

COORDINATING ADOPTION TAX BENEFITS: IS THERE A CHOICE?

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ABSTRACT

Previous literature has implied that there can sometimes be a choice between the adoption tax credit and the related exclusion. If so, the difficulty in coordinating these benefits can be immense. This paper discusses the related issues, including the doctrine of constructive receipt, to examine if the assumed choice between the credit and exclusion really exists.

INTRODUCTION

In 1996, legislation was passed which provided for two tax benefits for expenses relating to adopting children—an adoption tax credit and an exclusion from income for employer-paid adoption costs.¹ The 1996 legislation provided for expiration of these benefits at the end of 2001 except for the credit for adoptions of children with special needs. Therefore, additional legislation was enacted in 2001 which expanded and extended these adoption tax benefits.²

As a public and social policy issue, adoption tax benefits have broad bipartisan support. In a recent vote, the U.S. House of Representatives passed a bill which would make the adoption tax benefits permanent. All 414 representatives who voted on the bill voted in favor of it.³ Some of the discussion of this bill in the House of Representatives illustrates the public policy issues

²P.L. 107-16.

³U.S. House. 108th Congress, 2nd Session. H.R. 1057, *The Adoption Tax Relief Guarantee Act*. ONLINE. 23 September 2004. Thomas. Available: <http://thomas.loc.gov/home/r108query.html> [19 January 2005].

involved. Representative Camp from Michigan stated that “The importance of the Adoption Tax Relief Guarantee Act could not be clearer: helping abandoned children find safe, loving, permanent homes. . . . There are over 565,000 children in publicly-funded foster care waiting to be adopted. Even more are in the private system. Cutting the adoption tax credit will make it more difficult to move children out of foster care and into permanent homes. With H.R. 1057, we will permanently put the health and safety of children first and give our Nation’s foster children a fighting chance.”⁴ Representative Pomeroy of North Dakota spoke of the high cost of adoption and indicated that the adoption tax credit “will not cover all of them [the significant costs of adoption] in the great majority of cases” but that the credit “will make a critical difference in allowing families to participate in the miracle of adoption that otherwise would not be available.”⁵ After the issue of the cost of the adoption tax credit was raised, Representative DeMint from South Carolina indicated that the adoption tax credit “is . . . the best investment this country could make, building strong families,” and that the reduction in foster care costs alone would more than offset the cost of the credit.⁶

Additional public policy discussion on this bill focused on some of the emotion-filled issues surrounding adoption. “The adoption tax credits were originally limited to 10 years. No child should have limits placed on their hopes, dreams, and opportunities for the future, and no loving parent willing to take a child in should be denied due to the financial burdens imposed by the adoption process. . . . Money may not be able to buy you love, but in the case of adoptions, it may keep you from it. . . . Temporary is not an

⁴Camp, Rep. [MI]. “The Adoption Tax Relief Guarantee Act.” *Congressional Record* ONLINE 22 September 2004, p. H7376. Thomas. Available: <http://thomas.loc.gov/home/r108query.html> [18 January 2005].

⁵Pomeroy, Rep. [ND]. “The Adoption Tax Relief Guarantee Act.” *Congressional Record* ONLINE 22 September 2004, p. H7378. Thomas. Available: <http://thomas.loc.gov/home/r108query.html> [18 January 2005].

⁶DeMint, Rep. [SC]. “The Adoption Tax Relief Guarantee Act.” *Congressional Record* ONLINE 22 September 2004, p. H7378. Thomas. Available: <http://thomas.loc.gov/home/r108query.html> [18 January 2005].

option for adoption, and it should not be for this tax credit either.”⁷ Representative Brady had similar comments: “. . .without this tax credit. . .we are going to prevent some loving families from occurring. We are going to keep children in foster care who really ought to be in a loving home at night with parents reading to them and providing them with a future. This adoption tax credit is just critical. It ought not to be something that is temporary but permanent that families in our country can count on and encourage.”⁸

The legislation of adoption tax benefits over the past several years has not been without some challenges. Smith and Tew⁹ discuss the adoption tax credit and exclusion, illustrating some of the ironies of the credit and complications of the exclusion. One of the complications mentioned is the difficulty in coordinating the two tax benefits when there is a choice between them. In fact, Smith¹⁰ uses this coordination problem to argue for some changes in the tax policy with respect to adoption tax benefits. The arguments made in these papers presuppose that there can be a choice between (1) the credit, and (2) employer reimbursement and exclusion in certain situations. This paper discusses the merits of this presupposition and examines if the doctrine of constructive receipt would, in essence, remove the assumed choice between the credit and exclusion.

