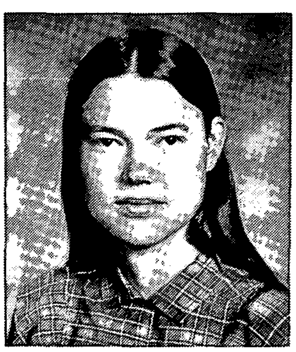
Section 1014(e) and the Lock-In Problem: Basis Considerations In Transfers of Appreciated Property

By **JANET A. MEADE**

According to the author, although Section 1014(e) prevents a form of tax abuse in that it prevents owners of appreciated property from transferring the property to a decedent immediately prior to death, and, by reacquiring the property by will, from avoiding the payment of income tax on the appreciation, it also leaves open several planning techniques in which a full or partial step-up in basis may be achieved.



Janet A. Meade is a Ph.D. candidate in accounting at Arizona State University, Tempe, Arizona.

Under Section 1001, taxpayers do not have to pay income tax on the increase in value of an asset until they sell or otherwise dispose of the asset. Because this is so, the owners of appreciated assets may hold such property longer than would otherwise be the case, as a means of avoiding the tax. When this phenomenon occurs, the owners are said to be "locked in" because of the tax penalty that they would incur if they were to sell their property and realize the gains. For elderly taxpayers, the lock-in problem can become particularly acute because of the incentive provided by Section 1014 to hold an asset until death so that the basis can be stepped up to fair market value and any unrealized gain can escape income taxation entirely.

Because an heir receives property from a decedent with a stepped-up basis, an heir attempting to alleviate the lock-in problem could transfer appreciated property to a decedent immediately prior to death in the hope of receiving the property back at the decedent's death with a higher basis. Section 1014(e), however, is intended to curb such a potential abuse by providing that the basis of appreciated property acquired by a decedent through gift within one year of death and subsequently passed to the original donor or the donor's spouse is to be the decedent's adjusted basis of the property immediately before his death. This article examines the lock-in problem in conjunction with Section 1014(e) and discusses possible planning techniques for reducing the negative tax consequences of Section 1014(e).

Background

Generally, Section 1014 provides that the basis of property acquired from a decedent is its fair market value on the date of death or, if elected, on the alternative valuation date. An important exception to this stepped-up basis rule is the provision of subsection (e). By denying a basis step-up for certain property, Section 1014(e) prevents the avoidance of income tax by the donor on the appreciation of the property prior to the decedent's death. Thus, an owner of appreciated property cannot give the property to a terminally ill person and then reacquire the property after the death of that person with a stepped-up basis if the decedent dies within one year of the gift. For Section 1014(e) to be operative, the following two conditions must be satisfied:

(1) The decedent must have received appreciated property as a gift during the one-year period ending with his death.[1] Under Section 1014(e)(2)(A), appreciated property is defined as property whose fair market value on the date of its transfer exceeds the adjusted basis in the hands of the donor.

(2) The property or benefit of the property or proceeds from the sale of the property must pass directly or indirectly from the decedent to the donor or the donor's spouse.[2]

Were it not for Section 1014(e), one spouse, S, could transfer low-basis property to the older or less healthy spouse, D, before D's death and D could transfer it back to S by will. Due to the application of the unlimited marital deduction of Section 2523, no gift tax would occur on the transfer from S to D. Moreover, upon D's death the bequest from D to S would not generate any estate tax because the inclusion of the property in D's gross estate would be offset by the marital deduction of Section 2056. Through two nontaxable transfers, therefore, S would be free to unlock his investment in the property without recognizing any taxable gain. In estates that do not exceed the exemption equivalent ($600,000 for years beginning after 1986), the same tax-free transactions could occur between nonspouses by use of the $10,000 annual gift tax exclusion and the unified gift and estate tax credit.[3]

The most obvious escape from Section 1014(e) is for the parties to time the original transfer of appreciated property to occur more than one year before the decedent's death. Where such foresight is not possible, however, the stepped-up basis rules will still apply if the decedent bequeaths the property to someone other than the donor or the donor's spouse. However, where the beneficiary of the property is related to the donor, as for example the donor's child, the IRS might attack the transaction as a sham, particularly if the original donor reaps any benefit from the transfer.[4]

> *Example (1):* P gives appreciated property to D shortly before D's death. If D bequeaths the property to P's child, C, and C subsequently sells the property, C should have no taxable gain since he is neither the donor nor the donor's spouse. However, if C uses the proceeds from the sale to discharge P's legal obligation to support C, the IRS could assert that P indirectly received the property from D and, pursuant to Section 1014(e), has a carryover basis. As a consequence, P would be taxable on the gain realized from the sale of the property by C.

