No. 21-1245

IN THE

Supreme Court of the United States

O'DONNELL & SONS, INC., on behalf of itself and all persons similarly situated,

Petitioner,

v.

NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE, THE STATE OF NEW YORK, AND AMANDA HILLER in her official capacity as Acting Tax Commissioner of the New York State Department of Taxation and Finance,

Respondents.

On Petition for a Writ of Certiorari to the Supreme Court of New York, Appellate Division, Second Department

REPLY BRIEF FOR PETITIONERS

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TABLE OF CONTENTS

TABLE OF AUTHORITIES ii

REPLY BRIEF FOR PETITIONERS 1

I. The New York Courts' Decisions Conflict with the Decisions of Federal Courts of Appeals 2

II. This Case Is a Suitable Vehicle to Decide the Question Presented 8

III. Respondents' Merits Arguments Are Not a Reason to Deny Certiorari 10

CONCLUSION 11

TABLE OF AUTHORITIES

Cases

Cal. Credit Union League v. City of Anaheim,
95 F.3d 30 (9th Cir. 1996) 7

Chemical Bank v. Meltzer,
712 N.E.2d 656 (N.Y. 1999) 3

County of Oakland v. Fed. Hous. Fin. Agency,
716 F.3d 935 (6th Cir. 2013) 8

Fed. Land Bank of New Orleans v. Crosland,
261 U.S. 374 (1923) 10

Fed. Land Bank of St. Paul v. Bismarck Lumber Co.,
314 U.S. 95 (1941) 10

Fed. Nat'l Mortg. Ass'n v. City of Chicago,
874 F.3d 959 (7th Cir. 2017) 4, 5

Gerseta Corp. v. Equitable Tr. Co. of N.Y.,
150 N.E. 501 (N.Y. 1926) 3

Hudson Valley Fed. Credit Union v. N.Y. State Dep't of Tax'n & Fin.,
906 N.Y.S.2d 680 (N.Y. Sup. Ct. 2010) 4, 5

Hudson Valley Fed. Credit Union v. N.Y. State Dep't of Tax'n & Fin.,
980 N.E.2d 473 (N.Y. 2012) 2

Laurens Fed. Sav. & Loan Ass'n v. S.C. Tax Comm'n,
365 U.S. 517 (1961) 10

Moore v. Illinois,
408 U.S. 786 (1972) 3

Pittman v. Home Owners' Loan Corp.,
308 U.S. 21 (1939) 10

United States v. Michigan,
851 F.2d 803 (6th Cir. 1988) 7

Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Jr. Univ., 489 U.S. 468 (1989) 3

Statutes

12 U.S.C. § 1768 ..... 1, 7

N.Y. Tax Law § 253.1-a(a) 1

N.Y. Tax Law § 258.1 ..... 1, 5

N.Y. Tax Law § 266 ..... 5, 6

REPLY BRIEF FOR PETITIONERS

The Federal Credit Union Act (FCUA) provides that federal credit unions and their property "shall be exempt from all taxation now or hereafter imposed by the United States or by any State, Territorial, or local taxing authority," with specific enumerated exceptions not applicable here. 12 U.S.C. § 1768. Nevertheless, New York charges a mortgage recording tax (MRT) "on each mortgage of real property situated within the state," N.Y. Tax Law § 253.1-a(a), and provides that no lender—including federal credit unions—can record mortgages, and thus perfect their security interest in the loans they issue, unless the MRT is paid, *id*. § 258.1. The same is true in many other States. The federal government has argued that such taxes cannot lawfully be imposed on federal credit union mortgages, and indistinguishable taxes have been rejected by federal circuit courts in indistinguishable contexts.

Respondents do not dispute that the validity of these taxes is important to the federal government, States, credit unions, and their members—affecting billions of dollars in loans nationwide. Pet. 21-23. Instead, respondents principally argue that because petitioner is not itself a federal credit union, it cannot challenge the MRT. BIO 2. They repackage this point as a vehicle argument, a way to distinguish cases in the split, and a merits contention. *See id.* at 2-3.

At a high level, these arguments are unpersuasive because the MRT is properly understood as a tax on lenders, including credit unions, and their property. When, as here, borrowers pay the MRT on the lender's behalf, they gain the ability to challenge the MRT's validity. The lower courts found that petitioner could

assert such a challenge under the doctrine of equitable subrogation, and that state-law holding is not subject to review in this Court. Accordingly, the Court can consider this case as if the credit union itself had brought an action to vindicate its own interests. Through that lens, most of respondents' arguments melt away—and the Court is left with an acknowledged split over an important question of federal law that warrants immediate review.

