



Adoption Tax Credit: A Guide for State Advocates

Mary Boo
North American Council on Adoptable Children

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Introduction

The federal adoption tax credit has been a valuable tool to encourage adoptions and to support adoptive families. For families adopting foster children with special needs, the credit has provided resources to meet their children's special needs. The credit—especially when it was refundable—has enabled many families to adopt when they might otherwise not be able to, especially if they had a more moderate income. The adoption credit is an important part of a comprehensive public effort to support all types of families, including services to low-income or struggling birth families, supports for grandparents and other relatives raising their kin, and services to help children who have special needs.

Unless Congress takes action, the adoption tax credit is set to almost completely end on December 31, 2012. This brief is intended to inform state advocates about the adoption tax credit, help them share accurate information with parents and adoption professionals in their communities, and ensure that administrators, adoption professionals, and policymakers understand the value of adoption credits in the future.

Current Status of the Adoption Tax Credit

For 2012, the credit has a maximum amount of \$12,650. It applies to all types of adoption—foster care, international, or private from the U.S.—other than stepparent adoptions. Families who adopt children who have been determined to be special needs can claim the maximum credit of \$12,650 even if they have no expenses. Other adoptive families can claim their qualified adoption expenses up to the maximum.

The adoption tax credit is not refundable for 2012, as it was in tax years 2010 and 2011. In 2012, only families who have tax liability—meaning they owe federal income tax—will be able to benefit.

The current adoption tax credit is set to expire (or sunset) on December 31, 2012. As of January 1, 2013, the adoption tax credit will be greatly limited. Families who adopt children determined to have special needs will be eligible for a credit of up to \$6,000 based on their qualified adoption expenses. Other adoptive families will

not be eligible. Since most families who adopt foster children with special needs do not have expenses, very few families will be eligible for the adoption credit.

The credit will not be refundable, so families can benefit only if they have federal income tax liability. The income limits for the credit are also reduced significantly in 2013, meaning that families with incomes above about \$75,000 will not benefit. (See chart below for income limits in 2012 and recent years.)

History of the Credit

The adoption tax credit was created by the Small Business Job Protection Act of 1996, which made the credit available for tax years 1997 to 2001. The law established a permanent adoption tax credit of up to \$6,000 for special needs adoptions. For all other adoptions (other than stepparent adoptions, which cannot be claimed), the maximum credit was \$5,000. The non-special needs credit was set to sunset after 2001. Taxpayers had up to six years to use up the non-refundable credit. The credit was available only to families who had modified adjusted gross incomes of \$75,000 or less.

In the law, Congress required an evaluation of the credit after two years. The evaluation found that few special needs adopters had used the credit.

In 2001, the Economic Growth and Tax Relief Reconciliation Act extended the adoption tax credit through December 31, 2010. The law also increased the maximum credit to \$10,000 for all adoption types, and doubled the income limit so that more families were eligible. The Act instituted annual cost-of-living adjustments to both the credit and income limits.

In an effort to ensure that more families adopting from foster care could benefit, the law also provided that, starting in tax year 2003, people adopting children who had been determined to have special needs could claim the maximum credit regardless of whether they had qualified adoption expenses. This is often referred to as a flat tax credit for special needs adoption.

All of these provisions were set to sunset after December 31, 2010.

In March 2010, the Patient Protection and Affordable Care Act made the adoption tax credit refundable for tax years 2010 and 2011, extended the credit through December 31, 2011, and increased the maximum credit by \$1,000. The credit amount and income limits had cost-of-living increases for 2011.

The Tax Relief Act, passed in December 2010, extended the adoption tax credit through December 31, 2012. The law did not make the credit refundable or include the \$1,000 increase that had been in the Affordable Care Act.

Key Definitions

- **Special needs** means that a state or county child welfare agency has determined that a child will not be adopted unless assistance is provided to the adoptive family. In other words, the child is considered hard to place for adoption. This is only an option for U.S. children, and is almost exclusively for children adopted from foster care. To qualify as special needs, a child must receive benefits through the adoption assistance program, which can include monthly adoption subsidy payments, Medicaid, and/or reimbursement of nonrecurring adoption expenses.

- **Flat for special needs adoptions** means that parents who adopt children with special needs can claim the maximum adoption tax credit even if they do not have qualified adoption expenses. Most parents who adopt children with special needs do not have many upfront expenses to complete the adoption. Many have no out-of-pocket expenses. However, these families often have ongoing expenses as they seek to meet their children's special needs. Before the adoption tax credit was made flat in 2003, few families who adopted from foster care were able to benefit.
- **Refundable** means taxpayers can benefit from the credit even if the credit is larger than what they owe in federal income tax. (A non-refundable credit is one in which taxpayers reduce what they owe in federal income taxes, but only up to the amount of income taxes they otherwise would have owed.) Close to half of Americans owe no federal income tax. Most are working or are seniors. Unless the credit is refundable, these individuals and their children cannot benefit.

