



**Congressional  
Research Service**

Informing the legislative debate since 1914

---

# Tax Benefits for Families: Adoption

**(name redacted)**

Specialist in Income Security

July 23, 2014

**Congressional Research Service**

7-....

[www.crs.gov](http://www.crs.gov)

RL33633

## Summary

The federal government provides assistance for the adoption of children through federal grants to states and through the tax code. Although federal assistance programs for adoption focus primarily on children adopted out of foster care, federal adoption tax provisions are available for all adoptions (except for adoptions of stepchildren).

The adoption tax credit provides a 100% credit for adoption-related expenses of up to \$13,190 in 2014. That limit is adjusted annually for inflation. The credit is not currently refundable, but it was refundable for tax years 2010 through 2012. A related tax preference, with the same limit on expenses, excludes employer adoption expenses from taxable income.

Both the adoption tax credit and the income tax exclusion are subject to an income phase-out. In 2014, adoption tax benefits are reduced for taxpayers with income above \$197,880, and taxpayers with income above \$237,880 are ineligible for the benefits.

For the purpose of the credit, families who adopt children with special needs are assumed to have expenses equal to the maximum of \$13,190. Most children adopted from the public child welfare system are considered to have special needs.

In tax year 2011, the most recent year for which data are available, \$610 million in adoption tax credits were claimed, with about \$201 million of the credit received as a refund (in excess of income tax liability). The average credit was nearly \$12,729. Total credits were \$1,207 million in tax year 2010, the first year that the adoption tax credit was refundable, but were \$278 million in tax year 2009, when the credit was not refundable.

This report outlines the tax benefits for adoption and provides a legislative history of the tax provisions for adoption. It also discusses policy issues, such as whether federal support for adoption should be provided through the tax system or through other means and whether special needs adoptions and adoptions from other countries should be treated differently than other adoptions.

## Contents

Scope of Adoption.....	1
Domestic Public Agency Adoptions.....	1
Domestic Private Adoptions.....	1
Intercountry Adoptions.....	2
Overview of the Tax Credit and Income Tax Exclusion.....	2
The Adoption Tax Credit.....	3
Qualifying Expenses.....	3
Rules for Special Needs Children.....	3
Differences in Rules for Intercountry and Domestic Adoptions.....	4
Income Limitation.....	5
Claiming the Credit.....	5
Income Tax Exclusion for Employer Adoption Assistance.....	5
Number and Amount of Credits.....	7
Policy Issues.....	9
Income Limitation, Maximum Credit, and Refundability.....	9
Federal and State Subsidies Versus Tax Incentives.....	9
Treatment of Special Needs Children.....	10
Tribal Parity for Special Needs Determinations.....	10
Domestic Versus Intercountry Adoptions.....	11
Legislative History.....	11
The Small Business and Job Protection Act of 1996 (P.L. 104-188).....	11
The Taxpayer Relief Act of 1997 (P.L. 105-34).....	12
IRS Restructuring and Reform Act of 1998 (P.L. 105-206).....	12
The Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16).....	12
The Job Creation and Worker Assistance Act of 2002 (P.L. 107-147).....	12
The Patient Protection and Affordable Care Act (P.L. 111-148).....	13
The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312).....	13
The American Taxpayer Relief Act of 2012 (P.L. 112-240).....	13

## Figures

Figure 1. Share of Returns Using the Adoption Tax Credit.....	8
---	---

## Tables

Table 1. Examples of Qualifying and Non-Qualifying Expenses.....	3
Table 2. When Qualified Expenses Are Eligible: Domestic and Intercountry Adoptions.....	4
Table 3. Utilization of the Adoption Tax Credit, Tax Year 2011.....	7

## Contacts

Author Contact Information.....	13
---------------------------------	----

Acknowledgments ..... 13

States have paramount responsibility in setting policy to govern the process of child adoption. Nonetheless, the federal government plays a significant role in supporting adoption, both through support to states that provides both one-time and ongoing subsidies to parents of adoptive children with special needs (under Title IV-E of the Social Security Act) and through tax benefits that help offset the costs of adopting a child.<sup>1</sup> This report focuses on federal tax benefits, which consist of an adoption tax credit and an income tax exclusion for employer-provided adoption assistance.

## Scope of Adoption

There are several types of adoption, including domestic public agency adoption, domestic private adoption, and intercountry adoption. The Department of Health and Human Services (HHS) compiles state data on children adopted with the involvement of state child welfare agencies, and the Department of State records the number of intercountry adoptions through its visa reporting system. However, private agencies and individuals who facilitate independent adoptions are not required to report data. The tax provisions described in this report cover all adoptions except for those by stepparents.

### Domestic Public Agency Adoptions

Children in state foster care are typically placed in either foster family homes; relative foster homes; group homes; or institutional settings, such as residential treatment centers. On the last day of FY2012, approximately 397,000 children were in foster care and 102,000 were “waiting” to be adopted.<sup>2</sup> (Foster children waiting to be adopted include those with a case plan with a goal of adoption and those whose parental rights have been terminated.) During FY2012, approximately 52,000 children were adopted with the involvement of state child welfare agencies.<sup>3</sup> The number of such adoptions has been stable over the past decade, ranging from about 50,000 to 57,000 a year.<sup>4</sup>

### Domestic Private Adoptions

Domestic private adoptions are facilitated by state-licensed private agencies or through independent agreements in which an individual arranges for another party to adopt his or her child.<sup>5</sup> Like all adoptions, private adoptions are finalized by state or tribal courts, but data on these adoptions are not systematically collected or reported.

