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Which Tax Records to Retain (and for how long)

Once you have gathered 2010's tax-related records and filed the required returns, you may be inclined to dispose of certain current and past year tax information.

However, you should be aware of the rules for retaining relevant tax records in the event that the IRS – or another taxing authority – wants you to produce those records as part of an audit.

Individual Taxpayers

Keep at Least Three Years. The following records are commonly used to substantiate a taxpayer's income and expense items:

- Form(s) W-2
- Form(s) 1099
- Form(s) K-1
- Bank and brokerage statements
- Canceled checks or other proof of payment of deductible expenses

At a minimum, the above tax records should be kept for a three-year period following the date that you file your return (or its due date, if later).

Six Years May Be Necessary. However, the IRS's time limit for initiating an audit on a return where income was grossly understated, yet no fraud was discovered, is six years. Therefore, retain the above documents for at least six years to better protect yourself in the event of an audit.

Investment Records. Similarly, you'll want to keep investment sales records after you liquidate an investment. Documentation that substantiates the gain or loss on an investment should be kept for the period that you retain other tax documents supporting the return on which you report the sale.

Prior Years' Tax Returns. It is a good idea to maintain one or more permanent files with important legal and personal documents, including those relating to taxes.

Specifically, as a general rule, you should retain copies of your federal and state income-tax returns (and any tax payments) *indefinitely*.

For instance, the IRS (or another taxing authority) could claim that you never filed a particular year's return. If that occurs, the IRS could assess tax and penalties relating to the return in question. You will need a copy of your return to bolster your position that you actually filed the return.

Business Taxpayers

It is an employer's responsibility to keep accurate, up-to-date business records. Similar to the concern of an individual taxpayer, businesses – especially small businesses – need to be prepared for the possibility of an audit.

Employment Tax Records. Employment tax records must be maintained for at least four years after the later of the due date of the tax return for the period to which the records relate or the date the tax is paid. The penalties for noncompliance can be harsh. These records should include the following information:

- Employer identification number (EIN);
- Amounts and dates of all wage, annuity, and pension payments;
- Amounts of tips reported;
- The fair market value of in-kind wages paid;
- Names, addresses, Social Security numbers, and occupations of employees and recipients;
- Employee copies of Forms W-2 that were returned as undeliverable;
- Dates of employment;

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- Periods for which employees and recipients were paid while absent due to sickness or injury, and the amount and weekly rate of payments made to them by the employer or third-party payers;
- Copies of employees' and recipients' income-tax withholding allowance certificates (Forms W-4, W-4P, W-4S, and W-4V);
- Dates and amounts of tax deposits;
- Copies of returns filed;
- Documentation for allocated tips; and
- Documentation for fringe benefits provided, including appropriate substantiation.

Pass-Through Business Entities. If you are an owner in a subchapter S corporation, LLC, LLP, or a limited partnership, you should retain a copy of the annual Form K-1 for as long as you own an interest in the entity plus four additional years. Also, keep any paperwork related to the sale or other disposition of your interest for at least four years after the disposition.

Corporate Income Tax Returns. It is highly advisable that you retain copies of all corporate tax returns *indefinitely*.

Other Business Records. In addition, you should keep the following business records indefinitely, in case of a tax audit:

- Board minutes
- Bylaws
- Business licenses
- Contracts, leases and mortgages
- Patents/Trademarks
- Shareholder records
- Stock registers/transactions
- Employee benefit plans, including pension/profit sharing plans
- Real estate purchases
- Construction records
- Leasehold improvements
- Annual financial statements
- Fixed asset purchases
- Depreciation schedules

The following business records should be retained for at least seven years:

- Accounts Payable/Receivable
- Inventory records
- Loan payment schedules
- Expense records
- Sales records
- Purchase orders
- Bank statements
- Cancelled checks
- Loan records
- Electronic payment records
- Payroll records

Doeren Mayhew Can Help

Filing your tax returns on time is just one part of properly handling your taxes. Make sure you can defend yourself in event of an audit by properly retaining your tax records. Please contact the tax professionals at Doeren Mayhew if we can be of assistance in any way.

