

LEGISLATIVE RESEARCH UNIT

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ADOPTION TAX INCENTIVES

You asked whether any of the states in our 18-state survey list offer adoptive parents income tax deductions or credits for adoption costs.

We searched by computer¹ and using printed indexes² to the laws of the states on our 18-state survey list (the 10 most populous states other than Illinois, neighboring states, and regional representatives)³ for income tax incentives for adoption. We found eight such states that offer deductions or credits for adoption costs. The Internal Revenue Code also offers a generous federal tax credit and exclusion for adoption. Each such law is described below; copies are enclosed.

Federal Credit and Exclusion

Persons who adopt a child who is under 18, or is "physically or mentally incapable of caring for himself," may take a credit against federal income tax for "qualified adoption expenses"—defined as reasonable and necessary adoption fees, court costs, attorney fees, and other expenses that are directly related to the adoption; are not incurred in violation of law or through a "surrogate parenting arrangement" (presumably meaning surrogate motherhood); are not connected with an adoption of a stepchild; and are not reimbursed under any other program.⁴

The maximum credit is adjusted annually for inflation.⁵ It is now \$11,390 per adoptive child, which can be spread over more than one year. Parents who adopt a "special needs" child can take the full credit regardless of their expenses;⁶ other

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adoptive parents can take a credit for their qualified adoption expenses up to \$11,390.⁷ A "special needs" child is defined as a child who is a U.S. citizen or resident, if a state has determined that the child (1) cannot or should not return to the child's parents, and (2) cannot be placed for adoption without assistance because of a factor such as ethnic background, age, membership in a minority or sibling group, medical conditions, or handicaps.⁸

The credit is to be taken in the year after the expenses are paid (or incurred if the adoption is not yet final). Expenses paid or incurred during or after the year in which an adoption becomes final may be taken as a credit for the year in which the expenses are paid or incurred.⁹

The credit begins to phase out if modified adjusted gross income exceeds \$170,820, and is eliminated if such income is at least \$210,820.¹⁰ Unused expenses may be carried forward for up to 5 years.¹¹

An employee may also exclude from gross income amounts paid or expenses incurred by an employer for qualified adoption expenses in connection with an adoption by that employee if the amounts are paid through an adoption assistance program (an employer's separate written plan of adoption assistance for employees). Amounts used for the credit described above may not be so excluded. The dollar and income limits for the exclusion are generally the same as for the credit.¹²

Arizona

Taxpayers may subtract from gross income up to \$3,000 in unreimbursed medical and hospital costs, adoption counseling costs, legal and agency fees, and other nonrecurring adoption costs. The subtraction may be taken only in the year in which a final adoption order is granted, but may include costs from prior years.¹³

California

Taxpayers may reduce their state income tax liability by half of the cost of adopting a child who, at the time of adoption, is a U.S. citizen or legal resident, and a ward of the state or a political subdivision. This tax credit is limited to \$2,500. Costs that can be used for the credit are:

- Fees for required services of either the Department of Social Services or a licensed adoption agency.
- Travel and related expenses for the adoptive family, if directly related to the adoption.

- Medical fees and expenses that are not reimbursed by insurance and are directly related to the adoption.

The credit may be claimed for the tax year in which the decree or order of adoption is entered. However, it may include costs of the adoption that were paid or incurred in prior years.

If the allowable credit exceeds the net tax, the excess may be carried over to later years until the credit is exhausted.¹⁴

Iowa

Adoptive parents may deduct from net income adoption expenses to the extent they exceed 3% of net income. These may include medical and hospital expenses of the biological mother that were paid by the adoptive parents, welfare agency fees, legal fees, and all other fees and costs relating to the adoption.¹⁵

Massachusetts

Adoptive parents may exempt from their adjusted "Part B" gross income (gross income except interest, dividends, and net capital gains¹⁶) fees paid to a licensed agency for adopting a child.¹⁷

Michigan

A person who claims the federal adoption tax credit may also take a credit against the state income tax. The credit is equal to the amount of qualified adoption expenses (as defined for the federal adoption tax credit) that exceed the amount claimed for the federal adoption tax credit or \$1,200 per child, whichever is less.¹⁸

