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Amend the Adoption Credit to Acknowledge Jurisdiction of Native American Tribes

PROBLEM

As of fiscal year (FY) 2011, over 104,000 children were waiting to be adopted in the United States.¹ Of the nearly 50,000 children adopted through public agencies that year, some 84 percent were considered to have special needs.² Congress enacted the adoption credit, in part, to defray the costs of adopting these children.³ Between January 1, 2003, and December 31, 2012, a taxpayer adopting a child who has been determined by a State to have special needs could claim an adoption tax credit of \$10,000, plus an inflation adjustment, even if the adoptive parent paid no actual qualified adoption expenses in connection with the adoption (hereafter referred to as the special needs adoption credit). The special needs adoption credit is permanent, although the rules for claiming the credit after 2012 may become more restrictive.⁴

A “child with special needs” is defined as a child whom a State has determined cannot or should not be returned to the home of his parents, and the State has also determined has a specific factor or condition making it reasonable to conclude that placement of the child with adoptive parents requires adoption assistance.⁵ Examples of a specific factor or condition include:

- Ethnic background;
- Age;
- Membership in a minority or sibling group;
- Medical conditions; or
- Physical, mental, or emotional handicaps.⁶

¹ See Children’s Bureau, U.S. Dep’t of Health & Human Services, The AFCARS Report: Preliminary FY 2011 (2011) *available at* <http://www.acf.hhs.gov/sites/default/files/cb/afcarsreport19.pdf>.

² See Children’s Bureau, U.S. Dep’t of Health & Human Services, ACF Report FY 2011 (2011) *available at* http://www.acf.hhs.gov/sites/default/files/cb/special_needs_2011.pdf.

³ See H.R. Rep. No. 107-64, at 13 (2001). At the time this report went to print, the credit was scheduled to sunset at the end of 2012, except for adoptions of children with special needs. See Pub. L. No. 111-312, § 101(b), 124 Stat. 3296, 3298 (2010).

⁴ Absent a legislative change, the adoption credit for children with special needs will revert to the provisions found in § 23 between January 1, 1997, and December 31, 2001. The credit will be capped at \$6,000, the adoptive parents of children who have been determined by a State to have special needs will be required to pay actual qualified adoption expenses, and the credit will be subject to a modified adjusted gross income phaseout that begins at \$75,000 and ends at \$115,000. See Pub. L. No. 104-188, § 1807(a), 110 Stat. 1755, 1899 (1996). For more information about the original version of the adoption credit, see Notice 97-9, 1997-1 C.B. 365 and Notice 1997-7, 1997-2 C.B. 332.

⁵ IRC § 23(a)(2)(B)(3). Note: For tax years (TYs) 2010 and 2011, IRC § 23 was redesignated as IRC § 36C. See Pub. L. No. 111-148, §10909(b)(1)(A), 124 Stat. 119, 1022 (2010).

⁶ IRC § 23(d)(3). For TYs 2010 and 2011, see IRC § 36C(d)(3).

Additionally, a child with special needs must be a citizen or resident of the United States, as defined in section 217(h)(3).⁷

Adoption assistance serves to minimize financial barriers to adoption. If a State determines a child has special needs, the State may provide financial assistance through its own programs, or by accessing federal funding, or both.⁸

In 2010 and 2011, when the adoption credit was refundable,⁹ the IRS required taxpayers who were claiming the special needs adoption credit for a finalized special needs adoption to attach to their paper return both the final adoption order or decree and the State's determination of the child's special needs.¹⁰

The consequence of a State determination of special needs is that the adoptive parents can claim the special needs adoption credit, which permits a credit without payment of actual qualified adoption expenses. Under the IRC, however, a Native American tribal government is treated as a State only if (a) a particular Code section specifically so provides, or (b) the Code section is listed in § 7871. Neither § 23 nor § 7871 provides that a Native American tribal government is to be treated as a State for purposes of the adoption credit. Thus, a determination by a Native American tribal government that a child is a special needs child would not be sufficient to entitle the adoptive parents to a special needs adoption credit. Nor can the State where the tribe is located issue this determination, because the Indian Child Welfare Act (ICWA) grants tribes exclusive jurisdiction over custody proceedings involving Native American children who are domiciled or reside within the reservation of such tribes.¹¹ Consequently, the adoptive parents of a Native American child with special needs cannot claim the special needs adoption credit.¹² Current law harms Native American children with special needs by increasing the cost of their adoptions relative to similarly situated special needs children in States.

⁷ IRC § 217(h)(3) uses the term "United States" to include the possessions of the U.S. (i.e., Guam, American Samoa, the Commonwealth of the Northern Mariana Islands, Puerto Rico, and the Virgin Islands).

