



970 RAYMOND AVENUE, SUITE 106  
ST. PAUL, MN 55114-1149  
WEB: WWW.NACAC.ORG

651-644-3036  
FAX: 651-644-9848  
E-MAIL: INFO@NACAC.ORG

## Federal Adoption Tax Credit for Special Needs Adoptions

In the summer of 2001, the Federal Adoption Tax Credit was updated. The most important update was to expand benefits to children with special needs adopted from the U.S. foster care system. Originally families adopting from the foster care system could claim the adoption tax credit, provided they had qualifying expenses. Unfortunately, the IRS list of qualifying expenses was limited to the cost of the adoption process, but not the day-to-day costs of raising a child with special needs. So starting in tax year 2003, families adopting a child with special needs from foster care, had access to this same tax credit without needing to document expenses. For tax year 2004, the tax credit is \$10,390 and you have up to five years in which to use it.

- The first question many people ask, or are asked by their tax preparer is, "How do I know if my child is considered to have special needs according to the IRS?"

The North American Council on Adoptable Children interprets the publication to say: if you receive an adoption subsidy (assistance) for your child, it means the state that provides the subsidy has determined your child has special needs. Your adoption subsidy agreement is the evidence that the state has determined your child to have special needs.

IRS publication 968, which can be found at <http://www.irs.gov/publications/p968/ar01.html#d0e511>, is quoted below:

### ***Special Rule for Adopting a Child With Special Needs***

*The maximum credit and exclusion, subject to the income and tax liability limits discussed earlier, will be allowed for the adoption of a child with special needs even if you do not have any qualifying expenses. For 2004, the maximum amount for each is \$10,390.*

***Child with special needs*** *An eligible child is a child with special needs if he or she is a citizen or resident of the United States (including U.S. possessions) and a state (including the District of Columbia) determines that the child cannot or should not be returned to his or her parents' home and probably will not be adopted unless adoption assistance is provided to the adoptive parents. Factors used by states to determine if a child has special needs could include:*

- *The child's ethnic background,*
- *The child's age,*
- *Whether the child is a member of a minority or sibling group, or*
- *Whether the child has a medical condition or physical, mental, or emotional handicap.*

*If your state has determined that the child you are adopting is a child with special needs, you should keep evidence of that fact for your records.*

(over)

- The second most common question is, "What does this mean to our family?" We don't know the specific answer to that question because we don't do your taxes. However, we can help you figure it out.

Many people believe the Federal Adoption Tax Credit won't help them because they get a refund every year, but that isn't necessarily true. A refund means you have overpaid what you owe in federal income tax, so the IRS refunds you the amount overpaid. The tax credit is applied against what you owe, and could reduce it to \$0, which would increase your refund. The amount that you owe is the number you come up with from the tax tables (or the number in line 28 of the 1040A, or line 45 of the 1040). Here are some examples of how the tax credit might benefit your family.

- Family one is a couple who adopts a sibling group of two children with special needs. They typically have \$6,500 in federal income tax withheld from their paychecks, and the tax that they owe is \$7,000, which means they owe \$500 in April. Now, with the adoption tax credit, they have \$20,780 in credits, and this year they could use up to \$7,000 of the credit.<sup>1</sup> This will mean they get a refund this year of \$6,500, and will have at least \$13,780 of tax credit to carryover for up to four years.
- Family two is a single mother who adopts a sibling group of three children with special needs. Typically she has \$5,000 in federal income tax withheld from her paychecks, and the tax that she owes is \$4,000, which means she receives a refund of \$1,000 in April. Now, with the adoption tax credit, she has \$31,170 in credits, and this year she could use up to \$4,000 of the credit.<sup>1</sup> This will mean she will get a refund this year of \$5,000, and will have at least \$27,170 of tax credit to carryover for up to four years.

### **Information for filling out Form 8839: Qualified Adoption Expenses**

If you do your own taxes, you may have a couple questions when you fill out Form 8839.

- What do you do when they ask for qualifying expenses on line 5 and you didn't have any?

Go to page 3 of the instructions for 8839, which can be found at <http://www.irs.gov/instructions/i8839/ch02.html#d0e616>, quoted below, it says:

*But, if you adopted a child with special needs and the adoption became final in 2004, enter \$10,390 on line 5.*

- What if the tax you owe is less than \$10,390?

Then you will also need to fill out the Credit Carryforward Worksheet on page 4 of the instructions for 8839. This is how you are able to carry the remaining credit forward for up to four years.

If you have questions on the adoption tax credit, contact the North American Council on Adoptable Children at 651-644-3036 or [adoption.assistance@nacac.org](mailto:adoption.assistance@nacac.org).

<sup>1</sup> If you can claim the child tax credit (see IRS publication 972) or other credits, you should claim them.