Case Comments

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CASE COMMENTS

TAXATION — Subchapter S Corporations — A Distribution of Property Will Qualify as a Distribution of Previously Taxed Income to the Shareholders of a Subchapter S Corporation and Will Not Be Taxed Except to the Extent That the Fair Market Value of the Property Exceeds Its Tax Basis to the Corporation. — On December 31, 1960, Marie L. DeTreville received a check for $17,631.34 from Forest Land Company, Inc., a qualifying small business corporation.1 This represented her portion of a total of $212,868.64 paid on that day to the shareholders of the corporation as a distribution of undistributed taxable income and previously taxed income. On January 6, 1961, DeTreville and the other shareholders issued checks to Forest for the purchase of shares of stock in the Mount Vernon Life Insurance Co. in substantially the same amounts as they had received on December 31, 1960.

The Internal Revenue Service found these transactions to be a sham. It determined that there was, in fact, only one transaction involving a distribution of property, not cash, and that it did not qualify as a tax-free distribution of previously taxed income under Treasury Regulation 1.1375-4(b).2 On the basis of these findings, DeTreville was assessed and paid additional personal income tax in the amount of $9,862.47. In an action to recover the amount, the court held: a distribution of property will qualify as a distribution of previously taxed income to the extent of the basis of the distributing corporation in the property, and only that portion of the value of the property which represents the excess of the fair market value over the basis will be subject to tax in the hands of the shareholders; insofar as Treasury Regulation 1.1375-4(b) states otherwise, it is invalid. DeTreville v. U.S., CCH 1970 STAND. FED. TAX REP., U.S. TAX CAS. (70-1, at 82,695) ¶ 9163 (D. S.C. Dec. 10, 1969).

On the surface, the holding of the court does not seem to disturb the law of small business corporations. The holding invalid of a Treasury Regulation as an attempt to “impose or add conditions or qualifications not imposed by Congress or within the Congressional purpose” is neither new nor unusual.3 The impact

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2 Treasury Regulation § 1.1375-4(b) provides that:
   Except as provided in paragraph (c) of this section, any actual distribution of money by an electing small business corporation to a shareholder which, but for the operation of this section, would be a dividend out of accumulated earnings and profits shall be considered a distribution of previously taxed income to the extent of the shareholder’s net share of previously taxed income immediately before the distribution. Thus, a distribution of property other than money or a distribution in exchange for stock, or a constructive distribution under section 1375(b), is never a distribution of previously taxed income. Since current earnings and profits are first applied to distributions of money which are not (1) in exchange for stock, or (2) distributions of the corporation’s undistributed taxable income for the immediately preceding taxable year under section 1375(f) and § 1.1375-6 (see paragraphs (d) and (e) of § 1.1373-1), a distribution of previously taxed income may occur only if during its taxable year the corporation makes such money distributions in excess of its earnings and profits for such taxable year. (See § 1.1375-5 for rules with respect to certain distributions of money which may be treated as having been made in a preceding taxable year.)
of such a holding may, however, be severe if the regulation invalidated constitutes an integral part of a scheme or plan sought to be achieved by the legislature.

The small business corporation (referred to as the "Sub S corporation") is part of a special category which has been carved out of the ordinary corporate tax law by what has been called "a novel scheme of statutory provisions." The "scheme" which does this "carving" is subchapter S of chapter 1 of the Internal Revenue Code. Subchapter S contains only eight sections and, as such, is by no means self-contained or all-inclusive. It simply denominates the manner in which Sub S corporations differ from other corporations under chapter 1. Other provisions of chapter 1 of the Code that are not inconsistent with subchapter S still apply to a Sub S corporation in the same manner that they apply to any other corporation.

With few exceptions, a Sub S corporation determines taxable income in the same manner as any other corporation. The basic difference between a Sub S corporation and an ordinary corporation is that the Sub S corporation is not "subject to taxes imposed by" the normal corporate law. The intent of the lawmakers was to allow the small business corporation to be taxed like a partnership. The likenesses between a Sub S corporation and a partnership extend basically to the point where the income of the entity is "passed through" to the shareholder. This income is included by the shareholder in his own gross income. The net effect is, of course, escape from the "double taxation" normally experienced by the corporate income that is distributed to shareholders.