The more likely block to such a transaction, however, is the estate tax on the appreciated property in the decedent's estate, as compared with the 20 percent maximum tax rate on long-term capital gains if the original owner had simply sold the property. When the inclusion of the property in the decedent's estate is not sheltered by the unified gift and estate tax credit, the minimum rate for estate tax is 37 percent and the maximum is 50 percent. Under such a circumstance, not only is the tax greater from a gift-bequest transaction, but the unified credit of a nonspouse donor also is reduced by the gift tax on the original transfer of property to the decedent.[5]

As a result of the estate and long-term capital gain tax rate differential, the most beneficial gift-bequest transactions would be those occurring between spouses where the unlimited marital de-

---

[1] IRC Sec. 1014(e)(1)(A).

[2] Section 1014(e)(1)(B) and (2)(B); H. R. Rep. No. 201, 97th Cong., 1st Sess. (1981), reprinted in 1981-2 CB 391.

[3] IRC Secs. 2010(a), 2503(b) and 2505(a); Reg. § 25.2503-2(a).

[4] Rev. Ruls. 59-357, 1959-2 CB 212, and 74-94, 1974-1 CB 26; *Royster v. Comm.*, CCH Dec. 42,123(M), 49 TCM 1594 (1985).

[5] H. R. Rep. No. 1380, 94th Cong., 2d Sess. (1976), reprinted in 1976-3 CB 747.

duction can be used to eliminate estate tax and the stepped-up basis rules can be used to avoid income tax on the future sale. Gift-bequest transactions also could be used when the decedent otherwise would not have fully utilized his unified credit. The remainder of this article examines gift-bequest transactions when one of these situations is present and assumes that the parties to such transactions wish to minimize their taxes cooperatively.

Pecuniary Bequests

The denial of a stepped-up basis applies regardless of whether the donor receives the benefit of the appreciated property from the decedent by specific bequest, general bequest, pecuniary bequest or residuary bequest. In the case of a pecuniary bequest, however, the donor is treated as receiving the benefit of the appreciated property only to the extent that the inclusion of such property in the decedent's estate affects the amount the donor receives under the pecuniary bequest.[6] While this rule presents no problem if the donor receives the appreciated property, it seems to require very difficult tracing where the estate distributes different property in satisfaction of the pecuniary bequest. The rule also seems to make the estate's tax basis on a sale of the appreciated property depend on a subjective evaluation of the effect of the sale on the donor's inheritance.

> *Example (2):* P gives appreciated property with a basis to him of $25 and a fair market value of $125 to D within one year of D's death. When D dies, the basis and fair market value of the property are $30 and $150, respectively. D's will leaves $150 to P. D's executor sells various properties of the estate, including the property gifted to D by P, and distributes the $150 bequest to P in cash. If the net assets of D's estate exceed $275, no taxable gain should be realized by the estate on the sale since the gift from P to D did not affect the amount of the pecuniary bequest which could have been funded by a sale of D's separately owned property.

Upon challenge by the IRS, the issue which must be determined is whether D would have bequeathed $150 to P in the absence of the earlier transfer of appreciated property from P to D. On the one hand, if D revised the amount of his bequest to P by $125 shortly after receiving the property from P, the IRS justifiably could argue that Section 1014(e) applies to the transfer and that D's estate is taxable on the gain of $120 ($150 sales price less $30 carryover basis) from the sale of the property. On the other hand, if D did not revise his will either before or after the receipt of the property from P, then Section 1014(e) should not apply and D's estate should recognize no taxable gain on the sale.

Factual situations lying somewhere between these two extremes present an interesting planning opportunity. For example, if the original gift of appreciated property to the decedent can be separated successfully from the pecuniary bequest to the donor, or nontax motives can be established for the transfers, the donor should be permitted a stepped-up basis. Before undertaking such a transaction, however, a tax planner must caution his clients that the use of a pecuniary bequest may involve litigation with the IRS, the outcome of which cannot be determined with any certainty.

