

When is the Right Time to Part Ways with Your Tax Files?

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As each tax year ends, the question of when it is acceptable to dispose of old tax files becomes commonplace. Much like the multifaceted nature of tax-related queries, the answer to this particular question is contingent on various factors.

Below, we delve into the Federal rules governing the retention of tax records, recognizing that state regulations may diverge. The Internal Revenue Code provisions establish a general framework allowing the Internal Revenue Service (IRS) three years from the filing date of an individual's tax return to scrutinize any reported items. However, exceptions exist. For instance, if a return omits more than 25% of income, the IRS can extend its examination period to six years. In cases of fraudulent filings, the IRS holds no statute of limitations enabling them to investigate without temporal constraints.

The information that follows not only outlines these guidelines but also provides insights into specific situations, such as real estate transactions, investments in marketable securities, gifts, and inherited property, as well as recommendations for the retention of business records.

Real Estate Transactions:

- a. Generally, all records supporting the basis in a property being sold should be

retained for three years after the property is sold. The settlement sheet for the purchase of the property, together with the support for improvements made to the property, should be retained. In addition, the settlement sheet for the sale of the property should be retained to support the gain, if any, on the property being sold.

Investments in Marketable Securities:

b. One should retain supporting records for three years after you sell the securities. You will need to report the purchase date and cost basis on your tax return, together with the proceeds and date of sale. Records showing any stock splits, dividend reinvestments, and nontaxable distributions should also be maintained for three years.

Gifts and Inherited Property:

c. If you receive property as a gift, your basis in the property is the same as the donor's basis. You will need to obtain such information from the donor. If you inherit property, you will receive a step-up in value at the date of death and your basis in the property becomes the fair market value. Therefore, you will need to obtain the date of death value from the executor or an appraisal. Records showing the property basis of these items should be retained for three years after you sell the asset.

Business Records:

d. Generally, business records should be maintained for a period longer than three years. As a rule of thumb, we would suggest that most records be maintained for seven years from the filing date of the company's income tax return. However, certain records such as copies of the company's tax returns and documents relating to the determination of income tax liability, general ledgers, financial statements, depreciation schedules, and others should be retained permanently.

The decision of when to dispose of old tax files is a nuanced one, influenced by a variety of factors and regulatory intricacies. The IRS establishes a baseline, granting

a three-year window from the filing date for auditing reported items, with exceptions for cases of significant income omission or fraudulent filings. Scenarios like real estate transactions, investments in marketable securities, gifts, inherited property, and business records, shed light on the need for extended record-keeping in certain circumstances. Navigating the labyrinth of tax compliance requires a keen understanding of these nuances, empowering individuals to make informed decisions about the retention and disposal of their financial records.

For more information or to discuss your specific scenario, contact your Anchin Relationship Partner, or [Josephine Lau](#) and [Marc Federbush](#), members of Anchin's Consumer Products Group.