If this were the full extent of the operation of Subchapter S, it would appear that there would be few problems. Shareholders, however, are not content to pay taxes on income that simply accumulates in the coffers of the entity in which they have part ownership. They want their share of the profits distributed to them. It is at this point that the highly technical, accounting-oriented aspects of subchapter S come into play to temper the wishes of such shareholders.

Initially, it is important to note that "earnings and profits of an electing [Sub S] corporation may, in some cases, exceed the taxable income of the corporation." This will be true in cases where statutory deductions from earnings and

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4 This commonly used term refers to the heading found before INT. REV. CODE of 1954, §§ 1371-78: SUBCHAPTER S—ELECTION OF CERTAIN SMALL BUSINESS CORPORATIONS AS TO TAXABLE STATUS.
5 INT. REV. CODE of 1954, ch.l.
7 The Internal Revenue Code is Title 26 of the United States Code.
8 INT. REV. CODE of 1954, §§ 1371-78.
10 Under section 1373(d), a Sub S corporation’s income determination may not include deductions for:
   a. net operating loss carrybacks or carryovers;
   b. dividends received from other corporations;
   c. certain tax exempt interest; and
   d. dividends from certain preferred stock.
12 INT. REV. CODE of 1954, § 1372(b).
15 INT. REV. CODE of 1954, § 1373(a).
17 178 BNA TAX MGMT. PORTFOLIO B-11 (1968).
profits are allowed before arriving at taxable income. An example of one such
deduction is the percentage depletion allowance on the extraction of natural
resources. In this case a certain amount of earnings and profits has escaped
taxation on the corporate level. If the corporation were a Sub S corporation these
earnings would also escape taxation (temporarily) on the shareholder level, becausethey do not represent any portion of the undistributed taxable income,
required to be included in the shareholders' gross incomes. It is for this reason
that subchapter S distinguishes between undistributed taxable income [UTI] and
earnings and profits [E&P].

The determination of the amount of UTI and its allocation is accomplished
by use of the statutory fiction of a constructive dividend, an amount equal to
that which a shareholder

would have received as a dividend, if on [the] last day of the taxable year
there had been distributed pro rata to its shareholders by [the] corporation
an amount equal to the corporation's undistributed taxable income for the
corporation's taxable year.

For purposes of this fiction, UTI is decreased by the amount of money that has
been distributed during the taxable year. It is extremely important to note that
only money distributions are excludable from UTI, and that an elaborate set of
regulations governs the tax consequences of property distributions made during
the year. These regulations state explicitly that "for the purposes of section
1373(c) a distribution of money does not include a distribution of... property
other than money in satisfaction of a dividend declared in money." For this
reason, "a property dividend may unexpectedly enlarge the amount of dividend
income taxed to the shareholders of a Subchapter S corporation, so that they
will be taxed on more than the current earnings of the corporation."

After E&P and UTI have been determined for the taxable year, E&P is
reduced by the amount of UTI before the recognition of money distributions.
Money distributions are then deducted and the adjusted UTI amount applied to
increase the basis of the shareholders' stock. The net effect of this manipulation
is to put the UTI in a position in which it cannot be distributed prior to the
distribution of E&P. This applied UTI is now generally known as previously
taxed income [PTI]. The PTI is "locked in" because any corporate distributions
are made first out of E&P and are taxable as such. This would seem to leave

18 These "statutory deductions" are in contradistinction to "accounting deductions" which
have a basis in the actual operations of the corporation. "Accounting deductions" are ex-

