

# Jim Gottstein

406 G Street, Suite 206  
Anchorage, Alaska 99501  
907-274-7686

June 3, 2012

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

Internal Revenue Service  
Attention: Appeals  
949 E. 36th Ave.  
Anchorage, AK 99508

Re: Appeal/Protest of Excess Benefits 30 Day Letter

Dear Internal Revenue Service (Service):

This is to appeal/protest the Service's findings in the enclosed "30 Day Letter" pertaining to asserted excess benefits with respect to tax years 2009 and 2010.

I do not agree with the Service's determination on Issue 2, that I received excess benefits, which means I also do not agree with the Service's determination on Issues 3 & 4 as well, that I owe a 25% excise tax and additional 200% additional tax for failing to correct an excess benefit transaction within the applicable tax period, and that I owe failure to pay penalties assessable for failure to file Form 4720.

With respect to the additional 200% tax, I was informed by Ms. Susan Brown, IRS Identification No. 0904966, that it would not be applicable if I paid the Center for the Study of Psychiatry d/b/a International Society for Ethical Psychology and Psychiatry (ISEPP) prior to a notice of deficiency, should that occur. I will have to borrow the money to do so and have such a loan in progress. I hope that instead the Appeals Office will agree the position taken by the Service is incorrect or we can achieve some sort of mutually acceptable resolution and avoid litigation in the Federal Courts.

Additionally, the Issue 4 penalty should not be assessed because the facts set forth below demonstrate I had reasonable cause and the failure was not due to willful neglect.

## Appeal Procedure.

As a preliminary matter, the instructions the Service provided regarding how to appeal are very confusing and contradictory. The 30-Day Letter states:

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.



Since I am not accepting the findings, it would not appear this appeal should be filed to the "address shown in the heading of [the 30-Day] letter," but instead the address shown in Publication 3498 or 892. Publication 3498 (Rev. 11-2004), The Examination Process, states on the first page, "You must request reconsideration in writing and submit it to your local IRS office. Publication 892 (Rev. 1-2012), How to Appeal an IRS Decision on Tax-Exempt Status, states on the first page, "Submit your protest and any supporting documents to the address shown on the letter." The only address on the 30-Day letter, other than for Taxpayer Advocate Assistance, is in the letterhead for Tax Exempt and Government Entities, which issued the 30-Day Letter, and does not appear to be the Appeals Office. Filing it there is contradictory to the inference from the above quoted section of the 30-Day Letter that an appeal is not to be filed there.

It is perhaps understandable there is no clear guidance from Publications 3498 and 892, since neither of them pertain to the 30-Day letter. Publication 892 (Rev. 1-2012), is titled How to Appeal an IRS Decision on Tax-Exempt Status, but the 30 Day Letter is not about tax exempt status. Much of what is contained therein is inapplicable. Similarly, Publication 3498 (Rev. 11-2004), The Examination Process, pertains to a different process and is also largely inapplicable.

My experience with calling Ms. Brown is that she will not put anything she advises me in writing and I do not feel I can rely on her oral representations because they may be denied or disavowed by the Service. In light of this and the contradictory written instructions, I feel I have no choice but to file in both places. If this is not sufficient, I believe you should consider the appeal properly and timely filed, forward the appeal to the proper office, and notify me of where that is. If, instead, I should file in some other place, you should notify me immediately.

#### Facts.

Substantively, in connection with my *pro bono* representation of William Bigley for the tax-exempt, public interest law firm, Law Project for Psychiatric Rights (PsychRights®), EIN 55-0805233, I subpoenaed documents from Dr. David Egilman, an expert witness in the multidistrict federal litigation over Eli Lilly (Lilly) hiding from doctors and the public that Zyprexa causes diabetes and other metabolic problems, and that Lilly had engaged in illegal "off-label" promotion. Under the terms of the applicable protective order, Dr. Egilman was not to produce the documents until after Lilly had a reasonable opportunity to object. I fully expected Lilly to object in time, in which event, I would be arguing to the Alaska court that Mr. Bigley was entitled to these documents because he needed them to demonstrate why being drugged against his will was not in his best interests.