⁸ See Children's Bureau, U.S. Dep't of Health and Human Services, Factsheet for Families, Adoption Assistance for Children Adopted From Foster Care (2011), Child Welfare Information Gateway *available at* www.childwelfare.gov/pubs/f_subsid.cfm.

⁹ Section 10909 of the Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119, 1021 (2010) made the adoption credit refundable for 2010 and 2011 and redesignated the section as § 36C for the period the credit was refundable. See Notice 2010-66, 2010-42 I.R.B. 437.

¹⁰ The IRS provided that acceptable documentation of the State's determination of special needs includes (but is not limited to) any of the following: 1) an adoption assistance or subsidy agreement issued by the State or county; 2) certification from the State or county child welfare agency verifying that the child is approved to receive adoption assistance; and 3) certification from the State or county child welfare agency verifying that the child has special needs.

¹¹ 25 U.S.C. § 1911(a).

¹² A taxpayer who adopts a Native American child who resides or is domiciled on a reservation may be able to claim the adoption credit for qualified adoption expenses incurred, but will not be entitled to the special needs adoption credit.

EXAMPLE

The biological parents of a Native American child, who resides on the reservation, are deceased. The child's aunt and uncle, who are also members of the tribe, adopt the child. The Native American tribal government has a health agency that provides a determination letter to the adoptive parents (the aunt and uncle) stating that the child meets one of the special needs factors set out in IRC § 23. The adoptive parents pay no actual qualified adoption expenses, but submit the determination letter in support of their claim of a special needs adoption credit. The absence of a State determination of special needs (as required by § 23(d)(3)(B)), results in the disallowance of the increased special needs adoption credit.

RECOMMENDATION

The National Taxpayer Advocate recommends that Congress amend IRC § 7871(a) to include IRC § 23 in the list of Code sections for which a Native American tribal government is treated as a "State." If an Native American tribal government is treated as a State for purposes of IRC § 23, its determination that a child has special needs would enable adoptive parents to claim the special needs adoption credit, provided that the other requirements of the Internal Revenue Code are met.¹³

PRESENT LAW

The adoption credit, enacted in 1996 and effective in 1997, allowed a nonrefundable tax credit of \$5,000 (\$6,000 in the case of a child with special needs) for qualified adoption expenses paid or incurred in connection with the adoption of an eligible child.¹⁴ In 2001, in an effort to encourage adoption, the maximum amount of the credit was increased to \$10,000 (subject to an inflation adjustment), with the maximum being allowable for both special needs and non-special needs adoptions.¹⁵ However, Congress remained concerned about the number of children with special needs waiting for adoption, and believed its previous attempts to provide incentives for adoption among this particular group were inadequate.¹⁶ In 2002, Congress amended IRC § 23 to permit adoptive parents to claim a special needs adoption credit of \$10,000 regardless of the amount of the expenses paid or incurred with respect to the adoption.¹⁷

¹³ As noted earlier, States may access federal funding under Title IV-E in providing adoption assistance subsidies. Title IV-E funding of Native American tribal governments may differ in some respects from Title IV-E funding of States. See Jack Trope, *Title IV-E: Helping Tribes Meet the Legal Requirements* (Mar. 2010) (working paper developed through the Indian Child Welfare Community of Practice), available at <http://childwelfare.ncaiprc.org> (last visited Dec. 21, 2012).

¹⁴ See Pub. L. No. 104-188, § 1807(a), 110 Stat. 1755, 1899 (1996).

¹⁵ Pub. L. No. 107-16, § 202, 115 Stat. 38, 47 (2001). The \$10,000 amount is adjusted for inflation.

¹⁶ See H.R. Rep. No. 107-64, at 13 (2001).

¹⁷ As a result of the concern for promoting the adoption of special needs children, Congress passed the *Job Creation and Worker Assistance Act of 2002*, Pub. L. No. 107-147, 116 Stat. 21 (2002), and amended IRC § 23(a), which permitted adoptive parents, in addition to being able to claim qualified adoption expenses actually paid or incurred during a taxable year and qualified expenses paid or incurred in all prior taxable years with respect to the adoption, to also claim the difference between the actual expenses incurred and \$10,000 (if any). For an in-depth discussion of the adoption credit see Most Serious Problem: *The IRS's Compliance Strategy for the Expanded Adoption Credit has Significantly and Unnecessarily Harmed Vulnerable Taxpayers, Has Increased Costs for the IRS, and Does Not Bode Well for Future Credit Administration*, *supra*.

