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## COMMENT

### THE INEQUITABLE TAX BENEFITS OF ADOPTION<sup>†</sup>

*Nathaniel S. Hibben<sup>††</sup>*

#### ABSTRACT

This Comment examines the two provisions of the Internal Revenue Code under which taxpayers may defray expenses incurred in adopting a child. First, under Internal Revenue Code § 137, taxpayers may exclude from income qualified adoption expenses paid or reimbursed by the taxpayer's employer pursuant to an adoption assistance program. There is no benefit gap under the exclusion-from-income provision; the value is identical to taxpayers regardless of income.

Second, under Internal Revenue Code § 23, an adoptive family receives a credit against tax liability to help discharge adoption-related expenses. Because this credit only discharges positive tax liability, only higher-income taxpayers are fully benefitted by the credit. Taxpayers without sufficient tax liability in the current year may carry forward unused portions of the credit for up to five years. However, simple present value analysis shows that, by carrying forward unused portions of the credit, these families receive less of a benefit than do families with higher income who are able to immediately claim the full credit. This benefit gap increases as family income decreases. Families without tax liability are not benefitted by the adoption credit. The amount of the adoption credit is indexed annually for inflation, but this indexation only increases the benefit gap between higher- and middle-income taxpayers. This Comment proposes multiple solutions to the current inequitable tax benefit paradigm, and it ultimately proposes a

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<sup>†</sup> After this Comment was selected for publication, but before it could be printed, Congress significantly changed the adoption tax credit. These changes are contained within the "Patient Protection and Affordable Care Act," Pub. L. No. 111-148, signed into law on March 23, 2010. See H.R. 3590 § 10909, available at [http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111\\_cong\\_bills&docid=f:h3590enr.txt.pdf](http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h3590enr.txt.pdf). Importantly, because the adoption tax credit is now refundable, the economic loss that resulted from carrying unused portions of the credit forward will no longer occur. Consequently, much of the analysis contained in this Comment is now outdated. Notwithstanding these changes, the Liberty University Law Review believes this Comment offers an important contribution and has determined that publishing it is appropriate.

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new business tax credit for businesses that provide adoption benefits to their employees.

## I. INTRODUCTION

Adoption serves an important social function.<sup>1</sup> Appropriately, the federal government has implemented pro-adoption policies, particularly within two provisions of the Internal Revenue Code.<sup>2</sup> First, § 23 allows an \$11,650 tax credit to adopting families.<sup>3</sup> This credit, as with all tax credits, reduces the taxpayer's tax liability dollar for dollar.<sup>4</sup> Second, § 137 permits taxpayers to exclude from income monetary adoption benefits provided by the taxpayer's employer.<sup>5</sup> An employee may exclude up to \$11,650 under this section.<sup>6</sup> Through these tax benefits, some families are able to discharge the significant costs associated with adoption.<sup>7</sup>

For a great many other families, however, the Internal Revenue Code's adoption deferral provisions are inadequate.<sup>8</sup> Because the § 23 credit only discharges existing tax liability, families need substantial income in order to generate sufficient tax liability to utilize the maximum benefit of the credit.<sup>9</sup> In 2008, a family without any other dependents would need to earn at least \$101,250 to fully utilize the \$11,650 adoption tax credit immediately.<sup>10</sup> Approximately 70% of all adoptive families earn less than this threshold amount and are unable to fully utilize the adoption tax credit in one year.<sup>11</sup> Indeed, in 2008 an adoptive family that has one other child, yet earns less than \$56,500, will not fully realize the benefit of the adoption tax credit, even when the unused portion of the credit is carried forward for five years.<sup>12</sup> Approximately one-third of all adoptions are made by families earning less than this threshold amount.<sup>13</sup> Thus, a third of all adoptive families are not able to fully utilize the adoption tax credit, even when

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1. *See infra* Part II.B.

2. *See infra* Part III.B; *see also* I.R.C. §§ 23, 137 (2006).

3. *See infra* Part III.

4. *See infra* Part III.B.1.

5. *See infra* Part III.B.2.

6. *See infra* Part III.B.2.

7. *See infra* Part IV.D.2.

8. *See infra* Part IV.A.

9. *See infra* Part IV.B.

10. *See infra* Part IV.D.1.

11. *See infra* Part IV.B-C.

12. *See infra* Part IV.C; Table 1.

13. *See infra* Part IV.D.1.

carried forward for up to five years.<sup>14</sup> Consequently, the credit has the effect of fully benefitting higher-income adoptive families while the benefit to low-income taxpayers declines significantly as income decreases.<sup>15</sup>

Conversely, the value of the exclusion-from-income provision under § 137 is identical across the income spectrum.<sup>16</sup> However, less than half of all employers provide adoption benefits to their employees, and practically all of the employers that even provide such benefits offer \$4,000 or less.<sup>17</sup>

Part II of this Comment surveys the history and purpose of adoption, including the impact adoption has upon society and adoptive families. Part III considers the tax treatment of adoption under current law. Part IV explores whether the existing tax treatment of adoption favors higher-income taxpayers at the expense of lower-income taxpayers. In order to resolve this question, this Comment utilizes present value analysis for determining the actual benefit of the adoption credit for adoptive families at different income levels. Part V analyzes various solutions to the problems noted in Part IV. This Comment concludes that the existing tax treatment of adoption is inequitable; consequently, a new business tax credit is proposed that results in a more equitable distribution of adoption tax benefits across the income spectrum.

## II. BACKGROUND

Implicit within the argument of this Comment is that adoption should be encouraged. Before that argument can be advanced, however, it is necessary to understand the role adoption has in society.

### A. *Brief History of Adoption*

Adoption had its beginnings in ancient civilization.<sup>18</sup> Perhaps the best-known adoption in history appears in the Book of Exodus, where Moses was rescued from the reeds of the Nile and adopted by the Pharaoh's daughter.<sup>19</sup> The Code of Hammurabi provided for the institution,<sup>20</sup> as did

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14. *See infra* Part IV.C.

15. *See infra* Part IV.D.1.

16. *See infra* Table 3.

17. *See infra* Part V.

18. CYNTHIA R. MABRY & LISA KELLY, *ADOPTION LAW: THEORY, POLICY AND PRACTICE* 1 (2006).

19. *See Exodus* 1:15-22, 2:1-10. Pharaoh issued an edict that all boys were to be thrown in the Nile and drowned. Moses' Hebrew mother refused to kill him, and instead placed him near the river bank in a tar and pitch-lined basket, where he was found by the maid of the daughter of Pharaoh. Pharaoh's daughter raised Moses as if he were her biological child.

early Roman law, primarily in the form of adults adopting adult males to ensure continuation of the adoptive parents' lineage.<sup>21</sup> As a legal category, however, classical and Greco-Roman adoption law reflected a sense that adoption served the needs of the adoptive parents.<sup>22</sup>

Today, the primary consideration in adoption law is the best interests of the child,<sup>23</sup> which reflects the concept that adoption, above all, is seen as an act of love by the one adopting.<sup>24</sup> Adoption was not embodied in the common law and was not recognized in England until 1926.<sup>25</sup> Thus, adoption law was not part of the common law the United States carried over from England.<sup>26</sup> Adoption in America did exist in an unregulated sense,

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20. Lisa J. Trembly, *Untangling the Adoption Web: New Jersey's Move to Legitimize Independent Adoptions*, 18 SETON HALL LEGIS. J. 371, 376 n.26 (1993).

21. *Id.*; see also MABRY & KELLY, *supra* note 18, at 1.

22. There is an abundance of sources that detail the practice and policy of adoption in ancient Greece. See, e.g., LENE RUBINSTEIN, *ADOPTION IN IV CENTURY ATHENS* 62-76 (1993); JAMES M. SCOTT, *ADOPTION AS SONS OF GOD* 3-5 (1992).

23. See Ruth-Arlene W. Howe, *Adoption Practices, Issues, and Laws 1958-1983*, 17 FAM. L.Q. 173, 175 (1983) (observing that "early U.S. adoption laws used Roman law as a guide, with one important and basic difference: Roman law was based upon the needs and rights of the adoptive parents; whereas American law, from the beginning, protected the welfare of adopted children").

24. See Pollack, Bleich, Reid, & Fadel, *Classical Religious Perspectives of Adoption Law*, 79 NOTRE DAME L. REV. 693, 712-13 (2004). Some scholars trace this loving model of adoption directly to the Apostle Paul, who taught that all who are led by the Spirit of God are sons of God. *Id.* at 713; see also Romans 8:14-15. The loving model of adoption finds support within biblical text. See, e.g., Romans 8:15 (the relationship between God and the individual was created by adoption, and allows God's children, the followers of Christ, to call upon God as "Abba, Father"); James 1:27 (admonishing the believer to "look after orphans . . . in their distress"); see also Pollack, *supra*, at 719 (quoting Aquinas: "Adoption depends upon the kindness of the one adopting and the one adopted. God is especially kind and the greatest lover of humankind. Therefore God is uniquely competent to adopt."). To the Christian, then, adoption is "the supreme expression of God's love and grace." *Id.* at 713. This loving model of adoption, dominant in modern adoption law, finds its roots in the foundation of the Christian tradition. *Id.*

25. See Stephen B. Presser, *The Historical Background of the American Law of Adoption*, 11 J. FAM. L. 443, 461-64 (1972); see also E. WAYNE CARP, *INTRODUCTION TO ADOPTION IN AMERICA* 1, 3 (E. Wayne Carp ed., 2004). Of course, like the United States, in England there were other methods for transfer of custody to persons outside the family – a transfer that could be, in effect, irreversible. See, e.g., Danaya Wright, *A Crisis of Child Custody: A History of the Birth of Family Law in England*, 11 COLUM. J. GENDER & L. 175, 183-90 (2002) (describing custody disputes between parents and third parties in the 1700s); see also *Hall v. Vallandingham*, 540 A.2d 1162, 1162 n.1 (Md. Ct. Spec. App. 1988).

26. For instance:

[In] 1891 the Supreme Court of California held that adoption was "unknown to the common law and repugnant to its principles." As Professor Henry H. Foster

however, through the practice of placing children in apprenticeships.<sup>27</sup> Informal adoptions were also created by cultural custom. For instance, nineteenth-century parents who were unable to care for their children often placed children with other families who were better situated financially to care for the children.<sup>28</sup> Additionally, as children of enslaved African families became separated from their parents, other adults in the community took responsibility to care for the parentless children.<sup>29</sup> This custom of informal adoption by “fictive kin” continues today in some communities.<sup>30</sup>

Before enactment of adoption statutes, persons who wanted to create a formal, legal relationship with a child could do so through private legislative acts.<sup>31</sup> This method was displaced by the advent of adoption statutes, the first being passed by Massachusetts in 1851.<sup>32</sup> Within 25 years,

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has observed, early U.S. adoption laws used Roman law as a guide, with one important and basic difference: Roman law was based upon the needs and rights of the adoptive parents; whereas American law, from the beginning, protected the welfare of adopted children.

Howe, *supra* note 23, at 175 (citations omitted) (quoting *Ex parte Clark*, 87 Cal. 638 (1891)). For another application, see *Hall*, 540 A.2d at 1162.

