Buried Under Old Papers? Here's How to Dig Out

Financial Records: What to Toss

by Alexandra Armstrong, CFP

In the last few articles I've written about preparing for retirement. As part of that process, many people downsize, which involves sorting through old records and deciding what to keep and what to toss. We frequently get calls from clients asking us what they must keep. So here's what we tell them.

Tax Returns and Forms

We recommend you keep federal and local tax returns for at least three years after their filing date. This means the 2016 tax return filed in April 2017 should be kept until April 2020. If you file your taxes on extension, the 2014 tax return filed in October 2017 should be kept until October 2020.

This is the minimum time you should 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 gives you seven years to claim the loss. Bottom line: We recommend you 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 your original W-2 statements that report your compensation until you begin receiving Social Security benefits. This way you can check them against your Social Security earnings history. We know of one case in which the Social Security Administration didn't accept copies of the W-2 statements! If the SSA 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. This is important because your Social Security benefits will be based on what you've earned over the years.

Keeping Records 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 recommend keeping 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 dividends, 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. 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. Old returns are generally available for the current year and the past six years.

Go to the IRS website (www.irs.gov) and look for the instructions for forms 4506 and 4506-T for more information.

Other Financial Statements

Credit card statements that show expenses that 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 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.

You should keep the settlement documents from the purchase of your home. In addition 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 all 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.

For jewelry and other valuables such as paintings, you should keep copies of the original cost as well as any subsequent appraisals should you need to file an insurance claim.

If you've filed gift tax returns, they should be kept forever.

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. 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.

Although it may take a while to get all this organized, 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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Examples are hypothetical and for illustrative purposes only.

No specific investments were used in the examples. Actual results will vary.