

**NOT FOR PUBLICATION WITHOUT THE APPROVAL OF
THE TAX COURT COMMITTEE ON OPINIONS**

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LINDA M. HARRINGTON, PETER D.	:	TAX COURT OF NEW JERSEY
HARRINGTON, JOANNE ROTH,	:	DOCKET NO. 009529-2011
OSCAR OVIEDO, MARTHA ORTIZ,	:	DOCKET NO. 000622-2011
GERARD SOLAS, MELANIE JACOB,	:	DOCKET NO. 007022-2011
ERIC K. JACOB, ROBERT K. SPACE,	:	DOCKET NO. 007023-2011
NANCY M. SPACE, ALAN MOONEY,	:	DOCKET NO. 007024-2011
and MARY MOONEY,	:	DOCKET NO. 007025-2011
	:	DOCKET NO. 007027-2011
	:	DOCKET NO. 007052-2011
Plaintiffs,	:	
	:	
v.	:	
	:	
DIRECTOR, DIVISION OF TAXATION,	:	Approved for Publication In the New Jersey Tax Court Reports
and STATE OF NEW JERSEY,	:	
DEPARTMENT OF THE TREASURY,	:	
DIVISION OF STATE LOTTERY,	:	
	:	
Defendants.	:	
-----x		

Decided: September 26, 2016

William D. Grand for plaintiffs (Greenbaum, Rowe, Smith & Davis, LLP, attorneys, Mr. Grand and Steven B. Gladis, Esq., on the briefs).

Thu N. Lam for defendant Division of State Lottery
(Christopher S. Porrino, Attorney General of New Jersey, attorney).

Ramanjit K. Chawla for defendant Director, Division of Taxation
(Christopher S. Porrino, Attorney General of New Jersey, attorney).

DeALMEIDA, P.J.T.C.

On June 29, 2009, the Legislature enacted a statute imposing for the first time in the State's history New Jersey gross income tax on New Jersey lottery winnings. The statute provides that it is effective as of June 29, 2009 and applies to all tax years beginning on or after January 1, 2009.

In an opinion issued today in a companion case, Milligan v. Director, Div. of Taxation, __ N.J. Tax __ (Tax 2016), this court held, among other things, that the square corners doctrine prevents the State from applying the amendment to assess income tax on installments of lottery winnings received by New Jersey residents in 2009 and later years from a lottery prize awarded prior to January 1, 2009. This case presents the related question of whether the square corners doctrine precludes the State from assessing gross income tax on lottery winnings from a prize awarded on or after January 1, 2009, but before June 29, 2009, the day on which the amendment to N.J.S.A. 54A:6-11 was enacted.

For the reasons stated more fully below, the court concludes that the square corners doctrine precludes the assessment of gross income tax on lottery winnings from a prize awarded on or after January 1, 2009 but before June 29, 2009. As explained in Milligan, supra, the State enacted a lottery to generate income, entered the marketplace to sell lottery tickets, and made a deliberate effort to generate ticket sales by affirmatively representing to the public that New Jersey lottery winnings are not subject to State income tax. These representations, in effect, became part of the contractual agreement between the State and plaintiffs as the bearers of a ticket entitling them to a New Jersey lottery prize awarded in March 2009. Having induced the purchase of lottery tickets with assurances that lottery winnings would not be subject to State income tax, the State may not impose the tax on winnings from any prize won prior to June 29, 2009, the date on which the amendment to N.J.S.A. 54A:6-11 was enacted. Even though plaintiffs won their lottery prize during 2009, the same year in which the amendment was enacted, the retroactive assessment of income tax on plaintiffs' lottery winnings would circumvent the State's obligation to act with integrity when engaging in financial transactions with members of the public.

I. Finding of Fact and Procedural History

Seven of the plaintiffs are residents of New Jersey who, along with three co-workers, on March 3, 2009, won a New Jersey Lottery Mega Millions lottery prize of \$216 million. They chose to receive a lump sum payment of approximately \$140 million. After the prize winnings were split ten ways, each plaintiff received approximately \$14 million.¹

When plaintiffs won their lottery prize and claimed their winnings, N.J.S.A. 54A:6-11 excluded New Jersey lottery winnings from income subject to New Jersey gross income tax. In March 2009, the Division of State Lottery advertised in its brochures and on its website that winners of a New Jersey lottery prize are not required to pay New Jersey gross income tax on their winnings. Division of State Lottery officials candidly admitted that these representations were intended to generate lottery ticket sales and to exploit a perceived business advantage over neighboring States. This was especially true with respect to New Jersey residents who work out of State. Prior to the amendment to N.J.S.A. 54A:6-11, while New Jersey excluded lottery winnings from State income tax, nearby States taxed lottery winnings.

