

What benefits are available under the Adoption Assistance Account?

The Flexible Benefits Plan's Adoption Assistance option provides reimbursement to you for the reasonable and necessary expenses that you incur in the process of legally adopting an eligible child, including adoption fees, court costs, attorney fees and related travel costs. Expenses that are not eligible for reimbursement include expenses incurred in violation of state or federal law, expenses incurred in carrying out a surrogate parenting arrangement, and expenses in connection with the adoption of a step-child. An "eligible child" is a child who has not yet reached age 18 or is physically or mentally incapable of caring for him or herself. Also, the child must be younger than you and must be unmarried. The maximum amount of reimbursement that you may receive in connection with the adoption of any one child is \$13,190 (this \$13,190 will be adjusted for inflation in years after 2014). ***This is a total rather than an annual amount, even if the expenses occur over a period of years.***

What are the tax benefits of reimbursement?

If your adjusted gross income, together with that of a legal Spouse (if married, and filing a joint tax return), is \$197,880 or less, in computing your income tax liability you can exclude from your gross income the entire amount of adoption expense reimbursement you receive under this Plan (subject to the \$13,190 cap). However, if your adjusted gross income exceeds \$197,880 the portion of reimbursement that may be excluded is reduced from \$13,190 based on the following formula (this \$197,880 will be adjusted for inflation in years after 2014):

Allowable exclusion: $\$13,190 - [(\text{adjusted gross income} - \$197,880) / \$40,000] \times \$13,190$

If, for example, your adjusted gross income was \$207,880, and you incurred \$13,190 or more in expenses to adopt a child, your maximum exclusion would be \$9,892.50, calculated as follows:

$$\$13,190 - (\$10,000 / \$40,000 \times \$13,190) = \$13,190 - \$3,297.50 = \$9,892.50$$

That is, \$13,190 in total expenses - \$3,297.50 pre-tax reduction = \$9,892.50 of expenses that may be reimbursed pre-tax.

Generally, any amounts paid to reimburse you for eligible adoption expenses would be excluded from your income for the year of the reimbursement. However, should you adopt a child who is not a citizen or resident of the United States, all amounts reimbursed to you would be excludable from your income only in the year in which the adoption becomes final.

While the amount of your salary that is withheld to pay adoption expenses is excluded from your income in determining your income tax liability, FICA (Social Security) and FUTA (Unemployment) taxes still apply.

What effect will electing the Adoption Assistance Account have on my right to take the adoption expense tax credit on my tax turn?

The federal tax laws also provides a tax credit (reducing federal tax liability) for adoption expenses that are not reimbursed by an employer or paid under a state or federal grant program. The maximum amount of the credit is \$13,190 per adoption (subject to inflation adjustments after 2014). You may claim the credit and receive nontaxable reimbursements from an Adoption Assistance Account in connection with the same adoption, but you may not take a credit and receive reimbursement for the same expense.

Does it make a difference if the child to be adopted is in the United States?

There is a difference between domestic (U.S.) and international adoption in terms of tax consequences. In the case of the adoption of a child who is neither a U.S. citizen nor a U.S. resident, the tax benefits of participating in the benefits option under the flex plan are contingent on, and deferred until, the adoption is finalized. You still choose an election amount based on your projected adoption expenses for that upcoming Plan Year, and you are still reimbursed as you incur expenses and submit claims for reimbursement within that Plan Year. At the end of the Plan Year, the total amount of reimbursement that you received during the Plan Year is debited from your taxable wages for income tax computation purposes (as shown on your W-2), whether or not the adoption became final in that year. However, in the case of an international adoption only, when you file your federal income tax return during the adoption process (Form 1040 series), the amount of the adoption reimbursement benefits you received during the period covered by the return will need to be added back into your taxable income, unless that international adoption proceeding was finalized by the last day of the year. When an international adoption does become finalized, you will be permitted to deduct all of the amounts that you previously had back into your income for the time prior to the adoption being finalized, as per the instructions for your next federal tax return. In contrast, when the child being adopted is a US child, adoption reimbursement amounts received in a particular year are excluded from taxable income for that year whether or not the adoption was final by the end of that year.

