

Subject Matter Jurisdiction of a State Court to Adjudicate the Merits of a Federal Tax Assessment

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RECENT DECISIONS

Subject Matter Jurisdiction of a State Court to Adjudicate the Merits of a Federal Tax Assessment: In *P. C. Monday Tea Co. v. Milwaukee County Expressway Comm'n*,¹ the Expressway Commission took real estate of the Tea Company by eminent domain, and the Company appealed the amount of the award to the circuit court; the Company was adjudicated a bankrupt, and plaintiff Robert W. Monday became assignee of the interest of the trustee in bankruptcy. The United States applied to be made a party, and filed a complaint alleging that the Company was liable for withholding taxes, interest, and penalties which had been assessed, that due notice had been given and demand made, and that notices of lien had been filed. The United States filed a Notice of Levy with the clerk of circuit court stating that it had a lien on all property of Mr. Monday, and that any money owed to him by the court was levied on and seized for satisfaction of the tax. After Mr. Monday was awarded judgment against the Commission, the United States ordered the clerk to retain \$14,000 pending disposition of the government claim, the validity of the assessment to be “. . . determined by this Court or another court having jurisdiction in the matter; . . .”²

In circuit court, Monday filed both an answer to the government's complaint and a counterclaim stating he was not personally liable for a 100% penalty for failure to collect, account for, and pay to the United States withholding taxes due from P. C. Monday Tea Company. The United States demurred to the counterclaim, stating that the counterclaim failed to show that the court had jurisdiction over the subject matter because sections 7421 and 7422 of the Internal Revenue Code (26 U.S.C.)³ prohibit suit for the purpose of restraining the assessment or collection of any tax or penalty in any court; the demurrer was sustained and Mr. Monday appealed.

The court determined the issue to be: whether a state court which has control of a fund on which the United States claims a lien for unpaid taxes, and against which the United States seeks to enforce its lien, has jurisdiction to go behind the assessment and determine the existence or amount of the taxpayer's liability. The court held that it had no such jurisdiction, and accordingly upheld the trial court which had sustained the demurrer.

Monday's objections to the assessment raised in his counter-

¹ 29 Wis.2d 372, 139 N.W.2d 26 (1966).

² *Id.* at 375, 139 N.W.2d at 27.

³ All section references hereafter will be to the Internal Revenue Code of 1954 unless otherwise indicated.

claim alleged no procedural defects, but only questioned the merits of the grounds for the assessment. In order to consider the merits, the circuit court must have jurisdiction to determine liability notwithstanding the determination made by the federal officer who entered the assessment. The court limited its discussion to subject matter jurisdiction, and found it unnecessary to consider: (1) whether the United States Attorney's request that the government be made a party in order to assert its claim is sufficient consent to adjudication by the circuit court of its claim based on Monday's individual liability, or (2) whether service on the clerk of the Notice of Levy, standing alone is consent to such adjudication.

Generally, the internal revenue system in the United States is one of self assessment; the taxpayer computes his own tax and makes a return to the Internal Revenue Service, which may audit and correct the return and assess a deficiency to the extent the tax shown on the return is not correctly computed, or may credit or refund any excess paid.⁴ The Secretary of the Treasury or his delegate is authorized to make inquiries, determinations, and assessments of taxes. Assessment is made by recording the liability of the taxpayer in the office of the Secretary or his delegate.

The Internal Revenue Code authorizes the Secretary of the Treasury or his delegate to enter into closing agreements with respect to taxes,⁵ or to compromise any civil or criminal case arising under internal revenue laws.⁶ Immediate assessment of a tax or deficiency is allowed by the Code if the Secretary or his delegate believes that assessment or collection will be jeopardized by delay.⁷

When an examination of a return is performed and a deficiency is found, the taxpayer and the examining agent may agree on the amount. If they do not agree, the taxpayer is entitled to settlement conferences at three stages:⁸ (1) the taxpayer may request a district conference; (2) if he by-passes the district conference or if it does not conclude in an agreement, he may have an appellate conference with the Appellate Division, upon filing of a formal protest; (3) if an agreement is not reached, a "90 day letter" (statutory notice of deficiency) is issued from which the taxpayer may appeal to the Tax Court.⁹ Except for jeopardy assessments, and in the case of bankruptcy, receivership, or certain minor technical exceptions,¹⁰ no assessment of income tax deficiencies nor levy or proceeding in

⁴ 30 AM. JUR. *Internal Revenue* §134 (1958).