<sup>1</sup> For information about other federal programs that support adoption see discussion of “Adoption Assistance” (Title IV-E of the Social Security Act), “Adoption Incentives,” and “Adoption Opportunities” in CRS Report R43458, *Child Welfare: An Overview of Federal Programs and Their Current Funding*, by (name redacted).

<sup>2</sup> Department of Health and Human Services, Administration for Children and Families, Children’s Bureau, *The AFCARS (Adoption and Foster Care Analysis and Reporting System) Report*, No. 20, at <http://www.acf.hhs.gov/sites/default/files/cb/afcarsreport20.pdf>.

<sup>3</sup> Ibid. The totals exclude children age 16 or older for whom parental rights have been terminated and who have a case plan goal of emancipation.

<sup>4</sup> Department of Health and Human Services, Administration for Children and Families, Children’s Bureau, *Trends in Foster Care and Adoption (FFY 2002 - FFY 2012)*, at [http://www.acf.hhs.gov/sites/default/files/cb/trends\\_fostercare\\_adoption2012.pdf](http://www.acf.hhs.gov/sites/default/files/cb/trends_fostercare_adoption2012.pdf), and CRS Report R43025, *Child Welfare: The Adoption Incentive Program and Its Reauthorization*, by (name redacted), Table B-1.

<sup>5</sup> Department of Health and Human Services, Administration for Children and Families, Children’s Bureau, *Adoption Options*, 2010, at [https://www.childwelfare.gov/pubs/f\\_adoption.cfm](https://www.childwelfare.gov/pubs/f_adoption.cfm).

## Intercountry Adoptions

Intercountry (also called foreign or international) adoptions are adoptions of noncitizen or nonresident children by families who are citizens or legal residents of the United States.<sup>6</sup> In FY2013, there were 7,094 adoptions from other countries.<sup>7</sup> From FY2002 through FY2006, there were more than 20,000 adoptions from other countries annually, but the number has declined each year since.<sup>8</sup>

## Overview of the Tax Credit and Income Tax Exclusion

Adoption costs vary widely, depending on the type of adoption, with the following estimated ranges:<sup>9</sup>

- Domestic public agency adoptions: \$0 to \$2,500.
- Domestic private adoptions: \$5,000 to \$40,000 (or more).
- Intercountry adoptions: \$15,000 to \$30,000.

The federal adoption tax credit and income tax exclusion (for employer-provided adoption expenses) are intended to offset costs of adoption for taxpayers.<sup>10</sup>

Both the credit and the income tax exclusion are subject to the same phaseout (or income limitation) and the same maximum qualified expenses that can be claimed per adoption. Both tax provisions use the same definitions of qualified expenses, eligible child, and special needs child, and both have the same rules for intercountry adoptions.

---

<sup>6</sup> For more information, see Department of State, Bureau of Consular Affairs, *Intercountry Adoption*, at <http://adoption.state.gov/>.

<sup>7</sup> Department of State, *FY2012 Annual Report on Intercountry Adoptions*, March 2014, at [http://adoption.state.gov/content/pdf/fy2013\\_annual\\_report.pdf](http://adoption.state.gov/content/pdf/fy2013_annual_report.pdf).

<sup>8</sup> Department of State, "Adoption Statistics," at [http://adoption.state.gov/about\\_us/statistics.php](http://adoption.state.gov/about_us/statistics.php).

<sup>9</sup> Department of Health and Human Services, Administration for Children and Families, Children's Bureau, *Costs of Adopting*, February 2011, at [https://www.childwelfare.gov/pubs/s\\_cost/s\\_costs.pdf](https://www.childwelfare.gov/pubs/s_cost/s_costs.pdf).

<sup>10</sup> For help with the tax terms used in this report, please see CRS Report RL30110, *Federal Individual Income Tax Terms: An Explanation*, by Mark P. Keightly, or Internal Revenue Service (IRS) Publication 17, *Your Federal Income Tax*.

## The Adoption Tax Credit

The adoption tax credit is available to taxpayers who have either initiated or completed the adoption process.<sup>11</sup> Unlike many other tax credits, the adoption tax credit has a 100% credit rate—the amount of the credit is the same as the amount of qualified expenses. In tax year 2014, the dollar limit for qualified expenses is \$13,190, and the limit is adjusted annually for inflation.<sup>12</sup>

### Qualifying Expenses

A taxpayer can claim only expenses that are necessary and reasonable and directly related to the adoption of an eligible child.<sup>13</sup> The term *eligible child* refers to children under age 18 and to older individuals who are physically or mentally incapable of taking care of themselves.<sup>14</sup> Taxpayers cannot claim expenses that violate federal or state law, are incurred in carrying out any surrogate parenting agreement, or are for the adoption of a child who is the child of the taxpayer's spouse (i.e., a stepchild).<sup>15</sup> Specific types of expenses eligible for the credit are not listed in the Internal Revenue Code (IRC) but are described by the IRS and are summarized in **Table 1**.

**Table 1. Examples of Qualifying and Non-Qualifying Expenses**

Qualifying Expenses	Non-Qualifying Expenses
—court costs	—expenses already covered by assistance through state, federal, employer, or other programs
—attorney fees	—expenses that violate state or federal law
—adoption fees	—expenses incurred for an adoption carried by a surrogate
—travel expenses	—expenses incurred for adopting a stepchild
—re-adoption expenses in the case of intercountry (foreign) adoptions	
—other costs directly related to the adoption	

**Source:** Internal Revenue Service, Instructions for Form 8839.

**Note:** These lists are not exhaustive but are intended to illustrate what are considered qualifying expenses and non-qualifying expenses.