27. See MABRY & KELLY, *supra* note 18, at 2.

28. *Id.*

29. *Id.*

30. See Monique Lee Hawthorne, *Family Unity in Immigration Law: Broadening the Scope of “Family,”* 11 LEWIS & CLARK L. REV. 809, 826 (2007) (stating that researchers have found family-like relations, known as “fictive kin,” commonly exist between non-blood individuals in the African American community). “Fictive kin” is also defined as “[a] term used to refer to individuals that are unrelated by either birth or marriage, who have an emotionally significant relationship with another individual that would take on the characteristics of family relationship.” *Id.* at 826; see also *Adoption Glossary*, ADOPTION.COM, <http://glossary.adoption.com/fictive-kin.html> (last visited Nov. 6, 2009). Members of Native American and Latino communities also engage in the custom. MABRY & KELLY, *supra* note 18, at 2.

31. See Annette R. Appell, *The Endurance of Biological Connection: Heteronormativity, Same-Sex Parenting and the Lessons of Adoption*, 22 BYU J. PUB. L. 289, 297 (2008); see also Stephen B. Presser, *The Historical Background of the American Law of Adoption*, 11 J. FAM. L. 443, 461-60 (1971). Professor Appell notes that, while Massachusetts is commonly credited with enacting the first adoption statute in 1851, Texas and Mississippi were actually the first states to adopt general adoption statutes. However, these earlier statutes merely permitted adopters to make public a private adoption arrangement, “analogous to recording a deed for a piece of land.” Appell, *supra*, at 297 n.50 (internal quotation marks omitted).

32. Appell, *supra* note 31, at 297; see also Massachusetts Adoption of Children’s Act of 1851, 1851 Mass. Acts 816, available at <http://www.uoregon.edu/~adoption/archive/massaca.htm>.

most states had followed suit.<sup>33</sup> These statutes established the hallmark of formal adoption: the termination of one family and creation of another.<sup>34</sup>

Not coincidentally, the shift toward formal adoption corresponded with the transition from an agrarian to an urban economy.<sup>35</sup> While remnants of the agrarian economy still linger in modern statutes,<sup>36</sup> the adoption statutes grew out of a notion that children, particularly children born to single mothers and families without the means to care for children, should be protected.<sup>37</sup> This “child saving movement” eventually evolved into the present-day child welfare system.<sup>38</sup>

While modern adoption law has remained unchanged in core principle, the procedure of modern adoption has been significantly modified. Contrary to the early days of adoption, modern adoptions are anonymous.<sup>39</sup> Court records are now usually sealed, and new birth certificates are issued for the adoptee.<sup>40</sup> Additionally, three distinct types of adoptions exist today: independent, private agency, and public agency.<sup>41</sup>

#### B. Social Benefits of Adoption

There are more than one-and-a-half million adopted children in the United States.<sup>42</sup> The social benefits of these adoptions are well-documented. For instance, every child adopted is less likely to grow up in poverty, more likely to obtain an education, and more likely to have a participating father than a child raised by an unmarried mother.<sup>43</sup> Adopted children generally

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33. Appell, *supra* note 31, at 297.

34. *Id.*

35. *Id.* at 298.

36. See, e.g., CAL. FAM. CODE § 7500 (West 2004) (“The mother of an unemancipated minor child, and the father, if presumed to be the father under Section 7611, are equally entitled to the services and earnings of the child.”).

37. Appell, *supra* note 31, at 298.

38. *Id.*

39. Elizabeth J. Samuels, *The Idea of Adoption: An Inquiry into the History of Adult Adoptee Access to Birth Records*, 53 RUTGERS L. REV. 367, 376 (2001).

40. *Id.* at 377. It was not until the 1930s that states began to issue new birth certificates that reflected the adoption, and even then, the original certificates remained unsealed for decades. *Id.* at 376.

41. This is beyond the scope of this Comment; however, for a good synopsis of the three different types of adoption, see Ted R. Youmans, *Adoption: An Answer for Children in Crisis*, 4 WHITTIER J. CHILD & FAM. AD. 71 (2004).

42. U.S. CENSUS BUREAU, ADOPTED CHILDREN AND STEPCHILDREN 2 (2000), available at <http://www.census.gov/prod/2003pubs/censr-6.pdf>. This figure includes only non-stepchildren under age 18.

43. Mary M. Beck, *Adoption of Children in Missouri*, 63 MO. L. REV. 423, 428 (1998);

live in wealthier and higher-educated households compared to their biological counterparts.<sup>44</sup> And adoptive parents benefit from having a child to love and nurture.

Moreover, the government benefits when foster children are adopted. In 2005, the total federal spending for foster care was \$1.8 billion with an additional \$2.1 billion for administrative expenses.<sup>45</sup> According to some estimates, adopting a child from foster care saves the government up to \$6,000 each year.<sup>46</sup> Thus, the effects of adoption upon the individual child and the economic effects upon the nation are significantly positive.

### III. TAX TREATMENT UNDER THE CURRENT TAX CODE

#### A. *Brief History of Adoption Incentives Under the Internal Revenue Code*

The federal government recognizes the impact adoption has on society and has implemented a pro-adoption tax policy. Tax incentives for adoption were first enacted as part of The Economic Recovery Tax Act of 1981 (ERTA), which provided for an itemized deduction for qualified adoption expenses incurred in connection with the adoption of a “special needs

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*see also* Wade F. Horn, *Dads Face Sad Statistics*, COLUMBUS DAILY TRIB., June 18, 2000, available at <http://archive.showmenews.com/2000/jun/20000618comm008.asp>.

Children who grow up absent their fathers are five times more likely to be poor, two to three times more likely to fail at school and two to three times more likely to suffer from an emotional or behavioral problem. As teenagers, fatherless children are more likely to commit crime, engage in early and promiscuous sexual activity and to commit suicide.

*Id.*

44. U.S. CENSUS BUREAU, *supra* note 42, at 16 (finding that the median annual income of adoptive families is \$56,138, while biological children live in households with a median income of \$48,200). *See generally In re Adoption of R.B.F.*, 803 A.2d 1195, 1198 (Pa. 2002) (identifying the benefits of adoption as “the legal protection of the children's existing familial bonds, their rights; the right to financial support from two parents instead of just one, rights; the right to inheritance from two parents; parent and the right to obtain other available dependent benefits”).

45. CYNTHIA ANDREWS SCARCELLA ET AL., THE URBAN INST., THE COST OF PROTECTING VULNERABLE CHILDREN V: UNDERSTANDING STATE VARIATION IN CHILD WELFARE FINANCING 15 (2006), available at [http://www.urban.org/UploadedPDF/311314\\_vulnerable\\_children.pdf](http://www.urban.org/UploadedPDF/311314_vulnerable_children.pdf).

46. *See* Ian Urbina, *Trying to Keep Child Care in the Family*, N.Y. TIMES, July 23, 2006, § 1, at 16, available at [http://www.nytimes.com/2006/07/23/us/23guardian.html?\\_r=1&oref=slogin&pagewanted=all](http://www.nytimes.com/2006/07/23/us/23guardian.html?_r=1&oref=slogin&pagewanted=all); *see also* 42 U.S.C. § 672 (2006) (statutory requirements of foster care payments).

child.”<sup>47</sup> This deduction was repealed by the Tax Reform Act of 1986.<sup>48</sup> Congress reconsidered its position and included in the conference report to the Technical and Miscellaneous Revenue Act of 1988 a call for a tax deduction “to encourage and facilitate adoption” but stopped short of actually implementing the deduction.<sup>49</sup> Tax credit and exclusion provisions for adoption were enacted by Congress as part of the Seven-Year Balanced Budget Reconciliation Act of 1995; that legislation, however, was vetoed by President Clinton.<sup>50</sup> The veto was apparently due to other considerations; one year later, President Clinton directed an Executive Memorandum to the Department of Health and Human Services recommending strategies to double the number of American adoptions.<sup>51</sup> Following the veto, the Adoption Promotion and Stability Act of 1996 was introduced.<sup>52</sup> This bill was rolled into and made a part of the Small Business Job Protection Act of 1996, which authorized a tax credit and an income exclusion provision to help ease the burdens of adoptions for many taxpayers.<sup>53</sup> In 2001, Congress and President Bush re-authorized and increased the tax benefits of adoption,<sup>54</sup> as well as provided for annual indexation of the credit and

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47. See Economic Recovery Tax Act of 1981 § 125 (repealed 1986); see also Internal Revenue Code of 1954 § 222 (amended 1986).

48. CRS REPORT FOR CONGRESS, ADOPTION TAX CREDIT AND EXCLUSION 3 (Aug. 23, 1996), available at <http://pennyhill.com/index.php?lastcat=27&catname=Families&viewdoc=96-692>.

49. *Id.*

50. *Id.*

51. See Memorandum on Adoption and Alternate Permanent Placement of Children in the Public Child Welfare System, 2 PUB. PAPERS 2209 (Dec. 14, 1996); see also DEP'T OF HEALTH & HUMAN SERV., ADOPTION 2002: A RESPONSE TO THE PRESIDENTIAL EXECUTIVE MEMORANDUM ON ADOPTION (2002), available at <http://www.acf.dhhs.gov/programs/cb/initiatives/adopt2002/2002toc.htm>. In 1997, over 500,000 children lived in foster care, but no more than 27,000 were adopted. See ELIZABETH BARTHOLET, NOBODY'S CHILDREN: ABUSE AND NEGLECT, FOSTER DRIFT AND THE ADOPTION ALTERNATIVES 25 (1999). Bartholet concludes that the states' family preservation services probably impede adoption of foster children. *Id.* at 25-26. However, adoptions out of foster care did nearly double between 1996 and 2000. Evan B. Donaldson, Adoption Inst., Foster Care Facts, available at <http://www.adoptioninstitute.org/FactOverview/foster.html> (last visited Oct. 16, 2008) (noting a 78% increase in adoptions from foster care between 1996 and 2000).

52. CRS REPORT FOR CONGRESS, *supra* note 48, at 4.

53. *Id.*

54. See Economic Growth and Tax Reconciliation Act of 2001 (EGTRAA), Pub. L. No. 107-16, 115 Stat. 38 (codified in scattered sections of Title 26 of the United States Code). For a discussion of the tax benefits, see *infra* Part III.B.

exclusion amounts.<sup>55</sup> Since then, facilitating and supporting adoptions has enjoyed bipartisan support.<sup>56</sup>

*B. The Tax Treatment of Qualified Adoption Expenses Incurred by the Taxpayer*

Currently, the Internal Revenue Code provides two mechanisms to help defray the costs of adopting a child.