19 INT. REV. CODE OF 1954, § 613(a)-(b).
20 INT. REV. CODE OF 1954, § 1373(a).
21 Id. § 1373(b).
22 Id. § 1373(c).
24 Id. § 1.1373-1(d).
26 INT. REV. CODE OF 1954, § 1377(a).
27 Id. § 1376(a).
29 INT. REV. CODE OF 1954, § 316(a).
Sub S corporation shareholders in an untenable position, since the earnings upon which they have paid taxes are unavailable, on a tax-free basis, until after E&P have been distributed. This dilemma is remedied, however, by section 1375(d) of the Code which allows the distribution of PTI before E&P. Until DeTreville, the distribution of PTI was limited solely to money distributions. This stipulation was not found on the face of section 1375(d) but rather in Treasury Regulation 1.1375-4(b) which states that "a distribution of property other than money or a distribution in exchange for stock, or a constructive distribution under section 1373(b), is never a distribution of previously taxed income."^{30}

In DeTreville, the court found that prior to making its Subchapter S election Forest Land Co., Inc. had an accumulated surplus [E&P] of about $500,000.\(^{31}\) (The term "surplus" was treated by the court as synonymous with "earnings and profits.") This accumulated E&P did not qualify as PTI, although it may have been taxed once at the corporate level, because no PTI account can exist, nor can PTI be accumulated, except as provided in Subchapter S.\(^{32}\)

The court also found that Forest's PTI after the close of its 1960 books totaled $212,868.64.\(^{33}\) The company had no current E&P or UTI because the 1961 tax year had not yet begun.

Since one of the findings of fact was that the transaction was a subterfuge and constituted a distribution of property out of PTI,\(^{34}\) the court would of necessity have found January 6, 1961 (when the shareholders purchased shares of Mount Vernon stock) to be the date of the transaction rather than December 31, 1960 (the date when Forest paid the shareholders). The 1960 UTI would not have become PTI until after the close of business on December 31, 1960.\(^{35}\)

The most critical question then is: what would the decision have been had the court found December 31, 1960\(^{36}\) to be the date of the distribution of the property?

In such a case, $84,801.10\(^{37}\) still would have been UTI under section 1373 of the Internal Revenue Code, which provides that UTI means taxable income . . . minus the amount of money distributed as dividends during the taxable year, to the extent that any such amount is a distribution out of earnings and profits of the taxable year as specified in section 316(a) (2) '(emphasis added)\(^{38}\)

Since money alone is allowed to be deducted from UTI for purposes of determin-
ing the amounts that should be included in individual gross income, the stockholders would be forced to include the $84,801.10 of UTI in their gross incomes with no deduction allowed for the value of the stock distributed. It would then have to be argued that the value of the stock comes out of PTI anyway and that UTI does not have any bearing on the issue.

This, however, is not applicable in the instant case. PTI from Forest's first year of election of Subchapter S status amounted to only $128,607.54. This was already used up by an equal amount in the value of the stock distributed. Since the total value of the stock distributed was $212,868.64, the remaining $84,801.10, regardless of the fact that it cannot come out of UTI or PTI, must be distributed from some corporate fund. The fact is, of course, that it is distributed out of the $500,000.00 of E&P accumulated by Forest before it elected Subchapter S status. This necessary conclusion has a drastic effect on the shareholder's individual tax. Since the E&P were not previously taxed to the individuals, any distribution therefrom is includible in individual gross income, as are UTI and money distributions during the taxable year. The occurrence of such a situation will leave the taxpayer reflecting upon the admonition that

the distinction made between property and money dividends, excluding the former from being a subtraction in determining the undistributed taxable income, creates hazards which require caution before undertaking a property distribution by a subchapter S corporation.

From this analysis it would appear that the plaintiff escaped extreme tax consequences by no more than one week. The property distribution could have taken place on January 1, 1961, a difference of only one day, and the result would have been the same. It would seem, therefore, that the court would be compelled by statute, rather than regulation, to hold that the difference between being taxed and not being taxed on a distribution of property is the difference between the close of business on December 31 and the opening of business on January 1, and that had the transaction taken place before the close of business on December 31, 1960, it would have meant a large amount of additional tax for the shareholders.

This circumstance is, of course, directly a product of the holding in De-Treville. If a shareholder or Sub S corporation sought a distribution of property it could simply wait until UTI became PTI to make the distribution tax-free. In the alternative, if there were sufficient accumulated PTI, it could deem that the distribution was made from such accumulation.

