



Tax Policy Center
Urban Institute and Brookings Institution

THE TAX POLICY

BRIEFING BOOK

*A Citizens' Guide for the
2008 Election and Beyond*

TAXATION AND THE FAMILY

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Taxation and the Family: What is the personal exemption?

Personal exemptions provide that only a person's income above some defined basic level is subject to tax. They thus help ensure that the poorest of the poor pay little if any income tax. The personal exemption has been a basic feature of the modern individual income tax since it was enacted. In 1913 it was set at \$3,000 (equivalent to \$66,937 in 2011 dollars), so that very few persons were expected to pay tax. The 2011 personal exemption, at \$3,700, is substantially lower in real terms, but the tax code has added other features since 1913, such as the standard deduction and various tax credits, that have partly offset the exemption's decline in value.

- The value of the personal exemption depends on an individual's marginal tax rate. For instance, a single taxpayer who would otherwise owe 15 percent on his or her first \$3,700 of income saves \$555, whereas a single taxpayer in a 35 percent bracket saves \$1,295. Thus, under a progressive income tax, exemptions are worth more to upper-income filers than to low-income filers. The rate structure itself can, however, be adjusted to compensate for that effect and achieve any desired degree of progressivity.
- Since 1990, the personal exemption has been phased out at higher income levels. Current tax law reduces the phase-out for the 2006-09 tax years and removes it entirely in 2010, 2011, and 2012 before returning it to full force in 2013.
- The alternative minimum tax (AMT) denies taxpayers the use of personal exemptions. As a result, larger families are more likely to owe AMT than smaller families.
- In 2008 tax filers reported \$8 trillion in adjusted gross income (AGI) and claimed \$981 billion in personal exemptions (although not all exemptions could be fully used to reduce tax). Returns that owed tax reported \$7.6 trillion of that AGI and claimed personal exemptions totaling \$592 billion.

See Also

Taxation and the Family: [Has the personal exemption kept up with prices and incomes?](#)

Data Sources

[Individual Income Tax Parameters \(Including Brackets\), 1945-2011](#)

TPC Tax Facts: Personal Exemption and Standard Deduction 2008

Authors: Adam Carasso and C. Eugene Steuerle

Last Updated: July 22, 2011

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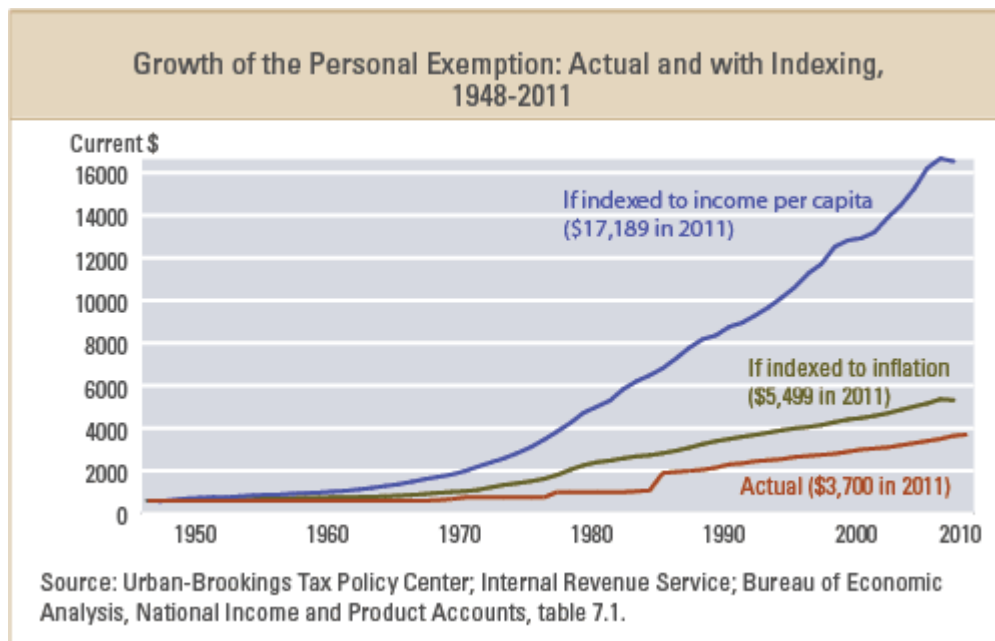
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Taxation and the Family: Has the personal exemption kept up with prices and incomes?

As the federal government expanded greatly in the postwar era, individual income taxes rose, and the personal exemption, which was fixed in nominal dollars, failed to keep pace with growing personal income or rising prices. Lawmakers increased it only occasionally before finally indexing it to increases in prices beginning in 1981.

- Had the personal exemption been indexed to prices beginning in 1948, its value in 2009 would have been roughly 50 percent higher than it was: \$5,499 rather than the actual \$3,650 (see figure). Setting the exemption at that higher level would, however, reduce annual revenues by more than \$53 billion.



- Had the personal exemption been indexed to personal income per capita since 1948, it would have been \$17,189 in 2011, more than four times what it actually is, and annual revenues would fall more than \$235 billion below current levels.
- Congress has, however, partially offset the erosion of the personal exemption with other changes to the tax code. Most importantly, it created the child credit and the earned income tax credit, both of which have helped to hold down taxes, particularly for larger, low- and middle-income households that are most affected by the falling real value of the exemption.

See Also

Taxation and the Family: What is the child tax credit?

Taxation and the Family: What is the earned income tax credit?

