

Adoption Credit and the Health Care Bill

Lets Talk Tax

By Brett Hersh, EA, MBA

Recent natural disasters, such as the earthquake that devastated Haiti, have impassioned those who see adoption as a way to help children escape danger and uncertainty. At the same time, however, the cost of adopting (often upwards of \$20-30,000) combined with the reality of economic recession and caused many who would like to adopt to put their plans on hold.

Aspiring parents: take heart. The Health Care Act (more exactly the Patient Protection and Affordability Act) has made some meaningful changes to the adoption expense credit. Today, we will highlight these changes and discuss the basics of the adoption credit. Perhaps, once made aware of the adoption credit and these cost-saving changes, you will reconsider the gift of adoption.

The Adoption Expense Credit and Exclusion reimburses adoptive parents for qualified adoption expenses and allows employer-provided adoption assistance to be excluded from income. Prior to the Health Care Act, the credit/exclusion was limited to \$12,170 (2010). The credit was also nonrefundable – meaning it would reduce your tax liability but would not generate a refund. Any unused credit could be carried over to the following year but would be lost if not used within five years. In addition, the credit was scheduled to be eliminated entirely at the end of 2010 (with the exception of a \$6,000 credit for special needs children, discussed below).

The Health Care Act made substantial changes to the adoption credit - changes that will help many financially-strapped parents adopt. Effective January 1st, 2010 the adoption credit and exclusion has increased to \$13,170 and the credit is made refundable – meaning you can receive the credit regardless of whether you owe any tax. The Health Care Act also extended this “refundable” form of the adoption credit through 2011.

The “Adoption Credit” actually has two parts, each of which is governed by a separate section of the tax code. These parts are called the Adoption Credit and the Adoption Fringe Benefit Exclusion. The adoption credit and fringe benefit exclusion are exclusive of one another. This means that an adoptive family can claim the \$13,170 credit (2010) and also exclude up to \$13,170 in employer assistance for the same adoption, allowing adopting parents to offset up to \$26,340 for each qualifying adoption. Both the credit and exclusion, however, are not allowed for the same expenses.

To qualify for the credit/exclusion, the adoptive child must be an “Eligible Child” or a “Special Needs Child”. An “eligible child” is either under the age of eighteen or a person (any age) who is physically or mentally unable to take care of themselves. A “special needs child” is one who meets the following three criteria: First, be a citizen or a resident of the United States or U.S. possession. Second, a state agency must determine that the child should not or cannot be returned to their parent’s home. And finally, the state must also determine that a specific factor (such as the child’s age, ethnic background, medical condition or handicap) makes adoption unlikely without assistance. The primary difference between adopting an eligible child or a special needs child (as it pertains to the adoption credit/exclusion) is that the credit for an “eligible child” is limited to qualified expenses actually spent on the adoption. The credit for adopting a “special needs child,” on the other hand, is the full credit amount (\$13,170) regardless of the amount actually spent.

Qualified adoption expenses include adoption fees, attorney fees, travel expenses and re-adoption fees for a foreign child. They do not include expenses paid or reimbursed by government programs, costs associated with surrogate parenting, or the cost of step-parent adoptions. If the adoption is a “foreign adoption” the credit/exclusion is only allowed if the adoption becomes final. If the child is a U.S. citizen or resident the credit is allowed whether or not the adoption is successful. The credit/exclusion limit is a per-child/adoption limit, not an annual limit.

In today’s column we have discussed the basics of and some major changes to the adoption credit. Unfortunately, we have not had time to discuss many of the credit’s complexities including; the time-line for claiming the credit,

limits on filing status, and income limitations for those who can claim the credit. As always, do not rely on this information as a basis to make any financial decisions. Contact a tax professional.

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