The next section provides a summary of the credit and exclusion along with the related qualifications and limitations. A

⁷Camp, p. H7376.

⁸Brady, Rep. [TX]. “The Adoption Tax Relief Guarantee Act.” *Congressional Record* ONLINE 22 September 2004, p. H7378. Thomas. Available: <http://thomas.loc.gov/home/r108query.html> [18 January 2005].

⁹Smith, Sheldon R. and Glade K. Tew, “Ironies of the Adoption Tax Credit,” *Tax Notes*, Vol. 85, No. 1, October 4, 1999, pp. 83-89 and Smith, Sheldon R. and Glade K. Tew, “The Adoption Exclusion: Complications for Employees,” *Tax Notes*, Vol. 90, No. 5, January 29, 2001, pp. 659-664.

¹⁰Smith, Sheldon R., “Adoption Tax Benefits: Policy Consideration,” *Tax Notes*, Vol. 91, No. 7, May 14, 2001, pp. 1159-1164 and Smith, Sheldon R., “Adoption Tax Benefits: How to Emphasize the Exclusion Before the Credit,” Western Decision Sciences Institute Annual Meeting Proceedings, April 2003.

section then describes the potential for a “choice” between the adoption tax credit and exclusion. That section is followed by a discussion of whether the doctrine of constructive receipt and related issues would be relevant to this situation.

THE ADOPTION TAX CREDIT AND EXCLUSION

Adoption Tax Credit¹¹

The current tax code¹² allows a tax credit of up to \$10,390¹³ for qualifying expenses paid for the adoption of an eligible child.¹⁴ In addition to the dollar limit on the credit, two other limits exist. One is an income limit. The credit phases out for taxpayers with a modified adjusted gross income (AGI) between \$155,860 and \$195,860.¹⁵ The other limit is a tax liability limit. The credit is nonrefundable, but it can reduce both the regular tax and the alternative minimum tax. Because of the large possible dollar amount of the adoption tax credit and the fact that it is nonrefundable, any unused credit can be carried forward for up to five years beyond the original year of the credit.

¹¹IRS Publication 968, “Tax Benefits for Adoption: For use in preparing 2003 Returns, 2003.

¹²I.R.C. §23.

¹³This is the 2004 adoption tax credit limit. The 1996 legislation had a \$5,000 tax credit limit (\$6,000 for the adoption of a child with special needs). The 2001 legislation, which first became effective in 2002, increased the amount to \$10,000 but also provided for indexing of the limit.

¹⁴“Qualifying expenses” and “eligible child” are defined by law. An explanation is included in IRS Publication 968. The credit is available for each adoption effort. If one or more unsuccessful adoption attempts are made before a successful adoption, these attempts count as one effort. For adoptions of domestic children (U.S. citizens or residents), the credit can still be claimed even if the adoption is unsuccessful. The adoption of more than one child will qualify for more than one adoption tax credit.

¹⁵The original 1996 legislation provided for a modified AGI phase-out range between \$75,000 and \$115,000. The 2001 legislation adjusted the range upward so that the lower limit of the range was \$150,000. The range is still \$40,000, but the lower limit to the range is indexed such that it is \$155,860 for 2004.

The timing of the credit depends on whether the adopted child is a domestic child (U.S. citizen or resident) or a foreign child. For domestic adoptions, the credit can be claimed in the year after the year of payment for qualifying expenses made in any year before adoption finalization. For qualifying expenses paid in the year of finalization or after, the credit can be claimed in the year of payment. For foreign adoptions, the credit cannot be claimed unless the adoption is finalized. Therefore, any qualifying expenses paid before or in the year of finalization can be claimed for the credit in the year of finalization.