⁵ INT. REV. CODE OF 1954, §7121(a).

⁶ INT. REV. CODE OF 1954, §7122(a).

⁷ INT. REV. CODE OF 1954, §§6861 *et seq.*

⁸ RABKIN AND JOHNSON, *FEDERAL INCOME, GIFT AND ESTATE TAXATION* §71.02B (1966).

⁹ INT. REV. CODE OF 1954, §§7421, 6212(a), 6213(a).

¹⁰ INT. REV. CODE OF 1954, §6213(b).

a court for its collection may be made, begun, or prosecuted until the notice has been mailed to the taxpayer, or until expiration of the period for filing a petition with the Tax Court, or, if a petition has been filed, until the decision of the Tax Court is final.¹¹ The Tax Court decision may be reviewed by a Court of Appeals.¹² The filing by a taxpayer of an appeal to the Tax Court normally precludes the government from requiring payment of the tax.¹³ A lien arises where a person neglects or refuses to pay any tax, after a demand is made;¹⁴ it arises at the time the assessment is made, and continues until liability for the amount assessed is satisfied or becomes unenforceable by lapse of time.¹⁵

The Wisconsin court found no federal statute which confers jurisdiction upon it to determine the validity of federal tax assessments which supports such liens. The Wisconsin court found that the broad, general policy concerning collection of disputed federal taxes is the doctrine of pay first-litigate later. The impact of that doctrine was emphasized to such an extent in *Flora v. United States*¹⁶ that it can hardly be overlooked:

Moreover, throughout the congressional debates are to be found frequent expressions of the principle that payment of the full tax was a preconditioned to suit: pay his tax * * * then * * * file a claim for refund'; 'pay the tax and then sue'; 'a review in the courts after payment of the tax'; 'he may seek court review, but he must first pay the tax assessed' . . .¹⁷

The so-called "pay first" rule is implemented by section 7421, which prohibits suits to restrain the assessment or collection of a federal tax in any court, except where the taxpayer petitions the Tax Court subsequent to his receipt of the "90 day letter."¹⁸ In *Mulcahy v. United States*,¹⁹ a 100% penalty which the government sought against the responsible officer of a corporation which had not paid over taxes withheld from employees, was a tax within section 7421. A suit may be maintained to enjoin collection of a tax

¹¹ 30 AM. JUR. *Internal Revenue* §156 (1958).

¹² INT. REV. CODE OF 1954, §7483.

¹³ *Flora v. United States*, 362 U.S. 145 (1960).

¹⁴ INT. REV. CODE OF 1954, §6321.

¹⁵ INT. REV. CODE OF 1954, §6322.

¹⁶ 362 U.S. 145, 159 (1960).

¹⁷ *Ibid.* The court continued its emphasis as follows: ". . . 'in order to go to court he must pay his assessment'; 'he must pay it [his assessment] before he can have a trial in court'; 'pay the tax adjudicated against him, and then commence a suit in a court'; 'pay the tax . . . [t]hen . . . sue to get it back'; 'paying his tax and bringing his suit'; 'first pay his tax and then sue to get it back'; 'take his case to the district court—conditioned, of course, upon his paying the assessment.'" *Id.* at 159.

¹⁸ See also INT. REV. CODE OF 1954, §§6212(a), (c), 6312 (a) for petitioning the Tax Court.

