Computer Records Retention Requirements

Most businesses today keep at least a portion of their books and records on a computer system. The Internal Revenue Service has recognized this and has issued some rules and guidelines relating to the retention of such records (Revenue Procedure 98-25). This Revenue Procedure generally applies to all taxpayers with assets of $10 million or more at the end of their taxable year. A group of controlled corporations is aggregated as one corporation for purposes of the $10 million test. Additionally, the Revenue Procedure applies to all matters under the jurisdiction of the IRS including income, excise, employment, and estate and gift taxes, as well as employee plans and exempt organizations. Use of a third party to provide computer services does not relieve a taxpayer of its obligations and responsibilities.

Applicability to Dealerships

In general, most dealerships will find that they are subject to these computer records retention requirements. Due to the amount of vehicles a dealership must carry, most dealerships will satisfy the $10 million asset test. Additionally, most if not all dealerships use a computer system to create transactions and maintain their books and records.

What Needs to be Done?

Revenue Procedure 98-25 requires dealers to maintain an electronic version of all general ledger activity for as long as these records would be material to the verification of their returns. A safe period of time to keep these records would be seven years. Dealers also are required to maintain all of the supporting documents, including all invoices for each year. Still other records must be retained for a longer period of time. Records relating to fixed assets would be an example of records that may need to be retained for a longer period as fixed assets are depreciated over a period of years. Dealerships that use the LIFO method to value inventories would be required to retain inventory records as long as they would have an effect on subsequent years LIFO computation.

Under the revenue procedure, key issues relating to computer records that need to be addressed are:

Documentation: The dealer must maintain and make available to the IRS upon request documentation of the business processes that create, modify, maintain and retain its records. In addition, support and verification of entries made on the taxpayers return to determine the tax liability is required. Documentation to support the authenticity and integrity of the taxpayer’s records is also required.
Resources: The dealer must provide the IRS at the time of examination with the resources (hardware, software, terminal access, etc.) that the IRS determines is necessary to process the books and records.

Notification: The dealer must notify the IRS if any of the applicable computer records are lost, stolen, destroyed or damaged so that they are no longer capable of being processed. The dealer must also notify the IRS if the records that have been retained are later found to be incomplete or inaccurate. The notice must provide a description of the records in question and a description including the timetable of a plan the dealer proposes to replace or restore the affected records. The plan must demonstrate that all requirements of the revenue procedure will continue to be met with respect to the affected records.

Maintenance: The dealer is urged to develop an overall record maintenance plan that will label and identify records, provide secure storage, create back-up copies, store records at an offsite location, and provide testing of records to confirm integrity. A good overall maintenance program could reduce penalties later assessed if data is lost.

The revenue procedure also includes a provision allowing the dealer a safe harbor by allowing agreements between the dealer and the IRS as to what records will be retained and the procedures used to maintain the records. The revenue procedure also allows the IRS the ability to test and evaluate your records as needed from time to time.

Hardcopy Records

The retention of computer records does not relieve the dealer from the requirement to retain hardcopies of documents generated or received in the ordinary course of business. Such hardcopy records are used to provide documentation of the retained computer records. Hardcopy documents do not need to be retained if the information contained on the hardcopies is also available in the computer records or if they are retained on in an electronic storage system as defined below.

Electronic Storage Systems

Revenue Procedure 97-22 provides guidance to dealers that retain images of their hardcopy printouts and documents. Most dealers use these systems to reduce the amount of paper documents that are produced or printed or received and required to be retained for a period of years. The use of these systems range from storing
specific documents to a total paperless environment. An electronic storage system that meets the requirements of Revenue Procedure 97-22 allows the dealer to destroy hardcopy documents that are included in the electronic storage system.

**Overview of Revenue Procedure 97-22**

The revenue procedure does not have a $10 million asset test as it generally applies to the retention of hardcopy documents that all dealers are subject. Additionally, the Revenue Procedure applies to all matters under the jurisdiction of the IRS including income, excise, employment, and estate and gift taxes, as well as employee plans and exempt organizations. Use of a third party to provide electric storage services does not relieve a taxpayer of its obligations and responsibilities.

The Revenue Procedure requires the electronic storage system to:

**Integrity:** The system should have reasonable controls to ensure the integrity, accuracy, and reliability of the system. Additionally it should have controls to prevent the unauthorized creation of, addition to, alteration of, deletion of, or deterioration of electronically stored books and records.

**Maintenance:** An overall maintenance system should be employed including regular evaluation of the system and tests of the documents stored on the system.

**Indexing:** The system should include retrieval systems that employ indexing to enhance the retrieval of documents. The indexing system requirement will be satisfied if it is functionally comparable to a reasonable hardcopy filing system.

**Document Reproduction:** The system should have the ability to reproduce legible and readable copies of the stored documents.

**Documentation:** The dealer must maintain and make available to the IRS upon request documentation of the business processes that create, modify, maintain and retain its electronic storage and indexing system. Documentation to support the authenticity and integrity of the electronic storage and indexing system is also required.

**Resources:** The dealer must provide the IRS at the time of examination with the resources (hardware, software, terminal access, etc.) that the IRS determines is necessary to use the system to locate, view and reprint related documents.
Many DMS providers have developed a solution that allows the dealer to store the data in a format that can be read or retrieved with or without the use of their system. In other words, the data can be stored to a CD and read from a personal computer. Additionally, the DMS provider can work with the IRS to ensure that its solution complies with the applicable Revenue Procedure and provide you with all documentation required.

Third party electronic document storage solutions can also work with the IRS to ensure that its solution complies with the applicable Revenue Procedure and can provide you with all documentation required.

However, the dealership is ultimately responsible for its systems and the data or documents that it has retained. It is advisable to spend enough time and ensure that you understand your systems and that you are in compliance with all applicable requirements.

The preceding is presented for information purposes only and should not be considered legal or tax advice. If you have questions or need assistance with any topic included in this article you can contact the author, Lou Galbraith, AutoDealerCFO at loug@autodealercfo.com. You can also find information on other topics at AutoDealerCFO.Com.