

# Child TRENDS<sup>®</sup> RESEARCH BRIEF

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## *The Adoption Tax Credit: Is it an Effective Approach to Promote Foster Care Adoption?*

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Approximately 115,000 children in foster care are waiting to be adopted because a court or child welfare agency has determined that they cannot return home to their parents. Each year, about 50,000 children are adopted from foster care. At the same time, more than 24,000 children “age-out” of the foster care system each year when they turn 18, because the state has not secured adoptive parents for them. These young adults leave foster care without a permanent connection to a loving family.<sup>1</sup>

In 1996, Congress first enacted legislation to promote the adoption of foster children<sup>2</sup> in the U.S. through the provision of a non-refundable<sup>3</sup> tax credit. While intended to promote foster care adoption, the tax credit was also made available to persons adopting children in the U.S. outside of the foster care system (private adoption) as well as those adopting children from other countries (foreign adoption).

How effective have tax credits been in promoting adoption and, in particular, adoption of foster children? Who received the adoption tax credit? This brief addresses these questions, based on our review of data provided by the U.S. Treasury from an analysis of income tax returns filed between 1999 and 2005.<sup>4</sup>

In sum, we find that:

- Tax credits may not be the most effective approach to promote foster care adoption, or adoption more generally.
- The vast majority of adoption tax credit recipients completed private or foreign adoptions rather than adoptions from foster care.
- The tax credit disproportionately supports higher-income families; those with incomes<sup>5</sup> above \$75,000 received two-thirds of the dollars.
- The tax credit primarily supports the adoption of younger children; more than 70 percent of the dollars were spent on children five and under.
- Nearly all foreign adoptions were supported by the adoption tax credit, but only 1 in 4 foster care adoptions were.

### THE FEDERAL ADOPTION TAX CREDIT

In 1996, the Adoption Promotion and Stability Act was introduced in the Congress (H.R. 3286) to help families defray adoption costs and to promote the adoption of foster care children. The Act was subsumed in the Small Business Job Protection Act, which Congress enacted in 1996. Since then, the federal individual income tax has included a tax credit to defray the expenses, up to a limit (\$10,960 per child in 2006), that are paid in connection with an adoption, including adoption fees, court costs, and attorneys' fees. Filers only receive the credit if they have tax liability (the credit is non-refundable). If a filer's tax liability for a particular year is less than their allowable credit, the filer may carry forward the unused credit amount for the next five tax years or until it is all used, whichever comes first.

The Economic Growth and Tax Relief Act of 2001 (EGTRA) liberalized the tax credit by increasing the expense limit from \$5,000 per adoption (\$6,000 for foster care adoptions) to \$10,000 in 2002. EGTRA also raised the phaseout range from \$75,000-\$115,000 of income to \$150,000-\$190,000 in 2002. Both the expense limit and the phaseout income limit are indexed for inflation. In addition, beginning in 2003, families adopting a child from foster care are able to access the adoption tax credit without needing to document expenses.

<sup>1</sup>In some states, youth may stay after their 18th birthday.

<sup>2</sup>We use the term foster care here as shorthand for “special needs” foster care. The tax credit is available to support “special needs” foster care adoption, though the vast majority of children adopted from foster care are considered special needs. States set criteria for determining special needs, but typically consider a child's ethnic background and age; whether the child is a member of a minority or sibling group, has a medical condition, or has a physical, mental, or emotional handicap.

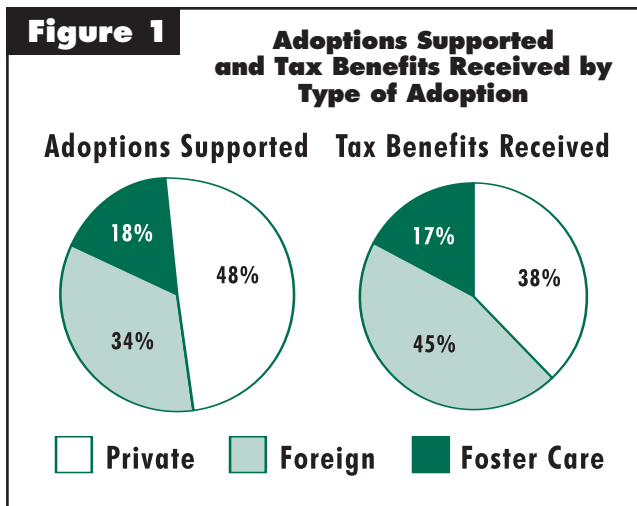
<sup>3</sup>This means that filers must have tax liability to receive the credit.

