No. C15-1701-1

In the Supreme Court of the United States

ROYAL HARKONNEN OIL COMPANY,

Petitioner,

v.

UNITED STATES,

Respondent

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTEENTH CIRCUIT

BRIEF FOR ROYAL HARKONNEN OIL COMPANY,
Petitioner

Team 14

STATEMENT OF THE ISSUES

1. Whether the United States improperly denied Royal Harkonnen Oil Company's foreign tax credit under 26 U.S.C. §§ 901 and 903 for compulsory tax payments made to the Republic of Arrakis.
2. Whether the Fourteenth Circuit erred in holding that the Inter-Sietch Fremen Independence League was not a proper taxing authority thereby denying Royal Harkonnen Oil Company foreign tax credit for income tax payments made to the sovereignty.

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JURISDICTIONAL STATEMENT

The judgment of the United States Court of Appeals for the Fourteenth Circuit was entered on October 1, 2014, affirming the United States District Court for the Central District of New Tejas' order denying Royal Harkonnen Oil Company's foreign tax credit for: (1) tax payments made to the Republic of Arrakis under 26 U.S.C. §§ 901 and 903 (2012), and (2) tax payments made to the Inter-Sietch Fremen Independence League. The petition for a writ of certiorari was granted to review the ruling of the Fourteenth Circuit Court of Appeals in October of 2014.

This Court possesses jurisdiction pursuant to 28 U.S.C. § 1254 (2012), which states that the United States Supreme Court may review opinions from the courts of appeals by "writ of certiorari granted upon the petition of any party to any civil . . . case, before or after rendition of judgment or decree." 28 U.S.C. § 1254 (2012).

OPINIONS AND ORDERS BELOW

The opinion of the United States District Court for the Central District of New Tejas is unreported. The unreported opinion of the United States Court of Appeals for the Fourteenth Circuit appears in the record at pages 2-21. The Order granting certiorari by the Supreme Court of the United States is set forth on page 1 of the record.

STATUTORY PROVISIONS

This case concerns compliance with 26 U.S.C. §§ 901 and 903 (2012); and 26 C.F.R. § 1.901-2 (2014). The applicable provisions are as follows:

26 U.S.C. § 901 reads, in pertinent part:

> (b) Amount allowed.--Subject to the limitation of section 904, the following amounts shall be allowed as the credit under subsection (a): (1) Citizens and domestic corporations.--In the case of a citizen of the United States and of a domestic corporation, the amount of any income . . . taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States.
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> . . .
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> (j) Denial of foreign tax credit, etc., with respect to certain foreign countries.--(2) Countries to which subsection applies.--(A) In general.--This subsection shall apply to any foreign country--(i) the government of which the United States does not recognize . . . with respect to which the United States has severed diplomatic relations, with respect to which the United States has not severed diplomatic relations but does not conduct such relations, or which the Secretary of State has . . . designated as a foreign country which repeatedly provides support for acts of international terrorisms.

26 U.S.C. § 903 reads:

> [T]he term "income, war profits, and excess profits taxes" shall include a tax paid [in-lieu-of] a tax on income, war profits, or excess profits otherwise generally imposed by any foreign country or by any possession of the United States.

26 C.F.R. § 1.901-2 reads, in pertinent part:

> (a) Definition of income, war profits, or excess profits tax--(1) In general.--(ii) The predominant character of that tax is that of an income tax in the [United States] sense. . . . (2) Tax--(ii)Dual capacity taxpayers--(B) Specific economic benefit. For purposes of this section . . . the term “specific economic benefit” means an economic benefit that is not made available on substantially the same terms to substantially all persons who are subject to the income tax that is generally imposed by the foreign country, or, if there is no such generally imposed income tax, an economic benefit that is not made available on substantially the same terms to the population of the country in general. . . . (3) Predominant character. The predominant character of a foreign tax is that of an income tax in the [United States] sense--(i) If . . . the foreign tax is likely to reach net gain in the normal circumstances in which it applies. . . .
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> . . .
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> (b) Net gain--(2) Realization--(i) In general. A foreign tax satisfies the realization requirement if, judged on the basis of its predominant character, it is imposed--(A) Upon or subsequent to the occurrence of events (“realization events”) that would result in the realization of income . . . (C) Upon the occurrence of a prerealization event. . . . (3) Gross receipts--(i) In general. A foreign tax satisfies the gross receipts requirement if, judged on the basis of its predominant character, it is imposed on the basis of--(A) Gross receipts; or