¹⁹ 237 F. Supp. 656 (D.C. Tex. 1964).

where in addition to the illegality of the tax there exist some extraordinary circumstances sufficient to bring the case within some acknowledged principle of equity jurisprudence;²⁰ however, such a suit may not be maintained where the legal remedy of paying the tax and bringing a refund suit to recover the amount paid is adequate.²¹ The prohibition of suits to restrain the assessment or collection of a federal tax is not inapplicable merely because collection would cause an irreparable injury, such as ruination of the taxpayer's enterprise. If section 7421 is to be inapplicable, the inadequacy of the legal remedy must be established.²²

The Wisconsin court found three exceptions to the rule of payment before litigation: (1) where there is express authorization to resort to the Tax Court; (2) where the United States brings an action at law to recover judgment for the amount of the tax; and (3) where the United States brings a suit in federal district court under section 7403 of the Internal Revenue Code. The first exception is discussed in an earlier part of this article.

Where the United States brings an action at law to recover judgment for the amount of the tax, (exception 2) the assessment is not conclusive, but only presumptive. This exception to the rule of payment before litigation began in *Clinkenbeard v. United States*²³ and *United States v. Rindskopf*.²⁴

Under section 7403 (exception 3), in any case where there has been a refusal or neglect to pay a tax or discharge any tax liability, whether or not levy has been made, a civil action may be filed in the United States District Court to enforce the tax lien of the United States or to subject any property of the delinquent taxpayer or in which he has any interest, to the payment of such tax or liability.²⁵ All persons having liens on or claiming any interest in the property involved are to be made parties to the action.²⁶ The court may adjudicate all matters involved and finally determine the merits of all claims to and liens on the property, and may decree sale and distribution where a claim or interest of the United States is established.²⁷ In such a proceeding, the United States may have a receiver appointed.²⁸

In *Pipola v. Chico*,²⁹ an action brought by the purchasers of real

²⁰ *Martin v. Andrews*, 283 F.2d 552, 65 A.L.R.2d 543 (9th Cir. 1956).

²¹ 30 AM. JUR. *Internal Revenue* §248 (1958).

²² *Enochs v. Williams Packing & Nav. Co.*, 370 U.S. 1 (1962).

²³ 88 U.S. (21 Wall.) 65 (1874).

²⁴ 105 U.S. 418 (1881).

²⁵ INT. REV. CODE OF 1954, §7403 (a).

²⁶ INT. REV. CODE OF 1954, §7403 (b).

²⁷ INT. REV. CODE OF 1954, §7403 (c).

²⁸ *United States v. Kensington S. & D. Corp.*, 187 F.2d 709, 27 A.L.R.2d 708 (3rd Cir. 1951).

²⁹ 274 F.2d 909 (2d Cir. 1960).

property (under section 2410 of the Judicial Code³⁰) to cancel a Government tax lien against their grantor as erroneously assessed, the Government successfully challenged the plaintiff's right to go behind a federal tax lien, on the theory that in *Bull v. United States*³¹ there was dictum stating a grantor could not do so; therefore, neither should a grantee be permitted to do so. Later, the Government reversed its position and concluded that although its victory in *Pipola* reached the correct result, the basis of that result should have been that the taxpayer could contest the assessment, but a transferee could not.

The right of a taxpayer to attack the merits of a tax assessment in an action brought against him by the Government under section 7403 was upheld by the Second Circuit in *United States v. O'Connor*,³² in a decision which overruled *Pipola*. The government's change of position after *Pipola* was based on the language of section 7403(c);³³ however, the court in *O'Connor* stated that this language settled nothing because, if as stated in *Bull*, the assessment had the force of a judgment except in a proceeding before the Tax Court under section 6213 or a refund suit under Internal Revenue Code section 7422³⁴ and Judicial Code section 1346(a)(1),³⁵ ". . . 'the merits' would simply be the procedural regularity of the assessment and the determination of the property to which the lien attached."³⁶

The Second Circuit in *O'Connor* found that the issue was:

Whether in a suit under §7403 the assessment is conclusive, as it would be in a summary method of enforcement, or presumptive but inconclusive as it would be in an action at law on the assessment or on a bond to secure its payment.

