Can provincial courts decide tax matters? Alberta clarifies Income Tax Act jurisdiction

May 11, 2026

The recent decision of the Court of King's Bench of Alberta in *2585929 Alberta Ltd (Re)*, 2026 ABKB 75 discusses when the jurisdiction of provincial courts can extend to matters relating to the *Income Tax Act*.

Key takeaways

- The Tax Court of Canada has the exclusive jurisdiction to hear and determine references and appeals to the Court on matters arising under the *Income Tax Act*.
- Provincial courts can interpret provisions of the *Income Tax Act* if it is necessary to decide an issue properly before the Court but cannot directly decide tax matters.

Case overview and background facts

A group of related companies (AMI) experiencing financial difficulties filed a notice of intention to make a proposal under the *Bankruptcy and Insolvency Act* to restructure their liabilities.

The Court issued a **reverse vesting order**, which allows a distressed company to transfer unwanted assets and liabilities to a new corporation (ResidualCo). This allows the distressed company to be acquired and continue its business, while ResidualCo is then usually wound down or makes an assignment into bankruptcy.

AMI transferred assets and liabilities to ResidualCo in exchange for promissory notes owing from AMI to ResidualCo. Subsequently, all the shareholders of AMI exchanged their shares for shares of ResidualCo. The result is that the creditors and shareholders of AMI become the creditors and shareholders of ResidualCo.

The shares of AMI owned by ResidualCo were then cancelled in contemplation of AMI being purchased by a third party. The reverse vesting order states that these shares were cancelled for no consideration to ResidualCo.

AMI was then acquired for almost $22 million, received by ResidualCo (the distributable proceeds) and distributed to the former creditors and shareholders of AMI (now the creditors and shareholders of ResidualCo).

Issues

The fundamental issue underlying this case is that ResidualCo wanted clarification as to the tax consequences of the reverse vesting order. Specifically, ResidualCo sought a declaration for an interpretation of the reverse vesting order under which the distributable proceeds were received by ResidualCo not directly as taxable income, but rather, as proceeds of disposition of the AMI shares that were cancelled.

Such an interpretation of the reverse vesting order would create favourable tax outcomes for ResidualCo but would appear to be in conflict with the plain reading of the reverse vesting order that the shares of AMI owned by ResidualCo were cancelled for no consideration.

ResidualCo also sought declarations related to their tax analysis. Specifically, ResidualCo sought advice and direction on how to determine the appropriate holdback amounts when distributing funds to equity claimants under the bankruptcy proceeding.

The Court was concerned with the threshold question of whether the Court of King's Bench of Alberta had the jurisdiction to decide such matters.

Decision summary

In relation to the declaratory relief sought by ResidualCo, Justice Barbara Johnston ultimately concluded that the Court of King's Bench of Alberta:

1. had the jurisdiction to grant such relief regarding the interpretation of the reverse vesting order, but ultimately declined to grant it; and
2. did not have the jurisdiction to grant such relief regarding the direct tax questions posed by ResidualCo.

The *Tax Court Act* gives the Tax Court of Canada the exclusive jurisdiction to hear and determine references and appeals on matters arising under the *Income Tax Act*. However, Justice Johnston noted that there was "no extant reference or appeal" in this case. No notice of assessment had been issued, and no return had been filed for ResidualCo. On this basis, the Court distinguishes several cases in which provincial courts declined jurisdiction and refused to provide declaratory relief where tax matters were at issue.

The Court fundamentally characterized ResidualCo's application as applying to the Court for an interpretation of the reverse vesting order, rather than for a direct determination of tax issues. On this basis, the Court found that the Tax Court did not have exclusive jurisdiction and that the Court did have the jurisdiction to grant the declaration.

However, the Court declined to grant the declaration for the following three reasons:

1. **Evidence**: There was a lack of evidence that the parties intended for the reverse vesting order to be interpreted in the manner now put forth by ResidualCo.
2. **Public interest**: The Court raised concerns that declaring an interpretation correct in advance of filing tax returns may not be in the public interest (*e.g.* because it may result in provincial courts doing the specialized work of the CRA and Tax Court in an unsystematic manner and lead to taxpayer confusion).
3. **Timing**: The Court raised concerns about the timing of the application. Professional advisers were engaged in the reverse vesting order structure, but this application now comes almost two years after the reverse vesting order was issued, with the applicant now seeking this declaration which essentially reads in language that was not argued when the reverse vesting order was initially granted.

The Court declined to grant the declaration related to ResidualCo's tax analysis on the basis that it did not have the jurisdiction to do so. ResidualCo wanted the Court to confirm issues such as whether certain shares are taxable Canadian property, and what the paid-up capital of those shares would be for income tax purposes. Ultimately, these determinations are not within the jurisdiction of the Court of King's Bench of Alberta. The Court stated that to make such determinations would be, in effect, an advance tax determination.

Provincial courts can interpret provisions of the *Income Tax Act* if it is necessary to decide an issue properly before the Court, but in seeking these specific declarations, ResidualCo was instead squarely asking the Court of King's Bench of Alberta to decide a tax issue.

Implications

This decision leaves open the possibility that a taxpayer could successfully obtain declaratory relief from a provincial court regarding the tax consequences of an order issued by a Court where the facts are suitably on the taxpayer's side (*e.g*. better evidence, timing, and public interest considerations). This may lead to litigants attempting to seek tax advice from provincial judges by seeking such declaratory relief and framing such attempts as a necessary corollary of an issue "properly" before the Court.

If such relief were granted in this case, it would have directly determined the figures used on ResidualCo's tax returns. Justice Johnston agreed that ResidualCo in effect sought to "have the court declare their interpretation of the [reverse vesting order] correct **in order to assert a resulting tax consequence**". In such cases, it would create jurisprudential clarity if provincial courts would simply decline jurisdiction. However, it would also restrict the flexibility for provincial court judges to deal with complex fact patterns, especially in areas which commonly interface with tax issues (such as bankruptcy proceedings).

Given the existing jurisdictional muddiness between the Tax Court and the Federal Court, a clearer and more principled doctrine may be required to avoid further confusion for both taxpayers and civil litigants in provincial court.

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