

Internal Revenue Service

Department of the Treasury
Tax Exempt and Government Entities
N14 W24200 Tower Place, Suite 202
Waukesha, WI 53188

REC'D MAY 29 2012

Date: May 23, 2012

James B. Gottstein
406 G Street
Suite 206
Anchorage, AK 99501

Taxpayer Identification Number:

Form:
4720

Tax Year(s) Ended:
December 31, 2009 and December 31, 2010

Person to Contact/ID Number:
Susan Brown/0904966

Contact Numbers:
Telephone: (262)513-3501
Fax: (262)513-3512

Certified Mail - Return Receipt Requested

Dear Mr. Gottstein:

We are enclosing a copy of our report of examination explaining proposed adjustments to the amount of your tax for the year(s) shown above. The report identifies the act, or failure to act, on which these adjustments are based and which requires correction.

If you accept our findings, please write or call the contact person at the telephone number or address shown in the heading of this letter.

If you do not accept our findings, you may appeal the proposed adjustments through our Appeals Office. Publication 3498 and Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

If you request a conference with Appeals, you must submit a written protest within 30 days from the date of this letter. An Appeals officer will review your case. The Appeals Office is independent of the Director, EO Examinations. Most disputes considered by Appeals are resolved informally and promptly.

You may also request that we seek technical advice as explained in Publication 892. If a technical advice decision is reached, with which you do not agree, you may then appeal that decision to the Appeals Office, as explained above.

If we do not hear from you within 30 days from the date of this letter, we will issue a Statutory Notice of Deficiency based on the adjustments shown in the report of examination. We will also notify appropriate state officials of the adjustment in accordance with section 6104(c) of the Internal Revenue Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

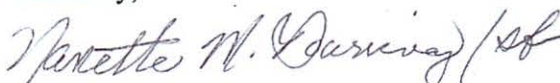
949 E. 36th Ave., Stop A-405
Anchorage, AK 99508

Phone: (907)271-6877
Fax: (907)271-6157

If you have any questions, please call the contact person 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 to contact you.

Thank you for your cooperation.

Sincerely,



Nanette M. Downing
Director, EO Examinations

Enclosures:
Publication 594
Publication 892
Publication 3498
Report of Examination
Copy of this Letter

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit 1
Name of Taxpayer James B. Gottstein		Year/Period Ended December 31, 2009 and December 31, 2010

Issue 1:

Whether James Gottstein is a disqualified person as defined in Internal Revenue Code (IRC) §4958(f)(1) with respect to The Center for the Study of Psychiatry, an organization exempt under IRC 501(c)(3).

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.

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.

Facts:

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. The Center was granted exemption as a IRC § 501(c)(3) February 27, 1975.

James Gottstein has been a member of the Board of Directors of The Center for the Study of Psychiatry since approximately 2005.

The Center for the Study of Psychiatry's forms 990-EZ for years ending May 31, 2009 and May 31, 2010 were under examination. It was determined through review of the organization's records, legal fee payments of \$16,761.50 had been made to the attorneys Beckman and Henoch and D. John McKay with a notation for Jim Gottstein's legal fund. Bank statements and check copies were reviewed to confirm the payments were accurately reported.

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Tax deductible donations to the James Gottstein Legal Fund were collected by the Center for the Study of Psychiatry and distributed to Mr. Gottstein's attorneys to pay personal legal fees incurred in defense of a lawsuit brought by drug company, Eli Lilly.

Eli Lilly filed suit against Mr. Gottstein for release of court protected documents to the public and the New York Times relating to the harmful effects of drug, Zyprexa. Mr. Gottstein had received the documents through a subpoena during the pro bono representation of William Bigley for the public interest law firm, Law Project for Psychiatric Rights (PsychRights).

James Gottstein is the founder, CEO and President of PsychRights. He states PsychRights bylaws indemnifies its officers against lawsuits brought about due to actions taken on behalf of the organization. However, the organization didn't have sufficient funds to pay the cost of Mr. Gottstein's legal fees relating to the Lilly suit. He, therefore, accepted The Center for the Study of Psychiatry offer of establishing a legal defense fund.

There are no minutes or written documentation of Board of Director's authorization, discussion or approval of the "James Gottstein Legal Fund" or that his actions were on behalf of The Center for the Study of Psychiatry at the time the lawsuit was filed. Dominick Riccio, PhD, past executive director, in an email dated October 6, 2011 stated a Board subcommittee had met in January 2007. It had been decided that actions taken by Mr. Gottstein were in keeping with the organization's mission of dissemination of the truth of psychiatric treatments and that a special fund raising effort be initiated.

The Center for the Study of Psychiatry did not file employment tax returns or Forms 1099-misc for Mr. Gottstein's legal fee payments.

Payments made by the Center for the Study of Psychiatry for Mr. Gottstein's legal expenses which were confirmed through review of supporting documentation from the Center for the Study of Psychiatry are as follows:

<u>Date</u>	<u>Organization's Check #</u>	<u>Amount</u>
2/04/2009	1320 Beckman, Henoch	\$7,287.00
11/16/2009	1331 Beckman, Henoch	<u>4,000.00</u>
	2009 Total	11,287.00
3/09/2010	1333 D. John McKay	<u>5,474.50</u>
	2010 Total	5,474.50

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Grand Total \$16,761.50

Law

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

Internal Revenue Code Section 4958(a)(1) 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.