For domestic adoptions, taxpayers may claim the adoption tax credit in the tax year following the tax year that they incur the qualifying expense, without regard to the status of the adoption. This means that the taxpayer may claim the adoption tax credit even if an adoption is never finalized. For intercountry adoptions, in contrast, the adoption must be finalized before the taxpayer can claim the credit.

### Rules for Special Needs Children

Beginning with tax year 2003, a taxpayer claiming the credit for the adoption of a special needs child is assumed to have incurred the maximum amount of qualifying expenses and may claim

<sup>11</sup> A taxpayer can incur qualified adoption expenses throughout, and even after completing, the adoption process. For example, adoption fees may be incurred at the beginning of the process. During the process, the taxpayer may incur travel expenses, and after completion of the adoption process, the taxpayer may incur final legal fees.

<sup>12</sup> In statute, the limitation is \$10,000 adjusted for inflation each year beginning with tax year 2003.

<sup>13</sup> Internal Revenue Code (IRC) §23(d)(1)(A).

<sup>14</sup> IRC §23(d)(2).

<sup>15</sup> IRC §23(d)(1)(B) and IRC §23(d)(1)(C).

the full credit.<sup>16</sup> Most children adopted with public child welfare agency involvement meet the definition of special needs for the adoption tax credit.<sup>17</sup> A child is considered to have special needs if the child’s state of residence determines that

- the child cannot or should not be returned to the birth parents’ home;
- there is a specific factor or condition that leads to the reasonable conclusion that the child will not be adopted without assistance provided to the adoptive parents; and
- the child is a citizen or legal resident of the United States.

Examples of specific factors (or conditions) that may be considered in determining whether a child is a special needs child include ethnicity; minority status; age; status as part of a sibling group; mental, emotional or physical handicap; and other medical conditions.<sup>18</sup> The definition of “special needs” for the adoption tax credit matches the definition provided in Section 473 (Title IV-E) of the Social Security Act for the federal Adoption Assistance Program.

### Differences in Rules for Intercountry and Domestic Adoptions

Under the tax code, a child must be a legal resident or citizen to qualify as a special needs child; therefore, no intercountry adoption meets the tax code’s definition of special needs.<sup>19</sup> Although a taxpayer may not claim an adoption tax credit of more than \$13,190 for any single adoption in tax year 2014, the taxpayer may claim the credit for a single adoption in more than one tax year, depending on when the adoption expenses are paid and whether the adoption is domestic or intercountry. For a domestic adoption, qualifying expenses may be claimed for the adoption tax credit prior to and during the adoption process, even if the adoption is not finalized; for an intercountry adoption, the adoption *must* be finalized before a taxpayer can claim the credit.<sup>20</sup> Therefore, a taxpayer adopting a foreign child may claim the credit only beginning in the tax year in which the adoption is finalized. **Table 2** shows the relationship between the timing of expenses and the tax year when those expenses are eligible for the adoption tax credit.

**Table 2. When Qualified Expenses Are Eligible: Domestic and Intercountry Adoptions**

When Qualified Expenses Are Incurred	Year Taxpayer May Claim Expenses	
	Domestic Adoptions	Intercountry Adoptions
Years before the year the adoption is finalized	Year following the year expenses are incurred	Year adoption is finalized
Year the adoption is finalized	Year adoption is finalized	Year adoption is finalized
Years after the year the adoption is finalized	Year expenses are incurred	Year expenses are incurred

<sup>16</sup> IRC §23(d)(3). Prior to tax year 2003, a taxpayer claiming the adoption tax credit (or using the income tax exclusion) for the adoption of a special needs child had to document the qualifying expenses.

<sup>17</sup> For more information, see Table 7 in CRS Report R42792, *Child Welfare: A Detailed Overview of Program Eligibility and Funding for Foster Care, Adoption Assistance and Kinship Guardianship Assistance under Title IV-E of the Social Security Act*, by (name redacted).

<sup>18</sup> Ibid.

<sup>19</sup> IRC §23(d)(3)(C).

<sup>20</sup> IRC §23(e).



**Source:** Internal Revenue Service, Instructions for Form 8839.

**Note:** Years refer to tax years.

## Income Limitation

The full credit can be claimed only by families with an adjusted gross income (AGI)<sup>21</sup> equal to or less than \$197,880 in tax year 2014; that amount is adjusted annually for inflation.<sup>22</sup> For taxpayers with incomes above this threshold amount, the credit is reduced by the ratio of their income above the threshold to \$40,000. For example, a taxpayer with an AGI of \$210,000 would have their credit reduced by 30.3% (because  $(\$210,000 - \$197,880) / \$40,000 = 30.3\%$ ). Taxpayers with an AGI of \$40,000 or more above the threshold—\$237,880 in 2014—are ineligible for the credit.

