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## **Federal Adoption Tax Credit for Special Needs Adoptions that were just Finalized**

Beginning in tax year 2003, families adopting a child with special needs from foster care could claim the adoption tax credit without needing to incur or document expenses. For tax year 2008, the tax credit is \$11,650 (and \$12,150 in 2009) per child and you have the year you finalized and up to the next five additional years in which to use it. If you finalized your adoption in earlier years and failed to claim the adoption tax credit, read the fact sheet *Amending Your Tax Return to Access the Federal Adoption Tax Credit* for more information.

The totals for the adoption tax credit and income restrictions found in this document are based on 2008 amounts. There will be a cost of living adjustment each year, so for tax years 2010 and beyond the numbers will change. There may be changes to the line numbers we list for the various forms too. Everything you need to know to claim the Federal Adoption Tax Credit is in this document.

### **Accessing the Tax Credit**

#### **How do I know if my child is considered to have special needs according to the IRS?**

Children that are hard to place for adoption such as older children; minority children; sibling groups; and children with medical conditions, or physical, mental, and emotional handicaps often are determined to have special needs.

NACAC interprets the instructions for Form 8839 (the Adoption Tax Credit form) this way: If you receive adoption subsidy (assistance) for your child, the state that provides the subsidy has determined that your child has special needs. Your adoption subsidy agreement (or application and agreement) is the evidence that the state has determined your child to have special needs.

If your child does not receive an adoption subsidy, NACAC believes the state has not determined that your child has special needs and you will not be able to take the credit without documenting expenses for the cost of the adoption.

The instructions, found at <http://www.irs.gov/pub/irs-pdf/i8839.pdf> state:

#### **Column (d)**

A child is a child with special needs if all three of the following statements are true.

1. The child was a citizen or resident of the United States or its possessions at the time the adoption process began.
2. A state (including the District of Columbia) has determined that the child cannot or should not be returned to his or her parents' home.
3. The state has determined that the child will not be adopted unless assistance is provided

to the adoptive parents. Factors used by states to make this determination include:

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

You may be able to claim a credit or exclusion for the adoption of a child with special needs even if you did not have any qualified expenses. See line 24 and the instructions for line 5.

If you check the box in column (d), indicating the child has special needs, be sure to keep evidence of the state's determination in your records.

### **What will the federal Adoption Tax Credit mean for our family?**

While every family's taxes are different, we can provide information to help you figure out what the credit means for you. How much, if any of the credit you can use is based on: (1) your income (families with federal modified adjusted gross income above \$214,730 in 2008, or \$222,180 in 2009, cannot claim the credit at all); and (2) your total federal tax liability. In one year, you can use as much of the credit as the full amount of your federal income tax liability. The amount of your tax liability (line 46 of Form 1040) is based on your taxable income.

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 paid more federal income tax than you needed to, so the IRS refunds the amount overpaid. The tax credit is applied against your total tax liability and could increase your refund. 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 had \$6,500 in federal income tax withheld from their paychecks, and their tax liability is \$7,000, which means they would owe \$500 in April. With the adoption tax credit, they have \$23,300 in credits, and this year they could use up to \$7,000 of the credit.\* They get a refund of \$6,500, and will have at least \$16,300 of tax credit to carryover for up to five additional years.
- Family two is a single mother who adopts a sibling group of three children with special needs. She had \$5,000 in federal income tax withheld from her paychecks, but her tax liability is only \$4,000, which means she would receive a refund of \$1,000 in April. With the adoption tax credit, she has \$34,950 in adoption tax credits, and this year she could use \$4,000 of the credit.\* She will get a refund this year of \$5,000, and can carry over \$30,950 of tax credit to carryover for up to five additional years.
- Family three is a couple with five other children who adopts a sibling group of two children with special needs. They had \$1,000 in federal income tax withheld from their paychecks, and their tax liability is \$0, which means they would receive a refund of \$1,000 in April. With the adoption tax credit, they have \$23,300 in credits. Since they have no tax liability, they are unable to use any of the possible \$23,300 adoption tax credit this year. They should still file the Form 8839 with their tax return because it will help establish the year the adoption was finalized. The credit would carry forward for five additional years and the family could use it when their tax liability is greater than zero in future years.

\*If you can claim the child tax credit (see IRS publication 972) or other credits, you should claim them.

## Filling out Form 8839: Qualified Adoption Expenses

### What do I do when the IRS asks for qualifying expenses on line 5?

The Instructions for Form 8839, Line 5 found at:  
<http://www.irs.gov/pub/irs-pdf/i8839.pdf> state:

**Special needs adoption.** If you adopted a child with special needs and the adoption became final in 2008, enter on line 5:

- \$11,650, minus any qualified adoption expenses you used to figure any adoption credit you claimed for the same child in a prior year. This is the amount you entered on line 3 of Form 8839 for this child.

If you did not claim any adoption credit for the child in a prior year, enter \$11,650 on line 5 even if your qualified adoption expenses for the child were less than \$11,650 (and even if you did not have any qualified adoption expenses for this child).

This means that you do NOT have to document qualified expenses to take the credit if your child is considered special needs or hard to place and receive adoption subsidy.

### What if my tax liability is less than the adoption tax credit?

Then you will also need to fill out the Credit Carryforward Worksheet in the Instructions for Form 8839. This documents the amount of the credit you can carry forward for up to five additional years or until it is used up, whichever is sooner. You do not need to submit this worksheet.

### Claiming the Child Tax Credit

If you can claim your child as a dependent, then you should also look into how to claim the Child Tax Credit. In years that you are using the Adoption Tax Credit and the Child Tax Credit, you will need to complete the worksheet in *Publication 972, Child Tax Credit*.

**Note—if you checked Yes on line 13 of the worksheet you may be eligible to take the Additional Child Tax Credit. The Additional Child Tax Credit is a refundable tax credit, which means you may receive more money in a refund than you had federal income tax withheld (unlike the Adoption Tax Credit). To claim this credit, you will need to complete Form 8812, Additional Child Tax.**

### Additional Questions

Finally, if you receive an adoption subsidy (assistance) for your child and have questions on whether it is taxable income or if you can claim that child as a dependent (and receive the child tax credit), you should read our fact sheet, *Tax Issues Related to Adoption Assistance and Adoption*, which can be found at: <http://www.nacac.org/adoptionssubsidy/factsheets/taxes.html>.

If you have additional 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).