The two early Supreme Court cases of *Clinkenbeard*³⁷ and *Rindskopf*,³⁸ not called to the court's attention in either *Bull* or *Pipola*, were

³⁰ 28 U.S.C. §2410(a) (1965).

³¹ 295 U.S. 247 (1935).

³² 291 F.2d 520, 100 A.L.R.2d 858 (2d Cir. 1961).

³³ INT. REV. CODE OF 1954, §7403(c) states that the court shall adjudicate all matters involved in the action and finally determine the merits of all claims to and liens on the property.

³⁴ INT. REV. CODE OF 1954, §7422; this section states that there may be no suit prior to filing a claim for refund, to recover any tax alleged to have been erroneously or illegally assessed or collected, or any penalty claimed to have been collected without authority.

³⁵ 28 U.S.C. §1346(a)(1) (1965); this section states that district courts have original jurisdiction concurrent with the court of claims, of any civil action against the United States for recovery of any internal revenue tax which the plaintiff alleges was erroneously or illegally assessed or collected, or any penalty he claims was collected without authority or any amount he alleges to have been excessive or wrongfully collected under internal revenue laws. The jurisdiction limit of \$10,000 does not apply on suits to recover taxes.

³⁶ *United States v. O'Connor*, 291 F.2d 520, 526, 100 A.L.R.2d 858 (2d Cir. 1961).

³⁷ *Clinkenbeard v. United States*, 88 U.S. (21 Wall.) 65 (1874).

³⁸ *United States v. Rindskopf*, 105 U.S. 418 (1881).

noted by the *O'Connor* court as holding that when the Government sues on a bond to secure payment of an assessment, the legality of the assessment is open for judicial determination. Thus, it was concluded that when the Government seeks the aid of the courts, it opens the assessment of scrutiny.³⁹ The court found further support for its conclusion in the history of the legislation; it was noted that section 7424, which concerns civil actions by third persons to clear title to property, expressly provides that the assessment upon which the lien of the United States is based is conclusively presumed valid, and that both section 7403 and section 7424 were once parts of Revised Statutes, section 3207, but that the conclusive presumption part of section 7424 was absent from section 7403. In 1954, when the House Committee added a provision to section 7403 which made the merits of the assessment conclusive, the Senate Committee eliminated the amendment.⁴⁰ This fact was considered insignificant in *Pipola*, as the Senate stated that its deletion was not intended to change the existing law.⁴¹ In *O'Connor*, the court reconsidered the deletion, and found that it had considerably greater impact than had been accorded to it in *Pipola*.

The *O'Connor* rule, regarding section 7403, has come under criticism.⁴² The conclusion that the merits of the Government's claim may be adjudicated in a section 7403 suit seems inconsistent with the congressional policy of summary tax collection.⁴³ Yet, subsequent cases have upheld the *O'Connor* conclusion.⁴⁴

Section 2410(a) of the Judicial Code⁴⁵ authorizes the naming of the United States as a party in any quiet title or foreclosure action in any district court or in any state court having subject matter jurisdiction, where the United States claims a mortgage or other lien on the property involved. In 1960, the *Pipola*⁴⁶ case, held that the court could not inquire into the merits of an assessment in a suit under section 2410; however, in 1961, this holding was disavowed in *O'Connor*,⁴⁷ casting doubt on whether or not the merits are closed in a section 2410 proceeding.⁴⁸ In *Cooper Agency, Inc. v.*

³⁹ "We think the closer analogy is to the action at law on the assessment; when the Government seeks the aid of the courts in enforcing the assessment in any form it opens the assessment to judicial scrutiny in all respects." United States v. *O'Connor*, 291 F.2d 520, 527, 100 A.L.R.2d 858 (2d Cir. 1961).