When almost a week went by without an objection from Lilly, Dr. Egilman determined Lilly had had a reasonable opportunity to object and produced the documents. PsychRights released them to the public, including the New York Times. This resulted in



a series of New York Times articles, starting on December 17, 2006,<sup>1</sup> which in turn reportedly caused the government's investigation into Lilly's actions around Zyprexa to "gain momentum," concluding in civil False Claims Act and criminal penalties of \$1.4 Billion.<sup>2</sup>

Neither PsychRights nor I received any of this money, but instead had been subjected to the legal onslaught by Lilly's army of lawyers. The initial payment of \$10,000 was paid by PsychRights, which was quite appropriate since I had undertaken the representation under its auspices. However, I quickly realized that PsychRights would be bankrupted by the legal costs and started trying to pay them myself. The legal costs were so high, however, that I was not able to pay them all myself.

PsychRights could have set up its own legal defense fund, and in fact was moving in that direction, but when ISEPP 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.

Except for what I think was a \$1,000 contribution from ISEPP, all of the funds paid to the lawyers were from directed donations by individuals to the Legal Defense Fund. In other words, people donated the money specifically to pay for the legal defense. I received no funds personally. The mission of ISEPP is closely aligned with that of PsychRights and I believe they considered that I had provided a hugely valuable service in furtherance of its mission as well. However, from my perspective, that is not the main point. 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. The only reason I paid any of them was because PsychRights was not in a position to do so.

Article IV, Section 8 of PsychRights Bylaws provides, "To the maximum extent allowed by law, the members of the Board of Directors and officers of the corporation shall be indemnified, defended and held harmless from all acts taken on behalf of the corporation." The representation that caused the legal fees was taken on behalf of the corporation. As noted above, the first \$10,000 payment was made from PsychRights funds, but inasmuch as the legal fees were going to bankrupt PsychRights, I started paying what I could, expecting PsychRights to indemnify me when it was in a position so to do. I have paid \$125,000 of my own funds and the lawyers are still owed an estimated almost \$130,000.

In sum, the legal fees were and are PsychRights' obligation. Thus, I received no excess benefit, directly or indirectly.

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<sup>1</sup> See, <http://psychrights.org/States/Alaska/CaseXX.htm#NYTimes>.

<sup>2</sup> See, Exhibit A, January 30, 2008, *New York Times* article titled, "Lilly in Settlement Talks With U.S." and Exhibit B, January 15, 2009, News Release from the Department of Justice, titled, "Eli Lilly and Company Agrees to Pay \$1.415 Billion to Resolve Allegations of Off-label Promotion of Zyprexa; \$515 Million Criminal Fine Is Largest Individual Corporate Criminal Fine in History; Civil Settlement up to \$800 Million."

Authority

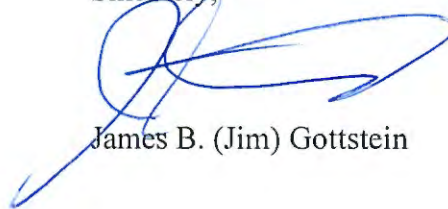
When I was in law school some 35 years ago, my tax law professor taught that the courts look at the substance of a transaction in deciding how to classify it. The substance of the transactions at issue in this appeal is that I received no excess benefit.

I was able to find just two court cases interpreting Treas. Reg. 53.4958, *Dzina v. U.S.*, 345 F.Supp.2d 818 (N.D.Ohio 2004) and *Caracci v. C.I.R.*, 456 F.3d 444, (5th Cir 2006). Neither case is directly applicable to the question at hand, but I would suggest the Service's position here is as overreaching as the 5th Circuit concluded in *Caracci*.

I hope the appeals office will correct this overreaching.

Under the penalties of perjury, I declare that I examined the facts stated in this protest, including any accompanying documents, and, to the best of my knowledge and belief, they are true, correct, and complete.

Sincerely,



James B. (Jim) Gottstein



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January 30, 2008

## Lilly in Settlement Talks With U.S.

By ALEX BERENSON

Eli Lilly and federal prosecutors are discussing a settlement of a civil and criminal investigation into the company's marketing of the antipsychotic drug Zyprexa that could result in Lilly's paying more than \$1 billion to federal and state governments.

If a deal is reached, the fine would be the largest ever paid by a drug company for breaking the federal laws that govern how drug makers can promote their medicines.