1. The Adoption Tax Credit

First, § 23 allows a tax credit to adopting parents to help discharge “qualified adoption expenses” (QAE), which include reasonable and necessary adoption fees, court costs, attorney fees, the birth mother’s reasonable living expenses, and other costs directly related to adopting an “eligible child.”<sup>57</sup> A child is eligible if he is under age eighteen or is incapable of caring for himself.<sup>58</sup> In 2008, the maximum adoption credit was \$11,650,<sup>59</sup> which meant that an adoptive family could offset adoption expenses up to the credit amount against income tax liability. The adoption credit amount is adjusted annually for inflation.<sup>60</sup> The credit reduces the taxpayer’s tax liability dollar for dollar but does not result in a negative tax liability.<sup>61</sup> Expenses that are otherwise reimbursed to the adoptive parents, such as through an adoption assistance program,<sup>62</sup> do not qualify, nor do

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55. *See infra* Part IV.D.2.

56. *See, e.g.*, Democratic Party 2008 Platform, *Renewing America’s Promise*, DEMOCRATS.ORG, <http://www.democrats.org/a/party/platform.html> (last visited Oct. 31, 2008) (“The Democratic Party also strongly supports a woman’s decision to have a child by ensuring access to and availability of . . . caring adoption programs;” and “We must protect our most vulnerable children, by . . . enhancing adoption programs”). The 2008 Republican Party Platform did not contain any statement supporting adoption. *See* GOP.COM, <http://platform.gop.com/2008Platform.pdf>. However, President Bush (R) signed into law the Fostering Connections to Success and Increasing Adoptions Act of 2008, Public Law No. 110-351, which promotes adoption of special needs children and requires adoption agencies to inform prospective adoptive parents of adoption tax benefits. For information and text of the Bill, see [http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110\\_cong\\_public\\_laws&docid=f:publ351.110.pdf](http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_public_laws&docid=f:publ351.110.pdf) (last visited Nov. 7, 2009).

57. I.R.C. § 23(a)(1), (d)(1) (2006).

58. I.R.C. § 23(d)(2).

59. *See* INTERNAL REVENUE SERVICE, ADOPTION BENEFITS INCREASED (Mar. 7, 2009), available at <http://www.irs.gov/formspubs/article/0,,id=177982,00.html>.

60. *See infra* note 69.

61. In other words, the adoption credit is not refundable. *See infra* Part V.A.

62. *See infra* Part III.B.2.

any expenses connected with step-parent adoptions<sup>63</sup> or surrogate parenting arrangements.<sup>64</sup> If the § 23 credit exceeds the parents' tax liability for the year in which the credit is taken, the parents may carry forward the unused portion of the credit for up to five years.<sup>65</sup>

The following example illustrates the tax benefits of the § 23 adoption credit.

In 2008, Paul and Mary adopted a child. They incurred QAE of \$10,000. Assume their gross income for the year is \$70,000, and their marginal tax rate is 25%. Thus, their federal income tax liability is \$17,500. They can claim a credit of \$10,000 (the credit is limited to QAE) under § 23, which reduces their tax liability to \$7,500. Through the adoption tax credit, their net adoption costs have been reduced to zero.

## 2. The Tax Treatment of Employer-Provided Adoption Monetary Benefits

The second mechanism through which adoptive families may defray expenses is found in § 137, which permits taxpayers to exclude from income QAE paid or reimbursed by the taxpayer's employer pursuant to an "adoption assistance program."<sup>66</sup> An adoption assistance program must be a separate, written plan and must not discriminate in favor of "highly compensated employees."<sup>67</sup> Although amounts paid by the employer under a qualified assistance program are excludable from the employee's income for income tax purposes, the amounts are subject to FICA taxes, and the employer must withhold the appropriate amount of FICA tax.<sup>68</sup> Sections 23 and 137 contain identical language providing that the relevant amount of credit or exclusion is adjusted annually for inflation, as set by I.R.C. § 1(f)(3).<sup>69</sup> Consequently, the exclusion amount under § 137 will always be identical to the maximum credit under § 23. In 2008, the maximum

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63. I.R.C. § 23(d)(1)(C).

64. I.R.C. § 23(d)(1)(B).

65. I.R.C. § 23(c).

66. I.R.C. § 137.

67. I.R.C. § 137(c). All employee benefit programs must not favor highly compensated employees. *See* I.R.C. § 127(b)(2), (3), (5), (6).

68. I.R.S. Notice 97-9, 1997-2 I.R.B. 35.

69. *See* I.R.C. §§ 23(h), 137(f).

exclusion under § 137 was \$11,650.<sup>70</sup> Both § 23 and § 137 can apply to a single adoption, but cannot apply to the same adoption expenses.<sup>71</sup>

The § 137 exclusion is demonstrated by the following example:

In 2008, Tom and Sally adopted a child. They incurred QAE of \$16,000. Assume their gross income for the year is \$50,000, and their marginal tax rate is 25%. Thus, their federal income tax liability is \$12,500. They can claim the full § 23 credit of \$11,650, which reduces their tax liability to \$850 and leaves Tom and Sally with \$4,350 in remaining QAE (\$16,000 – \$11,650). However, also assume Sally's employer provides up to \$5,000 under the employer's adoption assistance program. Thus, Tom and Sally receive \$4,350 from the employer and under § 137 are able to exclude the sum from income. Their net adoption costs have been reduced to zero, and the amount received under the adoption assistance program has not impacted the couple's tax liability.<sup>72</sup>

The § 23 credit and § 137 exclusion are phased out if the parents have gross income between \$174,730 and \$214,730.<sup>73</sup> Parents with gross income of \$214,730 or more cannot qualify for either the credit or the exclusion.<sup>74</sup>

Expenses incurred for adoptions of U.S. citizens can qualify for the credit even if the adoption is not finalized.<sup>75</sup> However, if the adoptive child is not a U.S. citizen, a taxpayer can take neither the credit nor the exclusion unless the adoption is finalized.<sup>76</sup>

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70. See *supra* note 59.

71. See I.R.C. § 23 (b)(3)(A); see also DEP'T OF TREASURY, REPORT TO THE CONGRESS ON TAX BENEFITS FOR ADOPTION 1 (2000), available at <http://www.treas.gov/offices/tax-policy/library/adoption.pdf>.

72. Notice there is no connection between QAE and tax liability; even if the former exceeds the latter, the taxpayer may nonetheless avail himself of the § 137 credit. Similarly, notice the credit affects tax liability while the exclusion does not.

73. See I.R.S. Notice 97-9, *supra* note 68.

74. See *id.*

75. See *id.*; see also I.R.S. Publication 968 at 3, available at <http://www.irs.ustreas.gov/pub/irs-prior/p968--2004.pdf>.

76. I.R.S. Notice 97-9, *supra* note 68; see also I.R.C. § 23(e)(1); I.R.S. Publication 968, *supra* note 75, at 4.

#### IV. THE EXISTING TAX TREATMENT OF ADOPTION FAVORS HIGHER-INCOME TAXPAYERS

##### A. *Outlining the Problem*

Adoption raises important policy questions, including how to promote the child's interests, how to protect fragile birth families, and how to place the child with a permanent family. Important policy questions must also be addressed when providing tax benefits for adoption. Most importantly, policy makers must determine how to allocate scarce resources among adoptive families. However, which income group to prefer when it comes to awarding tax benefits is not a legitimate policy issue. Quite simply, there is no legitimate reason to favor higher-income adoptive families over middle- or lower-income adoptive families. Yet the existing tax benefit structure does just that. Consider two problems with the existing tax incentives for adoption. First, middle-income taxpayers do not receive the same real economic benefit under the adoption tax credit as higher-income taxpayers, despite the fact that middle-income taxpayers undertake approximately 70% of all non-step-child adoptions.<sup>77</sup> Second, the existing tax incentive structure is such that the truly equitable adoption tax benefit, the § 137 exclusion-from-income provision, is underutilized. The exclusion is inherently more equitable than the credit because it has the same value to all taxpayers, regardless of their income.<sup>78</sup>

##### B. *The Normative Starting Point*

Adoptions can be expensive. Public agency adoptions<sup>79</sup> are generally the cheapest, with costs varying from \$0 to \$2,500. The cost of private agency adoptions can exceed \$30,000, while independent adoptions range from \$8,000 to more than \$30,000.<sup>80</sup> Anecdotal evidence suggests independent adoption costs can exceed \$40,000.<sup>81</sup> As for foreign adoptions, "adoptive parents can expect to pay \$18,000–\$35,000 to adopt a child from China, Korea, Russia, or Guatemala."<sup>82</sup> Major banks recognize that the costs of

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77. See *infra* Part IV.C.

78. See *infra* Table 3.

79. See *supra* note 41 and accompanying text.

80. See NAT'L ADOPTION INFO. CLEARINGHOUSE, U.S. DEP'T OF HEALTH & HUMAN SERVS., COSTS OF ADOPTING 1-3, available at [http://adoptiveparents.org/Reprinted\\_Articles/adoption\\_gip\\_two.pdf](http://adoptiveparents.org/Reprinted_Articles/adoption_gip_two.pdf).

81. *Id.*

82. See Solangel Maldonado, *Discouraging Racial Preferences in Adoption*, 39 U.C. DAVIS L. REV. 1415, 1441 (2006).

adoption exceed the tax benefits, and accordingly market adoption loans specifically to adoptive parents.<sup>83</sup>

There were 84,793 income tax returns that claimed the adoption credit in 2005, the last year for which complete data is available.<sup>84</sup> Approximately 70%, or 55,000, taxpayers claimed the adoption credit had insufficient tax liability to fully offset current-year adoption expenditures.<sup>85</sup> These taxpayers must carry forward unused portions of the credit.<sup>86</sup> The result is that taxpayers who must carry forward unused portions of the credit receive less of a benefit than do taxpayers who have sufficient tax liability to immediately utilize the credit.<sup>87</sup> This is because QAE is incurred and paid immediately, while the tax benefit is not realized until years later. Accordingly, present value analysis reveals the relationship between income tax liability and real value of the adoption credit: the lower the taxpayer's tax liability, the less the credit is worth.<sup>88</sup>

### C. *The Distribution of Adoption Tax Benefits Across the Income Spectrum*

Whereas the adoption tax credit is inequitable across the income spectrum, the real benefit of the § 137 exclusion-from-income provision is identical regardless of income.<sup>89</sup>

In 2008, the adoption tax benefit structure resulted in unequal distribution across four distinct tiers of income.<sup>90</sup> Tier One is the wealthiest tier. This Tier encompasses taxpayers with incomes of \$174,730 and above. These households are ineligible or partially ineligible for adoption benefits because their income level is too high.<sup>91</sup> The amount of adoption credit for which this Tier is eligible decreases as income increases. Tier Two is the

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83. Many major banks provide adoption loans. For a collection of adoption financing options, see Adoption.com, Adoption Loans, <http://www.adoptionloans.com>; [http://www.davethomasfoundation.org/Adoption-Resources/Adoption-Links#CMSNestedLinks\\_Id4](http://www.davethomasfoundation.org/Adoption-Resources/Adoption-Links#CMSNestedLinks_Id4) (follow the "financial assistance" link).

84. See *infra* Table 5.2; see also I.R.S. 2005 STATISTICS OF INCOME, available at <http://www.irs.gov/taxstats/indtaxstats/article/0,,id=133414,00.html> (click on "2005" under Table 2).

