can potentially challenge you on the item to which a particular record relates. This period generally is 3 years from the date you file your income tax return or, if later, 2 years from the time you pay the tax. If you file your return before the due date, the IRS gets to measure the 3-year period from the actual due date. Sometimes, the so-called limitation period is 6 years. There is no limit for the IRS to bring an action against someone who has filed a false or fraudulent return.

In some cases, you should keep records longer than the regular limitations period. For example, you should permanently keep records of your basis in property. Basis is the yardstick for measuring tax gain or loss and usually is the amount you paid for property and major improvements to it. Note: Although many homeowners may no longer need to keep track of basis for selling their principal residences due to the 1997 Taxpayer Relief Act's exclusion of $250,000 of gain from the sale of a principal residence ($500,000 exclusion for married taxpayers), most homeowners of higher-priced homes should keep records since the chance remains that inflation may push them above the $250,000 threshold at some future date.

You also should permanently retain certain documents. For example, keep trust documents, wills, partnership agreements, business contracts, divorce decrees, leases and the like.

If you have any questions about the recordkeeping matters touched upon here or have specific recordkeeping questions, please give us a call.

Sincerely yours,