Life Estates

Neither Section 1014(e) nor the committee reports address the situation where appreciated property received by a decedent through a gift is retransferred by will to the donor as a life estate. In the case of an interspousal transfer, the two most common forms of qualifying a life estate for the marital deduction are the power of appointment (marital deduction) trust and the qualified terminable interest property (QTIP) trust. The power of appointment trust calls for the surviving spouse to receive all trust income and to have the right, exercisable by the spouse alone, to transfer the principal of the trust to anyone, including himself or his estate. In addition, trust income must be paid out at least annually.[7] The QTIP trust requires that the surviving spouse receive all of the income for life from the trust and that no person other than the spouse be given a power to appoint any part of the property in the trust away from the spouse. Moreover, in order for the QTIP trust to qualify for the marital deduction, the executor must make an irrevocable election and the trust income must be paid out annually or at more frequent intervals.[8]

For appreciated property gifted to a decedent within one year of death and retransferred to the surviving spouse via a power of appointment trust, the provision of Section 2056(b)(5) that the surviving spouse be given a general power to appoint the interest in trust property

[6] H. R. Rep. No. 201, supra note 2.
[7] IRC Sec. 2056(b)(5); Reg. § 20.2056(b)-5.
[8] IRC Sec. 2056(b)(7); Prop. Reg. § 20.2056(b)-7.

to anyone, including himself or his estate, effectively gives the surviving spouse control over the beneficial enjoyment of the property and, as a consequence, appears to require that the basis of the property be determined in accordance with Section 1014(e). As specified by the House Report, the denial of the stepped-up basis rule applies where appreciated property passes either directly or indirectly from the decedent to the donor or the donor's spouse and where the donor receives the benefit of the appreciated property.[9]

By giving the surviving spouse the right to all the income from the property coupled with a general power to consume the property, a power of appointment trust makes the surviving spouse the virtual owner of the property.[10] Hence, a gift-bequest transaction between spouses utilizing a power of appointment trust should fall within the domain of Section 1014(e), and the basis of the appreciated property in the hands of the trustee should be the basis of the property in the hands of the decedent immediately before his death. Any attempt to limit the surviving spouse's control over the beneficial enjoyment of the property, either by the terms of the trust instrument or under applicable local law, necessarily will restrict the ability of the spouse to unlock his investment in the property and will disqualify the life estate for the marital deduction.[11]

Because the decedent determines where the property in a QTIP trust eventually will go, the surviving spouse does not enjoy the same degree of control over the property as with the power of appointment trust. Instead, the only portion of the QTIP trust which the surviving spouse controls is the income interest. As specified by the House Report, Section 1014(e) applies only to the extent that the donor is entitled to receive the value of the appreciated property.[12] Thus, initially it would appear that the remainder interest in the qualified property should receive a stepped-up basis.

The committee reports and proposed regulations, however, treat the entire property subject to a QTIP trust as passing to the surviving spouse.[13] In addition, Section 2519(a) and Proposed Reg. §§ 20.2044-1(e), Example (5), and 25.2519-1(h), Example (4), appear to view the surviving spouse as indirectly controlling both the income and remainder interests in the qualified property. According to these proposed regulations, if the surviving spouse transfers his income interest prior to death, the full amount of the remainder interest will be treated as also having been transferred. Thus, a surviving spouse's assignment of the right to 20 percent of the income from a QTIP trust would result in a Section 2511 gift of 20 percent of the income and a Section 2519 gift of the remainder interest in the full value of the QTIP trust.[14] Although it is not clear how these provisions would apply to the determination of basis, the tone of the Code, committee reports and proposed regulations seems to indicate that the trustee should take a carryover basis for appreciated property gifted to a decedent within one year of his death and retransferred to the surviving spouse via a QTIP trust.

Nonspousal bequests of life estates also appear to be ineffective at achieving a stepped-up basis for the donor. This is because a donor's gift of appreciated property to a decedent generally will be conditioned upon the donor receiving sufficient powers such that he is able to maintain control over both the principal and its ultimate disposition. Receipt of such broad powers, however, causes the donor's interest in the property to approach complete ownership.[15] As a consequence, the trustee's basis of the appreciated property should be determined under the carryover basis rules of Section 1014(e).

Pro-rata Determination of Basis

The denial of the stepped-up basis rule under Section 1014(e) applies only to the extent that the donor is entitled to receive the value of the appreciated property from the decedent. Accordingly, if some of the property must be used to pay the decedent's debts or administrative expenses, so that the donor is entitled only to a

---

[9] H. R. Rep. No. 201, supra note 2.

[10] S. Rep. No. 1013, pt. 2, 80th Cong., 2d Sess. (1948), reprinted in 1948-1 CB 343.