85. See *infra* Tables 4, 6.

86. See *supra* Part III.B.

87. See *infra* Part IV.C.

88. See *infra* Part IV.C.

89. See *infra* Table 3.

90. The Tier structure assumes no other dependents. See *infra* Tables 2, 5.

91. That is, their income exceeds the phase-out amount. For 2005 Tier One information, see Table 6. For 2008 Tier One information, see Table 2.

second wealthiest Tier.<sup>92</sup> Income in this Tier is between \$101,250 and \$174,730. This is the only group to fully benefit from the adoption tax credit. Tier Three is the next wealthiest Tier.<sup>93</sup> Tier Three income is between \$46,200 and \$101,249. This group only partially benefits from the adoption credit. As income decreases, the amount of adoption credit for which this Tier is eligible decreases. Approximately two-thirds of adoptions are undertaken by families within this Tier.<sup>94</sup> Tier Four is the least wealthy Tier.<sup>95</sup> The income of a household in this group is \$46,199 and below. This Tier is not able to utilize the adoption credit, even when carried forward for five years. Moreover, some households in this tier are completely ineligible to receive adoption tax credit benefits.<sup>96</sup>

#### D. General Principles of Tax Credits

Tax credits can be understood by recognizing three principles. First, a tax credit only discharges existing income tax liability.<sup>97</sup> Second, income tax liability is a product of income; a household without sufficient income will not generate tax liability and is ineligible to claim a tax credit.<sup>98</sup> Third, as the amount of the tax credit increases, so does the amount of income that is required to generate sufficient tax liability to fully utilize the credit.<sup>99</sup>

##### 1. Applying the Principles to the Adoption Tax Credit

Families need substantial income in order to use the benefits from the maximum possible adoption tax credit. In 2008, only a household with an income greater than \$101,250 would have sufficient tax liability to fully utilize the \$11,650 adoption credit in one year, assuming no other dependents.<sup>100</sup> The amount of necessary income increases to \$113,550 if the

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92. For 2005 Tier Two information, see Table 6. For 2008 Tier Two information, see Table 2.

93. For 2005 Tier Three information, see Table 6. For 2008 Tier Three information, see Table 2.

94. See *infra* Tables 5.2, 6.

95. For 2005 Tier Four information, see Table 6. For 2008 Tier Four information, see Table 2.

96. See *infra* Tables 2, 5.

97. See *infra* note 150 for more information on refundable tax credits. Most credits are not refundable. "Refundable" tax credits, such as the EITC, are an exception to this general rule.

98. See generally Brian H. Jenn, *The Case for Tax Credits*, 61 TAX LAW. 549 (2008).

99. *Id.*

100. See *infra* Table 1.

taxpayer has one other child and claims two child care credits.<sup>101</sup> Thus, only households earning between \$101,250 and the phase-out amount, which in 2008 was \$174,730, are eligible to utilize the maximum benefit of the adoption credit. In other words, for an adoptive family with income in that range, the value of the adoption credit is its maximum: \$11,650.

However, the real value of the adoption credit for a household with a 2008 income of \$101,250 or below is less than \$11,650. This is because taxpayers earning less than \$101,250 will not generate sufficient income tax liability to immediately utilize the credit and instead must carry forward unused portions. Present value analysis reveals the resulting inequity: the lower the taxpayer's tax liability, the less the credit is worth.<sup>102</sup> Because tax liability is a product of income, the current structure of the adoption tax credit strongly favors higher-income taxpayers relative to middle- and lower-income taxpayers. Thus, lower-income adopting households are at a significant economic disadvantage relative to their higher-income counterparts.

Consider two hypothetical adopting households, each without any other dependents. In 2008, Family One adopts a child, earns \$72,150 in income, and incurs QAE of \$11,650.<sup>103</sup> Family One will have \$5,825 of eligible tax liability,<sup>104</sup> which must be offset by the adoption credit immediately. The unused portion of the adoption credit is \$5,825, which may be carried forward and used as a credit on next year's tax liability.<sup>105</sup> However, by incurring the expenses immediately but not recouping those expenses until next year, Family One suffers an economic loss because it is not presently able to recover the expenses of the adoption. Assuming a 6% interest rate, Family One has suffered an economic loss of \$349.50.<sup>106</sup> The actual economic benefit of the adoption credit is reduced accordingly. Thus, the actual economic benefit of the adoption credit to Family One is \$11,300.50.<sup>107</sup>

Family Two adopts a child in 2008, earns \$46,200 in income, and incurs QAE of \$11,650.<sup>108</sup> Family Two will have \$1,941.67 of eligible tax

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101. See *infra* Table 1.

102. For full analysis of the inequity, see *infra* Table 2 (2008 data) and Table 6 (2005 data).

103. See *infra* Table 2.

104. See *infra* Table 2.

105. See *infra* Table 2.

106. See *infra* Table 2.

107. See *infra* Table 2.

108. See *infra* Table 2.

liability,<sup>109</sup> which must be offset by the adoption credit immediately. The unused portion of the adoption credit is \$9,708.35, which may be carried forward and used as a credit on next year's tax liability.<sup>110</sup> If next year's tax liability is not sufficient to fully utilize the unused portion of the credit, the unused portion will be carried forward to the next year. This will continue until the credit is fully utilized or Year 5 occurs, whichever is first.<sup>111</sup> Each time the credit is carried forward, Family Two suffers an economic loss because it is not presently able to recover the adoption expenses already paid.<sup>112</sup> Assuming both a 6% interest rate and that the credit is not fully utilized until Year 5, Family Two will have suffered an economic loss of \$1,747.50,<sup>113</sup> which reduces the actual economic benefit of the adoption credit to \$9,902.50.<sup>114</sup> If Family Two utilized loans to pay for the adoption, the value of the credit would be reduced according to the interest rate.

An adoptive family earning between \$35,242<sup>115</sup> and \$46,199 in 2008 will not generate sufficient tax liability to utilize the credit over a five-year period.<sup>116</sup> Thus, the value of the credit to such a family is significantly diminished, even as compared to Family Two above. The value of the adoption credit is \$0 to a family earning \$35,241 or less, because such a family will not have sufficient income to generate any tax liability.<sup>117</sup> This means that approximately 43.4 million American households, or one-third of all households in the United States, are completely ineligible for the adoption credit benefits.<sup>118</sup>

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109. See *infra* Table 2 for more information on the term "eligible" tax liability.

110. See *infra* Table 2.

111. See *supra* Part III.B.

112. See *supra* Part III.B.

113. See *supra* Part III.B.

114. See *supra* Part III.B.

115. This is the EITC limit for 2008. Under the assumptions of this analysis, households with income below this level will not have 2008 tax liability. See INTERNAL REVENUE SERVICE, EARNED INCOME TAX CREDIT 2008, available at <http://www.irs.gov/newsroom/article/0,,id=178069,00.html>.

116. See *infra* Table 2.

117. The income amount would be much higher if the family had other children, or was eligible for other credits.

118. In 2006, 43.4 million households had no tax liability. See TAX FOUNDATION, FISCAL FACTS, available at <http://www.taxfoundation.org/research/show/1410.html>. This percentage was an all-time high and has been growing since 1981. This number is actually higher; when people who do not earn enough to report income are counted, about 40% of all wage earners have no income tax liability. Moreover, according to one study, if President Obama's campaign tax plan is implemented, that figure will increase to close to 63 million (Senator McCain's plan would have been 62 million). *Id.*

This inequity might be more palatable if adoptions were only undertaken by those earning sufficient income to immediately utilize the full adoption credit.<sup>119</sup> It is true that adoptive households are generally wealthier than their biological counterparts.<sup>120</sup> It is inapposite, however, to measure the inequity of the adoption tax credit by comparing its benefit to biological parents. Instead, the equity of the adoption tax credit can be measured only by comparing its benefit among adoptive parents at different income levels.<sup>121</sup>

Moreover, the data shows that even taxpayers with above-average income do not receive the full benefit of the adoption tax credit.<sup>122</sup> In 2005, the national median family income was \$46,326.<sup>123</sup> But even a family earning \$90,000, or nearly twice the median, cannot utilize the full benefit of the adoption tax credit.<sup>124</sup> In total, approximately 70% of taxpayers claiming the adoption credit did not have sufficient income—hence sufficient tax liability—to fully offset current-year adoption expenditures in 2005.<sup>125</sup> Thus, present value analysis reveals that the adoption tax credit is worth less than the statutory maximum for 70% of those claiming its benefit.<sup>126</sup>

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119. The myth that only wealthy individuals adopt has been reinforced by popular culture; the recent movie *Juno*, for instance, is the story of a teenage girl from a blue-collar family who becomes pregnant and an upper middle class, suburban couple who want to adopt the child. *JUNO* (Fox Searchlight 2007).

120. See generally U.S. CENSUS BUREAU, *ADOPTED CHILDREN AND STEPCHILDREN* (2000), available at <http://www.census.gov/prod/2003pubs/censr-6.pdf>. The study found that an adoptive family's median income is \$56,138, while biological children live in households with a median income of \$48,200. *Id.*

121. Additionally, Congress has decided that the Tax Code should favor adoptive parents over biological parents. See generally *infra* Part III.A.

122. The national median income in 2005 was \$46,326. U.S. CENSUS BUREAU, *INCOME, POVERTY, AND HEALTH INSURANCE COVERAGE IN THE UNITED STATES 4* (2005), available at <http://www.census.gov/prod/2006pubs/p60-231.pdf>.

123. *Id.*

124. See *infra* Table 6.

125. In 2005, the threshold amount was \$92,800; any taxpayer earning less than this amount would have insufficient income tax liability to fully utilize the adoption tax credit immediately. See *infra* Table 6. Approximately 70% of taxpayers claiming the adoption credit earned less than this amount. See *infra* Table 4. This figure was calculated by dividing 60,000, the approximate number of taxpayers earning less than \$92,800 who claimed the credit, by 85,000, the approximate total number of taxpayers who claimed the adoption credit, and rounding to the nearest five or zero in order to avoid the appearance of undue precision.

126. See generally *infra* Tables 2, 6.

In 2005, the adoption credit was worth approximately \$600 less to a household earning \$54,000 than the same credit was worth to a family earning \$100,000.<sup>127</sup> One-third of taxpayers claiming the adoption credit in 2005 earned \$54,000 or less.<sup>128</sup> Additionally, 15% of taxpayers who claimed the adoption credit in 2005 earned insufficient income to fully utilize the adoption credit even when carrying forward unused portions for five years.<sup>129</sup> Only 30% of taxpayers claiming the adoption credit in 2005 were able to fully utilize the credit immediately, or were above the phase-out amount.<sup>130</sup>

## 2. Annual Indexation of the Adoption Credit

As the above analysis shows, the current structure of the adoption tax credit has resulted in a significant benefit gap between higher- and lower-income taxpayers. Moreover, this benefit gap grows every year because the adoption tax credit is indexed annually for inflation.<sup>131</sup> This is because families with substantial tax liability will be able to claim a credit for a greater amount of adoption expenses while lower-income taxpayers are not fully benefited, if at all.<sup>132</sup>

Annual indexation has led to other inequities. Since Congress instituted annual indexation of the adoption tax credit in 2001, the total percentage of claimed adoption credits that were disqualified has increased every year.<sup>133</sup> In 2002, the first year after the credit was increased from \$5,000 to \$10,000, 46% of the amount claimed in adoption credit was disqualified because it was claimed by taxpayers without tax liability.<sup>134</sup> In 2003, 51% of claimed amounts were disqualified,<sup>135</sup> while 53% were disqualified in 2004.<sup>136</sup> By 2005, 61% of the total amount of claimed adoption credits was disqualified due to insufficient tax liability.<sup>137</sup> Thus, in 2005, 61% of the total amount claimed in adoption credit had to be carried forward into

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127. *See infra* Tables 6.1, 6.3.

