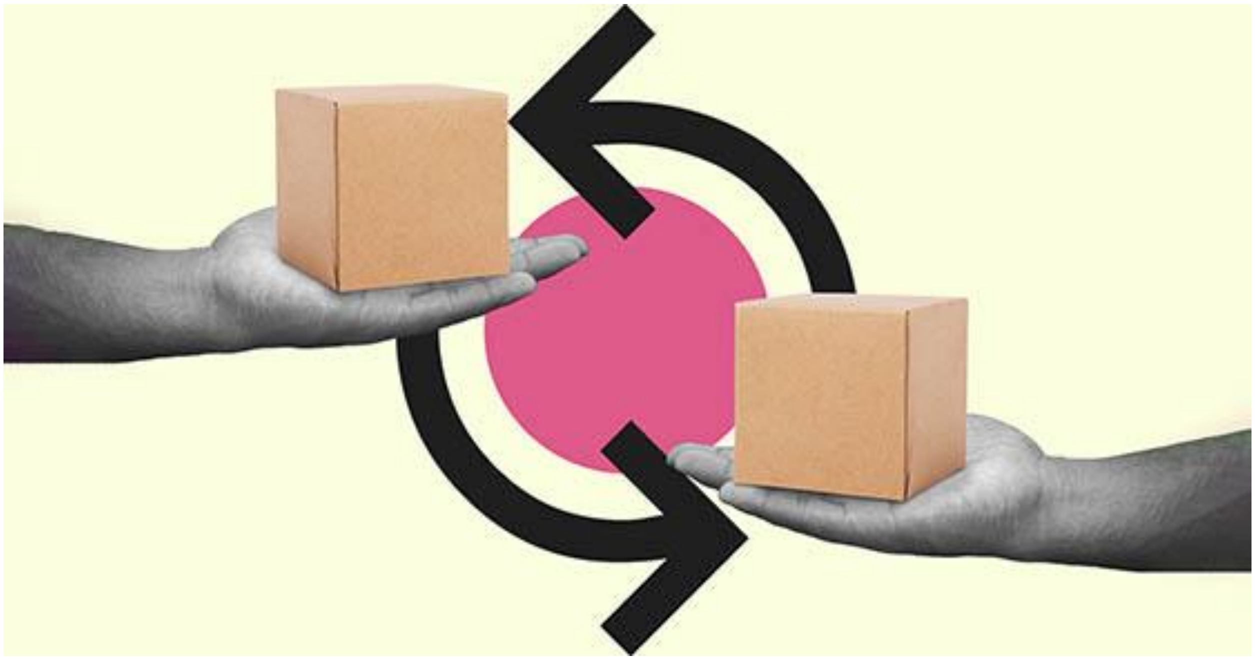

Let’s trade! Business bartering is still taxable

Trading items or services — without exchanging cash — has long been common among small businesses. Today, some use online barter exchanges to facilitate trades. In addition to preserving cash flow, these types of transactions may expand your purchasing power, help you move overstocked inventory and increase your business’s exposure to new markets. But bartering isn’t tax free. For tax purposes, bartering is treated the same as being paid in cash.

How it works

The fair market value (FMV) of goods you receive in business barter transactions must be reported as taxable income. And if you exchange services with another business, the transaction results in taxable income for both parties. You must report barter income the same way you report comparable income from regular cash transactions. For instance, a sole proprietor generally reports barter income on Schedule C, and this income may also be subject to self-employment tax.

Depending on what you receive in the exchange, you may be entitled to a business expense deduction or obtain tax basis in property. So, although bartering generates taxable income, it doesn’t necessarily increase taxable profit by the full value of the transaction.

Let's say a veterinarian agrees to exchange services with a marketing consultant. In this situation, both parties must report the FMV of the services *received* as income. So the veterinarian would report the FMV of the marketing services received, and the marketing consultant would report the FMV of the veterinary services received. This generally is the amount that would normally be charged for these services. If the parties agree to the value of the services in advance, that will be considered the fair market value unless there's contrary evidence.

Business expense deductions may also be available with barter transactions. For instance, if a plumber installs a new toilet at a local computer repair shop in exchange for fixing a broken laptop, the plumber would report the FMV of the computer repair services as income. But he or she may also deduct certain expenses:

- If the laptop is used in the plumber's business and the repair would have been deductible had it been paid for in cash, the plumber can still claim a business expense deduction for the repair, subject to the usual deduction rules.
- The plumber can also deduct qualifying business expenses associated with the plumbing work, such as materials, supplies and any wages paid to employees.

Income also must be reported if services are exchanged for property. For example, if an HVAC contractor does work for a retail business in exchange for unsold inventory, he or she will have to report income equal to the fair market value of the inventory. Or if an architect does work for a corporation in exchange for shares of the company's stock, he or she must report income equal to the fair market value of those shares.

Barter exchanges

Some businesses join online barter exchanges (sometimes referred to as barter clubs) that facilitate these transactions. Barter exchanges generally use a system of "credit units," which are awarded to members who provide goods and services. The credits can be redeemed for goods and services from other members.

In general, bartering is taxable in the year it occurs. But if you participate in a barter exchange, you may be taxed on the value of credit units at the time they're added to your account, even if you don't redeem them for actual goods and services until a later year. For example, let's say that you earn 2,500 credit units one year and that each unit is redeemable for $3 in goods and services. In that year, you'll have $7,500 of income. If you redeem the units the next year, you won't pay additional tax because you've already been taxed on that income.

If you join a barter exchange, you'll generally be asked to provide your taxpayer identification number — such as your Social Security number or Employer

Identification Number — and complete Form W-9 or a similar certification. In certain circumstances, including failure to provide or properly certify a taxpayer identification number, barter income may be subject to 24% backup withholding.

The IRS generally treats barter exchanges as brokers. If the reporting requirements apply, a barter exchange will send participants a Form 1099-B, “Proceeds From Broker and Barter Exchange Transactions,” by February 15 of the following calendar year. This form shows the value of cash, property, services and credits that you received through the exchange during the previous year. This information will also be reported to the IRS.

No tax-free trade

Bartering may be more common than you think: According to the National Association of Trade Exchanges, more than 400,000 U.S. businesses used some form of barter in 2022, the latest available statistics. Regardless of how you make a trade — directly with another business or through a barter exchange — remember your federal and state tax obligations. We can help you estimate the fair market value of items and services exchanged, identify potential deductions, and maintain the records needed to report these transactions properly. Contact us to learn more.