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IRTA®

Raising the Standard of the Trade and Barter Industry Since 1979

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CHARACTER, USE, AND VALUATION OF TRADE DOLLARS IN THE U.S.

CHARACTER AND USE OF TRADE DOLLARS

Trade dollars arise in the course of barter trade between buyers and sellers who are organized into a network of trading partners by means of written agreement with a company known as a barter exchange. Section 6045 of the Internal Revenue Code defines the term "barter exchange" as follows:

> *"The term 'barter exchange' means any person with members or clients that contract either with each other or with such person to trade or barter property or services either directly or through such person."*

A barter exchange/member contract that organizes the barter network and establishes the terms and conditions of trade is executed by each client with the barter exchange. Under the terms of a typical contract, the client agrees to make available a certain dollar amount of goods or services for barter trade with other clients and with the exchange. In so doing, they agree to accept a specified minimum amount of barter business by selling goods or services in return for payment received in the form of trade dollars.

As defined by the International Reciprocal Trade Association, a trade dollar is a unit of account that denotes the right to receive, or the obligation to pay, one U.S. dollar's worth of goods or services available within a barter system. (The terms "barter network" and "barter system" are identical). The Treasury Department has recognized the existence o f trade dollars in Treasure Regulations T.D. 7873 (26 CFR part 1) issued March 11, 1983: "Property or services are exchanged through a barter exchange if payment for property or services is made by means of a credit on the books of the barter exchange or scrip issued by the barter exchange or if the barter exchange arranges a direct exchange of property or services among its members or clients or exchanges property or services with a member or client." The fact that a credit on the books of the exchange is linked in the same sentence with a direct exchange of property or services indicates the essential equivalence of the two transaction in the eyes of this authority. Where credit is given on the books of the exchange, payment is to be made by delivery of goods or services in the future, rather than in the present as occurs in a direct exchange.

In the cash economy, when a sale is made and payment is deferred, there is an extension of credit from seller to buyer. In a barter network, when a sale is made and payment (in goods or services) is deferred, there is likewise an extension of credit by the seller. Under the exchange agreement, sellers accept trade dollars as payment and look to the other participants in the barter network <u>collectively</u> to fulfill their trade dollars.

At any point in time within a barter network, some participants will be net creditors, that is, holders of trade dollars. They have given up greater value than they have received in goods and services, and so they hold the balance as an asset or claim on goods or services available from the system. They are said to be in a positive or surplus position in their account. Other participants will be net debtors, that is, they will have spent more than their earnings and will owe trade dollars. They are said to be in a negative or deficit position.

Trade dollar assets are the liabilities of debtor members collectively, that is they are liabilities of those members who owe the system. It is axiomatic that barter assets and liabilities should always balance, that is, for every trade dollar outstanding there is a contractual obligation imposed on debtor members of the network to make available a U.S. dollar's worth of fulfillment goods and services. When the system balances perfectly, it is known as a "zero-based system."

The Internal Revenue Service has analyzed barter exchanges to determine whether trade dollars received in payment constitute income. In Revenue Ruling 80-52, IRS promulgated the "valuable right" doctrine. Under this doctrine, trade dollars are a "valuable right" and receipt of trade dollars as payment constitutes receipt of income. Promulgation of the "valuable right" doctrine supports IRTA's view that trade dollars constitute real claims upon valuable goods and services available from the members of the barter system. This capability is underpinned by the exchange agreement and by the debtor-creditor relationship established among the members, and between the exchange and its members, in the course of executing numerous barter transactions daily. Trade dollar assets are offset by an equal number of trade dollar liabilities, that is, an unqualified obligation of debtors within the exchange network to pay in goods and services an amount certain (valued in U.S. dollars) by a date certain.

Writing in Minnesota Law Review, Vol. 67:441, 1982, Professor Robert I. Keller states in "The Taxation of Barter Transactions":

> *"Trade units, however, represent more than the mere promise of the individual member for whom the taxpayer performed services or to whom he or she sold goods. Rather, each trade unit represents the promise of the entire exchange membership, as a group, to allow the recipient of the unit to use it to acquire the goods and services offered by the membership. Moreover, at least in the case of the established exchanges, these promises represented by trade units, are readily assignable or transferable to other members of the trade exchange." (p.494)*

Concerning the exchange's own use of trade dollars, Professor Keller writes:

> *"It is in its capacity as broker that the Exchange receives commission from members. Any commissions the Exchange receives in trade units it can use in the same manner as any member to acquire goods and services within the system. The Exchange may use the goods and services it acquires from its members for its own business purposes or may transfer them to the individual shareholders, proprietors, or partners of the Exchange to be used by them for personal purposes. Frequently, however, Exchanges use their trade units to acquire merchandise which is maintained in the showrooms and warehouses of the Exchange for re-trade to members. This results in the Exchange's second role as a trader of goods.*
>
> *To the extent the Exchange sells the acquired merchandise for the same number of trade units it paid for them, it simply acts as a clearing house for members' goods. Nevertheless, the Exchange clearly*

benefits from this activity. Most importantly, by acquiring members' goods for trade units, the Exchange keeps units circulating and thereby maintains an active barter economy. Also, to the extent the Exchange succeeds in re-trading the acquired goods to members, the Exchange earns additional commissions."

