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Letter Ruling 88-12: Adoption Expenses Qualifying for Exemption Under G.L. c. 62, s. 3(B)(b)(5)

July 21, 1988

The ("Agency") is a licensed Massachusetts adoption agency. You have received several inquiries from prospective adoptive parents about the income tax status of adoption expenses. You ask whether the income exemption under G.L. c. 62, § 3(B)(b)(5) applies to the following specific adoption-related expenses:

1. Home study fee;
2. Agency fee;
3. Legal fees to Agency for formalization of adoption;
4. Fees paid to Agency by adoptive parents for counseling of birth parents;
5. Fees for post-placement follow-up studies of parents which are required by law and paid for by the adoptive parents;
6. Transportation and housing costs of birth mother, paid by the adoptive parents to the Agency;
7. Medical costs of the birth mother, paid to the Agency for payment to medical providers;
8. Other reasonable, related expenses allowed under the law, to be paid to birth mother by adoptive parents; and
9. Travel and other expenses incurred by the adoptive parents, not paid to the Agency, related to the adoption process.

Massachusetts General Laws chapter 62, section 3(B)(b)(5) provides an exemption for individuals against Part B income (i.e. income described by G.L. c. 62, § 2(b)(2)) for: "[a]n amount equal to the fees, in excess of three per cent of the Part B adjusted gross income paid within the taxable year to any agency licensed to place children for adoption by the taxpayer on account of the adoption of a minor child."

By its terms, the statute limits the exemption to: (1) fees paid by a taxpayer; (2) within the taxable year; (3) to an agency licensed to place children for adoption; (4) on account of the adoption of a minor child; (5) to the extent that the qualifying fees exceed three percent of the taxpayer's Part B adjusted gross income. We assume, for the purposes of this ruling, that restrictions (1), (2), and (5) above have been met, and we limit our discussion to restrictions (3) and (4).

We consider restriction (3) first. The statute limits an exemption to "the fees...paid...to any agency licensed to place children for adoption...." Since you state that the Agency is licensed in Massachusetts, the only issue is whether the adoption expenses which you list are actually fees paid to the Agency. In general, amounts paid to compensate the Agency for overhead expenses or for services performed by its agents and employees are fees paid to an agency within the meaning of the statute. Amounts paid to other parties, such as the birth parents, or amounts paid to other parties through the Agency, for services not performed by the Agency, are not "fees...paid...to any agency..." within the meaning of G.L. c. 62, § 3(B)(b)(5), and do not qualify for the exemption.

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Applying this standard to the fees which you have listed, we assume that the adoption agency fee (item "b") is a payment which compensates the Agency for overhead expense and for Agency services. The home study fee, the fees for counseling the birth parents, and the fees for post-placement studies (items "a", "d", and "e") also qualify as payments to the Agency, provided that the respective services are performed by Agency employees or agents. Finally, the legal expenses of the Agency (item "c"), which are ultimately paid by the taxpayer, qualify as fees paid to the Agency under G.L. c. 62, § 3(B)(b)(5), provided that they are expenses properly incurred by the Agency rather than by the taxpayer. For example, if the taxpayer compensates the Agency for the fee of an attorney who appears at an adoption hearing, the fee qualifies as a payment to an agency for income tax purposes if the attorney represented the Agency, but not if the attorney represented the taxpayer. None of the other adoption expenses which you have listed (items "f"- "i") constitute fees paid to an agency for purposes of G.L. c. 62, § 3(B)(b)(5).

We turn to restriction (4) above. Fees paid to a licensed adoption agency qualify for the exemption of G.L. c. 62, § 3(B)(b)(5) only if they are "paid...on account of the adoption of a minor child." Thus, the Agency services for which a fee is paid must be services customarily provided in the adoption process. Under this standard, expenses "a" through "e" on your list all qualify as fees paid on account of the adoption of a minor child provided that they are customary adoption expenses, reasonable in amount, and provided that the taxpayer adopts a minor child. Because the expenses which you list as "f" through "i" are not fees paid to a licensed adoption agency for purposes of G.L. c. 62, § 3(B)(b)(5), we do not consider whether these expenses are related to the adoption of a minor child within the meaning of the statute.

In conclusion, expenses "a" through "e" qualify for the income tax exemption of G.L. c. 62, § 3(B)(b)(5) under the conditions stated in this letter. Expenses "f" through "i" do not qualify for the exemption.

Very truly yours,
/s/Stephen W. Kidder
Stephen W. Kidder
Commissioner of Revenue
July 21, 1988
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