## Claiming the Credit

To claim the adoption tax credit, a taxpayer must fill out IRS Form 8839. Depending on the taxpayer's marital status, the filing requirements may vary. Generally, a married couple must file a joint tax return to claim the adoption tax credit.<sup>23</sup> If two taxpayers who are not married adopt a child together, they may split the qualified expenses and the resulting credit by mutual agreement, but the total credit is still subject to the same limit (\$13,190 in tax year 2014).<sup>24</sup> Taxpayers must include the tax identification number (e.g., the Social Security number) of the child they are adopting.<sup>25</sup> Finally, taxpayers must keep all receipts and records of expenses for reporting purposes.<sup>26</sup>

## Income Tax Exclusion for Employer Adoption Assistance

Many of the same rules, applications, and limitations that apply to the adoption tax credit also apply to the income tax exclusion for employer adoption assistance.<sup>27</sup> The maximum amount of qualified expenses is subject to the same dollar limitation of \$13,190 in tax year 2014, and the same income limitation rules apply.<sup>28</sup> The income tax exclusion follows the same definitions of

<sup>21</sup> AGI is total taxable income after statutory adjustments. Total taxable income does not include income that is exempt from income taxes (such as veterans' benefits). Statutory adjustments reduce taxable income before exemptions and any standard or itemized deductions. Examples of statutory adjustments are Health Savings Accounts, IRA deductions, and alimony paid. For the specific definition of AGI used for adoption assistance programs, see IRC §23(b)(3).

<sup>22</sup> IRC §23(b)(2)(A). The income limitation was \$150,000 in 2002 and under law is adjusted for inflation beginning in 2003.

<sup>23</sup> IRC §23(f)(1). If a married person has been living apart from his or her spouse for the last six months of the tax year, the child lived in the person's home for more than six months of the tax year, and the person has paid more than one-half of the cost of his or her home, then the married person may claim the adoption tax credit with a married filing separate status.

<sup>24</sup> Internal Revenue Service, "Answers to Frequently Asked Questions for Registered Domestic Partners and Individuals in Civil Unions," September 19, 2013, at <http://www.irs.gov/uac/Answers-to-Frequently-Asked-Questions-for-Registered-Domestic-Partners-and-Individuals-in-Civil-Unions>.

<sup>25</sup> IRC §23(f)(2).

<sup>26</sup> IRS, *Topic 607 - Adoption Credit and Adoption Assistance Programs*, December 12, 2013, at <http://www.irs.gov/taxtopics/tc607.html>.

<sup>27</sup> An income tax exclusion is a form of income that is not subject to taxation. An income tax exclusion is normally not reported for federal income tax purposes on a person's wage statement or W-2 form but may be reported on the form for information purposes. Other examples of income tax exclusions include 401(k) contributions and fringe benefits.

<sup>28</sup> IRC §137(b).

special needs children, qualified expenses, and eligible children, and the same rules for intercountry adoptions and filing requirements apply.<sup>29</sup>

Individuals can use both the adoption tax credit and the income tax exclusion (if both are available to them), but they cannot claim the same expenses for both tax provisions.<sup>30</sup> Employer-provided adoption assistance must be provided through a separate written plan for an adoption assistance program that is generally available to all employees.<sup>31</sup>

Whereas the adoption tax credit directly reduces the amount of tax paid, the income tax exclusion for employer adoption assistance programs is less valuable because it reduces taxable income. That is, an employee who has qualifying expenses paid for by the employer or through a reimbursement program funded by the employer, employee, or both parties does not have to include the value of those expenses as income for federal income taxes.<sup>32</sup> The reduction in taxes is therefore equal to the exclusion amount times the taxpayer's marginal income tax rate.

Employer adoption assistance programs are a separate employee benefit and are provided by direct payment of eligible expenses by the employer or the reimbursement of eligible expenses through an account (usually administered by a third party) funded by the employee, employer, or both.<sup>33</sup> Employers may include an adoption assistance program based on reimbursement as part of a cafeteria plan for employee benefits, and they may reduce an employee's salary to pay for the benefit. Companies may offer informational and referral benefits, direct payment or reimbursement of eligible expenses, paid leave benefits, or a combination of benefits for adoption.<sup>34</sup>

According to the Department of Health and Human Services, a Hewitt Associates study found that 39% of major U.S. companies offered adoption assistance as an employee benefit in 2004.<sup>35</sup> Employers sampled by Hewitt offered from \$1,500 to \$15,000, with an average of \$3,879 in reimbursement of adoption expenses.<sup>36</sup> Because employers have discretion in the amount and type of assistance offered for adoption, they may not cover all expenses that qualify for the adoption tax credit.

Although employer-provided adoption assistance is excluded from federal income taxes, it is still subject to Social Security and Medicare payroll taxes, unlike other flexible benefits, such as child care assistance.

---

<sup>29</sup> IRC §137(e).

<sup>30</sup> IRC §23(b)(3)(A).

<sup>31</sup> IRC §137(c), and IRS Publication 15-B, *Employer's Tax Guide to Fringe Benefits*. During the year, no more than 5% of all payments made by the adoption program can be for shareholders or owners (or their spouses or dependents). A shareholder or owner is defined as someone who owns 5% or more of the stock, capital, or profit of the business (on any day of the year).

<sup>32</sup> IRC §137(a)(1)

<sup>33</sup> *Los Angeles Times*, Business: "Personal Finance; Aid is Available to Help Ease Adoption Burden," p. C2, July 31, 2005 (hereinafter referred to as *Personal Finance; Aid is Available*).

<sup>34</sup> Department of Health and Human Services, Administration for Children and Families, Children's Bureau, *Employer-Provided Adoption Benefits*, February 2011, at [https://www.childwelfare.gov/pubs/f\\_benefi.pdf](https://www.childwelfare.gov/pubs/f_benefi.pdf).

