REC'D OCT 15 2012

Internal Revenue Service
Tax Exempt/Government Entities
N14 W24200 Tower Place
Waukesha, WI 53188

Department of the Treasury

REC'D OCT 15 2012

November 11, 2012

Taxpayer Identification Number:
[redacted]
Form:
4720-A
Tax Year(s) Ended:
December 31, 2009
December 31, 2010
Person to Contact/ID Number:
Susan Brown
Contact Numbers:
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James Gottstein
406 G Street, Suite 206
Anchorage, AK 99501

Dear Mr. Gottstein:

Thank you for your reply to our 30-day letter and the subsequent information request. We have considered your information, but have concluded that it does not change our original report.

Enclosed is the rebuttal to your protest to Appeals of June 3, 2012 and the information as provided following the July 24, 2012 conference call.

Your case will now be sent through a review process and forwarded to Appeals as you requested.

If you have any questions, please call me at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need contact you.

Sincerely,

Susan Brown
Revenue Agent
EO Examinations

Enclosures:
Rebuttal

Rebuttal to James Gottstein's Reply dated June 3, 2012 and August 15, 2012 to IRS Report #1

James Gottstein's Appeal/Protest of Excess Benefits 30 Day Letter dated June 3, 2012 and August 15, 2012, made the following statements in response to Revenue Agent's Report #1 which we are rebutting. Statements made in Mr. Gottstein's Appeal which do not contribute to the clarification of related issues will not be addressed.

Mr. Gottstein's disagrees with Issue 2, and consequently Issue 3 and 4.

Issue 2:

Whether James Gottstein, as a disqualified person, received excess benefit under IRC § 4958(c) due to the payment of personal legal fees by The Center for the Study of Psychiatry (a.k.a International Center for the Study of Psychiatry and Psychology, Inc-ICSPP; also International Society for Ethical Psychology and Psychiatry-ISEPP) .

Issue 3:

Whether James Gottstein is liable for excise tax of 25% under IRC § 4958(a)(1); and whether James Gottstein is also liable for the additional tax (200%) on disqualified persons for failing to correct an excess benefit transaction under IRC § 4958(b).

Issue 4:

Whether James Gottstein is liable for the failure to file and failure to pay penalties assessable for failure to file Form 4720 as required under IRC § 6651.

Service Rebuttal Response:

James Gottstein failed to address in his response, 1) he is a disqualified person as a member of the Center for the Study of Psychiatry's Board of Director; 2) he participated in excess benefit transactions with the Center as defined in Internal Revenue Code Section 4958(c)(1)(A). It specifies that:

> "Excess benefit transaction" is 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.

1) Mr. Gottstein cites Article IV, Section 8 of PsychRights Bylaws:

"To the maximum extent allowed by law, the members of the Board of Directors and officers of corporation shall be indemnified..."

Service Rebuttal Response: Mr. Gottstein's contention is that a publicly supported IRC § 501(c) (3) exempt organization bylaws can require the *organization to expend its* total assets to indemnify its officers. This is incompatible with exempt organizational and operational requirements. IRC § 501(c) (3) exempt organization must provide a public benefit with "no part of the net earnings of which inures to the benefit of any private shareholder or individual..."

2) Mr. Gottstein states:

"The main point is that the legal fees are properly the obligation of PsychRights and the payments to the lawyers were for the benefit of PsychRights. They were incurred in connection with my pro bono work for PsychRights."

Mr. Gottstein provided a copy of Notice of Taking Deposition of David Egilman, MD, MPH as substantiation of PsychRights' connection under which the released information initially was received.

Service Rebuttal Response: The payments were made for legal expenses to James Gottstein's attorneys for a lawsuit filed against James Gottstein by drug manufacturer Eli Lilly, IN RE ZYPREXA INJUNCTION 474 F.Supp.2d 385 (2007). The suit was brought for permanent injunction relating to release of court protected documents which Mr. Gottstein provided to New York Times reporter Alex Berenson and others. The lawsuit was not in connection to pro bono services provided by PsychRights. PsychRights was not named as a party to the legal action. PsychRights bears no responsibility towards Mr. Gottstein for payment of his personal legal fees resulting from an unauthorized disclosure of court protected information.