I. The New York Courts' Decisions Conflict with the Decisions of Federal Courts of Appeals

The federal courts of appeals overwhelmingly hold that when, as here, a federal statute exempts a protected entity from all taxation, that includes recordation taxes. *See* Pet. 10-15. Those holdings cannot be reconciled with the decisions below, nor with the New York Court of Appeals' previous decision in *Hudson Valley Federal Credit Union v. N.Y. State Department of Taxation & Finance*, 980 N.E.2d 473, 427-29 (N.Y. 2012), which hold that "all taxation" in the FCUA does not include mortgage recording taxes.

1. Respondents argue that the circuit court cases holding similar taxes invalid involved situations in which the taxes were paid by federally protected entities—and not by their counterparties—and that there is no split about whether states can validly impose taxes on protected entities' counterparties. BIO 15-18.

The first problem with this argument is that the lower courts in this case did not adopt it. They rejected respondents' argument that because petitioner is not itself a federal credit union, it lacks standing to challenge the validity of the MRT. Pet. App. 8a-9a.

Instead, the lower courts held that petitioner is an equitable subrogee who effectively stands in the shoes of the credit union because it paid the MRT that the credit union owed. *Id*. at 9a. That holding has never been disturbed in the state courts—because it is clearly correct. Subrogation allows a party that pays another's debts to stand in the latter's shoes. *See Chem. Bank v. Meltzer*, 712 N.E.2d 656, 661 (N.Y. 1999); *Gerseta Corp. v. Equitable Tr. Co. of N.Y.*, 150 N.E. 501, 504 (N.Y. 1926). Here, petitioner paid a tax that, the complaint alleges, the credit union should have paid. The state courts accordingly held that petitioner is an equitable subrogee, and petitioner now stands in the credit union's shoes with respect to its ability to challenge the validity of the tax. Pet. App. 9a.

Respondents acknowledge that holding, BIO 8, and disagree with it, *id*. at 13. That state law question, however, is "not subject to review here." *Moore v. Illinois*, 408 U.S. 786, 799 (1972); *see also Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Jr. Univ.*, 489 U.S. 468, 474 (1989). For this Court's purposes, then, accepting that the federal credit union can challenge the tax (a point respondents do not dispute), petitioner is entitled to do the same.

Respondents also argue that the tax in this case was directly imposed on petitioner, and not on the lender. This argument has also been rejected by state courts in decisions that have never been overturned. Thus, in *Hudson Valley*, the trial court held that the MRT is a tax on lenders, including credit unions. As the court there explained (in a decision that was affirmed), "whether mortgage loans made by federal credit unions are subject to the MRT, do[es] not turn

on whether the federal credit union pays such costs itself, whether it passes such costs on to the mortgagee, or whether it amortizes such costs over the life of the loan." *Hudson Valley Fed. Credit Union v. N.Y. State Dep't of Tax'n & Fin.*, 906 N.Y.S.2d 680, 685 (N.Y. Sup. Ct. 2010). "Regardless of who pays the tax, the burden and the benefits rest primarily with the mortgage holder," *i.e.*, the credit union. *Ibid*. In the face of this clear authority, respondents' contention that the MRT is not a tax on credit unions simply because it was paid by the borrower falls flat.

The lower courts in this case also proceeded from the premise that *Hudson Valley* was correct. Although they upheld the MRT, they did not do so on the ground that the MRT is a tax on borrowers. Instead, the lower courts adhered to *Hudson Valley*'s holding that the MRT is not unlawful, even on credit unions. *See id.* at 4a, 9a-10a. In the process, the state courts determined that they were "bound by the Court of Appeals' decision in *Hudson Valley Fed. Credit Union*, despite conflicting federal intermediate court decisions which post-date it." Pet. App. 4a. Consequently, respondents' argument does not disprove the split.

The case respondents cite for the proposition that a protected institution's counterparties may be taxed, *Federal National Mortgage Association v. City of Chicago*, 874 F.3d 959 (7th Cir. 2017), is beside the point because the parties in that case were not deemed to be equitable subrogees of the protected entity. Indeed, the case involved differently situated parties, and different taxes too. There, the taxed parties were private parties that had no pre-existing relationship with the protected entities and purchased property from them, and the relevant statutes expressly placed the

incidence of the taxes on the "purchaser" or "transferee." *See id*. at 961. Here, by contrast, the MRT is being paid by the protected credit unions' members (who own the credit union), and the tax is imposed on the lenders, including credit unions, who may pass on the cost to borrowers.