States determine if an adopted child is a child with special needs. If so, the full \$10,390 credit can be taken, regardless of the amount of adoption expenses paid.¹⁶

The Adoption Exclusion¹⁷

The same legislation which provides for the adoption tax credit also provides for an exclusion from income for adoption costs paid by an employer under an adoption assistance program.¹⁸ Because both tax benefits are available, both can potentially be claimed for the same adoption but not for the same expense. The exclusion is available for employer-paid adoption costs whereas the credit is available for unreimbursed costs. Although employer payments which qualify for the exclusion are not subject to federal income tax, they are still subject to social security and Medicare taxes.¹⁹

The dollar limit on the exclusion is the same as the dollar limit on the credit. The income phase-out range for the exclusion also mirrors the phase-out range for the credit. The timing on the exclusion is slightly different than it is for the credit, at least for

¹⁶This rule was part of the 2001 legislation, but it did not become effective until 2003. The \$10,390 is again the 2004 limit because of indexing.

¹⁷IRS Publication 968, 2003.

¹⁸I.R.C. § 137. The legislation and code define the requirements for an adoption assistance program. These requirements are mentioned in IRS Publication 968.

¹⁹These adoption assistance payments are also subject to federal unemployment taxes for the employer, assuming the maximum has not already been paid for that employee for that year.

domestic adoptions. In these cases, the exclusion is available in the year the employer paid for qualifying adoption expenses under an adoption assistance program. For foreign adoptions, the exclusion is not available until an adoption is final. Therefore, any employer payments prior to or in the year of finalization are not excludable until the year of finalization. For the adoption of a child with special needs, a taxpayer can exclude employer payments (up to the dollar limit) regardless of whether the payments were for qualifying adoption expenses or not. In other words, an employer could choose to pay an adoptive parent employee up to \$10,390 for a 2004 special needs adoption even if no expenses were incurred for the adoption, and the individual could exclude the entire amount from income.²⁰

THE POTENTIAL FOR CHOICE BETWEEN THE CREDIT AND THE EXCLUSION

In some cases, the adoption costs will be so high that adoptive parents would simply want to take as much excludable employer reimbursement as offered (up to the \$10,390 limit) and then claim the entire credit available.²¹ For example, if adoption costs of \$20,000 were incurred and employer reimbursement is available for up to \$5,000, the adoptive parent taxpayer would want to claim the entire \$5,000 of reimbursement/exclusion and

²⁰Since the credit and exclusion for adoptions of children with special needs are not dependent on an amount of adoption expenses, the coordination issues are not really relevant in these situations. Therefore, further discussion will focus on adoptions of children who do not have special needs. In addition, for simplification, further discussion will assume domestic adoptions.

²¹Of course, in some cases, employees would want to take even more employer reimbursement than \$10,390, if offered. For example, if adoption expenses of \$30,000 were incurred and an employer reimbursement of up to \$15,000 were available, the employee would want to take the entire \$15,000 of employer reimbursement. Even though some of it will not qualify for the exclusion, the taxpayer has more than \$10,390 of other, nonreimbursed expenses that will qualify for the credit. A taxable employer reimbursement (for the additional \$4,610 which would not be excludable) is still better than no reimbursement.

also claim the maximum \$10,390 of adoption tax credit. In this case, there is no real coordination necessary.²²

However, in other cases, a potential choice may exist as to whether to claim the credit or the employer reimbursement and exclusion. Depending on the circumstances, adoptive parent taxpayers may prefer one of the adoption tax benefits over the other. Since the credit is a 100% credit, it offers a dollar-for-dollar benefit. The employer reimbursement/exclusion is not a dollar-for-dollar benefit because employer payments are still subject to social security and Medicare taxes. Consequently, adoptive taxpayers may sometimes prefer the credit. In other cases, because of zero or low taxable income with resulting zero or low tax liability, the credit will either be lost, wholly or partially at the end of the five-year carryforward period, or at least take a long time to provide an economic benefit. Therefore, the adoptive taxpayers may sometimes prefer the reimbursement/exclusion.

For example, if an employer has an adoption assistance plan that will pay up to \$15,000 of adoption costs and the adoption costs incurred were exactly \$15,000, it would be in the employee's best interest to claim no more than \$10,390 from the employer so the remaining amount could be claimed through the credit, at least if there is a tax liability to offset with the credit. In some cases, an employee might even want to claim less than \$10,390 from the employer because the credit might be more valuable than the reimbursement/exclusion.

As another example, suppose an employer is willing to reimburse up to \$1,000 of adoption costs and the employee pays \$4,000 of adoption costs. If the taxpayer will otherwise have a tax liability of at least \$4,000 to offset, he/she might prefer to simply forego the employer reimbursement/exclusion and simply take the entire \$4,000 as an adoption tax credit.

