Part IV—Items of General Interest

Finality of Foreign Adoptions

Announcement 2005-45

The Internal Revenue Service has issued Rev. Proc. 2005-31, 2005-27 I.R.B., which finalizes, with modifications, a revenue procedure proposed in Notice 2003-15, 2003-1 C.B. 540 (the proposed revenue procedure). This announcement discusses issues raised by comments received in response to Notice 2003-15 and the modifications to the proposed revenue procedure.

BACKGROUND

Section 23 of the Internal Revenue Code provides a credit for qualified adoption expenses (QAE) paid or incurred in connection with the adoption of an eligible child. Section 137 provides an exclusion from income for employer-provided adoption assistance. Notice 2003-15 proposed a revenue procedure to establish certain safe harbors for determining the finality of the adoption of a foreign-born child who has received an “immediate relative” (IR) visa from the Department of State. The proposed revenue procedure provided:

(1) If the child receives an IR2 or an IR4 visa and enters the United States under a decree of simple adoption, the adoption will be treated as final in the taxable year in which a home state court enters a decree of re-adoption or otherwise recognizes the adoption decree of the foreign-sending country;

(2) If the child receives an IR3 visa, the adoption will be treated as final in the

taxable year in which the competent authority enters the decree of adoption; and

(3) If the child receives an IR4 visa and enters the United States under a guardianship or legal custody arrangement, the adoption will be treated as final in the taxable year in which a home state court enters a decree of adoption.

The Service requested comments on the proposed revenue procedure. Several comments were received.

COMMENTS

Time of finality and alternative provisions

Commentators disagreed that the adoption of a foreign-born child who receives an IR2 visa or who receives an IR4 visa and enters the United States under a decree of simple adoption should be final only upon action of the home state. The commentators suggested that the credit should be available earlier, when the foreign-sending country enters a decree of adoption. The final revenue procedure adopts this suggestion and provides alternative dates of finality for the adoption of a child who receives an IR2 or an IR3 visa, or who receives an IR4 visa and enters the United States under a decree of simple adoption. Taxpayers may treat these adoptions as final for federal income tax purposes:

(a) In the taxable year in which the competent authority enters a decree of adoption; or

(b) In the taxable year in which a home state enters a decree of re-adoption or otherwise recognizes the decree of the foreign-sending country, if that taxable year is one of the next two taxable years after the taxable year in which the competent authority enters the decree.

Retroactivity

A commentator expressed concern that the proposed revenue procedure, if applied retroactively, would require taxpayers who had taken positions inconsistent with the proposed revenue procedure to file amended returns. Specifically, the commentator asserted that many taxpayers whose children received IR4 visas and entered the United States under a decree of simple adoption had claimed the credit in the year the competent authority of the foreign-sending country entered the decree of adoption, rather than in the year that a state court re-adoption occurred. The final revenue procedure permits taxpayers to treat these adoptions as final in the year the competent authority enters the decree of adoption, and permits taxpayers to apply Notice 2003-15 or the final revenue procedure to prior taxable years.

The Intercountry Adoption Act

A commentator questioned whether the proposed revenue procedure would apply after the Intercountry Adoption Act of 2000 (IAA), Pub. L. 106-279, 114 Stat. 825, 42 U.S.C. §§ 14901-14954, implements the 1993 Hague Convention on Protection of Children and Co-operation in Respect of Intercountry Adoption (the Convention). See Senate Treaty Doc. 105-51 (Sept. 20, 2000). In response to this comment, the final revenue procedure states that it does not apply to adoptions for which the Convention and the IAA determine finality.

OTHER MODIFICATIONS TO THE PROPOSED REVENUE PROCEDURE

Treatment of re-adoption expenses as QAE

Section 23(d)(1) and Notice 97-9 define QAE to include reasonable and necessary expenses relating to the legal adoption of an eligible child. In most adoptions

of foreign-born children, the foreign-sending country has entered a decree of adoption before the child has been issued a visa. Many adoptive parents pay or incur expenses in connection with home state re-adoptions of their foreign-born children for practical reasons, such as obtaining a birth certificate issued in English, rather than because re-adoption is required by law. Therefore, the revenue procedure clarifies that otherwise qualified expenses paid or incurred in connection with a re-adoption do not fail the requirement that QAE must be "reasonable and necessary."

Effective date

Notice 2003-15 proposed that the final revenue procedure would be effective for expenses paid or incurred after the date of its publication. The final revenue procedure is effective for QAE paid or incurred after the date of its publication. However, the Service will not challenge the time of finality of adoptions by taxpayers who apply the final revenue procedure or Notice 2003-15 to QAE paid or incurred on or before June 15, 2005, in a taxable year for which the period of limitation under § 6511 has not expired.

DRAFTING INFORMATION

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