

# The Barter System

By Larry Burkett

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Good businessmen know that if they try to operate only in the traditional, open economic arena, where the federal government regulates and taxes every transaction, their profits will be reduced or eliminated.

But fortunately, the American economy is still free enough to offer channels in which the knowledgeable entrepreneur can sidestep the system and legally reduce or eliminate much of the burdensome taxation. The informed person can not only survive but also build a sizable fortune if he or she knows how to use tax-free exchanges and low-tax barter trades. These represent the essence of the free-market system that made our economy strong.

As we've seen, there are illegal ways to beat the government in the underground economy, mainly through the use of cash transactions to evade the payment of taxes. And the sense of unfairness, which has tainted the attitude of much of the American population as a result of burdensome government regulation and taxation, has pushed many into this outlaw realm-to the tune of billions of dollars a year. In fact, as has been mentioned, the amount of money involved in this mass cash-economy tax evasion may run as high as \$700 billion, or more than one fourth of our gross national product.

But it's important to distinguish between tax *evasion*, which is illegal, and tax *avoidance*, which is perfectly legal and desirable. You evade taxes, and may be opening yourself up to criminal penalties, if you fail to file an income tax return or intentionally declare less income than you actually earn. But there are also many legal ways to use the law, or just step outside its scope to avoid the payment of excessive taxes, and that's one of the things I want to stress in this chapter.

For example, many sophisticated investors who are in a high income tax bracket may put their money into "tax shelters" that enable their investments to grow, but without the necessity of paying the highest tax rates on any increases. Some real estate investments, which we'll be discussing in detail later in this book, fall into this category. The reason the well-to-do are attracted to these deals is that the deductions for interest payments, depreciation on buildings, taxes and other such costs may equal or exceed any income the investor earns. And that will mean he doesn't owe any taxes-even though he may quite legally, pocket a huge return.

But I'm getting ahead of myself in discussing the investment aspect of the underground economy. Before we get into that, there are other, extremely lucrative and entirely legal ways that you can gain monetary benefits that are taxable at a much-reduced rate. And the crown jewel of these cashless techniques is the contemporary version of that ancient system of exchange known as *barter*, which goes back to the earliest periods of our existence and was in full bloom during our nation's formation.

In many sections of colonial America, where currency was not widely available, our ancestors got used to carrying on their business transactions by exchanging goods and services instead of money. This method of doing business could be cumbersome and inexact since nobody was ever quite sure just how many bales of hay or cotton it took to make an equal exchange for a good horse or wagon. And because it was more convenient to carry paper currency than some farm commodity in their purse or hip pocket, most people were quite happy to make the shift over to money when the federal government got stronger and was able to control the nation's monetary system.

But what the average citizen didn't foresee was just how controlling the federal government could become in overseeing money transactions. As the government's needs increased in this century, the tax rates also increased to give the federal bureaucracy a means of paying for its programs. And when these tax rates finally became confiscatory -especially in the 1920's and thereafter- more and more individuals began to return to various forms of the old barter system to avoid the grasp of the Internal Revenue Service.

In other words, Americans began to *go underground*, both legally and illegally, to avoid taxes. It's ironic that a movement has begun to return to those economic roots that we once so freely gave up. But that's exactly what has happened, as increasing numbers of astute business experts, in all effort to escape government control and strangulation, have looked for and found ways to conduct their dealings completely outside normal channels,

Let me give you a couple of examples of how this sort of thing is being done on a rather large scale, and then we'll examine how you can take advantage of the technique yourself.

A barter system can be defined simply as an arrangement for the swapping of goods or services, without using any medium of exchange like money. You can see the big advantage of this way of doing business if we really are headed for a currency collapse because, if a good part of your business is conducted *without* money, you don't have to worry so much about what may happen to the money.

But big corporations are interested in barter exchanges for reasons other than protection against a monetary crisis. For one thing, by setting up elaborate systems to trade goods and services, they can reduce the need for accumulating huge cash reserves to purchase expensive equipment-and they stay ahead of the game even if they have to pay taxes on the exchanges after they occur.

Let me explain by giving you a couple of concrete examples. There are about six or seven very large computer-controlled corporate barter Systems in this country that do a multimillion-dollar business each year.

One way they operate is for the barter exchange itself to go out and purchase equipment and then offer it to member corporations in exchange for other equipment. The central barter organization makes its profit by arranging the property exchanges at a higher price than they paid for the equipment and then pocketing the difference in dollars, or *barter credits*,

But the most common way for these big barter organizations to function is strictly as a broker for equipment that corporations already own. For example, suppose some company in Atlanta needs a piece of \$500 typesetting equipment, which a party in California happens to have. But the Atlanta people don't have anything they can exchange directly with the California company.

