

Adoption Advocate



Understanding the Adoption Tax Credit

BY RYAN HANLON AND BECKY WILMOTH

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While Americans have a very positive view of adoption, a majority describe private adoptions as either expensive or very expensive.¹ The Adoption Tax Credit (ATC) can help offset the cost and fees of an adoption process. But it is essential that prospective adoptive parents understand the basics of the credit before they can determine how much it can help them.

In this updated guide to understanding the adoption tax credit, we explain what the ATC is, how it is different from a tax deduction, how it works, and what the eligibility and qualifying expenses are. We also discuss proposed legislation to improve the ATC's ability to help more families and strengthen opportunities for more children to thrive in permanent, loving families.

Note: This information is provided for general educational purposes and is not meant as tax

advice. This is a general summary and does not cover each family's unique situation. Consult a competent tax adviser for individual advice regarding your own situation.

A Brief Legislative History of the Adoption Tax Credit

The adoption tax credit first became available to American taxpayers following the passage of the Small Business and Job Protection Act of 1996.² This was due, in no small part, to the advocacy of National Council For Adoption³ and other advocates seeking to make adoption more affordable for families. Beginning in 1997, the credit was up to a maximum of \$5,000 for qualifying families, and has been repeatedly expanded in subsequent years. The Economic Growth and Tax Relief Reconciliation Act of 2001 expanded and extended the adoption tax credit until 2010.⁴

¹ <https://www.davethomasfoundation.org/wp-content/uploads/2018/02/2017-adoption-attitudes-survey-us.pdf>

² Public Law 104-188 <https://www.congress.gov/104/plaws/publ188/PLAW-104publ188.pdf>

³ <https://www.washingtonpost.com/archive/politics/1996/08/10/wage-bill-includes-provisions-intended-to-increase-adoptions/1c4a2369-aa81-423e-944a-8285bc0dfcc5/>

⁴ Public Law 107-16 <https://www.congress.gov/107/plaws/publ16/PLAW-107publ16.htm>

In 2010, two laws were passed impacting the adoption tax credit. The Patient Protection and Affordable Care Act both increased the credit and made the credit refundable (for years 2010 and 2011).⁵ The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 extended the credit, but ended the modifications made by the Affordable Care Act (including an end to refundability of the credit in 2011).⁶

The American Taxpayer Relief Act of 2012 made the adoption tax credit a permanent part of the tax code.⁷ Though the tax code changed dramatically in 2018, the adoption tax credit was preserved.⁸

Qualifying for the Adoption Tax Credit

- You qualify for the ATC if you adopted a child (unless it is a spouse's child) and paid out-of-pocket expenses relating to the adoption. The amount of the tax credit you qualify for is directly related to how much you spent on adoption-related expenses. Income can also be excluded as taxable through an employer-provided adoption benefit program. Both a credit and exclusion may be claimed for the same adoption; however, both cannot be claimed for the same expenses.
- If you adopt a child with special needs through foster care, you may be entitled to claim the full amount of the adoption tax credit. Each state has different criteria that

qualify a child as special needs and eligible to claim the tax credit. The special needs declaration *must come from the state in which the adoption was final*. The “subsidy agreement” has the determination of special needs that the IRS accepts. Some states call it the “adoption eligibility assistance determination.” (Learn more about [subsidies here](#).)

- Intercountry adoptions are not considered special needs for IRS purposes, so for these families the credit is for the amount of qualified expenses only.
- There are eligibility restrictions based upon taxpayers' modified adjusted gross income (MAGI). For example, in tax year 2020, the MAGI phase-out begins at \$214,520 and ends at \$254,520.⁹ The adoption tax credit limitations and restrictions change on an annual basis and should be referenced through IRS publications.

How the Adoption Tax Credit Works

- When filing their tax return, an adoptive family can apply this credit toward their federal tax liability, which can reduce what the family owes in federal income tax.
- The difference between your tax liability and your federal withholding is either what you get as a refund or what you owe when you do your tax return. For those who are eligible, the adoption tax

⁵ Public Law 111-148 <https://www.congress.gov/111/plaws/publ148/PLAW-111publ148.pdf>

⁶ Public Law 111-312 <https://www.congress.gov/111/plaws/publ312/PLAW-111publ312.htm>

⁷ Public Law 112-240 <https://www.congress.gov/112/plaws/publ240/PLAW-112publ240.pdf>

⁸ <https://www.nbc26.com/news/national/house-and-senate-agree-the-adoption-tax-credit-stays>

⁹ <https://www.irs.gov/taxtopics/tc607>

credit covers your tax liability up to the maximum amount of the credit. You will get your withholding back if tax liability is less than the maximum credit amount.

- To claim the adoption tax credit, you must file IRS Form 8839,¹⁰ which includes specific information about the child by adoption.¹¹
- If the child by adoption does not have a social security number yet, the filer can use an adoption taxpayer identification number (ATIN).¹²
- If you do not use all of the credit in the first year, you can carry it forward for up to five years.

Guidelines for IRS Documentation

Taxpayers who claim the adoption tax credit should keep, at a minimum, the following documentation in case they are audited by the IRS:

- Adoption Assistance Eligibility Determination (Subsidy Agreement) that declares the child special needs, if claiming credit for a child declared special needs by your state through foster care (applicable to adoptions from foster care).
- A home study/placement agreement completed by an authorized placement agency (for all types of adoption except adoptions from foster care).
- All documentation of paid qualified expenses (for all types of adoption except those domestic adoptions qualifying as special needs by IRS).

- Final Judgment of Adoption (for all types of adoption).

