Tax Cuts and Jobs Act of 2017

Wealth Management

Summary of potential impacts of key provisions

On December 22, 2017, President Trump signed the Tax Cuts and Jobs Act. This Act incorporated some of the most significant tax changes for individuals and corporations since 1986. While RBC Wealth Management does not provide tax or legal advice, we do want to share insights on key provisions that may impact wealth management planning decisions of our valued clients. The following provides a summary of several changes. Please discuss how they may affect your specific financial circumstances with your RBC Wealth Management financial advisor in conjunction with your independent tax and/or legal advisor.

Individual taxes

The Act made several significant changes to taxes imposed upon individuals. These changes fall broadly into three categories: rate adjustments, changes to deductions, and the alternative minimum tax.

I. Individual taxes

The prior individual income tax scheme had seven tax brackets ranging from 10% to 39.6%.

The current Act retains the seven brackets, adjusting the ordinary income tax rate and thresholds for most brackets. All rates and totals are now indexed for chained Consumer Price Index (CPI), a variant of the traditional CPI. While the tax rates and brackets sunset December 31, 2025, the change to the inflation calculation remains. The following are the 2018 tax year marginal income tax brackets for married filing jointly and individual taxpayers.

Rate	Married filing joint	Individual
10% tax rate	$0 to $19,050	$0 to $9,525
12% tax rate	$19,050 to $77,400	$9,525 to $38,700
22% tax rate	$77,400 to $165,000	$38,700 to $82,500
24% tax rate	$165,000 to $315,000	$82,500 to $157,500
32% tax rate	$315,000 to $400,000	$157,500 to $200,000
35% tax rate	$400,000 to $600,000	$200,000 to $500,000
37% tax rate	$600,000 or more	$500,000 or more

The Act does not change the current tax treatment of capital gains and qualified dividends. These rates remain at:

- 0% for married filing jointly under $77,200, head of household under $51,700, single under $38,600, trusts/“kiddie” under $2,600.
- 15% for married filing jointly under $479,000, head of household under $452,400, single under $425,800, trusts/“kiddie” under $12,700.
- 20% above limits outlined above.

The Act also lowered the effective tax rate on pass-through income for partnerships, S corporations, LLCs and sole proprietorships by allowing these entities a 20% deduction of certain specified income. This deduction does not apply to service related businesses unless the taxable income of the business owner is below $157,000 for individuals or $315,000 for a married couple filing jointly. Business interests owned through trusts are also now eligible for the 20% deduction as well. This provision will also sunset December 31, 2025.

Take away

Our clients can expect to see a slight reduction in income taxes based on these changes, particularly at higher incomes. Arguably the more significant change may be the reduction in the pass-through tax rate. This change could result in lower taxes for clients that own their own businesses and elect to have them taxed as pass-through entities, provided they are not specified service businesses.

II. Changes to deductions

The Act made a number of changes, both to the standard deduction and to itemized deductions. The prior standard deduction was $6,350 for individuals, $9,350 for heads of households, and $12,700 for married couples filing jointly. The current law increased the standard deduction to $12,000 for individuals, $18,000 for heads of households, and $24,000 for married couples filing jointly. The prior personal exemption amount of $4,050 was repealed for tax years 2018 through 2025.

While the standard deduction has increased, many itemized deductions have been changed or eliminated. Some of these will sunset and come back into effect on January 1, 2026. Those that do not sunset will remain in effect past December 31, 2025. Some of the more pertinent changes are as follows.

- Deductions for medical expenses are temporarily expanded – subject to a 7.5% floor for 2017 and 2018, then raises back to 10% in 2019. (Does not sunset)
- Deductions for state and local income, sales, and property taxes are capped at a combined $10,000 deduction, $5,000 for married taxpayers filing a separate return. (Sunsets)
- Home mortgage interest deductions on "acquired indebtedness" are reduced from $1,000,000 to $750,000; no home equity debt deductions are permitted; deductions are permitted on second homes if within this cap. The Act allows current homeowners to keep the prior limitation of $1,000,000 if the original indebtedness was incurred before December 15, 2017. (Sunsets)
- Cash contributions to a public charity are allowed an increased deduction from prior law of 50% of Adjusted Gross Income (AGI) to 60% under the current law. (Sunsets)
- Student loan interest deductions are retained.
- Miscellaneous itemized deductions subject to the 2% AGI floor are repealed. (Sunsets)
- Deductions for alimony payments are repealed starting in 2019, but will no longer be taxable as income to the recipient. (Does not sunset)

