

**Harvey & Parmelee LLP**  
Certified Public Accountants

**How long should I retain my financial records?**

By Debi Rhinehart, CPA, May 26, 2004

The following is a general guideline for the length of time that various records should be kept. This is only a general guideline and any specific situations should be discussed with us. Some examples where records may need to be produced include for a tax audit, as a condition of a loan, insurance payments, etc.

**Tax returns:** Permanently - You should also keep your certified receipts or other proof-of-mailings with your returns permanently.

**Tax return supporting documents:** Usually for six years

In general, except in cases of fraud or substantial understatements of income, the IRS can only assess tax within three years after the return for that year was filed (or, if later, three years after the return was due). For example, if you filed your 2000 individual income tax return by its original due date of April 15, 2001, the IRS would have until April 15, 2004 to assess a tax deficiency against you. If you filed your return late, the IRS generally would have three years from the date you filed the return to assess a deficiency.

The problem with the three-year rule is that the assessment period is extended to six years if more than 25% of gross income is omitted from a return. In addition, the assessment period does not begin to run until a return is filed. Therefore, if the IRS claims that you never filed a return for a particular year, it can assess tax for that year at any time (even beyond three or six years), unless you can prove that you did file. Proving that you filed would, of course, be impossible after you have discarded your returns. You should also keep your certified receipts or other proof-of-mailings.

For California, the general statute of limitations (the amount of time that the taxing authority can audit your return) is four years in comparison to the three years for the IRS. Thus if you file a California return, at minimum you should keep all supporting documents for four years. If you file a tax return for any other state, either as a resident of that state or a non-resident return, you should check with that state to determine that specific state's statute of limitations. If that state's statute of limitations is longer, then you should keep all supporting documents until that state's statute of limitation has expired.

While it's impossible to be completely sure that the IRS will not at some point seek to assess tax, retaining tax returns indefinitely and supporting documents for six years after the return is filed should, as a practical matter, should be adequate.

**Records relating to property:** From six years to permanently:

- Keep all records showing the purchase price (including closing escrow statements),
- the cost of any permanent improvements (such as room additions, roof replacements, appliance replacements, etc.), and
- the cost of any expenses incurred in selling or buying the property

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Keep in mind that the tax consequences of a transaction that occurs in one year may depend on things that happened in earlier years and that the period for which you should retain records must be measured from the year in which the tax consequences actually occur. This may be significant, for example, where you sell property that you bought years earlier. For example, suppose you bought your home in 1980 for \$100,000 and made an additional \$20,000 of capital improvements in 1987. To determine the tax consequences of the sale, it's necessary to know your basis (i.e., original cost plus later capital improvements). If you sold your home in 1998, and your return for that year was audited, you might have to produce records relating to the purchase in 1980 and the capital improvement in 1987 to be able to show what your basis is. Therefore, those records should be kept for at least six years after your 1998 return was filed (or the due date of the return, if later) instead of just six years after the transactions they relate to occurred. Note: Even though as much as \$250,000 of home sale gain can now escape tax (up to \$500,000 for joint return filers), you should still retain all records relating to home purchases and improvements. There's no telling how much the home will be worth when it's sold, and there's no guarantee that the home sale exclusion will still be available when the future sale takes place.

When new property takes the basis of old property, records relating to the old property should be kept until six years after the sale of the new property is reported. For example, suppose you purchased a car for business use in 1995 and you traded it in on a new car for business use in 1998. If you sell the new car in 1999, your basis in the new car will determine whether you have a tax gain or a tax loss on the sale, and your basis in the new car is determined, at least in part, by your basis in the car you traded in. Accordingly, records relating to your old car should be kept until 2006 (i.e., for six years after your 1999 return is filed).

Property acquired by inheritance - The basis of property acquired by inheritance is generally determined by the value of the property on the date of death of the person from whom you inherited it. Therefore, you should keep a copy of the Estate Tax Return (Form 706) and/or the appraisal done as of the date of death.