For the parent to claim this \$10,000 special needs adoption credit, the following three conditions must be satisfied:

1. A State has determined that the child cannot or should not be returned to the home of his or her parents;
2. A State has determined that the child exhibits a specific factor or condition (such as ethnic background, age, membership in a minority or sibling group, medical conditions, or physical, mental, or emotional handicaps) making it reasonable to conclude that placement of the child with adoptive parents requires adoption assistance; and
3. The child must be a citizen or resident of the United States.¹⁸

If the above requirements are met, the adoptive parent can claim the inflation-adjusted credit of \$10,000 regardless of the expenses the adoptive parent actually paid or incurred. The taxpayer is treated as having paid the qualified adoption expenses with respect to the adoption during the taxable year in which the adoption becomes final, less any qualified adoption expenses previously claimed on the return.¹⁹

As mentioned above, the ICWA generally prevents States from issuing the required determination of special needs for a Native American child. The ICWA was passed by Congress in 1978 in an effort to address growing concerns regarding the removal of Native American children from their families and subsequent placement of those children in non-Native American homes. The ICWA grants tribes exclusive jurisdiction over custody proceedings involving Native American children residing or domiciled on the reservation, such as adoption, so that these decisions are free from States' intrusion. Further, the ICWA establishes uniform standards for placement of Native American children in foster or adoptive homes, including provisions governing parental consent and intervention procedures, tribal court jurisdiction over child placement proceedings, and non-Native American agency priority placement of Native American children with extended family members. The ICWA also authorizes federal grants to Native American tribal governments for family development programs.²⁰

REASON FOR CHANGE

The adoption credit was enacted to mitigate the financial burden experienced by families adopting children as well as to reduce the number of children waiting for adoption.²¹ Congress increased the amount of the credit and permitted adoptive parents to claim a special needs adoption credit of \$10,000 regardless of the amount of the expenses paid or

¹⁸ Under 8 U.S.C. § 1401, Native Americans are citizens of the United States.

¹⁹ IRC § 23(a)(3).

²⁰ 25 U.S.C. § 1911(a). See H.R. Rep. No. 1386, 95th Cong., 2d Sess. (1978). See also, S. 1214, Pub. L. No. 95-608, 92 Stat. 3069 (1978), which stated that the purpose of this act was "To establish standards for the placement of Native American children in foster or adoptive homes, to prevent the breakup of Native American families, and for other purposes."

²¹ H.R. Rep. No. 104-542, pt. 2, at 17 (1996), "[T]he financial costs of the adoption process should not be a barrier to adoptions. In addition, the Committee wishes to further encourage the adoption of special needs children."

incurred with respect to the adoption.²² However, current law prevents parents who adopt a child from a Native American tribal government from claiming the credit crafted for adoptions of special needs children because the special needs determination letter provided by the tribal agency is not acceptable under the Code. Further, the ICWA generally precludes the State in which the tribe is located from issuing the determination letter for a Native American child domiciled or residing on the reservation. Therefore, individuals adopting Native American children with special needs are unfairly excluded from claiming the credit intended for special needs adoptions.

This creates a disparity in the tax law (*i.e.*, taxpayers who adopt a non-Native American special needs child can claim the credit while taxpayers who adopt a special needs child from a Native American tribe cannot) and essentially promotes adoption of one group of children over another. Congress can correct this disparity in the tax law by amending IRC § 7871(a) to refer to IRC § 23, thereby treating tribes as States for purposes of IRC § 23 so that tribal determination letters can be accepted by the IRS. This adjustment would serve the purposes of the ICWA, granting appropriate recognition to tribal determinations in this tax context.

EXPLANATION OF RECOMMENDATION

As IRC § 23 currently reads, the taxpayer must have a State determination before the taxpayer can claim that the adoptive child has special needs. A Native American tribal government is not treated as a State for purposes of IRC § 23. Thus, a determination issued by a Native American tribal government is not acceptable for the purpose of claiming the special needs adoption credit. Further, under the ICWA, the State within which the tribal agency is located is precluded from issuing such a determination for that child. Accordingly, taxpayers who adopt a child from a Native American tribal government cannot claim the credit intended for special needs adoptions. Native American children could be broadly affected, since their ethnicity or minority status might qualify them as having special needs.

Permitting a determination letter from a Native American tribal government to satisfy the requirements under IRC § 23(d)(3)(B) will make the credit for adopting a special needs child more equitable. It will also remove a disadvantage currently experienced by Native American children who are domiciled or reside on a reservation and in need of adoption. It is reasonable to permit the IRS to accept determination letters from the tribal government agency, since the tribal government is situated most favorably to issue the determination letter in a timely, efficient manner. Therefore, the IRS should have the legal authority to accept a determination letter from a Native American tribal government as sufficient substantiation, assuming all other requirements of IRC § 23 are satisfied.

²² See Pub. L. No. 107-16, 115 Stat. 38 (2001) and Pub. L. No. 107-147, 116 Stat. 21 (2002).