

Blog

What Happened to my Exemptions? How Dependent Children Fit in Under the New Tax Code

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As recently as tax year 2017, eligible persons were able to claim exemptions from their adjusted gross income of as much as \$4,050 per dependent child. To have qualified, the dependent child must have lived with the person(s) claiming the exemption(s) for more than one-half of the tax year and must have been under either the age of 19 (if not a full-time student) or 24 (if a full-time student) at the end of the tax year. By way of example, a person who was eligible to claim two child dependency exemptions in 2017 effectively avoided paying federal income tax on \$8,100 of her income. The dependency (and personal, a topic for another day) exemption was eliminated effective in tax year 2018 as part of sweeping changes to the federal tax code enacted in late 2017. So now what?

Much of what seems to be a negative change for taxpayers with child dependents is not what it first appears to be. Among changes to the law that mitigate the elimination of the dependency exemption are those made to the Child Tax Credit effective for tax year 2018. Most dependents for whom an exemption was previously available to the taxpayer(s) now trigger a credit of up to \$2,000 each against a total tax obligation. While a Child Tax Credit was available in previous tax years, the changes in how it is applied in 2018 as compared to 2017 are dramatic. Changes include the maximum credit per child (\$2,000 up from \$1,000) and, most significantly, an increase in the “phase-out” amounts, meaning the income thresholds above which the credit begins to reduce, eventually to zero. In 2017, phase-outs began for married filing jointly (MFJ) taxpayers with total modified adjusted gross income (MAGI) of \$110,000; for married filing separately (MFS) taxpayers with total MAGI of \$55,000; and for all other taxpayers with total MAGI of \$75,000. In 2018, the phase-outs begin at total MAGI of \$400,000 for MFJ taxpayers and \$200,000 for all other filing statuses.

What does all of this mean when practically applied? Let’s say the taxpayer with two minor dependents referenced above had total MAGIs of \$100,000 in 2017 and \$100,000 in 2018. In both years, her filing status was Head of Household. Further assume that in both years she had a marginal tax rate, i.e. her total tax owed divided by her total taxable income, of 25%.

In 2017, she saved tax of 25% of the total exemption amount of \$8,100, or \$2,025. She also received a tax credit, after a reduction for the phase-out, of \$750. As a credit is applied directly against a total tax obligation, the net savings between the exemption and the credit to the taxpayer were \$2,775.

In 2018, there was no exemption available to the taxpayer. However, she was entitled to a full credit of \$4,000 as her MAGI was below the phase-out amount. Therefore, the net savings to the taxpayer were \$4,000, or \$1,225 more than she saved in 2017.

While the tax code can be complicated, it is important to understand with your attorney and tax preparer various considerations, including available tax filing statuses, especially when involved in the process of divorcing. If you have questions about this or any other area of family law, we can help. Call us at 215-340-2207, or email info@bucksfamilylawyers.com.