

## **NEW GUIDANCE ON THE EXPANDED ADOPTION CREDIT AVAILABLE IN 2010 AND 2011**

**Adoption credit.** For tax year 2010, the adoption credit is **increased to \$13,170** (from \$12,170) and covers both nonspecial and special-needs adoptions. The increased credit amount will be adjusted for inflation in 2011. For 2010, the credit will begin to phase out when modified AGI reaches \$182,520 and is completely phased out when modified AGI reaches \$222,520 (regardless of the taxpayer's filing status).

**Adoption assistance programs.** For tax years beginning in 2010, employers may exclude up to \$13,170 from the employee's gross income for amounts paid or expenses incurred by the taxpayer for qualified adoption expenses paid under an adoption assistance program. If the employee adopts a special needs child, the employer may exclude \$13,170 from the employee's gross income regardless of the amount of expenses actually paid or incurred. The exclusion amount is subject to the same phaseout rules as the credit.

**Refundability.** Under prior law, the adoption credit was a nonrefundable credit and any expenses that could not be used in the year the credit was first claimed were carried forward up to five tax years. However, under the new law, any carryover of the adoption credit to 2010 from a prior year will now be fully refundable in 2010. Thus, the entire carryforward amount may be taken as a refundable credit in 2010. The carryforward is not subject to the phaseout amounts.

**Example:** In 2008, the taxpayer paid \$5,000 in qualified adoption expenses to adopt a child. In 2009, the adoption of the child became final and the taxpayer incurred an additional \$6,000 in qualified expenses (for a total of \$11,000).

In 2009, the taxpayer's tax liability was \$3,000, allowing the taxpayer to take an adoption credit of \$3,000 on their 2009 return. The remaining \$8,000 credit was carried forward to tax year 2010.

In 2010, the taxpayer has a tax liability of \$4,000. Even though the taxpayer's tax liability is \$4,000, the taxpayer may claim the entire carryforward of the adoption credit from 2009 on their 2010 tax return. The taxpayer will receive a refund of \$4,000 because the \$8,000 adoption credit carried over from 2009 to 2010 is refundable and exceeds the taxpayer's tax liability by \$4,000.

**Substantiation and e-file restrictions.** Taxpayers claiming the adoption credit in 2010 **must** complete Form 8839, *Qualified Adoption Expenses*, and comply with new documentation requirements. Due to the new documentation requirement, tax returns claiming the adoption credit must be mailed in and are no longer eligible to be e-filed. All taxpayers claiming the credit in 2010 **must** submit an order or decree establishing that the adoption has been finalized and the date the adoption was finalized. Taxpayers are permitted to redact or black-out sensitive information from documents, however the IRS has reserved the right to request an unredacted copy if deemed necessary to substantiate the claim for the credit. Qualifying documentation is as follows:

*Special needs.* In addition to the documentation outlined below, the taxpayer must attach to the return a copy of the state determination of special needs.

*Domestic children.* If the adoption is final, taxpayers are required to submit the order or decree of adoption. If the adoption has not been finalized, the taxpayer must submit one of the following:

- Taxpayers must provide on the tax return the adoption taxpayer identification number (ATIN) obtained for the child instead of attaching the order or decree,
- A home study completed by an authorized placement agency,
- A placement agreement with an authorized placement agency,
- A document signed by a hospital official authorizing release of a newborn to the taxpayer for legal adoption,
- A court document ordering or approving the placement of the child with the taxpayer for legal adoption, or
- An original affidavit or notarized statement signed under penalties of perjury from an adoption attorney, government official, or other person stating the signor:
  - Placed or is placing a child with the taxpayer for legal adoption, or
  - Is facilitating the adoption process for the taxpayer in an official capacity, and summarizes the facilitation.

Betty Jo Smith Douglas (bdouglas@hrblock.com)

H & R Block

1314 N 7 Hwy

Blue Springs, MO 64014

Tax office: 816-220-3192, Daytime-816-854-5869, Cell 816-820-5883.