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THE TAX LAWYER

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Tax Preparer Wins Tax Paid Lottery, But Are Tax Paid Lotteries Tax Free?

Gene Taylor is a Los Angeles area tax preparer who bought one of California's latest lottery gimmicks: the taxes paid scratcher. California and other states wanted to offer the guiltless pleasure of playing the lottery without the horrible sting that often befalls winners. They have trouble with big tax bills.

As the California Lottery puts it, "With Taxes Paid Scratchers, winning the top prize is like winning the *whole enchilada*. The *whole hog*. The *whole nine yards*. The *whole kit 'n' caboodle*. The *whole ball of wax*. That's because when you win the **top prize, we pay the taxes** so the winnings are all yours."

"And the same is true for the 2nd Chance bonus draw. Simply submit your non-winning Taxes Paid Scratchers into 2nd Chance between **January 26 and February 23**, and you'll be given entries for a chance to win the 2nd Chance Bonus Draw prize (up to 50 entries per submission) of **\$20,000 – Taxes Paid***"



Sure, it's marketing, and a little like many other taxes paid promotions where the cost is built in. But you have to admit it's clever. After all, 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.

Gene Taylor picked up three tickets on an errand. He said he was "blown away" when one turned out to be a winner. The \$1 million prize is net of federal taxes calculated at a 25 percent tax rate. The Taxes Paid game is designed to let winners keep most, if not all, of their winnings. Asked if he'll keep playing the lottery, Taylor said, "That's as certain as death and, er, taxes. Yes. I'm a lucky guy."

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](#).

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