Several people involved in the investigation confirmed the settlement discussions. They insisted on anonymity because they have not been authorized to talk about the negotiations.

Zyprexa has serious side effects and is approved only to treat people with schizophrenia and severe bipolar disorder. But documents from Lilly show that between 2000 and 2003, Lilly encouraged doctors to prescribe Zyprexa to people with age-related dementia, as well as people with mild bipolar disorder who had previously been diagnosed only as depressed.

Although doctors can prescribe drugs for any use once they are on the market, it is illegal for drug makers to promote their medicines any uses not formally approved by the Food and Drug Administration.

Lilly may also plead guilty to a misdemeanor criminal charge as part of the agreement, the people involved with the investigation said. But the company would be allowed to keep selling Zyprexa to Medicare and Medicaid, the government programs that are the biggest customers for the drug. Zyprexa is Lilly's most profitable product and among the world's best-selling medicines, with 2007 sales of \$4.8 billion, about half in the United States.

Lilly would neither confirm nor deny the settlement talks.

"We have been and are continuing to cooperate in state and federal investigations related to Zyprexa, including providing a broad range of documents and information," Lilly said in a statement Wednesday afternoon. "As part of that cooperation we regularly have discussions with the government. However, we have no intention of sharing those discussions with the news media and it would be speculative and irresponsible for anyone to do so."

Lilly also said that it had always followed state and federal laws when promoting Zyprexa.

The Lilly fine would be distributed among federal and state governments, which spend about \$1.5 billion on Zyprexa each year through Medicare and Medicaid.



The fine would be in addition to \$1.2 billion that Lilly has already paid to settle 30,000 lawsuits from people who claim that Zyprexa caused them to suffer diabetes or other diseases. Zyprexa can cause severe weight gain in many patients and has been linked to diabetes by the American Diabetes Association.

Prescriptions for Zyprexa have skidded since 2003 over concerns about those side effects. But the drug continues to be widely used, especially among severely mentally ill patients. Many psychiatrists say that it works better than other medicines at calming patients who are psychotic and hallucinating. About four million Zyprexa prescriptions were written in the United States last year.

Federal prosecutors in Philadelphia are leading the settlement talks for the government, in consultation with the Department of Justice headquarters in Washington. State attorneys general's offices are also involved. Lawyers at Pepper Hamilton, a firm based in Philadelphia, and Sidley Austin, a firm based in Chicago, are negotiating for Lilly.

Nina Gussack, who is representing Lilly at Pepper Hamilton, said she could not comment on the case. Joseph Trautwein, an assistant United States attorney in the Eastern District of Pennsylvania, also declined to comment.

While a settlement has not been concluded and the negotiations could collapse, both sides want to reach an agreement, according to the people involved in the investigation. Besides the escalating pressure of the federal criminal inquiry, Lilly faces a civil trial scheduled for March in Anchorage, Alaska, in a lawsuit brought by the state of Alaska to recover money the state has spent on Zyprexa prescriptions. A loss in that lawsuit would damage Lilly's bargaining position in the Philadelphia talks.

While expensive for Lilly, the settlement would end a four-year federal investigation and remove a cloud over Zyprexa. While Zyprexa prescriptions are falling, its overall dollar volume of sales is rising because Lilly has raised Zyprexa's price about 40 percent since 2003.

Federal prosecutors have been investigating Lilly for its marketing of Zyprexa since 2004, and state attorneys general since 2005. The people involved in the investigations said the inquiries gained momentum after December 2006, when The New York Times published articles describing Lilly's multiyear efforts to play down Zyprexa's side effects and to promote the drug for conditions other than schizophrenia and severe bipolar disorder — a practice called off-label marketing.

Internal Lilly marketing documents and e-mail messages showed that Lilly wanted to convince doctors to prescribe Zyprexa for patients with age-related dementia or relatively mild bipolar disorder.

In one document, an unidentified Lilly marketing executive wrote that primary care doctors "do treat dementia" but leave schizophrenia and bipolar disorder to psychiatrists. As a result, "dementia should be first message" to primary-care doctors, according to the document, which appears to be part of a larger marketing presentation but is not marked more specifically. Later, the same document says that some primary care doctors "might prescribe outside of label."