According to the United States Court of Appeals for the Second Circuit, Eli Lilly & Co. v James B. Gottstein, decided August 12, 2010, Docket No. 07-107-cv, "...agreed with the district court that Mr. Gottstein's actions in acquiring and disseminating certain of these documents involved his aiding and abetting a violation of the court's protective order through the use of sham subpoenas. The district court had the power to enjoin Mr. Gottstein in these circumstances." There is no inclusion of PsychRights in the initial lawsuit or in the subsequent appeal.

However, the issue is not whether PsychRights had a responsibility to indemnify Mr. Gottstein for legal fees but that the Center for the Study of Psychiatry did pay Mr. Gottstein's legal fees.

The Center for the Study of Psychiatry, an IRC § 501 (c)(3) exempt organization, established the "Gottstein Legal Defense Fund", collected <u>tax deductible contributions</u> and paid Mr. Gottstein's attorneys with the funds. However, as an IRC § 501(c) (3) organization, they are prohibited from participating in any transaction involving inurement. As a member of the Board of Directors, James Gottstein is a disqualified person and may not receive economic benefit, directly or indirectly. Treas. Reg. 53.4958-3(c); IRC § 4958(c) (1) (A)

The Center for the Study of Psychiatry was unable to provide documentation as to the reason they chose to establish the legal defense fund or that the Board approved the payment of Mr. Gottstein's legal fees. This demonstrates Mr. Gottstein's substantial influence as a disqualified person on the organization's actions.

The Center's stated exempt purpose is research and education. Payment of a Board member's legal fees does not qualify as an educational or a research exempt purpose. The organization was not operating within its exempt purposes when it established the legal defense fund. The payments from the legal defense fund to Mr. Gottstein's attorneys provided a private benefit rather than a public benefit.

The Taxpayer Bill of Rights 2 added section 4958 to the Internal Revenue Code. Section 4958 adds intermediate sanctions as an alternative to revocation of the exempt status of an organization when private persons benefit from transactions with a nonprofit organization. Intermediate sanctions allow the Internal Revenue Service to impose excise taxes (i.e., penalties) on certain persons who improperly benefit from transactions with an exempt organization. Intermediate sanctions penalize the person(s) who benefit from an improper transaction, rather than the organization.

Imposition of the intermediate sanctions was appropriate because the excess benefit did not rise to a level where it called into question whether, on the whole, the organization functioned as a charitable tax-exempt organization.

3) Mr. Gottstein asserts:

> "PsychRights could have set up its own legal defense fund and in fact was moving in that direction, but when ISEPP," (a.k.a. Center for the Study of Psychiatry), "offered to do so, PsychRights accepted the offer. The name, 'Jim Gottstein Legal Defense Fund' was selected because it was believed it would yield the most donations."

Service Rebuttal Response: Again, the Center for the Study of Psychiatry was unable to produce any documentation relating to the establishment of the fund or authorization of the legal defense fund expenditures by their Board of Directors. No funds were paid to PsychRights. However, proof in the form of cancelled checks issued by the Center to Mr. Gottstein's attorneys is available.

4) In a letter dated August 14, 2012, Vice President of PsychRights Donald E. Roberts, questions the IRS's position relating to the donations as being for PsychRights.

Service Rebuttal Response: There is no evidence to substantiate the claim that the legal fund was for anything other than Mr. Gottstein's legal defense related to the release of court protected documents. This is clearly not an exempt purpose of a IRC § 501(c)(3) organization such as the Center for the Study of Psychiatry.

5) Mr. Gottstein provided a blog by Robert Whitaker, posted on June 7, 2012 in response to a request for substantiation of PsychRights' legal fees paid to his attorneys.

Service Rebuttal Response:

This document reiterates as previously stated,

> "...the International Center for the Study of Psychiatry and Psychology, where Gottstein was a board member, set up a legal defense fund for Gottstein, and in 2009 and 2010, paid $16,761.50 to his attorneys."

We disagree with the statement that he is to pay an excise tax of $16,761.50. This is the amount of the correction that is to be returned to the Center to be used for its charitable exempt purposes.

In summary, James Gottstein, as a disqualified person, has received excess benefit from an IRC 501(c)(3) organization and is subject to excise taxes and penalties as defined by IRC 4958 and IRC 6651.