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In this installment of Real Assessment, the authors examine a recent decision by the U.S. Supreme Court not to consider a case involving the applicability of New York state mortgage recording taxes to a federal credit union.

New York state's taxes associated with real property, including mortgage taxes, transfer taxes, and multiple layers of ad valorem real property taxes, are among the country's most extensive and complex. Determining when and how exemptions to those taxes apply is of critical importance to tax and real estate professionals. A recent decision by the U.S. Supreme Court not to consider a case involving the applicability of New York mortgage recording taxes to a federal credit union underscored the importance of navigating and understanding New York's complex tax structure.

New York Mortgage Recording Tax

New York imposes a mortgage recording tax (MRT) when a mortgage lien is granted on real property in the state. This tax is paid to the county recording office where the mortgaged property is located when the mortgage is recorded. Different tax rates may apply in each New York county, in addition to the taxes imposed by the state. Also, the residential MRT rate is lower than its commercial counterpart.

The MRT includes four components:

1. a basic tax of 50 cents per $100 of mortgage debt or obligation secured;
2. a special additional tax of 25 cents per $100;
3. an additional tax of 25 cents per $100 — this increases to 30 cents per $100 for counties in the metropolitan commuter transportation district — which is applied unless the additional tax has been suspended in the county; and
4. a county or city tax of between 25 cents and 50 cents per $100, where applicable.

The third item has an additional caveat: If the property is principally improved or is to be improved by a one- or two-family residence, the first $10,000 of principal debt or obligation secured is subtracted when computing additional tax, providing a lower mortgage tax responsibility for applicable mortgage holders.

For example, a New York county residential mortgage is subject to an aggregate tax rate of $2.175 per $100. This rate combines the New York City tax rate of $1.125 per $100, basic tax rate of 50 cents per $100, special additional tax of 25 cents

per $100, and additional tax of 30 cents per $100. Under this rate, the MRT for a median-priced home of $760,000 would be $16,530. This is a significant cost to a residential mortgage transaction, so, not surprisingly, borrowers and lenders are incentivized to seek MRT exemptions.

A New York county commercial property of the same value is taxed at a higher rate, as the New York City tax for commercial properties worth over $500,000 is $1.75 per $100, making the total tax rate $2.80 per $100. In total, then, the MRT on a commercial property worth $760,000 would be $21,280, illustrating the sometimes dramatically higher recording tax rate for which commercial mortgage holders are responsible.

Given the potentially high cost associated with the MRT for both residential and commercial transactions, federal credit unions sought clarity as to whether they were exempt from paying it because of their status under the Federal Credit Union Act (FCUA).

The Federal Credit Union Act

The FCUA was enacted in 1934, during the Great Depression, to help stabilize the nation's credit structure, increase the availability of loans, and make credit available to people of smaller means. To achieve these aims, the FCUA established a framework for the creation and oversight of a system of federal credit unions.

Under the FCUA, federal credit unions are exempt from all taxes except local personal property and real property taxes.[1] FCUA section 1768 exempts "the Federal credit unions organized hereunder, their property, their franchises, capital, reserves, surpluses, and other funds, and their income . . . from all taxation now or hereafter imposed by the United States or by any State, Territorial, or local taxing authority," other than applicable real and personal property taxes.[2] Congress added this tax exemption provision to the FCUA as part of an amendment to reduce the disparity in tax burdens faced by federal credit unions compared with banks.

This exemption could have massive implications for federal credit unions' financial conditions, depending on the scope of the taxes from which they are deemed exempt. Accordingly, federal credit unions have brought numerous cases over the years, seeking to understand their exemption status.

The Case the Supreme Court Declined to Hear

A recent federal credit union case drew attention in June when the U.S. Supreme Court decided not to consider *O'Donnell & Sons Inc.*[3] In that case, a taxpayer sought to determine whether federal credit unions are exempt from state and local MRTs. While this issue has been addressed by lower state courts, the parties in *O'Donnell* sought a final, federal level decision from the Supreme Court.

In *O'Donnell*, a taxpayer sued the New York State Department of Taxation and Finance, seeking to recover MRT payments in transactions involving TEG Federal Credit Union as the lender, and a determination that federal credit unions and their members are exempt from the New York MRT.

At its most surface level, the question of the interaction between the FCUA and New York's MRT is how federal and state laws work together — a potentially complicated matter of legal analysis. In deciding *O'Donnell*, the New York appellate court held that it was bound by the New York State Court of Appeals' decision in *Hudson Valley Federal Credit Union*.[4] In that case, the state court of appeals held that federal credit unions are not exempt from the New York MRT. The plaintiffs in *O'Donnell* maintained that since the *Hudson Valley* case was decided, more than 30 federal courts determined that, as a statutory term, "all taxation" includes all taxation, even excise taxes such as an MRT.[5] Therefore, the plaintiffs in *O'Donnell* argued, federal credit unions' exemption from "all taxation" under the FCUA necessarily extended to New York's MRT.

[1] 12 U.S.C. section 1768.

[2] *Id.*

[3] *O'Donnell & Sons Inc. v. New York State Department of Taxation and Finance*, 147 N.Y.S.3d 636 (N.Y. App. Div. 2021), *cert. denied*, 142 S. Ct. 2869 (2022).

