



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

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MEMORANDUM FOR
INTERNAL REVENUE SERVICE

FROM: Lewis J. Fernandez
Deputy Assistant Chief Counsel
(Income Tax & Accounting)

SUBJECT: Tax Treatment of Certain Adoption Assistance Payments

LEGEND:

State =

Department Z =

Section X =

\$v =

\$x =

\$y =

\$z =

This technical assistance responds to your memorandum dated March 10, 1999. You requested our views on the tax treatment of certain adoption assistance payments made by State to adoptive parents of special needs children. Specifically, you have asked (1) whether adoption assistance payments to adoptive parents are taxable income, and (2) whether State must issue a Form 1099 to the adoptive parents.

Technical assistance does not relate to a specific case and is not binding on Examination or Appeals. This document is not to be cited as precedent.

State operates a program under which it makes certain types of adoption assistance payments to adoptive parents of “special needs children.” The payments may be provided to persons who are legally free for adoption, for whom State’s Department Z (“Department”) is legally responsible, who are State residents and who the Department has determined have special needs, which make it reasonable to conclude that the child cannot be adopted without such assistance. The payments are authorized by Section X.

Consistent with the requirements of federal law, State adoption assistance payments are not means-tested. Title IV-E of the Social Security Act, 42 U.S.C. § 674, is a federal grant program that reimburses (in whole or in part) state outlays to adoptive parents for nonrecurring adoption expenses and ongoing child support costs. The federal grant program specifically prohibits states from using means-testing in determining adoptive parents’ eligibility to receive such payments.¹ 45 CFR § 1356.40(c). However, State may consider other circumstances of the adoptive parents and special needs children in determining the types and amounts of assistance under its program. In general, State considers a child a special needs child only if the following conditions are met:

- (1) There has been a judicial determination that either the child is abused, neglected or dependent, or there is probable cause to so believe; and
- (2) The Department has determined that the child will suffer further abuse or neglect or will not be adequately cared for if returned to the parents; and
- (3) There has been an unsuccessful effort to place the child with adoptive parents without providing adoption assistance and the prospective adoptive parents have informed the Department they are not willing or able to adopt the child without adoption assistance;² and
- (4) The child has disabilities that are irreversible, noncorrectable, or correctable with surgery, treatment, or other specialized services, or is at least three years of age, or is a member of a sibling group being placed together if certain other conditions are met.

Section X specifically describes three types of adoption assistance payments that the Department makes. The first type of payment is for the nonrecurring costs of adopting

¹ In fiscal year 1998, State received \$x in adoption assistance grant awards under this program.

² This condition may be waived if the Department determines that alternative adoptive placement is not in the child’s best interests because the child has developed significant emotional ties with the prospective parents while in their foster care.

a child (*e.g.*, adoption fees, court costs, attorney fees), not exceeding \$y per adopted child. ("Nonrecurring Payments").

The second type of payment described in Section X is for the ongoing monthly costs of the child's support ("Ongoing Payments"). The Ongoing Payments are not to exceed the licensed foster care payment level, subject to adjustment every two years, or more frequently based on the changes in the circumstances of the adoptive parents and the needs of the adopted child. The Department determines whether and if to make Ongoing Payments in each individual case by considering the circumstances of the adoptive parents, and the needs, age, and type of placement of the child, adjusted for any benefits the child receives, such as Social Security benefits.

The third type of payment described in Section X is payment for certain medical care costs, not payable through insurance or other public resources that are associated with or result from a condition whose onset occurred prior to completion of the adoption ("Medical Assistance Payments"). State also makes adoption assistance payments when special needs children with pre-existing medical conditions or risk factors require care that was not needed at the time of adoption.

Ongoing Payments and Medical Care Payments are made only if the special needs child has been cared for by a person other than the natural parents for at least one year (except for a disabled child), and the child is eligible for certain state and federal benefits (*e.g.*, SSI benefits).

Currently, State reports the adoption assistance payments it makes in box 7 (nonemployee compensation) of Form 1099-MISC. A recipient of these payments has asked you whether State should be reporting these payments on Form 1099-MISC.

Section 61(a) of the Internal Revenue Code provides the general rule that, except as otherwise provided by law, gross income includes all income from whatever source derived.

However, the Internal Revenue Service has held that payments under legislatively provided social benefit programs for the promotion of general welfare are not includible in an individual's gross income (the general welfare exception). In determining whether the general welfare exception applies to such payments, the Internal Revenue Service generally requires that the payments (1) be made from a governmental general welfare fund; (2) be for the promotion of the general welfare (*i.e.*, on the basis of need rather than to all residents without regard to, for example, financial status, health, educational background, or employment status) and (3) not be made with respect to services rendered by the recipient. Compare Rev. Rul. 76-131, 1976-1 C.B. 16, with Rev. Rul. 98-19, 1998-1 C.B. 840 (relocation payments authorized under § 105(a)(11) of the Housing and Community Development Act of 1974, 42 U.S.C. § 5305(a)(11), made by a local jurisdiction to an individual moving from a flood-damaged residence is in the nature of general welfare and not includible in the individual's gross income under § 61).

In this case, the special needs children have been displaced from their homes because State has determined that they (i) are neglected, abused, or dependent (or there is probable cause to so believe) and (ii) will suffer further abuse or neglect or will not be adequately cared for if they are returned to their parents. The payments, though made to the parents, reimburse the parents for the support and maintenance of the children. Thus, the payments are made from a governmental welfare fund, are based on the needs of the special needs children, and are not for services rendered. Because the payments are intended to reimburse the parents' expenses of promoting the health and well-being of these special needs children, the interposition of the parents as recipients of the payments does not preclude application of the general welfare exception. State's adoption assistance payments made pursuant to Section X are, therefore, not includible in the recipients' gross incomes. Consequently, State should not issue Forms 1099 for adoption assistance payments authorized under Section X that are made directly to the adoptive parents of the special needs children.

We hope this memorandum is responsive to your request. If you have any further questions, please contact _____ at (202) 622-4920.