<sup>4</sup>The Treasury Report, “Federal Income Tax Benefits for Adoption: Use by Taxpayers 1999-2005,” was completed in response to a request by Representative Jim McDermott, Chairman of the Committee on Ways and Means, Subcommittee on Income Security and Family Support, <http://www.house.gov/mcdermott/>

<sup>5</sup>The numbers in this brief refer to total income. Analysis using adjusted gross income produces similar results.

## A SMALL PORTION OF THE ADOPTION TAX CREDIT SUPPORTS FOSTER CARE ADOPTIONS

In 2004, the last year for which data are available, private adoptions accounted for almost half of the children supported by the adoption tax credit, and 38 percent of the dollars spent on the credit.<sup>6</sup> Foreign adoptions accounted for just over one-third of the children supported, but 45 percent of the dollars spent. Foster care children accounted for 18 percent of the children supported and 17 percent of the dollars spent (see Figure 1).



## THE ADOPTION TAX CREDIT DISPROPORTIONATELY SUPPORTS HIGHER INCOME, MARRIED FAMILIES

In 2005, 56,000 tax returns filed claimed approximately \$355 million in allowable adoption tax credits.<sup>7</sup> Approximately two-thirds of the total dollars spent on the tax credit in 2005 were received by tax filers with incomes above \$74,999 (see Table 1). Approximately 88 percent of the dollars were received by persons who filed as “married filing jointly.”

## HIGHER INCOME FAMILIES RECEIVE TAX BENEFITS FOR FOREIGN AND PRIVATE ADOPTIONS

The type of adoption completed varied greatly by income. Foreign adoptions accounted for more than 45 percent of adoptions completed by filers with incomes above \$100,000 compared with 20 percent

**Table 1** 2005 Adoption Tax Credit Benefits Received by Income<sup>8</sup>

Income Range	Percent of All Credits Received	Percent of All Returns Claiming Credit
Under \$25,000	<1%	4%
\$25,000 – \$49,999	8	19
\$50,000 – \$74,000	25	27
\$75,000 – \$99,999	27	21
\$100,000 – 155,860	34	21
\$155,860 – 195,860	5	4
Over \$195,860	1	2
	100%	100%

of adoptions among filers with incomes below \$50,000. Foster care adoptions accounted for about 10 percent of the adoptions completed by filers with incomes over \$100,000, compared with more than 25 percent of the adoptions completed by filers with incomes below \$50,000 (see Table 2).

**Table 2** Type of Adoption by Total Income<sup>8</sup>

Total Income	Foster Care (%)	Private (%)	Foreign (%)	All (%)
All Incomes	18%	48%	34%	100%
Under \$25,000	29	55	16	100%
\$25,000 – \$49,999	26	54	21	100%
\$50,000 – \$74,000	20	50	30	100%
\$75,000 – \$99,999	16	47	38	100%
\$100,000 – 155,860	11	43	45	100%
\$155,860 – 195,860	8	41	49	100%
Over \$195,860	4	42	48	100%

## THE ADOPTION TAX CREDIT PRIMARILY SUPPORTS THE ADOPTION OF YOUNGER CHILDREN

In 2004, 40 percent of the children for whom filers received an adoption tax credit were under the age of two, and 71 percent were under age five. However, this age distribution is very different when taking into account the type of adoption. For example, 45 percent and 48 percent of children adopted privately and from foreign countries, respectively, were under age two, compared to 13 percent of foster children adopted.

