You Can Clear Out Those Files — Just Not Too Soon

Keeping Financial Records

by Alexandra Armstrong, CFP, and Kelly Wright, CFP

Clients often ask us: How long should we keep our financial records? Although some people are inclined to keep records forever, there comes a time when you need to reduce what you've accumulated over the years. Here are some guidelines for how to do this intelligently.

Tax Returns and Forms

Keep federal and local tax returns for an absolute minimum of three years after their filing date. This means the 2014 tax return filed in April 2015 should be kept until April 2018. If you file your taxes on extension, the 2014 tax return filed in October 2015 should be kept until October 2018.

Again, this is the minimum time to keep your tax records, since this is the general statute of limitations for being audited by the Internal Revenue Service. This is also the period during which you can file an amended return to claim a tax credit or deduction that you may have missed or to report income that was previously misstated or overlooked.

If the IRS suspects your income was understated by 25 percent or more, however, the statute of limitations for an audit extends to six years. If you have bad debts or securities that became worthless, the IRS suggests you save that information for seven years. Bottom line: To be safe, keep income tax returns for at least seven years after they were filed.

You should also keep the records you used to prepare your tax returns for at least seven years in case the IRS asks you to substantiate what you've reported. This includes receipts and canceled checks for deductions claimed, 1099 forms, proof of business income and expenses for a self-employed person, and statements for stocks and other securities you've sold.

W-2 Statements and Your Social Security Benefits

You should keep W-2 statements that report your compensation and check them against your Social Security earnings history. This is important, as the Social Security Administration no longer automatically sends out the annual reports projecting your benefits and identifying your earnings.

If the Social Security Administration has recorded your earnings incorrectly, and if you have your W-2 statements, you'll be able to get Social Security to correct its records as long as you do so within three years, three months and 15 days after the end of the calendar year in which the income is reported. This is important because your Social Security benefits will be based on what you've earned over the years.

The best approach is to review the earnings shown on the benefit estimate statements from the Social Security Administration each year and compare them with your W-2 earnings so that if there are problems you can fix them right away. In September 2014, the SSA resumed mailing printed statements, but only to workers aged 25, 30, 35, 40, 45, 50, 55 and 60 or older who had not by then created a **my Social Security** account to access the statement online. Unfortunately, this means if you're younger than 60, you get a statement mailed to you only every five years at best. If you ever created an online profile, you won't get a statement at all.

If you're under 60, to be able to compare your W-2 earnings against your Social Security earnings history before the three year and three month deadline to make corrections, you must create an account online at **www.socialsecurity.gov/myaccount** and compare your Social Security earnings history against your W-2 earnings or self-employment earnings. Again, checking annually solves this issue.

Hanging On for 7 Years — or Longer

Another tax form you should keep longer than seven years is Form 8606, which is filed if you ever made nondeductible contributions to an Individual Retirement Account. The IRS requires you to keep copies of forms 8606, 1099-R and 5498 until all the money is withdrawn from your IRA accounts.

Although we tell you that you have to keep your tax returns for only seven years, sometimes keeping tax returns longer might prove useful. For instance, if you own a stock and have reinvested the dividends into additional shares, you should keep all the annual statements showing these reinvestments.

Since the amounts you reinvested add to the cost basis of your investment for tax purposes, a higher cost means less taxable gain when you sell. If you can't locate all the statements showing the amounts of these reinvestments, you could check the old tax returns to see what amounts you reported as income from that investment. If you reinvested them, you can add these amounts to the cost. If that doesn't work, the custodian for the investment may be able to produce back dividend reinvestment records for you.

If you need a copy of an old tax return you've thrown out, the first place to start is with the accountant who prepared the return for you. But accountants often don't keep returns longer than seven years. If that doesn't work, you can request a copy of your actual tax return from the IRS, but you'll have to pay a $50 fee for each return you order and returns more than 3 years old probably won't be available. Go to the IRS website and look for the instructions for forms 4506 and 4506-T for more information. You can also visit the IRS website at **IRS.gov** and click on Order a Return or Account Transcript or call **800/908-9946**.

Other Financial Statements

How long should you keep other documents such as credit card statements, bills and insurance policies for your car and home?

Credit card statements that show expenses you deducted on a tax return should be kept at least seven years unless you have another way to prove you paid those expenses. Otherwise, as long as there are no disputes about the charges, there's no need to keep these statements beyond the current year.

You should keep bills and receipts for tax items however for at least seven years.

Receipts for the purchases of valuables should be kept as long as you own the item, since they might be needed for an insurance claim if the item is ever lost or damaged. You can throw out receipts for non-tax-related items you've charged as soon as you confirm the amounts shown on your credit card statement.

You can discard policies for auto and homeowner's insurance once the policy has expired. Note that you probably don't receive the actual policy document itself every year, just the new proof of coverage each time the policy is renewed. Make sure you save the policy itself as long as it's in effect and retain proof of your current coverage. Proof of coverage for prior policy periods can be discarded.

Finally, you should keep receipts of all home-improvement expenses. Home maintenance such as repainting doesn't count, but modernizing your kitchen or bathroom does. You not only need the credit card receipts, but you also should have a description of the work performed. If you redo your kitchen, you probably have architectural drawings and an itemized list of expenses.

All these records should be kept so that when you sell your home, you can add these to your tax cost and can substantiate these expenses. If you've filed gift tax returns, they should be kept forever.

Other Important Documents

Besides financial and tax records, we suggest keeping the following important documents:

- Legal documents such as your will, your trust (if you have one), health power of attorney, financial power of attorney and living will.
- Social Security card, Medicare card, birth certificate, marriage/divorce certificates and military discharge papers.
- Deeds to your home, cars and cemetery plot.
- Mortgage agreement and automobile leasing agreements.
- Your insurance policies such as auto, household, casualty, life and long-term-care insurance.
- Warranties for home appliances.
- A list of names and contact information for your key financial advisers (accountant, lawyer, financial planner, stockbroker, life insurance agent, casualty insurance agent).
- Copy of your passport and credit cards (front and back) in case of theft.

Make Sure Your Records Are Safe

If you keep paper copies of information, we suggest you put these records in a fireproof cabinet. We recommend having a file for each year's tax return with supporting documentation filed in chronological order. You should have a separate file for each insurance policy as well as credit card statements, home improvement documentation and receipts for valuables purchased.

Make sure you shred the documents when you dispose of them or take them somewhere where they can be shredded. This information is too important to fall into the wrong hands.

Today, many people keep electronic copies of documents. If you do so, it's important to have a data backup system and use it frequently to make sure a duplicate copy is kept electronically.

You wouldn't want to have all your data lost because of a failed hard drive in your computer.

Additionally, all sensitive computer information should be password-protected so that if your computer is stolen, all of your financial data isn't easily available.

It may take awhile to get all this organized, but it's worthwhile, especially if your tax return is audited, you have an insurance claim or sell your home. Taking some time now will save headaches later!

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