

1% decrease in Ontario corporate tax rate – What it means

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Effective July 1, 2026, the small business corporate tax rate in Ontario is going down from 3.2% to 2.2% for an effective combined federal/provincial corporate tax rate of 11.2% on the first \$500,000 of active business income (ABI) of an Ontario resident Canadian controlled-private corporation (CCPC). CCPC's with a year end straddling the effective date will see a blended rate for their fiscal year. The March 26, 2026, Ontario budget also announced a corresponding 1% decrease in the dividend tax credit for non-eligible dividends effective January 1, 2027, increasing the effective top marginal personal tax rate on non-eligible dividends from 47.74% to 48.89% for Ontario resident shareholders.

Deferral and dis-integration

The tax rate reduction will increase corporate tax deferral versus earning ABI personally for Ontario CCPC's to 42.33% (53.53% top personal marginal tax rate – 11.2%). However, the increase in non-eligible dividend tax at the personal level has broader implications. It not only impacts CCPC's that distribute after-tax business profits from ABI increasing the fully integrated cost of earning ABI at the small business rate from 54.12% to 54.61% in 2027, it also impacts CCPC's earning passive investment income with the fully integrated cost of earning interest income increasing from 57.93% to 58.86% (versus 53.53%) and capital gains from 28.97% to 29.43% (versus 26.67%). This all adds up to "dis-integration".

And greater still, to the extent that a CCPC has undistributed surplus that has benefited from tax deferral in the past, this dividend tax increase is effectively a retroactive tax rate increase on all past earnings that are retained inside the corporation. On distribution, this will subject these earnings to greater levels of dividend tax than would have been the case when those earnings were earned – exacerbating dis-integration.

This has been a trend since the 1990's. Since then, corporate tax rates have dramatically decreased, and personal tax rates have increased. With decreases in corporate tax rates, personal tax rates on dividends have to go up to attempt to maintain integration.

Corporate-owned life insurance can help

Broadly speaking, the Ontario changes contribute to a greater incentive not to distribute trapped surplus. With the growth in trapped surplus, business valuations also grow. To the extent that trapped surplus is not going to be distributed during a shareholder's lifetime it will be subject to "dis-integration".

The growth within an exempt life insurance policy is not subject to income tax unless the policy is disposed of. The growth within a corporate-owned policy is not considered adjusted aggregate investment income of a CCPC.

Corporate-owned life insurance creates liquidity on death to pay tax liabilities arising from the deemed disposition on death. The CDA credit arising from life insurance death benefits can integrate with post-mortem planning allowing for more tax-efficient distributions – diminishing or eliminating "dis-integration".

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