Hoping to make this case appear more like *City of Chicago*, and less like the many cases holding recording taxes invalid, respondents argue that the MRT does not fall in the first instance on lenders, contending that the statute "does not specify who must pay the tax, let alone assign any order of priority as to whether the tax incidence falls first on the borrower or lender." BIO 14. That argument is foreclosed by the state-law authority cited above. It is also unpersuasive on its own terms. Taking as a given respondents' premise that the statute is silent about who must pay the tax, it does not follow that the law expressly imposes the tax on borrowers (unlike the statutes in *City of Chicago*, which expressly imposed taxes on purchasers).

Instead, the state courts were clearly correct to hold that "[r]egardless of who pays the tax, the burden and the benefits rest primarily with the mortgage holder." *Hudson Valley*, 906 N.Y.S.2d at 685. On the burden side of the equation, the MRT's enforcement mechanisms show that the tax falls on the lender in every case. Unless the MRT is paid, the lender cannot perfect its security interest by recording the mortgage, N.Y. Tax Law § 258.1, and the attorney general can commence an action against the lender for payment, *id*. § 266. On the benefit side, payment of the MRT permits the lender to perfect its security interest, which is a prerequisite to foreclosure and to asserting priority against other claims on the subject property.

To be sure, the MRT also sometimes burdens borrowers. Thus, the attorney general can *also* commence an action against the borrower "whereby stipulations contained in such mortgage it is made the duty of the mortgagor to pay such tax, or where the mortgagor is liable for the tax imposed under this article." N.Y. Tax Law § 266. But this conditional authority shows that the law does not impose the MRT in the first instance on borrowers; instead, borrowers take on a derivative obligation in a subset of cases. Here, the duty to pay the MRT was passed on in a letter from the lender requiring borrowers to pay all required fees. But if the lender has no lawful tax obligation (because the tax is deemed invalid), then there would be no agreement to pass the obligation on. The structure of this enforcement provision shows that the law imposes the MRT on lenders in the first instance.

Moreover, even when the borrower assumes the duty to pay, such that the attorney general has the power to go after the borrower, she does not lose her power to *also* pursue the lender for nonpayment. *See* N.Y. Tax Law § 266 (providing that the attorney general "may pursue either, any or all such remedies" when the MRT is not paid). Far from proving the cases in the split inapposite, this shows that there is no situation in which the lender is not responsible for the MRT. The scope of the FCUA's tax exemption—*i.e.*, the heart of the circuit conflict—is therefore squarely presented here.

Respondents also have no good answer to the argument that state attorneys general likewise disagree as to whether the FCUA prohibit the collection of recordation taxes on credit union mortgages. *See* Pet. 15-16. Respondents fall back to their argument that

States have not opined whether taxes can be collected from credit union customers, BIO 18-19—but in light of the procedural posture of the case, and petitioner's status as an equitable subrogee, that distinction is beside the point. Only this Court can bring clarity to the law so that States definitively understand their rights and obligations vis-à-vis federal credit unions.

3. Respondents also argue that the tax exemptions for entities like Fannie Mae, Freddie Mac, and the Federal Housing Finance Agency (FHFA) are broader than the exception for federal credit unions. BIO 19-20. Not so. The FCUA exempts credit unions and their property[1] from "all taxation." 12 U.S.C. § 1768. Respondents argue that this broad exemption does not mention mortgages and loans specifically, BIO 19, but they have no answer to cases construing the FCUA's exemption to include taxes that are not specifically enumerated. *See, e.g.*, *United States v. Michigan*, 851 F.2d 803, 804 (6th Cir. 1988) (reading the FCUA's exemption to cover sales taxes, even though they were not enumerated); *Cal. Credit Union League v. City of Anaheim*, 95 F.3d 30, 30 (9th Cir. 1996) (holding that Section 1768 exempts credit union employees from hotel taxes). Under these authorities, there is no need to name the specific taxes that are exempted; the broad exemption from "all taxation" does the work absent a specific exception. Moreover, as the petition explained (at 12-13), the FHFA's exemption is indistinguishable from the FCUA's exemption, and the Sixth Circuit effectively held as much in *County of Oakland v. Federal Housing Finance Agency*, 716 F.3d 935, 940-41 (6th

[1] Excluding "real property and any tangible personal property." 12 U.S.C. § 1768.

Cir. 2013), when it applied the reasoning of *Michigan* to the FHFA's exemption. Other cases in the split likewise relied on the broad "all taxation" language—and not specific references to mortgages or loans. *See* Pet. 13-14 (citing cases).

Respondents also argue that exemptions for other protected entities use the word "including," and the FCUA's exemption does not. BIO 19-20. But such language is not necessary because, by its plain terms, the statute covers "all taxation" on credit unions as well as their "property." Both terms cover the MRT, whether the tax is construed as an excise tax (in which case it would be similar to the sales taxes deemed barred in *Michigan*), or whether it is a tax on the credit union's intangible property, *i.e.*, its security interest in the mortgaged real estate.