²²Actually, a coordination issue could still arise if the employer is willing to reimburse costs prior to finalization. In these cases, an adoptive taxpayer may still need to coordinate which costs to claim for the credit and which to claim for reimbursement/exclusion because of the possible differences in the timing of the two benefits.

Another example arises because of the different timing requirements on the credit and exclusion. If an employer will only reimburse adoption costs after finalization, costs incurred two years before finalization could qualify for the credit one year before finalization but only qualify in the year of finalization for the reimbursement/exclusion. Certainly a taxpayer would not want to wait longer to get the employer reimbursement but would prefer to claim the credit as soon as possible, at least if taxable income will allow “immediate” economic benefit from the credit.

Do these choices really exist for the adoptive parent taxpayers? Or is the adoptive parent taxpayer required to first exhaust all resources available from his/her employer’s adoption assistance program before being eligible for the credit? Would the doctrine of constructive receipt apply if an adoptive taxpayer did not claim some or all of the adoption benefits to which he/she was entitled under his/her employer’s adoption assistance plan?²³ In other words, if the adoptive taxpayer did not claim employer reimbursement for adoption costs that could have been reimbursed through the employer’s adoption assistance plan, would the taxpayer be in constructive receipt of these amounts, thus making these amounts ineligible expenses for the credit?

The Treasury Regulations say, “Gains, profits, and income are to be included in gross income for the taxable year in which they are actually or constructively received by the taxpayer. . . .”²⁴ As a simple example of constructive receipt, assume an employee whose paycheck was ready to be picked up in the usual place at work on December 27, 2003, decided not to pick up the check until January 2, 2004, assuming the income from that check could then be deferred to the 2004 tax year because, under the cash basis, it was not received in 2003. “Income although not actually reduced to a taxpayer’s possession is constructively received by him in the taxable year during which it is credited to his account, set apart for

²³The possible application of the doctrine of constructive receipt for adoption tax benefits was first raised by Eugene Seago in a conversation with the author in February 2004.

²⁴Treasury Regulation §1.451.1(a).

him, or otherwise made available so that he may draw upon it at any time. . . .”²⁵ Because the check was prepared and made available to the employee on December 27, 2003, it was constructively received even though not actually received. Thus, the income would be taxable to the employee in 2003. On the other hand, if the company normally mailed paychecks to employees on the last day of the month, the check mailed on December 31, 2003 and received by the employee in 2004 was not actually or constructively received in 2003 and would not be taxable in 2003.

The following two subsections present issues supporting or opposing the application of the doctrine of constructive receipt with respect to employer adoption benefits. A discussion of these and related issues is then presented in the next section.

Issues Favoring Application of Constructive Receipt for Employer Adoption Benefits

The assumed rational preference for the government in circumstances where there might be a potential choice between the credit and the exclusion for a certain taxpayer would be a preference for the employer payment/exclusion.²⁶ Allowing a 100% credit costs the government more than does granting an equal-dollar-amount exclusion. In addition, adoption costs paid by the employer also raise additional revenue for social security and Medicare taxes.

“The constructive receipt doctrine expands the concept of ‘receipt’ to include items generally made available to the taxpayer provided they are not subject ‘to substantial limitations or restrictions.’”²⁷ Thus, income items that are made available to the

²⁵Treasury Regulation §1.451-2(a).

²⁶Smith (2001, 2003) makes policy proposals which would, in many cases, make the employer reimbursement/exclusion the preferred adoption tax benefit where it is available. These proposals might increase employer participation in paying for adoption costs, reducing the overall cost to the government.

²⁷Butler, Gordon T., “Economic Benefit: Formulating a Workable Theory of Income Recognition,” *Seton Hall Law Review*, Vol. 27, 1996, pp. 70-137 at 76.

taxpayer, even though not actually received by the taxpayer, may be deemed to have been constructively received by the taxpayer and included in that taxpayer's income. "The standard for income recognition under the doctrine of constructive receipt is whether the taxpayer has unfettered discretion over the receipt of income or whether the receipt is subject to restrictions or limitations that are not self-imposed by the taxpayer."²⁸ Perhaps these statements could be used to argue that the doctrine of constructive receipt would apply to employer adoption benefits available but not taken.