<sup>35</sup> *Ibid.*

<sup>36</sup> *Ibid.*

## Number and Amount of Credits

As shown in **Table 3**, 47,956 taxpayers claimed the adoption tax credit in tax year 2011, which was 0.03% of all tax returns. Those with AGIs of between \$100,000 and \$200,000 were the most likely to claim the credit, and those with incomes of less than \$50,000 were significantly less likely. Relatively few taxpayers with AGIs of more than \$200,000 claimed the credit because of the income phaseout. The average credit was \$12,729, which was close to the maximum credit of \$13,360 for that tax year.

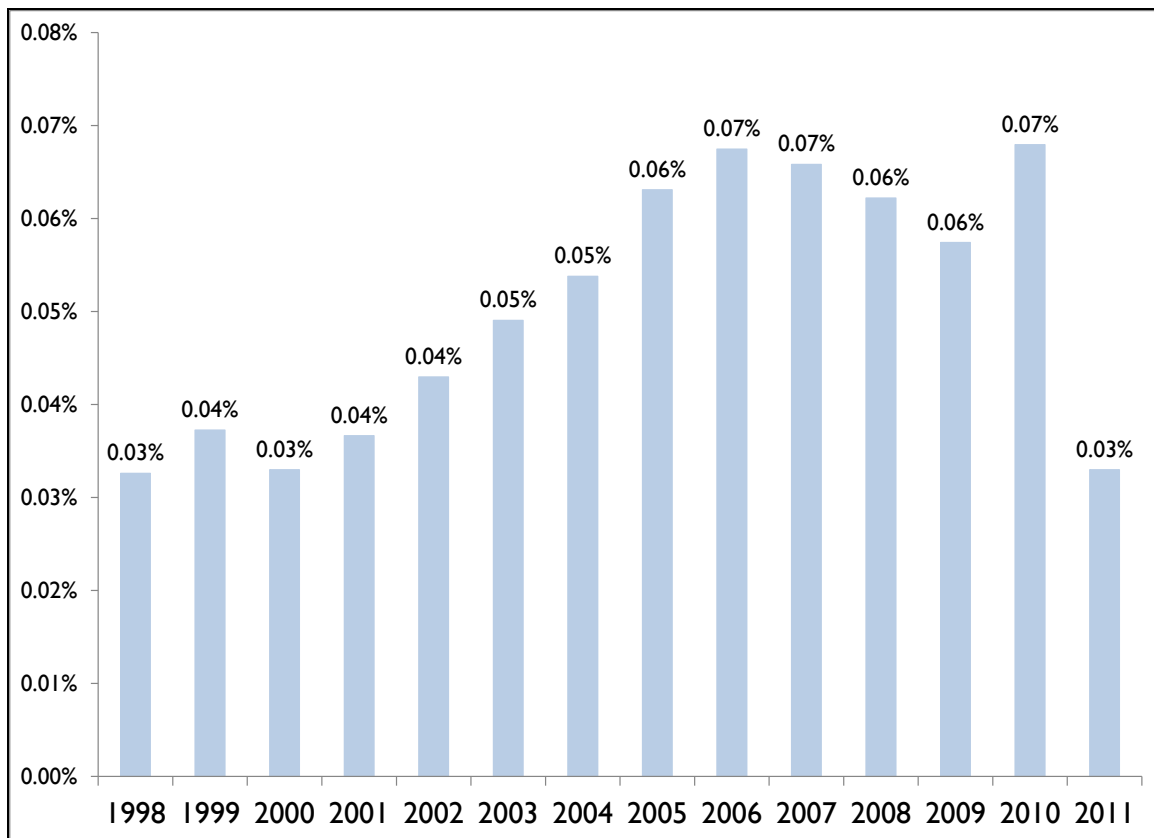
**Table 3. Utilization of the Adoption Tax Credit, Tax Year 2011**

Adjusted Gross Income	Total Tax Returns	Tax Returns with the Adoption Tax Credit	Share of Returns With Adoption Tax Credit	Total Credit	Average Credit Amount per Return
Under \$30,000	69,534,687	8,357	0.01%	\$150,446,000	\$18,002
\$30,000 to under \$50,000	25,504,052	5,006	0.02%	\$71,009,000	\$14,185
\$50,000 to under \$75,000	18,949,278	11,298	0.06%	\$130,251,000	\$11,529
\$75,000 to under \$100,000	11,926,401	7,328	0.06%	\$53,301,000	\$7,274
\$100,000 to under \$200,000	14,755,766	14,761	0.10%	\$202,325,000	\$13,707
\$200,000 and over	4,700,056	1,205	0.03%	\$3,100,000	\$2,573
<b>Total</b>	<b>145,370,240</b>	<b>47,956</b>	<b>0.03%</b>	<b>\$610,434,000</b>	<b>\$12,729</b>

**Source:** Internal Revenue Service, *Individual Complete Report, Publication 1304*, 2011, Table 3.3, at <http://www.irs.gov/uac/SOI-Tax-Stats-Individual-Income-Tax>Returns-Publication-1304-%28Complete-Report%29>, and unpublished data provided by IRS to CRS, June 19, 2014.