As a participant in the barter system, the exchange earns trade dollars through commissions and profits on sale of goods and services to the other participants. Clearly, the trade dollars earned by the exchange represent a valuable claim on the goods and services of other members of the barter system. These members may be those seeking to earn trade dollars to repay their debt, or those seeking additional sales to increase their stock of trade dollars. <u>In preparing the exchange's financial statements, it would seem inappropriate, even irresponsible, to fail to account for the exchange's trade dollar assets, liabilities, receipts, and expenditures.</u>

VALUATION AND ACCOUNTING FOR TRADE DOLLARS

The U.S. Government, in Treasury Regulation T.D. 78 73 cited above, addresses the question of trade dollar valuation as follows: "The amount received by a member or client in an exchange includes cash received, the fair market value of any property or services received, and the fair market value of any credits to the account of the member or client in a subsequent exchange of credits or scrip. For purposes of this section, the fair market value of a credit or scrip is the value assigned to such credit or scrip by the issuing barter exchange for the purpose of exchanges unless the Commissioner requires the use of a different value that the Commissioner determines more accurately reflects fair market value."

In requiring trade exchanges to set the value of their trade dollar for all participants in the barter system, and to set that value at the amount (in dollars) used "for purpose of exchanges", the U.S. Treasury was following an approach recommended by Professor Keller. Professor Keller called his method of valuation the "medium of exchange" approach and describes it as follows:

"The value of a trade unit should be determined by what it can buy within the exchange, and not the cash price for which it can be purchased or sold. By analogy, if a U.S. taxpayer receives foreign currency, usable within the foreign country to acquire goods and services, but not readily convertible into U.S. dollars, an informal market often develops, in which the taxpayer can sell the foreign currency to U.S. citizens wishing to invest or spend the currency in the foreign country. In such circumstances, it would be clearly improper to value the currency at the dollar amount realizable in the United States, since "the dollar amount realizable in the United States might be but a fraction of the dollar value of the property…which the foreign income would buy in the foreign country." Since trade units are the equivalent of a foreign currency, they too should be valued by their "purchasing power" within the trade exchange, and not by what they would bring in a cash sale…

"The more appropriate approach, both as a matter of substantive law and from the viewpoint of administrative convenience, would be one that treats trade units, when used to acquire goods and services, as a medium of exchange. Under this approach, the goods and services acquired would be conclusively assumed to be equal in value to that of the trade units used to acquire them. Good deals and bad deals would simply be ignored. The taxpayer would, in effect, be treated as receiving the average value of the goods and services a trade unit could buy, which, absent exchange fluctuation,

would be the same amount the taxpayer took into income on receipt of the unit. Assuming that there is indeed no change in the value of the trade unit itself from the time of acquisition to the time of disposition, this approach would result in no gain or loss to the taxpayer on the disposition of trade units, and produce tax deductions, if deductible business goods and services were acquired, equal to the value of the units used."

The basic accounting doctrine for barter exchanges is set forth in Accounting Principles Board Opinion Number 29, "Accounting for Non-Monetary Transactions." This document was issued in 1972 by the predecessor to the current Financial Accounting Standards Board. It is an authoritative pronouncement of the accounting profession.

Bost and Yeakel (Management Accounting, December 1992) summarize the basic tenets of APB 29 as follows:

"APB Opinion No. 29, Accounting for Nonmonetary Transactions, defines nonmonetary assets and liabilities as those which are not fixed in terms of units of currency by contract or otherwise. With these transactions, questions may arise due to the subjectivity in valuation of an asset received or resulting liability, or the recognition of any gain or loss on the transaction. The Opinion states that the cost of a nonmonetary asset should be recorded at the fair value of the asset surrendered to obtain it. Any difference in fair value and book value given is recognized as again or loss. If fair value of the asset received is clearer than that of the asset given, the former should be used in valuation. Fair value should equal estimated realizable value for cash transactions involving same or similar assets, quoted market prices, independent appraisal, estimated fair value of merchandise or service received in exchange, or other available evidence. No gains should be recognized if fair value is not determinable within reasonable limits or if an exchange is not the culmination of an earnings process, such as exchanges of similar productive assets. Disclosures are required on the nature of the transaction, the basis of accounting, and any gains or losses recognized."