Data Sources

History of the Personal Exemption

Authors: Adam Carasso and C. Eugene Steuerle

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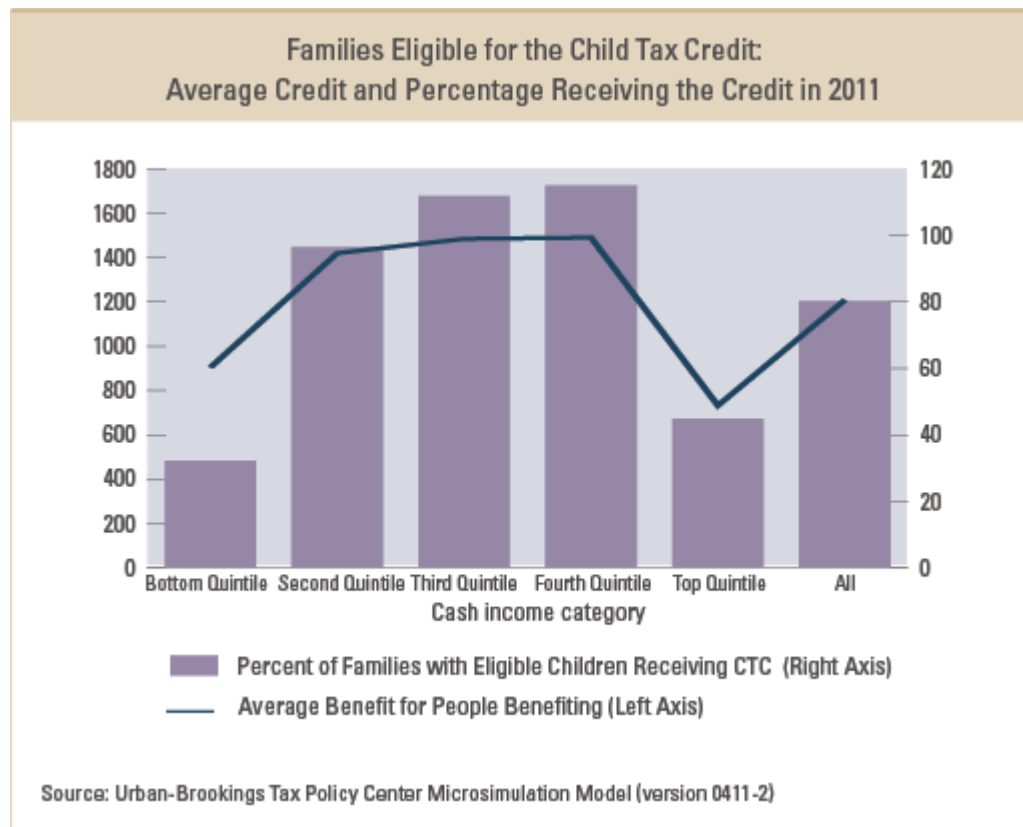
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Taxation and the Family: What is the child tax credit (CTC)?

Taxpayers can claim a child tax credit (CTC) of up to \$1,000 per child under age 17. The credit is reduced by 5 percent of adjusted gross income over \$110,000 for married couples (\$75,000 for single parents). If the credit exceeds taxes owed, taxpayers can receive some or all of the balance as a refund, known as the additional child tax credit (ACTC) or refundable CTC. The ACTC is limited to 15 percent of earnings above a threshold that is indexed to inflation; the threshold is temporarily reduced to \$3,000 in 2011 and 2012. Because the income range over which the ACTC phases in overlaps at least part of the range over which the earned income tax credit (EITC) phases out, the CTC partly offsets the high marginal tax rates associated with that phase-out.

The CTC is the largest tax code provision benefiting families with children. TPC projects that 35 million families will claim credits totaling about \$52 billion in 2011. (Urban-Brookings Tax Policy Center Microsimulation Model, version 0411-2) The temporary reduction of the ACTC earnings' threshold means that families in the lowest income quintile get a larger share of total benefits than under permanent law: 8 percent in 2011 compared with less than 1 percent in 2001. In 2011, TPC estimates that more than 80 percent of benefits will go to families in the middle three quintiles and the remaining 11 percent to families in the highest income quintile.



- The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) doubled the CTC from \$500 to \$1,000 per child, made it refundable for more families and allowed it regardless of AMT liability. The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 extended those temporary provisions through 2012. Barring fur-

ther extension, the CTC will revert to \$500 per child when the temporary provisions sunset in 2013, and many families will lose eligibility for the refundable portion of the credit.

- Before EGTRRA, only families with at least three children could receive a refundable CTC and then only up to the Social Security and payroll taxes they paid in excess of their Earned Income Tax Credit.
- EGTRRA extended the refundable CTC to all families with children, setting it equal to 15 percent of earnings over a threshold that is indexed annually for inflation. Under EGTRRA, the 2011 threshold would have been \$12,750.
- The American Recovery and Reinvestment Tax Act of 2009 temporarily reduced the refundability threshold to \$3,000 for 2009 and 2010 and the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 extended this provision through 2012.
- If Congress allows the temporary provisions to expire in 2013 as scheduled, the new form of refundability—15 percent of earnings over a threshold—will disappear and only the much more limited refundability for larger families would apply.
- The refundable CTC complicates tax filing, especially for larger families who may calculate their credit under both the EGTRRA and pre-EGTRRA rules.
- Because the CTC is not indexed for inflation, its value erodes each year. Furthermore, the only credit parameter indexed to inflation is the permanent threshold over which families may receive a refundable credit. As the nominal threshold rises, families must earn more each year to receive the same refundable credit. This situation only affects families who do not have enough tax liability to get the entire \$1,000 per child credit.
- In 2011, 28 percent of children whose parents work lived in families that received less than the full credit because the parents earned too little. Five percent of these children were in families which received no credit at all because their earnings fell below the refundability threshold. The proportion of children in this situation has declined considerably after the refundability threshold was lowered in 2009.
- Possible reforms of the CTC include:
 - Make the \$1,000 value permanent (even if the other EGTRRA provisions are not);
 - Index the value of the credit and the phaseout thresholds;
 - Index the maximum CTC for inflation but limit it to taxpayers who obtain health insurance for their children; or
 - Permanently lower or eliminate the refundability threshold so that all working families, especially those with low incomes could receive the credit.

The President's 2012 Budget proposed to make temporary provisions of the Child Tax Credit permanent: a \$1,000 credit per child, refundable up to an amount equal to 15 percent of income earned in excess of \$3,000 (not indexed for inflation) and allowable regardless of AMT liability.