At this point, the barter outfit steps in and says they have located a third party, down in New Orleans, which has a piece of equipment that the California people would like-say a copying machine, which we'll assume has the same \$500 value as the typesetting equipment.

So now the stage is set for the barter exchange: The company in California agrees to ship the typesetting equipment to the Atlanta company, and as a result the Atlanta company would be debited 500 credits and the California company would get 500 barter credits. Then, the California group uses their 500 credits to get the copying machine from the New Orleans company.

The final result of this particular transaction is that the Atlanta company still owes somebody in the barter system 500 credits worth of equipment, the California company is even, and the New Orleans organization has the right to 500 credits worth of goods from someone. Usually, there is a requirement that those with a deficit of barter credits must pay off their debt in *usable* equipment or money within a *limited period of time*.

The barter swaps are quite simple if the equipment is of equal value, but of course, that's rarely the case. Experts must first assess exactly what a piece of used equipment is worth, and a certain number of barter credits are assigned to it. The barter exchange always marks up each item by a number of points and takes those extra points as payment for brokerage. Then, when the equipment gets out into the system and transactions start taking place, barter credits get added and subtracted from the accounts of different members of the system. The central barter organization can also participate in these deals by trading its brokerage credits for equipment, which it may in turn sell on the open market.

One of the largest systems of barter exchanges ever set up involved military aircraft. In one series of deals, the fellow in charge of this exchange heard that the Mexican government was in the process of phasing out all its old DC 3's. He also learned that another government in South America wanted some of those planes, so he arranged a swap-but the second government didn't have enough money to pay for the planes. They did have a lot of bananas, though.

Unfortunately, the Mexican government didn't want bananas. They wanted airplane tires. So the barter man started looking around in other parts of the world for some substitute barter items. Finally, he discovered a country in the Middle East that was willing to trade some oil for the bananas; another country had some rugs they wanted to swap for the oil; and still another country was ready to make a deal for the rugs in exchange for some airplane tires they had on hand.

So through this series of complex international deals, the barter man was able to consummate the transaction between the Mexican government with the airplanes and the South American regime with the surplus of bananas. And he also made a profit on each of the intermediate deals he set up by marking up the trade value of each set of items and then selling what he had left over after each deal on the open market.

Both of these examples of big business barterers involve potentially taxable transactions, but the individuals and companies involved in them can still often come out far ahead financially-and may end up paying little or no tax. For example, those involved in a barter exchange can mark off the cost of the item they are trading, just as they would mark off the cost of an ordinary item they sold for currency. In other words, if someone trades a copying machine that cost \$500 for a typewriter that cost \$500, each party could deduct the "cost basis" of his respective property, which in each case would be \$500. And because neither party would have realized any taxable income in this case, neither would owe any income tax.

On the other hand, the central barter exchange-and the barter man, in the case of the military aircraft-would owe tax on what they had earned as brokerage fees or credits. And any member company of an American barter system would owe tax on the *barter credits* they received, in lieu of property.

Now, these are big barter exchange deals that involve a lot of expensive property and high finance. But you can get involved in exactly the same sort of thing on a much smaller scale-and end up far ahead of the game in your personal finances.

Remember: The barter system started off in a small way in the American colonies, where the key factor was that individuals in different fields started generating a surplus of goods. The farmer might harvest more wheat than he could use in a given year. And the shoemaker, by working a little longer each day, might put out more shoes than he could easily sell. So those with such surpluses started getting together and trading the extra goods they had accumulated.

In our own time, the simplest barter exchange you can get involved in is to walk across your backyard and agree to exchange the use of your lawnmower for your neighbor's chain saw. Or you might decide to baby-sit for his kids this weekend if he'll mow your lawn while you're away on vacation.

Many times, assistance like this may be offered just because people are friends and they want to volunteer to help each other out, without expecting anything in return. But sometimes neighbors get involved in more formal exchanges of goods and services-especially when the agreed-upon tasks become regular, time-consuming things. And those transactions are nothing more than barter conducted on the lowest, grass-roots levels of our society.

What are the legal and tax implications of these barter arrangements?

As increasing numbers of people get involved in exchanges of goods and services, which take place largely outside the regulation of the federal bureaucracy, you can bet the government isn't sleeping. Tax dollars are at stake, and that's a serious matter in these times, when the federal and local governments are hard-pressed for funds to cover programs that are being threatened through the high cost of inflation and also the conservative movement to limit government spending.