Missouri

Anyone who proceeds in good faith with adoption of a "special needs" child may take an income tax credit up to \$10,000 for nonrecurring adoption expenses (defined as reasonable and necessary adoption fees, court costs, attorney fees, and other expenses directly related to the adoption of a special needs child¹⁹). A business that pays such expenses for an employee may take the credit as well; but the total credit per child may not exceed \$10,000.²⁰ A special needs child is one who, as determined by the Division of Family Services, a licensed child-placing agency, or a court, (1) cannot or should not be returned to the home of the child's parents, and (2) cannot be easily placed with adoptive parents because of a factor such

as ethnic background, age, membership in a minority or sibling group, medical condition, or handicap.²¹

Half the credit is available when a child is placed in a home, and half when the adoption becomes final. Total statewide credits given in a year may not exceed \$4 million unless more is appropriated. Half of that amount must be allocated for adoption of special needs children who are residents, or wards of residents, of the state when the adoption is initiated.²²

Any tax credit that exceeds tax liability for that year, or that cannot be used due to the \$4 million limit, may be applied to later tax years for up to 5 years.²³

Ohio

Adoptive parents may take an income tax credit equal to \$1,500 for each child adopted when under 18 years old. The credit may be taken in the year in which the adoption is finalized. If the credit allowable exceeds the tax due, the excess may be carried over for 2 years.²⁴

Wisconsin

Adoptive parents, when calculating state adjusted gross income from their federal adjusted gross income,²⁵ may subtract up to \$5,000 spent in the current and last 2 years on adoption fees, court costs, or legal fees related to the adoption. The subtraction is to be taken in the year in which a final adoption order is entered.²⁶

We hope this information is helpful. Please let us know if we can be of further assistance.

Sincerely,



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Enclosures

1. 26 U.S. Code sec. 23.
2. 26 U.S. Code sec. 137.
3. Ariz. Rev. Stat., sec. 43-1022, subd. 20.
4. Cal. Rev. & Tax. Code, sec. 17052.25.
5. Iowa Code, sec. 422.9, subd. 2.c.
6. Mass. Gen. Laws, ch. 62, sec. 3, subd. B.(b)(5).
7. Mich. Comp. Laws, secs. 206.267 and 206.268.

8. Mo. Rev. Stat., secs. 135.326, 135.327, and 135.333.
9. Ohio Rev. Code, sec. 5747.37.
10. Wis. Stat., subsec. 71.05(6)(b)22.

Notes

1. We searched the surveyed states' laws for ("adopt__" within 10 words of "child__"), in the same section as "credit__" or "deduct__" or "exempt__" or "subtract__".
2. We searched West's printed indexes to the surveyed states' laws under the heading "Adoption," subheadings "Income Tax" and "Tax".
3. Those states are Arizona, California, Florida, Georgia, Indiana, Iowa, Massachusetts, Michigan, Missouri, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Texas, Virginia, Washington, and Wisconsin.
4. 26 U.S. Code subsec. 23(d).
5. 26 U.S. Code subsec. 23(h).
6. 26 U.S. Code subsec. 23(a)(3) and Rev. Proc. 2006-53, sec. 3.03 (Nov. 27, 2006).
7. 26 U.S. Code subsec. 23(b)(1) and Rev. Proc. 2006-53, sec. 3.03 (Nov. 27, 2006).
8. 26 U.S. Code subsec. 23(d)(3).
9. 26 U.S. Code subsec. 23(a)(2).
10. 26 U.S. Code subsec. 23(b)(2) and Rev. Proc. 2006-53, sec. 3.03 (Nov. 27, 2006).
11. 26 U.S. Code subsec. 23(c).
12. 26 U.S. Code sec. 137 and Rev. Proc. 2006-53, sec. 3.15 (Nov. 27, 2006).
13. Ariz. Rev. Stat., sec. 43-1022, subd. 20.
14. Cal. Rev. & Tax. Code, sec. 17052.25.
15. Iowa Code, sec. 422.9, subd. 2.c.
16. Mass. Gen. Laws, ch. 62, subsec. 2(b).
17. Mass. Gen. Laws, ch. 62, sec. 3, subd. B.(b)(5).
18. Mich. Comp. Laws, secs. 206.267 and 206.268.
19. Mo. Rev. Stat., subsec. 135.326(3).
20. Mo. Rev. Stat., sec. 135.327, subd. 3.
21. Mo. Rev. Stat., subsec. 135.326(4).
22. Mo. Rev. Stat., sec. 135.327, subds. 3 and 4.
23. Mo. Rev. Stat., sec. 135.333, subd. 1.
24. Ohio Rev. Code, sec. 5747.37.
25. Wis. Stat., subsec. 71.01(13).
26. Wis. Stat., subsec. 71.05(6)(b)22.