Legislative Proposals to Extend the Credit

There are four bills in the current Congress that propose to make the adoption tax credit permanent and make other changes to the benefit:

- **Making Adoption Affordable Act (S 3616/HR 4373** — The Making Adoption Affordable Act is the only proposed legislation that would make the adoption credit refundable (including for 2012), which makes it accessible to lower and moderate income families. The bill would set the adoption tax credit at \$13,360 and make it permanent. S. 3616 includes the same provisions but also asks the IRS to consider recommendations to improve adoption tax credit review and processing. These bills would benefit far more adoptive families than the bills below. Since families who adopt from foster care have, on average, lower incomes than other adoptive families, a refundable credit also benefits more families who offer a permanent family to a child in foster care.
- **Adoption Tax Relief Guarantee Act (S 82/HR 184)** — This bill would make the adoption tax credit permanent, maintain the \$1,000 increase in the maximum amount created in the Affordable Care Act, and allow prospective adopters to claim expenses in the year they incur expenses for a non-finalized adoption.

State advocates have an important role in informing their community members, including policymakers, about the current status of the adoption tax credit and noting that there are ways to extend it and improve it. As advocates discuss the credit, the following talking points can be of use:

- The adoption tax credit has helped tens of thousands of children find a permanent, loving family. By refunding some of the adoption expenses families pay, the adoption credit makes international and domestic adoptions more affordable, ensuring that more children have the opportunity to have a family and that families at all income levels can offer children a loving home.
- From the beginning, the credit was designed to include all types of adoptions (other than step-parent adoption) in an effort to ensure that all children can find a family and that even lower- or moderate-income families can afford adoption. With each legislative change, Congress has continued to maintain the credit for all types of adoption. Over time, Congress made specific changes to make the credit more accessible to families who adopt from foster care.

- In the case of adoption of children with special needs from foster care, the adoption tax credit encourages families to adopt children who might otherwise spend their lives in foster care. These children are almost always children who are older, who are waiting to be adopted with their brothers or sisters, or who have a disability. If foster children are not adopted, the government pays the cost of their care until they become adults. Research has shown each adoption from care can save up to \$235,000 in public costs over the course of a child's life.

The cost of raising children with special needs is often much higher than the expense of raising other children. Families adopting a group of two brothers and two sisters may need to build onto their home so the girls and boys can have separate bedrooms. Other children may need ongoing therapy or other services to address the neglect and abuse they suffered early in their lives. Many children adopted from foster care are far behind in school, and may need special support to catch up. When adopting a child or youth with a physical disability, parents may need to buy adaptive equipment or make changes to their homes to accommodate the child's special needs.

Claiming the Adoption Credit

State advocates can play a key role in ensuring that families who adopted between 2005 and 2011 understand the credit and that they may still benefit if they haven't claimed it already. Many families, especially relatives and others who adopted from foster care and those without Internet access, still do not know that they may be able to receive a refund of thousands of dollars.

As long as they meet income requirements, families who receive adoption assistance benefits on behalf of a child are eligible to claim the maximum credit for the year of adoption finalization, regardless of whether they had any adoption expenses. Families who have modified adjusted gross incomes above the upper income limit cannot claim any credit. Those between the lower and upper limit can claim a prorated, reduced amount of the credit.

| Year | Maximum Credit per Child | Lower Income Limit | Upper Income Limit |
|------|--------------------------|--------------------|--------------------|
| 2012 | \$12,650 | \$189,710 | \$229,710 |
| 2011 | \$13,360 | \$185,210 | \$225,210 |
| 2010 | \$13,170 | \$182,520 | \$222,520 |
| 2009 | \$12,150 | \$182,180 | \$222,180 |
| 2008 | \$11,650 | \$174,730 | \$214,730 |
| 2007 | \$11,390 | \$170,820 | \$210,820 |
| 2006 | \$10,960 | \$164,410 | \$204,410 |
| 2005 | \$10,630 | \$159,450 | \$199,450 |

How families who adopt children with special needs claim the credit depends on the year of finalization. For each year, family must file a Form 8839 and send it with either a Form 1040X to amend their taxes or a Form 1040 if they haven't filed taxes for that year.

- 2012 — Families will be able to claim the credit when they file their 2012 taxes early in 2013. The credit is not refundable so will benefit only those taxpayers who have income tax liability. Any unused credit can be carried forward for up to five additional years.