(B) Gross receipts computed under a method that is likely to produce an amount that is not greater than fair market value. . . . (4) Net income--(i) In general. A foreign tax satisfies the net income requirement if, judged on the basis of its predominant character, the base of the tax is computed by reducing gross receipts . . . to permit--(A) Recovery of the significant costs and expenses [] attributable, under reasonable principles, to such gross receipts; or (B) Recovery of such significant costs and expenses computed under a method that is likely to produce an amount that approximates, or is greater than, recovery of such significant costs and expenses.

. . .

(e) Amount of income tax that is creditable--(5) Noncompulsory amounts--(i) In general . . . if the taxpayer exhausts all effective and practical remedies . . . to reduce, over time, the taxpayer's liability for foreign tax . . . the taxpayer's use or failure to use such options or elections does not result in a payment in excess of the taxpayer's liability for foreign tax.

. . .

(f) Taxpayer--(1) In general. The person by whom tax is considered paid [] is the person on whom foreign law imposes legal liability for such tax, even if another person (e.g., a withholding agent) remits such tax. . . .

26 C.F.R. § 1.903-1 reads, in pertinent part:

(a) In general. Section 903 provides that the term "income, war profits, and excess profits taxes" shall include a tax paid in-lieu-of a tax on income []

otherwise generally imposed by any foreign country. . . .

. . .

(b) Substitution--(1) In general. A foreign tax satisfies the substitution requirement if the tax in fact operates as a tax imposed in substitution for, and not in addition to, an income tax or a series of income taxes otherwise generally imposed. . . .

STATEMENT OF THE CASE

After being denied United States tax credit for tax payments made to the Republic of Arrakis [hereinafter Arrakis] and the Inter-Sietch Fremen Independence League [hereinafter IFIL], Royal Harkonnen Oil Company [hereinafter Harkonnen Oil] filed suit in the United States District Court for the Central District of New Tejas. The District Court dismissed Harkonnen Oil's claim that it was entitled to United States tax credits for tax payments made to Arrakis and IFIL. On appeal, the United States Court of Appeals for the Fourteenth Circuit affirmed the District Court's holding on October 1, 2014. The United States Supreme Court granted certiorari to review the ruling of the Fourteenth Circuit Court of Appeals in October of 2014.

STATEMENT OF THE FACTS

In February of 2008, Harkonnen Oil began negotiations with Arrakis for the exclusive rights to develop its oil and gas reserves within the Caladan Oil Field – located entirely within the northern and eastern boundaries of Arrakis. (R. 2-3). As part of an effort to modernize the Arrakis tax code, the President of Arrakis, President Jules Corrino, drafted and signed into law the "Republic of Arrakis Foreign Value Tax" in March of 2008. (R. 5). The tax was calculated based upon multiplying gross receipts by a tax percentage, which is then applied uniformly to all foreign entities operating machinery within the sovereign territory of Arrakis. (R. 5).

The Central Bank of Arrakis was tasked with enforcement of the "Republic of Arrakis Foreign Value Tax." (R. 5). Per the new tax, all income earned in Arrakis was required to be deposited in the Central Bank of Arrakis. The Central Bank of Arrakis would then calculate all applicable taxes and remit remaining funds to the foreign entity within ninety days of the original deposit. (R. 5).

In April of 2008, a rebellion arose in the northern region of Arrakis, commonly referred to as the "Sietch Dunes." (R. 5). In order to restore stability, Arrakis mobilized its military to the Sietch Dune region. (R. 5). Shortly thereafter, on May 11th, 2008, Arrakis withdrew its military from the region. (R. 6).

