

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Ma/Niello Analyst: Jahna Alvarado Bill Number: AB 47
Related Bills: See Legislative History Telephone: 845-5683 Introduced Date: December 1, 2008
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Child Adoption Costs Credit

SUMMARY

This bill would amend the existing Child Adoption Credit to increase the credit allowed from 50% to 75% of the adoption costs of a qualifying minor child, as specified, provide additional credits of up to \$5,000 for the adoption if that minor child meets certain criteria, and increase the maximum credit from \$2,500 to \$5,000 for that qualified child.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to encourage the adoption of older foster youth.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and, by its terms, is specifically operative for taxable years beginning on or after January 1, 2009.

POSITION

Pending.

ANALYSIS

FEDERAL LAW

Federal law allows taxpayers to claim a nonrefundable credit equal to 100% of the expenses incurred in adopting a child, up to a maximum of \$12,150 (as adjusted for inflation for the 2009 taxable year) per adoption. A taxpayer that adopts a child with special needs qualifies for the maximum amount of the credit without regard to expenses incurred. In addition, taxpayers may exclude from gross income employer contributions toward adoption expenses, up to a maximum of \$12,150 (as adjusted for inflation for the 2009 taxable year) per adoption. The credit and exclusion are phased out for taxpayers with adjusted gross income (AGI) exceeding \$182,180 (as adjusted for inflation for the 2009 taxable year). Any credit unused in the year earned may be carried forward for five years.

Board Position:

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Department Director

Date

Lynette Iwafuchi

03/09/09

STATE LAW

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 and was 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, travel, and expenses for the adoptive family that are directly related to the adoption process. In addition, medical fees not reimbursed by insurance and 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 and can be carried over to succeeding taxable years until exhausted.

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 do the following:

1. Increase the current Child Adoption Credit calculation from 50% to 75% of the costs to adopt a qualifying minor child,
2. Provide an additional credit of up to \$2,500 per qualifying minor child over 12 years of age at the time of adoption, and
3. Provide an additional credit of up to \$2,500 per qualifying minor child living in a group home or residential treatment facility at the time of adoption.

The maximum credit allowed by this bill would be \$5,000 per qualifying minor child.

A qualifying minor child would be defined as any minor child who is a person described in Section 300, 601, or 602 of the Welfare and Institutions Code (WIC) immediately prior to his or her adoption. In general, Section 300 of the WIC describes a child who is within the jurisdiction of the juvenile court due to being at risk of serious physical or emotional harm. Sections 601 and 602 of the WIC, in general, describe a child who is within the jurisdiction of the juvenile court, which may adjudge that child to be a ward of the court, due to the child's persistent or habitual refusal to obey his or her parent or the child's violation of any law of this state.

This bill would apply to taxable years beginning on or after January 1, 2009.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

1. This bill would increase the current Child Adoption Credit for a taxpayer that adopts a minor child who, immediately prior to adoption, meets the description of a person described in Section 300, 601 or 602 of the WIC. Verification of this requirement would be difficult for Franchise Tax Board (FTB) unless the author amends the bill to include certification from an agency such as the Department of Social Services.
2. This bill would provide an additional credit of up to \$2,500 per qualifying minor child living in a group home or residential treatment facility at the time of adoption. This bill lacks a definition for the terms "group home" and "residential treatment facility," which could lead to disagreements between the department and the taxpayer claiming the credit.
3. This bill would provide an additional credit of up to \$2,500 per qualifying minor child who is over 12 years old at the time of adoption and an additional credit of up to \$2,500 if the qualifying child is living in a group home or residential treatment facility at the time of adoption in addition to a credit of 75% of the adoption costs paid or incurred. This may result in a taxpayer claiming a credit in excess of the \$5,000 limit. The author may wish to clarify that the "additional credits" and the credit amount based on adoption costs cannot be combined to exceed \$5,000 per qualifying adoption.

TECHNICAL CONSIDERATIONS

This bill would provide an additional credit of up to \$2,500 per qualifying minor child who is over 12 years old at the time of adoption and an additional credit of up to \$2,500 if the qualifying child is living in a group home or residential treatment facility at the time of adoption. If it is the author's intent to allow only one additional credit amount of up to \$2,500 if the adopted child meets both the age and residence specifications, on page 2, line 12, replace "and" with "or".

This bill refers to a credit being "given". Credits are "allowed." On page 2, line 16 and line 19, replace "given" with "allowed".