[4] *Hudson Valley Federal Credit Union v. New York State Department of Taxation and Finance*, 20 N.Y.3d 1, 13 (N.Y. 2012).

[5] Brief for Plaintiff-Appellant at 2-3, *O'Donnell & Sons*, 147 N.Y.S.3d 636 (No. 2019-00150), 2019 WL 12074000.

The *O'Donnell* court disagreed and held it was bound by the *Hudson Valley* decision, "despite conflicting federal intermediate court decisions which post-date it."[6] This is consistent with New York state precedent, which establishes that New York appellate courts are "bound by the rulings of [New York's] highest court" when there is conflict between the lower federal courts and the New York Court of Appeals.[7] Ultimately, this led to the *O'Donnell* court's declaration that federal credit unions are not exempt from the MRT, upholding the reasoning in *Hudson Valley*. To fully understand why the *O'Donnell* court reached this conclusion, it is helpful to review *Hudson Valley* more closely.

Hudson Valley

The *Hudson Valley* court's holding was based on statutory interpretation of the FCUA and Congress's previous treatment of similar exemptions. In explaining its ruling, the *Hudson Valley* court described the approach of construing federal tax exemptions strictly — in derogation of state tax authorities. Generally, courts decline to extend these federal exemptions beyond their express, written provisions. In declining to do so here, the court noted that Congress has expressly immunized "'mortgages' of federally chartered lending entities from state taxation" in other contexts and found that the absence of express immunization here is a strong indication that Congress did not intend to extend this immunization to credit unions under the FCUA.[8]

So the court decided federal credit unions are not exempt from the MRT, given the FCUA's language. The *Hudson Valley* court makes clear that Congress has a history of being explicit in its exemptions, specifically listing the parties' mortgages as exempt from taxation when it intended to exempt them. Despite containing an extensive list of exemptions pertaining to federal credit unions, the FCUA includes no language about mortgages or loans of any kind, bolstering the court's conclusion that Congress never intended to exempt federal credit unions and their members from state recording and local taxes like the MRT.

Anticipating this explicit exemption statutory analysis, Hudson Valley Federal Credit Union argued that mortgages fall within federal credit unions' "property," which the FCUA *does* enumerate as exempt from all state, local, and federal taxation other than local personal property and real property taxes. However, the court refuted this argument through an examination of the FCUA's legislative history.

The court noted that Congress added the provision of the FCUA at issue, section 1768, to the statute in 1937 to address the disproportionate tax burden faced by federal credit unions compared with banks. At that time, federal credit unions were not authorized to issue mortgages to their members; thus, the court concluded that Congress could not possibly have intended "property" to encompass mortgages when it amended the FCUA in 1937. Further, the court explained that Congress's failure to further amend section 1768 to include mortgages once federal credit unions gained the authority to issue them in 1977 underscores the lack of congressional intent to exempt mortgages.

Hudson Valley also attempted to argue that allowing the MRT to apply to federal credit unions "thwarts the FCUA's purpose . . . of making credit more accessible for 'provident or productive purposes' to 'people of small' or modest means . . . and has serious financial ramifications for federal credit unions."[9] However, the court asserted that because of Congress's expansion of credit unions' powers over the years, they now offer many of the same services as banks. Thus, the court held that the MRT poses little to no threat of driving federal credit unions out of business.

Finally, the *Hudson Valley* court addressed the credit union's contention that federal credit unions are federal instrumentalities, and thus entitled to exemption from the MRT under the U.S. Constitution's supremacy clause. It determined that a federal credit union is not so closely associated with the federal government

[6] *O'Donnell & Sons Inc. v. New York State Department of Taxation and Finance*, 193 A.D.3d 1063, 1065 (N.Y. App. Div. 2021).

[7] *People v. Jackson*, 847 N.Y.S.2d 743, 744 (N.Y. App. Div. 2007) (quoting *Boyd v. Constantine*, 586 N.Y.S.2d 439, 441 (N.Y. App. Div. 1992)).

[8] *Hudson Valley*, 20 N.Y.3d at 8-9.

[9] *Id.* at 11.

that it cannot be viewed as a separate entity in a mortgage context. The court emphasized that federal credit unions are member-owned, funded, and managed private associations, whose elected directors retain significant autonomy in the management of daily operations. Because of this autonomy, the court concluded that federal credit unions are not so closely connected to the U.S. government that they could not be viewed as separate entities. Thus, federal credit unions are not a federal instrumentality, which would be exempted under the supremacy clause. Essentially, the court held that the FCUA would not take supremacy over the state law MRT given the tenuous relationship between federal credit unions' mortgage-lending activities and the U.S. government.

So, for now, New York courts take the position that federal credit unions are not exempt from the MRT. It is interesting that the Supreme Court declined to weigh in on the *O'Donnell* case, since New York's position is seemingly at odds with the interpretation of the FCUA by federal courts in other jurisdictions. But it is hard to infer too much from the Supreme Court declining to hear the case. Since the Court has discretion to hear a case like *O'Donnell*, its decision not to do so does not imply support for the New York court's reasoning and decision in the case. Rather, the decision not to hear the case only means that fewer than four justices on the Court thought that the decision warranted review by the country's highest court.

Real estate professionals and tax advisers should continue to monitor this issue to see if Congress clarifies the FCUA or if New York, either through legislation or further court action, modifies this position. ■