See Also

Taxation and the Family: [What is the Earned Income Tax Credit?](#)

Taxation and the Family: [How does the tax system subsidize child care expenses?](#)

Data Sources

Distribution of Tax Benefits for Units with Eligible Children

- By cash income: [Table T10-0074](#)
- By cash income percentile: [Table T10-0075](#)

Authors: Elaine Maag and Adam Carasso
Last Updated: June 25, 2011

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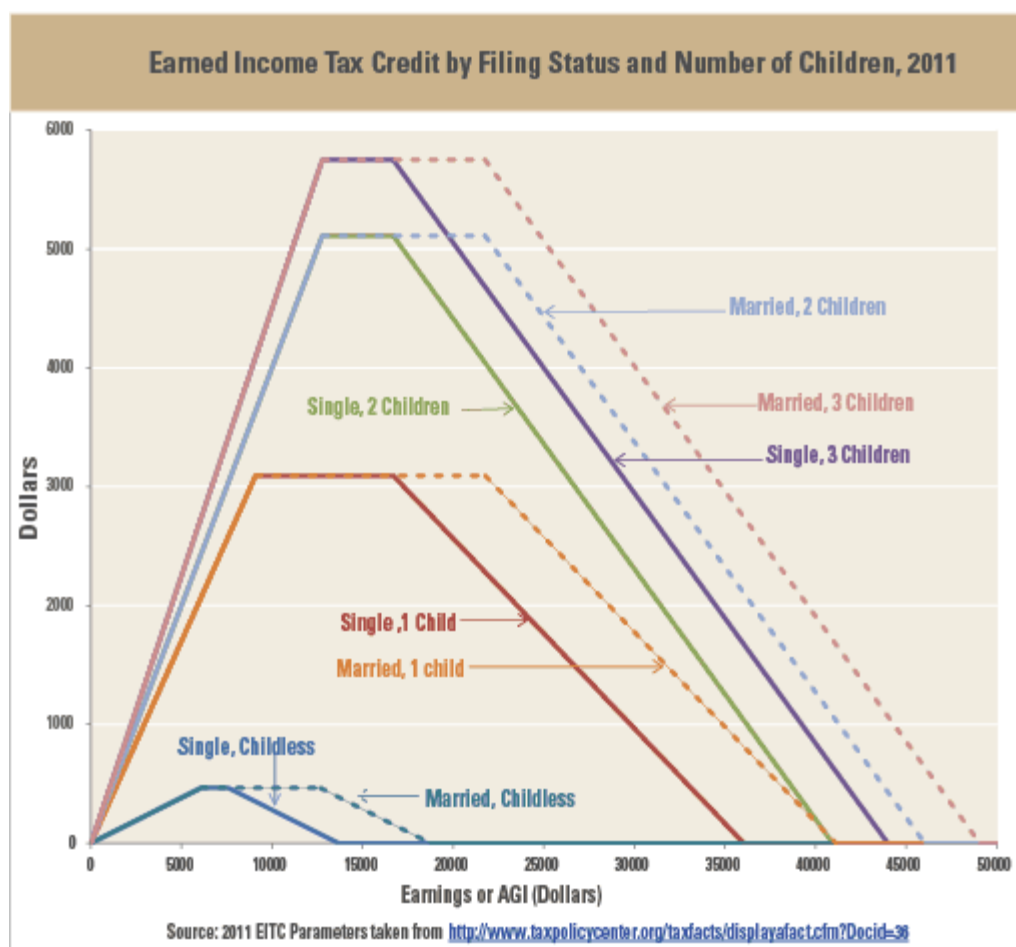
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Taxation and the Family: What is the Earned Income Tax Credit (EITC)?

The earned income tax credit (EITC) provides a subsidy for low-income working families. The credit equals a fixed percentage of earnings from the first dollar of earnings until the credit reaches a maximum; both the percentage and the maximum credit depend on the number of children in the family. The credit then stays flat at that maximum as earnings continue to rise, but eventually earnings reach a phase-out range. From that point the credit falls with each additional dollar of income until it disappears entirely (figures 1 and 2). The phaseout begins at a higher income for married couples than for single parents. The credit is fully refundable: any excess beyond a family's income tax liability is paid as a tax refund.



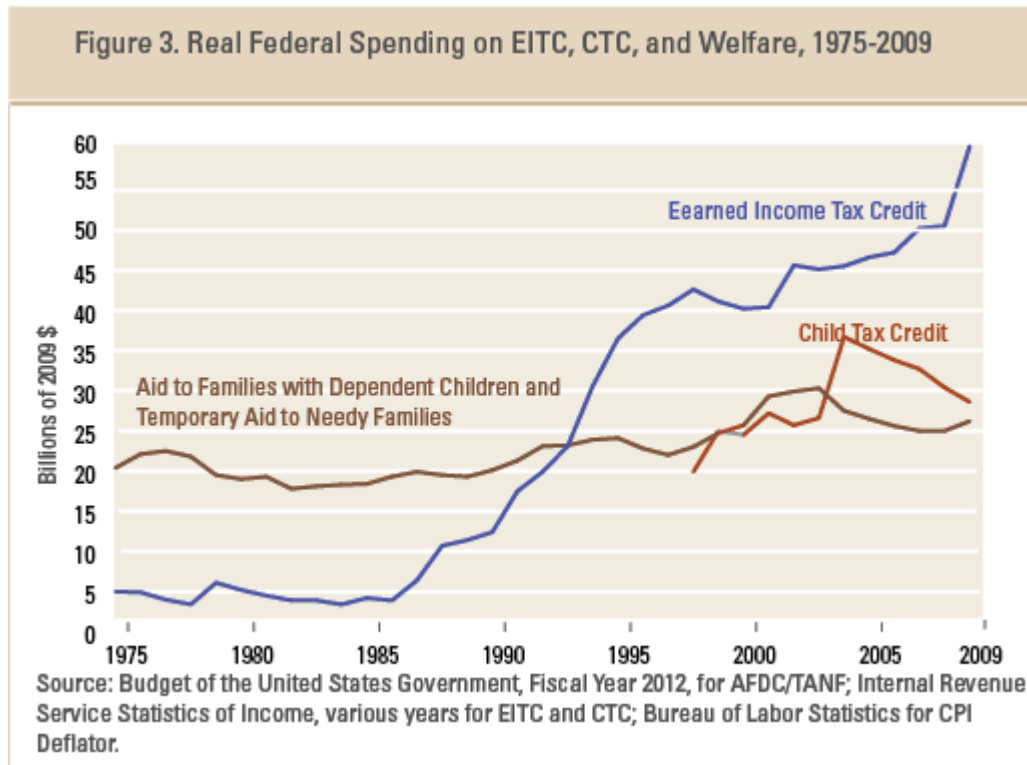
Underlying Data: [Download](#)

- Families with three or more children may receive a credit of up to \$5,751 in 2011. The maximum credit is \$5,112 for families with two children, \$3,094 for families with one child, and just \$464 for those without children.
- In addition, 23 states and the District of Columbia are administering their own state EITCs in 2010. States typically offer the EITC as a fixed percentage of the federal credit and the EITC is refundable in 19 states and the District of Columbia.