Higher income tax credit recipients were much more likely to have adopted young children. For example, children under age 2 accounted for about one third of children adopted by filers with incomes below \$75,000 but more than half of those adopted by filers with incomes above \$100,000. The exact

<sup>6</sup>Technically, these dollars are not “spent,” but rather represent less federal revenue received.

<sup>7</sup>This does not include the tax returns reporting adoption credits carried forward from prior years. Including these, more than 86,000 tax returns reported qualified adoption expenses. An additional \$414 million in adoption tax credit benefits were carried forward to future years. This estimate may overstate the credits available in future years, because it does exclude unused credits carried forward from prior years that expire in the current year.

<sup>8</sup>Totals may not add to 100 percent due to rounding and small amount of uncategorized data.

opposite trend is observed when looking at older children. Lower income filers are more likely to have adopted children ages 10 years and over (see Table 3).

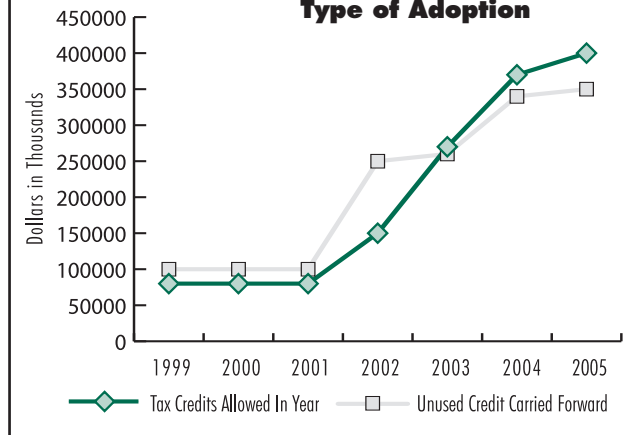
**Table 3 Age Adopted Child by Total Income<sup>8</sup>**

	Under 2 years	2 years to 5 years	6 years to 9 years	10 years and over	All ages
All Incomes	40%	31%	14%	15%	100%
Under \$25,000	22	34	20	23	100%
\$25,000 – \$49,999	27	35	18	18	100%
\$50,000 – \$74,000	36	32	15	15	100%
\$75,000 – \$99,999	43	29	12	14	100%
\$100,000 – 155,860	51	26	10	12	100%
\$155,860 – 195,860	53	26	9	9	100%
Over \$195,860	55	29	6	6	100%

## TOTAL ADOPTION TAX BENEFITS AND ADOPTIONS SUPPORTED HAVE INCREASED SIGNIFICANTLY

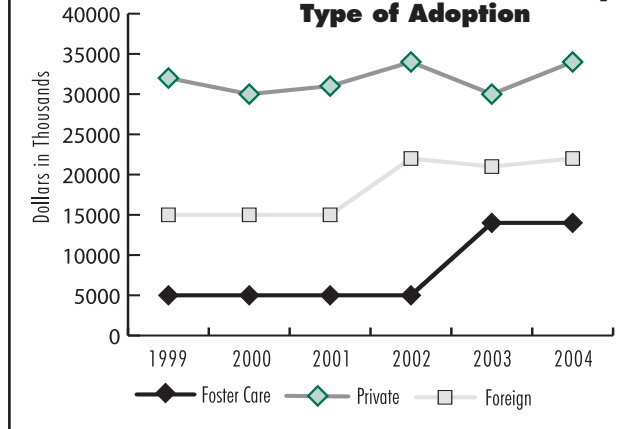
Both the dollars spent on the adoption tax credit and the amount of unused credit carried forward have increased substantially (see Figure 2). Overall, the total amount of tax benefits received increased by 244 percent (unadjusted) between 1999 and 2005, from \$103 million to \$355 million. Over the same period, the amount of unused credit carried forward increased by 407 percent, from \$82 million to \$414 million.

