



Highlights of [GAO-12-98](#), a report to congressional requesters

Why GAO Did This Study

The federal adoption tax credit, established in 1996, was amended in 2010. These amendments included making the credit refundable (meaning taxpayers could receive payments in excess of their tax liability) and increasing the maximum allowable credit to \$13,170 of qualified adoption expenses for tax year 2010. As of August 20, 2011, taxpayers filed just under 100,000 returns, claiming about \$1.2 billion in adoption credits. Following these changes, the Internal Revenue Service (IRS) developed a strategy for processing adoption credit claims. GAO was asked to (1) describe IRS's strategy for ensuring compliance with the adoption credit for the 2011 filing season, (2) assess IRS's related communication with taxpayers and stakeholders, and (3) assess its processing and audit of claims. To conduct its analysis, GAO analyzed IRS data and documents, interviewed IRS officials, observed IRS examiners, and interviewed other stakeholders.

What GAO Recommends

GAO recommends that IRS communicate with state and local adoption officials, provide examiners with examples of adoption assistance agreements, place the agreements on its website, and determine whether sending a letter before initiating an audit would reduce the need for audits.

IRS generally agreed with three of GAO's recommendations, but had concerns that placing sample agreements on its website may enable fraud. However, since other proof of adoption must accompany a tax credit claim, GAO believes the benefits of making these agreements available to adoptive parents outweigh the risks.

View [GAO-12-98](#) or key components. For more information, contact James R. White at (202) 512-9110 or whitej@gao.gov.

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ADOPTION TAX CREDIT

IRS Can Reduce Audits and Refund Delays

What GAO Found

IRS's strategy for ensuring taxpayer compliance with the adoption credit included the following:

- Communicating and reaching out to taxpayers and other stakeholders, including tax professionals and adoption organizations, about new requirements.
- Requiring taxpayers seeking the adoption credit to submit proof of a completed or in-progress adoption with their return. Because taxpayers claiming the credit for a special needs child (meaning that a state determined the child cannot or should not be returned to a parent, and using specified criteria, the state can reasonably assume that the child will not be adopted without state assistance) are allowed to claim the full credit without providing documentation of adoption expenses, they also needed to provide documentation certifying the special needs status of the child.
- Requiring that returns and supporting documentation be filed on paper.
- Automatically sending returns with missing or invalid documentation for correspondence audits (audits that IRS conducts by mail).

To inform taxpayers, paid preparers and other stakeholders about new adoption credit requirements, IRS used various tools including its website, Twitter accounts, and YouTube recordings. However, IRS did not make a specific effort to communicate or convey information about documentation requirements for special needs children to state adoption managers, who administer state adoption programs. Further, IRS did not specify in training materials for its audit examiners what documentation was required to prove special needs status. IRS later revised its training materials to say that a state adoption assistance agreement (an agreement between the state and adoptive parents) was sufficient proof but did not provide samples of such agreements in the materials or place any on its website. As a consequence, taxpayers submitted a majority of returns with either no documentation or insufficient documentation.

As of August 2011, 68 percent of the nearly 100,000 returns on which taxpayers claimed the adoption credit were sent to correspondence audit. However, of the approximately 35,000 returns on which audits have been completed as of August, IRS only assessed additional tax about 17 percent of the time. The equivalent rate for all correspondence audits in 2010 was 86 percent. The time it has taken IRS to audit these predominantly legitimate adoption credit claims has resulted in considerable delays in the payment of the related refunds. For the 2012 filing season, IRS has options that might allow it to reduce the number of costly audits and issue refunds faster while still maintaining a robust enforcement strategy. One option is for IRS to immediately send a letter to taxpayers who submit returns without any documentation requesting it before initiating an audit.

This could potentially reduce the number of audits and delayed refunds, but IRS has not yet determined the extent of this impact. IRS officials acknowledged that data from the 2011 filing season experience should allow them to determine whether sending an initial letter requesting documentation would be more effective than initiating a correspondence audit.