

**LEGISLATIVE SERVICES AGENCY  
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS**

301 State House  
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**FISCAL IMPACT STATEMENT**

**LS 7138**

**BILL NUMBER: SB 497**

**DATE PREPARED: Jan 8, 2002**

**BILL AMENDED:**

**SUBJECT:** Adoption Expense Tax Credits.

**FISCAL ANALYST:** Jim Landers

**PHONE NUMBER:** 232-9869

**FUNDS AFFECTED: X GENERAL  
DEDICATED  
FEDERAL**

**IMPACT:** State & Local

**Summary of Legislation:** The bill provides a credit against Adjusted Gross Income (AGI) Tax for adoption-related expenses incurred by a taxpayer who adopts a child. The bill also provides that the credit does not apply to stepparent adoptions. The bill allows a tax credit of not more than \$5,000 for a taxpayer whose household income is \$75,000 or less and gradually reduces the credit for taxpayers with household incomes greater than \$75,000 but less than \$115,000. For each special needs child adopted by a taxpayer in a taxable year, the bill provides a tax credit of not more than \$5,000 against Adjusted Gross Income (AGI) Tax for expenses related to the adoption of the special needs child without regard to the income levels applied to the adoption of a nonspecial needs child.

**Effective Date:** January 1, 2003.

**Explanation of State Expenditures:** The Department of State Revenue (DOR) would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to incorporate this tax credit. These expenses presumably could be absorbed given the DOR's existing budget and resources. Under the bill, the DOR could adopt rules after consultation with the Division of Family and Children to implement this tax credit.

**Explanation of State Revenues:** The bill would reduce state AGI Tax liabilities for individual taxpayers who incur eligible adoption-related expenses. If all taxpayers with eligible adoption expenses claim the maximum allowable credit amount, the revenue loss due to this bill could potentially total as much as \$9.6 M beginning in FY 2004. However, the impact may be less since the state credit is disallowed for regular adoptions if the taxpayer also claims the higher federal adoption credit; or is offset to the extent of the taxpayer's federal adoption credit in the case of special needs adoptions.

The bill establishes two AGI Tax credits for adoption expenses. The Child Adoption Tax Credit is a nonrefundable tax credit equal to the lesser of a taxpayer's adoption-related expenses or \$5,000, for those

taxpayers with household incomes of \$75,000 or less. The tax credit is reduced proportionately for taxpayers with household income exceeding \$75,000 but less than \$115,000. This reduction is based on the proportion of (1) the amount by which household income exceeds \$75,000 to (2) \$40,000. Thus, the tax credit is not allowed for taxpayers with household income of \$115,000 or more. The Special Needs Child Adoption Tax Credit also is a nonrefundable tax credit equal to the lesser of a taxpayer's qualified adoption-related expenses or \$5,000.

The Child Adoption Tax Credit would not be allowed for expenses incurred for the adoption of a child by the child's stepparent or in carrying out a surrogate parenting arrangement. In addition, the Child Adoption Tax Credit would not be allowed: (1) to the extent that adoption expenses are paid by a federal, state, or local program; or (2) if the taxpayer claims a tax credit or deduction for such expenses under any other federal or state law. In contrast, the bill would require that the Special Needs Child Adoption Tax Credit be reduced by an amount equal to any deductions, credits, or funds for adoption expenses the taxpayer is eligible to receive under any state or federal law or program. If the amount of either credit exceeds the taxpayer's liability, the excess credit could be carried forward in subsequent years. The carryforward for the Child Adoption Tax Credit is limited to 15 years, while the carryforward is not limited for the Special Needs Child Adoption Tax Credit. In either case, a taxpayer would not be entitled to a carryback or a refund of any unused credit.

Since the adoption tax credits are effective beginning in tax year 2003, the fiscal impact would begin in FY 2004. Revenue from the Adjusted Gross Income Tax is deposited in the state General Fund.

*Federal Adoption Credit:* Since 1997, federal law has allowed an individual income tax credit for adoption-related expenses. Through tax year 2001, the maximum credit was equal to \$5,000 (\$6,000 for special needs adoptions) and covered adoption-related expenses similar to that covered under the bill. The maximum credit also was phased out for taxpayers earning over \$75,000 and less than \$115,000. However, the phaseout applied to the credit for regular as well as special needs adoptions. The federal credit also is not refundable and may be carried over for only five years. Federal legislation in 2001 made the adoption credit permanent and changed the maximum credit levels and phaseout incomes. Beginning tax year 2002, the maximum credit increases to \$10,000 for regular and special needs adoptions, and the phaseout range increases to \$150,000 to \$190,000. Both the maximum credit level and the income limitation amounts will be inflation-adjusted after 2002.

