Personal Exemption
Not What It Used to Be

By Adam Carasso and C. Eugene Steuerle

The personal exemption, designed to shelter a basic minimum income from taxation, has declined in relative importance over time. In the aggregate, while it grew modestly from $406 billion to $505 billion (in real 2002 dollars) from 1948 to 1999, as a fraction of personal income the exemption has declined precipitously, from 27.3 percent to just 6.3 percent.

The personal exemption for tax year 2002 was $3,000 apiece for taxpayers and their eligible dependents. Thus, an exemption for a taxpayer in the 15 percent bracket was worth $450 in reduced tax (15 percent times $3,000 of exemption) while for a taxpayer in the 38.6 percent bracket it was worth $1,158.

From 1948 to 2002 (see chart), growth in the personal exemption has often been ad hoc, trailing the growth in prices by 50 percent and the growth in per capita personal income by greater than a factor of four. Congressional policy since the 1960s has been more or less to exempt a poverty-level income for individuals and small families through the personal exemption and standard deduction. The exemption was indexed in 1981 for inflation in years after 1984. The increased taxation of poor families with children, as well as the noted declines in the exemption value, led lawmakers to pass the last major increase in the personal exemption in the Tax Reform Act of 1986.1


The personal exemption for dependents by one estimate was once the largest single source of federal spending on children, providing 65 percent of all monies spent in 1960. In recent years it has declined to 16 percent.2 However, child-related tax provisions such as the EITC and the child credit have significantly expanded in recent years. The EITC is now the largest single source of federal spending on children.

While the personal exemption currently phases out at high incomes,3 the 2001 tax cut will repeal this phase-out by 2010. However, since the exemption is treated as a “preference” item under the alternative minimum tax, it will effectively phase out at lower incomes for a large and rapidly growing number of taxpayers anyway.4

3This phaseout, referred to as “PEP,” is at a 2 percent rate beginning at $132,950 for singles and $199,450 for couples.