⁴⁰ H.R. REP. No. 1337, 83d Cong., 2d Sess. A431 (1954).

⁴¹ S. REP. No. 1622, 83d Cong., 2d Sess. 610 (1954).

⁴² Note, 71 YALE L. J. 1329 (1962).

⁴³ Further arguments are contained *Id.* at 1336.

⁴⁴ *Quinn v. Hook*, 231 F.Supp. 718, 721 (E.D. Pa. 1964); *United States v. Lease*, 346 F.2d 696, 698 (2d Cir. 1965).

⁴⁵ 28 U.S.C. §2410(a) (1965).

⁴⁶ *Pipola v. Chico*, 274 F.2d 909 (2d Cir. 1960).

⁴⁷ *United States v. O'Connor*, 291 F.2d 520, 100 A.L.R. 858 (2d Cir. 1961).

⁴⁸ Note, 71 YALE L. J. 1329 (1962).

McLeod,⁴⁹ a suit was brought by transferees to enjoin the United States from taking action to enforce collection of jeopardy assessments and to have the assessments and lien declared invalid. In granting the defendant's motion to dismiss, the court stated that the intent of the court in *O'Connor* in overruling *Pipola* was not to allow inquiry into the merits of an assessment in an action under section 2410, and that *Pipola* was overruled only because it was based on a faulty premise, and not because it reached an erroneous conclusion.⁵⁰ Several other cases have since reached the same conclusion.⁵¹

In the recent case of *Falik v. United States*,⁵² the Second Circuit held that section 2410 was not intended to overturn the longstanding principle that, except in certain exceptional cases with respect to determinations of deficiencies of income, gift, and estate tax by the Tax Court,⁵³ a person whose sole claim is that a federal tax assessment was not well grounded in fact and law must pay first and litigate later. The court noted that an action to remove a tax lien as a cloud on a taxpayer's title was not maintainable because it was, in effect, not a suit for an injunction to restrain assessment or collection of tax, and therefore forbidden by section 7421(a). Such action is similar to that contemplated by the Declaratory Judgment Act⁵⁴ to which Congress attached an exception with respect to federal taxes, and to allow maintenance of such an action would constitute a radical departure from the long-continued policy of Congress.

The Wisconsin court, in *Monday*, cited section 610 of the Restatement of Conflicts and found an anomaly in a state court deciding the issue of an individual's liability under tax laws of the United States. Although the Restatement stated that "No action can be maintained by a foreign state to enforce its license, or revenue laws, or claims for taxes,"⁵⁵ the 1948 Supplement to the Restatement deleted this statement, added a caveat that no opinion was expressed on whether an action could be maintained by a foreign state on a claim for taxes, and added

⁴⁹ 235 F.Supp. 276 (E.D.S.C. 1964).

⁵⁰ *Id.* at 284.

⁵¹ *Quinn v. Hook*, 231 F.Supp. 718 (E.D. Pa. 1964); *Broadwell v. United States*, 234 F.Supp. 17, 18 (No. Car. 1964); *Seff v. Machiz*, 246 F.Supp. 823 (E.D. So. Car. 1965); *McCann v. United States*, 248 F.Supp. 585, 587 (E.D. Pa. 1965).

⁵² 343 F.2d 38 (2d Cir. 1965).

⁵³ INT. REV. CODE OF 1954, §6213.

⁵⁴ 28 U.S.C. §2201 (1965). The Federal Declaratory Judgment Act of 1934 was amended by section 405 of the Revenue Act of 1935 to exclude federal tax disputes. The Senate report (S.Rep. No. 1240, 74th Cong., 1st Sess.) explained that the Act has no application to federal taxes because its application thereto ". . . would constitute a radical departure from the long continued policy of Congress with respect to the determination, assessment, and collection of Federal taxes." The court in *Flora v. United States*, 362 U.S. 145, 164 (1960) stated: "It is clear enough that one 'radical departure' which was averted by the amendment was the potential circumvention of the 'pay first and litigate later' rule by way of suits for declaratory judgments in tax cases."