Figure 2. 2011 Earned Income Tax Credit Parameters

Type of Return	Single Filers					
	Maximum eligible earnings	Dollars			Percent	
		Maximum credits	Begin phase-outs	Break even points	Credit Rate	Phase-out Rate
Childless	6,070	464	7,590	13,660	7.65	7.65
One child	9,100	3,094	16,690	36,052	34.00	15.98
Two children	12,780	5,112	16,690	40,964	40.00	21.06
Three or More Children	12,780	5,751	16,690	43,998	45.00	21.06
Married Couples Filing Jointly						
Childless	6,070	464	12,670	18,740	7.65	7.65
One child	9,100	3,094	21,770	41,132	34.00	15.98
Two children	12,780	5,112	21,770	46,044	40.00	21.06
Three or More Children	12,780	5,751	21,770	49,078	45.00	21.06

- After the Supplemental Nutritional Assistance Program (SNAP), the EITC is the largest cash or near cash assistance program targeted at low-income families. An estimated 26 million households received a total of \$55 billion in reduced taxes and refunds in 2010 (Urban-Brookings Tax Policy Center Microsimulation Model, version 0411-2). The IRS estimates that in 2009, the credit lifted nearly 7 million people out of poverty, including over 3 million children. The IRS also reports that more than three-fourths of eligible families claimed the Earned Income Tax Credit in 2009, a much higher take-up rate than that for Temporary Assistance to Needy Families (40 percent in 2005) or for SNAP (60 percent in 2005).



Underlying Data: [Download](#)

- The EITC has been successful at encouraging people, particularly single mothers, to take jobs. Its effectiveness at increasing hours worked is more ambiguous.
- Critics complain that the EITC is too complex, forcing potential recipients to seek help filing their federal tax return: two-thirds of low-income parents get such assistance, typically from paid tax preparers.
- The credit's complexity may also contribute to its relatively high error rate. In 2011 the IRS reported that about a quarter of EITC claims (\$11-\$13 billion annually) are paid out in error. Misreporting of income is the principal error made by tax filers claiming the credit.
- The EITC imposes significant marriage penalties on some families. If a single parent receiving the EITC marries, the addition of the spouse's income may reduce or eliminate the credit. To address this issue, the Economic Growth and Tax Relief Reconciliation Act of 2001 raised the income level at which the EITC begins to phase out for couples to \$3,000 above that for single filers. The American Recovery and Reinvestment Act of 2009 (ARRA) increased that amount to \$5,000 for 2009 and indexed that threshold to inflation. The Tax Relief Unemployment Insurance Reauthorization and Job Creation Act of 2010 extended ARRA's EITC provisions through 2012: this resulted in the 2011 phaseout threshold for joint

filers being \$5,080 higher than that for singles.

- Several reforms to the EITC have been proposed. One would increase the credit for childless workers to an amount closer to that for families with children; that would provide much-needed assistance for many additional poor workers.
- The EITC could also be consolidated with other tax provisions benefiting families with children into a single family credit, with lower phaseout rates and a uniform definition of who counts as a child. That could simplify tax filing and increase the assistance provided to working families with children.
- Separating the EITC into two parts—one directed at providing an incentive to work and the other at costs associated with raising children—could both increase work effort and provide more assistance for needy families with children.
- The Administration’s FY2012 Budget proposed to make permanent the higher credit percentage and phaseout threshold for families with three or more children and the \$5,000 increase in the phaseout threshold for joint filers.

See Also

Taxation and the Family: [What is the Child Tax Credit \(CTC\)?](#)

Taxation and the Family: [How does the tax system subsidize child care expenses?](#)

Data Sources

Tables T07-0109 & T07-0110: Distribution of the Tax Benefits of the Earned Income Tax Credit by Cash Income Percentile

Tables T07-0163 & T07-0095 Options to expand the EITC for childless workers T07-0097: Options for EITC for 3+ kids

Authors: Elaine Maag and Adam Carasso
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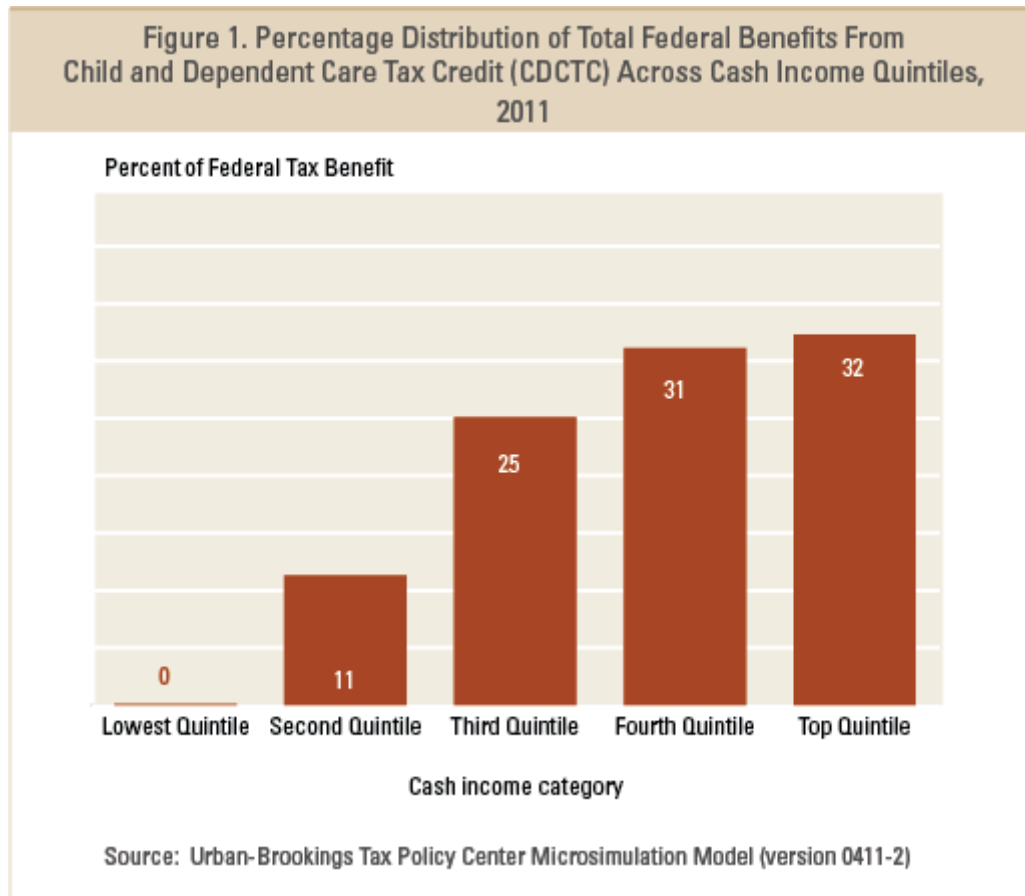
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Taxation and the Family: How does the tax system subsidize child care expenses?