128. *See infra* Table 4.

129. *See infra* Table 4. This figure was arrived at by dividing 14,000, the approximate number of taxpayers who claimed the credit earning less than \$43,099, by 85,000, the approximate total number of taxpayers who claimed the adoption credit, and rounding to the nearest five or zero in order to avoid the appearance of undue precision.

130. *See infra* Tables 4, 6.

131. *See infra* Part IV.D.2.

132. *See supra* Part IV.D.1.

133. *See infra* Table 5.2.

134. *See infra* Table 5.2.

135. *See infra* Table 5.2.

136. *See infra* Table 5.2.

137. *See infra* Table 5.2.

future years, and 61% of adoption expenses already incurred could not be presently recouped.

As the credit increased due to annual indexation, so did the amount of disqualified claimed credit.<sup>138</sup> The credits were disqualified only because the taxpayer did not have sufficient income tax liability to utilize the credit.<sup>139</sup> The net effect is that the benefit gap—the amount of tax benefit received by higher-income adoptive families relative to lower-income adoptive families—grows every year. Adoptive families with sufficient income to generate tax liability were able to claim the credit and offset adoption expenses, while a lower-income adoptive family, or a family with declining income, received less benefit, even though that family still incurred the adoption expense. Thus, Congress was not being charitable when it instituted annual indexation, but instead inequitable.

This is predictable, though perhaps counterintuitive. First, annual indexation disproportionately benefits taxpayers with substantial income.<sup>140</sup> But as is shown above, a majority of those claiming the adoption credit earn too little to fully utilize the credit immediately.<sup>141</sup> Second, annual indexation is harmful in the case of an adoptive family without significant tax liability, or where the annual percentage increase in income is less than the percentage of annual indexation. Indeed, to be benefitted by the annual indexation, a taxpayer also must have a yearly increase in tax liability at least equal to the increase in the credit amount. In other words, in order for the annual credit increase to benefit any taxpayer, the product of the taxpayer's income tax rate (R) and difference between the taxpayer's current-year income (I<sub>2</sub>) and previous-year income (I<sub>1</sub>) must be greater than the amount of the adoption credit increase (C<sub>increase</sub>). Thus, only if

$$(I_2 - I_1) \times R > C_{\text{increase}}$$

is the taxpayer benefitted by the annual indexation.

Indexation has also resulted in an inverse relationship between claimed credits and allowed credit: as the total number of adoption credit claims increased, the actual dollar amount allowed as a credit decreased.<sup>142</sup> The number of taxpayers who claim the adoption credit has increased every year

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138. See *infra* Table 5.1.

139. See *infra* Table 5.2. For a definition of “nontaxable return,” and an explanation on why the claimed amounts were disqualified, see I.R.S. Explanation of Terms, available at <http://www.irs.gov/pub/irs-soi/06insec4.pdf>.

140. See *supra* Part IV.D.1.

141. See *supra* Part IV.D.2.

142. See *infra* Table 5.1.

since 2001, as has the total amount of claimed credit.<sup>143</sup> In 2005, for instance, the total number of returns claiming the adoption credit increased by 17% as compared to 2004. However, the total amount of allowed credit peaked in 2003 and has decreased every year since.<sup>144</sup> As compared to 2003, there was a 25% increase in the total number of adoption credit claims. But the total dollar amount of allowed credit was 27% lower in 2005 than at its peak in 2003, even though the amount claimed had increased by 9% in the same time span.<sup>145</sup> More dollars in credit were claimed in 2005 than in any previous year.<sup>146</sup> But 2005 was also a record year for the percentage of amount claimed on non-taxable returns, and consequently not allowed in the present year.<sup>147</sup>

Two conclusions can be drawn from this data. First, as the credit increased due to annual indexation, so did the amount of disqualified claimed credit. Second, as the total number of adoption credit claims increased, the actual dollar amount allowed as a credit decreased. The result is that the actual dollar amount of tax benefit received by a taxpayer depends upon the total income of the taxpayer: the more income, the more tax benefit for adopting. Taxpayers with less income receive less tax benefit.

## V. EXPLORING SOME SOLUTIONS

As the above analysis shows, the fundamental problem of the adoption credit is that it is inequitable. In real dollars, the credit benefits higher-income taxpayers more than it does lower- and middle-income taxpayers.<sup>148</sup> Simply raising the credit amount does not solve the problem; indeed, raising the allowable credit exacerbates the dilemma.<sup>149</sup> Instead, the very structure of the credit must be addressed.

### A. *Solution #1: Make the Credit Refundable*

Perhaps the most obvious solution is to make the adoption credit “refundable” against tax, meaning that the excess of the credit value over

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143. *See infra* Table 5.2.

144. *See infra* Table 5.2.

145. *See infra* Table 5.2.

146. *See infra* Table 5.2.

147. *See infra* Table 5.2.

148. *See supra* Part IV.D.1.

149. *See supra* Part IV.D.2.

tax liability is actually paid by the government directly to the taxpayer.<sup>150</sup> In general, refundable tax credits are used today only when the “government wishes to allocate money to achieve a fundamental societal objective.”<sup>151</sup> This is certainly true with the adoption tax credit. The major refundable tax credits in existence today are the earned income tax credit (EITC), the child care credit, and a small health insurance credit.<sup>152</sup> The use of refundable tax credits has increased dramatically since 1986,<sup>153</sup> in part because, as some argue, refundable credits are the most efficient manner of equally distributing tax incentives to all taxpayers.<sup>154</sup>

A refundable adoption tax credit makes sense from an equity standpoint because a credit would apply the same marginal incentive to all taxpayers regardless of rate bracket or filing status. Accordingly, taxpayers who incur adoption expenses would be able to immediately recoup those expenses, regardless of income level.<sup>155</sup>

Refundable tax credits are not without critics, however, who often claim that refundable credits are undesirable as essentially equivalent to a welfare system administered through the Internal Revenue Code.<sup>156</sup> In particular, the EITC has been subject to criticism due to the large amount and frequency of overpayments to taxpayers.<sup>157</sup> A refundable adoption tax credit

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150. A “refundable” credit is so called because the excess of the credit is receivable by the taxpayer after the credit has offset existing income tax liability. See Lily Batchelder, Fred Goldberg, & Peter Orszag, *Efficiency and Tax Incentives: The Case for Refundable Tax Credits*, 59 STAN. L. REV. 23, 27 (2006) (arguing that “refundable credits are the most efficient default form [of credits]”). For a definition of the “Earned Income Credit,” see I.R.S. Explanation of Terms, available at <http://www.irs.gov/pub/irs-soi/06insec4.pdf>.

151. Lisa Milot, *The Case Against Tax Incentives for Organ Transfers*, 45 WILLAMETTE L. REV. 67, 79 (2008).

152. I.R.C. §§ 32, 35, 45F (2006) (respectively).

153. See generally Milot, *supra* note 151, at 78.

154. See generally Batchelder et al., *supra* note 150.

155. For instance, a taxpayer with QAE of \$7,000 but no tax liability would receive a “refund” of \$7,000, thus reducing QAE to zero.

156. See, e.g., Press Release, Republican Study Comm., House Conservatives: “Tax Code Should Not Be The Place For Welfare,” Urge Changes in EITC & Refundable Child Tax Credit (June 11, 2003), available at <http://johnshadegg.house.gov/RSC/PR61103.pdf> (quoting Representative Sue Myrick as stating that “[t]he debate over the ‘refundable child tax credit’ isn’t a debate about a tax issue; it’s a welfare issue”).

157. See Jeffrey M. Jones, *Welfare: The Mother of All Tax Credits*, 2 HOOVER DIG., available at <http://www.hoover.org/publications/digest/3042856.html> (stating that EITC errors resulted in \$8.5 to \$9.9 billion in overpayments for the 1999 tax year and that there was a 30% error rate); Robert Greenstein, Ctr. on Budget & Policy Priorities, *The New Procedures for the Earned Income Tax Credit* 5 (2003), available at <http://www.cbpp.org/5-20-03eitc2.pdf> (stating that, as a result of new Service procedures initiated in 2003, “the

would also lead to a loss of government revenue. Based on these critiques, skeptics of refundable credits in general may be hostile to a refundable adoption credit.

*B. Solution #2: Decrease the Credit and Increase the Exclusion Amount*

Another potential solution to the adoption credit's equity problem is to decrease the amount of available adoption credit, and to increase the amount of adoption assistance excluded from income under § 137. The credit already seems too high because the percentage of claimed credits that were disqualified due to the taxpayer filing a non-taxable return is increasing every year.<sup>158</sup> Quite simply, taxpayers do not have enough tax liability as it is to fully utilize the credit; decreasing the credit, however, would allow taxpayers at the lower- or middle-income ranges to realize the same benefit as higher-income earners. With a carefully chosen credit amount,<sup>159</sup> the government could maximize the number of taxpayers who receive roughly the same benefit. Under such a schema, even families with marginal positive tax liability would receive the identical tax benefit as a higher-income household. If the adoptive family's employer provided monetary adoption benefits, the § 137 exclusion could cover the gap to the extent that adoption expenses exceeded the available credit. Because the value of the exclusion is identical across the income spectrum,<sup>160</sup> decreasing the credit and relying more on the exclusion results in a more equitable benefit distribution paradigm.

This solution presents some significant problems of its own. First, this solution is really a compromise of decreasing the benefit for adoptions, even though expenses often exceed \$5,000, for greater equity among all taxpayers. Second, an adoptive family is not benefited even by a decreased credit amount unless their tax liability exceeds the credit amount. Even a carefully chosen credit amount, as advocated above, will not result in equal distribution of the benefit in the case of a household without tax liability.<sup>161</sup>

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rates at which EITC filers will be subject either to audit or to other documentation requirements and verification procedures will be sharply higher than the rates at which other filers are subject to scrutiny").

158. See *infra* Table 5.2; see also *supra* Part IV.C.

159. The author offers \$5,000 as a prudent amount for the adoption credit.

160. See *infra* Table 3.

161. See *supra* note 96 and accompanying text for a discussion of the number of American households that are either outside of the income tax system or within it solely to collect refunds. Because these households do not have income tax liability, they receive no benefit from the adoption credit.