LEGISLATIVE HISTORY

AB 246 (Campbell, 2000/2001) would have increased the Child Adoption Credit from 50% to 100% of the taxpayer's costs for adopting a minor child. This bill failed to pass out of the Assembly Revenue & Taxation Committee by the constitutional deadline.

AB 847 (LaSuer, 2000/2001) would have increased the Child Adoption Credit to 100% of the taxpayer's costs, not to exceed \$10,000, for adopting a qualified minor child and increased the income exclusion for adoption expenses paid by the taxpayer's employer to \$10,000 per qualified adoption. This bill failed to pass out of the Assembly Revenue & Taxation Committee by the constitutional deadline.

AB 763 (Bates, 1999/2000) would have repealed the current Child Adoption Credit and conformed to the federal child adoption credit with modifications. This bill failed to pass out of the Assembly Appropriations Committee by the constitutional deadline.

AB 119 (Runner, 1997/1998) would have repealed the current Child Adoption Credit and conformed to the federal child adoption credit with modifications. This bill failed to pass the second house by the constitutional deadline.

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

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws. Except for Michigan and Massachusetts, provisions providing comparable adoption credits or deductions were not located.

Michigan allows a refundable adoption credit for expenses that exceed the amount of the federal adoption credit, or \$1,200 per child, whichever is less.

Massachusetts allows taxpayers to deduct from taxable income the fees paid to an adoption agency to adopt a minor child.

FISCAL IMPACT

This bill would not significantly impact the department's costs if the implementation considerations addressed in this analysis are resolved.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following annual revenue losses beginning in fiscal year 2009-10:

Estimated Revenue Impact of AB 47 Effective for tax years BOA January 1, 2009 Enactment Assumed After 6/30/09		
2009-10	2010-11	2011-12
-\$300,000	-\$550,000	-\$800,000

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

The revenue impact of this bill would depend on the amount of additional adoption credits generated and applied to reduce income tax liabilities. For the 2003-2006 taxable years, adoption credit usage averaged \$2 million annually and was reported on 1,700 tax returns.

Under current law, it is estimated that 9% of credits reported, or \$180,000 (\$2 million x 9%) are for children that would qualify under this bill for the increased credit. Under this bill, the cost-based credit for taxpayers who adopt these children would increase by 50%, or an additional \$90,000 (\$180,000 x 50%). Due to the proposed incentive credit, it is assumed that adoptions of qualified children would increase by 2%, and adoption credits would increase by \$5,400 $[(\$180,000 + \$90,000) \times 2\%]$. The sum of increased adoption credits generated is \$95,400 $(\$90,000 + \$5,400)$. It is assumed that credits would be applied to reduce tax liabilities at a rate of 25% per year.

The adopters of this group of qualified children would also qualify for an additional \$2,500 credit if the child is over 12 and a \$2,500 credit if the child is in a group home or residential care facility at the time of adoption. Assuming each return filed equals one adoption and one \$2,500 credit is claimed, then 156 adoptions would meet this bill's criteria annually $[(1,700 \text{ tax returns} \times 9\% \text{ qualifying children}) + (1,700 \text{ tax returns} \times 9\% \text{ qualifying children} \times 2\% \text{ growth})]$ generating additional new credits of \$390,000 $(\$2,500 \times 156)$.

Currently, an applied adoption credit reduces tax liability, on average, by \$1,182. It is assumed the \$390,000 in additional new credits generated would be used ratably over four years because there would be insufficient tax liability to use all of the credit in the year it was earned.

Based on information from the Department of Health Services, approximately 6,000 children of all ages are adopted in California annually. As indicated previously, approximately 1,700 returns are filed annually reporting an adoption credit leaving 4,300 adoptions with the potential to receive a credit of \$2,500 for qualifying children. Assuming 9% of the children adopted, or 387 children $(4,300 \times 9\%)$, would qualify their adopter for a tax credit of \$2,500, the amount of tax credits generated is \$967,500 $(\$2,500 \times 387)$.

Of the total annual credits generated of \$967,500, it is assumed that half would not be used because the adopter would not have a current or future tax liability to use the credit. Of the approximate \$485,000 $(\$967,500 \times 50\%)$ in credits that would be applied, it's assumed they are used at a rate of 25% each year or \$121,250. For the 2009 taxable year, the sum of additional adoption credits and additional new credits would result in annual loss of \$300,000. Taxable year estimates are converted to fiscal-year estimates in the table above.

LEGISLATIVE STAFF CONTACT

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