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Careful, That Unclaimed Winning $540M Lottery Ticket Could Be Dangerous

Someone is holding the single winning ticket for the $540 million Mega Millions jackpot. The ticket worth half a billion dollars was sold at a Speedway gas station near Interstate 70 in Cambridge City, Indiana, 50 miles east of Indianapolis. The numbers drawn late Friday night were 20, 19, 55, 73 and 8. The megaball is 5. The winner has 180 days to claim it, so what can go wrong? Plenty.

Sure, winning the $540 million Mega Millions jackpot would make you an instant millionaire. But to begin with, if you want a lump sum, the jackpot is actually only $380 million, about 30 percent less. You only get $540 million if you take your winnings in 30 payments over 29 years. Then there are taxes, and tallying the tax bill can be daunting. Taxes on lottery winnings are unavoidable, but tax withholding is only a part of it. The federal income tax withholding rate on lottery winnings is only 25%, so some lottery winners can have trouble paying their taxes when they later file their tax returns.

The 25% withholding rate isn't for everyone, but it apples to most people, provided that they provide a (valid) Social Security Number (SSN). If they don't have an SSN or don't provide it, the rate is 28%. Non-U.S. taxpayers usually have 30% withholding. But whichever withholding tax rate applies, it may not be enough. If (like most winners) your withholding is at 25%, you might owe as much as a whopping 14.6% in federal income taxes at tax return time next year. More than a few lottery winners have trouble making that big tax payment. By tax time, they may have spent some, given it away, invested it, and otherwise made writing a big check difficult to do. Then, you must add state taxes, and even local ones.

What's worse than the tax man? Unless you can manage to stay anonymous, you can expect friends, family, co-workers, creditors, and various service providers to come calling. Some just want to partake in your success. But some may actually want to sue you. Some good-natured kidding that, ‘if I ever win the lottery, I will…’ might be remembered as a binding contract.

The fallout from lottery lawsuits can be devastating. Claims by co-workers, former spouses and others who say they deserve a share of the loot can tie up the money for years. They can also make an already difficult tax situation more complex. A recent unhappy headline found a [jilted lottery winner filing for bankruptcy](). The woman won the lottery, then was sued by her former boyfriend over an alleged *oral* contract to divide the loot. An oral contract? Yes. The lottery winner lost, and then [filed for bankruptcy]().

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. A 53-year-old California woman won $1 million, but then faced a lawsuit by the owner of the liquor store where she bought the winning ticket. So, be careful what you say and to whom. Even a 20-year-old oral agreement to split lottery winnings was upheld.

Disputes can plague lottery winners. An added problem is taxes on such suits. Unless there is a partnership for tax purposes, 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. Common technical reasons for these unjust tax results are limitations on tax deductions and the alternative minimum tax (AMT). If you win a lawsuit, you still must pay the IRS, sometimes even on the attorney's fees paid to your lawyer.

Disputes with family members or friends 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. She tried to put the winning ticket in a company so she could reduce her liability as well as spread the wealth with her member members. Unfortunately, the Tax Court held that she was liable for gift taxes when she transferred the winning ticket to her family company. She only owned 49%. Tax advice before the plan would have avoided the extra tax dollars. The moral: don't do tax planning in a waffle house.

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