Third, the most recent statistics indicate that only about 40% of employers offer adoption assistance benefits to their employees.<sup>162</sup> Of the employers that do provide adoption assistance benefits, the average amount of maximum reimbursement offered to employees is approximately \$4,000,<sup>163</sup> or roughly one-third of the amount the taxpayer could receive tax-free from the employer.<sup>164</sup> Thus, the structure of the exclusion is equitable in principle, but its application by private employers is anything but equitable. Under the current system, the only incentives employers receive for offering adoption benefits are goodwill and, for profitable private businesses, a business tax deduction.<sup>165</sup>

The data also suggest that the current exclusion, \$11,650 in 2008, is too low.<sup>166</sup> In 2005, the § 137 exclusion accounted for only 1.7% of all allowed adoption tax benefits.<sup>167</sup> The remainder of allowed adoption tax benefits were allowed under the § 23 credit.<sup>168</sup> The percentage of allowed exclusion benefits as compared to all allowed benefits has decreased every year since indexation began in 2001.<sup>169</sup> This fact, coupled with the increase in credits claimed on non-taxable returns,<sup>170</sup> suggests that taxpayers who rely on the credit despite their lack of tax liability do so because their employer does not provide adoption benefits. Increasing the exclusion amount would provide a greater incentive for employers to offer adoption benefits to their employees because the employee would be able to exclude the amount from income and the business would receive a larger deduction. Because the structure of the exclusion is more equitable than the credit, increased reliance on the exclusion, which is a foreseeable consequence of providing greater incentives for the employer to provide benefits, results in a more equitable distribution of adoption tax benefits.<sup>171</sup>

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162. See Dave Thomas Foundation for Adoption, Adoption-Friendly Workplace: Employer Toolkit, <http://www.davethomasfoundation.org/Adoption-Resources/Free-Materials/Adoption-Benefits>. For data from past years, see Child Welfare Information Gateway, available at [http://www.childwelfare.gov/pubs/f\\_benefi.cfm](http://www.childwelfare.gov/pubs/f_benefi.cfm).

163. Child Welfare Information Gateway, *supra* note 162.

164. See *supra* Part III.B.

165. I.R.C. § 162 (2006).

166. See INTERNAL REVENUE SERVICE, *supra* note 59.

167. See *infra* Table 5.1.

168. See *infra* Table 5.1; see also I.R.C. § 23 (allowing deduction for adoption expenses not covered by employer).

169. See *infra* Table 5.1.

170. See *supra* Part IV.C.

171. Some companies already provide adoption benefits to their employees in excess of the allowed exclusion amount. See Dave Thomas Foundation, Top 100 Best Adoption-Friendly Workplaces, <http://www.davethomasfoundation.org/Our-Work/Adoption-Friendly->

C. *Solution #3: Turn the Exclusion into a Credit for Businesses That Provide Adoption Benefits*

How then can the government increase the rate at which employers offer adoption benefits to their employees? As the above has shown, the exclusion is theoretically more equitable than the adoption credit.<sup>172</sup> But this is only true in practice if more employers provide adoption benefits to their employees.<sup>173</sup> One such method of increasing employer participation is to increase the exclusion amount.<sup>174</sup> Another is for employees to request that their employers provide adoption benefits.<sup>175</sup>

Perhaps the most novel method of increasing employer participation is to create a new tax credit for businesses that provide adoption assistance to their employees. Providing businesses with a tax credit instead of a deduction would directly result in a more equitable distribution of adoption benefits across the income spectrum. Contrary to the existing adoption credit, the value of the exclusion is identical regardless of the employee's income level. Creating a new tax credit for businesses that provide adoption benefits would encourage more employers to offer adoption benefits to their employees.

Businesses would receive a tax credit instead of a deduction for providing adoption assistance benefits. Under the current paradigm, businesses receive a deduction, the value of which is equal to reimbursement provided to the employee multiplied by the business's tax rate. Thus, a business with a 20% marginal rate that provides \$1,000 in adoption assistance benefits receives a \$200 discount in tax liability. But if that same business received a credit instead of a deduction, the business's tax liability would be reduced dollar for dollar according to the amount provided the employee in adoption benefits. Under such a plan, employees

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Workplace. Wendy's International, Inc. was rated the best adoption-friendly workplace in 2008, providing \$23,300 in financial reimbursement to its employees. See [http://www.davethomasfoundation.org/Our-Work/Adoption-Friendly-Workplace/Best-Adoption-Friendly-Workplaces-List-\(1\)/2009\\_BestAdoptionFriendlyWorkplaces](http://www.davethomasfoundation.org/Our-Work/Adoption-Friendly-Workplace/Best-Adoption-Friendly-Workplaces-List-(1)/2009_BestAdoptionFriendlyWorkplaces). These employers still receive a deduction, but the employee must recognize income to the extent that benefits exceed the § 137 exclusion amount. See I.R.C. § 62 (2006) (defining adjusted gross income); *id.* § 162 (allowing business deductions); *id.* § 137 (allowing adoption credits for employees as a business deduction). Increasing the exclusion would reduce income tax consequences for the employees who work for these generous employers.

172. See *infra* Table 5.1.

173. See *supra* Part IV.

174. See *supra* Part V.B.

175. Information kits designed for this purpose are available free of charge through the Dave Thomas Foundation for Adoption at <http://www.davethomasfoundation.org/>.

should retain the ability to exclude from income the adoption benefits. And as with any form of employee benefits, the business could not discriminate in favor of “highly compensated employees.”<sup>176</sup>

A greater percentage of employers would almost certainly offer their employees adoption benefits if they received a credit instead of a deduction. This is because a business with positive tax liability would essentially be faced with two choices: pay the government a tax, or offer that money to employees in the form of adoption benefits.

Understood in conjunction with the societal benefits of adoption,<sup>177</sup> a new business tax credit represents cooperation by the government with private business to subsidize beneficial conduct. Through a new business tax credit, private business would effectively direct the use of what would otherwise be government funds to adoptive families. Although operation of this proposed credit is not as stark as if a business paid \$1,000 to the government in taxes and instructed the government to write a \$1,000 check to the employee on the business’s behalf, the final distribution of resources is the same as if the government were writing checks on behalf of adoptive families.<sup>178</sup> Thus, the government has \$1,000 less than it would without the credit, and the adoptive family has an additional \$1,000.<sup>179</sup>

The value of this proposed credit generally would be the same to the adoptive family as would a direct expenditure program that paid the adoptive family’s expenses.<sup>180</sup> However, because the same level of benefits is provided for each adoption regardless of the adoptive family’s income, this proposed credit would likely have a greater total cost than the existing adoption credit.<sup>181</sup> Other potential problems with this proposed credit include treatment of flow-thru entities. Additionally, non-profit or unprofitable businesses would not have the tax incentive that for-profit businesses would have to offer their employees adoption benefits.

The upside of such a credit is that it fulfills political interests. Both of the major political parties express support for increased adoption programs,<sup>182</sup>

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176. I.R.C. § 401(a)(4).

177. *See supra* Part IV.A.

178. *See generally* Brian H. Jenn, *The Case for Tax Credits*, 61 TAX LAW. 549, 561 (2008).

179. *Id.*

180. A 100% credit reduces tax liability dollar for dollar; thus, the amount of money the government has is identical, regardless of whether the taxpayer receives a credit or the government collects a tax but then distributes out the same amount in a subsidy.

181. Estimating the total cost is beyond the scope of this Comment.

182. *See* Samuels, *supra* note 39.

and both parties could understand the proposed credit as fostering a culture that values vulnerable children and works to create strong families.

The proposed credit might also be understood as an apolitical attempt to reduce the number of abortions in our society.<sup>183</sup> Judge Posner, for instance, has long advocated for the state to directly provide incentives to pregnant women to give their children up for adoption rather than to abort their children.<sup>184</sup> By providing private business an incentive to offer adoption benefits, the proposed credit might contribute to attempts at creating a “culture of life” in our society, thus indirectly furthering Judge Posner’s proposition.

## VI. CONCLUSION

This Comment has demonstrated the inequitable structure of the adoption tax credit. Under the existing paradigm, even families with income above the national median are not able to fully benefit from the adoption credit. This is contrasted with the exclusion-from-income provision, which is equitable across all income ranges. This Comment has explored some alternative methods of resolving this inequality, and ultimately has proposed a new business tax credit that results in a more equitable distribution of adoption benefits at all income levels and that furthers different political and social aims.

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183. The number of reported abortions was 1,220,000 in 2004, the most recent year for which reliable data is available. See Guttmacher Institute 2008 Study: Trends in Characteristics of Women Obtaining Abortions, 1974-2004, available at [http://www.guttmacher.org/pubs/2008/09/18/Report\\_Trends\\_Women\\_Obtaining\\_Abortions.pdf](http://www.guttmacher.org/pubs/2008/09/18/Report_Trends_Women_Obtaining_Abortions.pdf). While abortion is a highly charged political issue, both parties have expressed support for decreasing the frequency of abortion. See REMARKS BY THE SENATOR HILLARY RODHAM CLINTON TO THE NYS FAMILY PLANNING PROVIDERS, Jan. 24, 2005, available at <http://clinton.senate.gov/~clinton/speeches/2005125A05.html> (outlining “a roadmap to the destination of fewer unwanted pregnancies -- to the day when abortion is truly safe, legal, and rare”) (emphasis added); see Samuels, *supra* note 39 (for Republican Platform).

184. Richard A. Posner, *The Regulation of the Market in Adoptions*, 67 B.U. L. Rev. 59, 63 (1987) (“Because of *Roe v. Wade*, the state cannot compel a woman determined to have an abortion to have the baby and give it up for adoption, but it does not follow that the woman should not be given incentives to do so.”).

## TABLES

TABLE 1<sup>185</sup>

MINIMUM ANNUAL GROSS INCOME REQUIRED TO FULLY UTILIZE THE  
MAXIMUM AMOUNT OF THE ADOPTION TAX CREDIT FOR  
ONE ADOPTED CHILD  
(MARRIED COUPLE FILING JOINT TAX RETURN, 2007)<sup>186</sup>

Situation	\$11,650 Adoption Credit	
	Used in One Year	Used Over Six Years <sup>187</sup>
<b>No Other Children</b>		
No Child Care Credit	\$101,250	\$46,350
\$600 Child Care Credit <sup>188</sup>	\$103,650	\$50,350
<b>One Other Child</b>		
No Child Care Credit	\$108,750	\$56,500
\$600 Child Care Credit	\$111,150	\$60,500
\$1,200 Child Care Credit	\$113,550	\$64,500

185. All Tables assume the taxpayer earns the same income across the time included in the analysis and that the standard deduction remains the same as the 2008 level. Because the standard deduction and adoption benefit changes each year, and the taxpayer's income probably changes each year, it is not possible to arrive at exact figures over a five-year present value analysis. Nonetheless, the analysis reveals the general inequity of the adoption tax credit. Moreover, as this Comment has shown, the inequity inherent in the adoption tax credit is likely to be greater in five years time than it is currently.