The credit must be applied to a different set of expenses than the expenses for which you are reimbursed under the plan. Since the federal tax credit has greater value, a good strategy will be to make sure that you use your credit on your first expenses up to the \$13,190 maximum, and then elect the flex plan adoption benefit only for expenses in excess of the credit amount, and because of the “use-or-lose” rule (see below) that applies to all Flexible Spending Account elections, only for expenses that you are certain to have.

If I make an election for Adoption Assistance benefits now, are any of my expenses from prior years eligible for reimbursement?

No. You can only be reimbursed the adoption expenses for the participating year you have enrolled in. If you make a mid-year benefit election after open enrollment, only expenses that you have after the date of that election will qualify for reimbursement.

Bear in mind, however, that the federal adoption assistance tax credit could allow you to benefit with respect to past expenses. This credit, also with a maximum of \$13,190 per adoption, reduces your federal income tax liability once it has been computed on your Form 1040. The credit is taken on the tax return for the year following the year in which the expenses are incurred, and is subject to the same rule for international adoptions that applies to adoption reimbursement benefits; i.e., tax savings are deferred until the adoption is finalized.

What happens if I have a large adoption expense that is more than the amount credited to my Adoption Assistance Account at the time?

The only funds available for reimbursement at a given time are funds that have already been withheld from your pay based on your election amount and that have not already been used to reimburse for expenses. If you were to submit a claim for more than the amount that is credited to your account you would receive the current account balance, and then, as additional money was withheld from your pay, you would be reimbursed all further benefit payment withholdings until the claim was fully paid.

This contrasts with a Medical Expense Reimbursement Account which, by law, Participants are entitled to

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reimbursement of their entire elected benefit amount from the first day of the Plan Year irrespective of how much has been withheld from pay to date.

What happens if I make an election of Adoption Assistance benefits and then the adoption falls through?

If you had an adoption assistance election in effect for a particular Plan Year, and then the adoption was cancelled, you could stop your election, which includes your payroll withholdings. However, you would not be entitled to a refund of any money that remained in your adoption assistance account. You would forfeit that money.

What happens if I overestimate my Adoption Assistance expenses and have money left over in my Adoption Assistance Account at the end of the plan year?

The use-or-lose-it rule requires that any money that is left over after you've been reimbursed for all of your eligible expenses during a particular plan year must be forfeited. By law, the left over money may not be carried forward into the next Plan Year. That's why any benefit election that you decide to make should be based strictly on expenses that you are certain to have during the Plan Year covered by the election.

What supporting information must I submit with my claims?

P&A must have evidence that you have started an adoption (this would be apparent if you submit a bill from an adoption agency or a document from a court indicating the nature of the judicial proceeding). Also, P&A must be able to see that expenses such as travel costs are related to your adoption proceeding.

How can I make the best use of both my federal adoption expense tax credit and the adoption assistance benefit under the Flexible Benefits Plan?

Because any election for adoption assistance benefits under this Plan should be coordinated with the use of the tax credit, the Administrator strongly recommends that you seek advice from your own tax adviser before electing benefits under the Flexible Benefits Plan. However, a basic strategy to consider that will serve the best interests of most Plan Participants is to make sure that your federal tax credit will be fully utilized on your first set of adoption expenses up to the maximum amount before an election for adoption assistance benefits under this Plan goes into effect.

For example, assume you start an adoption in the middle of a Plan Year. At that time, you are certain to have \$15,000 in adoption expenses before the end of that Plan Year. Since the credit may be applied to the first \$13,190 of your expenses, the appropriate amount of benefits to elect under the Flexible Benefits Plan for the remainder of that Plan Year would be \$1,810 (\$15,000-\$13,190).

P&A Customer Service

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