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m e m o r a n d u m

TO: All Clients

FROM: Steven L. Jager, CPA, MST, USTCP

DATE: January, 2019 – but timeless

SUBJECT: Maintenance of Adequate Records

What are good tax records?
For how long must these records be kept?

Should your tax returns ever be challenged, your primary protection against deficiency assessments and penalties (which are NOT tax deductible) are good underlying records, which will demonstrate that an accurate and complete tax return was filed.

The responsibility to maintain these records is yours. Most tax records must be kept for as long as their contents are material in administering federal and state tax laws… records that support an item of income or deduction appearing on a tax return must be kept until the statute of limitations for the return expires. The IRS usually requires three years from the date the tax return was due or filed, or two years from the date the tax was paid, whichever occurs first. In the special cases where the taxpayer has understated his gross income by more than 25%, the statute of limitations is extended to six years. The California requirements are similar, although State law provides for a four-year period rather than three years.

Adequate records could consist of paid receipts, canceled checks, sales slips, escrow statements, etc… In cases where original documents are not available, substitute records (including electronically preserved records), may be acceptable. One common example is the supporting evidence for business related travel and entertainment expenses. Because of the inherent difficulty in substantiating these expenditures, the government will usually accept a properly kept (i.e., contemporaneous) diary or travel log indicating destination, odometer readings and expenses incurred and paid.

Of SPECIAL note would be records to verify basis in real property owned – whether your personal residence or rental properties or any other real estate. These records should be kept indefinitely and take on special importance when real estate has been inherited. In those circumstances, documentation of the properties' fair market value at the date of death is critically important, and may be found on an Estate Tax Return if one was required to be filed, or by appraisal if no estate tax return was required.

ALSO of special note is the case of a net operating loss, even if that loss is carried forward over a period of years. Under such circumstances, it is fair for the IRS to require substantiation of the loss for a prior tax year, even if that year is no longer "open" under the statute of limitations.

With respect to copies of your records which may be part of the file that I maintain for you as a client, please do NOT rely upon my office to maintain those records for you indefinitely. I cannot accept the responsibility to be your "custodian of records." The law requires that I preserve the file for 7 years, but my general policy is to preserve them for 10 years, after which time they are destroyed.

For more information about keeping good records and record retention, please also read my Record Retention Guide on this website at: https://cre8ivcpa.com/resources/tax-retention-guide/.

If you have any questions or other issues impacting your tax returns, I encourage you to discuss them with me.