At this point, the law is in a state of flux on the barter issue. The IRS is pushing hard for increasing its power to collect taxes on barter, and private tax experts are countering that the IRS is going too far and would lose in tax court on some of its positions. But even with this confusion, it's important to lay the issues out on the table right now because much of what I'm going to say about the advantages of community support systems hinges on the extent to which those systems can exist largely outside the realm of government control.

Many tax attorneys questioned on which barter transactions between individuals they absolutely feel are taxable replied that *only exchanges of those goods and services, which you offer for pay in your business are taxable*. In other words, if an owner of a television store swaps a TV to the owner of a furniture store in return for a couch, that's definitely a taxable exchange. The tax, as was the case with the big-business barter we talked about, will be determined by the fair market value of the products exchanged. And those involved in the barter will be able to subtract from that fair market value the cost basis-or the amount they originally paid-for the item they are giving up.

Similarly, these private tax experts say, if a doctor renders some medical service to an attorney in return for having a will drawn up, that's a taxable exchange of services, and each person has to declare on his income tax return the equivalent monetary value of the services he received. So, if the medical services were worth \$100 and the will would have cost \$100, each individual must include an extra \$100 in income tax on his return.

But most private tax lawyers and accountants came to a different conclusion on the situation where the individuals are exchanging goods and services which are *not* part of their regular income-producing business pursuits or part of a 'professional' barter exchange.

For example, if an attorney who is a woodworking hobbyist makes a table for a doctor who is an auto-repair buff, and the doctor in exchange gives the lawyer a valve job, the tax experts agree that this transaction should not be taxable.

But the IRS disagrees. They regard *any* exchange of goods and services between two individuals, for which value is received on both sides, to be a taxable exchange. In fact, the IRS is so concerned about the growing underground economy in barter transactions that they have rendered a couple of revenue rules on this subject.

One of these rulings relates to what the IRS calls *barter - club transactions*, and the service states its position this way: "A barter club uses credit units to credit or debit members' accounts for goods or services provided or received. As soon as units are credited to the member's account, the member may use them to purchase goods or services or may sell or transfer the units to other members. The value of credit units received is includible in the gross income of members for the taxable year in which the units are credited to their accounts. The dollar value of units received for services by an employee of the club, who may use the units in the same manner as other members, is - includible in gross income for the taxable year in which received." (Rev. Rul. 80-52. 1980).

In a recent U.S. district court decision, the IRS even won the right to get a barter club's member lists and records of transactions.

In the other ruling, which concerns the *exchange by professionals of their regular business services*, the IRS said, "... the owner of an apartment building who receives a work of art created by a professional artist in return for the rent-free use of an apartment must include in income the fair market value of the work of art, and the artist must include the fair rental value of the apartment." (Rev. Rul. 79-24. 1979).

The interpretation given by some IRS agents on the service's position on barter goes further than either of these rulings. The first ruling related to formal barter organizations, and the second dealt mainly with the exchange of goods and services which were part of the individuals' regular occupations. But there are IRS representatives who would levy taxes in the situation where two private individuals, not in a barter organization, exchanged skills developed as hobbies.

So, as you can see, the law in this field is in a state of change and uncertainty, and you'll have to make up your own mind as to the position you'll take toward the taxability of any barter transactions you may engage in. But as the situation stands, keep these guidelines in mind:

- Experts agree that if you exchange goods or services involved in your regular business, you can be taxed on the value of what you've received.

- If you and your tax consultants decide that the IRS is all wet in its position on barter clubs or any other issue, you can take the service to court, regardless of the existence of any revenue ruling. A ruling by the service is only a formal statement of their position, but it's not law. Their position only becomes law when a Tax Court rules in their favor, and even that decision can be challenged in higher appellate courts. But if you're going to challenge the IRS, you have to be willing to put in a considerable amount of time, and probably a fair amount of money-especially if you get a lawyer to represent you rather than trying to argue your case yourself.

- You're more likely to come under the scrutiny of the IRS if you conduct your barter transactions through an established barter club than if you engage in them on a less formal basis, either as an independent individual or as part of an organization that exists primarily for some purpose other than bartering.

These, then, are a few examples and principles to introduce you to the basics of barter. Next, we'll consider in some detail how you can set up a barter system yourself. The most effective barter arrangements are often tied closely to a well-established community that can offer you much more than just barter opportunities. Above all, don't allow the IRS to bully you out of your right to exchange your goods or services for those of your friends. At worst you'll be taxed on the value received, which is still better than paying retail. Now let me take some time now to go into more detail on the kind of support community that will help you get maximum benefit from the underground exchange network.