It should be stressed that "Fair value should equal estimated realizable value for cash transactions involving same or similar assets, quoted market prices, independent appraisal, estimated fair value of merchandise or services received in exchange, or other available evidence."

In light of the foregoing authorities, the sole issue is the validity of the International Reciprocal Trade Association's position, which expresses the view of the leading members of the commercial barter industry, that the value of a trade dollar in an operating commercial barter exchange (one that executes above 1,000 transactions per year) is, on average, equal to one U.S. Dollar. IRTA's position asserts that one trade dollar equals one U.S. dollar not because the barter industry has arbitrarily assigned this value, set it for administrative convenience or simplicity, or established it for tax compliance purposes, but that the value of a trade dollar is in fact one U.S. dollar, on average over a broad range of transactions executed through a commercial barter exchange.

The key to this proposition is that, while trade dollars are indeed a unit of account and a medium of exchange within a barter system, the prices of goods and services bought and sold are denominated entirely in U.S. dollars. This means the trade dollar is a unit of account, but not a standard of value. A trade dollar has meaning in value terms only by reference to the U.S. dollar prices of the goods and services it can purchase. U.S. dollar prices are the same for the barter system as for the cash system under the terms of the contract between the exchange and its clients, and in actual practice for the vast bulk of trades. In algebraic terms, the larger the number of transactions considered, the more the value of the trade dollar will approach one U.S. dollar as a limit.

The trade dollar is a unit that has no intrinsic value, because prices set in trade dollars would be meaningless and, in fact, are non-existent. Prices are set only in U.S. dollars, and the number of trade dollars given or received is determined entirely by U.S. dollar prices and quantity. Put another way, a trade dollar is a financial unit of identical value to a cash dollar, except that a trade dollar is redeemable only by a dollar's worth of goods and services and not by cash.

The crucial role of U.S. dollar prices as the standard of value in the barter economy means that, on average, across thousands of transactions, the value of trade dollars spent within the barter system is one U.S. dollar. While in particular cases there can be a variance between cash and trade dollar prices, in the vast majority of transactions these prices are the same.

To properly depict the financial results of barter transactions in financial statements, IRTA is persuaded that the trade dollar should be valued as a medium of exchange rather than looking at its value in discrete transactions. The latter approach would considerably magnify and complicate the accounting process, with little attendant benefit. It can be demonstrated empirically that the value of a trade dollar as a medium of exchange (the average value for a large number of transactions) is one U.S. dollar.

TRADE DOLLARS ARE A MEDIUM OF EXCHANGE

The medium of exchange for barter transactions is no more nor less in value than the U.S. dollar. But this is not to say that the two currencies are of equal utility for commerce. The supply of one is controlled by government, the other is privately-created and capable of expanding with trade. The value of one erodes steadily with inflation, but the trade dollar can realize constant-purchasing power by means of an annual price level adjustment applied to each deposit. The trade dollars required to pay for this adjustment can be obtained by transfer from debtors, or by a small levy on the gains from trade.

Trade dollars are a medium of exchange or currency within the barter system, not within the U.S. economy. They represent a claim on the ascertainable goods and services available from members' in the barter system, who are obligated by contract to make a specified portion of their goods/services available for trade upon demand, and who willingly accept trade dollars and seek to acquire them to finance their purchases.

True, unlike lawful currency, trade dollars are not claims on the gross national product. But a trade dollar nonetheless represents a legal claim for a U.S. dollar's worth of real goods and services. The fact that the claim is on a specific subset of firms in the economy, and not on the economy at large, has little relevance. All that matters is that the owners of trade dollars hold legally binding claims against others—not just a single firm but the entire group of firms who comprise the barter network. This lends solidity to the contractual promise to provide goods and services to the holders of trade dollars on demand.

Trade dollars are a form of privately-created medium of exchange, based upon contract. They are not lawful currency of the United States, but this does not mean that their financial consequences can be ignored in the preparation of financial statements. Under APB 29, as a general rule the financial consequences of a contract for non-monetary exchange can and should be valued. The IRS holds that only in rare and exceptional cases can a non-monetary transaction not be valued for tax purposes.

Under APB 29, in general an exchange of non-monetary assets is assumed to culminate an earnings process, so that gain, loss, and income should be currently recognized. Deferring recognition to a later period could significantly distort the financial picture, especially for a company that engages in a large number of transactions on a daily basis.