A related issue that would argue against a taxpayer choice in terms of adoption tax benefits relates to business expenses that were reimbursable but for which the employee did not seek reimbursement. "It is established that a trade or business deduction is not allowable to the extent that the employee is entitled to reimbursement from his employer,"²⁹ even if the employee did not seek reimbursement. Even if allowed, the deduction would only provide a partial benefit to the employee (based on the employee's marginal tax rate), whereas the reimbursement would make the employee whole. Therefore, it is difficult to understand why an employee would want to intentionally not claim the reimbursement and then try to claim an unreimbursed business expense deduction. In addition, unreimbursed business expenses are included in the items that only provide a benefit for individuals who itemize and then only if they are above 2% of AGI.

Another tax issue that might be used to argue against a choice is the requirement that in calculating the taxable status of the proceeds on the gain of the sale of depreciable property, the basis of the property is reduced by any depreciation allowed or allowable, not just the depreciation taken. In this case, even if the taxpayer does not take the depreciation deduction in prior years does not mean the basis of the asset does not decrease. Although this example is not as directly related as the prior example involving an employer reimbursement, it does illustrate a case where a taxpayer could not intentionally forego a tax advantage

²⁸Butler at 77.

²⁹Crumpton v. Commissioner, TC Memo 1992-117, February 26, 1992.

(depreciation deduction) currently, perhaps with the intent of avoiding depreciation recapture at a later date when the asset is sold.

Issues Opposing Application of Constructive Receipt for Employer Adoption Benefits

The doctrine of constructive receipt is usually applied in cases where the timing, not the existence, of income is the question. The applications that are most common are those where taxpayers attempt to defer income to a future tax year or future tax years. “Thus, the constructive receipt doctrine prevents the taxpayer from deferring income by merely turning his back on it and unilaterally selecting the year of reporting.”³⁰ IRS Revenue Ruling 60-31³¹ discusses five specific cases where taxpayers were attempting to exclude income from certain tax years. However, all of these cases involved deferral of income for tax purposes, not any attempt to avoid income in total. “Income although not actually reduced to a taxpayer’s possession is constructively received by him in the taxable year during which it is credited to his account or set apart for him so that he may draw upon it at any time. However, income is not constructively received if the taxpayer’s control of its receipt is subject to substantial limitations or restrictions.”³² In the case of adoption expenses that could be reimbursed through an employer’s adoption assistance plan, “limitations or restrictions” are present because, before the amounts can be paid or reimbursed by the employer, the employee “must provide reasonable substantiation that payments or reimbursements are for qualifying expenses.”³³ In addition, Revenue Ruling 60-31 states that “it is clear that the doctrine of constructive receipt is to be sparingly used.”³⁴

A court case which provides some support for a tax benefit

³⁰Butler at 77.

³¹Revenue Ruling 60-31, 1960-1 CB 174.

³²Revenue Ruling 60-31.

³³IRS Publication 968, 2003 at 5.

³⁴Revenue Ruling 60-31.

for an unclaimed insurance reimbursement is *Henry L. and Frances O. Hills v. Commissioner of Internal Revenue*.³⁵ In this case, affirmed by the 11th Circuit Court of Appeals, the taxpayers were allowed to deduct a casualty loss from a theft in their vacation home even though they voluntarily elected not to file an insurance claim when the loss would have been covered by their insurance policy. I.R.C. Section 165 says, “There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.”³⁶ One of the arguments of the majority opinion in this case is that the loss was not compensated for by the insurance company. A distinction is made between “not compensated” and “not covered.” Although the loss was covered by the insurance policy, it was not compensated for by the insurance company because no claim was made. Since the loss was not compensated for by the insurance company, it was eligible for the casualty loss deduction. At least in this case, it seems that very straightforward and specific meaning was given to the wording used in the legislation granting a casualty loss deduction.

A choice of different tax benefits for the same tax item is not without precedent. For example, taxpayers may qualify for either a tuition and fees deduction or education credit, but not both, for the same student for the same year.³⁷ Additionally, taxpayers may have a choice between a deduction or a credit for foreign taxes paid.³⁸ Another example involves expenditures which “qualify as both a medical care expense and a dependent care expense (i.e., expenses for household and dependent care services that the taxpayer must pay to be gainfully employed). A taxpayer who incurs an expense that qualifies under both provisions may choose to take either a medical expense deduction or a tax credit”

³⁵*Henry L. and Frances O. Hills v. Commissioner of Internal Revenue*, U.S. Court of Appeals, 11th Circuit, NO. 81-7668, 691 F2d 997, November 15, 1982.

