

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: La Suer Analyst: Darrine Distefano Bill Number: AB 847

Related Bills: See Legislative History Telephone: 845-6458 Amended Date: 04-02-2001

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Child Adoption Credit/Exclusion/Employer Paid Adoption Expenses/Household and Dependent Care Services Credit

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _____.

AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided

AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _____.

FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO _____.

REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED February 22, 2001 STILL APPLIES.

OTHER - See comments below.

SUMMARY

This bill would make changes to the:

- Household and Dependent Care Credit,
- Child Adoption Credit, and
- Exclusion for adoption expenses.

SUMMARY OF AMENDMENTS

The April 2, 2001, amendments added the Child Adoption Credit and employer adoption payment exclusion provisions discussed in this analysis. The remainder of the department's analysis of the Household and Dependent Care Credit provision of the bill, as introduced February 22, 2001, still applies.

CHILD ADOPTION CREDIT AND EXCLUSION

PURPOSE OF THE BILL

According to the author's staff, the intent of this bill is to conform to current federal law and proposed federal legislation and to allow greater tax benefits with respect to adoption costs.

Board Position:

____ S ____ NA ____ NP
____ SA ____ O ____ NAR
____ N ____ OUA ____ X PENDING

Department Director

Date

Alan Hunter for GHG

05/11/01

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would be effective immediately upon enactment. Thus, this bill would apply to taxable years beginning on or after January 1, 2001.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Federal law allows taxpayers to claim a nonrefundable credit for expenses incurred in adopting a child, up to a maximum of \$5,000 per adoption (\$6,000 for a special needs adoption). In addition, taxpayers may exclude from gross income employer contributions toward adoption expenses, up to a maximum of \$5,000 per adoption (\$6,000 for a special needs adoption). The credit and exclusion are phased out for taxpayers with adjusted gross income (AGI) exceeding \$115,000. The \$5,000 credit and the exclusions will not be available for expenses incurred after December 31, 2001. However, the \$6,000 special needs adoption credit is permanent. Any credit unused in the year earned may be carried forward for five years.

Current state law conforms to the federal law allowing employer contributions towards adoption expenses to be excluded from taxation. The state exclusion terminates when the federal law ends on December 31, 2001.

Current state law allows a credit equal to 50% (not to exceed \$2,500) of the costs paid or incurred by the taxpayer to adopt a minor child who is a citizen or legal resident of the United States. The minor child must have been in the custody of a public agency of California or a political subdivision of California. The costs eligible for the Child Adoption Credit include fees for required services of either the Department of Social Services or a licensed adoption agency, costs for travel, and expenses for the adoptive family that are directly related to the adoption process. In addition, medical fees that are not reimbursed by insurance and are directly related to the adoption are qualified expenses.

This credit may be claimed for the taxable year in which the decree or order of adoption is entered.

Any deduction for expenses on which the adoption credit is based is reduced by the amount of the credit allowed.

THIS BILL

This bill would amend the existing Child Adoption Credit to apply only to taxable years beginning before January 1, 2001.

For taxable years beginning on or after January 1, 2001, this bill would add a new Child Adoption Credit for 100% of the qualified adoption expenses paid by the taxpayer for an eligible child or a child with special needs limited to \$10,000 for each adopted child.

This bill also would supplement the adoption assistance exclusion under existing law, which expires December 31, 2001, by adding a new exclusion from gross income for amounts or expenses paid by an employer into a qualified adoption assistance program. The exclusion amount cannot exceed \$10,000 for each adopted child. The federal and existing state exclusion will terminate December 31, 2001. The new state exclusion added by the bill would continue indefinitely. The federal definition of the adoption assistance program will still apply for state purposes.

The credit and exclusion are phased out for taxpayers with AGI exceeding \$150,000, with a complete phaseout of the credit and exclusion for taxpayers with AGI equal to or in excess of \$190,000. This bill increases the exclusion AGI limitations from \$115,000 to \$190,000.

Both the credit and the exclusion from gross income would be adjusted annually for cost of living as determined by federal law.

For both the credit and the exclusion, the bill would define the following:

- “Qualified adoption expenses” are reasonable and necessary adoption fees, court costs, attorney fees, and other expenses, including travel and medical fees not reimbursed by insurance, that are directly related to the adoption of either an eligible child or a child with special needs.
- “Eligible child” is any individual, other than a child with special needs, who is not yet 18, or who is physically or mentally incapable of caring for himself or herself.
- “Child with special needs” is any child whose adoption, without financial assistance, would be unlikely, because of adverse parental background, age, ethnic background, race, color, language, siblings that should not be separated, or a mental, physical, medical, or emotional handicap.