The percentage of tax returns using the adoption tax credit grew in the years after it was created, as shown in **Figure 1**. In tax year 1998, the first year the credit was available, it was claimed on 0.03% of returns. The share of tax returns using the credit increased to a high of 0.07% in tax year 2010, the first year that the credit was refundable. It then declined substantially in 2011, most likely because no returns in that year included carryover credits. In years before 2010, when the credit was not refundable, taxpayers whose credit exceeded their income tax liability could carryover the unused credit for up to five years. Because the credit was refundable in 2010, taxpayers could use all of their 2010 credit and any carryover credit they had from previous years, so no credits were carried over to 2011.

**Figure 1. Share of Returns Using the Adoption Tax Credit**



**Source:** Internal Revenue Service, Individual Complete Report, Publication 1304, 2011, Table A, at <http://www.irs.gov/uac/SOI-Tax-Stats-Individual-Income-Tax>Returns-Publication-1304-%28Complete-Report%29>.

The change to the phase-out income level made by the Economic Growth and Tax Relief Reconciliation Act (EGTRRA; P.L. 107-16)<sup>37</sup> significantly increased the percentage of returns with AGI between \$100,000 and \$200,000 claiming the adoption tax credit (from 0.03% in tax year 2000 to 0.16% in tax year 2004).

The most recent public data available on the use of the adoption tax credit by the type of adoption are for tax year 2004 and therefore do not reflect subsequent changes in policy and adoption

<sup>37</sup> EGTRRA (P.L. 107-16) raised the income threshold for the phase-out of the adoption tax credit from \$75,000 to \$150,000.

patterns. In tax year 2004, taxpayers claimed adoption tax benefits for the adoption of 12,432 children with special needs, or about 18% of the 69,096 adoptions for which tax benefits were claimed. In contrast, in that same year, taxpayers adopting internationally claimed some part of the tax credit for 23,296 adoptions, representing about 34% of the adoptions for which tax benefits were claimed.<sup>38</sup> In contrast, in tax year 1998, tax benefits were claimed for the adoption of 50,400 individuals, including 4,700 special needs children and 14,300 intercountry adoptions.<sup>39</sup>

According to a 2007 survey of adoptive families, 86% of families adopting internationally filed for the adoption tax credit, as did 84% of those who completed a private domestic adoption (excluding stepparent adoptions, which are ineligible for the credit). Among families adopting from foster care, 66% filed for the credit, and 39% received some reimbursement from the agency.<sup>40</sup>

## Policy Issues

Several policy issues are associated with the federal adoption tax provisions, including factors affecting the credit amount, and whether the tax provisions are the best way to provide adoption assistance, and the rules for special needs children and intercountry adoptions.

### Income Limitation, Maximum Credit, and Refundability

The credit amount could be changed in several ways. First, the maximum amount could be increased or reduced. Second, the thresholds between the credit phases out could be adjusted. Finally, the credit could be made refundable, as it was in 2010 and 2011, and as is proposed in the Adoption Tax Credit Refundability Act of 2013 (S. 1056 and H.R. 2144).

Some proposals, including H.R. 243 (Bowles-Simpson Plan of Lowering America's Debt Act) and the Tax Reform Act of 2014, would eliminate the adoption tax credit.<sup>41</sup>

### Federal and State Subsidies Versus Tax Incentives

Another issue is whether the tax system is the best way to assist adoptive families. Support could also be provided through federal and state spending. Congress considered the efficiency of adoption tax provisions and adoption subsidy programs in the 1980s. In 1980, the federal government began sharing with the states the cost of providing monthly subsidies for parents who adopt children with special needs (Adoption Assistance and Child Welfare Act of 1980; P.L. 96-272). This federal adoption assistance program, which helps parents with the ongoing costs of raising an adoptive special needs child, is authorized under Title IV-E of the Social Security Act. In 1981, the Economic Recovery Tax Act (P.L. 97-34) established an itemized tax deduction for

<sup>38</sup> *Federal Income Tax Benefits for Adoption, Use by Taxpayers, 1999-2005*, June 2007, p. 44. The data in the report on the adoption tax credit reflect the credit taken that tax year. Taxpayers may not be able to use the full amount of the adoption tax credit in the tax year in which they incur qualified adoption expenses. They can carryover any unused adoption tax credit to future tax years (for up to five tax years).

<sup>39</sup> Department of the Treasury, *Report to the Congress on Tax Benefits for Adoption*, October 2000, pp. 2-3, at <http://www.treasury.gov/resource-center/tax-policy/Documents/Tax-Benefits-For-Adoption-10-2000.pdf>.

<sup>40</sup> Department of Health and Human Services, Office of the Assistant Secretary for Planning and Evaluation, *Adoption USA: A Chartbook Based on the 2007 National Survey of Adoptive Parents*, p. 43, at <http://aspe.hhs.gov/hsp/09/nsap/chartbook/doc/chartbook.pdf>.

<sup>41</sup> The Tax Reform Act of 2014 has not been introduced. Draft legislation and additional information is available at <http://tax.house.gov>.

certain costs of adopting a child with special needs. The provision was intended to encourage adoption of special needs children by relieving some of the financial burden for taxpayers.<sup>42</sup>

In 1986, the Tax Reform Act (P.L. 99-514) repealed the itemized deduction and expanded the Title IV-E program to require that states provide direct assistance to adoptive parents to help with the initial and nonrecurring costs of adopting a special needs child. That legislation also authorized federal matching grants to states for this purpose, which, as implemented, range up to \$2,000 for an adoptive family, with the federal government reimbursing 50% (\$1,000) of the cost to the state. Congress made the change to make support more equitable: The itemized tax deduction provided the greatest benefit to high-income earners and provided no benefits to taxpayers who did not itemize and to those without tax liability. Congress also believed that agencies with expertise in placing children with special needs should have budgetary control over adoption assistance and that grant programs would facilitate more appropriate federal spending than the tax system.<sup>43</sup>

Since 1997, however, when the Small Business and Job Protection Act of 1996 (P.L. 104-188, described in more detail below) first provided for an adoption tax credit, federal assistance for adoption has been provided through both the Title IV-E program and the tax code.

