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Adoption Tax Credit for Special Needs Adoptions Finalized between 2003 and 2009

Most families that adopted foster children who receive adoption assistance between 2005 and 2009, and a few who adopted earlier, should be able to take advantage of the federal adoption tax credit, even if they had no expenses related to the adoption. A new law and guidance have now made the tax credit refundable for the first time. [For non-special needs adoptions (except step-parent adoptions, which do not qualify for the credit), parents can claim the credit with the same rules as below, except that they have to document qualified adoption expenses.]

Background on the Adoption Tax Credit

For adoptions finalized in 2003 or later, a child whom the state determines has special needs qualified for the full adoption tax credit, regardless of expenses paid, unless the adoptive parents' income in that year exceeded particular limits. This includes children whose special needs determination is based on being hard to place due to age, race or membership in a sibling group. NACAC's interpretation is that, if a child receives adoption assistance (subsidy), the state has determined the child is special needs.*

Until tax year 2010, the credit was not refundable, so many families with lower or moderate incomes (and thus low federal tax liability) could not take advantage of the credit. **Starting in 2010, the credit is refundable, which means it will benefit many more families—even those who adopted earlier but didn't have enough tax liability to access the credit in previous years.**

Families who finalized in 2005 or later will benefit from refundability because the tax credit can be carried forward for up to six years. For example, a family who adopted a child with special needs in 2009 earned a \$12,150 adoption tax credit. They were able to take only \$4,000 of the credit in 2009 because \$4,000 was their total tax liability that year. The remaining \$8,150 carried forward to 2010. When they file their 2010 return, the family will get a refund of the full \$8,150 credit, regardless of their tax liability.

To document the adoption and the child's special needs determination, you should include with your 2010 tax return a copy of the adoption decree and the adoption assistance agreement.

Below is more information to help families access the credit for adoptions before 2010.

How Can I Access the Credit?

If you already claimed the credit in the year you finalized an adoption:

If you finalized in 2005 or later and carried forward the adoption tax credit on each year's returns, just carry forward the remaining amount of the credit from your 2009 return to 2010, using the 2010 IRS Form 8839. You can claim the full amount remaining as a credit on your 2010 return. (If you claimed the credit the year you finalized, but didn't carry the credit forward in subsequent years' tax forms, you'll need to file amended returns for those years.)

If you didn't claim the credit but finalized an adoption in 2005 or more recently:

You must file for the adoption tax credit in the year you finalized the adoption. If you finalized between 2007 and 2009, it is quite simple. The IRS allows people to amend returns for a period of three years in order to claim a credit, so you can amend a 2007 return through April 15, 2011. You must amend your return for the year the adoption was finalized and any subsequent years, carrying forward the amount of the adoption tax credit that was not paid in each year. Any part of the credit not paid by 2010 can be used fully with the 2010 return, using the 2010 IRS Form 8839.

For adoptions finalized in 2005 and 2006, even though they are more than three years old, the IRS has stated (view the letter at www.nacac.org/policy/irsletter.pdf) that those credits can be accessed. If you adopted in either of these

* This interpretation is based on the fact that the statutory language is almost identical in the laws on the adoption tax credit [26 USC 23 (d)(3) and 26 USC 36C (d)(3)]—and the laws on adoption assistance [42 USC 673(c)].

two years, you should amend your returns starting the year you finalized. However, you cannot be paid a refund for the credit in 2005 or 2006, even if one is due to you. In the amended returns for years 2005 and 2006, you must complete the return as if you are getting a refund for the credit used. Any credit that you could have been refunded in these years will be lost to you. Then when you amend your 2007 taxes and forward, you can use any credit that would have been due to you that year. Whatever is not used or lost from 2005 to 2009, can be carried over and refunded in 2010. Please note that the IRS may reject your amendment but we encourage you to appeal. A taxpayer advocate may be helpful in the appeal.

For example, a family who adopted one child in 2006 earned \$10,960 in adoption tax credit, but didn't claim the credit with their 2006 return. Their tax liability was \$4,000. They amend the 2006 return, and claim the credit. Although they cannot receive the \$4,000 because 2006 was more than three years ago, they can only carry forward to 2007 \$6,960 (\$10,960 less the \$4,000 they would gotten in 2006). The family then amends for 2007, when they had a tax liability of \$2,000. They will be refunded the \$2,000, and can carry forward the remaining \$4,960. They had no tax liability in 2008 or 2009, but still need to amend those returns to show that they are carrying forward the \$4,960. When they file in 2010, they can take the full \$4,960 credit regardless of their tax liability.

If you didn't file in 2005 or 2006 and had sufficient tax liability in 2005 and 2006 to use up the whole credit, there is no reason for you to amend your taxes. Since 2007 is the first year you can get a refund of any past credit, you need to have some credit carried forward to 2007 to get a payment.