On June 30, 2008, President Corrino set the "Republic of Arrakis Foreign Value Tax" at a rate of forty-five percent and renamed the tax the "Republic of Arrakis Foreign Tax." (R. 7). Harkonnen Oil and President Corrino then signed the "Arrakis Lease" for development of the Caladan Oil Field. (R. 7). The provisions of the lease stipulated that Harkonnen Oil would pay a bonus of fifty-five million dollars and a fifteen percent royalty payment. (R. 7). Production of the Caladan Oil Field began in January of 2009. (R. 7).

In March of 2010, a second insurrection arose within the Sietch Dune region.

(R. 8). A group known as the Independent People of Sietch [hereinafter IPS] organized the uprising. On March 20, 2010, the IPS assumed control of the Sietch Dune region and declared its independence from Arrakis. (R. 8). In order to suppress the rebellion, the next day Arrakis mobilized its military to the region. (R. 8). The United Nations condemned Arrakis' action and the United States State Department declared Arrakis to be a "Dangerous State" and withdrew its embassy from the capital city, Arrakeen. (R. 8).

On April 9, 2010, amidst reports of an inordinate amount of IPS casualties, the United States Ambassador to Arrakis, along with the leader of the IPS, met with President Corrino in Arrakeen. (R. 8). The conference was commonly referred to as the Arrakeen Peace Summit, which lasted three days and resulted in the "Sietch Dunes Peace Treaty." (R. 8). The Treaty specified that: the Sietch Dunes region would become the "Sietch State" and be designated as a Province of Arrakis; the people of the Sietch State would select the Vice-President of Arrakis; the IPS would be a recognized political party of the Sietch State; the Sietch State would pay monetary tribute to Arrakis and never again seek independence. (R. 8-9).

Following the Sietch Dunes Peace Treaty, on April 13, 2010, President Corrino drafted an amendment to the Arrakis Constitution in accordance with the provisions of the Treaty. (R. 9). The amendment enumerated the powers and requirements of the Vice-President, which included the power to levy a single tax and amend such tax with the approval of the sitting President of Arrakis. (R. 9).

On April 15, 2010, Paul Atreides won the Sietch State election and was declared Vice-President of Arrakis. (R. 9). The next day, Vice-President Atreides decreed a single tax of ten percent on all income generated in the Sietch State less any applicable deductions. (R. 10). The Sietch State adopted all deductions available under the Arrakis Tax code and applied them equally to all income generating entities regardless of citizenship. (R. 10). The I.R.S. stipulated that the "deductions match available deductions under the United States tax code." (R. 4).

On April 21, 2010, Harkonnen Oil and Vice-President Atreides executed an oil and gas lease – the "Sietch Lease" – which included a bonus payment of five million dollars and an annual royalty payment of five percent. (R. 10). On July 6, 2010, the United States State Department removed Arrakis' "Dangerous State" designation. (R. 10). Furthermore, the Department declared the Sietch State "a Quasi-Autonomous Region" and agreed to establish diplomatic ties with the Sietch State. (R. 10).

On December 31, 2010, IFIL, a nomadic organization, launched a rebellion within the Sietch State. (R. 11). The United States State Department classified IFIL as an independent splinter group from the Bene Gesserit, a terrorist organization that operates in the countries surrounding Arrakis. (R. 11). However, IFIL previously publicly denounced the Bene Gesserit to be an "archaic organization with fundamentalist beliefs that have no place in the modern world." (R. 11).

Al Dhanab and Anbus, two countries that share a border with Arrakis, support IFIL. (R. 12). In a contractual agreement, Al Dhanab and Anbus agreed to fund IFIL in consideration for IFIL's promotion of economic development within the region and its public opposition to the Bene Gesserit. (R. 12). The governing structure of IFIL consists of a single leader elected annually by an electoral college. (R. 12). The electoral college is composed of seven votes stemming from the royal families of Al Dhanab and Anbus, as well as all members of IFIL. (R. 12).

In January of 2011, IFIL was recognized as an independent State of the Sietch Dunes region by Al Dhanab and Anbus. (R. 12). Al Dhanab and Anbus also petitioned the United States and the United Nations for IFIL's recognition. (R. 12). Subsequently, both France and Russia recognized the legitimacy of IFIL as an independent State within the region. (R. 13).