In the opinion, the court focuses primarily on the fact that the stock dis-

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41 The amount of additional tax which would need to be paid is, of course, a function of the tax bracket within which the individual shareholder falls. As a group, however, the shareholders of Forest Land Co., Inc. would be faced with including a total of $242,984.94 in their individual gross incomes as opposed to $158,183.84.

These figures do not, of course, include the amounts that are added by the court's decision.
tributed had a tax basis of only $17.77 per share. This basis was lower than the value of $22.50 assigned by Forest at the time of the distribution.

The assigned value was achieved by a well-thought-out plan utilized by Forest when it purchased Mount Vernon's stock. Forest executed two subscription contracts for the purchase of the stock. One contract was for 10,866 shares, and for this block of stock property with a book value (and tax basis) of $244,472.21 was transferred to Mount Vernon. This gave the stock received a tax basis of approximately $22.50 per share. The second subscription contract was for 2,890 shares of Mount Vernon stock, and for these shares Forest transferred property with no book value or tax basis. Obviously, then, the stock received under this contract had no tax basis per share.

The determination of how these "transactions" should be viewed was what the court considered the main issue in DeTreville. The court found that:

It is obvious that this attempt by the Corporation to create different tax bases for the stock acquired by it in the Insurance Company cannot be sustained. The Corporation was making simultaneous transfers to the Insurance Company for Insurance Company stock. Its subscription must be viewed and valued as a whole; and each share of stock subscribed for acquired [sic] and must be given a like tax basis. Accordingly, the Corporation took its stock in the Insurance Company with a tax basis of $17.77 per share.42

The basic concern then, as the court sees it, is to make sure that "such excess ($22.50 − $17.77 = $4.73) cannot pass to the distributee-stockholder as previously taxed profit."43 To the extent that Treasury Regulation 1.1375-4(b) did not bear directly on this point, the court found

no reason why the tax basis of such stock, to the extent of previously taxed but undistributed profits of the Corporation, should not be permitted to pass, undiminished by the imposition of a second tax, to the stockholder-distributee.44

At this point, it is obvious that the court and the defendant are arguing at cross-purposes; one argues stock basis and the other argues the nature of PTI. To this extent, the court does not address itself to the critical issue posed by the Government, i.e., why it should not be entitled to keep the taxes collected by virtue of section 1375(d) and interpretive regulations.

The finding that Treasury Regulation 1.1375-4(b) is invalid constitutes one of those perfunctory acts which a court sometimes performs when it considers the crux of the matter to have been decided and the remaining questions to be merely incidental. It appears, on the basis of the limited discussion accorded the argument of the defendant, that the court felt the issue of the Treasury Regulation to be no more than ancillary. The closest the court comes to treating this question is in a short discussion in which it points

43 Id.
44 Id.
out language in section 1375(a)(1) and (b) to the effect that a non-taxable distribution "is described in terms of a distribution of property out of earnings and profits of the taxable year as specified in Section 316(a)(2)." The court, however, ignores the fact that section 1375(a) constitutes

a very important exception to the general rule that, despite the "pass through" to the stockholders of the amount of income of the Subchapter S corporation the character of the income in the corporation's hands does not likewise "pass through" to shareholders.

and that section 1375(b) is peripheral to the subject of UTI and PTI since it provides that a distribution of current earnings or PTI is not to be considered a dividend for purposes of computing the retirement income credit or the dividend exclusion. The court could have arrived at the defendant's position by taking a closer look at the language in section 1375(f) which it discarded in favor of the above language.

Section 1375(f) is known as the "2½ month rule." It states that any distribution of money made within 2½ months after the close of the taxable year "shall, for the purposes of this chapter, be considered a distribution which is not a dividend, and the earnings and profits of the corporation shall not be reduced by reason of such distribution." This is nothing more than an extension of the time within which distributions of money will be considered made out of UTI, and not PTI or E&P. The significance of this section is that it continues to limit these distributions to money. The term "property" could have been used, as it was in section 1375(a) and (b). It was not used, however, because the continuity of limiting distributions from UTI to money would have been broken. This, coupled with the fact that UTI goes to PTI after the taxable year, indicates that the limiting of distributions to money should follow UTI into PTI. The DeTreville court, however, discarded language pertinent to the UTI-PTI question in favor of language from sections not bearing on the point.