Property acquired by gift - The basis of property acquired by gift is generally the lesser of the basis (original cost) of the donor or the value at the date of gift. There are some situations where you might actually need both amounts, so you should retain a copy of the Gift Tax Return (if one was filed) or other supporting documents.

Because the calculation of the casualty and theft loss deduction is determined in part by your basis in the damaged or stolen property, you'll need to have records to support that basis, until six years after you file the return claiming the loss deduction.

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**Brokerage statements:** Six years after you file the return claiming the sale of the stock

You need to keep proof of the cost of the purchase of any stock in a business corporation or in a mutual fund, bonds (or other debt securities), etc. In particular, remember that if you reinvest dividends to purchase additional shares of stock, each reinvestment is a separate security purchase, and the records of each reinvestment should be kept along with the purchase records for a least six years after the return is filed for the year in which the security is sold. If you receive annual statements from your brokerage firm, you can just keep the annual statement and discard the monthly statements and individual notices after you have checked to make sure the year-end summary statement is accurate and includes all transactions for the year.

**IRA contributions:** Permanently

If you made an IRA contribution that was non-deductible on your individual tax return, you need to keep proof on the contribution to prove that you have already paid tax on this amount. For many early contributors, your state deductions might be different than your federal, so keep appropriate records.

**Bank records:** From one month to permanently

Any cancelled checks or credit card receipts which relate to taxable items (such as charitable contributions, business expenses, tax payments, etc.) should be kept with your tax supporting documents (see above section for tax return supporting documents). Any cancelled checks or receipts relating to household improvements should be kept to support the cost basis at the time of sale (see above section for records relating to property). You should also keep any receipts for valuable items with your home inventory records. These might be needed to prove the value for insurance purposes. Most other cancelled checks, ATM receipts and credit card receipts can be shredded once you have reconciled them to the monthly statements. You might want to hang on to merchandise receipts for a few months to make sure you don't decide to return the merchandise. You should also consider keeping merchandise receipts with your tax return supporting documents to support your new requirement to report and pay use tax to the state of California.

**Utility statements:** From one month to six years

Generally you can discard your utility statements once the bills are paid. If you are claiming a home office deduction or deducting any of the utilities on your tax return due to business use, you need to keep your utility statements with your tax supporting documents (see above).

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**In case of separation or divorce:**

If separation or divorce becomes a possibility, be sure you have a copy of any tax records affecting you, since in such situations, relations may become strained and access to the records difficult. Your records should include a copy of the divorce decree or agreement of separate maintenance, which may be needed to substantiate alimony payments and distinguish them from child support or a property settlement. Copies of all joint returns filed and supporting records are important, since the liability for tax on a joint return is joint and several and a deficiency may be asserted against either spouse. Your records should also include agreements or decrees over custody of children and any agreements as to who is entitled to claim an exemption for them. Retain records of the cost of all jointly-owned property. Also, get records as to the cost or other basis of all property your spouse or former spouse transferred to you during your marriage or as a result of the divorce, because your basis in that property is the same as your spouse's or former spouse's basis.

**Loss or destruction of records:**

To safeguard your records against loss from theft, fire or other disaster, you should consider keeping your most important records in a safe deposit box or other safe place outside your home. In addition, consider keeping copies of the most important records in a single, easily accessible location so that you can grab them if you have to leave your home in an emergency.

If, in spite of your precautions, records are lost or destroyed, it may be possible to reconstruct some of them. Most preparers retain copies of your return for a certain number of years and can furnish a copy if yours is not available. In the case of our own clients, we generally retain copies of returns, but not necessarily your supporting documents, for a period of 7 years. Similarly, other professionals who assisted you in a transaction may retain records relating to the transaction. For example, a stockbroker through whom you bought securities may be able to help you to determine the basis of the securities, and an attorney who represented you in the purchase of your home may retain records relating to the closing. Nonetheless, because you can never be sure whether those persons will actually have the records you need, the safest course of action is to keep them yourself, in as safe a place as possible.

If you have any specific situations or questions, please contact our offices at (562) 698-9891 or e-mail us at [info@acpa4u.com](mailto:info@acpa4u.com).