In March of 2011, IFIL acquired control of a territory of the Sietch State known as the Badlands. (R. 13). Contrary to Arrakisian tendencies, Arrakis did not mobilize its military to the area to squelch the uprising. (R. 13). IFIL also assumed control of the Harkonnen Oil drilling station known as "Unit Twelve" in response to Harkonnen Oil's slant drilling of the Badlands. (R. 13). On March 22, 2011 the C.E.O. of Harkonnen Oil met with IFIL Leader-Elect, Jessica Mohiam, to negotiate an oil and gas lease for oil production of Unit Twelve. (R. 13). Known as the "IFIL Lease," the agreement stipulated that Harkonnen Oil would pay a bonus of five-hundred and fifty thousand dollars and a five percent royalty fee to IFIL. (R. 13). After signing the lease, Leader-Elect Mohiam levied a tax of two percent on all income generated by Unit Twelve – calculated at a rate and afforded deductions identical to the Sietch State tax. (R. 13).

Seeking to reduce its tax burden to IFIL, Harkonnen Oil petitioned the Holy

Royal Court of Arrakis for a determination of IFIL's legitimacy. (R. 14). The Holy Royal Court of Arrakis then recognized "IFIL as a part of Sietch." (R. 14). On April 16, 2011, the President of the United States issued Executive Order 14012 declaring IFIL a "sovereign friend of the United States, whom [the United States] would like to establish trade relations with." (R. 14).

On May 16, 2011, the C.E.O. of Harkonnen Oil, President Corrino, Vice President Atreides, and Leader-Elect Mohiam, met for the First Annual Caladan Oil Field Conference. (R. 15). The conference resulted in President Corrino lowering the Arrakis Foreign Tax rate from forty-five percent to thirty-three percent. (R. 15). President Corrino also issued "Proclamation 102," which permitted foreign corporations to recover ninety-five percent of all deductions available to Arrakis citizens as Arrakisian religious law does not allow foreign entities to receive the same benefits as "true believers." (R. 15-6).

For the year of 2011, Harkonnen Oil timely paid: (1) the thirty-three percent tax less applicable deductions for total income generated within Arrakis, (2) the ten percent tax less applicable deductions to the Sietch State, and (3) the two percent tax to IFIL for income generated by Unit Twelve. (R. 16). On March 15, 2012, Harkonnen Oil timely filed Form 1118 claiming foreign tax credits for taxes paid to Arrakis, the Sietch State, and IFIL. (R. 16). Accordingly, the I.R.S. alleged that Harkonnen Oil's taxes paid to Arrakis did not qualify for foreign tax credit because the tax failed to sufficiently reach net income. (R. 16-7). Furthermore, the I.R.S. purported Harkonnen Oil's taxes paid to IFIL did not qualify for foreign tax credit because: IFIL was not a proper taxing authority; the tax violated the Arrakis Constitution; and Harkonnen Oil failed to exhaust all available remedies in seeking to reduce its tax burden. (R. 17).

STANDARD OF REVIEW

The United States Court of Appeals for the Fourteenth Circuit improperly denied Harkonnen Oil's foreign tax credits for tax payments made to Arrakis and IFIL. As neither party disputes factual findings, the issues before the Court involve an application of law. This Court reviews a lower court's interpretation of statutory provisions and customary international law *de novo*. *U.S. v. Haggar Apparel Co.*, 526 U.S. 380, 381 (1999); *BG Grp., PLC v. Rep. of Arg.*, 134 S. Ct. 1198, 1204 (2014).

SUMMARY OF THE ARGUMENT

The United States Court of Appeals for the Fourteenth Circuit erred in dismissing Harkonnen Oil's claim as it is entitled to United States tax credits for tax payments made to Arrakis and IFIL. The lower court erred in denying Harkonnen Oil creditability for payments to Arrakis as the Arrakis tax complies with the necessary requirements of 26 U.S.C. §§ 901 and 903 (2012) [hereinafter I.R.C. §§ 901 and 903]. Additionally, the plain language and legislative history of the statutes indicate Congress's intent to award credit for foreign taxes paid by a domestic taxpayer. Therefore, based on these clear statutory mandates, this Court is not permitted to engage in conjecture as to whether Congress intended otherwise.