[11] Reg. § 20.2056(b)-5(g); *Burnett v. U. S.*, 71-1 USTC ¶ 12,762, 436 F. 2d 975 (CA-4); *Jackson v. U. S.*, 64-1 USTC ¶ 12,221, 376 U. S. 503 (1964); Rev. Rul. 76-502, 1976-2 CB 273. Note, however, that Rev. Rul. 69-56, 1969-1 CB 224, provides that directions to, or powers conferred upon, a fiduciary by the trust instrument will not result in the disallowance or diminution of the marital deduction for estate tax purposes unless the execution of such directions would, or the exercise of such powers could, cause the surviving spouse to have less than substantially full beneficial enjoyment of the interest transferred.

[12] H. R. Rep. No. 201, supra note 2.

[13] Id. at 378; S. Rep. No. 592, 97th Cong., 2d Sess. (1982), reprinted in 1983-1 CB 483; Prop. Reg. § 20.2056(b)-7(a).

[14] Under Section 2036(a)(1), 80 percent of the value of the remainder interest deemed a gift under Section 2519 also would be included in the surviving spouse's gross estate for estate tax purposes.

[15] Reg. §§ 20.2041-1 and 20.2041-3.

portion of the transferred property, the rule applies on a pro-rata basis.[16]

Example (3): P gives appreciated property with a basis to him of $25 and a fair market value of $125 to D within one year of D's death. When D dies, the only property in his estate is the appreciated property transferred to him by P. At the date of D's death, the basis and fair market value of the property are $30 and $150, respectively, and the liabilities of D's estate are $50. If the executor sells the property for $150, pays off the $50 debt and distributes the balance to P, the executor's basis would be $70 (one-third of $150, or $50, plus two-thirds of $30, or $20) and the estate would recognize a gain of $80. This result arises from the fact that P was entitled to only two-thirds of the appreciated property. Thus, two-thirds of the property received a carryover basis while one-third received a stepped-up basis.

When examined in conjunction with Section 1041(a)(1), the pro-rata basis rule of Section 1014(e)(2)(B) offers an interesting planning opportunity to married couples. Section 1041, added to the Code by Section 421 of the Tax Reform Act of 1984, provides that no gain or loss shall be recognized in a transfer of property between spouses.[17] Moreover, according to Temporary Reg. § 1.1041-1T(d), Q-12, no gain or loss is recognized even if the transferred property is subject to liabilities which exceed the basis of the property.

Example (4): S owns appreciated property with a basis to him of $30 and a fair maket value of $150. In contemplation of making a transfer of this property to his spouse, D, S borrows $100 from a bank, using the property as security for the borrowing. S then transfers the property to D, with D assuming the liability to pay the $100 debt. S invests his $100 and transfers sufficient income to D to pay the interest on D's debt. Within one year of the transfer, D dies. At the date of D's death, the basis and fair market value of the property are unchanged at $30 and $150, respectively. If the executor sells the property for $150, pays off the $100 debt and distributes the balance to S, the executor's basis would be $110 (two-thirds of $150, or $100, plus one-third of $30, or $10), and the estate would recognize a gain of $40. If both S and the estate are in the 50 percent marginal income tax bracket, the use of the gift-bequest transaction would result in a $16 tax saving to S.[18] If the estate is in a lower marginal income tax bracket than S, as frequently may be the case, the tax savings from the gift-bequest transaction would be even greater. Under either circumstance, however, the use of a gift-bequest transaction would allow S to unlock his investment in the appreciated property at a substantially lower tax cost than otherwise would be possible.

For nonspousal transfers, Reg. § 1.1001-2(a) provides that the amount realized on the disposition of encumbered property includes the full amount of any debt relief. This rule applies without regard to whether the liability from which the transferor is discharged exceeds the value of the property, is recourse or nonrecourse or was incurred in conjunction with the purchase or after the date of the property's acquisition. Reg. § 1.1001-1(e) further stipulates that when a transfer of property is in part a sale and in part a gift, the transferor recognizes gain to the extent that the amount realized by him exceeds his basis of the property. The transferee's basis of property acquired in a part-sale/part-gift transfer is determined under Reg. § 1.1015-4(a) and, in cases where no boot is exchanged and the amount of debt relief exceeds the transferor's basis, is equal to the amount of debt assumed by the transferee plus any gift tax attributable to the net appreciation on the gift.[19]

The effect of these regulations is to severely limit the circumstances under which a gift-bequest transaction between nonspouses will produce more favorable tax consequences than a direct sale of the property by the donor. Recall that an essential requirement of any gift-bequest transaction between nonspouses is that the decedent's estate be too small to claim the full benefit of the unified gift and estate tax credit. An additional requirment is that the donor be willing to utilize a portion of his unified credit or that the fair market value of the transferred property be less than the annual gift tax exclusion of $10,000 ($20,000 if

---

[16] IRC Sec. 1014(e)(2)(B); H. R. Rep. No. 201, supra note 2.

