

## Who Benefits From the Dependent Exemption?

By Elaine Maag

The dependent exemption reduces taxable income by a fixed amount (\$3,650 in 2010) for each qualifying child or relative in the family. How much the exemption benefits particular families depends on their marginal tax rate. Low-income families, who would otherwise face a 10 percent tax rate, see a relatively low benefit (a tax reduction of up to \$365 per exemption) compared to high-income families that face a 35 percent tax rate and see a relatively high benefit (a tax reduction of \$1,278 per exemption). Beginning in 1985, the dependent exemption grows annually with inflation.

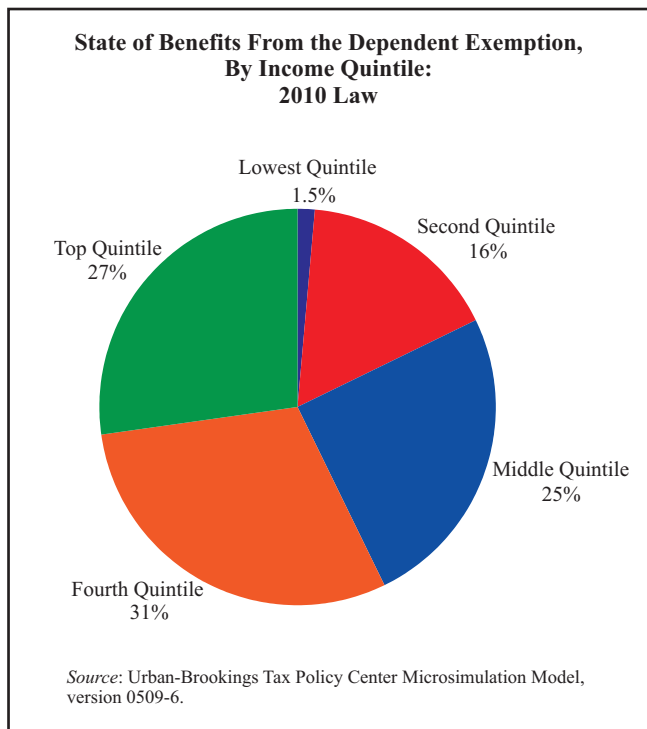
The exemption hasn't always been indexed, and as a percent of per capita income, the dependent exemption has shrunk considerably since its introduction in 1913. At that time, the dependent exemption was set at \$3,000. This resulted in very few people paying taxes. As the value of the exemption declined, relative to personal income, programs like the standard deduction, child tax credit, and the earned income tax credit were created and served as partial replacements for the exemption.

Starting in 1990, the dependent exemption was phased out for families with higher incomes, but since 2006, that phaseout has been reduced. In 2010, the phaseout was removed entirely. Pending legislation removes the phaseout for an additional two years. If it doesn't pass, high-income families will once again not get the full benefit of the exemption.

Complicating matters, the personal exemption is not deductible from income subject to the alternative minimum tax. Every year, the mere presence of children in the family results in large numbers of taxpayers being subject to the complicated AMT. The Tax Policy Center (TPC) estimates that in 2010, 800,000 families will be moved onto the AMT because of the dependent exemption, assuming that

the temporarily higher 2009 AMT exemption levels are extended and indexed — as they have been since 2001 (the AMT patch). Legislation on this issue is pending, but leaders of both parties have promised the AMT patch would pass before the end of the year.

Assuming Congress patches the AMT once more in 2010, the TPC estimates that the dependent exemption will reduce tax liability by \$38 billion, benefiting 48 million families. Benefits from this rather large child subsidy flow mostly to families with relatively high incomes. Among families with children, only 1.5 percent of benefits will accrue to families in the lowest income quintile while 57.1 percent of benefits will accrue to families in the top 40 percent of the income distribution (see figure).



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