The Fourteenth Circuit erred in denying Harkonnen Oil's payments to Arrakis, as they qualify as a creditable foreign tax under I.R.C. § 901 of the tax code. I.R.C. § 901 requires that a payment be compulsory and mimic United States income taxes. Here, Harkonnen Oil made compulsory payments to Arrakis, which were similar to standard United States income taxes imposed on domestic corporations. Additionally, while the name of the tax Harkonnen Oil paid was changed from the "Republic of Arrakis Foreign Value Tax," to the "Republic of Arrakis Foreign Tax," precedent insists that the name of a compulsory tax is not indicative of whether it is creditable. Further, under the predominant character test, as promulgated by 26 C.F.R. § 1.901-2 (2014) [hereinafter Treas. Reg. § 1.901-2], Harkonnen Oil's tax payments to Arrakis creditably reach net income thereby qualifying for United States tax credit as they are realized, meet gross receipts, and reach net gain. This interpretation is also supported by relevant case law.

The lower court further erred in holding that deductions granted by Arrakis fail to allow Harkonnen Oil's payments to reach "significant cost recoveries." The court's reliance on the United States Claims Court's antiquated holding in *Inland Steel Co. v. U.S.*, 677 F.2d 72 (Cl. Ct. 1982) indicates an intent to ignore the subsequent promulgation of Treas. Reg. § 1.901-2, and the courts' holdings in *Texasgulf, Inc. v. C.I.R.*, 172 F.3d 209 (2d Cir. 1999) and *Exxon Corp. v. C.I.R.*, 113 T.C. 338 (1999), which permit the admission of extrinsic evidence to establish whether a tax on a corporation allows for significant cost recoveries. Here, by instating a cap of ninety-five percent on all applicable deductions, President Corrino demonstrated the intent to approximate significant cost recoveries within the confines of the restrictive religious laws of Arrakis.

The Fourteenth Circuit erred in holding that I.R.C. § 903 does not afford Harkonnen Oil creditability as the statutory mandate permits payments made "in-lieu-of" income taxes to qualify for United States income tax credit. A plain reading of the statute and a thorough analysis of applicable case law indicates that the base on which the Arrakis tax is levied – gross receipts – does not prevent creditability. Further, the Central Bank of Arrakis' practice of withholding funds prior to remittance qualifies the tax payments as withholding taxes. While the funds are comingled amongst other monies including royalties and bonuses, the tax code insists that this does not disqualify the payments for creditability.

These arguments and assertions are further supported by a review of the legislative history, which reveals that Congress specifically sought to grant foreign tax credit to prevent double taxation of domestic corporations. Additionally, as the purpose of levying taxes is to promote the well-being and the economy of a foreign State, the United States' disqualification of Harkonenn Oil's foreign tax credits does not properly reimburse Arrakis for natural resources extracted from its land. Further, should the United States refuse to grant creditability, it would create a disincentive for domestic corporations to engage in foreign operations.

The Fourteenth Circuit erred in its determination that Harkonnen Oil's income tax paid to IFIL failed to qualify as foreign tax credit. As an independent State, IFIL is a proper taxing authority, and Harkonnen Oil's payments to IFIL should therefore be credited. The criteria for statehood, introduced in the

Montevideo Convention on Rights and Duties of States, stipulates that a state must have defined territory, a permanent population, an effective government, and the capacity to enter into formal relations with other states. Montevideo Convention on Rights and Duties of States, Dec. 26, 1933, 49 Stat. 3097, 165 L.N.T.S. 19 [hereinafter Montevideo Convention]. IFIL satisfies these criteria as it has defined territory known as the Badlands, a population that is both significant and permanent, a government structure that maintains effective control over its territory, and the capacity to enter into formal relations with other states. Alternatively, failure to satisfy these criteria does not disqualify IFIL as a proper taxing authority because IFIL qualifies as a "foreign country" according to relevant case law.