The court deals the deciding blow to the defendant's case with the assertion that

...certainly, Section 316, 26 U.S.C., to which the statute points for clarification of the type of distribution qualifying under Section 1375, does not support the argument of the defendant. Under that Section, a distribution may qualify, whether it be in money or in property. [Citing Edmister v. C.R. 391 F.2d 584, 585 (6th Cir. 1968)].

In this, the court is absolutely correct. A distribution of property may qualify as a dividend under section 316, but only as a distribution

(1) out of ... earnings and profits accumulated after February 28, 1913, or...
(2). out of... earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distribution made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made. Except as otherwise provided... every distribution is made out of earnings and profits. (Emphasis added.)

Section 316 contemplates no such thing as PTI or UTI. Thus, any distribution made pursuant to section 316 would be taxable as a distribution out of previously untaxed E&P. This fact serves only to buttress the defendant's case.

The net effect of DeTreville seems to be more than the simple overruling of a Treasury Regulation. Due to the scheme of Subchapter S, other provisions have been affected; parts of section 1373 have been emasculated. The stipulation that only money will be allowed as a deduction from UTI has no teeth if the corporation can simply wait until UTI becomes PTI to make distributions that are not in the form of money. There may be other grounds, upon which the court could have reached the same conclusions, that would make the holding in the case more viable. A discussion of the conceptual differences between UTI and PTI might have been used to support the invalidation of the regulation, or there is the argument that anything with a high degree of liquidity and a ready market constitutes money. Unfortunately, in the light of the court's decision, this becomes mere conjecture.

On the basis of the foregoing, the only conclusion that can be reached regarding the validity of Treasury Regulation 1.1375-4(b) is that it did not "impose or add conditions or qualifications not imposed by Congressional purpose" and that it was "necessary to make effective the statutory intent."

Robert Salatka

TORTS — RESCUE DOCTRINE — RESCUERS OR THEIR REPRESENTATIVES ARE ALLOWED RECOVERY WHERE DANGER TO THE VICTIM WAS A RESULT OF A BREACH OF IMPLIED WARRANTY. — On October 2, 1957, a sewer repair team, headed by engineer John J. Rooney, entered a sewer in the city of New York. Rooney tested for poisonous gas and found none. Wearing gas masks, Rooney and a member of his crew, Fattore, entered a lateral tunnel, leaving Guarino at the bottom of the vertical shaft, Messina at the next highest level, and four other men at various other levels. While returning to the vertical shaft, Rooney collapsed. Unable to move Rooney by himself, Fattore removed his own gas mask and called for help. Guarino and Messina entered the tunnel without masks to give assistance. The four other members of the crew likewise entered the sewer in response to the call for help. Rooney was dead of asphyxiation, due to a faulty gas mask. Guarino and Messina died two days later. Fattore and the other four men suffered various injuries from the poisonous gas.

The surviving crew members, Mirabile, Marino, Dagnell, Colello and

50 INT. REV. CODE of 1954, § 316.
Fattore, and the estates of Guarino and Messina, brought actions against the Mine Safety Appliance Company for wrongful death and personal injuries sustained in attempting to rescue Rooney. At trial, judgments were entered for the plaintiffs. The Appelate Division affirmed. On appeal, the Court of Appeals of New York affirmed the judgment below and held: a rescuer or his representative may recover for injuries or wrongful death suffered when responding to the dangerous situation of a victim, when such situation is created by the breach of an implied warranty of a manufacturer. Guarino v. Mine Safety Appliance Co., 25 N.Y.2d 460, 306 N.Y.S.2d 942, 255 N.E.2d 173 (1969).