³⁶I.R.C. §165(a).

³⁷IRS Form 1040 and Instructions, 2003.

³⁸IRS Form 1040 and Instructions, 2003.

for dependent care expenses.³⁹ Since choices are sometimes available between alternative tax benefits, it seems reasonable that a choice between the two adoption tax benefits could be available.

It does seem clear that the legislative intent of I.R.C. Sec. 23 (adoption tax credit) and I.R.C. Sec. 137 (adoption exclusion) is to avoid a double benefit. Sec. 23 says, "No credit shall be allowed under subsection (a) for any expense for which a deduction or credit is allowed under any other provision of this chapter."⁴⁰ That section also says, "No credit shall be allowed under subsection (a) for any expense to the extent that funds for such expense are received under any Federal, State, or local program."⁴¹ In addition, for the adoption tax credit "qualified adoption expenses" are defined as "reasonable and necessary adoption fees, court costs, attorney fees, and other expenses. . . which are not reimbursed under an employer program or otherwise."⁴² Of course, employer-reimbursed adoption costs are qualified expenses for purposes of the exclusion.⁴³

However, even though the adoption tax benefit legislation is clearly intended to avoid a double benefit, it makes no implication that one of the adoption tax benefits takes precedence over the other. Had this been the legislative intent, it would have been quite simple and easy to so state that intent.

DISCUSSION

It is not clear whether legislative discussion contemplated the possible application of the doctrine of constructive receipt which would require the exhausting of employer reimbursement before the credit could be claimed. However, it does seem likely that this interpretation is not consistent with legislative intent. While the legislation specifically allows both tax benefits for the

³⁹Pope, Thomas R., Kenneth E. Anderson, and John L. Kramer, eds., *Prentice Hall's Federal Taxation 2004 Individuals*, Prentice Hall, 2004 at 17-33.

⁴⁰I.R.C. §23(b)(3)(A).

⁴¹I.R.C. §23(b)(3)(B).

⁴²I.R.C. §23(d)(1).

⁴³I.R.C. §137(d).

same adoption although not for the same expense, it is silent on requiring the exclusion to be used first. In fact, because of the timing requirements on both the credit and the exclusion, it is quite possible for some adoption costs to qualify for the credit before they would qualify for the exclusion. Since the legislation is quite plain on the different timing requirements, it seems that a specific requirement to take the employer reimbursement first would need to be stated explicitly in the law.

The doctrine of constructive receipt is to be used sparingly.⁴⁴ In addition, it seems that constructive receipt usually depends on a specific amount being set aside or in an account so that it can be drawn on at any time by a specific taxpayer,⁴⁵ not a general benefit available from an employer, if requested, upon provision of appropriate documentation. In addition, the taxpayer's control of the receipt cannot be subject to substantial limitations or restrictions such as would be required to document qualified adoption expenses under an adoption assistance program. Therefore, it seems clear that the doctrine of constructive receipt would not apply in the instance of the availability of adoption benefits which were not claimed so that an adoption tax credit could instead be claimed.

Based on the clear "generous" nature of these adoption tax benefits and that one of them is intended to encourage employer adoption assistance, it seems unlikely that legislative intent would have been to result in the irony illustrated in the following example if the doctrine of constructive receipt were imposed. Suppose two different adoptive parent couples each incur \$20,000 of adoption expenses. Each couple has employer adoption benefits available. Couple A can claim up to \$15,000 of reimbursement, and Couple B can claim up to \$10,000 of reimbursement. If Couple A is "forced" to take \$15,000 of employer benefits, only \$10,390 will be excludable, leaving the other \$4,610 as a taxable benefit and leaving only \$5,000 of unreimbursed expenses available for the credit. On the other hand, Couple B can receive \$10,000 of

⁴⁴Revenue Ruling 60-31.

