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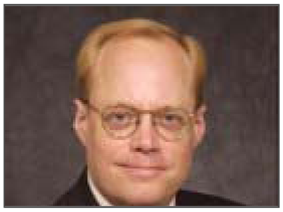

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It's Not Taxable, We Just Swapped!

Some people think they can escape taxes by arguing they received a gift. Another classic in the panoply of "I'm not taxable" claims? The "nontaxable" trade. Hey, how can I be taxed if I just traded my laptop for an electric guitar?

Easy, the IRS says so. Income is usually created on both sides of the deal. 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.

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. There's even a video interview of an IRS official explaining what to do and what forms to file. Of course, most casual barter exchanges probably aren't on anyone's tax radar.

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. Even simple trades of goods trigger taxes. If you swap your prized wristwatch for a painting, you may consider it an even swap and not a taxable event. Still, your trade can be viewed as two separate transactions, producing gain or loss depending on your basis in your watch.

Say you originally received the watch by inheritance from your uncle. When he died, the watch was worth $5,000. If it has doubled in value to $10,000 and the painting you are receiving in exchange is also worth $10,000. That means you have $5,000 of income on the swap. It may be long term capital gain, but that depends on the facts and how long you owned the watch.

If you received the watch 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 (taxable), and then bought the painting for $10,000. If you later sell the painting for $11,000 you'll have a gain of $1,000.

Beware 1031. Don't be confused about non-taxable swaps. True, some swaps (of like-kind business and investment property) are tax-free (so-called 1031 exchanges). But that provision probably won't help here. For information about 1031 exchanges, see Ten Things To Know About 1031 Exchanges.

For more, see:

Do You Barter? The IRS Wants Its Cut

Don't Foul Up Your 1031 Exchange

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