The rescue doctrine states that a rescuer who acts to save someone imperiled by the wrongful act of another may maintain a cause of action against the wrongdoer. The doctrine had its beginnings in the United States in 1871 in the New York case of Eckert v. Long Island R.R. In that case, the question before the court was whether or not a plaintiff had been contributorily negligent when he acted to rescue a child from the path of a fast-approaching train. In holding that he was not, the court noted that: "The law has so high a regard for human life that it will not impute negligence to an effort to preserve it, unless made under such circumstances as to constitute rashness in the judgment of prudent persons." The opinion of the Eckert court was soon recognized by other courts as a significant statement on the law of rescuers. It was aptly described as "tending to foster a proper spirit of generous impulses toward persons who are in danger."

The landmark decision in the area came with the opinion of Judge Cardozo in Wagner v. International Ry. In his formulation of what is now generally recognized as the rescue doctrine, Cardozo phrased the general rule with a broad scope: "[T]he wrong that imperils life is a wrong to the imperiled victim; it is a wrong also to his rescuer." With this declaration, Cardozo emphasized the social policy that persons undertaking risks for the purpose of saving endangered lives should be encouraged.

The next major development of the doctrine came in 1946, in the case of Carney v. Buyea, when recovery was granted a rescuer despite the fact that the person rescued had negligently produced the perilous situation. In that case, the defendant had placed herself in front of her own automobile which she had failed to securely brake. Plaintiff received injuries while rescuing her from in front of the rolling car. Later, in plaintiff's suit against her, the defendant argued that since she could not be negligent against herself, there could be no negligence to her upon which the protection of the rescue doctrine could arise.

3 Id. at 505, 3 Am. R. at 723.
4 Id. at 506, 3 Am. R. at 723.
5 Peyton v. Texas & P. Ry., 41 La. Ann. 861, 6 So. 690 (1889); Lennehan v. Sampon, 125 Mass. 506 (1879); Donahoe v. Wabash, St.L. & P. Ry., 83 Mo. 560 (1884); Gibney v. New York, 137 N.Y. 1, 33 N.E. 142 (1893); Pennsylvania Co. v. Langdendorff, 48 Ohio St. 316, 28 N.E. 172 (1891).
8 Id. at 180, 133 N.E. at 437.
10 Brugh v. Bigelow, 310 Mich. 74, 16 N.W.2d 698 (1944).
The court stated that a lack of self-protective care may be negligence toward a person in the vicinity if that person is injured while undertaking a rescue.\(^{11}\)

Another dimension was added in 1960 to the rescue doctrine in New York. In *Talbert v. Talbert*,\(^{12}\) the rescuer was allowed to recover for injuries received when rescuing the defendant from his own suicide. The court found that the suicide attempt "was wrongful to plaintiff because it caused that undue risk of injury to the defendant which consequently brought about the attempt to rescue him to plaintiff's injury."\(^{13}\)

While these cases represent expansion of the rescue doctrine, recovery has not been allowed in all instances. In *Sirianni v. Anna*,\(^{14}\) for example, a mother had surrendered a kidney to her son, who had lost his kidneys because of the negligence of the defendants. In her suit against the defendants, she urged recovery under the rescue doctrine. The court denied recovery, concluding that the negligence of the defendants had come to rest in the son. The action of the mother could not rekindle it to provide a basis for her recovery.\(^{15}\)

The doctrine has been applied in most jurisdictions throughout the United States, but the cases have so strongly associated the rescue doctrine with negligence actions that it is frequently stated that "a person, who is injured while attempting to rescue one put in peril through the negligence of a third party, can recover from that party."\(^{16}\) (Emphasis added.) There is, however, no reason to limit the doctrine solely to cases arising out of negligence.\(^{17}\) This was aptly illustrated by the Court of Appeals of New York in the *Guarino* case.

It is well to note at this point that the estate of John J. Rooney, the engineer whose gas mask failed in the sewer tunnel, brought an earlier, separate suit against Mine Safety Appliance Company for Rooney's wrongful death.\(^{18}\) Basing its claim on Mine Safety's breach of an implied warranty of merchantibility of the gas mask that failed, it was successful and recovered from Mine Safety.