In late 2000, Lilly began a marketing campaign called Viva Zyprexa and told its sales representatives to suggest that doctors prescribe Zyprexa to older patients with symptoms of dementia.



The documents were under federal court seal when The Times published the articles, and Judge [Jack B. Weinstein](#) of Federal District Court in Brooklyn rebuked The Times for publishing them.

The settlement negotiations in Philadelphia began several months ago, according to the people involved in the investigation.

Last fall, the two sides were close to a deal in which Lilly would have paid less than \$1 billion to settle the case, which at the time consisted only of a civil complaint.

Then Justice Department lawyers in Washington pressed for a grand jury investigation to examine whether Lilly should be charged criminally for its promotional activities, according to the people involved in the negotiations. A few days ago, facing the possibility of both civil and criminal charges, Lilly opened new discussions with the prosecutors in Philadelphia.

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# Department of Justice

FOR IMMEDIATE RELEASE  
Thursday, January 15, 2009  
[WWW.USDOJ.GOV](http://WWW.USDOJ.GOV)

CIV  
(202) 514-2007  
TDD (202) 514-1888

## **Eli Lilly and Company Agrees to Pay \$1.415 Billion to Resolve Allegations of Off-label Promotion of Zyprexa**

***\$515 Million Criminal Fine Is Largest Individual Corporate Criminal Fine in History; Civil Settlement up to \$800 Million***

American pharmaceutical giant Eli Lilly and Company today agreed to plead guilty and pay \$1.415 billion for promoting its drug Zyprexa for uses not approved by the Food and Drug Administration (FDA), the Department of Justice announced today. This resolution includes a criminal fine of \$515 million, the largest ever in a health care case, and the largest criminal fine for an individual corporation ever imposed in a United States criminal prosecution of any kind. Eli Lilly will also pay up to \$800 million in a civil settlement with the federal government and the states.

Eli Lilly agreed to enter a global resolution with the United States to resolve criminal and civil allegations that it promoted its antipsychotic drug Zyprexa for uses not approved by the FDA, the Department said. Such unapproved uses are also known as "off-label" uses because they are not included in the drug's FDA approved product label.

Assistant Attorney General for the Civil Division Gregory G. Katsas and acting U.S. Attorney for the Eastern District of Pennsylvania Laurie Magid today announced the filing of a criminal information against Eli Lilly for promoting Zyprexa for uses not approved by the FDA. Eli Lilly, headquartered in Indianapolis, is charged in the information with promoting Zyprexa for such off-label or unapproved uses as treatment for dementia, including Alzheimer's dementia, in elderly people.

The company has signed a plea agreement admitting its guilt to a misdemeanor criminal charge. Eli Lilly also signed a civil settlement to resolve civil claims that by marketing Zyprexa for unapproved uses, it caused false claims for payment to be submitted to federal insurance programs such as Medicaid, TRICARE and the Federal Employee Health Benefits Program, none of which provided coverage for such off-label uses.

The plea agreement provides that Eli Lilly will pay a criminal fine of \$515 million and forfeit assets of \$100 million. The civil settlement agreement provides that Eli Lilly will pay up to an additional \$800 million to the federal government and the states to resolve civil allegations originally brought in four separate lawsuits under the *qui tam* provisions of the federal False Claims Act. The federal share of the civil settlement amount is \$438 million. Under the terms of the civil settlement, Eli Lilly will pay up to \$361 million to those states that opt to participate in the agreement.

Under the Food, Drug, and Cosmetic Act (FDCA), a company must specify the intended uses of a product in its new drug application to the FDA. Before approving a drug, the FDA must determine that the drug is safe and effective for the use proposed by the company. Once approved, the drug may not be marketed or promoted for off-label uses.

The FDA originally approved Zyprexa, also known by the chemical name olanzapine, in Sept. 1996 for the treatment of manifestations of psychotic disorders. In March 2000, FDA approved Zyprexa for the short-term treatment of acute manic episodes associated with Bipolar I Disorder. In Nov. 2000, FDA approved Zyprexa for the short term treatment of schizophrenia in place of the management of the manifestations of psychotic disorders. Also in Nov. 2000, FDA approved Zyprexa for maintaining treatment response in schizophrenic patients who had been stable for approximately eight weeks and were then followed for a period of up to eight months. Zyprexa has never been approved for the treatment of dementia or Alzheimer's dementia.