Working parents can utilize two primary tax benefits to offset child care costs: the child and dependent care tax credit (CDCTC) and the employer-provided child care exclusion. To receive the CDCTC, parents report up to \$3,000 of expenses per child (to a maximum of \$6,000) and receive a credit of between 20 and 35 percent of that amount, depending on their adjusted gross income (AGI). Higher credit rates are available to families with lower incomes. To benefit from the exclusion, employees arrange with their employer to exclude up to \$5,000 from their salary, regardless of the number of children receiving care. These dollars are pre-tax. Higher-income families generally benefit more from the exclusion than from the credit, since the excluded income avoids both income and payroll taxes, but it is only available to those taxpayers whose employers offer it.

Although the same expenses cannot be used to claim both the CDCTC and the exclusion, parents can still in some cases benefit from both provisions. If a parent's child care expenses exceed the amount excluded from income, these excess expenses may be applied to the CDCTC, provided the total expenses claimed under both provisions do not exceed the maximum eligible amount under the CDCTC. For example, families with two or more children excluding the maximum \$5,000 can still claim a CDCTC for an additional \$1,000 of expenses, so long as their total child care expenses are at least \$6,000.

- To benefit from the CDCTC, both parents must be working or in school. The expenses claimed may not exceed the lower-earning parent's earnings. The exclusion, however, can be used even if only one parent is working.
- The highest credit rate for the CDCTC (35 percent) applies to families with AGI below \$15,000 and decreases by 1 percentage point for each additional \$2,000 of AGI. The lowest credit rate (20 percent) applies to families with AGI greater than \$43,000.
- In 2011, among families claiming the CDCTC, the largest average benefit went to those with incomes between \$100,000 and \$200,000. People in the highest income quintile received the greatest share of benefits, both because their average expenses are higher than other income groups and because more people in this quintile have child care expenses (figure 1).

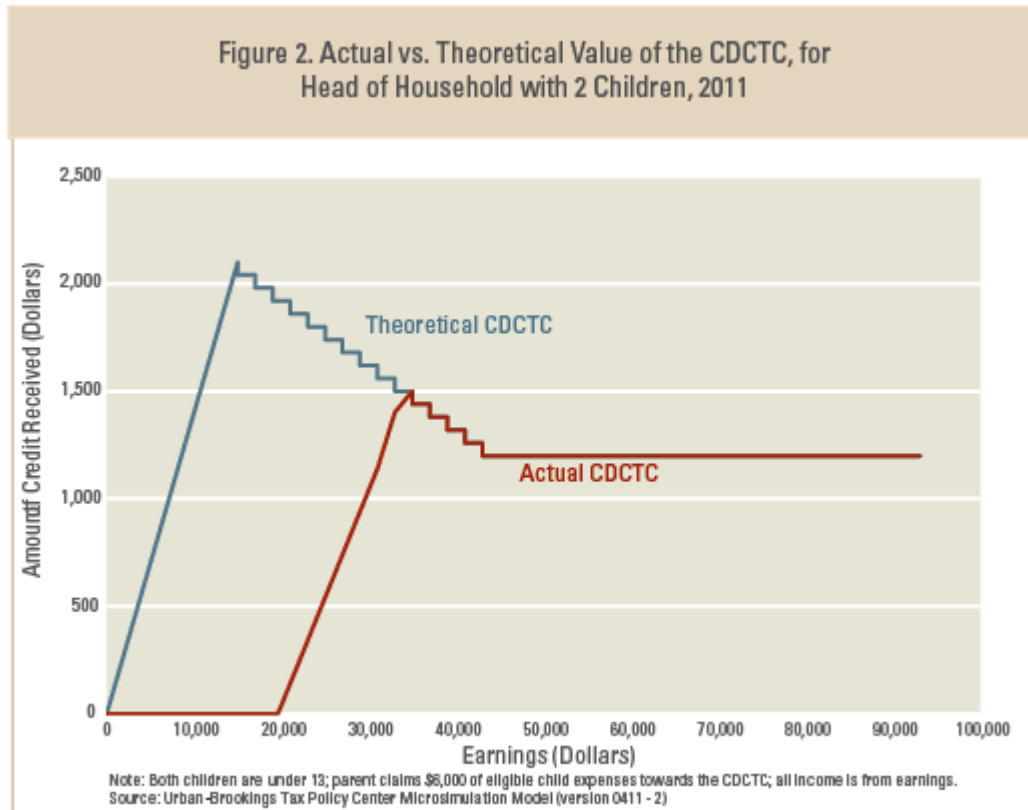


Underlying Data: [Download](#)

- Because the CDCTC is not refundable, only families who owe income taxes can benefit, and low-income families rarely qualify for the maximum benefit.
- Maximum eligible expenses for the CDCTC are scheduled to revert back to their pre-2001 levels in 2013 (\$2,400 per child, \$4,800 maximum per family), and the maximum credit rate will be reduced to 30 percent. In the 2012 budget, the President proposes instead to continue to the EGTRRA credit rules and apply the 35 percent credit rate to all families with AGI under \$75,000. After that, the credit would phase-down until it reached 20 percent for families with AGI exceeding \$103,000.
- The exclusion applies to both payroll and income taxes; its value (that is, the actual reduction in tax) is thus the excluded income times the sum of the rates of the two taxes. Because income tax rates rise with income, the value of the employer exclusion is greater for higher-income taxpayers.
- Maximum allowable expenses for both the CDCTC and the exclusion are not indexed for inflation. Thus each year the value of these provisions erodes.
- Possible reforms to the CDCTC would make it refundable, so that low-income families can receive the maximum benefit regardless of their income tax liability; raise the ceiling on eligible expenses for both the credit and the exclusion, to more closely align them with actual expenses people face (or, more modestly, allowable expenses could be indexed for inflation); or extend

the credit rates and allowable expenses under current law to keep them from reverting to their lower, pre-EGTRRA levels.