- 2011 — Families can amend or file their 2011 taxes to claim the credit. The adoption tax credit was refundable in 2011, so families should be able to receive the full amount of the credit as a refund even if they had no taxable income in 2011.
- 2010 — Families can amend or file their 2010 taxes to claim the credit. The adoption tax credit was refundable in 2010, so families should be able to receive the full amount of the credit as a refund even if they had no taxable income in 2010.
- 2009 — Families can amend or file their 2009 taxes to claim the credit. If they had tax liability in 2009, they will receive that amount of the credit as a refund with their 2009 return. Any unused credit can be carried forward to 2010 when the credit was refundable, so even families without tax liability should receive the full amount of the credit. Families would also need to amend or file 2010 taxes to claim any credit carried forward.
- 2005–2008 — The IRS considers these years officially closed, which means that families cannot receive any refund they were due in those years. However, because the adoption tax credit can be carried forward for up to five more years, many families can still receive some or all of the credit by carrying the credit forward into the open years of 2009 and 2010. Families must amend their taxes starting with the year of finalization, and use Form 8839 for that year to calculate what credit (if any) they might have used. That amount of the credit is lost to them, but they can carry forward any remaining amount to the next year.

Example: A family adopts two children with special needs in 2006, but never claimed the credit of \$21,920 (\$10,960 per child). They are now amending their tax returns to claim the credit. They had tax liability of \$2,000 per year. It is too late for them to get the \$2,000 they could have gotten in 2006, 2007, and 2008, so they lose \$6,000 of the credit and have \$15,920 to carry forward. They must still amend their taxes and file a form 8839 for 2006 to 2008 but do not receive a refund. When they amend their taxes for 2009, they receive a \$2,000 refund, and can carry \$13,920 to 2010. Because the tax credit was refundable for 2010, their tax liability no longer matters and they receive a refund of the remaining \$13,920 with their 2010 amended return.

Key Points to Share with Adoptive Families

- If an adoption finalized from 2005 to 2008, parents may still be able to claim the adoption tax credit if they haven't already. For adoptions from 2009 to 2011, parents should definitely be able to benefit.
- For adoptions finalized between 2005 and 2011, the family may benefit even if they did not work and do not normally file taxes.
- For purposes of the adoption tax credit, a child with special needs is typically a U.S. foster child who was considered hard to place. The child does not need to have a disability or specific special need to be eligible—the family simply needs to be receiving adoption assistance benefits on the child's behalf.
- Roughly 80 to 90 percent of children adopted from foster care are considered special needs because they receive adoption assistance benefits. Children adopted internationally are never considered special needs for purposes of the adoption credit.

- For special needs adoptions, eligibility for the credit is based on the year of finalization. It does not matter when the child was placed or the process began. For example, if a child is placed with a family in 2011 and the adoption finalizes in 2012, the family can claim the adoption credit with their 2012 taxes (filed in early 2013). They are not eligible for the refundable 2011 adoption tax credit.
- As current law stands, if the adoption tax credit is not extended, families who finalized an adoption in 2013 will not benefit unless it is an adoption of a child determined to have special needs and the family had unreimbursed adoption expenses. It does not matter if the adoption process began before 2013.

Sharing Information with Families

State child advocacy organizations are uniquely positioned to help ensure adoptive families know about and understand the adoption tax credit. The Fostering Connections to Success and Increasing Adoptions Act of 2008 requires states to inform prospective adopters about the availability of the adoption tax credit. The law “provides that the State will inform any individual who is adopting, or whom the State is made aware is considering adopting, a child who is in foster care under the responsibility of the State of the potential eligibility of the individual for a Federal tax credit under section 23 of the Internal Revenue Code of 1986.”

State child advocates can ask staff at their state department of social services how they are accomplishing this goal, and can advocate that the efforts be widespread and comprehensive. In addition, however, state advocates can play a key role in ensuring that states also share information with parents who have adopted in recent years and who may still benefit. Many of these families were never informed about the credit, and advocates can either encourage states to share information or can do so themselves. Advocates can find out from state adoption administrators what they have done to notify both prospective and current adoptive parents, and review the information they are sharing. Advocates can be a great help at ensuring the information shared is disseminated widely and that it is detailed enough to be helpful.

Some states, often in partnership with state-based advocacy and support organizations, have taken extensive efforts to share information about the adoption tax credit. One, for example, prints a note about the adoption tax credit on every parent’s adoption assistance check stub. Another has done mailings once or twice a year to all adoptive families in the state, often sharing adoption tax credit factsheets prepared by the North American Council on Adoptable Children (NACAC). In other cases, the task of informing parents has been taken on by state support or advocacy organizations. Many foster and adoptive parent associations have put regular updates about the tax credit into their newsletters or other mailings.

