

# Adoption Tax Credit UPDATE



## What is the new federal adoption tax credit?

**The Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16) provides a non-refundable maximum \$10,000 per child federal tax credit for qualified expenses incurred after January 1, 2002.** This credit applies to all adoptions whose qualified expenses were not reimbursed by another source. Families who have a modified adjusted gross income of less than \$150,000 may claim this tax credit. Families who meet the criteria but earn between \$150,000 and \$190,000 will be eligible for a credit in an adjusted amount based on their income.

*Beginning in January 2003, the requirement of qualified expenses will be eliminated for the adoption of special needs children.* In other words, beginning in January 2003, taxpayers earning less than \$150,000 who complete an adoption that includes adoption assistance, will qualify for a full \$10,000 tax credit even if they had zero expenses. Taxpayers earning \$150,000 to \$190,000 also need not document their qualified expenses to receive the adjusted credit.

## What are considered qualified expenses?

**Qualified expenses are defined as reasonable and necessary expenses directly related to a legal adoption.** Examples include adoption fees, court costs, attorney fees, medical expenses, travel expenses (including amounts expended for meals and lodging), and other expenses related to the principal purpose of adopting an eligible child.

This may also include reasonable and necessary expenses specifically required by a state to meet the needs of a child as a condition of the adoption, such as the cost of construction,

renovations, alterations or purchases.

*Excluded expenses* include adoption of a spouse's child, expenses paid or reimbursed by federal, state or local programs, expenses already allowed as a credit or deduction under another income tax rule, expenses incurred in carrying out a surrogate parenting arrangement or expenses that violate state or federal law.

## How can the credit be claimed?

**Claims for the credit will be allowed in the taxable year following the tax year in which the expenses were incurred.** However, if expenses are incurred in the tax year in which the adoption becomes final, the expenses are allowable that year.

To claim the credit, the taxpayer must complete IRS Form 8839 and attach that form to IRS Form 1040 or 1040A. For more information, refer to IRS Publication 968, *Tax Benefits for Adoption*.

## Please define special needs children.

**For this law, a special needs child is a child who is a citizen or resident of the U.S. who a state has determined cannot or should not be returned to the home of his or her parents and for whom it has been determined there exists a specific factor or condition** (such as ethnic background, age or membership in a minority or sibling group, or the presence of factors such as medical conditions or physical, mental or emotional handicaps) because of which it is reasonable to conclude that the child cannot be placed with adoptive parents without adoption assistance.

## Can the credit be claimed if the adoptive parent has less than \$10,000 in tax liability?

**Since the credit is non-refundable, an adoptive parent with no tax liability is not eligible for the credit.** However, an adoptive parent who cannot use the full amount can carry forward any unused portion of the credit for up to five years.

## What if a child is adopted from another country?

**In the case of an adoption of a child who is not a citizen or resident of the U.S., a \$10,000 maximum credit is still available for qualified expenses.** If the child has special needs and is adopted from another country, the maximum credit allowed is also \$10,000 for qualified expenses. The automatic tax credit becomes available only when the inter-country adoption is finalized and it occurs on or after January 1, 2003.

## Other Stipulations

- Married adoptive parents must file a joint return to claim the credit.
- The IRS must prescribe regulations which will treat two unmarried individuals, who incur qualified adoption expenses with respect to the same child, as one taxpayer for the purposes of applying the dollar limitation on the use of the credit.
- A tax return must include a correct name, age and tax identification number (Social Security Number) of the adopted child.

**Michigan taxpayers who are eligible for the federal adoption tax credit may claim a maximum Michigan income tax credit of \$1,200 per child using Form MI-8839.**

Prepared by the Michigan Federation for Children & Families • [www.michfed.org](http://www.michfed.org) • December 2002

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