⁵⁵ RESTATEMENT, CONFLICTS OF LAW, §610 (1934).

that if a position were taken now it would seem desirable to hold contrary to the original view.

It was noted by the court that Mr. Monday cited the Texas case of *Paddock v. Siemoneit*,⁵⁶ in which a state court decided a dispute over liability of a taxpayer for federal taxes where the United States had intervened in a state action for personal judgment for the penalty and foreclosure of its lien. The State court decided the case without discussing its power to do so. The Wisconsin case of *Estate of Olson*,⁵⁷ not cited in the principal case, was similar to the Texas case. Olson died in December, 1953, and in connection with the probate of his estate, the District Director of Internal Revenue filed a claim for additional taxes owed by Olson and the administrator filed objections. The trial court's decision for the Government was upheld on appeal, and, again, the issue of jurisdiction of a state court to determine the validity of a federal tax lien on its merits was never raised.

The Wisconsin court found that Monday's counterclaim was susceptible to either of two interpretations, but that the same conclusion resulted either way. (1) If treated as a complaint in an action to quiet title to the fund held by the court, the federal assessment would be conclusive under the rule promulgated in *Falik*. (2) If viewed as a defensive pleading, and this is more realistic, the question would be whether the enactments and doctrines of the federal scheme of tax collection impliedly exclude state court jurisdiction to set aside assessments of federal taxes. The court refused to apply the *O'Connor* doctrine relating to section 7403 to a suit brought in a state court, and concluded that state courts are, in fact, impliedly excluded from such jurisdiction.

"Congressional policy," said the Wisconsin court in *Monday*, "appears to favor adjudication in such [tax] disputes in federal courts after payment of the tax assessed. We conclude, therefore, that the state courts are not to adjudicate them, at least in the situation present here."⁵⁸ This statement set the tone for the majority's reasoning throughout the case; the court seemed to be rather unsure of its footing, and repeatedly restricted its decision to the facts of the case before it. In form, the decision limited its conclusion that a state has no subject matter jurisdiction to adjudicate disputes over the merits of a federal tax assessment to the facts of the present case—where the court is holding a fund on which the Government claims a tax lien; however, a review of the court's reasoning points to a far different effect.

The Wisconsin court made an important addition to the *O'Connor* rule; it has found that although *O'Connor* made no statement expressly

⁵⁶ 147 Tex. 571, 218 S.W.2d 428, 7 A.L.R.2d 1062 (1949).

⁵⁷ 271 Wis. 199, 72 N.W.2d 717 (1955).

⁵⁸ *P. C. Monday Tea Co. v. Milwaukee County Expressway Comm'n.*, 29 Wis.2d 372, 382, 139 N.W.2d 26, 32 (1966).

restricting its holding to an action in a federal court, the particular action involved was in a federal court and was brought there pursuant to a federal statute. Thus, the Wisconsin court held that while a federal court may have the power to adjudicate the merits of a federal tax assessment in a suit brought to enforce the lien of the United States, a state court has no such power. The court found an implied exclusion of state court jurisdiction, at least where the United States is demanding payment out of a fund in the control of the state court; such implication arose from the general rule of pay first—litigate later, and the anomaly which would exist if a state court had the power to review administrative decisions of a federal officer. The court further pointed out that it would also be anomalous for a state court to decide an individual's liability to the United States under federal tax laws, and in granting power to a state court to review administrative decisions of a federal officer in his application of federal laws. The duty of state courts to give full recognition to laws of the United States ". . . does not compel the conclusion that Congress intended state courts to have jurisdiction to determine disputes over liability for federal taxes."⁵⁹

