

**ANALYSIS OF ORIGINAL BILL**

Author: Runner Analyst: Colin Stevens Bill Number: AB 119

Related Bills: SB 1920 (1993/94) Telephone: 845-3036 Introduced Date: 1-14-97

Attorney: Doug Bramhall Sponsor:

SUBJECT: Adoption Credit

SUMMARY

Under the Personal Income Tax Law (PITL), this bill would allow a \$1,000 credit for each minor child adopted by the taxpayer during the taxable year.

EFFECTIVE DATE

As a tax levy, this bill would take effect immediately upon enactment and would apply to taxable or income years beginning on or after January 1, 1997.

SPECIFIC FINDINGS

**Federal law** provides that taxpayers may 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 between \$75,000 and \$115,000. The credit and exclusions are effective for expenses incurred in taxable years beginning on or after January 1, 1997. 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** provides 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 custody of a public agency of California or political subdivision of California. The costs eligible for 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 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.

DEPARTMENTS THAT MAY BE AFFECTED:

STATE MANDATE  GOVERNOR'S APPOINTMENT

Department Director Position: <input type="checkbox"/> S <input type="checkbox"/> O <input type="checkbox"/> SA <input type="checkbox"/> OUA <input checked="" type="checkbox"/> N <input type="checkbox"/> NP <input type="checkbox"/> NA <input type="checkbox"/> NAR <input type="checkbox"/> PENDING	Agency Secretary Position: <input type="checkbox"/> S <input type="checkbox"/> O <input type="checkbox"/> SA <input type="checkbox"/> OUA <input type="checkbox"/> N <input type="checkbox"/> NP <input type="checkbox"/> NA <input type="checkbox"/> NAR DEFER TO _____	<b>GOVERNOR'S OFFICE USE</b>  Position Approved <input type="checkbox"/> Position Disapproved <input type="checkbox"/> Position Noted <input type="checkbox"/>
Department Director Gerald H. Goldberg 3/11/97	Agency Secretary Date	By: Date:

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

Under the PITL, **this bill** would allow a \$1,000 credit for each minor child adopted by the taxpayer during the taxable year. Only one credit would be allowed for each minor child adopted. Any unused credit would be allowed to be carried forward in succeeding years, until exhausted.

Since this bill does not specify otherwise, this credit would not be allowed to reduce regular tax below tentative minimum tax for purposes of calculating alternative minimum tax.

#### Policy Considerations

Department staff has identified the following policy concerns. The proposed amendment, requested by the author's office, would resolve all but the final policy consideration discussed below.

State law already provides an adoption credit of up to \$2,500 and also allows for deductions based on the medical costs incurred in an adoption. This bill would allow a taxpayer to claim the existing state credit, any allowable deductions and this credit, possibly resulting in a total tax benefit larger than the taxpayer's adoption expenses.

Credits generally are based on the cost of a particular item. As written, the credit amount would be \$1,000 even if the taxpayers have no actual out-of-pocket expenses.

While the author's office has indicated that this bill is intended to provide an incentive for taxpayers to adopt children from within California, it does not require that adoption be from this state or even the United States to qualify for this credit.

The author's office indicated that this credit is intended to provide an incentive for taxpayers to adopt and to lessen the cost of adoption. This credit would allow taxpayers who adopt in 1997 prior to the passage of the credit to claim the credit, providing a benefit to those taxpayers without an incentive effect.

California law currently provides a credit for adoption expenses. This credit would be allowed without modification to the existing credit, possibly causing confusion among taxpayers since they could take this credit or both of the credits, depending upon their circumstances.

Most credits are enacted with a sunset date so the Legislature may review its effectiveness. This credit does not contain a sunset date.

This credit does not limit the number of years which the credit may be carried over.

#### Implementation Considerations

Implementation of this bill could be handled during the department's annual updates.

FISCAL IMPACT

Departmental Costs

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

Tax Revenue Estimate

This proposal is estimated to impact PIT revenue as shown in the following table.

Fiscal Year Cash Flow			
Taxable Years Beginning After December 31, 1996			
Enactment Assumed After June 30, 1997			
\$ Millions			
1997-8	1998-9	1999-0	2000-01
(\$7)	(\$7)	(\$8)	(\$8)

Some credits in any given period would be limited due to tentative minimum tax interaction, but probably not significantly. Additionally, this analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Tax Revenue Discussion

The revenue impact for this bill would be determined by the number of adoptions made during any given taxable year and the average amount of credit applied.

This estimate was developed in the following steps. First, the total number of adoptions by California residents was based on information received from Department of Social Services. During fiscal year 1994-5, there were approximately 6,088 adoptions in California. There were approximately 1,850 independent adoptions, 3,592 agency adoptions and 646 intercountry adoptions. 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 credits. Third, the total number of adoptions was multiplied by \$1,000. Thus, the total credit available would be approximately \$7 million for fiscal year 1997-8 (7,048 x 1,000 = 7,048,000). Fourth, it was assumed that taxpayers who adopt children generally have higher tax liabilities and would be able to use 90% of the credit amount per year. It also was assumed that the unapplied carryover credits would be exhausted in the subsequent year.

POSITION

Neutral.

Department staff's position is determined by administrative considerations and does not take into account revenue impact on the state.

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#  
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FRANCHISE TAX BOARD'S  
PROPOSED AMENDMENTS TO AB 119  
As Introduced January 14, 1997

AMENDMENT 1

On page 1, strike lines 3 through 6 and on page 2, strike lines 1 through 11 and insert:

17053.18 (a) For each taxable year beginning on or after January 1, 1998, and before January 1, 2005, there shall be allowed as a credit against the "net tax," as defined in Section 17039, an amount equal to the qualified costs paid or incurred by a taxpayer for the adoption of any qualified minor child who is adopted by means of an agency adoption or an independent adoption during the taxable year. The credit shall not exceed \$1,000 per minor child.

(b) "Qualified costs" shall include the following:

- (1) Fees for required services of a licensed adoption agency;
- (2) Travel and related expenses for the adoptive family that are directly related to the adoption process;
- (3) Medical fees and expenses that are not reimbursed by insurance and are directly related to the adoption process; and
- (4) Attorney and court fees and expenses directly related to the adoption process.

(c) For purposes of this bill,

- (1) "Qualified minor child" means an unmarried child under 18 years of age on the date of adoption who:
  - (A) was not, for purposes of the credit under Section 17052.25, in the custody of a public agency of this state or a political subdivision of this state;
  - (B) is a citizen or legal resident of the United States and has either been present within the state of California for a period of one year or greater (excluding absences not to exceed 30 days), or, if under one year of age on the date of adoption, was born in California; and
  - (C) was not a natural or adopted child of the spouse of the taxpayer prior to the adoption by the taxpayer.

- (2) "Agency adoption" means an agency adoption as defined in Section 8506 of the Family Code.
- (3) "Independent adoption" means an independent adoption as defined in Section 8524 of the Family Code.
- (d) The credit authorized by this section shall be claimed only for the taxable year in which the decree or order of adoption is entered pursuant to Section 8612 of the Family Code. However, the allowable credit claimed may include any qualified costs of that adoption paid or incurred in any prior taxable year.
- (e) In the case where the credit allowed by this section exceeds the "net tax," the excess may be carried over to reduce the "net tax" in the following year, and succeeding years if necessary, until the credit is exhausted.
- (f) Any deduction or credit otherwise allowed or allowable under this part for any amount paid or incurred by the taxpayer upon which the credit is based shall be reduced by the amount of the credit allowed under this section.
- (g) This section shall remain in effect only until December 1, 2005, and as of that date is repealed.