186. Table 1 assumes taxpayers utilize the married filing jointly status, the standard deduction, the \$1,000 per child tax credit, and the child and dependent care credit. Also, Table 1 assumes that no other credit is available. All numbers were factored according to the following method: the adoption credit (\$11,650) was added to the amount of other credits (\$1,000 child tax credit + \$3,000 child care credit [which results in a \$600 credit] = \$1,600), which equals \$13,250. This is the amount of tax liability needed to fully use the adoption tax credit in one year. In 2008, the amount of taxable income needed to produce a \$13,650 tax liability was \$82,250. See I.R.S. PUBLICATION 678-W, 2008 TAX TABLE, available at <http://www.irs.gov/pub/irs-pdf/i1040tt.pdf>. Add the standard deduction (\$10,900 in 2008) and the exemptions (\$3,500 per individual in 2008), which equals \$21,400. This amount is added to the taxable income arrived at above. Thus, \$82,250 + \$21,400 = \$103,650 is the needed gross income to fully utilize the adoption credit in one year. The same method, with appropriate credits added or excluded, was used to arrive at the other figures.

187. This means a taxpayer must have at least this amount of income in order to realize the full benefit of the adoption tax credit. Taxpayers with less income will not realize the full benefit of the credit due to insufficient tax liability.

188. This is the maximum credit allowed for \$3,000 in expenses, the statutory limit. See I.R.S. FORM 2441, CHILD AND DEPENDENT CARE EXPENSES FORM, available at <http://www.irs.gov/pub/irs-pdf/f2441.pdf>.

TABLE 2

INCOME NEEDED IN 2008 TO FULLY UTILIZE THE ADOPTION TAX CREDIT  
AND ECONOMIC LOSS THAT RESULTS IF TAXPAYER DOES NOT HAVE  
SUFFICIENT INCOME TO UTILIZE THE CREDIT<sup>189</sup>

TABLE 2.1: BENEFIT FULLY UTILIZED IMMEDIATELY

Income: \$101,250 <sup>190</sup>	Adoption Credit Utilized	Outstanding QAE	Remainder Factor	Present Value of Credit	Economic Loss per Year
Year 0	11,650	0	1	11,650	0
Year 1	0	-	-	0	-
Year 2	-	-	-	-	-
Year 3	-	-	-	-	-
Year 4	-	-	-	-	-
Year 5	-	-	-	-	-
Total	11,650	0	-	11,650	0

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189. Table 2 assumes taxpayers utilize the married filing jointly status, the standard deduction, and the \$1,000 per child tax credit, but not the child care credit. Present Value of Credit is determined by multiplying the amount of the Adoption Credit Utilized by the Remainder Factor, which is determined at a 6% rate, according to I.R.S. PUBLICATION 1457, Table B, available at <http://www.irs.gov/pub/irs-pdf/f1457.pdf>. Economic Loss per Year is determined by subtracting the Present Value of Credit from the Adoption Credit Utilized.

190. This number was arrived at in the following manner. First, divide \$11,650 by 1 (the number of years to fully utilize the credit), which equals \$11,650. That is the amount of tax liability needed to cover the adoption credit. To that figure, add \$1,000 child tax credit, which equals \$12,650. In 2008, taxable income of \$79,850 is needed to produce that much tax liability. Add to that figure exemptions (\$10,500) and standard deduction (\$10,900), which equals \$101,250 in gross income needed to utilize the adoption credit in one year.

TABLE 2.2: BENEFIT FULLY UTILIZED BY YEAR 1

Income: 72,250 <sup>191</sup>	Adoption Credit Utilized	Outstanding QAE	Remainder Factor	Present Value of Credit	Economic Loss per Year
Year 0	5,825	5,825	1	5,825.00	0
Year 1	5,825	0	.94	5,475.50	349.50
Year 2	0	-	-	0	-
Year 3	-	-	-	-	-
Year 4	-	-	-	-	-
Year 5	-	-	-	-	-
Total	11,650	0	-	11,300.50	349.50

TABLE 2.3: BENEFIT FULLY REALIZED BY YEAR 2

Income: 59,300 <sup>192</sup>	Adoption Credit Utilized	Outstanding QAE	Remainder Factor	Present Value of Credit	Economic Loss per Year
Year 0	3,883.33	7,766.67	1	3,883.33	0
Year 1	3,883.33	3,883.33	.94	3,650.33	233.00
Year 2	3,883.33	0	.89	3,456.16	427.18
Year 3	0	-	-	0	-
Year 4	-	-	-	-	-
Year 5	-	-	-	-	-
Total	11,650	0	-	10,989.82	660.18

191. This number was arrived at in the following manner. First, divide \$11,650 by 2 (the number of years to fully utilize the credit), which equals \$5,825. That is the amount of tax liability needed to cover the adoption credit. To that figure, add \$1,000 child tax credit, which equals \$6,825. In 2008, taxable income of \$50,850 is needed to produce that much tax liability. Add to that figure exemptions (\$10,500) and standard deduction (\$10,900), which equals \$72,250 in gross income needed to utilize the adoption credit in two years.

192. This number was arrived at in the following manner. First, divide \$11,650 by 3 (the number of years to fully utilize the credit), which equals \$3,883.33. That is the amount of tax liability needed to cover the adoption credit. To that figure, add \$1,000 child tax credit, which equals \$4,883.33. In 2008, taxable income of \$37,900 is needed to produce that much tax liability. Add to that figure exemptions (\$10,500) and standard deduction (\$10,900), which equals \$59,300 in gross income needed to utilize the adoption credit in three years.

TABLE 2.4: BENEFIT FULLY REALIZED BY YEAR 3

Income: 52,850 <sup>193</sup>	Adoption Credit Utilized	Outstanding QAE	Remainder Factor	Present Value of Credit	Economic Loss per Year
Year 0	2,912.50	8,737.50	1	2,912.50	0
Year 1	2,912.50	5,825.00	.94	2,737.75	174.75
Year 2	2,912.50	2,912.50	.89	2,592.13	320.37
Year 3	2,912.50	0	.84	2,446.50	466.00
Year 4	0	-	-	0	-
Year 5	-	-	-	-	-
Total	11,650	0	-	10,688.88	961.12

TABLE 2.5: BENEFIT FULLY REALIZED BY YEAR 4

Income: 48,850 <sup>194</sup>	Adoption Credit Utilized	Outstanding QAE	Remainder Factor	Present Value of Credit	Economic Loss per Year
Year 0	2,330	9,320	1	2,330.00	0
Year 1	2,330	6,990	.94	2,190.20	139.80
Year 2	2,330	4,660	.89	2,073.70	256.30
Year 3	2,330	2330	.84	1,957.20	372.80
Year 4	2,330	0	.79	1,840.70	489.00
Year 5	0	-	-	0	-
Total	11,650	0	-	10,427.80	1,258.20

193. This number was arrived at in the following manner. First, divide \$11,650 by 4 (the number of years to fully utilize the credit), which equals \$2,912.50. That is the amount of tax liability needed to cover the adoption credit. To that figure, add \$1,000 child tax credit, which equals \$3,912.50. In 2008, taxable income of \$31,450 is needed to produce that much tax liability. Add to that figure exemptions (\$10,500) and standard deduction (\$10,900), which equals \$52,850 in gross income needed to utilize the adoption credit in four years.

194. This number was arrived at in the following manner. First, divide \$11,650 by 5 (the number of years to fully utilize the credit), which equals \$2,330. That is the amount of tax liability needed to cover the adoption credit. To that figure, add \$1,000 child tax credit, which equals \$3,330. In 2008, taxable income of \$27,550 is needed to produce that much tax liability. Add to that figure exemptions (\$10,500) and standard deduction (\$10,900), which equals \$48,950 in gross income needed to utilize the adoption credit in five years.

TABLE 2.6: BENEFIT FULLY REALIZED BY YEAR 5

Income: 46,350 <sup>195</sup>	Adoption Credit Utilized	Outstanding QAE	Remainder Factor	Present Value of Credit	Economic Loss per Year
Year 0	1,941.67	9,708.35	1	1,941.67	0
Year 1	1,941.67	7,766.69	.94	1,474.67	116.50
Year 2	1,941.67	5,825.02	.89	1,592.17	213.58
Year 3	1,941.67	3,883.37	.84	1,708.67	310.67
Year 4	1,941.67	1,941.67	.79	1,825.17	408.00
Year 5	1,941.67	0	.75	1,941.67	485.42
Total	11,650	0	-	10,116.10	1,533.92

SUMMARY OF TABLE 2

Income	Years Necessary to Fully Realize Benefit of Adoption Tax Credit	Actual Economic Benefit of the Credit (present value of the credit)
\$101,250 – phase-out amount	Zero	11,650.00
\$101,249 - \$72,250	One	11,300.50
\$72,249 - \$59,300	Two	10,951.00
\$59,299 - \$52,850	Three	10,683.88
\$52,849 - \$48,850	Four	10,427.80
\$48,849 - \$46,350	Five	10,116.10
\$46,349 or less	Benefit not fully utilized	< \$10,000

195. This number was arrived at in the following manner. First, divide \$11,650 by 6 (the number of years to fully utilize the credit), which equals \$1,941.67. That is the amount of tax liability needed to cover the adoption credit. To that figure, add \$1,000 child tax credit, which equals \$2,941.67. In 2008, taxable income of \$24,950 is needed to produce that much tax liability. Add to that figure exemptions (\$10,500) and standard deduction (\$10,900), which equals \$46,350 in gross income needed to utilize the adoption credit in six years.

TABLE 3  
COMPARISON OF VALUE OF ADOPTION CREDIT AND EXCLUSION AT  
VARIOUS INCOME LEVELS, 2008

Income	Value of § 23 Credit	Value of § 137 Exclusion
\$101,250 – phase-out amount	11,650.00	11,650
\$101,249 - \$72,250	11,300.50	11,650
\$72,249 - \$59,300	10,951.00	11,650
\$59,299 - \$52,850	10,683.88	11,650
\$52,849 - \$48,850	10,427.80	11,650
\$48,849 - \$46,350	10,116.10	11,650
\$46,349 or less	< \$10,000	11,650

TABLE 4  
RETURNS CLAIMING THE § 23 ADOPTION TAX CREDIT, 1997 – 2006<sup>196</sup>

	Total returns	Amount	\$0-15,000	\$15,000-30,000	\$30,000-40,000	\$40,000-50,000	\$50,000-75,000	\$75,000-100,000	\$100,000-200,000	\$200,000+
1999	30,721	58,522	3,161	6,264	-	5,373	14,463	508	951	-
1998	40,668	83,046	-	4,936	6,969	7,884	11,896	7,108	1,879	3
1999	47,349	103,016	-	2,924	2,981	7,780	20,653	6,133	6,729	151
2000	42,881	91,888	-	1,898	1,911	7,932	17,142	11,060	2,729	8
2001	47,737	88,781	1,978	2,013	3,305	3,892	15,413	17,869	3,112	156
2002 <sup>197</sup>	66,906	234,109	-	2,010	2,043	4,992	19,216	15,247	12,386	11
2003	63,980	348,793	-	948	5,207	3,856	17,654	17,501	18,797	17
2004	71,136	301,890	-	974	6,947	3,739	19,969	23,706	15,477	324
2005	84,793	319,558	-	3,310	7,829	10,423	26,465	17,525	18,684	546
2006	93,369	351,184	-	2,395	11,922	18,967	98,193	64,195	150,208	5,248

196. This Table was compiled from Internal Revenue Service, *Statistics of Income Complete Year Bulletins*, available at [http://www.irs.gov/taxstats/indtaxstats/article/0,,id=133414,00.html#\\_complete](http://www.irs.gov/taxstats/indtaxstats/article/0,,id=133414,00.html#_complete) (under Table 2, select the link for the appropriate year, which opens an Excel Document). Monetary amounts are in thousands of dollars.

