WHAT TO DO WITH YOUR INCOME TAX RECORDS

Are you ready for a major housecleaning but not sure how long you need to keep old income tax records? Before throwing away important income tax records, consider the following general guidelines.

The general rule under federal income tax regulations requires you to keep your records as long as the contents may be material to the administration of the tax law.

The retention periods apply to records needed to substantiate your federal income tax return and are generally based on the federal statute of limitations, which is normally three years. This means the IRS could audit your return up to three years from the due date of the tax return or the date of filing, whichever is later. However, if you substantially underreport income, fail to file a return or file a fraudulent return, the statute of limitations could be much longer.

In addition, the statute of limitations in some states exceeds the federal statute, or the states have laws or regulations that require taxpayers to maintain records beyond the state’s statute of limitations, often to verify carryovers, etc.

Tailor your years of retention to the longer of the federal or state requirements. In deciding your own record retention schedule, consider indefinitely keeping those records that cannot be recreated by any other office, institution or governmental unit. Also, keep in mind your own financial concerns that may affect the length of time you keep your records. Most importantly, consult with your attorney for approval of any record retention policy.

STATUTE OF LIMITATIONS FOR INCOME TAX ASSESSMENTS & MINIMUM RECORD RETENTION PERIODS FOR STATES WHERE BKD HAS OFFICES

<table>
<thead>
<tr>
<th>STATE</th>
<th>STATUTE</th>
<th>MINIMUM RECORD RETENTION PERIOD</th>
</tr>
</thead>
<tbody>
<tr>
<td>ARKANSAS</td>
<td>3 years</td>
<td>Arkansas requires records to be kept for six years.</td>
</tr>
<tr>
<td>COLORADO</td>
<td>4 years</td>
<td>Colorado requires records to be kept for four years.</td>
</tr>
<tr>
<td>ILLINOIS</td>
<td>3 years</td>
<td>Illinois does not specify minimum record retention periods.</td>
</tr>
<tr>
<td>IOWA</td>
<td>3 years</td>
<td>Iowa requires records to be kept for three years.</td>
</tr>
<tr>
<td>INDIANA</td>
<td>3 years</td>
<td>Indiana requires records to be kept for three years.</td>
</tr>
<tr>
<td>KANSAS</td>
<td>3 years</td>
<td>Kansas does not specify minimum record retention periods.</td>
</tr>
<tr>
<td>KENTUCKY</td>
<td>4 years</td>
<td>Kentucky requires records on tax payments to be maintained for seven years and all other income tax records for five years.</td>
</tr>
<tr>
<td>MISSISSIPPI</td>
<td>3 years</td>
<td>Mississippi requires records for withholding to be kept for three years and does not specify a minimum for other types of tax records.</td>
</tr>
<tr>
<td>MISSOURI</td>
<td>3 years</td>
<td>Missouri requires records to be kept for four years.</td>
</tr>
<tr>
<td>NEBRASKA</td>
<td>3 years</td>
<td>Nebraska does not specify minimum record retention periods.</td>
</tr>
<tr>
<td>OHIO</td>
<td>4 years</td>
<td>Ohio requires records to be kept for four years.</td>
</tr>
<tr>
<td>OKLAHOMA</td>
<td>3 years</td>
<td>Oklahoma does not specify minimum record retention periods.</td>
</tr>
<tr>
<td>PENNSYLVANIA</td>
<td>4 years</td>
<td>Pennsylvania requires records to be kept for four years.</td>
</tr>
<tr>
<td>TENNESSEE</td>
<td>3 years</td>
<td>Tennessee requires records be kept for three years.</td>
</tr>
<tr>
<td>TEXAS</td>
<td>4 years</td>
<td>Texas requires records to be kept for four years.</td>
</tr>
</tbody>
</table>

1 Statutes may increase due to substantial understatements of income, failure to file a return or fraud.
2 Unless otherwise noted, the statute of limitations and record retention period apply to business and individual income tax returns.
3 Ohio statute of limitations and record retention period applies to the commercial activity tax (CAT) and individual income tax.
4 Tennessee statute of limitations refers to corporations; individual income tax statute of limitations is five years.
5 Texas statute of limitations and record retention period applies to the franchise and gross margins tax.
SPECIAL RULES FOR COMPUTER RECORDS

The definition of books and records goes beyond the typical hard copy items when you maintain all or part of your accounting records on a computer. In general, record retention periods are the same for “machine-sensible” records as they are for their hard-copy counterparts.

A machine-sensible record is data in an electronic format intended for computer use. Machine-sensible records do not include paper records or paper records that have been converted to an electronic storage medium, such as microfilm, microfiche, optical disk or laser disk. Retrievability is important where machine-sensible records are concerned. Not only must certain records be maintained, but the IRS must have access to those records. This becomes especially burdensome when computer systems are upgraded or converted.

If you or your business have more than $10 million in assets and you maintain all or a portion of your accounting records on a computer, the IRS requires that your machine-sensible records be in a retrievable format that provides the information necessary to determine the correct income tax liability. This requirement applies even if your accounting system is maintained by a third-party service provider. To comply with this requirement, you must retain the following specific documentation for all data files:

- Record formats (including the meaning of all the codes used to represent information)
- System and program flowcharts
- Label descriptions
- Source program listings of programs that created the files retained
- Detailed charts of accounts
- Evidence that periodic tests are performed on the retained records to ensure they can produce the data stored in the records
- Evidence that retained records reconcile to the taxpayer’s books and the tax return

If you or your business have less than $10 million in assets and you maintain all or a portion of your accounting records on a computer, the IRS requires you to conform to the above standards if (1) all or a portion of your books and records only are available in machine-sensible format, (2) machine-sensible records were used for complex computations (such as LIFO) or (3) you are notified by the IRS.

GUIDELINES FOR PAPER RECORDS

Three Years (From Date of Filing Return or Due Date of Return, Whichever Is Later)

- Bank deposit slips
- Cancelled checks
- Daily sales records
- Entertainment records
- Expense reports
- Paid vendor invoices
- Written acknowledgment from charity for contributions of $250 or more

Six Years

- Auto mileage logs
- Bank statements
- Contracts (after expiration)

Records to Retain Permanently

- Annual financial statements
- Corporate stock records
- Partnership/LLC agreement and amendments
- Operating agreement and amendments
- General ledger and journals
- Real estate records
- Tax returns
- Copy C of Form W-2 (until you begin receiving Social Security benefits)
- LIFO inventory records

Other

- Depreciation schedules (three years after disposal of asset)
- Meeting minutes (life of company)
- IRA contribution and distribution records (three years after final distribution)

6 Members of a controlled group of corporations are combined for this purpose.

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