Personal Exemption
Not What It Used to Be

By Adam Carasso and
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The personal exemption, designed to shelter a basic
minimum income from taxation, has declined in rela-
tive 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 per-
sonal 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 stan-
dard deduction. The exemption
was indexed in 1981 for infla-
tion in years after 1984. The in-
creased taxation of poor
families with children, as well
as the noted declines in the ex-
emption value, led lawmakers
to pass the last major increase
in the personal exemption in
the Tax Reform Act of 1986.1

1See J. A. Pechman, Federal Tax
Policy, 5th Edition, Washington, DC:
81-86.

The personal exemption for dependents by one es-
timate 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 ex-
panded 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

2See C. E. Steuerle, R. Clark, R. B. King, and C. Spiro,
the New Federalism, Occasional Paper No. 45, Urban In-
3This phaseout, referred to as “PEP,” is at a 2 percent rate
beginning at $132,950 for singles and $199,450 for couples.
4See L. Burman, W. Gale, J. Rohaly, and B. Harris, “The
AMT: Out of Control,” Urban-Brookings Tax Policy Center,
Brief No. 5, September 2002.

1See J. A. Pechman, Federal Tax
Policy, 5th Edition, Washington, DC:
81-86.