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## Tax Issues Related to Adoption Assistance and Adoption

Adoptive parents often ask whether adoption assistance (adoption subsidy) payments are taxable. Many also wonder about claiming their child as a dependent and using the child tax credit. NACAC reviewed related IRS publications, and below we offer our interpretation of these issues. Please know that NACAC is not a tax expert, and these opinions should not be considered legal or financial advice. You should consult your own tax advisor before filing.

### Adoption Assistance Payments as Taxable Income

Since 1974, the IRS has ruled that adoptive parents do not normally need to include adoption assistance benefits in their taxable income (*see box below for specific IRS language*).

However, the IRS also says that adoption assistance benefits may be taxable if they exceed the amount an adoptive family spends to support the child. This situation might occur if adoption assistance was a family's sole source of income. In cases such as this, some of the adoption assistance funds are used to meet the needs of the parent(s), so not all funds are being spent to support the child.

NACAC is not aware of any states that have a different definition of taxable income, but parents should consult their tax preparers or a tax advisor about state specific rules.

### Claiming Your Child as a Dependent

The following information is from *IRS Publication 501: Exemptions, Standard Deduction, and Filing Information*. The IRS recognizes that an adopted child is like any other child—"An adopted child is always treated as your child. The term 'adopted child' includes a child who was lawfully placed with you for legal adoption." However, a child can be claimed as a dependent only when all five of the conditions described in the chart on the next page are met.

Both the residency and support rulings changed for tax year 2005. One will make it more difficult for adoptive parents to claim children as their dependents, the other will make it easier.

#### **IRS Publication 17: Your Federal Income Tax**

*Publication 17* has made two references related to the taxability of adoption assistance:

- Chapter 12: Other Income—Welfare and Other Public Assistance states "do not include in income the benefit payments from a public welfare fund" (p. 84). In 1974, the IRS ruled that adoption assistance benefits were public welfare payments and thus exempt from taxation under this clause.
- In a previous version of *Publication 17*, the IRS specifically stated "do not include in your income payments from a state agency to help you care for your adopted child" (p. 67 of the 1986 *Publication 17*).

To meet the residency requirements for 2005, an adopted child would have to live with the adoptive family for at least six months during 2005. In previous years, a child placed with you for adoption any time during the tax year (including on December 31) could be claimed as a dependent.

The support test changed in a way that is more helpful for adoptive parents whose children receive adoption assistance. Now, a parent is considered to have met the support test unless the adopted child provides more than half of his or her own support. Adoption assistance payments are considered support from the state, not the child, so they do not factor into this criteria. In the past, parents had to provide more than half of all support for the child.

## Qualifying for the Child Tax Credit

Most families who can claim a child as a dependent as described above should also be able to claim the child tax credit. This credit is in addition to the adoption tax credit, the credit for child and dependent care expenses, and the earned income tax credit.

Again, the IRS recognizes adopted children as the same as other legal children. To qualify for the child tax credit, a child must meet all of the following five criteria. The child must:

1. be your child (including foster child) or sibling, or a descendant of your child or sibling (for example, your grandchild)
2. have been under age 17 at the end of 2005
3. not provide over half of his or her own support for 2005

4. have lived with you for more than half of 2005
5. be a U.S. citizen, a U.S. national, or a resident of the United States (If you are a U.S. citizen or U.S. national and your adopted child lived with you all year in 2005, that child meets this condition.)

The maximum amount you can claim for the credit is \$1,000 for each qualifying child. Families who are claiming both the adoption tax credit and the child tax credit will need to complete a worksheet in *IRS Publication 972: Child Tax Credit* to determine the specific amount of the credit. Most other families can complete a worksheet in the 1040 or 1040A instructions to determine the amount of the credit.

To claim the credit on your IRS Form 1040 or 1040A, check the Child Tax Credit box on line 6c, column 4.

### Can I Claim My Child as a Dependent?

Category	To claim a child as a dependent, the child must:
Relationship	<ul style="list-style-type: none"> <li>• be your son, daughter, stepchild, eligible foster child*, or a descendant (for example, your grandchild) of any of them, or</li> <li>• be your brother, sister, half brother, half sister, stepbrother, stepsister, or a descendant (for example, your niece or nephew) of any of them</li> </ul> <p>(*An eligible foster child is an individual placed with you by an authorized placement agency or by judgment, decree, or other order of any court of competent jurisdiction.)</p>
Age	<ul style="list-style-type: none"> <li>• be under the age of 19 at the end of the year,</li> <li>• be a full-time student under age 24 at the end of the year, or</li> <li>• be permanently and totally disabled at any time during the year, regardless of age</li> </ul>
Residency	have lived with you for more than half of the year (There are exceptions for temporary absences, children who were born or died during the year, kidnapped children, and children of divorced or separated parents. There is no specific exception for adoption.)
Support	not have provided more than half of his or her own support during the year
Special Test for Qualifying Child of More Than One Person	not be claimed by a dependent by anyone else (The IRS has a specific test for children who might be claimed by more than one person, such as divorcing parents. Please see <i>Publication 501</i> if you need more information.)

*For state-specific information about adoption assistance, please contact NACAC's Adoption Subsidy Resource Center at 800-470-6665 / 651-644-3036 or [adoption.assistance@nacac.org](mailto:adoption.assistance@nacac.org). The Center was created by NACAC to help educate parents and professionals throughout the U.S. on adoption subsidy issues. The Center is funded in part by the Dave Thomas Foundation on Adoption.*