- On paper, the CDCTC appears larger than it actually is. Most taxpayers eligible for the higher rates have insufficient tax liability to benefit from the credit. Figure 2 shows the benefit taxpayers actually receive compared to what the law suggests they could receive.



Underlying Data: [Download](#)

See Also

Taxation and the Family: [What is the Earned Income Tax Credit?](#)

Taxation and the Family: [What is the Child Tax Credit \(CTC\)?](#)

Data Sources

[TPC Table T11-0251](#): Federal Tax Benefits of the Child and Dependent Care Tax Credit, Distribution by Cash Income Percentile, 2011

[TPC Table T07-0156](#) Fully Refundable Child and Dependent Care Tax Credit (CDCTC), Returns and Amount Reported Compared to Current Law, 2006

[TPC Table T07-0158](#) EGTRRA Changes to Child and Dependent Care Tax Credit (CDCTC), Distribution of Federal Tax Change by Cash Income Class, 2006

[TPC Table T07-0160](#) EGTRRA Changes to Child and Dependent Care Tax Credit (CDCTC), Returns and Amount Reported Compared to Pre-EGTRRA Law, 2006

[TPC Table T07-0162](#) Child and Dependent Care Tax Credit (CDCTC) Options, Static Impact on Individual Income Tax Liability and Revenue (\$ billions), 2007-17

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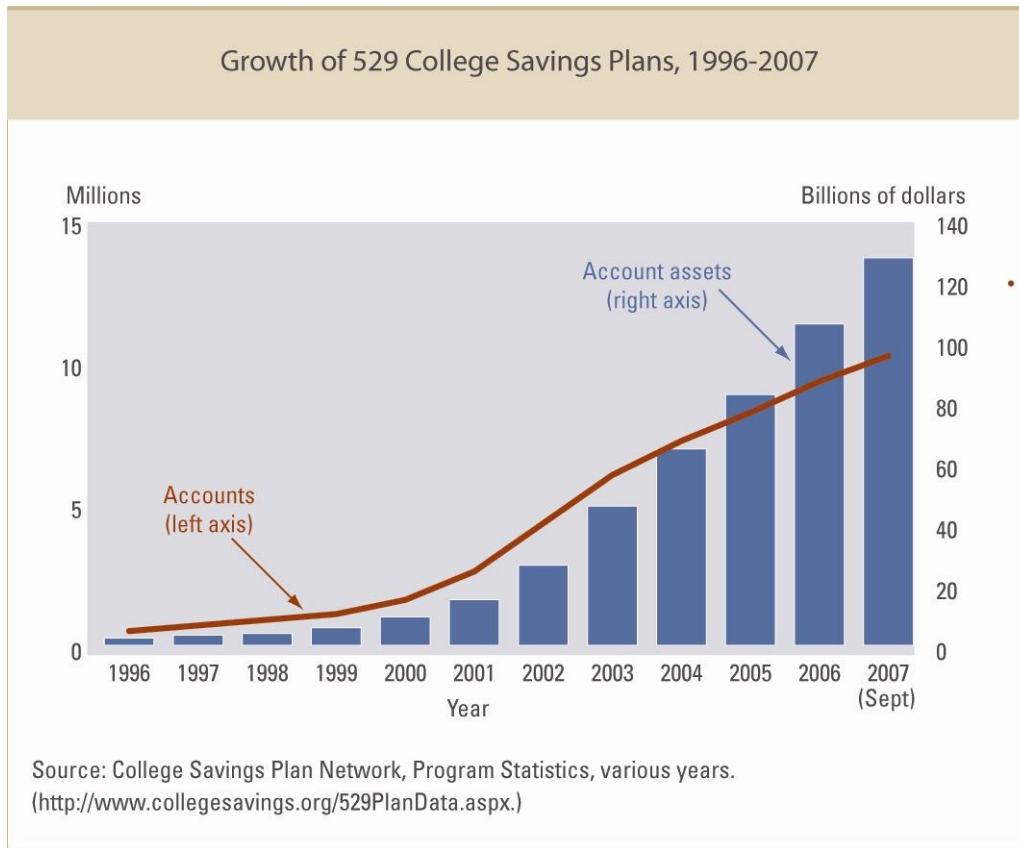
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Taxation and the Family: What tax incentives exist to help families save for college?

Three tax-favored savings instruments encourage families to save for college: Coverdell savings accounts, qualified tuition programs (commonly referred to as 529 plans), and the education savings bond program. Use of funds from any of these three programs for other than permitted educational expenses subjects those funds to income taxes and penalties. In addition, certain retirement savings vehicles such as Roth Individual Retirement Accounts (IRAs) may be used to pay for higher education without penalty. Because the benefits of each of these programs are proportional to the family's marginal tax rate, they give greater saving incentives to higher-income than to lower-income families.

- Anyone, regardless of income, may contribute to a 529 plan for a named beneficiary. A donor may contribute up to \$12,000 annually for each beneficiary without triggering a gift tax and may make up to five years of contributions in a lump sum without triggering a gift tax so long as no additional gifts are given to the beneficiary during the five-year period. Funds in a 529 plan grow untaxed. Since the passage of EGTRRA, funds used to pay for postsecondary education are not taxed when withdrawn. Donors retain ownership of the accounts but may use the funds to pay educational expenses only for the named beneficiary. They may, however, transfer funds to another beneficiary, subject to relationship requirements between the original and the new beneficiary.
- Growth of 529 plans since 1996 has been tremendous. At that time only 500,000 accounts existed, containing \$2.4 billion in assets (see figure). As of September 2007 there were 10.2 million 529 plan accounts, containing \$127 billion in assets.
- Every state except Wyoming sponsors a 529 plan (but Wyoming residents receive preferred treatment in the Colorado 529 plan). In states with a personal income tax, residents investing in their state-sponsored 529 plan often receive a state tax break for at least part of their investment. In 2007 families with adjusted gross income (AGI) below \$110,000 (\$220,000 if filing a joint return) may deposit up to \$2,000 per beneficiary in a Coverdell account on an after-tax basis. Funds grow untaxed and may be withdrawn tax free if used to pay educational expenses.
- The education savings bond program allows users to exclude interest on certain bonds from income tax if the money is used to pay for postsecondary education. In 2007 families could cash in these bonds tax free only if their AGI was less than \$80,600 (\$128,400 if filing a joint return; income limits are indexed for inflation). This program is substantially smaller than the other two.