*Estimation Method:* The National Adoption Information Clearinghouse indicates that adoption filings in Indiana averaged around 3,300 from 1988 to 1997. Research by Fango and Fango (1995) suggests that about 42% of adoptions involve a stepparent and, thus, would be ineligible for the credit. Thus, adoptions eligible for the credit are estimated to total approximately 1,900. Based on information from the Division of Family and Children, about 900 of these could be eligible for the Special Needs credit. Assuming that the maximum credit is claimed for eligible expenses connected with these adoptions, the estimated revenue loss from special needs adoptions would total about \$4.5 M and the estimated revenue loss from other adoptions would total about \$5.1 M. It is important to note that there are a number of factors that may cause the actual impact of the bill to vary from these estimates.

(1) Taxpayers in the phaseout range may decrease the impact of the bill. Since some taxpayers claiming the adoption credit would likely have earnings in excess of \$75,000, the fiscal impact from the Child Adoption Tax Credit could be somewhat less than the estimate above. About 10.5% of 1999 state income tax returns had an adjusted gross income over \$75,000.

(2) The more lucrative federal adoption credit may decrease the impact of the bill. Most taxpayers likely will have a greater incentive to claim the federal adoption credit. This is because most taxpayers likely have a larger federal tax liability, and because the federal adoption credit is greater than the credit proposed in the bill. As a result, the impact of the state credit may be much lower than the maximum estimate outlined above. If a taxpayer claims the federal credit for regular adoption expenses, the Child Adoption Credit is disallowed. In the case of special needs adoption expenses, the Special Needs Child Adoption Credit would be reduced by the amount of the federal credit claimed. Federal tax data for 1997 and 1998 indicates that the average eligible adoption expense exceeded \$6,000, and grew by 5.8% from 1997 to 1998. This suggests that the average eligible adoption expense could equal or exceed \$9,000 when this credit goes into effect and could exceed \$10,000 soon after that. Since taxpayers would be disallowed for the Child Adoption Credit if they utilize the federal adoption credit, this could reduce the impact of this credit well below the \$5.1 M estimate. The impact of the Special Needs Child Adoption Credit also could be reduced by as much as half of the \$4.5 M estimate as federal tax data suggests that the average amount claimed under the federal credit is only about half of the reported eligible adoption expenses. This reduction could arise since the Special Needs credit would be reduced (rather than disallowed) by the amount of the federal adoption credit the taxpayer receives.

(3) The absence of an income limitation on the Special Needs Child Adoption Credit may change the estimated impact of the bill. However, the federal special needs adoption credit may mitigate this impact. Thus, some taxpayers with adjusted gross income over the federal income limit of \$190,000 in 2002 who incur expenses for special needs adoptions may claim the state credit with no offset from the federal income tax credit. However, only 1.3% of 1999 state income tax returns had an adjusted gross income over \$190,000. It is also likely that a portion of these taxpayers would be over the age range of individuals more likely to adopt children.

(4) The carryover provisions for both credits may increase the impact of the bill in future years. Taxpayers claiming these credits may be unable to exhaust them in the first year. The tax credits are not refundable and can not be carried back. But they may be carried over to reduce the taxpayer's liability in subsequent years. Due to the phaseout provision, the maximum allowable Child Adoption Credit generally exceeds the tax liability at about \$90,000 income. Since it is not phased out, the maximum allowable Special Needs Child Adoption Credit generally exceeds the tax liability at about \$150,000. As the credit for such taxpayers will likely be exhausted in the first few years after the adoption expenses are claimed, the potential annual revenue loss may be slightly higher in future years due to the carryover of these credits.

**Explanation of Local Expenditures:**

**Explanation of Local Revenues:**

**State Agencies Affected:** Department of State Revenue.

**Local Agencies Affected:**

**Information Sources:** Amy Brown, FSSA, (317) 232-1149; Sandy Byberg, Statistics of Income Division, U. S. Internal Revenue Service, (202) 874-0453; *2002 U.S. Master Tax Guide*, Commerce Clearing House; National Adoption Information Clearinghouse, *Filing Trends in Adoption, 1988 to 1997*; U.S. Department of the Treasury, *Report to the Congress on Tax Benefits for Adoption*, October 2000.