Limit the tax records you save

Some documents used for your return can be shredded

By Sandra Block
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Tax day is over. Now it's time to find the top of your desk.

If you're like most people, your home office is littered with 1099s, W-2s, letters from charities and other detritus used to prepare a tax return. Most of us are terrified to dispose of these documents, and for good reason: In an IRS audit, "The dog ate my credit card receipt" is not an excuse.

It's not necessary to hang on to everything. In fact, keeping too many documents could make it difficult to find what you really need. Here's a look at what you should save and what you can shred:

■ Tax returns. Save your tax returns and supporting documents for at least three years. That's how long the IRS has to audit you. There are, however, exceptions. The IRS has up to six years to audit you if you underreport your income by 25 percent or more. There is no statute of limitations on audits of fraudulent returns.

There's also no statute of limitations on audits of taxpayers who don't file a return, says Barbara Weltman, author of J.K. Lasser's 1001 Deductions and Tax Breaks. She recommends keeping a record that you filed your return indefinitely. That goes for your state return, too.

Taxpayers who e-file should print a copy of the e-mail acknowledging receipt of their return and keep it with their records, Weltman says. Those who file paper returns should send them to the IRS via certified mail and keep a copy of the receipt, she says. (This will also provide proof that you mailed your return before the deadline.)

Keep W-2s, 1099s, acknowledgments from charities and other supporting documents for as long as you keep your tax returns, says Don Rosenberg, an enrolled agent based in Yorktown Heights, N.Y.

If you discuss deductions and other tax strategies with your tax preparer, keep notes of those conversations with your returns, too, Rosenberg adds. They could be helpful in an audit.

Some experts recommend you keep copies of tax returns forever, because they provide a record of your financial history. You may need previous returns to apply for a mortgage or student loan.

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■ Real estate records. Hold on to your closing statements, purchase and sales invoices, proof of payment and insurance records for at least four years after you sell the property, says Steven Hoffman, a former IRS revenue agent who now works as a tax consultant.

You should also keep records of any major improvements made to your home, such as an addition or a new roof, Weltman says. When you sell, you can add the cost of these improvements to the amount you paid for your home, which will reduce taxes on capital gains.

Most homeowners don't have to worry about paying taxes on the sale of their homes. For singles, up to $250,000 in profit on the sale of a primary home is excluded from taxes; married couples can pocket up to $500,000 tax-free.

Still, homeowners who have owned their homes for a long time could exceed those thresholds. And there's no guarantee the tax break will last forever, Rosenberg says. "Right now capital gains (on primary residences) are excluded for up to $500,000, but there was a time when that wasn't the case."

■ Investments. As is the case with real estate, you should hold on to documents that show the purchase price of your stocks and mutual funds until three years after you sell. You should also keep records of dividends, reinvested dividends, loads and stock splits.

These documents will show the IRS how much you paid for your investments, known as the basis. Without proof of the basis, you could be liable for taxes on the entire proceeds of a sale, even if you sell at a loss. If you claim a loss for worthless securities, hold on to the supporting documents for at least seven years after you file your return.

Financial institutions will be required to track the basis for stocks held by their customers starting this year, mutual funds in 2012, and bonds in 2013. They'll also report this info to the IRS.

However, the law doesn't require financial institutions to provide the basis for securities purchased before the effective dates, Weltman says. So you should keep records of securities bought before Jan. 1 (or in the case of mutual funds and bonds, before 2012 and 2013, respectively).

■ Bank and credit card statements. Keep credit card receipts and canceled checks that support your tax deductions on your tax return for as long as you keep the return. Statements that aren't related to your tax returns should be saved for a year then discarded, the Federal Deposit Insurance Corp. says. Canceled checks that aren't related to your taxes can be shredded after you've reconciled them with your bank statement.

Many banks don't send canceled checks to customers. But you can order copies of tax-related checks as soon as you get your bank statement, or keep the statement and order tax-related checks in the event of an audit. In general, banks that don't provide canceled checks must keep copies for seven years, the FDIC says. You may have to pay a fee for copies more than a year old.

The IRS allows electronic storage systems as long as they provide an accurate and accessible record of the data.

For more info about IRS record-keeping rules, see Publication 552, available at www.irs.gov.