197. This is the first year the Economic Growth and Tax Reconciliation Act of 2001 (EGTRA) applied. EGTRA, Pub. L. No. 107-16, 115 Stat. 38 (2001) (codified in scattered sections of the I.R.C.).

TABLE 5

TAX RETURNS UNDER THE EXISTING ADOPTION BENEFIT SYSTEM<sup>198</sup>

TABLE 5.1: TREASURY DEPARTMENT DATA

Year	Number of Returns with Adoption Expenses	Total Tax Benefit of Adoption Provisions (in thousands of dollars)	Current Year Credit Allowance (foregone revenue)	Current Year Exclusion Allowance (foregone revenue)	% Change From Previous Year in Total Benefits Allowed	Exclusion Benefits as % of Whole
1997	[information not available]					
1998	[information not available]					
1999	45,759	107,997	103,139	4,858	-	4.5
2000	43,902	109,299	106,440	2,859	1.2	2.6
2001	43,614	108,979	105,468	3,511	(.01)	3.3
2002	54,592	245,965	240,636	5,329	56	2.2
2003	57,230	282,561	277,089	5,472	28	1.9
2004	59,664	341,625	335,346	6,279	17	1.8
2005	56,423	361,527	355,319	6,208	5.8	1.7

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198. This Table is compiled from data in DEP'T OF TREASURY, *supra* note 71.

TABLE 5.2: INTERNAL REVENUE SERVICE DATA<sup>199</sup>  
NON-TAXABLE RETURNS

	<b>Total Returns Claiming Adoption Credit</b>	<b>Non-Taxable Returns</b>	<b>Amount of Credit Claimed</b>	<b>Amount Claimed on Non-Taxable Returns</b>	<b>% Amount Claimed on Non-Taxable Returns</b>
1997	30,721	11,688	58,522	32,703	56%
1998	40,668	16,809	83,046	42,772	52%
1999	47,349	10,787	103,016	27,582	27%
2000	42,881	18,933	91,866	55,272	60%
2001	47,737	13,576	88,781	20,020	23%
2002	66,906	22,206	234,109	107,872	46%
2003	63,980	30,924	348,793	179,376	51%
2004	71,136	39,344	301,890	158,616	53%
2005	84,793	52,664	319,558	195,303	61%
2006	93,369		351,184		

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199. This Table was compiled from Internal Revenue Service, *Statistics of Income Complete Year Bulletins*, available at [http://www.irs.gov/taxstats/indtaxstats/article/0,,id=133414,00.html#\\_complete](http://www.irs.gov/taxstats/indtaxstats/article/0,,id=133414,00.html#_complete) (under Table 2, select the link for the appropriate year, which opens an Excel Document).

TABLE 6

INCOME NEEDED IN 2005 TO FULLY UTILIZE THE ADOPTION TAX CREDIT  
AND ECONOMIC LOSS THAT RESULTS IF TAXPAYER DOES NOT HAVE  
SUFFICIENT INCOME TO UTILIZE THE CREDIT<sup>200</sup>

TABLE 6.1: BENEFIT FULLY UTILIZED IMMEDIATELY

Income: \$92,800 <sup>201</sup>	Adoption Credit Utilized	Outstanding QAE	Remainder Factor	Present Value of Credit	Economic Loss per Year
Year 0	10,630	0	1	10,630	0
Year 1	0	-	-	0	-
Year 2	-	-	-	-	-
Year 3	-	-	-	-	-
Year 4	-	-	-	-	-
Year 5	-	-	-	-	-
Total	10,630	0	-	10,630	0

200. Table 6 assumes taxpayers utilize the married filing jointly status, the standard deduction, and the \$1,000 per child tax credit, but not the child care credit. Present Value of Credit is determined by multiplying the amount of the Adoption Credit Utilized by the Remainder Factor, which is determined at a 6% rate, according to I.R.S. PUBLICATION 1457, Table B, *available at* <http://www.irs.gov/pub/irs-pdf/f1457.pdf>. Economic Loss per Year is determined by subtracting the Present Value of Credit from the Adoption Credit Utilized.

201. This number was arrived at in the following manner. First, divide \$10,630 by 1 (the number of years to fully utilize the credit), which equals \$10,630. That is the amount of tax liability needed to cover the adoption credit. To that figure, add \$1,000 child tax credit, which equals \$11,630. In 2005, taxable income of \$73,200 was needed to produce that much tax liability. Add to that figure exemptions (\$9,600) and standard deduction (\$10,000), which equals \$92,800 in gross income needed to utilize the adoption credit in one year.

TABLE 6.2: BENEFIT FULLY UTILIZED BY YEAR 1

Income: \$66,600 <sup>202</sup>	Adoption Credit Utilized	Outstanding QAE	Remainder Factor	Present Value of Credit	Economic Loss per Year
Year 0	5,315	5,315	1	5,315.00	0
Year 1	5,315	0	.94	4,996.10	318.90
Year 2	0	-	-	0	-
Year 3	-	-	-	-	-
Year 4	-	-	-	-	-
Year 5	-	-	-	-	-
Total	10,630	0	-	10,311.10	318.90

TABLE 6.3: BENEFIT FULLY REALIZED BY YEAR 2

Income: \$4,750 <sup>203</sup>	Adoption Credit Utilized	Outstanding QAE	Remainder Factor	Present Value of Credit	Economic Loss per Year
Year 0	3,543.33	7,086.67	1	3,543.33	0
Year 1	3,543.33	3,543.33	.94	3,330.73	212.60
Year 2	3,543.33	0	.89	3,153.56	389.77
Year 3	0	-	-	0	-
Year 4	-	-	-	-	-
Year 5	-	-	-	-	-
Total	10,630	0	-	10,027.62	602.37

202. This number was arrived at in the following manner. First, divide \$10,630 by 2 (the number of years to fully utilize the credit), which equals \$5,315. That is the amount of tax liability needed to cover the adoption credit. To that figure, add \$1,000 child tax credit, which equals \$6,315. In 2005, taxable income of \$47,000 was needed to produce that much tax liability. Add to that figure exemptions (\$9,600) and standard deduction (\$10,000), which equals \$66,600 in gross income needed to utilize the adoption credit in two years.

203. This number was arrived at in the following manner. First, divide \$10,630 by 3 (the number of years to fully utilize the credit), which equals \$3,543.33. That is the amount of tax liability needed to cover the adoption credit. To that figure, add \$1,000 child tax credit, which equals \$4,434.33. In 2005, taxable income of \$35,150 was needed to produce that much tax liability. Add to that figure exemptions (\$9,600) and standard deduction (\$10,000), which equals \$54,750 in gross income needed to utilize the adoption credit in three years.

TABLE 6.4: BENEFIT FULLY REALIZED BY YEAR 3

Income: 48,850 <sup>204</sup>	Adoption Credit Utilized	Outstanding QAE	Remainder Factor	Present Value of Credit	Economic Loss per Year
Year 0	2,657.50	7,972.50	1	2,657.50	0
Year 1	2,657.50	5,315.50	.94	2,498.05	174.75
Year 2	2,657.50	2,657.50	.89	2,365.18	320.37
Year 3	2,657.50	0	.84	2,232.30	466.00
Year 4	0	-	-	0	-
Year 5	-	-	-	-	-
Total	10,630	0	-	9,753.03	876.98

TABLE 6.5: BENEFIT FULLY REALIZED BY YEAR 4

Income: 45,300 <sup>205</sup>	Adoption Credit Utilized	Outstanding QAE	Remainder Factor	Present Value of Credit	Economic Loss per Year
Year 0	2,126	8,504	1	2,126.00	0
Year 1	2,126	6,378	.94	1,998.44	139.80
Year 2	2,126	4,252	.89	1,892.14	256.30
Year 3	2,126	2,126	.84	1,785.84	372.80
Year 4	2,126	0	.79	1,679.54	489.00
Year 5	0	-	-	0	-
Total	10,630	0	-	9,517.96	1,148.04

204. This number was arrived at in the following manner. First, divide \$10,630 by 4 (the number of years to fully utilize the credit), which equals \$2,657.50. That is the amount of tax liability needed to cover the adoption credit. To that figure, add \$1,000 child tax credit, which equals \$3,657.50. In 2005, taxable income of \$29,250 was needed to produce that much tax liability. Add to that figure exemptions (\$9,600) and standard deduction (\$10,000), which equals \$48,850 in gross income needed to utilize the adoption credit in four years.

205. This number was arrived at in the following manner. First, divide \$10,630 by 5 (the number of years to fully utilize the credit), which equals \$2,126. That is the amount of tax liability needed to cover the adoption credit. To that figure, add \$1,000 child tax credit, which equals \$3,126. In 2005, taxable income of \$25,700 was needed to produce that much tax liability. Add to that figure exemptions (\$9,600) and standard deduction (\$10,000), which equals \$45,300 in gross income needed to utilize the adoption credit in five years.

TABLE 6.6: BENEFIT FULLY REALIZED BY YEAR 5

Income: 43,100 <sup>206</sup>	Adoption Credit Utilized	Outstanding QAE	Remainder Factor	Present Value of Credit	Economic Loss per Year
Year 0	1,771.67	8,858.33	1	1,771.67	0
Year 1	1,771.67	7,086.67	.94	1,665.37	106.30
Year 2	1,771.67	5,315.00	.89	1,576.79	194.88
Year 3	1,771.67	3,543.33	.84	1,488.20	283.47
Year 4	1,771.67	1771.67	.79	1,399.62	372.00
Year 5	1,771.67	0	.75	1,328.75	442.92
Total	10,630	0	-	9,230.40	1,399.62

## SUMMARY OF TABLE 6

Income	Years Needed to Fully Utilize Adoption Tax Credit	Actual Economic Benefit of the Credit (PV of Credit)
\$92,800 - phase-out amount	Zero	10,630.00
\$92,799 - \$66,600	One	10,311.10
\$66,599 - \$54,750	Two	10,027.62
\$54,749 - \$48,850	Three	9,753.03
\$48,849 - \$45,300	Four	9,517.96
\$45,299 - \$43,100	Five	9,230.40
\$43,099 or less	Benefit not fully utilized	< 9,230.00

206. This number was arrived at in the following manner. First, divide \$10,630 by 6 (the number of years to fully utilize the credit), which equals \$1,771.67. That is the amount of tax liability needed to cover the adoption credit. To that figure, add \$1,000 child tax credit, which equals \$2,771.67. In 2005, taxable income of \$23,500 was needed to produce that much tax liability. Add to that figure exemptions (\$9,600) and standard deduction (\$10,000), which equals \$43,100 in gross income needed to utilize the adoption credit in six years.