As Dominick DeMarco, the Public Information Officer for the State Lottery in 2009, explained in a February 3, 2009 email: “[W]e have a competitive advantage right now, since both PA and NY tax winnings in their states. It may not sound like much, but the bigger jackpots get, the more that comes into play.” During discovery, the State Lottery admitted that prior to June 29, 2009, the Division’s website stated that “New Jersey residents who win a New Jersey Lottery prize are not required to pay any New Jersey state income tax on their winnings.” Similar statements

¹ An additional five plaintiffs are the spouses of lottery winners, with whom they file joint New Jersey gross income tax returns. The twelve plaintiffs are referred to collectively as “plaintiffs” in this opinion.

were for years prior to June 29, 2009 stated in game rules, game descriptions, websites, and game pamphlets distributed to over 6,000 retail locations throughout the State.

Plaintiffs validated their winning ticket and claimed their prize winnings shortly after the March 3, 2009 drawing. On March 17, 2009, after federal income tax was withheld, each plaintiff received from the State a check in the amount of \$10,546,875. Each plaintiff also received a letter signed by the acting Executive Director of the State Lottery which stated:

The total amount of your cash prize is \$14,062,500.00. The check which you receive today will be in the net amount of \$10,546,875.00, which is your cash prize of \$14,062,500.00 less twenty-five percent (25%) federal withholding tax of \$3,515,625.00 which the Lottery is required to deduct”

Neither the Executive Director’s letter nor any other materials issued to plaintiffs at the time that they received their winnings indicated that their lottery winnings were subject to New Jersey gross income tax. This is so because at the time that plaintiffs received their prize money, N.J.S.A. 54A:6-11 excluded New Jersey lottery winnings from State income tax.

In 2009, the Legislature, as part of the annual State budget process, identified the need to raise over \$1 billion in revenue. On June 11, 2009, a few months after plaintiffs claimed their lottery prize, A4102 was introduced in the State Legislature. That bill, amending N.J.S.A. 54A:6-11 to provide that New Jersey Lottery “winnings from a prize in an amount exceeding \$10,000 shall be included in gross income” subject to tax, was enacted into law on June 29, 2009. L. 2009, c. 69. According to L. 2009, c. 69, §5, the amendment to N.J.S.A. 54A:6-11 “shall take effect immediately and apply to taxable years beginning on or after January 1, 2009.”²

² When N.J.S.A. 54A:6-11 was amended to extend the gross income tax to certain lottery winnings, the Legislature also enacted legislation temporarily increasing gross income tax rates for taxpayers with taxable income exceeding \$400,000 and temporarily suspending property tax deductions for certain taxpayers with income exceeding \$150,000. See L. 2009, c. 69. A Fiscal Note estimated a total of more than \$1 billion in new revenue from the three measures.

On or about April 15, 2010, plaintiffs timely filed 2009 New Jersey gross income tax returns, reporting their New Jersey Lottery winnings in excess of \$10,000 as taxable income. Although plaintiffs disputed application of the amendment to N.J.S.A. 54A:6-11 to their New Jersey Lottery winnings, they paid the gross income tax reflected on their returns. The returns included a written expression of their disagreement with the application of the amendment to their lottery winnings.

On or about May 20, 2010, plaintiffs filed amended 2009 New Jersey gross income tax returns. The amended returns excluded plaintiffs' New Jersey Lottery winnings from taxable income. Each unmarried plaintiff and plaintiff couple sought a refund of approximately \$1.49 million dollars in gross income tax paid with their original returns.

By letters dated July 9, 2010 and August 2, 2010, the Director, Division of Taxation, denied plaintiffs' refund requests.

On August 10, 2010, plaintiffs timely sought an administrative appeal of the Director's denials through the filing of written protests with the Director.

On February 7, 2011, the Director rejected plaintiffs' administrative appeals and issued final determinations upholding the denial of their refund requests.

On April 1, 2011, plaintiffs filed a Complaint in the Superior Court, Law Division, Ocean County. Plaintiffs name as defendants the Director, Division of Taxation and the Division of State Lottery. In the First Count of the Complaint, plaintiffs allege that application of the amendment to N.J.S.A. 54A:6-11 to plaintiffs' lottery winnings violates the manifest injustice doctrine. In the Second Count of the Complaint, plaintiffs allege that application of the amendment to N.J.S.A. 54A:6-11 to their lottery winnings violates the due process, equal protection and other clauses of

the United States and New Jersey Constitutions. The Third Count of the Complaint alleges a breach of contract claim against both defendants.

On April 8, 2011, each unmarried plaintiff and plaintiff couple filed a Complaint in this court challenging the Director's final determination denying their respective refund claims.

On June 24, 2011, the Hon. Craig L. Wellerson, J.S.C., granted defendants' motion to transfer the Superior Court Complaint to this court. See N.J.S.A. 2B:13-2(b)("The Tax Court shall have jurisdiction over actions cognizable in the Superior Court which raise issues as to which expertise in matters involving taxation is desirable, and which have been transferred to the Tax Court pursuant to the Rules of the Supreme Court.").

