

## **NEW FEDERAL ADOPTION EXPENSE TAX CREDIT MAKES ADOPTION MUCH MORE AFFORDABLE**

The adoption expense tax credit and the exclusion from income of employer adoption programs were modified and made permanent as part of the tax bill signed by President Clinton on June 7, 2001. Below is information that may help you understand the changes and benefit from them. The answers are based on past IRS guidance and best conjecture. For the specifics of official Treasury Department policy and instructions to claim the credit, consult the IRS website, [www.irs.gov](http://www.irs.gov), or consult a tax professional. The idea is to provide tax relief for adoption-related expenses (i.e., legal expenses, homestudy, agency fees, birthmother living expenses) so as to promote adoption.

**Q. In a nutshell what are the changes the new tax law made in adoption benefits?**

**A.** Except as noted, after Dec. 31, 2001 it:

- increased the adoption tax credit for all adoptions to \$10,000\*;
- made the credit permanent for all adoptions;
- set the credit for adoption of special needs children at \$10,000,\* regardless of actual expenses, beginning in 2003;
- increased the income level below which you can claim the full credit (in 2008 the amount is \$174,730 adjusted gross income);
- increased the income level at which the credit phases out to zero (in 2008 the amount is \$214,730 adjusted gross income);
- made the exclusion of income from employer adoption assistance programs permanent;
- applied a cost of living adjustment to the credit and the exclusion beginning in 2003;
- the adoption credit is allowed against the alternative minimum tax permanently.

**Q. Which children qualify for the credit?**

**A.** An eligible child is an individual who has not attained the age of 18, or who is physically or mentally incapable of caring for himself or herself. An eligible child may not be the child of the taxpayer's spouse.

\*Note: the tax credit increases slightly each year. The 2008 credit is \$11,650.00.

**Q. What presently are qualifying expenses for all adoptions and after Dec. 31, 2002, for non-special needs adoptions?**

**A.** Qualifying adoption expenses are reasonable and necessary adoption fees, court costs, attorney fees, traveling expenses (including amounts spent for meals and lodging) while away from home, and other expenses directly related to, and whose principal purpose is for, the legal adoption of an eligible child. In the case of the adoption of a U.S. citizen or resident, the credit can be taken even if the adoption never becomes final; in the case of an adoption of a child not a citizen or resident of the U.S. the credit can only be taken if the adoption becomes final.

**Q. What is a special needs child for the IRS?**

**A.** An eligible child is a child with special needs if he/she is a citizen or resident of the U.S. and a state determines that the child cannot or should not be returned to his/her parents' home, and probably will not be adopted unless adoption assistance is provided to the adoptive parents.

**Q. When can the credit be taken?**

**A.** In the case of a special needs adoption after Dec. 31, 2002, the credit is allowable in the taxable year in which the adoption becomes final. In non-specials needs adoptions and special needs adoptions before Dec. 31, 2002, the answer depends on whether the eligible child is a U.S. citizen or resident. If the child is a U.S. citizen or resident take the credit as shown below:

(1) If you pay or incur qualifying expenses in any year before the year the adoption becomes final, then take the credit in the year after the year of the payment.

(2) If you pay or incur qualifying expenses in the year the adoption becomes final, then take the credit the year the adoption becomes final.

(3) If you pay or incur qualifying expenses in any year after the year the adoption becomes final, then take the credit in the year of the payment.

If the child is not a U.S. citizen or resident take the credit as shown below:

(1) If you pay or incur qualifying expenses in any year before or during the year the adoption becomes final, then take the credit in the year the adoption becomes final.

(2) If you pay or incur qualifying expenses in any year after the year the adoption becomes final, then take the credit in the year of the payment.

**Q. What if your regular tax liability for a year is less than your allowable credit for the year?**

**A.** The credit operates by allowing you to subtract credit amounts directly from your otherwise owed tax bill, but if you reduce your tax bill to zero and still have credit coming to you, the unused credit amounts can be carried forward to your next 5 tax years, or until it is all used, whichever comes first.

**Q. How do I claim the credit?**

**A.** You must file Form 8839 with either Form 1040 or Form 1040A to take the credit. You should maintain records to support any credit claimed.

**Q. Can a foreign adoption be a special needs adoption for purposes of the tax credit?**

**A.** No.

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**Important Note:** The above information is taken from federal materials and is intended for general educational purposes. It is not intended as legal advice, and should not be read as such. For specific answer to specific tax questions, consult a tax attorney or your tax preparer.