The fact that there was a breach of an implied warranty of merchantibility was thus res judicata when Guarino and the other men in the tunnel brought their actions against Mine Safety. This gave the *Guarino* court the factual

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13 Id. at 785, 199 N.Y.S.2d at 216.
15 Id. at 555, 285 N.Y.S.2d at 712. The court quoted Judge Desmond's opinion in *Williams v. New York*, 18 N.Y.2d 481, 276 N.Y.S.2d 885, 223 N.E.2d 343, where he explained the denial of recovery in that case: "Impossibility of entertaining this suit comes not so much from difficulty in measuring the alleged damages as from the absence from our legal concept of any such idea as a 'wrong'..."
16 Id. at 556, 285 N.Y.S.2d at 712.
18 Only when Cardozo applied the doctrine to the facts of *Wagner* did he employ the word negligence. *Wagner v. International Ry.*, 232 N.Y. 176, 182, 133 N.E. 437, 438 (1921).
situation with which to expand the rescue doctrine. Here there was no negligence — only the breach of the implied warranty of merchantibility and the resulting rescue.

Historically, the law of breach of warranty was clearly in tort, developing from the action on the case for deceit.20 With the later evolution of the action of assumpsit, breach of warranty began to become intertwined with the law of contract.21 Dean Prosser refers to breach of warranty in terms that best summarize its early growth as “a freak hybrid born of the illicit intercourse of tort and contract.”22 Long after the shift over to contract, breach of warranty still retained aspects of the law of torts.23

In 1938 the Court of Appeals of New York faced the question of whether or not a breach of implied warranty, where personal injury results to the person given the warranty, is a tortious act by the person breaching the warranty.24 In granting recovery under the New York Wrongful Death statute, the court stated: “Though the action may be brought solely for breach of implied warranty, the breach is a wrongful act, a default and in its essential nature a tort.”25

The historical development of liability for breach of warranty in New York paralleled the evolution of the law in other jurisdictions. In 1923, for example, it was the general rule in New York that “a manufacturer or seller of food, or other articles of personal property, is not liable to third persons, under an implied warranty, who have no contractual relations with him”;26 in 1961, the New York courts, though not discarding the 1923 law, expanded the meaning of “purchaser” to include all members of the actual purchaser’s household;27 and one year later, in an action for breach of express warranty by a remote purchaser who had relied on a manufacturer’s advertising, they dispensed altogether with the privity requirement.28 While the holding in this latter case was deemed to be limited to the particular facts, the court seemed to express a willingness to abandon the privity requirement entirely and turn to strict liability.29 Building on this case, the New York courts clearly made a break from old doctrines with the 1963 case of Goldberg v. Kollsman Instrument Corp.30 In that case, a passenger on a commercial airline was killed when the plane in which she was riding crashed as a result of a defective altimeter. In a suit by the passenger’s estate, the court refused to extend the privity rule to hold the manufacturer of the altimeter liable, but it did allow the estate to recover against the manufacturer of the airplane, even though there was no privity between the passenger and the manufacturer.31 In doing so, the New York court held the

20 1 T. Street, The Foundation of Legal Liability 389 (1906).
21 Id.
22 Prosser, The Assault upon the Citadel, 69 Yale L.J. 1099, 1126 (1960).
24 Id. at 31-32, 12 N.E.2d at 550.
25 Id. at 34, 12 N.E.2d at 561.
29 Id. at 16, 181 N.E.2d at 404, 226 N.Y.S.2d at 370.
31 Id. at 437, 191 N.E.2d at 83, 240 N.Y.S.2d at 595.
manufacturer strictly liable in tort and noted as the purpose for the rule: "to see to it that the cost of injuries resulting from defective products are borne by the manufacturers who put the products on the market rather than by injured persons who are powerless to protect themselves ...." The court summarized the law on breach of warranty for New York to now be: "A breach of warranty, it is now clear, is not only a violation of the sales contract out of which the warranty arises but is a tortious wrong ...."