**Figure 2 Adoptions Supported and Tax Benefits Received by Type of Adoption**



Between 1999 and 2004, the total number of adopted children for whom tax credits were claimed increased by 28 percent (see Figure 3). While foster care children represent the smallest proportion of the children supported by the tax credit, this was the group with the largest increase in tax credits

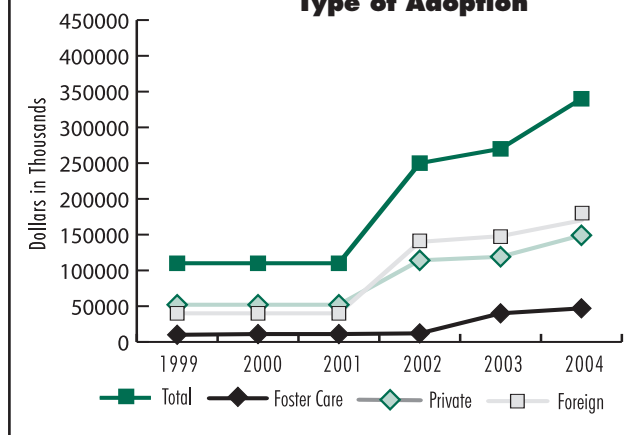
**Figure 3 Adoptions Supported and Tax Benefits Received by Type of Adoption**



claimed (138 percent). The number of children adopted privately for whom tax credit benefits were claimed increased by 5 percent, while the number of foreign adoptions supported by the credit increased by 61 percent.

Similarly, the total dollars spent on tax credits on behalf of foster care children increased by 613 percent. The dollars spent on private adoptions increased by 130 percent, and on foreign adoptions by 282 percent (see Figure 4).

**Figure 4 Tax Benefits by Type of Adoption**



It is important to note that the significant increase in foster care adoptions supported by the tax credit has occurred during the period where available data suggest that the overall number of foster care adoptions has been stagnant. Between 2000 and 2005, the number of children adopted from foster care increased by only 1 percent. During the same time period, foreign adoptions increased by 28 percent.

## NEARLY ALL FOREIGN ADOPTIONS, BUT RELATIVELY FEW FOSTER CARE ADOPTIONS, ARE SUPPORTED BY THE ADOPTION TAX CREDIT

The likelihood that an adoption of a child is supported by the adoption tax credit varies immensely by the type of adoption. While accurate data on the number of children adopted privately are unavailable, data do exist on the other types of adoptions. The U.S. Department of Health and Human Services reported that in 2004, approximately 52,000 children were adopted from the U.S. foster care system.<sup>9</sup> Given that in 2004 taxpayers claimed the adoption tax credit for only 12,432 children adopted from foster care, it appears that taxpayers claimed credit for less than one in four foster children adopted. In comparison, the best data available on foreign-born adoptions is available through the U.S. State Department which reported that, in 2004, 22,884 children were adopted from foreign countries.<sup>10</sup> Data from 2004 tax returns suggest that filers claimed adoption tax benefits for 23,296 children adopted from outside the U.S. Parents can take a tax credit for their adoption expenses, even if the adoption is never finalized. Thus, tax payers who adopted children from abroad were much more likely to claim adoption tax credit benefits.

Using the 2004 state-level HHS data on foster care adoptions, we also observe significant variation in claims for adoption tax benefits by state (see Table 4). In 11 states, at least one third of children adopted from foster care were supported by the adoption tax credit while in 12 states, less than 15 percent were.

### CONCLUSIONS AND POLICY IMPLICATIONS

The original intent of the adoption tax credit was to promote adoption and, specifically, the adoption of U.S. foster children.<sup>11</sup> The data summarized above raise serious doubts about whether the tax credit is the most effective approach to promoting foster care adoption. While the amount of adoption tax credit dollars received by persons adopting children from foster care increased by more than 600 percent between 1999 and 2004, more than 82 percent of the total adoption tax credit dollars spent support children adopted privately or from foreign countries. Nationally, the number of children adopted from foster care is virtually unchanged since 2000.