All documents must be signed and dated (for all types of adoption). The IRS will not accept home studies, placement agreements, judgments of adoption, or subsidy agreements/eligibility agreements unless they have been signed and dated by the proper authorities.

Improving the Adoption Tax Credit: The Impact of Refundability

The adoption tax credit is currently a nonrefundable credit. It helps many families, but could help many more families if it were refundable. With the cost of adoptions continuing to increase, and thousands of children in the U.S. and around the world in need of permanent families, NCFCA is committed to advocating for legislation that offers meaningful resources to overcome the financial barriers to adoption.

Adoption Tax Credit Advocacy Alerts

Receive information and tools to make your voice heard in support of the Adoption Tax Credit Refundability Act and other legislative efforts to strengthen adoption. Sign up for NCFCA advocacy alerts at <https://adoptioncouncil.org/who-we-are/adoption-advocacy>

¹⁰ <https://www.irs.gov/forms-pubs/about-form-8839>

¹¹ <https://www.irs.gov/pub/irs-pdf/f8839.pdf>

¹² <https://www.irs.gov/individuals/adoption-taxpayer-identification-number>

A nonrefundable credit is subtracted from your income tax liability, up to the total amount you owe, but unlike a refundable tax credit, a nonrefundable credit cannot reduce your tax balance beyond zero.

Since it is not refundable at this time, it will not cover self-employment tax, early pension distribution penalty, or first-time homebuyer payback. When the adoption tax credit is refundable it will help many more families in the lower to medium income range and others who have a low federal tax liability.

A refundable tax credit would allow taxpayers with little or no tax liability to claim the entire value of the credit in a given year. Not only would a refundable credit promote equity among adoptive parents with different incomes, but it would also make adoption less financially burdensome—particularly for families who adopt from foster care.

Adoption Tax Credit FAQs

How much is the adoption tax credit?

For adoptions finalized in 2020 (tax returns claimed in early 2021), the maximum amount a family can receive as credit is \$14,300.

Does the adoption tax credit just reduce my federal tax liability, or does it also reduce my state tax liability?

This article, and the information herein, focuses on federal tax benefits. Many states do have an adoption tax benefit in addition to the federal tax credit. These state benefits can be claimed when filing state tax returns.



The Eldridge Family

Our family adopted our daughter from China in 2019, after a whirlwind process due to our daughter's medical special needs. After she joined our family, I temporarily stopped working to ensure she got the care she needed. With the amount of medical appointments, trauma therapies, and continued adoption-related needs post adoption, the financial burden has been lofty for us on my husband's income as a pastor. Our adoption process had already been more costly than normal because it was a medical expedite. We had many balances still to pay and upcoming therapies and medical procedures we planned to use the tax credit towards the following year. When we did our taxes, we were surprised to find out that our family did not receive the full benefit of the adoption tax credit because of the way my husband's income is taxed. As a pastor, his income is subject to SECA taxes, and according to the current adoption tax credit rules, the credit will not apply to self-employment tax, only ordinary tax. Even though the amount of adoption fees paid would have allowed us to use most or all of the credit in this year, we were only able to use \$1,500 of the over \$14,000 in qualified adoption expenses. We actually owed a rather large amount, and will carry forward the remaining adoption tax credit to (hopefully) use within the next five years. Had the tax credit been refundable, our family could have used the credit to offset the significant fees associated with our adoption, and we would have been better equipped to meet our daughter's therapeutic, medical, and other needs.

Share Your Story

Too often the cost of the adoption process stands in the way of children coming into permanent, loving families. Lawmakers are considering legislative solutions and Congress wants to hear how a refundable adoption tax credit would help American families.

If you are an adoptive family, a family in the process to adopt, or are seriously considering adoption but aren't sure that you can afford it, we ask you to share your story with us at <https://adoptioncouncil.org/atcr-stories>

Why does the adoption tax credit amount change from year to year?

The amount of the credit is adjusted for inflation each year. The eligibility restrictions based upon taxpayers' modified adjusted gross income (MAGI) are also adjusted for inflation each year.

How does it work if a family adopts more than one child during the same tax year?

The adoption tax credit is calculated on a per child basis, so qualifying families who adopt multiple children will have the credit applied on a per child basis.

What is the difference between a tax credit and a tax deduction?

A tax credit is better than a tax deduction; a credit is directly subtracted from the tax you owe, while a deduction only reduces the amount of taxable income.¹³

Because the credit is now permanent, does that mean it cannot go away in the future?

No, when a credit is said to be permanent, it means it is not scheduled to “sunset” or be terminated. However, future legislation could eliminate this credit or alter the credit in positive or negative ways.

What other financial resources are available to help with the cost of adoption?

Visit our [Financial Resources page](#) and check out a free webinar from Your Adoption Finance Coach.

Additional Resources

- IRS Adoption Credit and Adoption Assistance Programs
<https://www.irs.gov/taxtopics/tc607>
- Bills Tax Service Specialists
<http://centralia-il-taxservice.com/tax-services/adoption-tax-services/>

¹³ <https://www.irs.gov/credits-deductions-for-individuals>

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Ryan Hanlon is Vice President at National Council For Adoption (NCFa). Additionally, Ryan is an adjunct instructor for graduate students in the social work program at The Catholic University of America (CUA). Prior to joining NCFa, Ryan worked for over 13 years as an adoption professional. He lives in northern Virginia with his wife and their four children. His family has personally benefited from the adoption tax credit and he is committed to ensuring it stays a permanent part of the tax code, with hopes of seeing it expand and become refundable, helping even more families afford adoption.

This issue of the *Adoption Advocate* was edited by
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