



Walthall, Drake & Wallace LLP

CERTIFIED PUBLIC ACCOUNTANTS

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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.

DISCLOSURE UNDER UNITED STATES TREASURY RULES - If this communication contains any tax advice, such advice is not intended or written by the practitioner to be used, and cannot be used by the taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer.

### 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. ♦



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## Client Line

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### Who's News

WD&W is pleased to welcome **Christine Bade** as its new Director of Marketing. Cris comes to WD&W with more than 25 years' experience in sales, marketing, and customer service.

Also of note: **Cindy Kula** served on the OSCP Scholarship Committee at both the state and local levels; **Ken Stefanski** was appointed to be a member of the City of Independence Charter Review Commission, and **Tony Jelenic** was appointed to the Advisory Board of the Trout Club of The Cleveland Museum of Natural History.

Did you know WD&W presents seminars and workshops? **Cindy Kula** and **John Kromar**, members of the WDW Financial Planning Group, presented "360 Degrees of Financial Success" to the Chagrin Valley Chamber of Commerce, and **Paul Weisinger, Donna Jenkins, Lauren Van Camp, Brian Daniels** and **Brian Ditz** presented "Backpack to Briefcase" at Notre Dame College. Backpack to Briefcase is a workshop on transitioning from college into the workforce.

On a fun note, **Tom Scharf** won Hermit Idol III! He performed the Big Bopper's "Chantilly Lace," accompanied by the band, "Three Cheeses." ♦

Visit [www.walthall.com/news](http://www.walthall.com/news) to see our upcoming events. All are welcome to attend.

### Tips on Avoiding an IRS Audit

By *Andrea Plassard, CPA*



In your mail is a notice from the IRS inquiring about your tax return or selecting your return for examination. Understandably one of your first questions is, "Why me? Why did my return get selected for an audit?"

Some returns selected for an IRS audit are done so based on the findings of an IRS computer-generated program that gives returns a numeric "score." This is referred to as the Discriminant Function System (DIF) score. This program compares your deductions to others in your income bracket and weighs the differences. The results are used to select returns with the highest probability for change. The DIF formula also considers where you live, your family size, and your profession.

The relationship between the amount of deductions claimed, such as mortgage interest or charitable contributions, should be reasonable based on your income. As with all amounts on a tax return, you must be able to prove your deduction.

The Unreported Income DIF (UIDIF) score rates returns for the potential of unreported income. The highest scoring returns are screened by IRS agents and could be selected for an audit. It is then when a professional tax preparer can benefit his/her client in identifying unusual situations.

Other reasons you are more likely to be audited have to do with errors found through the information matching program. Returns can be selected for examination if the amounts reported from a W-2 or from a 1099 form do not match the income reported on the forms provided to the IRS from employers, banks, or brokerage firms. Unless the omissions of income are large or the IRS has reason to believe they are intentional, those examinations are generally handled through inquiries and by mail.

Returns may be selected for an IRS examination when they involve transactions with other taxpayers. For example, when the IRS audits an S Corporation or a Partnership return, the likelihood of also examining the individual tax returns of its shareholders or partners increases.

Verifying the accuracy of the social security numbers for yourself, your spouse, and your dependents is an important step in avoiding issues with the IRS. In addition, verifying the accuracy of the math and the reported income amounts are easy ways to avoid a second look by the IRS. E-filing can assist in identifying errors in social security numbers.

Depending on the inquiry, an examination can be conducted by mail correspondence or through an in-person interview process. The interview can be held at an IRS office or the taxpayer's home, place of business, or accountant's office. The IRS notification will inform you of what records are needed. While taxpayers have the right to represent themselves, we recommend them authorizing their tax preparer to act on their behalf.

When asked for additional records, be organized and prepare the records requested. Know and follow record retention guidelines recommended by the IRS.

Be able to substantiate each amount on your tax return, particularly each deduction on your return. Unless the IRS finds fraud or significant underreporting, the audit must be complete within three years of the time the tax return is filed.

As you can see, organized records along with an accurate tax return will keep your return away from IRS scrutiny. If you have any questions, please contact us. ♦



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