Take away

Deductions are highly personal to the individual taxpayer and it is difficult to draw broad conclusions, however one point does stand out. Taxpayers who itemize have traditionally been able to deduct all or a portion of their state income/sales and property taxes paid on their federal taxes (depending on whether they may have paid Alternative Minimum Tax). Limiting these deductions will impact most people who itemize their taxes, but will disproportionately affect individuals living in states with higher income taxes because they may have been receiving a larger benefit. Therefore, clients with significant state income and/or property taxes may find their federal taxes increase as their deductions may be limited.

III. Retirement accounts

Most of the prior rules for 401(k) plans and other retirement plans remain the same under the current law. One important aspect of the current law is the repeal of the rule allowing a taxpayer to re-characterize their Roth IRA conversion back to a traditional IRA, thus unwinding the Roth conversion by the taxpayer's return due date (including extensions) of the following year.

Take away

The Act takes away the opportunity to see how the converted assets perform in the following year. If the assets increased in value, the taxpayer would have benefited from the gains and would not be subject to tax, however, if the assets decreased in value, retroactively reversing the conversion would have allowed the taxpayer to avoid taxes on some or all of the converted amount.

IV. Alternative Minimum Tax

In 1969, it was reported that 155 taxpayers earning over $200,000 per year (roughly $1.3 million in today's dollars accounting for inflation) had been able to structure their income so as to pay no income tax at all. The backlash from this discovery led to the Alternative Minimum Tax (AMT). The AMT is a complex tax that operates alongside the individual income tax, assessing an additional layer of taxation on lightly taxed income with the goal of ensuring that all taxpayers experience at least some minimum level of taxation. Over the years, the AMT has gradually expanded beyond its original scope and today affects about 4.5 million people.

Despite much debate, the current Act retained the individual AMT, but with an increased exemption amount, $109,400 for married taxpayers, and $70,300 for others, except trusts and estates. It also raised the exemption phase-out levels to an income level of $1,000,000 for those married filing jointly and $500,000 for others. This provision is subject to sunset on December 31, 2025.

Take away

Despite the increased exemption amount, the AMT can still result in a significant tax burden, and the Act's failure to repeal the individual AMT will prove costly for those who are still impacted by it.

Estate taxes

Under prior law, property in an estate subject to tax was generally subject to a tax rate of 40% before passing to the decedent's non-spouse beneficiaries. In 2017, estates valued at more than $5.49 million per person, or $10.98 million per couple, were taxable.

The Act kept the estate tax intact, but doubled the personal exemptions for individuals for tax years 2018-2025.

Take away

Clients with significant wealth still face the possibility of a 40% estate tax, but increasing the exemption amount to about $22 million, per couple, does take some of the sting out of it. Note that this has no bearing on whether or not individual states may impose estate taxes. It is always a good idea to review an estate plan every few years, or after life events such as marriage, divorce, deaths and births, as well as when new tax laws are enacted. However, since provision of the Act is set to sunset on December 31, 2025, major changes to an estate plan may be unlikely. Finally, additional guidance is still needed from the Treasury on how gifts made during this period would be treated if the exemption is lower at the time of death.

Corporate taxes

The prior corporate tax system had four tax brackets ranging from 15% for income less than $50,000 to up to 35% for income over $10,000,000.

The corporate tax rate was reduced to a flat 21% effective for tax year's beginning after December 31, 2017, and corporate AMT is repealed.

The current Act also followed the Senate plan that enacted the deemed repatriation of currently deferred foreign profits at a rate of 15.5% for liquid assets and 8% for illiquid assets.

Take away

Cutting corporate taxes will result in higher corporate profits and a territorial tax system that brings the U.S. in line with the tax systems of most other countries. These changes should help make U.S. companies more profitable and more competitive in the global marketplace.

