Retaining and Storing Income Tax Records

Retaining and storing your income tax records is an important final step of your tax filing responsibility. This letter is a refresher on the rules for keeping your tax records along with some information on storage options.

When determining how long to keep most of your income tax records, we look at the time frame over which the IRS can audit a return and assess a tax deficiency or that you can file an amended return. For most taxpayers, this period is three years from the original due date of the return or the date the return is filed, if later. For example, if you file your 2012 Form 1040 on or before April 15, 2013, the IRS has until April 15, 2016, to audit the return and assess a deficiency. However, if a return includes a substantial understatement of income, which is defined as omitting income exceeding 25% of the amount reported on the return, the statute of limitations period is extended to six years.

A good rule of thumb for keeping tax records is to add a year to the IRS statute of limitations period. Using this approach, you should keep your income tax records for a minimum of four years, but it may be more prudent to retain them for seven years, which is what the IRS informally recommends. State tax rules must also be considered, but holding records long enough for IRS purposes will normally suffice for federal and state tax purposes, assuming the federal and state returns were filed at the same time.

Certain tax records, however, should be kept much longer than described above and some, indefinitely. Records substantiating the cost basis of property that could eventually be sold, such as investment property and business fixed assets, should be retained based on the record retention period for the year in which the property is sold. Tax returns, IRS and state audit reports, and business ledgers and financial statements are examples of the types of records you should normally retain indefinitely.

Keep in mind that there may be nontax reasons to keep certain tax records beyond the time needed for tax purposes. This might include documents such as insurance policies, leases, real estate closing statements, employment records, and other legal documents. Your attorney can provide additional guidance.

It’s also important to know that the IRS permits taxpayers to store certain tax documents electronically. Although the rules are aimed primarily at businesses and sole proprietors, they presumably apply to individuals as well. The rules permit taxpayers to convert paper documents to electronic images and maintain only the electronic files. The paper documents can then be destroyed. Certain requirements must be met to take advantage of an electronic storage system, so contact us if you want more details.

We hope this brief overview helps you understand the income tax record retention rules. If you have any questions regarding your specific situation or you would like to discuss these rules in more detail, please give us a call.