**Table 4** Percent of Foster Care Adoptions by State<sup>9</sup> for which Adoption Tax Credit Benefits were Claimed (2004)

South Carolina	81%	Alabama	20%
Wyoming	61%	Texas	20%
Arizona	40%	Georgia	19%
Utah	39%	Oregon	18%
Washington	36%	Delaware	18%
Vermont	35%	Mississippi	18%
New Mexico	35%	Montana	18%
Nevada	34%	Hawaii	17%
Idaho	34%	Kentucky	17%
Minnesota	33%	Pennsylvania	17%
Virginia	33%	Illinois	17%
New Hampshire	31%	California	15%
Connecticut	30%	Florida	15%
North Dakota	30%	Massachusetts	14%
Iowa	28%	Nebraska	13%
Maine	26%	Arkansas	14%
Alaska	25%	South Dakota	12%
Wisconsin	24%	Rhode Island	12%
Tennessee	23%	West Virginia	11%
North Carolina	23%	Louisiana	11%
Kansas	22%	Oklahoma	11%
Indiana	21%	New Jersey	10%
Ohio	21%	Michigan	19%
Colorado	20%	New York	6%
Missouri	20%	District of Columbia	5%
Maryland	20%		

It is also uncertain whether the adoption tax credit is providing an incentive to adopt more generally. The availability of children for private adoption has diminished, and foreign countries have placed additional restrictions on international adoptions. At the same time, interest in adoption has increased substantially due to a variety of demographic and societal changes. When there is often already an 18-month waiting list to adopt foreign-born children, it is doubtful that the adoption tax credit is promoting adoption of these children. Moreover, anecdotal evidence suggests that many people who adopt are not aware of the tax credit when they begin the process.

Finally, it appears that nearly all foreign adoptions are supported by the adoption tax credit, while only 1 in 4 foster care adoptions is supported by the credit.

On December 31, 2010, provisions that have expanded the adoption tax credit will sunset, and the amount that adoptive parents can claim will be reduced significantly (from \$10,960 to \$5,000). Three bills have been introduced in the 110th Congress to repeal the sunset provision. In

<sup>9</sup>Department of Health and Human Services [www.acf.hhs.gov/programs/cb/stats\\_research/afcars/adoptchild05.htm](http://www.acf.hhs.gov/programs/cb/stats_research/afcars/adoptchild05.htm).

<sup>10</sup>This is number of immigrant visas issued to orphans coming to the U.S.

<sup>11</sup>For a legislative history, see House Report 104-542. In the "Explanation of the Bill" the House Report notes the reason for the legislation as "The Committee believes that the financial costs of the adoption process should not be a barrier to adoptions. In addition, the Committee wishes to encourage further the adoption of special needs children. Therefore the tax credit is allowed in addition to any grant money received for the adoption expenses associated with the adoption of special needs children"

determining whether and how to continue the expanded adoption tax credit, policymakers should consider the following if they seek to achieve the original goals of the legislation:

- **Require child welfare agencies to educate adoptive parents about the availability of the tax credit and their eligibility to receive it.** The number of foster care adoptions supported by the tax credit more than doubled between 2002 and 2003 after Congress removed the requirement for persons adopting foster children to document their expenses. However, more education about the credit is needed and training of child welfare agency workers is likely a necessary first step.
- **Make the tax credit refundable.** Many of the parents who adopt foster children cannot benefit from the credit because they have relatively low incomes and thus little or no tax liability.
- **Consider alternative approaches to promoting foster care adoption.** Analysis of the adoption tax credit should be discussed within the larger context of foster care adoption. Tax credits may or may not be the most effective means of increasing the adoption of foster children. For example, these funds could be used to support state and local efforts to recruit adoptive parents and in particular, intensive recruitment efforts for harder-to-place children. Alternatively, funds for the adoption tax credit could be used to support post-adoption services. Prospective parents may be more likely to complete the process of adopting foster children if they are confident that supportive services would be available to them after adoption. Such services could also support parents who adopt children privately or from foreign countries.

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