PERSPECTIVE
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# Powerball lands in California, so what happens if you win?

**By Robert W. Wood**

Believe, and Believe Big. That's right, California has added Powerball to its repertoire of lottery offerings. Might you win big? Maybe. After all, Californians won a whopping $2.56 billion in lottery money last year. What's more, after a unanimous decision of the California Lottery Commission, we now have Powerball too.

Powerball boasts six out of ten of the biggest lottery jackpots in the country. In a way, Powerball supersizes the Golden State. Forget SuperLotto Plus and Mega Millions, which involve small stakes by comparison. Powerball lets a $2 ticket compete for $40 million. What's more, that amount goes up $10 million for each drawing without a winner.

If you need a Powerball lesson, here goes. Pick five numbers between 1 and 59, plus a Powerball number from 1 to 35. Of course, if you watch the print and TV advertisements, you might think it's about something altogether bigger, like maybe space exploration or voter's rights.

*BELIEVE, Californians are exhorted. BELIEVE IN SOMETHING BIGGER.*

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But the odds against hitting Powerball's six-number jackpot turn out to be more than 175 million to one. That's dismal, perhaps like the odds of going to outer space powered by a rubber band. You may never win the lottery, but you can always dream, and while you're at it, you may as well dream big.

California sure does, which is one reason why there's serendipity in California's Powerball. California needs money. California has high taxes and a notoriously aggressive state income taxing agency, the Franchise Tax Board. Many athletes and entertainers—not to mention regular old folks—have found themselves in scotch with California. Even if you leave California, the tax man may pursue you.

If you beat the odds and win Powerball, if you are like many lottery winners, you might have messy tax problems. Time and again, winners have trouble paying their taxes or get confused, especially if they start giving money to charity or family. Start with the presumption that all payments from any source are income. That's certainly true with lottery winnings.

For federal income tax purposes, all such winnings are income. In fact, even Nobel Prize winnings are income. No matter the contrast, if you win big, you can assume you'll pay the top 39.6 percent federal rate. Paying tax isn't optional either, as an IRS Form W-2G will report your lottery winnings.

Although most states now have lotteries, the states vary in their tax treatment of lottery winnings. A few states still don't have lotteries. But more than 40 states participate in Powerball. So does California tax our lottery winnings? Yes and no, but mostly yes.

As a result of the tax increases championed by Governor Jerry Brown, voters approved a steep increase in California's top tax rates. Currently, the Golden State's top rate is a stratospheric 13.3 percent on incomes above $1 million. Curiously, California doesn't tax winners of its *own* state lotteries, though federal tax certainly applies. Well, at least lottery winnings are not subject to the new 3.8 percent tax on investment income that is part of Obamacare.

However, the Golden State *does* tax anyone in California who wins the lottery from *any other* state. For example, if a California resident buys a non-California lottery ticket while traveling, California and the feds will both tax you. Powerball isn't strictly a California lottery, so if you win, both the feds and California will tax you.

In short, winning big doesn't mean avoiding the taxman. Some states exempt some lottery winnings but not the IRS. You might think that's the end of our story, but lottery winnings seem to attract controversy. If you're generous and give all your winnings to family, friends or even charity, no one can tax you, right? Actually, it depends on the time at which you give it away and the intended recipients. Most of the cases don't involve charity but rather involve family members.

In *Dickerson v. Commissioner*, T.C. Memo. 2012-60, an Alabama waitress won a $10 million jackpot on a ticket given to her by a customer. Ms. Dickerson's restaurant was frequented by a customer who often made gifts of Florida lottery tickets. The customer gave her a lottery ticket she later learned had a cash payout of $5 million (more than $10 million if paid over 30 years). Dickerson's family had a tradition of buying lottery tickets and often talked about sharing a jackpot, but had no written agreement.

Dickerson went to a lawyer who prepared incorporation papers for a corporation owned 49 percent by Dickerson, and 17 percent each by her mother and two siblings. But two days later, Dickerson learned that fellow waitresses claimed 80 percent of the money. When she went to Florida to collect on the ticket she elected a 30-year payout but ended up in court when lottery officials wouldn't pay in view of the competing claims.

The trial court found for her co-workers, but the Alabama Supreme Court reversed and held for Dickerson. And then came the IRS to collect gift tax on the family company shares she gave to her mother, brother and sister. So Dickerson ended up paying nearing $800,000 in gift tax too.

The Tax Court said that Dickerson would have been saved if there had been an enforceable, preexisting contract to share the lottery prize among the members of her family. There wasn't.

If you win the lottery, see an accountant or tax lawyer promptly and plan your tax moves carefully. Set aside money for taxes. Plan any transfer to charity, family or friends carefully. If you do anything aggressive on your tax return, keep a reserve. One more thing. If you don't want to attract attention, keep quiet!

**Robert W. Wood** *is a tax lawyer with a nationwide practice (www.WoodLLP.com). The author of more than 30 books including "Taxation of Damage Awards & Settlement Payments" (4th Ed. 2009 With 2012 Supplement www.taxinstitute.com), he can be reached 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.*