Form 886A	Department of the Treasury - Internal Revenue Service **Explanation of Items**	Schedule No. or Exhibit
Name of Taxpayer James B. Gottstein	**DRAFT DOCUMENT**	**Year/Period Ended** December 31, 2009 and December 31, 2010

REC'D MAR 15 2012

Issues:

Whether the legal fees of a member of the Board of Directors, James Gottstein, paid by an IRC § 501(c)(3) exempt organization, The Center for the Study of Psychiatry, is excess benefit and subject to correction, interest and excise tax of 25% and if uncorrected during the taxable period, an additional 200% excise tax.

Facts:

During the examination of forms 990-EZ for years ending May 31, 2009 and May 31, 2010, it was discovered payments of $19,796.50 had been paid by the Center for the Study of Psychiatry through a designated legal fund to attorneys for James Gottstein's legal fees.

The Center for the Study of Psychiatry's application for recognition of exemption, form 1023, filed on October 31, 1974, requested exemption based on "research and educational endeavors" to be made available to the general public relating to psychosurgery.

Tax deductible donations to the James Gottstein Legal Fund were collected by the Center for the Study of Psychiatry and distributed to pay personal legal fees incurred in defense of a lawsuit brought by drug company, Eli Lilly. The amount spent on the legal defense fund represented a significant portion of all expenses paid throughout the organization's fiscal years 2009 and 2010.

James Gottstein was a director on The Center for the Study of Psychiatry's Board of Directors during the time payments were made.

The organization did not file employment tax returns or Forms 1099-misc for benefit provided to James Gottstein through the payment of legal fees. There is no documentation that he was acting on behalf of the organization.

Law:

Section 4958 of the Code imposes excise taxes on each excess benefit transaction between an applicable tax-exempt organization and a disqualified person.

Section 4958(e) defines "applicable tax-exempt organization" as an organization described in either IRC § 501(c)(3) or IRC § 501(c)(4), or an organization which was so described at any time during the five-year period ending on the date of the excess benefit transaction, but such term does not include a private foundation as defined in IRC §509(a).

Section 4958(c)(1)(A) defines "excess benefit transaction" as any transaction in which an economic benefit is provided by an "applicable tax-exempt organization" directly or indirectly to or for the use of any disqualified person if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit.

Section 4958(f)(1) of the regulations defines "disqualified persons" as (A) any person who was, at any time during the five-year period ending on the date of such transaction, in a position to exercise substantial influence over the affairs of the organization, (B) a member of the family of a disqualified person, and (C) a 35 percent controlled entity.

Reg. 53.4958-3(c) provides that voting members of the governing body, presidents, chief executive officers, or chief operating officers are persons who are in a position to exercise substantial influence over the affairs of the organization.

Reg. 53.4958-4(c)(1) provides that an economic benefit is not treated as consideration for the performance of services unless the applicable tax-exempt organization providing the benefit clearly indicates its intent to treat the benefit as compensation when the benefit is paid.

Reg. 53.4958-4(a)(2) provides, in relevant part, that a transaction that would be an excess benefit transaction if the applicable tax-exempt organization engaged in it directly with a disqualified person is likewise an excess benefit transaction when it is accomplished indirectly through an intermediary.

Section 4958(a)(1) of the Code imposes on each excess benefit transaction a tax equal to 25 percent of the excess benefit (the "first tier tax"). This tax must be paid by any disqualified person with respect to such transaction.

Section 4958(b) of the Code provides that where an initial tax is imposed, but the excess benefit involved in such transaction is not corrected within the taxable period, a tax equal to 200 percent of the excess benefit involved is imposed and must be paid by any disqualified person with respect to such transaction (the "second tier tax").

Taxpayer's Position

In his letter to the Internal Revenue Service dated February 17, 2012, James Gottstein stated that there is "no excess benefit payment and no tax due" and he believes there wasn't anything improper with the payments to his lawyers.

Mr. Gottstein's legal fees stem from his defense against drug maker, Eli Lilly, resulting from a release of information under protective order regarding the harmful effects of the drug, Zyprexa

Mr. Gottstein accepted The Center for the Study of Psychiatry's offer to *establish a* legal defense fund after public interest law firm, PsychRights was unable to fully fund the cost of his litigation.

The payments to Mr. Gottstein's attorneys from the legal defense fund were contributed specifically to pay for his legal defense. He further expresses the opinion that he provided a valuable service to the Center for the Study of Psychiatry in the furtherance of its mission.

Government Position

James Gottstein is a disqualified person as a member of the Board of Directors to the exempt organization under IRC section 4958(f)(1) and Treas. Reg. section 53.4958-3.

The stated exempt purpose of the Center for the Study of Psychiatry is public education and research. The organization performs its exempt purpose by education and dissemination of information through its website, publications and annual conferences.

Exemption under IRC 501(c)(3), prohibits the provision of private benefit to a disqualified person (excess benefit). Excess benefit may result in intermediate sanctions and potential revocation of the organization's exemption.

No documentation was provided by the exempt organization indicating the Mr. Gottstein was acting on their behalf or the organization was involved in the legal action resulting in the attorney fees.

The payment of personal legal fees by the organization has resulted in excess benefit to Mr. Gottstein.

Conclusion

Based on the facts presented in the examination of the Center for the Study of Psychiatry, James Gottstein is liable for the return of the legal fee payments with interest to the organization, and an excise tax of 25% under 4958(a)(1). Failing correction of the excess benefit, excise tax of 200% under IRC section 4958(b) will be imposed if the excess benefit is not corrected within the taxable period. The taxable period begins with the date on which the transactions occurred and ends on the earlier of (1) the date of mailing a notice of deficiency or the date of which the tax imposed by section 4958(a)(1) is assessed.