The Guarino court bases its decision squarely on the rescue doctrine as propounded by Cardozo. "We do not believe that the theory of the action, whether it be negligence or breach of warranty, is significant where the doctrine of 'danger invites rescue' applies." The court appears to read the doctrine as providing a separate cause of action, the elements of which are (a) a wrongful act creating a situation dangerous to life or limb (not caused by the rescuer); (b) an attempted rescue in response to the situation which was neither rash nor wanton; and (c) injury to the rescuer. The wrongful act of the defendant placed Rooney in the dangerous situation. The court points out that the rescuers had no time for reflection, and to require of them an analysis of the nature of the wrongful act would be an illogical standard.

Once breach of implied warranty has been recognized as a wrongful act, the application of the rescue doctrine eliminates any further considerations of the ordinary breach of warranty case, even with its modern liberal standards.

Judge Scileppi, concurring in result only, argues that the expansion of the doctrine is unnecessary and too broad. He would rather limit the decision "to cases of great moral obligation." The application of such a standard would be the imposition of a kind of privity requirement for rescuers. This requirement of moral obligation would demand that the rescuer first determine if the original wrong was breach of warranty and if so then decide if he has a close enough relationship with the imperiled individual. Such a requirement would be contrary to the true purpose of the doctrine — to encourage the saving of lives.

Judge Scileppi also foresees "a myriad of situations where the application of the doctrine would result in unjustified liability to manufacturers." In the rescue doctrine itself, safeguards are present to preclude unjustified liability. The case of Brown v. Ross points out that the doctrine only applies where the effort to rescue is reasonable. The test as to what is reasonable is the conduct of

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32 Id.
33 Id. at 436, 191 N.E.2d at 82, 240 N.Y.S.2d at 594.
35 Id. at 464, 255 N.E.2d at 175, 306 N.Y.S.2d at 944.
36 Id. at 464, 255 N.E.2d at 175, 306 N.Y.S.2d at 945.
37 The court, quoting from the Appellate Division's holding, states the conclusion that "the rescuer's status as a user or non-user of a defective instrumentality is not directly relevant to our analysis." Id. at 465, 255 N.E.2d at 175, 306 N.Y.S.2d at 945.
39 Id. at 466, 255 N.E.2d at 176, 306 N.Y.S.2d at 946. The great moral obligation which the Judge refers to is that which had arisen among the members of the crew and their relationships with one another as parts of a unit.
40 Id. at 466, 255 N.E.2d at 176, 306 N.Y.S.2d at 946.
42 345 Mich. 54, 75 N.W.2d 68 (1956).
an ordinarily prudent person in the same circumstances. In *Provenso v. San,* Judge Scileppi himself states that “more than a mere suspicion of danger to the life of another is requisite before the doctrine should be implemented.” The application of these limitations will effectively prevent abuse of the *Guarino* interpretation of the rescue doctrine.

At this time, when it appears that more and more products are being defectively designed or manufactured, it would seem that the *Guarino* decision will be called on to provide recovery to the persons hearing the cry of distress of which Cardozo spoke. It will not matter whether the victim’s cause of action is based in negligence, breach of warranty or strict liability in tort. The doctrine seeks allocation of the injury of the rescuer to the individual at fault. If the courts determine that public policy requires that the manufacturer bear the burden of the defective product, they likewise should include the loss incurred by the person meeting the requirements of the doctrine.

This decision was arrived at in the true tradition of common law development. The 1871 rescue doctrine of *Eckert v. Long Island R.R.* was limited in scope to avoiding the use of the defense of contributory negligence against the rescuer. The policy the court sought to implement, namely that efforts to preserve life should be encouraged, was far broader than the decision itself. Cardozo gave a statement of the doctrine more in line with the underlying policy, but the cases following *Wagner* did not present the need to read *Wagner* in its full capacity. With the interpretation of a breach of warranty as a wrongful act, the fact pattern of *Guarino* finally provided a case beyond the bounds of negligence to read Cardozo’s statement — “danger invites rescue” — as it was written. In *Guarino* the court refused to rewrite these words as “negligently-caused danger invites rescue.” The logic of the decision made on a straightforward fact situation and coupled with the basic reasoning of Cardozo lend weight to the belief that this decision will be followed by other jurisdictions as the problem arises.

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48 *Id.* at 505, 3 Am. Rep. at 723.
50 *Id.* at 180, 133 N.E. at 437.