[17] Note, however, that Section 1041(d) provides that Section 1041(a)(1) shall not apply where the spouse of the individual making the transfer is a nonresident alien.

[18] If S had sold the property directly, he would have incurred $24 of tax on the $120 long-term capital gain ($150 sales price less $30 basis). This tax would have been $16 greater than the $8 of tax paid by the estate on the $40 long-term capital gain.

[19] IRC Sec. 1015(d); Reg. § 1.1015-5.

the donor is married and his wife elects to gift-split).[20] The most common circumstances under which a gift-bequest transaction between nonspouses might be considered are those where the donor has no heirs, has an estate valued well below the gift and estate tax exemption equivalent of $600,000 (for years beginning after 1986), is unconcerned about the amount of tax paid by his estate or wishes to minimize the present value of his income and estate taxes.

> *Example (5):* P owns appreciated property with a basis to him of $30 and a fair market value of $150. In contemplation of making a transfer of this property to D, P borrows $100 from a bank, using the property as security for the borrowing. P then transfers the property to D, with D assuming the liability to pay the $100 debt. P invests his $100 and transfers sufficient income to D to pay the interest on D's debt. Within one year of the transfer, D dies. At the date of D's death, the basis and fair market value of the property are $100 (pursuant to Reg. § 1.1015-4(a)) and $150, respectively. If the executor sells the property for $150, pays off the $100 debt and distributes the balance to P, the executor's basis would be $133 (two-thirds of $150, or $100, plus one-third of $100, or $33) and the estate would recognize a gain of $17. In addition, P would recognize a gain of $70 on the original transfer of the property to D because, pursuant to Reg. § 1.1001-2(a), P is deemed to have realized $100 of debt relief on the transfer and, accordingly, must recognize gain, as determined under Reg. § 1.1001-1(e), to the extent the $100 exceeds his basis of $30. P would also incur gift tax, thereby reducing his unified gift and estate credit, to the extent that the transfers of the appreciated property and periodic income to D exceed the annual gift tax exclusion of $10,000 ($20,000 if P is married and his wife elects to gift-split).[21] If both P and the estate are in the 50 percent marginal income tax bracket, the use of the gift-bequest transaction would result in a $6.6 tax savings to P, as compared to a direct sale of the property.[22]

Depending on the age of the donor, the closeness of his relationship with his heirs, the estimated size of his estate and other factors, a potentially more beneficial result could be achieved by having the decedent borrow against the property and then transfer the proceeds to the donor. Such a transaction would utilize the same amount of the decedent's unified credit, but would result in more immediate tax benefits to the donor.

> *Example (6):* P gives appreciated property with a basis to him of $30 and a fair market value of $150 to D within one year of D's death. Shortly before his death, D borrows $100 from a bank, using the property as security for the borrowing, and makes a gift to P of this amount. P invests the $100 and transfers sufficient income to D to pay the interest on D's debt. At the date of D's death, the basis and fair market value of the property are unchanged at $30 and $150, respectively. If the executor sells the property for $150, pays off the $100 debt and distributes the balance to P, the executor's basis would be $110 (two-thirds of $150, or $100, plus one-third of $30, or $10), and the estate would recognize a gain of $40. If both P and the estate are in the 50 percent marginal income tax bracket, the use of the gift-bequest transaction would result in a $16 tax saving to P.[23] However, P's unified credit would be reduced by the gift tax on the transfers of appreciated property and periodic income to D to the extent they exceed the annual gift tax exclusion of $10,000 ($20,000 if P is married and his wife elects to gift-split).[24]

Although the use of a gift-bequest transaction between nonspouses can produce an immediate tax saving to the donor, it is important to recognize that the transaction also can increase the donor's total income and estate taxes. In the preceding two examples, the gift-bequest transactions reduced the donor's unified credit by $13 and $42, respectively, assuming that no taxable gifts had previously been made by the donor.[25]

---

[20] IRC Secs. 2503(b) and 2513(a); Reg. §§ 25-2503-2 (a) and 25.2513-1.

