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Getting Your Financial Records in Order

By Lori Sullivan, CPA



Answering IRS inquiries and providing back-up documentation can be frustrating and time-consuming. The best way to avoid these annoyances is to set up and maintain organized financial records. A good recordkeeping system can help you expose possible deductions, avoid interest charges, penalties, and additional taxes, and reveal financial and tax planning opportunities to your CPA. It also provides necessary

financial information to loved ones should you become incapacitated or die suddenly.

A safe-deposit box is essential for all “permanent” documents, such as birth and marriage certificates, wills, trust agreements, power of attorney, passports, adoption and divorce papers, and an inventory listing of personal belongings (including photos). Your box should also contain proof of ownership for major possessions like your house deed, titles for vehicles, and stock or bond certificates.

The filing system itself can be physical or electronic, but if using the electronic version, it is **crucial** that you keep a backup file in case your computer is damaged or destroyed. Files should be categorized as Current or Ongoing and then broken down into at least six main categories: taxes, banking, investments, retirement plans, insurance policies, and home.

Taxes

There is no time frame after which the IRS cannot investigate your taxes, if it believes you have committed fraud or failed to file a return; however, we recommend tax returns be kept for six years. On the rare chance you need copies of prior returns, the IRS can supply them, although you will be charged a fee for this service.

Banking

A checking account is another essential ingredient of a good filing system, since it records a large amount of your income and expenses. Your Banking file should have subcategories for each account. Current year statements should be kept for a year and then discarded after verifying interest earned against year-end 1099 forms.

Cancelled checks can also be discarded after a year, unless they support tax deductions, a home purchase, capital improvements to your home, investment purchases, or nondeductible IRA contributions.

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Investments

Similar to Banking, you should have a file for each investment account, containing its monthly statements. Investment sales can trigger the capital gains tax, so you must have records to substantiate the amount of the gain. Save all the paperwork on the purchase of the investment, its sale, and any activity that occurs in between. These records should be held for at least three years after they are sold.



Retirement Plans

You are probably covered by at least one plan and maybe several. Each retirement plan file should house enrollment papers, statements, a list of beneficiary designations, and contact information. If you have an IRA and are making nondeductible contributions (contributions on which a deduction cannot be taken on the tax return), the IRS requires you include Form 8606 with your return. A copy of this form should also be kept in your IRA file. Keeping these records eliminates the chance of paying tax on income that's already been taxed.

Insurance Plans

This file should contain your policy number, the issuing company's name, and your agent's name. Be sure the file includes everyone covered by the policy and any beneficiaries.

Home

The last area to discuss, and one that can accumulate a lot of paperwork, is your home. Your records should include files on the purchase of your home (containing sales agreements, closing documents, mortgage papers, and copies of appraisals) and home improvements. The IRS has determined that a home improvement which increases the home's value is a capital improvement and will raise your home's cost basis. Increasing your home basis decreases the amount of any applicable gain when the home is sold.

WD&W would be more than happy to answer any specific filing questions you may have and/or help you set up a filing system for your home or business. Having organized records will give you a full picture of your financial identity and ensure you are in a position to handle any tax or financial disputes. ♦