

SUPPORT FAMILIES AND STUDENTS

MAKE ADOPTION TAX CREDIT REFUNDABLE AND ALLOW CERTAIN GUARDIANSHIP ARRANGEMENTS TO QUALIFY

Current Law

Two tax benefits are provided to taxpayers who adopt children: (a) a nonrefundable 100 percent tax credit for a limited amount of qualified expenses incurred in the adoption of a child; and (b) an exclusion from gross income of a limited amount of qualified adoption expenses paid or reimbursed by an employer under an adoption assistance program. For taxable year 2022 the separate limits on qualified adoption expenses for the credit and the exclusion are \$14,890. Taxpayers may use both adoption tax benefits, but the same expenses cannot be used for both benefits. Taxpayers may claim the credit for domestic and foreign adoptions, although the rules differ.

For domestic adoptions, qualifying expenses paid prior to the year in which the adoption is finalized are allowable as a credit in the year following the year of payment (even if the adoption is never finalized); however, qualifying expenses paid in the year in which the adoption is finalized (or later) are allowable as a credit in the year of payment. For foreign adoptions, the credit may be claimed only in the year the adoption becomes final (or, if later, in the year the qualified expense is paid).

Taxpayers who adopt children with special needs may claim the full \$14,890 credit even if total adoption expenses are less than that amount, although credits in excess of actual expenses may only be claimed for the year the adoption is finalized.

Taxpayers may carry forward unused credit amounts for up to five years.

If modified adjusted gross income (AGI) exceeds \$223,410, both the credit amount and the amount excluded from gross income are reduced pro rata over the next \$40,000 of modified AGI. The maximum credit, the maximum exclusion, and the income at which the phaseout range begins are indexed annually for inflation. The limits for the tax credit and the exclusion are per adoption so that benefits for a given adoption may be claimed over several years.

Reasons for Change

Tax benefits for adoption lower the cost of adoptions. Because adoption credits are currently non-refundable, low- and moderate-income families are unlikely to have sufficient tax liability to benefit from the full amount of the credit to which they are otherwise entitled. This assistance would help low- and moderate-income families afford adoption expenses, potentially making adoption more attainable for these families and ensuring that this credit is available to all taxpayers, regardless of tax liability. Because the adoption process, and therefore the expenses, may extend over several years, it is important that the change to make the adoption credit refundable be made permanent.

There are circumstances where a family might choose to claim legal and financial responsibility for a child via guardianship instead of adoption. Expanding the credit to include families bonded by legal guardianship rather than adoption promotes the goal of creating stability for vulnerable children and provides assistance to the families caring for them.

Proposal

The proposal would make the adoption credit fully refundable. Thus, taxpayers could claim the full amount of any eligible credit in the year that the expense was first eligible regardless of tax liability.

In addition, taxpayers with unused carryforward amounts from eligible expenses from earlier adoptions would be able to claim the full amount of any unused carryforward on their 2023 tax return. However, unused carryforward amounts that expired before 2023 (pursuant to the 5-year limit under current law) would not be eligible to be claimed.

The proposal would also allow families who enter into a guardianship arrangement with a child that meets the requirements below to claim a refundable credit for the expenses related to establishing the guardianship relationship in the year such requirements are satisfied. Unless otherwise specified, eligible expenses and the timing of claims for guardianships would follow existing rules for domestic adoptions.¹ The extra benefit for special needs adoptions would not be extended to include cases of guardianships.

A guardianship arrangement would be eligible for the credit if four requirements were met: (a) the relationship must be established by court order, (b) the relationship must not be with one's own child or stepchild (as is the case with the adoption credit), (c) the guardian and the child must meet a residency requirement, and (d) the child must be under 18 at the time the relationship was established.

In cases where the child was later adopted by the same individual (or individuals on a joint return), allowable expenses for the adoption credit by this individual (or individuals) would be decreased by the amount already claimed.

The Secretary and her delegates would be granted regulatory authority to develop rules and reporting requirements to ensure that eligibility, relationships, and expenses are well defined and verifiable and to establish cooperation procedures with relevant State and local agencies and courts.

The proposal will be effective for taxable years beginning after December 31, 2022

¹ As with adoption, qualified expenses would include court and attorney fees, travel, and other expenses directly related to and for the principal purpose of the establishing guardianship of the child. Taxpayers generally claim a credit for domestic adoption expenses in the taxable year after the expense was paid or incurred, except in the year the adoption is finalized (expenses paid or incurred in the year the adoption is finalized can be claimed as a credit in such year).