[21] H. R. Rep. No. 1380, supra note 5; see id.

[22] If P had sold the property directly, he would have incurred $24 of tax on the $120 long-term capital gain ($150 sales price less $30 basis). This tax would have been $6.6 greater than the tax of $17.4 resulting from the gift-bequest transaction (tax of $14 to P on the $70 long-term capital gain plus tax of $3.40 to the estate on the $17 long-term capital gain).

[23] See note 18, supra.

[24] See note 21, supra.

[25] In Example (5), the transfer of appreciated property to the decedent resulted in a gift of $50 ($150 fair market value less $100 debt assumed by the decedent) by the donor, pursuant to Section 2512(b). In Example (6), the transfer of appreciated property to the decedent resulted in a gift of $150 by the donor pursuant to Section 2512(a). Under the assumption that in order to pay the interest on the debt the donor transferred to the decedent an amount equal to the annual gift tax exclu-

(Continued on following page.)

If at the time of the transfer the donor had a life expectancy of 30 years, the present values of the reductions of his unified credit would be $2.3 and $7.3, respectively, using a 6 percent discount rate.[26] Thus, the present values of the donor's tax savings from the transfer would be only $4.3 and $8.7, respectively.[27] In addition, any proceeds from the sale of the appreciated property which are not disposed of during the donor's lifetime would be included in the donor's gross estate and, upon his death, would be subject to estate tax.[28]

Conclusion

Under certain circumstances, owners of appreciated property may hold their investments longer than ordinarily would be the case because of their reluctance to incur the long-term capital gains tax arising from a sale of the property. Section 1014(e) seeks to prevent these individuals from transferring their property to a decedent immediately prior to death and, by reacquiring the property by will with a stepped-up basis, from avoiding the payment of income tax on the appreciation. Although Section 1014(e) prevents this specific form of tax abuse, it also leaves open several planning techniques. As discussed in this article, in certain situations owners of appreciated property may be able to achieve a full or partial step-up in basis by use of either the pecuniary bequest or pro-rata basis rules. However, because such gift-bequest transactions may be subject to challenge by the IRS, it is imperative that all parties document their motives.

It is also important that the parties involved in a gift-bequest transaction recognize that Section 1014(e) applies to prevent only the step-up in basis of appreciated property. If the transferred property is depreciated rather than appreciated in value, the reacquisition of the property by a donor would result in a stepped-down basis and no loss would be recognized upon a subsequent sale of the property. ●

(Footnote 25 continued.)
sion and that the donor previously had not made any taxable gifts, the gift tax resulting from the gift-bequest transaction would be $13 and $42, respectively, in each of the two examples. For illustrative purposes, these tax computations are based on thousands of dollars and are reported omitting the last three digits.

[26] Assuming in Examples (5) and (6) that the donor had a life expectancy of 20 years at the time of the transfer, the present values of the reductions of his unified credit would be $4 and $13, respectively, using a 6 percent discount rate, or $2.3 and $7.5, respectively, using a 9 percent discount rate.

[27] In Examples (5) and (6), the gift-bequest transactions resulted in an immediate tax saving to the donor of $6.6 and $16, respectively. By subtracting from these tax savings the present values of the reductions in the donor's unified credit of $2.3 and $7.3, the present values of the donor's tax savings are calculated as $4.3 and $8.7, respectively.

[28] IRC Sec. 2031(a); Reg. § 20.2031-1(a).

Labor Organization Not Liable for Political Organization's Tax

A labor organization that did not earmark a certain percentage of members' dues for use for political purposes but that transferred funds from its general accounts into separate segregated accounts for state election purposes was considered to have made a qualifying transfer to a separate fund for purposes of avoiding the tax on political organizations, the IRS has privately ruled.

The organization's bylaws contained no provision that required a specified amount to be withheld from a member's dues and turned over to a segregated fund for election purposes. However, the union officers and board of directors determined the amounts to be transferred into the segregated accounts at their meetings.

The IRS determined that the organization's funds, which were expended only for state election purposes, satisfied state campaign financing laws, which did not require that members must voluntarily check off the amount of their dues that is to be used for campaign purposes. The funds remained in the organization's interest-earning general accounts for a short period of time, satisfying the IRS that the funds were not used to earn investment income for the organization. —IRS Letter Ruling 8628001, CCH EXEMPT ORGANIZATIONS REPORTS ¶ 7075.