- All families face the same 10 percent penalty if account funds are used for other than permitted educational expenses, regardless of how much benefit they would receive if they used the money for education. Even with the penalty, high-income families can benefit from 529 plans and Coverdell accounts because the accounts let them shift money to their children, who typically face lower tax rates. That benefit does not extend to low-income families, who already face lower tax rates.
- The benefits of 529 plans and Coverdell accounts are also less for low-income families because they can reduce financial aid for which they would otherwise qualify.
- Benefits in college savings accounts accumulate over time. To reap the maximum benefit, families must invest well before they know whether a child will attend college. That uncertainty is greatest for low-income families, whose children are least likely to attend college, and this increases their risk of penalties for using the funds for noneducational purposes.
- The tax incentives that these programs provide are of greatest benefit to families whose children are most likely to attend college even without a subsidy. As a result, it is unlikely that these programs significantly increase college attendance.

See Also

Retirement Saving: How does tax-favored retirement saving affect national saving?

Retirement Saving: What types of non-employer-sponsored accounts are available?

Data Sources

College Savings Plans Network

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Taxation and the Family: What incentives exist to help families pay for college?

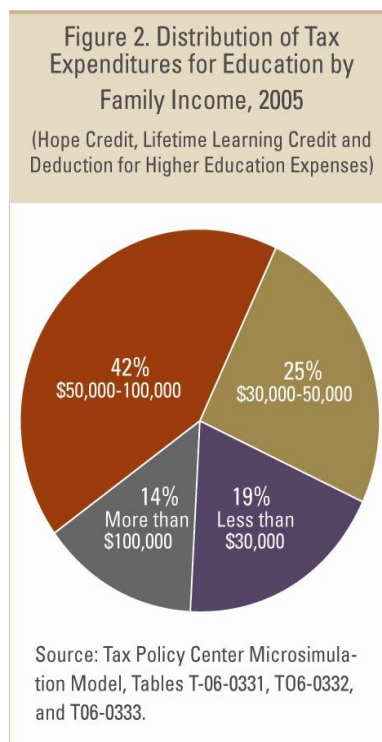
Rapidly rising college expenses in the 1990s spurred the 1997 enactment of tax incentives for higher education: the Hope Credit, the Lifetime Learning Credit, and a deduction for tuition and fees. As a consequence, federal tax subsidies for college students rose from zero before enactment to roughly \$6 billion in 2005-06. Other tax incentives encourage families to save for college (see Taxation of the Family: What tax incentives exist to help families save for college?).

The American Recovery and Reinvestment Tax Act of 2009 replaced the Hope Credit with the partially refundable American Opportunity Tax Credit (AOTC), increasing the amount of expenses eligible for the credit, extending coverage to the first four years of school (up from the first two years allowed by the Hope credit), expanding the types of expenses allowable for the credit, and making the credit partially refundable so it is available to more low-income students. Taxpayers may claim the new credit for 2009 and 2010 only. The President's 2011 budget proposes extending the AOTC through 2011.

Before Congress created the AOTC, critics complained that the tax benefits had not had much effect on college enrollment, but rather had provided subsidies to people who are likely to attend college anyway. Many low-income students who might be most influenced by reduced college costs could get little or no benefit from the Hope and LLC credits because they are nonrefundable and thus can only offset income taxes owed. At the other end of the income scale, the credits are phased out for many high-income families. As a result, the largest average benefits go to families with annual incomes between \$30,000 and \$100,000. The impact of making the credit refundable is not yet known. Unless Congress acts to extend it, the AOTC will expire after 2010 and the Hope Credit will be restored.

- For each student, families may claim only one of the three tax benefits but they need not claim the same benefit for all students. Complexity associated with having to choose which benefit to take results in people frequently choosing sub-optimally (GAO 2005).
- The American Opportunity Tax Credit applies to tuition, fees, and required books for students enrolled at least half time in their first four years of college. The credit equals 100 percent of the first \$2,000 of eligible expenses plus 25 percent of the next \$2,000, yielding an annual maximum credit of \$2,500 when qualifying expenses are at least \$4,000. Forty percent of the credit is refundable and thus available to all students, regardless of their tax liability. Each qualifying student in the household may receive the AOTC.
- The Lifetime Learning Credit equals 20 percent of tuition and fees for any post-secondary education, up to a maximum annual credit of \$2,000. That maximum applies to the combined expenses of all students in the household claiming the credit and is reached when total qualifying expenses reach \$10,000.
- The maximum benefit for the American Opportunity Tax Credit phases out between adjusted gross income \$80,000 and \$90,000 (between \$160,000 and \$180,000 for married couples). The maximum benefit for the Lifetime Learning Credit phases out between adjusted gross incomes of \$45,000 and \$55,000 for single taxpayers, or between \$90,000 and \$110,000 for married couples.

- The deduction for tuition and fees allows taxpayers (parents or students, whichever pays) to reduce taxable income by up to \$4,000. To qualify, a family's adjusted gross income may not exceed \$65,000 for single filers or \$130,000 for married filers. Single filers with AGI between \$65,000 and \$80,000 or married filers with AGI between \$130,000 and \$160,000 can deduct up to \$2,000 of expenses. After that, a family is no longer eligible for the deduction. The tuition and fees deduction is scheduled to expire after 2009.
- Most people who qualify for a tax credit for education expenses will benefit more from the American Opportunity Tax Credit than the Lifetime Learning Credit by virtue of the AOTC being the larger of the two. Students who do not qualify for the AOTC – those who are less than half-time, or are in their fifth year of school, for example – will benefit more from the LLC.
- The Lifetime Learning Credit is nonrefundable, so only people who owe income tax can benefit. Similarly, the deduction for tuition and fees is valuable only for people with taxable income.
- Prior to the enactment of the American Opportunity Tax Credit, the education tax programs provide relatively modest benefits: an average of \$771 per household. Average benefits are highest for those receiving a Hope Credit (\$1,069), followed by the Lifetime Learning Credit (\$978), and finally the tuition and fees deduction (\$324). Average benefits under the American Opportunity Tax Credit will be higher.
- Using the tax system to subsidize higher education has two primary advantages: Students need not fill out the complicated Free Application for Federal Student Aid form, and every student who qualifies receives a benefit.



