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Winner Of $1.3 Billion Powerball May Face Suits By Friends, Co-Workers, Family

With no winner so far, the Powerball jackpot rose to $1.3 billion. These astounding numbers seem even more likely to brew big potential liabilities. Of course, the taxes on winning tickets are an unavoidable downside. Yet even after taxes, most people assume they will end up with a lot. But apart from paying the taxman, what if friends, family or co-workers claim a share of the loot?

It happens more often than you might think, often based on an alleged oral agreement. An innocent remark about splitting the winnings might be misinterpreted. Then, you must add the inevitable lawyers' fees for defending against the claims. Most such cases settle, yet taxes can hit on such legal settlements in surprising ways too. The jackpots do not need to be in the hundreds of millions for winners to be targets. Take the 53-year-old California woman who won $1 million, but who faced a lawsuit by the liquor store owner who sold her the winning ticket.

Eva Reyes was a winner, but the owner of the liquor Store where she bought the ticket sued her. Laxmi Bhardwaj owns USA Liquors in Milpitas, California, where Ms. Reyes bought the ticket. The store owner claimed that Ms. Reyes promised to split the money—$350,000 each after taxes—for fronting the money to buy the tickets. The plaintiff claims there is a signed note guaranteeing him half the winnings. But Ms. Reyes claims the deal was for $50,000, not half.

Lottery winnings are taxed, with the IRS taking taxes at the top 39.6%. Yet the tax withholding rate on lottery winnings is only 25%. Some lottery winners can have trouble paying their taxes when they file. One must add state taxes too, and even local ones. Most states will take a nice chunk of the money too.

Still, the fallout from lottery lawsuits can be especially devastating. For one thing, the shadow of claims by co-workers, former spouses and others who say they deserve a share can tie up the money for years. So be careful what you say and to whom. In one recent case, a 20-year-old oral agreement to split lottery winnings was upheld.

Down and dirty disputes can plague lottery winners. The stakes and tax problems are larger on bigger lottery prizes, and one can only imagine that over a billion dollar win could attract all sorts of creative claims. An added problem is taxes. Unless there is a tax partnership, a winner may be taxed on it all, yet only be allowed a partial write-off for the damages paid to those claiming a share. The technical reasons are limitations on tax deductions and the dreaded AMT, which stands for alternative minimum tax.

Even if you win a lawsuit, you may have to pay the IRS, even on your attorney's fees paid directly to your lawyer. When people talk of paying tax on money they never see—like money paid to a contingent fee lawyer from a case—it is usually because of the AMT. Not every lottery case involves co-workers or friends. Sometimes the disputes are with family members, which can be even worse.

In *Dickerson v. Commissioner*, an Alabama Waffle House waitress won a $10 million lottery jackpot on a ticket given to her by a customer. The trouble started when she tried to benefit her family and spread the wealth. The Tax Court held she was liable for gift tax when she transferred the winning ticket to a family company of which she owned 49%.

Tax advice before the plan would have avoided the extra tax dollars, that were generated because the tax plan was half-baked. She shouldn't have assigned her claim in a waffle house. Time and again, winners have trouble paying their taxes and resolving disputes. But cheer up, your chances of winning are, well, tiny.

For alerts to future tax articles, email me at Wood@WoodLLP.com. This discussion is not legal advice.