Credits and Exemptions for Children

By Elaine Maag

The Earned Income Tax Credit, Child Tax Credit (CTC), Additional Child Tax Credit (ACTC), and the dependent exemption all provide benefits to families with children. In 2009, a single mom (or dad) with two children can receive benefits ranging from $0 to about $7,500 — depending on her income, age of the children, and where the children live. While this assistance is extremely important to many low-income families, they must navigate a bewildering set of rules to take full advantage of the credits.

The Working Families Tax Relief Act of 2004 simplified the definition of a child in many tax programs, but retained differences in age limits to qualify for particular programs. For example, only children under age 19 or students under age 24 count as children for dependent exemptions and the EITC. The CTC and the ACTC require that children be less than 17. Generally, children must live with the taxpayer for more than one-half of the year.

The four benefits phase in and out on different schedules. While the EITC begins with the first dollar of earnings, a parent must earn at least $3,000 to get the ACTC. The dependent exemption has no value until income exceeds $12,000 — the point where the parent would first owe tax, absent the exemption. The EITC reaches its maximum of $5,028 for a single parent with two children when earnings reach $12,570 and maintains that level until it begins to phase out when income exceeds $16,420. The CTC/ACTC tops out for a family with two children ($2,000) when earnings reach $16,333 and starts to phase out when earnings exceed $75,000. Meanwhile, benefits from the dependent exemption continue to phase in and increase as each tax bracket threshold is crossed. Once earnings reach $115,000, only the dependent exemption benefits the family. Total benefits bounce around erratically as income grows. (See figure.)

All four benefits vary further with different filing status and number of children. And if that's not enough, the rules are scheduled to change in 2011. The CTC/ACTC will fall by half and only some families with three or more children will get the refundable portion. The EITC will shrink for families with more than two children and for many married couples. Perhaps it's time for Congress to follow the suggestion of President Bush's tax reform commission and others and combine these provisions into a single tax credit.