The Fourteenth Circuit erred in holding that the IFIL tax was not creditable based upon the Arrakis Constitution. As the Holy Royal Court of Arrakis is the supreme authority on matters dealing with interpretation of the Arrakis Constitution, the lower court is not authorized to invalidate the Holy Royal Court's opinion. The doctrine of comity dictates that decisions of foreign courts on matters solely within the purview of their own domestic laws are given deference within the courts of the United States. Therefore, the Holy Royal Court, having already determined the constitutionality of the IFIL tax under its own constitution, cannot be superseded by courts within the United States.

The Fourteenth Circuit erred in holding that Harkonnen Oil failed to exhaust all administrative remedies in seeking to reduce its tax burden to IFIL. All effective and practical remedies were exhausted when Harkonnen Oil petitioned the Holy Royal Court of Arrakis. To require domestic corporations to engage in futile litigation in foreign courts for purposes of qualifying payments as foreign tax credits would be unduly burdensome and beyond what is required by the code.

ARGUMENT

I. PAYMENTS TO ARRAKIS ARE ELIGIBLE FOR UNITED STATES INCOME TAX CREDIT AS THEY COMPLY WITH THE STATUTORY REQUIREMENTS AND THE CONGRESSIONAL INTENT OF I.R.C. §§ 901 AND 903

The United States Court of Appeals for the Fourteenth Circuit incorrectly held that I.R.C. §§ 901 and 903's language limits Harkonnen Oil's ability to secure income tax credit because Arrakis' compulsory tax is similar to United States income tax and as payments creditably reach net gain. A reading of the statutory langue of I.R.C. § 901 permits a taxpayer to claim credit for "the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country," while I.R.C. § 903 credits any payments made in-lieu-of a tax on income "otherwise generally imposed by any foreign country." I.R.C. §§ 901 and 903.

The United States' attempt to restrict Harkonnen Oil's tax creditability directly contradicts the plain language of I.R.C. §§ 901 and 903. The United States Supreme Court's holding in *Sorenson v. Sec'y of Treasury of U.S.*, confirms that "[i]n the face of [a] rather clear statutory mandate . . . we conclude that we are not free to speculate that Congress intended otherwise." 475 U.S. 851, 859 (1986) (deferring to legislative intent to interpret a tax refund provision in the Social Security Act).

Critically, as previously stated by the United States Supreme Court in *Gould v. Gould*:

> In the interpretation of statutes levying taxes it is the established rule not to extend their provisions by implication, beyond the clear import of the language used, or to enlarge their operation so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the government. . . .

245 U.S. 151, 153 (1917). Therefore, where plain language and legislative history make clear a statutory mandate, courts are not free to speculate that Congress intended otherwise thereby resolving any statutory ambiguities. *Sorenson*, 475 U.S. at 859.

In enacting I.R.C. § 903, the Senate Finance Committee indicated that the statute was intended to enjoy a broad construction, and that:

> [T]he commissioner, the Board, and the courts have consistently adhered to a concept of income tax rather closely related to our own, and if such foreign tax was not imposed upon a basis corresponding approximately to net income it was not recognized as a basis for such credit. Thus if a foreign country in imposing income taxation authorized, for reasons growing out of the administrative difficulties of determining net income or taxable basis within that country, a United States domestic corporation doing business in such country to pay a tax in-lieu-of such income tax but measured, for example, by gross income, gross sales or a number of units produced within the country, such tax has not heretofore been recognized as a basis for a credit. Your committee has deemed it desirable to extend the scope of this section. Accordingly, [§ 903] provides that the term 'income, war profits, and excess profits taxes' shall . . . include a tax paid by a domestic taxpayer in-lieu-of the tax upon income, war profits, and excess profits taxes which would otherwise be imposed upon such taxpayer.

S. Rep. No. 77-1631, at 130-33 (1942) (Conf. Rep.). While legislative history on I.R.C. § 901 is limited, "[c]ourts assume that a legislature always has in mind previous statutes relating to the same subject when it enacts a new provision." 2B Norman J. Singer & J.D. Shambie Singer, *Statutes and Statutory Construction* § 51:2 (7th ed. 2012) (citing *Allen v. Grand Cent. Aircraft Co.*, 347 U.S. 535 (1954)).