The Wisconsin court pointed out, and rightfully so, that the Declaratory Judgment Act expressly excepts all tax disputes. Furthermore, the court cited *Falik*⁶⁰ in noting that in an action brought under section 2410 of the Judicial Code, for quiet title or foreclosure actions, a court has no jurisdiction to go behind a tax assessment and determine its validity. It also pointed out that congressional policy favors payment before litigation unless resort is made to the Tax Court, and that there is no federal statute conferring jurisdiction on a state court to determine the merits of a federal tax assessment. Thus, while the court, by its express language, limited its holding to the facts before it, it has, by implication, concluded that a state court has no subject matter jurisdiction to adjudicate disputes over liability for federal taxes in virtually all situations. In light of this conclusion, it seems that the only reason for deciding the tax assessment on its merits in the *Olson* case was that the issue of jurisdiction was never raised.

The court was apparently reluctant to hold that a state court has jurisdiction to determine the validity of a federal tax lien on its merits, without express authority from Congress or at least some federal court; even the open door of the *O'Connor* case was insufficient to persuade the court that it had such power, though *O'Connor* set down a broad principle which did not expressly exclude state courts. Section 7403 of the Internal Revenue Code, cited in *O'Connor*, expressly speaks of bringing a suit in a federal district court, but does not exclude bringing a suit in a state court. The conclusion that the statute limits suits to/

⁵⁹ *Ibid.*

⁶⁰ *Falik v. United States*, 343 F.2d 38 (2d Cir. 1965).

enforce a tax lien to federal courts, is apparently not as clear-cut as it would appear on the surface, for Justice Hallows, in his dissent in *Monday*, stated that he believed the *O'Connor* rule applies to state courts as well as federal courts. Justice Hallows also found no implied exclusion of a state court's jurisdiction, as the majority did, nor any anomaly in according to the Wisconsin court the power to decide this issue. He argued that the United States sought this result when it applied to the state court for enforcement of a lien against money in its custody.⁶¹

Actually, the holding of the majority seems reasonable in light of the federal statutes and the apparent anomaly of a state court overriding a federal officer's determination based on federal law. Should Justice Hallows' view be adopted, additional problems would arise concerning the extent of a state court's jurisdiction; for example: would jurisdiction be limited to those cases in which the court held assets of the taxpayer? In any event, it appears that it will take a federal statute or at least a federal court decision stating expressly that a state court has the power to determine the validity of a federal tax assessment on its merits before Justice Hallows' view is followed in Wisconsin.

MARTIN J. KURZER

Diversity Jurisdiction: Erie Amenability of a Foreign Corporation to Federal Court Derivative Suit: In *Lapides v. Doner*¹ a minority stockholder of the DWG Cigar Corporation, incorporated in Ohio, and three of the corporate directors brought a diversity derivative suit in United States District Court for the Eastern District of Michigan against five directors and the corporation seeking a declaration that resolutions adopted at a meeting of the board of directors were void. The resolutions included the replacement of the plaintiffs with the individual defendants on the board of directors and the executive committee.

Since under *Wojtczak v. American United Ins. Co.*,² the Michigan courts would not assume jurisdiction over an action involving the exercise of control or management of the internal affairs of a foreign corporation, the case hinged on whether the *Erie*³ doctrine, as developed by later cases⁴ required the district court to apply the Michigan rule. Thus, the ultimate problem was whether the Michigan rule, as expressed

⁶¹ *P. C. Monday Tea Co. v. Milwaukee County Expressway Comm'n.*, 29 Wis.2d 372, 383, 139 N.W.2d 26, 32 (1966).

¹ 248 F.Supp. 883 (1965).

² 293 Mich. 449, 292 N.W. 364 (1940).

³ *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938), Federal Courts in diversity matters must apply the substantive law of the state wherein the cause of action occurred, and federal procedural law.

⁴ *Guaranty Trust Co., v. York*, 326 U.S. 99 (1945); *Byrd v. Blue Ridge Rural Electric Coop., Inc.*, 356 U.S. 525 (1958).