Possible options for reform

- Even though some books are now eligible expenses for the American Opportunity Tax Credit (as opposed to only tuition and fees for the Lifetime Learning Credit), additional assistance could be provided by broadening coverage to include more expenses such as room and board.
- Providing benefits directly to schools when students enroll (based on the previous year's taxes) would help students cover college costs when they actually have to make payments, not months later when their families file tax returns.

See Also

Taxation of the Family: What tax incentives exist to help families save for college?

Data Sources

Education Tax Incentives, TPC Tables T06-0325 to T06-0336

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Further Reading

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Taxation and the Family: What are marriage penalties and bonuses?

Couples face a marriage penalty when they pay more income tax filing jointly as a married couple than they would if they had remained single and filed separately as individuals. Conversely, a marriage bonus occurs if a couple pays less tax filing jointly than they would if they were single. Under a progressive income tax, marriage penalties and bonuses arise because the household rather than the individual is the unit of taxation. Tax provisions that phase in or phase out with income also produce penalties or bonuses. Many more married couples receive bonuses than incur penalties.

- Marriage penalties and bonuses result from the combination of progressive tax rates and taxation of a married couple as a single tax unit. With progressive taxes (which impose higher rates on higher incomes), combining spouses' incomes can result in some income being taxed at higher rates than if spouses' incomes were taxed separately. That can occur only if joint tax brackets are less than twice as wide as individual brackets. (A couple does not have to file a joint tax return but their alternative-filing separately as a married couple-almost always results in greater tax liability.)
- Couples in which spouses have similar incomes are more likely to incur marriage penalties than couples where one spouse earns most of the income, because combining incomes in joint filing can push both spouses into higher tax brackets.
 - *Example of a marriage penalty:* A husband and wife with two children earn \$100,000 each and itemize deductions totaling \$40,000. Filing jointly, their taxable income is \$146,801, on which their 2008 income tax liability is \$27,848. But the alternative minimum tax (AMT) raises that liability to \$30,825. If they could file separately as single and head of household with two children, the single filer would owe a tax of \$15,469 and the head-of-household filer would owe \$10,438, or a total of \$25,906, and they would not be subject to the AMT. Their joint tax bill is thus \$4,919 higher than the sum of their individual tax bills, imposing on them a marriage penalty equal to 2.5 percent of their pretax income. (see example details)
- Couples in which one spouse earns all of the couple's income never incur a marriage penalty and almost always receive a marriage bonus, because joint filing shifts the higher earner's income into a lower tax bracket.
 - *Example of a marriage bonus:* A wife earns \$200,000 and her husband earns nothing. They have two children and itemize deductions equal to \$40,000. Filing jointly, their taxable income is \$146,801, on which their 2008 income tax liability is \$27,848. But the AMT raises that liability to \$30,825. If they could file separately, the husband as single and the wife as head of household with two children, the wife would owe taxes of \$38,957 (including the AMT) and the husband would owe nothing. Their joint tax bill is \$8,132 less than their combined individual tax bills, giving them a marriage bonus equal to 4.1 percent of their pretax income. (see example details)
- Before the 2001 tax act, married couples were already significantly more likely to get bonuses than penalties. The Congressional Budget Office estimated that 51 percent of married couples received marriage bonuses totaling nearly \$33 billion in 1996, and 42 percent incurred marriage penalties totaling almost \$29 billion.

- Tax legislation since 2001 has substantially reduced marriage penalties and increased marriage bonuses, by raising the standard deduction for couples to twice that for single filers and by setting the income ranges of the 10 and 15 percent tax brackets for couples to twice the corresponding ranges for individuals. Legislation also raised the starting point for the earned income tax credit (EITC) phase-out range by \$3,000 for married couples.
- Marriage penalty relief is costly. TPC estimates that extending the marriage penalty reductions from their scheduled sunset in 2010 through 2017 would cost more than \$130 billion in tax revenue. Much of the cost results from raising marriage bonuses.
- Much of the benefit of marriage penalty relief goes to the wealthiest taxpayers. TPC estimates that marriage penalty tax cuts will increase after-tax income in 2010 by 0.66 percent for the average taxpayer in the top income quintile, but by only 0.24 percent for middle-quintile taxpayers (see figure).
- Despite the recent reductions, many aspects of the tax code perpetuate penalties. Joint filer brackets for tax rates above 15 percent are less than twice as wide as single brackets, and therefore combining income for joint filing can lead to higher tax rates. In fact, the 35 percent bracket starts at the same level of taxable income for single filers, joint filers, and heads of household and imposes significant marriage penalties on high-income couples. In addition, income limits on some tax subsidies are less than twice as high for couples as for single filers. For example, the child tax credit starts to phase out for unmarried filers when adjusted gross income exceeds \$75,000; for married couples filing jointly, the threshold is \$110,000, which is less than twice the single filer's threshold and can thus cause marriage penalties for some taxpayers. Finally, AMT parameters for couples are less than twice those for unmarried individuals. For example, the 28 percent AMT bracket starts at \$175,000 for both single and joint tax filers.
- Taxpayers who might qualify for the EITC can suffer particularly large marriage penalties if the income of one spouse disqualifies the other from getting the credit. However, marriage can increase the EITC if a nonworking parent marries a low-earning worker.
 - *Example of a marriage penalty due to the EITC: A husband and wife with two children earn \$20,000 each and claim the standard deduction of \$10,900. Filing jointly, their taxable income is \$15,100, on which their 2008 income tax liability is \$1,510. They qualify for an EITC of \$347 and a child credit of \$2,000, yielding a net refund of \$837. If they filed separately, the wife as a head of household with two children and the husband as single, the wife would have a tax bill of \$150 minus an EITC of \$3,927 and a child credit of \$1,343, for a net refund of \$5,119. The husband would owe \$1,256 with no offsetting credits. Their separate tax bills would thus yield a combined net refund of \$3,863, and so they incur a marriage penalty of \$3,026, or 7.6 percent of their pretax income. (see example details)*
- Marriage penalties are not confined to the tax system. Married couples often receive lower benefits from government programs than they would if they had not married.

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