The bottom line is simple. As the lower courts in this case acknowledged, their decisions clash with "conflicting federal intermediate court decisions" holding that broad tax exemptions like the FCUA's preclude the collection of recording taxes. Pet. App. 4a. Certiorari is warranted to resolve the conflict.

II. This Case Is a Suitable Vehicle to Decide the Question Presented

Respondents argue that because petitioner is not a federal credit union, but instead a credit union member, it cannot challenge the MRT. BIO 9. Importantly, respondents do not assert an Article III standing problem—and none exists, because it is undisputed that petitioner paid the MRT, and therefore suffered an economic injury that is fairly traceable to the imposition of the MRT on credit union mortgages. *See* Pet. 23-24. Instead, respondents assert what are, in effect,

merits arguments about the breadth of the FCUA's tax exemption, arguing that the tax is not unlawful so long as members pay it instead of the credit unions themselves. Respondents package this argument as lack of a cause of action (BIO 9-10); lack of statutory standing (*id*. at 10-12); and lack of third-party standing (*id*. at 12-14). Respondents also contend that petitioner was required to join the credit union as a necessary party. *Id*. at 15. But respondents do not contend that any of these are jurisdictional (they are not), and none were accepted below, so the Court need not reach them to decide the question presented. Thus, none of these arguments poses a vehicle problem.

Respondents' arguments are also wrong on their own terms. Respondents argue that petitioner has no cause of action because the FCUA exempts only credit unions, and not their members or counterparties. BIO 9-10. The lower courts' "equitable subrogee" finding disposes of this point because even if only federal credit unions have a cause of action, that right of action has effectively been assigned to petitioner—and respondents do not argue (nor could they) that federal law prohibits that assignment. Indeed, the FCUA does not provide that *only* credit unions may challenge unlawful taxes, nor impose any other limits on who may seek to vindicate the statutory interests.

Independent of subrogation, borrowers like petitioner can challenge the MRT as unlawful. First, as a member of the credit union, petitioner is a part owner, and thus has a close relationship to it. Second, petitioner has a strong stake in the controversy because petitioner paid the tax, and was subject to an action by the attorney general for collection alongside with the credit union. Third, credit unions in New York have

little incentive to challenge the MRT as long as *Hudson Valley* binds the state courts. Any credit union even considering such a challenge faces certain defeat in state court, and will need to obtain this Court's review at the threshold. Faced with the effort and expense of bringing a case here, it is highly likely that most credit unions will take the far more expedient course of passing the obligation to pay the MRT on to borrowers. Accordingly, borrowers are the only realistic candidates to bring a judicial challenge to the MRT; they are injured by its application, and they are best-positioned to sue to redress it. Accordingly, there is no prudential reason to be skeptical of petitioner's action.

III. Respondents' Merits Arguments Are Not a Reason to Deny Certiorari

Respondents argue that *Hudson Valley* was correct and that the FCUA's tax exemption does not cover mortgage recording taxes. The merits were addressed in the petition (at 16-21), and there is no need to rehash those arguments in detail. The most important point is that the FCUA, by its terms, bars "all taxation" on federal credit unions and their property, and this Court's precedents hold that similarly broad tax exemptions include recordation taxes. *See Laurens Fed. Sav. & Loan Ass'n v. S.C. Tax Comm'n*, 365 U.S. 517, 520-21 (1961) (holding that recordation tax was covered by exemption); *Pittman v. Home Owners' Loan Corp.*, 308 U.S. 21, 30-31 (1939) (same); *Fed. Land Bank of St. Paul v. Bismarck Lumber Co.*, 314 U.S. 95, 99-100 (1941) (holding that even taxes that are not specifically enumerated are barred by broad tax exemptions on protected entities); *Fed. Land Bank of New Orleans v. Crosland*, 261 U.S. 374, 377-78 (1923) (holding that taxes imposed on the act of recording are

tantamount to taxes on the mortgage itself when, as here, recording is a practical necessity). Respondents' efforts to nitpick those precedents and manufacture distinctions—for example by arguing that the MRT is a tax on the privilege of recording a mortgage, and not a tax on the mortgage itself—are unpersuasive. Indeed, the federal government filed an amicus brief in *Hudson Valley* arguing that the MRT is a tax on both federal credit unions' property, and on credit unions themselves, and thus doubly barred by the FCUA.

Ultimately, whoever is right about the merits, this Court should take up the question to resolve the split in authority and provide clarity to States, credit unions, and borrowers.

CONCLUSION

Certiorari should be granted.

Respectfully submitted,

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