



Expert View

## Do You Barter? The IRS Wants Its Cut

Robert W. Wood, 11.11.09, 11:00 AM ET

If Rodney Dangerfield were alive, he might complain that even bartering is in a recession. Yet the Internal Revenue Service thinks otherwise and seems to be paying more attention to taxing barter activity.

At least that's the impression from an e-mail that appeared in my inbox recently. "Do you barter?" queried the headline. Somehow, I knew this e-mail was not about Bart Simpson. In fact, it sounded almost accusatory. No, I actually don't barter (honest), though I think lots of people out there do.

The e-mail was one of a [series of regular releases](#) the IRS sends to tax lawyers, accountants and even regular citizens who care to sign up. It's a great way to keep up with all the rules and regulations the IRS churns out and to keep an eye on what the agency is worrying about. You do, however, sometimes get news items you'd rather ignore. I'll bet that is the reaction a lot of recipients have to the IRS's recent missive on bartering.

The IRS's view of barter.

The IRS starts with a down-home definition. Bartering is trading one product or service for another, whether informally and one-on-one or with multiple parties in a commercial setting. It has a storied, even ancient tradition. "Our ancestors may have exchanged eggs for corn," explains the IRS, but "today you can barter computer services for auto repair." The IRS also lists plumbing services for dental work. You name the swap, the IRS wants to tax it.

Wherever it arises, it is income to both sides, just like cash, according to the IRS. That means each side must report the fair market value of the item or services received on their tax returns. It isn't clear how much bartering goes on, or how much self-reporting there is. My guess is there is quite a lot of the former and not much of the latter.

But that could change. The IRS has set up a [Bartering Tax Center](#) and it's worth a look. There's even a [video interview](#) you can watch of an IRS official who explains what to do, what forms to file and more.

Of course, most casual barter exchanges probably aren't on anyone's tax radar, for two reasons. First, most parties in this situation probably don't think about the tax consequences. Second, even if they do, they probably think they're unlikely to get caught. That may be true today, but how long it will remain true isn't clear.

Barter income can be messy.

Suppose you receive \$1,000 of dental work in exchange for your gardening services. Technically, you have \$1,000 of income, and you can't claim the value of your gardening services as you could a medical expense deduction. (For more on medical deductions [click here](#).)

That can make the situation messy, expensive and complicated. Quite apart from service swaps, even simple trades of goods trigger multiple tax rules. Suppose you swap your prized wristwatch for a painting you love. You consider it an even swap and not a tax event. Sorry, you may still have income. Your trade is likely to be viewed as two separate transactions, producing gain or loss depending on your basis in the watch.

Say you originally received the wristwatch as part of an inheritance from your great uncle. When he died, the watch was worth \$5,000. If it has doubled in value to \$10,000 and the painting you are to receive in exchange is similarly worth \$10,000, you will have \$5,000 of income. It might be long term capital gain (taxed at a top rate of 15%), but that depends on the facts and how long you owned the watch.

If you received it within the past year, your gain is short term and taxed up to the top 35% rate. In the IRS's view, you sold the watch so you should pay tax. Then, you bought the painting for \$10,000 and, should you later sell it for \$11,000, you'll

have a taxable gain of only \$1,000. Some swaps (of like-kind business and investment property) are tax-free (so-called 1031 exchanges), but that probably won't help here.

How will the IRS know about your swap? They probably won't unless you receive a Form 1099. According to [IRS Tax Tip 2008-25](#), you should ask the other party for one. If they don't produce it, you should call the IRS. I doubt that many people follow this advice. In any case, the IRS says you must report any income on your return regardless of whether you receive a Form 1099.

Technology raises the stakes.

One culprit in the IRS's view is the Internet, the new medium for the barter exchange industry. The IRS describes the typical Internet barter exchange: an agreement or process in place to value goods and services exchanged, which is facilitated by the barter exchange for a fee. Such a barter exchange functions primarily as the organizer of a marketplace where members buy and sell products and services among themselves. As bartering via the Internet grows, so too will the IRS's determination to get a piece of it.

Form 1099 is the key.

There's always been some level of barter activity, and there probably always will be. Estimates vary, but it clearly causes some erosion in tax collections. In this age of powerful computers and a shrinking IRS auditor force, document matching and Form 1099 seem to be the IRS's answer to most problems.

A barter exchange that hosts more than 100 transactions a year is required to send out 1099-Bs (Proceeds From Broker and Barter Exchange Transactions) to those involved in the trades. A 1982 law even requires a barter exchange to initiate "back-up" withholding if a participant doesn't submit a valid Social Security number or other tax identification number. Since such withholding is impossible when it comes to bartering, these exchanges are theoretically subject to penalties. (They can apply to get them waived.)

That raises the pressure on barter exchanges to get accurate information from you. Remember, the IRS matches all those 1099s with your tax return. So if you get a Form 1099-B from bartering, don't ignore it. (For more on the importance of 1099s, [click here](#).)

The IRS seems right to focus on the intermediaries that are facilitating the expansion of barter activity from the junkyard to the information superhighway. That seems likely to continue.

Holiday question: Did Bob Crachit have income?

If the barter exchange occurs in the employment context, it's not only income tax you have to worry about, there's also employment tax. If you're the employer, that can mean a penalty liability for failure to withhold.

There is what's known as a "de minimis" exception for small holiday gifts you give your employees. So yes, the [IRS says](#), you can hand out turkeys and holiday food baskets to the underpaid, overworked Bob Crachits on your staff--provided the gifts don't exceed \$100 in value.

But say that a worker puts in extra, unpaid overtime and you reward him with tickets to the Super Bowl? That's income to him as far as the IRS is concerned.

Just how do you withhold on Super Bowl tickets? Hold back one quarter of the game? In fact, what you're supposed to do is increase the withholding on the wages you pay in cash to take into account the value of the tickets, and then report that value as income to him.

Of course, that works only if you pay your employee with a combination of cash and goods. If a buddy who isn't a regular employee helps you out at your business occasionally (say he helps you deal with viruses on your computers) and you thank him with those Super Bowl tickets, then the IRS will likely view what you've given him as taxable pay, not a tax-free gift.

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See Also:

[Three Tax Mistakes You Make Every Day](#)

[Ten Ways To Audit Proof Your Tax Return](#)