On September 13, 2011, this court denied plaintiffs' motion to recuse the undersigned and have this matter assigned to another Judge of the Tax Court.

On March 5, 2015, the court granted plaintiffs' motion for a declaration that they filed a timely Notice of Contract Claim and denied defendants' motion to bar plaintiffs' contract claims. In addition, the court denied defendant Division of State Lottery's motion pursuant to R. 4:6-2 to dismiss plaintiffs' contract claims for failure to state a claim upon which relief can be granted.

On June 18, 2015, plaintiffs filed a First Amended Complaint in each pending matter. The First Amended Complaint contained Count I (Manifest Injustice), Count II (Violations of the United States and New Jersey Constitutions) and Count III (Breach of Contract).

On March 18, 2016, plaintiffs moved for summary judgment on the Counts II and III of their Amended Complaints.

On April 22, 2016, defendants opposed plaintiffs' motion and cross-moved for summary judgment on those Counts. Defendants also cross-moved for summary judgment on all Counts of the First Amended Complaints. While plaintiffs contend that for purposes of their manifest

injustice claims there are no disputed material facts with respect to plaintiffs' reliance on the law as it existed when they purchased their ticket and claimed their prize, they contend that summary judgment should be denied on their manifest injustice claims to allow for further discovery.

On July 22, 2016, the court heard oral argument from counsel on the cross-motions.

II. Conclusions of Law

Summary judgment should be granted where “the pleadings, depositions, answers to interrogatories and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact challenged and that the moving party is entitled to a judgment or order as a matter of law.” R. 4:46-2. In Brill v. Guardian Life Ins. Co., 142 N.J. 520, 523 (1995), our Supreme Court established the standard for summary judgment as follows:

[W]hen deciding a motion for summary judgment under Rule 4:46-2, the determination whether there exists a genuine issue with respect to a material fact challenged requires the motion judge to consider whether the competent evidential materials presented, when viewed in the light most favorable to the non-moving party in consideration of the applicable evidentiary standard, are sufficient to permit a rational factfinder to resolve the alleged disputed issue in favor of the non-moving party.

The court finds that there are sufficient undisputed material facts in the motion record to determine plaintiffs' claims under the square corners doctrine.

A. Whether the Amendment to N.J.S.A. 54A:6-11 Applies to Lottery Winning from Prizes Awarded on or after January 1, 2009 and before June 29, 2009.

As a threshold matter, plaintiffs challenge the Director, Division of Taxation's interpretation of the amendment to N.J.S.A. 54A:6-11. They argue that the amendment was not intended to extend the gross income tax to lottery winnings from a prize awarded on or after January 1, 2009 but prior to the June 29, 2009 enactment of the amendment. According to plaintiffs, there is nothing in the plain language of the statute or its legislative history that suggests

that the Legislature intended to apply the amendment to N.J.S.A. 54A:6-11 retroactively. Plaintiffs argue that interpreting the amendment to apply the tax only to winnings from lottery prizes awarded on or after June 29, 2009 comports with L. 2009, c. 69, §5, which provides that the amendment “shall take effect immediately and apply to taxable years beginning on or after January 1, 2009.” In plaintiffs’ view, the amendment “take[s] effect immediately” if it applies to winnings from lottery prizes awarded on or after June 29, 2009, the immediate date on which the amendment was enacted, and not to winnings from lottery prizes awarded prior to that date. In addition, plaintiffs argue that interpreting the amendment in this fashion applies the statute to “taxable years beginning on or after January 1, 2009” because June 29, 2009 took place in the tax year beginning on January 1, 2009. The Taxation Director takes the position that the amendment extends to all lottery winnings received on or after January 1, 2009, regardless of the date on which the lottery prize from which they derive was awarded.

In Milligan, supra, the court analyzed at length the Taxation Director’s interpretation of the amendment to N.J.S.A. 54A:6-11, the text of the statute, and its legislative history. The court concluded that both the interpretation of the amendment proffered by the plaintiffs in that case and the Taxation Director’s interpretation of the amendment were reasonable. In addition, the court concluded that the amendment’s legislative history reveals no credible evidence of Legislative intent with respect to the treatment for gross income tax purposes of lottery winnings received in 2009 and later years from a lottery prize won prior to January 1, 2009. The court ultimately concluded that the Director’s interpretation of the statute is not “plainly at odds with” the statute, see ADVO, Inc. v. Director, Div. of Taxation, 25 N.J. Tax 504, 511 (Tax 2010), and must be upheld.

