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THE TAX LAWYER

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How Lottery Winners, Losers & Underground Brokers Beat Taxes

Even if you beat long odds and win the lottery, you'll have taxes to pay. It can be more challenging than you might think. Time and again, winners have trouble paying their taxes or get confused. The states vary in how they treat lottery winnings. A few states still don't have lotteries. Some states exempt their *own* state lottery winnings but not Powerball or other state lotteries.

At least the IRS is consistent. If you win big you'll pay the top 39.6% federal rate. Paying tax isn't optional, as an IRS [Form W-2G](#) will report your winnings. The lottery will make sure you pay by withholding the money and sending it to the IRS for you. But you can deduct lottery losses?



5 Year Anniversary California Lottery Tickets (Photo credit: Wikipedia)

After all, if you win \$100 but spend \$50 on tickets, you really only have a \$50 profit. From that simple rule, a business idea was born. It turns out this 'business' has become a controversial [cottage industry that helps lottery winners dodge taxes](#).

The idea was to gather up and sell losing lottery tickets. Just go on on Craigslist and eBay and see. That way you can help winners offset the profits with what might *look like real* gambling losses but here are, well, phony.

Large volumes of losing tickets are worthless, but in an odd tax-shelter way, not necessarily to everybody. Someone out there might want to buy them! And what about the flip side of this anything-goes marketplace?

Some Craigslist advertisers look to buy winners and not losers. Why? This too is pretty clever. Say you have a winning ticket but don't want to step forward to claim it. You know it's a surefire winner, but to stay in the shadows, you might be willing to sell it at a discount.

That way, the reasoning goes, you won't pay tax. And the person who buys it will have to claim it and get taxed. In fairness, it's not just taxes that closet winners are trying to dodge. There could be court orders like child support or spousal maintenance, or other types of legal debts.

Ads may indicate willingness to buy a \$1,000 ticket for \$750 and take care of the taxes. Generically, some people call these underground buyers "Ten Percenters." Talk about a strange profession. For a fee, they'll cash in your winning ticket so you can stay on the down low.

But be careful. For all parties, there could be criminal violations being committed here. The state or federal government might even be able to add a conspiracy charge. In any case, being—or dealing with—a Ten Percenter is not wise. See [Some lottery winning streaks have defied belief](#).

The fact that the lotteries *themselves* are unhappy about this may be the biggest indication that something will break. Some claim that no one is doing enough to discourage this. In Massachusetts, the Attorney General's office is said to be stirring the Ten Percenter pot, so stay tuned.

If someone cashes hundreds of winning tickets, what are the odds? Something must be up. Increasingly, there's tax withholding on winners, except for small amounts. Tax withholding doesn't completely solve the issue, but it helps.

Arguably, though, buying losing tickets is a more nuanced strategy. Losing tickets seem to be easy to find to generate phony losses. If you had to prove you bought them when they still had a chance to win, that could mess up any tax strategy, no matter how misguided.

So how big is this problem? It's not clear, and much of the juice may be in small but repetitive dollars. That could mean the IRS won't look too hard. Conversely, Ten Percenters in the horse racing industry—or in more big time lottery payments—could face tax evasion charges and jail.

But what's legal and what's not can be debated. It is evidently legal to buy or sell used tickets, though not for the purpose of tax evasion or fraud. A run for the state border with your cash isn't likely to work either, however tempting it may sound.

Remember, you can be taxed even if you split the money with family, friends or charity unless you are careful. Lottery winners frequently make tax mistakes. In [*Dickerson v. Commissioner*](#), an Alabama waitress won a \$10 million jackpot on a ticket given to her by a customer. The Tax Court held her liable for gift tax when she transferred the winning ticket to a family corporation. See [Don't Assign Litigation Claims in a Waffle House](#).

The moral? Plan your tax moves carefully. After all, tax problems can snowball—not unlike Powerball jackpots.

Contact me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.