The chart below will help you look back at your tax forms to see how much you have in tax liability for each year. Although it is actually a bit more complicated, you can look at your total tax liability to see the maximum amount of the credit you would be able to use.

Tax Year	Maximum Credit	Tax Liability
2003	\$10,160	1040 – Line 43 • 1040A – Line 28
2004	\$10,390	1040 – Line 45 • 1040A – Line 28
2005	\$10,630	1040 – Line 46 • 1040A – Line 28
2006	\$10,960	1040 – Line 46 • 1040A – Line 28
2007	\$11,390	1040 – Line 46 • 1040A – Line 28
2008	\$11,650	1040 – Line 46 • 1040A – Line 28
2009	\$12,150	1040 – Line 46 • 1040A – Line 28

If you didn't claim the credit but finalized an adoption before 2005:

If you finalized an adoption in 2003 or 2004, the same issue about amending returns more than three years old applies (see above) and you are less likely to benefit. A family with insufficient tax liability will probably not benefit because they can't carry forward to tax year 2010 when the credit becomes refundable. A family with significant tax liability may use up all of the adoption tax credit in the years before 2007, but they cannot get a refund for these years. Those families who have a moderate tax liability might be able to carry forward some of the credit to 2007, 2008, or 2009, when they could get a refund for whatever tax liability they had that year.

Those who adopted before 2003 are unlikely to benefit at this time. Before 2003, the credit was only for documented expenses. Even if you had expenses, for adoptions finalized in 2001, you cannot carry forward any credits into 2007, the year in which you could get a refund of any credit that would have been due to you. If you adopted in 2002 and had documented expenses *and had credit that carried forward to 2007 and had tax liability in 2007*, you could amend all of your returns from 2002 to 2007, and get a refund for 2007.

How Do I Amend Past Returns?

If you paid someone to prepare your taxes, you should ask them to amend your taxes for free since they failed to include the adoption tax credit.

To amend your own taxes, complete Form 1040X, which can be found at www.irs.gov/pub/irs-pdf/f1040x.pdf or by calling 1-800-829-1040. You will need copies of the returns you filed for each year you amend, plus blank copies of Form 8839 (the Adoption Tax Credit form) for each year you amend. Access previous year's

forms at www.irs.gov/formspubs/article/0,,id=98339,00.html. If you are only amending credits, you will need to complete lines 6 to 22 of Form 1040X.

Child Tax Credit

Since the child tax credit and adoption tax credit interacted from 2002 to 2009, families must complete the Child Tax Credit Worksheet in IRS Publication 972 to see what is the appropriate amount of the child tax credit to take. This may lead a family to take less or no child tax credit, instead taking that amount as an additional child tax credit (which is another refundable credit). You need to complete Publication 972 for each year you are amending to figure out the child tax credit and how much of the adoption tax credit you can claim in that year (and then how much you might carry forward).

If you already claimed the child tax credit, you will still need to work through Publication 972's Worksheet to figure out the amount of the adoption tax credit you can use for a given year. Claiming the adoption credit may affect whether you can claim the child tax credit. If your child tax credit is reduced because you claim the adoption tax credit, you should check to see if you can claim the additional child tax credit instead.

What If I Have Additional Questions?

If you receive adoption assistance (subsidy) for your child and have questions on whether it is taxable income or if you can claim that child as a dependent, read NACAC's fact sheet, *Tax Issues Related to Adoption Assistance and Adoption* — <http://www.nacac.org/adoptionssubsidy/factsheets/taxes.html>.

If you have additional questions on the adoption tax credit or adoption subsidy, contact the North American Council on Adoptable Children at 800-470-6665 or adoption.assistance@nacac.org.

Note: This fact sheet is NACAC's interpretation of the adoption tax credit; it is not intended as legal or tax advice. Each person's tax situation is unique.

Was This Fact Sheet Helpful to You? If So, Please Help Us Help Others!

NACAC was instrumental in passage of the law that made the full tax credit available to families who adopt from foster care without documenting expenses. We need your support to continue similar advocacy efforts and to enable us to share information about the credit with other families. Please take a moment today to become a member of NACAC or to make a donation. Either visit www.nacac.org or complete the form below.

I'd like to become an individual/family member of NACAC (*dues are \$45/year*)

I'd like to donate \$_____ to NACAC. (Donations are tax-deductible.)

Name: _____

Address: _____

Daytime Phone (home/ cell/ office): _____

E-mail Address: _____

Payment: check (made payable to NACAC) credit card (complete information below)

MasterCard VISA Card Number _____

Name on Card _____

Exp. Date _____

Signature _____