The court incorporates its analysis and holding in Milligan to the claims raised in this matter as if fully set forth herein. Plaintiffs' proffered interpretation of the amendment to N.J.S.A. 54A:6-11 might well be viewed as reasonable. Nothing in the plain language of the statute or its legislative history suggests that limitation of the extension of the income tax to winnings from lottery prizes awarded on or after June 29, 2009 is contrary to legislative intent. Yet, as the court held in Milligan, it is the Taxation Director who has the statutory authority and duty to interpret the State's tax statutes. His interpretation of the amendment to N.J.S.A. 54A:6-11 is reasonable and entitled to judicial deference. That holding applies here.

B. Whether Taxation of Plaintiffs' Lottery Winnings is barred by the Square Corners Doctrine.

Having determined that the Director's interpretation of the amendment to N.J.S.A. 54A:6-11 must be upheld, the court is confronted with the question of whether that interpretation of the statute, when applied to plaintiffs, comports with the State's obligation to act with integrity under the square corners doctrine. As noted above, in Milligan, supra, the court held that the square corners doctrine precludes the assessment of gross income tax on lottery winnings received in 2009 and later years from a prize awarded prior to January 1, 2009. Plaintiffs argue that the same holding should obtain with respect to lottery winnings from a prize awarded on or after January 1, 2009 but before the June 29, 2009 amendment to N.J.S.A. 54A:6-11.

The court incorporates its analysis and holding in Milligan, supra, with respect to the square corners doctrine as if fully set forth herein. There is no material distinction between the facts in Milligan and the facts in this case in the context of the square corners doctrine. Like the plaintiffs in Milligan, the plaintiffs here purchased lottery tickets in a marketplace in which the State was an active player. To encourage the sale of lottery tickets, State officials made representations to the public that lottery winnings are not subject to New Jersey gross income tax. Those representations

became part of the contractual relationship between the State and plaintiffs when they won the March 3, 2009 lottery prize. The State must abide by its obligation to act fairly and with compunction with dealing with the public. That obligation includes abiding by the representations it made to the public to encourage the sale of lottery tickets prior to the June 29, 2009 extension of the gross income tax to certain New Jersey lottery winnings.

The mere fact that plaintiffs purchased their winning ticket and claimed their prize during the 2009 tax year does not change the court's analysis. The holding in Milligan is based on the State's affirmative representations to the public and the contractual nature of the relationship between the State and the holders of winning lottery tickets. When they purchased their winning ticket and claimed their prize, plaintiffs had no reason to suspect that the State would reverse its position with respect to the taxation of New Jersey lottery winnings. The bill that ultimately was enacted as an amendment to N.J.S.A. 54A:6-11 and extended the income tax to New Jersey lottery winnings for the first time was not introduced in the Legislature until June 2009, months after plaintiffs and the State formed their contractual relationship.³

As was the case in Milligan, *supra*, having determined that plaintiffs are entitled to relief under the square corner doctrine, the court need not reach the constitutional claims raised by plaintiffs. "Ordinarily, we will not reach a constitutional issue if a case can be decided on narrower grounds." Residuary Trust A v. Director, Div. of Taxation, 28 N.J. Tax 541, 545 n.3 (App. Div. 2015)(citing Randolph Town Ctr., LP v. County of Morris, 186 N.J. 78, 80 (2006); A.Z. v. Higher Educ. Student Assistance Auth. 427 N.J. Super. 389, 395 (App. Div. 2012)). The court, therefore,

³ The first bill proposing to extend the gross income tax to New Jersey lottery winnings, A-3830, was introduced in the Assembly on March 9, 2009, six days after plaintiffs won their lottery prize. That bill, which would have applied the tax to "lottery winnings from multistate games in which the New Jersey Lottery participates," was not enacted into law.

reserves decision on plaintiffs' claims under the federal and State Constitutions. In addition, the court reserves decision on plaintiffs' breach of contract claims and agrees with plaintiffs' argument that resolution of the claims under the manifest injustice doctrine should await further discovery.⁴

In light of these findings of fact and conclusions of law, this court will enter an Order in each of the above-listed matters granting plaintiffs' motion for summary judgment, in part, and denying defendants' cross-motion for summary judgment, in part. Plaintiffs will be granted summary judgment in their favor with respect to their request for an Order declaring that assessment of gross income tax on their New Jersey lottery winnings is prohibited by the square corners doctrine. Defendants will be denied summary judgment with respect to the same issue. The court reserves decision on both plaintiffs' motion for summary judgment and defendants' cross-motion for summary judgment on the remainder of the claims raised in the Complaints.

⁴ Today, the court issued an opinion in a companion case, Leger v. Director, Div. of Taxation, ___ N.J. Tax __ (Tax 2016), holding that the assessment of gross income tax on New Jersey lottery winnings from a prize awarded in December 2008, in addition to violating the square corners doctrine, would be manifestly unjust. See Oberhand v. Director, Div. of Taxation, 193 N.J. 558 (2008).