

## Adoption Assistance Programs

A qualified adoption assistance program established under Internal Revenue Code § 137 can be offered as a flexible spending account through a cafeteria plan, or it can be offered outside a cafeteria plan arrangement. An adoption assistance program may be funded by the employer, by the employee, or by both on a pretax basis. Through an adoption assistance program, employees may exclude from gross income reimbursements made for their expenses relating to adopting a child.

Any employer can sponsor a qualified adoption assistance program; however, restrictions on eligible participants apply, making former employees and self-employed individuals (such as partners and more than 2 percent shareholders in an S Corporation) ineligible to participate in the plan. The employer determines:

- Whether the adoption assistance program will apply only to employees who finalize the adoption, or also to those with unsuccessful adoption efforts.
- The amount of financial assistance.
- Employee eligibility requirements.

### Program Requirements

A qualified adoption assistance program requires a formal, written plan document and must meet the following four requirements:

- Must benefit all eligible employees, not just those who are “highly compensated.”
- Must not pay more than five percent of its benefits to shareholders or owners (or their spouses or dependents).
- Employer must give reasonable notice of the plan to eligible employees.
- Employees must provide reasonable substantiation that payments or reimbursements are for qualifying adoption expenses.

### Qualified Adoption Expenses

As defined in Internal Revenue Code § 23(d)(1), **qualified adoption expenses** are those deemed necessary and reasonable, such as adoption fees, attorney fees, court costs, and travel expenses that are directly related to and for the principal purpose of the legal adoption of an eligible child. Expenses related to using a surrogate mother or adopting a spouse’s child are sometimes covered by employer programs. Special rules apply for foreign adoptions.

An **eligible child** is any individual who has not reached the age of 18 or is physically or mentally incapable of caring for themselves.

## Tax Treatment

Tax benefits for adoption include both a tax credit for qualified adoption expenses paid to adopt an eligible child and an exclusion from income for employer-provided adoption assistance provided through a qualified adoption assistance program. The Internal Revenue Service (IRS) allows employers to exclude from federal income tax withholding all or some of the reimbursements and payments made to or on behalf of employees who participate in the program. However, the payments are not excluded from Medicare, Social Security, and federal unemployment, or FUTA, taxes.

The IRS establishes an annual maximum tax credit and maximum amount of employer provided adoption assistance that can be excluded from wages as part of an employer provided adoption benefits program, and restricts the full exclusion amount to individuals with a modified adjusted gross income (MAGI) below a certain level. The 2022 maximum exclusion is \$14,890, and individuals with a MAGI over \$223,410 are not allowed to take the full exclusion amount. The 2023 maximum exclusion is \$15,950. The amount excludable from an employee's gross income begins to phase out for individuals with a MAGI in excess of \$239,230 and is completely phased out for individuals with a MAGI of \$279,230 or more.

Employer adoption assistance reimbursement cannot be used for expenses paid with funds from a government program or another organization. Employees may take advantage of both the tax credit and tax exclusion for employer reimbursements; however, the same expenses cannot be used for both. Employees must claim any allowable exclusion before claiming any allowable credit. Expenses used for the exclusion reduce the amount of qualified adoption expenses available for the credit.

## W-2

An employer must report on employees' W-2 forms the total assistance amount the employer paid (or the total expenses the employer incurred) on behalf of each benefiting employee. This amount is reported in Box 12 of the W-2 form, using Alpha Code "T." Do not report qualified adoption assistance benefits as wages in Box 1. The reported total in Box 12 (but not Box 1) should include benefits paid from a cafeteria plan account attributable to an employee's pretax contributions. Because adoption assistance benefits are subject to FICA taxes, employers also must report them as wages in Box 3 (for Social Security tax purposes) and Box 5 (for Medicare tax purposes) of the Form W-2.

## Nondiscrimination Rules

Adoption assistance programs are subject to certain nondiscrimination tests. These tests are:

- **Eligibility test:** The program must benefit employees who qualify under an eligibility classification that does not discriminate in favor of highly compensated employees or their dependents.
- **Concentration Test:** Individuals who own more than five percent of the stock, capital, or profit interest in the employer and their spouses and dependents cannot receive more than five percent of the total benefits under the program.

**Note:** The tests above apply regardless of whether the program is offered through a cafeteria plan. If the program is offered through a cafeteria plan, it must also satisfy the three nondiscrimination tests (eligibility, contributions and benefits, and key employee concentration) required under cafeteria plan rules.



## Official Guidance

[Tax Topic No. 607 Adoption Credit and Adoption Assistance Programs](#) provides additional details regarding qualified adoption assistance programs, adoption credit and qualified adoption expenses.

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