Sharing information about the adoption tax credit is also a great way for advocacy organizations to build a new audience. Parents who connect with the organization to learn more about the tax credit may get more engaged with the organization and support any future grassroots advocacy efforts.

State Adoption Credits or Exclusion

At least 16 states offer a state adoption tax credit or income exclusion as further incentive to help children find permanent adoptive families. Advocates may consider replicating these credits or exclusions in their states. Those credits that are not based on expenses will be the best incentive to encourage adoptions from foster care and to provide additional support to families raising children with special needs.

| State | Credit or Exclusion? | Maximum Amount per Child | Special Provisions |
|----------------|----------------------|--|---|
| Arizona | Exclusion | \$3,000 | <ul style="list-style-type: none"> • Credit is based on qualified adoption expenses. |
| California | Credit | \$2,500 | <ul style="list-style-type: none"> • Credit is for adopting a child who was in the custody of a California public child welfare agency. • Parents can claim up to 50 percent of the cost of adopting the child, up to \$2,500 per child. • Any unused credit can be carried forward to future years. |
| Georgia | Credit | \$2,000 per year | <ul style="list-style-type: none"> • Credit is for those who adopted from DHR foster care since 2008. • Can be taken every year from finalization until the child turns 18. |
| Kansas | Credit | \$1,500 | <ul style="list-style-type: none"> • Credit is \$1,500 for a Kansas resident who adopts a child in the custody of the secretary of social and rehabilitation services or a child with special needs. • The state also has a general adoption credit for other adoptions (25 percent of the federal adoption credit claimed). • Any unused credit can be carried forward to future years. |
| Mississippi | Credit | \$2,500 | <ul style="list-style-type: none"> • Credit is for qualified adoption expenses. • Qualified applicants can apply for the credit the year the adoption is finalized, and unused credit can be carried forward to future years. |
| Missouri | Credit | \$10,000 | <ul style="list-style-type: none"> • The credit is for families adopting a special needs child who have qualified adoption expenses. • Half of the expenses can be claimed before the finalization and the remainder after finalization. Any excess credit can be carried to future years |
| Montana | Credit | \$1,000 | <ul style="list-style-type: none"> • Excess credits can be carried forward for up to five more years |
| New Mexico | Exclusion | \$1,000 per year | <ul style="list-style-type: none"> • Exclusion is for a child determined to have special needs. • Exclusion can be taken every year as long as the child can be claimed as a dependent. |
| North Carolina | Credit | 50% of the families' federal adoption tax credit | |
| North Dakota | Exclusion | \$1,750 | <ul style="list-style-type: none"> • For the adoption of a child under age 18. |
| Ohio | Credit | \$1,500 | <ul style="list-style-type: none"> • Unused amounts can be carried forward for up to two years. |

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| Oklahoma | Exclusion | \$20,000 | <ul style="list-style-type: none"> Families can deduct up to \$20,000 in qualified adoption expenses incurred during the year. Nonrecurring adoption expenses include adoption fees, court costs, medical expenses, attorney fees, and expenses directly related to the legal process of adoption of a child. |
| South Carolina | Exclusion | \$2,000 per year | <ul style="list-style-type: none"> Exclusion is for the adoption of a child with special needs. The exclusion can be taken every year beginning with the year of finalization as long as the child is claimed as a dependent on the federal tax return. |
| Utah | Refundable Credit | \$1,000 | <ul style="list-style-type: none"> Refundable credit is for the adoption of a child with special needs aged 5 to 18. Credit is claimed in the year of finalization. |
| West Virginia | Credit | \$2,000 | <ul style="list-style-type: none"> Credit is for the adoption of a child who is not related to the family by blood or marriage. Credit can be used in the year of the adoption or spread over a three-year period. |
| Wisconsin | Exclusion | \$5,000 | <ul style="list-style-type: none"> Exclusion is for adoption expenses (including adoption fees, court costs, and legal fees), and is claimed in the year of finalization. Any unused credit can be carried forward for up to five additional years. |

Conclusion

Thanks to the work of state leaders, advocates, associations, and parents, more families are learning about the federal adoption tax credit every day. Unfortunately, more work needs to be done—both to inform families and to maintain this important benefit. We encourage state advocates to keep reaching out and ensuring that no parent who could benefit from the adoption credit is unaware of the benefit.



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Contact the Author

Mary Boo
Assistant Director
North American Council on Adoptable Children
maryboo@nacac.org
651.644.3036 ext. 19