Internal Revenue Code Section 4958(b) 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").

Internal Revenue Code 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.

Internal Revenue Code 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).

Internal Revenue Code 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.

Internal Revenue Code Section 6651(a)(1) relating to failure to file any return required unless due to reasonable cause and not willful neglect, an additional tax of 5 percent per month of failure, not to exceed 25 percent.

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Internal Revenue Code Section 6651(a)(2) imposes an amount of .5 percent of the tax if the tax is not paid when due for each month during which such failure continues, not exceeding 25 percent in the aggregate.

Treasury Regulation 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.

Treasury Regulation 53.4958-4(a)(2) provides 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.

Treasury Regulation 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.

Treasury Regulation 53.4958-7(c) provides the correction amount is the sum of the excess benefit and interest. The interest charge is determined by multiplying the excess benefit by an interest rate equaling or exceeding the applicable federal rate compounded annually from the date of the transaction to the date of the correction.

Treasury Regulation 53.6011-1(b) states every person who is liable for tax imposed by section 4958 shall file the annual return with respect to each act for the year in which the liability occurred.

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". He believes there wasn't anything improper with the payments to his lawyers by The Center for the Study of Psychiatry.

The payments to Mr. Gottstein's attorneys from the legal defense fund were contributed by donors 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.

In his response dated March 27, 2012, Mr. Gottstein maintains that the legal fees are actually the responsibility of PsychRights due to his indemnification by that organization.

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Government Position

James Gottstein is a disqualified person as a member of the Board of Directors of the IRC § 501(c)(3) exempt organization, The Center for the Study of Psychiatry, under IRC section 4958(f)(1) and Treas. Reg. section 53.4958-3.

According to the organizations application for exemption, the charitable exempt purpose of the Center for the Study of Psychiatry is public education and research. The organization performs its exempt purpose by dissemination of information through its website, publications and annual conferences. Nothing in its bylaws suggests its exempt purpose includes payment of board member legal fees. While Mr. Gottstein's actions may have indirectly benefited the organization's purpose, there is no documentation that these actions were authorized by their Board of Directors or undertaken on the organization's behalf. As a fellow Board member, one would expect to see a summary discussion of how the organization's funds in paying for Mr. Gottstein's personal expense furthered the organization's public purposes. Funding an individual, for the most part, would typically violate the fundamental provisions of IRC Section 501(c)(3) indicating private as opposed to public intent.

The legal fees paid to Mr. Gottstein's attorneys were for personal services related to the lawsuit regarding the Eli Lilly document release, not the defense of Mr. William Bigley by PsychRights. Though Mr. Gottstein did not receive payments directly from the Legal Defense Fund, payments were solely for his benefit. Treasury Regulation 53.4958-4(a)(2).

It is unlikely the organization would have established a legal defense fund for Mr. Gottstein if he hadn't been a member of their Board of Directors, which points to Mr. Gottstein's substantial influence. IRC § 4958(f)(1).

The payment of personal legal fees by the organization has resulted in excess benefit to Mr. Gottstein as defined in IRC § 4958.

Conclusion

Issue 1 - Based on the facts presented, James Gottstein is a disqualified person according to IRC § 4958(f)(1) and Treas. Reg. 53.4958-3(c). As a Board member, he is in a position to influence the management and oversight of the Center for the Study of Psychiatry.

Issue 2 - Mr. Gottstein engaged in excess benefit transactions as defined in IRC § 4958(c)(1)(A). Funds were collected by the Center for the Study of Psychiatry and paid

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to Mr. Gottstein's personal attorney in order to contest a legal action against him. The legal action was not aimed at the Center for the Study of Psychiatry.

Issue 3 – As a result of engaging in excess benefit transactions, Mr. Gottstein is liable for the excise tax of 25% under 4958(a)(1).

To date, Mr. Gottstein has failed to correct the excess benefit and return the funds paid to him (with interest) to Center for the Study of Psychiatry. Under IRC Section 4958(b), in any case in which an initial tax is imposed by Subsection 4958(a)(1) of the Code on an excess benefit transaction and such transaction is not corrected within the taxable period, the excise tax of 200% will be imposed. 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.

The correction amount is the total of the excess benefit transaction plus interest compounded annually from the transaction date.

EBT Date	EBT Amount	Correction Date	AFR Term	Interest Rate	Compound Interest
2/4/2009	7,287.00	6/1/2012	Mid	1.65	407.23
11/16/2009	4,000.00	6/1/2012	Short	0.71	72.58
3/9/2010	5,474.50	6/1/2012	Short	0.64	78.49
Total	16,761.50				558.30
Total Correction Required: = \$ 17,319.80					

Mr. Gottstein is liable for 25% excise tax related to the excess benefit he received and failing correction within the taxable period, he is also responsible for the 200% excise tax as shown below:

25% Excise tax applicable for year ending December 31, 2009	\$2821.75
25% Excise tax applicable for year ending December 31, 2010	<u>\$1368.63</u>
	\$4190.38
200% Excise tax applicable for year ending December 31, 2009	\$22,574.
200% Excise tax applicable for year ending December 31, 2010	<u>\$10,949.</u>
	\$33,523

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Issue 4 – Form 4720 must be filed annually reporting the excess benefit transactions that occurred which gave rise to the tax liability under IRC §4958. Treas. Reg. 53.6011-1(b).

