



Adoption Tax Benefits Update

BY DOUGLAS DORMIRE POWERS

Q: How will the adoption tax credit work for us? Have there been changes to the available benefits in recent years?

The IRS offers significant help to adopting parents through two tax benefits available to offset the expenses of adopting a child: the adoption tax credit and the income tax exclusion of benefits received under an employer's adoption assistance program.

Tax practitioners will tell you that there is nothing better than a tax credit. A tax credit means that after you compute all your deductions and exclusions, apply the tax rate to your taxable income, and come up with your tax liability, you apply the tax credit directly to that bill so that it represents a dollar-for-dollar reduction in what you owe.

The income tax exclusion applies only to money received from an employer who has established a formal, written adoption assistance plan. Often, employers make such assistance available through a plan that offers employees the opportunity to choose from a number of different benefits, such as using pre-tax compensation to fund flexible spending accounts for medical expenses or to pay for group term life insurance.

These provisions went into effect in 1997. Effective in 2002, Congress made them more attractive by doubling the amount of the available tax credit and exclusion so they each are now \$10,000. In other words, adoptive parents may be able to take a tax credit of up to \$10,000 for adoption expenses and also exclude from their income an additional \$10,000 of employer-provided adoption assistance. Both tax breaks are subject to reduction or elimination depending on how much the taxpayer's adjusted gross income exceeds \$150,000.

Early this year, the IRS clarified an area of uncertainty. For domestic adoptions, taxpayers can use the tax credit and income exclusion in the year in which expenses are paid or incurred, even if the adoption is never finalized. For international adoptions, the provisions do not apply until the adoption is "final"

But what does "final" mean? Given the variety of laws and procedures of various countries from which Americans adopt, this has been hard to pin down.

The IRS has now tied an adoption's status as "final" to the type of "immediate relative" ("IR") visa granted to an adopted child. For a foreign-born child with an IR-3 visa, the adoption is considered final as of the date a foreign country enters a decree of adoption. The adoption of a foreign-born child who

Still Have Questions?

For more information about tax benefits for adoption, go to the IRS Web site at www.irs.gov and use the search feature to access Publication 968. And take a look at *Adoptive Families'* two previous articles on the adoption tax credit at www.adoptivefamilies.com/articles.php?aid=24 and www.adoptivefamilies.com/articles.php?aid=377.

receives an IR-4 visa and enters the United States under a guardianship or legal custody arrangement is considered final when the court of the home state enters a decree of adoption. The adoption of a child who enters the United States with an IR-2 visa or an IR-4 visa under a decree of simple adoption is considered final when a state court enters a decree of readoption or otherwise recognizes the foreign adoption decree.

What does this mean for parents facing the high cost of adoption? First, explore whether your employer has or is willing to establish an adoption assistance program. Second, ask your agency to explain the mechanics of the adoption process thoroughly. Then, talk with your attorney or tax advisor about how you can take advantage of the tax credit and income tax exclusion. Along the way, make sure you keep accurate records of all your adoption expenses.

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