

# Key Elements of the U.S. Tax System

What is the adoption tax credit?

TAXES AND THE FAMILY

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## Q. What is the adoption tax credit?

**A. The tax code provides an adoption credit of up to \$13,810 of qualified expenses (in 2018) for each child adopted, whether via public foster care, domestic private adoption, or international adoption. The total amount of adoption credits for 2018 is estimated to reach approximately \$400 million.**

### CREDIT AMOUNT

Taxpayers can receive a tax credit for all qualifying adoption expenses up to \$13,810 in 2018. The maximum credit is indexed for inflation. Taxpayers may also exclude from income qualified adoption expenses paid or reimbursed by an employer, up to the same limit as the credit. Taxpayers can use the tax credit and the income exclusion but cannot claim the same expenses for both.

“Special needs” adoptions automatically qualify for the maximum credit regardless of actual out-of-pocket expenses. For purposes of the credit, a child has special needs if a state’s welfare agency determines that the child cannot or should not be returned to his or her parents’ home and that the child probably will not be adoptable without assistance provided to the adoptive family. This provision is designed to encourage parents to adopt children who would otherwise be hard to place, even if most of the adoption expenses are covered by someone else (such as a public foster care program).

### ELIGIBILITY

The adoption credit is available to most adoptive parents, with some exceptions. The credit is not available to taxpayers whose income exceeds certain thresholds. The thresholds are indexed for inflation. In 2018 the credit begins to phase out at \$207,140 of modified adjusted gross income and phases out entirely at income of \$247,140. The credit also is not available for adoptions of stepchildren.

### REFUNDABILITY

The adoption tax credit is nonrefundable but can be carried forward for up to five years. The credit is thus of little or no value to low-income families who pay little or no income tax over a period of years. The Patient Protection and Affordable Care Act of 2010 made the adoption tax credit refundable for 2010 and 2011. Concerned about the potential for fraud, the Internal Revenue Service (IRS) stepped up compliance efforts. The result, according to the National Taxpayer Advocate Service, was substantial delays for taxpayers, with 69 percent of all adoption credit claims filed in 2012 selected for audit. The IRS ultimately disallowed only 1.5 percent of claims, and 20 percent of the savings from the disallowed credits was spent on interest owed to taxpayers with delayed refunds. The credit reverted to nonrefundability in 2012.

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### COST OF THE CREDIT

The credit has been repeatedly expanded, from an initial maximum value of \$5,000 in 1997 to \$13,810 in 2018. In 2016, taxpayers claimed total adoption credit of \$290 million (figure 1). The temporary availability of a refundable credit pushed the cost of the credit up to the dramatically higher figures of \$1.2 billion in 2010 and \$610 million in 2011 (including the refundable portion).

### WHO GETS IT

The distribution of the credit across income groups ranges from small amounts for low- and moderate-income households (because of their minimal tax liability and the credit's nonrefundability) and the highest-income households (because of the income cap) to substantial amounts to those with upper-middle incomes. For example, in tax year 2016, the credit for those with incomes between \$50,000 and \$75,000 (almost one-third of claimants) averaged \$2,388 per adoption, while the average credit for households with incomes between \$100,000 and \$200,000 (about 30 percent of claimants) was \$7,233 per adoption (table 1).

The most recent year with data available by adoption type (2004) indicates that nearly half of adoptions for which the credit was claimed were for domestic children without special needs, with only 18 percent classified as special needs, and the remainder reflecting international adoptions.

FIGURE 1

### Cost of the Adoption Credit Tax years 1998–2016

Millions of dollars



Source: Internal Revenue Service (IRS), Statistics of Income (SOI) Tax Stats, Individual Income Tax Returns, Publication 1304, "Table A. All Returns: Selected Income and Tax Items in Current and Constant 1990 Dollars, Tax Years 1990-2016." August 2018.



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TABLE 1

### Distribution of Adoption Credit By adjusted gross income, tax year 2016



Size of Adjusted Gross Income (dollars)	Total Number of Returns with Eligible Expenses	Total Amount of Benefits	Average Amount of Credit
Less than \$40,000	7,113	\$5,392,000	\$758
\$40,000 – under \$50,000	6,337	\$10,795,000	\$1,703
\$50,000 – under \$75,000	21,421	\$51,154,000	\$2,388
\$75,000 – under \$100,000	10,639	\$48,944,000	\$4,600
\$100,000 – under \$200,000	20,074	\$169,067,000	\$8,422
\$200,000 and over	666	\$4,817,000	\$7,233
All returns	66,250	\$290,168,000	\$4,380

**Source:** Internal Revenue Service (IRS), Statistics of Income (SOI) Tax Stats, Individual Income Tax Returns, Publication 1304, "Table 3.3 All Returns: Tax Liability, Tax Credits, and Tax Payments, by Size of Adjusted Gross Income, Tax Year 2016 (Filing Year 2017)." August 2018.

### Data Sources

Office of Management and Budget. *Budget of the US Government*, various years, Analytical Perspectives. Table 14.1. "Estimates of Total Income Tax Expenditures."

IRS, Statistics of Income Division. *SOI Tax Stats—Individual Income Tax Returns Publication 1304 (Complete Report)* Table A. "Selected Income and Tax Items for Selected Years, in Current and Constant 1990 Dollars"; and Table 3.3. "All Returns: Tax Liability, Tax Credits, and Tax Payments."

### Further Reading

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Internal Revenue Service. 2018. "[Topic 607: Adoption Credit and Adoption Assistance Programs.](#)" March 1., Washington, DC.

National Taxpayer Advocate Service. 2012. "[Most Serious Problems #7: The IRS's Compliance Strategy for the Expanded Adoption Credit Has Significantly and Unnecessarily Harmed Vulnerable Taxpayers, Has Increased Costs for the IRS, and Does Not Bode Well for Future Credit Administration.](#)" In *2012 Annual Report to Congress*, volume 1, 111–33. Washington, DC: Taxpayer Advocate Service.

Treasury Inspector General for Tax Administration. 2012. "[Processes to Address Erroneous Adoption Credits Result in Increased Taxpayer Burden and Credits Allowed to Nonqualifying Individuals.](#)" Washington, DC: US Department of the Treasury.