## **Treatment of Special Needs Children**

Although the maximum amount of qualified expenses is the same for all adoptions, since 2003 a taxpayer who adopts a special needs child has been eligible for the maximum amount of qualified expenses, regardless of actual expenses. Therefore, a taxpayer who adopts a special needs child often receives a larger tax benefit than a taxpayer who adopts a non-special needs child and has the same adoption expenses.

The interest in providing additional support for special needs children has been reflected in Congress's decision in 1996 to set a higher limit on qualifying expenses for special needs children, and the decision in 2002 to set the qualifying expenses for special needs children at the maximum credit amount, regardless of the actual expenses. (See "Legislative History" below for details.)

The preference for special needs children is intended to encourage adoption of children who might otherwise enter adulthood without a permanent family.<sup>44</sup> Special needs children are generally harder to place for adoption than other children.

## **Tribal Parity for Special Needs Determinations**

Indian Tribal Governments (ITGs) manage adoptions, but they do not currently have the same authority as states to determine that a child has special needs for the purposes of the tax credit. The President's FY2015 Budget proposed granting ITGs the legal authority to make those special

---

<sup>42</sup> Joint Committee on Taxation, *General Explanation of the Economic Recovery Tax Act of 1981*, JCS-10-87, December 29, 1981, pp. 57-58.

<sup>43</sup> Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986*, May 4, 1987, pp. 52-53.

<sup>44</sup> The preference for special needs children has existed since the itemized deduction for adoption expenses, which was *only* for the adoption of a special needs child, was established by the Economic Recovery Tax Act of 1981 (P.L. 97-34).

needs determinations.<sup>45</sup> In the 113<sup>th</sup> Congress, the same policy is proposed in H.R. 2332 (the Adoption Tax Credit Tribal Parity Act of 2013) and in S. 2570.

## Domestic Versus Intercountry Adoptions

As described above in “Rules for Intercountry Adoptions,” the federal tax assistance for domestic adoption is more favorable than for intercountry adoptions. Qualifying expenses for domestic adoptions may be claimed even if a domestic adoption does not finalize, but intercountry adoptions *must* become finalized *before* a taxpayer can claim any qualifying expenses for the tax credit or income tax exclusion. That preference for domestic adoption may be considered inequitable by some families that do not receive a tax benefit because their intercountry adoption was not finalized.

## Legislative History

As noted earlier, federal tax assistance for adoption began with the Economic Recovery Tax Act of 1981 (P.L. 97-34), which provided an itemized deduction for adoption expenses, which was repealed by the Tax Reform Act of 1986 (P.L. 99-514). However, the 1986 law also amended Title IV-E of the Social Security Act to require states to make direct payments to parents adopting children with special needs to help offset the nonrecurring costs of adoption (attorney fees, court costs, etc.) and authorized 50% federal matching funds to states for these purposes.<sup>46</sup>

Several bills subsequently introduced proposed tax incentives for adoption. Tax provisions for adoption (a tax credit and income tax exclusion for employer-provided adoption programs) were included in the Balanced Budget Act of 1995 (H.R. 2491, 104<sup>th</sup> Congress),<sup>47</sup> which was vetoed by President Clinton (for reasons unrelated to the adoption tax provisions). The Adoption Promotion and Stability Act of 1996 (H.R. 3286, 104<sup>th</sup> Congress) also proposed an adoption tax credit and income tax exclusion. The Finance Committee report on the bill noted that one justification for the adoption tax provisions was that the financial costs of adoption should not be a barrier to adoption.<sup>48</sup>

## The Small Business and Job Protection Act of 1996 (P.L. 104-188)

In 1996, P.L. 104-188 provided a federal tax credit and income tax exclusion to taxpayers for qualified adoption expenses. Qualifying expenses were limited to \$5,000 for an adoption and to \$6,000 for the adoption of a special needs child. P.L. 104-188 provided a phase-out provision that reduced the tax benefits for taxpayers with incomes of more than \$75,000 and eliminated them for those with incomes of more than \$115,000. The law also allowed taxpayers whose adoption tax credit exceeded their tax liability to carryover the excess tax credit for up to five years. Finally, the law provided the current definitions of qualifying expenses, eligible child, and child

<sup>45</sup> Department of the Treasury, *General Explanations of the Administration’s Fiscal Year 2015 Revenue Proposals*, March 2014, p.250, at <http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2015.pdf#262>.

<sup>46</sup> Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986*, JCS-10-87, May 4, 1987, pp. 52-53 and pp.1350-1351.

<sup>47</sup> This legislation is also referred to as the Seven-Year Balanced Budget Reconciliation Act of 1995, the original title of the legislation as passed by the House of Representatives and before the Senate amendment. The text above uses the title from the conference report (H.Rept. 104-350) agreed to by the House on November 17, 1995.