As a disqualified person, Mr. Gottstein was required to file Form 4720 and pay the excise taxes that should have been reported on Form 4720 on or before the required due date, including extensions of time. A penalty of 5% up to 25% of the amount of the correct tax under IRC § 4958 for failure to file the required return and penalty of 1/2% for each month that the disqualified person did not pay the correct tax would apply, but not exceeding 25% in total. If the disqualified person establishes that the failure to pay was due to reasonable cause and not due to willful neglect, the penalty would not apply. A showing of reasonable cause would include factors that indicated that the disqualified person exercise ordinary care and prudence. In determining if the taxpayer exercised ordinary care and prudence in providing for the payment of his tax liability, consideration will be given to the nature of the tax which the taxpayer has failed to pay. See IRC § 6651(a)(1); IRC § 6651(a)(2).

James Gottstein's failure to file form 4720 for the tax years ending December 31, 2009 and December 31, 2010 results in the following applicable penalties:

<u>Year</u>	<u>Tax</u>	<u>Due Date</u>	<u>Months Late</u>	<u>Penalty</u>
2009	\$2,821.75	5/15/2010	5 x 4.5%	\$ 634.89
2009	\$2,821.75	5/15/2010	25 x ½%	\$ 352.72
2010	\$1,368.75	5/15/2010	5 X 4.5%	\$ 307.97
2010	\$1,368.75	5/15/2011	13 x ½%	\$ 88.97
Total Penalties under §6651(a)(1) & 6651(a)(2)				\$1,384.55

Exempt Organizations - Report of Examination

(Proposed Tax Changes)

1. Form No. 4720	2. Area Office Waukesha	3. Date of Report 5/22/2012
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4. Name and Address of Taxpayer James Gottstein 406 G Street, Suite 206 Anchorage, AK 99501-2164	5. Name and Address of Private Foundation or Other Exempt Organization (If different from Item 4) Center for the Study of Psychiatry d/b/a International Society for Ethical Psychology and Psychiatry 2711 Sunrise Point Rd Las Cruces, NM 88011
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6. Social Security Number or Employer Identification Number [REDACTED]	7. Tax Period(s) Ended		8. Private Foundation's or other Exempt Organization's Employer Identification Number (If different from Item 6) 23-7378417	9. Tax Period(s) Ended	
	12/31/2009	12/31/2010		5/31/2009	5/31/2010

10. Report Preparer's Name Susan Brown	11. Agreement Secured (Check one.) Yes <input type="checkbox"/> No <input checked="" type="checkbox"/>
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12. Findings Discussed with (Name and Title) James Gottstein	13. Agreement Date
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14a. Summary of Proposed Adjustments				14b. Penalty	
Internal Revenue Code Section (1)	Period Covered by Examination (2)	Amount of Tax (3)	Additional Tax (4)	Internal Revenue Code Section (1)	Amount (2)
4958(a)(1)	12/31/2009	2821.75		6651(a)(1)	634.89
4958(a)(1)	12/31/2009			6651(a)(2)	352.72
4958(b)	12/31/2009	22574.00			
4958(a)(1)	12/31/2010	1368.63		6651(a)(1)	307.97
4958(a)(1)	12/31/2010			6651(a)(2)	88.97
4958(b)	12/31/2010	10949.00			

15. Remarks See form 886A for explanation of proposed adjustment.
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16. Attachments form 886A, form 4883, letter 3614,

Exempt Organizations Excise Tax Audit Changes

(Chapter 41, Chapter 42, and Section 170(f)(10)(F) Excise Taxes)

Name of Taxpayer James Gottstein	Employer ID No. [REDACTED]	Schedule or Exhibit 1
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Name of Exempt Organization (if different from taxpayer)

Center for the Study of Psychiatry

		Taxable Years Ended		
		12/31/2009	12/31/2010	
Internal Revenue Code Section for Proposed Adjustment		4958	4958	
1. Adjustments	Excess benefit transactions	11287.00	5474.50	
2.	Total Adjustments	11287.00	5474.50	
3.	Amount reported on return or as previously adjusted	0	0	
4.	Total amount as corrected	11287.00	5474.50	
5.	Applicable tax rate %	25%	25%	
6.	Initial tax liability as corrected (line 4 x line 5)	2821.75	1368.63	
7.	Initial tax liability reported	0	0	
8.	Increase or (decrease) in tax	2821.75	1368.63	
9.	Additional tax (minimum)	22574.00	10,949.00	
10.	Penalties (Code section <u>6651(a)(1) & (2)</u>)	987.61	396.94	

Explanation of Adjustments

See 886A for the explanation of adjustments.