The criminal information, filed in the Eastern District of Pennsylvania, alleges that from Sept. 1999 through at least Nov. 2003, Eli Lilly promoted Zyprexa for the treatment of agitation, aggression, hostility, dementia, Alzheimer's dementia, depression and generalized sleep disorder. The information alleges that Eli Lilly's management created marketing materials promoting Zyprexa for off-label uses, trained its sales force to disregard the law and directed its sales personnel to promote Zyprexa for off-label uses.

The information alleges that beginning in 1999, Eli Lilly expended significant resources to promote Zyprexa in nursing homes and assisted-living facilities, primarily through its long-term care sales force. Eli Lilly sought to convince doctors to prescribe Zyprexa to treat patients with disorders such as dementia, Alzheimer's dementia, depression, anxiety, and sleep problems, and behavioral symptoms such as agitation, aggression, and hostility.

The information further alleges that the FDA never approved Zyprexa for the treatment of dementia, Alzheimer's dementia, psychosis associated with Alzheimer's disease, or the cognitive deficits associated with dementia.

The information also alleges that building on its unlawful promotion and success in the long-term care market, Eli Lilly executives decided to market Zyprexa to primary-care physicians. In Oct. 2000, Eli Lilly began this off-label marketing campaign targeting primary care physicians, even though the company knew that there was virtually no approved use for Zyprexa in the primary-care market. Eli Lilly trained its primary-care physician sales representatives to promote Zyprexa by focusing on symptoms, rather than Zyprexa's FDA approved indications.

The *qui tam* lawsuits alleged that between Sept. 1999 and the end of 2005, Eli Lilly promoted Zyprexa for use in patients of all ages and for the treatment of anxiety, irritability, depression, nausea, Alzheimer's and other mood disorders. The *qui tam* lawsuits also alleged that the company funded continuing medical education programs, through millions of dollars in grants, to promote off-label uses of its drugs, in violation of the FDA's requirements.

"Off-label promotion of pharmaceutical drugs is a serious crime because it undermines the FDA's role in protecting the American public by determining that a drug is safe and effective for a particular use before it is marketed," said Gregory G. Katsas, Assistant Attorney General for the Civil Division. "This settlement demonstrates the Department's ongoing diligence in prosecuting cases involving violations of the Food, Drug, and Cosmetic Act, and recovering taxpayer dollars used to pay for drugs sold as a result of off-label marketing campaigns."

"When pharmaceutical companies ignore the government's process for protecting the public, they undermine the integrity of the doctor-patient relationship and place innocent people in harm's way," said acting U.S. Attorney for the Eastern District of Pennsylvania, Laurie Magid. "Off-label marketing created unnecessary risks for patients. People have an absolute right to their doctor's medical expertise, and to know that their health care provider's judgment has not been clouded by misinformation from a company trying to build its bottom line."

The global resolution includes the following agreements:

- A plea agreement signed by Eli Lilly admitting guilt to the criminal charge of misbranding. Specifically, Eli Lilly admits that between Sept. 1999 and March 31, 2001, the company promoted Zyprexa in elderly populations as treatment for dementia, including Alzheimer's dementia. Eli Lilly has agreed to pay a \$515 million criminal fine and to forfeit an additional \$100 million in assets.
- A civil settlement between Eli Lilly, the United States and various States, in which Eli Lilly will pay up to \$800 million to the federal government and the states to resolve False Claims Act claims and related state claims by Medicaid and other federal programs and agencies including TRICARE, the Federal Employees Health Benefits Program, Department of Veterans Affairs, Bureau of Prisons and the Public Health Service Entities. The federal government will receive \$438,171,544 from the civil settlement. The state Medicaid programs and the District of Columbia will share up to \$361,828,456 of the civil settlement, depending on the number of states that participate in the settlement.
- The *qui tam* relators will receive \$78,870,877 from the federal share of the settlement amount.
- A Corporate Integrity Agreement (CIA) between Eli Lilly and the Office of Inspector General of the Department of Health and Human Services. The five-year CIA requires, among other things, that a Board of Directors committee annually review the company's compliance program and certify its effectiveness; that certain managers annually certify that their departments or functional areas are compliant; that Eli Lilly send doctors a letter notifying them about the global settlement; and that the company post on its website



information about payments to doctors, such as honoraria, travel or lodging. Eli Lilly is subject to exclusion from Federal health care programs, including Medicare and Medicaid, for a material breach of the CIA and subject to monetary penalties for less significant breaches.