⁴⁵Revenue Ruling 60-31.

employer benefits, all excludable, leaving \$10,000 of unreimbursed adoption expenses available for the credit. If we assume that the doctrine of constructive receipt would be applied, the more generous adoption benefit package offered by A's employer is actually a detriment leading to less after-tax benefit from the reimbursement/exclusion and adoption tax credit.⁴⁶

The wording defining "qualified adoption expenses" for the adoption tax credit specifically states that they are expenses "which are not reimbursed under an employer program or otherwise."⁴⁷ Had the legislative intent wanted to impose the doctrine of constructive receipt, the wording could easily have said, "which are not reimbursable under an employer program or otherwise." Using the majority opinion in the *Hills v. Commissioner* case⁴⁸ cited earlier which distinguishes "not compensated for by insurance" from "not covered by insurance," it seems equally appropriate to distinguish "not reimbursed under an employer program" from "not reimbursable under an employer program."

IRS Publication 968 for 2003 tax returns indicates, "You may claim both a credit and an exclusion for expenses of adopting an eligible child. For example, you may be able to claim a credit of up to \$10,160 [\$10,390 for 2004] and also exclude up to \$10,160 [\$10,390 for 2004] from your income. However, you cannot claim both a credit and an exclusion for the same expense."⁴⁹ This language seems quite clear but does not prioritize the two tax benefits. In fact, in this statement, the credit is listed first.

⁴⁶Although it seems clear that legislative intent included a reduction of the adoption tax credit claimed by encouraging employer participation through the exclusion, it seems unlikely that the intent would have been to "penalize" adoptive parent taxpayers who had employers with more generous adoption benefits.

⁴⁷I.R.C. §23(d)(1)(D).

⁴⁸*Hills v. Commissioner*.

⁴⁹IRS Publication 968 at 2. The limits in this quote are the 2003 limits, so the 2004 limits were added in brackets. Publication 968 for 2004 returns has not yet been published. It will include the new \$10,390 limits.

No case law could be found to support an argument for or against the application of the doctrine of constructive receipt in this context. The adoption tax benefits are new enough that related cases, if they exist, may still be pending in the court system. In addition, it seems somewhat unlikely that cases will arise in this specific area. First, it would be difficult for the IRS to track benefits not claimed. Although employers must report qualifying adoption expenses paid under an adoption assistance plan on the employee's Form W-2, the employer would have no reason to worry about or track adoption expenses not claimed. Thus, the IRS will have no third-party verification of these expenses. It is unlikely that the IRS will want to specifically audit tax returns with an adoption tax credit claimed to verify if there were employer benefits offered but unclaimed. Thus, even if the doctrine of constructive receipt were relevant, it would be difficult to find and try cases of constructive receipt of adoption benefits from employers. Also, because these tax benefits are motivated, to a great extent, by social policy, it may not be "politically correct" to attempt to try such a case. While political correctness does not define law or legislative intent, it may certainly influence court action by the IRS.

In a phone conversation with the author, Marilyn Brookens, an attorney in the Office of IRS Chief Counsel who works extensively with adoption tax credit issues (although not with the exclusion specifically), indicated that she did not see constructive receipt as an issue for adoption tax benefits.⁵⁰ Of course, this phone conversation was simply a discussion of ideas and did not represent an IRS position. However, she did indicate that the idea of constructive receipt had never crossed her mind with respect to adoption tax benefits. If this issue had been contemplated in legislative intent, it is fairly likely that she would have been aware of it.

Even though the government may be "better off" encouraging one adoption tax benefit over another, in cases where

⁵⁰Brookens, Marilyn, phone conversation with author, February 11, 2004.

taxpayers have a choice, such as the tuition and fees deduction or the education credits, legislators certainly contemplate that taxpayers will choose the option which provides the greatest benefit to the taxpayer, not to the government. In addition, if one tax benefit is to be encouraged or required first, that can easily be stated in the legislation.

CONCLUSION

This paper has examined the potential choice adoptive parent taxpayers may have between the two adoption tax benefits. Prior literature has assumed that this choice exists but has not examined possible arguments to the contrary. One such argument is that the doctrine of constructive receipt would be applied in the case where an adoptive parent taxpayer refused to claim employer reimbursement, where available, so the adoption tax credit could be claimed. The arguments supporting and opposing the doctrine of constructive receipt in this case have been examined. Although the evidence examined does not provide a definitive answer, it does favor the theory that this doctrine would not apply to employer adoption tax benefits. In addition, it seems clear that legislative wording, and therefore legislative intent, does not preclude the choice between the two adoption tax benefits where the potential choice exists.