The credit may be claimed in the taxable year in which the decree or order of adoption is entered. However, adoption expenses paid or incurred in prior years may be included in the credit base for the year the credit may be claimed. Also, for expenses in years following the year in which the adoption is final, the credit may be claimed in that year.

Any deduction for expenses on which the adoption credit is based would be reduced by the amount of the credit allowed.

Any unused credit would be carried over indefinitely.

This credit would be allowed to reduce regular tax below tentative minimum tax for purposes of the alternative minimum tax calculation.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

TECHNICAL CONSIDERATIONS

The author may wish to use the state's standard mechanism for inflation adjustment of the credit and the exclusion based on state data and agency action, instead of the federal inflation adjustment which is based on national data and federal agency actions.

LEGISLATIVE HISTORY

SB 1920 (Lewis, Stats. 1994, Ch. 827) enacted the current Child Adoption Credit.

AB 119 (Runner, 1997/1998) would have repealed the Child Adoption Credit and conformed to the federal child adoption credit with modifications. This bill died in Senate Appropriations.

AB 763 (Bates, 1999/2000) would have conformed to the federal child adoption credit with modifications for adoptions that are not eligible for the state Child Adoption Credit. This bill died in Assembly Appropriations.

AB 246 (Bill Campbell, 2001/2002) will amend the existing Child Adoption Credit to increase the credit allowed from 50% to 100% of adoption costs. This bill is currently in the Assembly Revenue & Taxation Committee.

AB 665 (Bates, 2001/2002) will allow a credit for adoption expenses not covered by the current state Child Adoption Credit. This bill is currently in the Assembly Revenue & Taxation Committee.

OTHER STATES' INFORMATION

Massachusetts provides a limited exemption to taxpayers for adoption fees paid to a licensed adoption agency

A review of *Illinois, Michigan, Minnesota, and New York* laws found no comparable tax credits or deductions.

These states were reviewed because of the similarities between California income tax laws and their tax laws.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in revenue gains as shown in the following table:

Fiscal Year Cash Flow Taxable Years Beginning After December 31, 2000 Enactment Assumed After June 30, 2001 \$ Millions			
	2001-02	2002-03	2003-04
New Adoption Credit	-\$5	-\$10	-\$12
Adoption Exclusion	Negligible Loss*	Minor Loss**	Minor Loss**
Dependent Care Credit	\$24	\$23	\$21
Net Revenue Gain	\$19	\$13	\$9

* Loss less than \$250,000

** Loss less than \$500,000

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

The revenue impact for the adoption provision of this bill will be determined by the number of qualified adoptions made during any given taxable year, the average qualifying costs, and the tax liabilities of claimants.

This estimate was developed in the following steps. First, the total number of adoptions by California residents was based on information received from the Department of Social Services. During fiscal year 1998-9, there were approximately 8,270 adoptions in California, of which 5,210 were public agency, 760 private, 1,300 independent, and 1,000 intercountry. Second, the total number of adoptions was increased 5% per year to allow for growth and an incentive effect from both federal and state tax incentives. Third, the average costs vary among these adoptions, \$500 for public, \$7,000 for private, \$21,000 for independent, and \$15,000 for intercountry. The maximum credit under this bill would be \$10,000 per child adopted. It was assumed that the average credit would be equal to the costs paid or incurred, but not to exceed \$10,000. The maximum credit for taxpayers with AGIs between \$150,000 and \$190,000 was estimated to be half of the expenses paid or incurred, but not to exceed \$5,000 due to the AGI phase out. The revenue estimate was adjusted to account for the repeal of the current law credit and deductions.

Currently, California is in conformity with federal law as it relates to the exclusion (not to exceed \$5,000 or \$6,000 for special needs children) from the taxpayer's gross income for expenses paid or incurred by the taxpayer's employer that are incurred on or before December 31, 2001. The revenue shown above takes into account current law and the increased amount that can be excluded from the taxpayer's gross income as stated in the bill.

The discussion in the department's prior revenue analysis for the Household and Dependent Care Credit still applies.

ARGUMENTS/POLICY CONCERNS

By allowing the taxpayer to claim the proposed credit in addition to the exclusion for the same expense, this bill would allow taxpayers to claim multiple tax benefits for the same item of expense.

This bill does not specify a repeal date or limit the number of years for the carryover period for the Child Adoption Credit. Credits typically are enacted with a repeal date to allow the Legislature to review their effectiveness. However, even if a repeal date were added, the department would be required to retain the carryover on the tax forms indefinitely because an unlimited credit carryover period is allowed. Recent credits have been enacted with a carryover period limitation since experience shows credits are typically used within eight years of being earned.

Credits generally are provided as a percentage of amounts paid or incurred. This bill would allow a 100% credit, up to \$10,000 for each adopted child, which is unprecedented.

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