"OIG's Corporate Integrity Agreement will increase the transparency of Eli Lilly's interactions with physicians and strengthen Eli Lilly's accountability for its compliance with the law," said Department of Health and Human Services Inspector General Daniel R. Levinson. "This historic resolution demonstrates the Government's commitment to improve the integrity of drug promotion activities."

In addition to the \$1.415 billion criminal and civil settlement announced today, Eli Lilly previously agreed to pay \$62 million to settle consumer protection lawsuits brought by 33 states. The state consumer protection settlements were announced on Oct. 7, 2008.

"Today's announcement of the filing of a criminal charge and the unprecedented terms of this settlement demonstrates the government's increasing efforts aimed at pharmaceutical companies that choose to put profits ahead of the public's health," said Special Agent-in-Charge Kim Rice of FDA's Office of Criminal Investigations. "The FDA will continue to devote resources to criminal investigations targeting pharmaceutical companies that disregard the safeguards of the drug approval process and recklessly promote drugs for uses for which they have not been proven to be safe and effective."

"The illegal scheme used by Eli Lilly significantly impacted the integrity of TRICARE, the Department of Defense's healthcare system," said Ed Bradley, Special Agent-in-Charge, Defense Criminal Investigative Service. "This illegal activity increases patients' costs, threatens their safety and negatively affects the delivery of healthcare services to the over nine million military members, retirees and their families who rely on this system. Today's charges and settlement demonstrate the ongoing commitment of the Defense Criminal Investigative Service and its partners in law enforcement to investigate and prosecute those that abuse the government's healthcare programs at the expense of the taxpayers and patients."

"This case should serve as still another warning to all those who break the law in order to improve their profits," said Patrick Doyle, Special Agent-in-Charge of the Office of Inspector General for the Department of Health and Human Services in Philadelphia. "OIG, working with our law enforcement partners, will pursue and bring to justice those who would steal from vulnerable beneficiaries and the taxpayers."

The civil settlement resolves four *qui tam* actions filed in the Eastern District of Pennsylvania: *United States ex rel. Rudolf, et al., v. Eli Lilly and Company*, Civil Action No. 03-943 (E.D. Pa.); *United States ex rel. Faltous v. Eli Lilly and Company*, Civil Action No. 06-2909 (E.D. Pa.); *United States ex rel. Woodward v. Dr. George B. Jerusalem, et al.*, Civil Action No. 06-5526 (E.D. Pa.); and *United States ex rel. Vicente v. Eli Lilly and Company*, Civil Action No. 07-1791 (E.D. Pa.). All of those cases were filed by former Eli Lilly sales representatives.

The criminal case is being prosecuted by the U.S. Attorney's Office for the Eastern District of Pennsylvania and the Office of Consumer Litigation of the Justice Department's Civil Division. The civil settlement was reached by the U.S. Attorney's Office and the Commercial Litigation Branch of the Justice Department's Civil Division.

This matter was investigated by the FDA's Office of Criminal Investigations, the Defense Criminal Investigative Service and the Department of Health and Human Services Office of Inspector General.

Assistance was provided by representatives of FDA's Office of Chief Counsel and the National Association of Medicaid Fraud Control Units.

The Corporate Integrity Agreement was negotiated by the Office of Inspector General of the Department of Health and Human Services.

Eli Lilly's guilty plea and sentence is not final until accepted by the U.S. District Court.

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09-038



**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:

[REDACTED]

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:

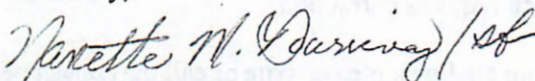
949 E. 36th Ave., Stop A-405  
Anchorage, AK 99508

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 <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	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.



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

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,
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# 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) &amp; (2)</u> )	987.61	396.94	

## Explanation of Adjustments

See 886A for the explanation of adjustments.