<sup>48</sup> U.S. Congress, Committee on Finance, S.Rept. 104-279, Adoption Promotion and Stability Act of 1995, pp. 2-5.

with special needs and the current rules for intercountry adoptions. P.L. 104-188 provided that beginning after December 31, 2001, only special needs adoptions would be eligible for the tax credit and that the income tax exclusion for employer-provided adoption programs would expire.

### **The Taxpayer Relief Act of 1997 (P.L. 105-34)**

P.L. 105-34 clarified that the adoption tax credit is claimed the tax year after qualified expenses are incurred only when the adoption has not been finalized. Previously, the provision simply stated that the adoption tax credit was claimed the tax year after expenses were incurred, except for expenses incurred the tax year the adoption was finalized, which could be claimed the tax year incurred. P.L. 105-34 also made the definition of AGI for the phaseout of the income tax exclusion the same as the definition of AGI used for the phaseout of the adoption tax credit.

### **IRS Restructuring and Reform Act of 1998 (P.L. 105-206)**

P.L. 105-206 changed the carryover provision of the credit so that the phaseout of the credit applies only in the year in which the credit is generated and does not reduce carryover credit amounts.

### **The Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16)**

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA; P.L. 107-16) increased the limit on qualified adoption expenses to \$10,000 for all children (from \$5,000 for non-special needs children and \$6,000 for special needs children). In addition, EGTRRA increased the income level for the beginning of the credit phaseout to \$150,000 (from the previous level of \$75,000) and provided for an annual inflation adjustment beginning in 2003 for the limit on qualified adoption expenses and the phase-out income level. EGTRRA also included a sunset provision for the legislation. Under EGTRRA, the changes to the adoption tax provisions would have expired on December 31, 2010.

Congress believed that the EGTRRA provisions were necessary to continue to encourage adoptions. This belief was based on reported increases in adoption expenses and the success of the tax credit and income tax exclusion in reducing the net costs of adoption for taxpayers.<sup>49</sup>

### **The Job Creation and Worker Assistance Act of 2002 (P.L. 107-147)**

The Job Creation and Worker Assistance Act (P.L. 107-147) clarified that qualifying expenses for the adoption of children with special needs do not need to be documented. Therefore, a family seeking to adopt a child with special needs could claim the maximum credit without having to document expenses. The conference report accompanying H.R. 1836 (EGTRRA; P.L. 107-16) provided that the maximum amount of qualifying expenses was assumed to have been claimed (without the documentation requirement) in the case of a special needs adoption for tax years beginning after 2002. However, the legislative language of EGTRRA did not make this provision clear. Therefore, a technical correction was made in P.L. 107-147.<sup>50</sup> P.L. 107-147 also provided

<sup>49</sup> Joint Committee on Taxation, *General Explanation of Tax Legislation in the 107<sup>th</sup> Congress*, JCS-1-03, January 24, 2003.

<sup>50</sup> U.S. Congress, Committee on Ways and Means, *Economic Growth and Tax Relief Reconciliation Act of 2001, Conference Report to Accompany H.R. 1836*, H.Rept. 107-84, May 26, 2001, pp. 140-141.



that any qualifying expenses incurred prior to tax year 2002 are subject to the pre-EGTRRA provisions. In other words, expenses incurred prior to 2002 were limited to qualifying expenses of \$5,000 for non-special needs children and \$6,000 for special needs children. Taxpayers claiming expenses prior to 2002 were also subject to the phase-out income level that existed prior to EGTRRA.

### **The Patient Protection and Affordable Care Act (P.L. 111-148)**

The Patient Protection and Affordable Care Act (P.L. 111-148) provided that the adoption tax credit be refundable for *tax years 2010 and 2011 only*. The law also increased the qualified expenses for the adoption tax credit and the income tax exclusion for employer-provided adoption assistance to \$13,170 for tax year 2010, with this amount indexed for inflation in 2011.

### **The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)**

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312) extended the EGTRRA provisions for adoption to tax year 2012.

### **The American Taxpayer Relief Act of 2012 (P.L. 112-240)**

The American Taxpayer Relief Act of 2012 (ATRA; P.L. 112-240) made permanent the provisions in EGTRRA that increased the adoption tax credit amount and the income level for the beginning of the credit phaseout and indexed both of those parameters to inflation.

## **Author Contact Information**

(name redacted)  
Specialist in Income Security  
f[redacted]@crs.loc.gov , 7-....

## **Acknowledgments**

This report was originally written by (name redacted).

# EveryCRSReport.com

The Congressional Research Service (CRS) is a federal legislative branch agency, housed inside the Library of Congress, charged with providing the United States Congress non-partisan advice on issues that may come before Congress.

EveryCRSReport.com republishes CRS reports that are available to all Congressional staff. The reports are not classified, and Members of Congress routinely make individual reports available to the public.

Prior to our republication, we redacted names, phone numbers and email addresses of analysts who produced the reports. We also added this page to the report. We have not intentionally made any other changes to any report published on EveryCRSReport.com.

CRS reports, as a work of the United States government, are not subject to copyright protection in the United States. Any CRS report may be reproduced and distributed in its entirety without permission from CRS. However, as a CRS report may include copyrighted images or material from a third party, you may need to obtain permission of the copyright holder if you wish to copy or otherwise use copyrighted material.

Information in a CRS report should not be relied upon for purposes other than public understanding of information that has been provided by CRS to members of Congress in connection with CRS' institutional role.

EveryCRSReport.com is not a government website and is not affiliated with CRS. We do not claim copyright on any CRS report we have republished.