Further, "[i]n the absence of any express repeal or amendment, the new provision is presumed to accord with the legislative policy embodied in those prior statutes, and they all should be construed together." *Id.* (citing *Sanford's Estate v. C.I.R.*, 308 U.S. 39 (1939); *Int'l Union of Elec., Radio and Mach. Workers, AFL-CIO-CLC v. Westinghouse Elec. Corp.*, 631 F.2d 1094 (3d Cir. 1980); *McLean v. Cent. States, Se. & Sw. Areas Pension Fund*, 762 F.2d 1204 (4th Cir. 1985)). Therefore, as I.R.C. § 901 was enacted in 1954, the 1942 Senate comments on I.R.C. § 903 should be read contemporaneously as they shed light on Congressional intent in passing I.R.C. § 901.

"Notwithstanding the crucial importance of tax revenues for the support of government and its services, courts have settled the rule that tax laws are strictly construed against the state and in favor of the taxpayer." *Id.* § 66:1. In fact, "[w]here there is reasonable doubt about the meaning of a revenue statute, that doubt is resolved in favor of those taxed." *Id.* (citing *Morrissey v. C.I.R.*, 296 U.S. 344 (1935); *Miller v. Standard Nut Margine Co. of Fl.*, 284 U.S. 498 (1932)).

In light of the aforementioned precedent, this Court should defer to the plain language of the statutes, which clearly indicate that foreign tax credits are available for any payments made as a tax, or in-lieu-of a tax, on income paid to a foreign country. Particularly, this Court should focus on the legislative history indicating Congress's intent to award foreign tax credits for these payments.

A. Regardless of its original title, the Arrakis tax is a compulsory payment that mimics income tax in the United States sense

Harkonnen Oil bears the duty to prove that it is entitled to United States income tax credit. The "general rule in tax law is that tax credits are a matter of legislative grace, and taxpayers bear the burden of clearly showing that they are entitled to them." *Schumacher v. U.S.*, 931 F.2d 650, 652 (10th Cir. 1991) (citations omitted).

The entirety of Harkonnen Oil's payments to Arrakis qualify as creditable tax based on Revenue Ruling 78-61 which states that qualification "depends on whether [the foreign] tax constitutes an 'income tax' as determined from an examination of the Federal income tax laws of the United States." Rev. Rul. 78-61, 1978-1 C.B. 223. Later promulgated under Treas. Reg. § 1.901-2, Harkonnen Oil's payments are identified as an income tax under I.R.C. § 901 as the predominant character of the tax matches income tax in the "United States sense." Treas. Reg. §1.901-2(a)(1)(ii). The payments further qualify as they are compulsory and as they are identifiable based on their separation from royalty and bonus payments – which do not qualify for United States tax credit.

The purported tax payment must not be for a "specific economic benefit" – "an economic benefit that is not made available on substantially the same terms to substantially all persons who are subject to the income tax that is generally imposed by the foreign country." Treas. Reg. § 1.901-2(a)(2)(ii)(B). Arrakis' levy on Harkonnen Oil's gross receipts is therefore a tax as it is not a voluntary payment for a specific economic benefit.

Specific economic benefit payments are not creditable because a tax payment is for return of a variety of nonspecific government services rather than one specific service. Treas. Reg. § 1.901-2(a)(2) establishes the creditability regulations for broad government services and payments for specific economic benefits. *See Riggs Nat'l Corp. v. C.I.R.*, 107 T.C. 301 (1996) (holding that payments to the Central Bank of Brazil were compulsory as the taxpayer was required to make the payments as a tax obligation in exchange for net loan transactions). Therefore, as payments for specific economic benefits are voluntary, creditable taxes must be compulsory payments that are indiscriminately levied for general government services. Treas. Reg. §1.901-2(a)(2).

Notably, in *Exxon Corp. v. C.I.R.*, the Tax Court recognized the difference between a general tax and a specific economic benefit payment. 113 T.C. at 338. In that case, *Exxon Corp.* attempted to retain tax credits for a U.K. Petroleum Revenue Tax on its petroleum extraction processes in the North Sea. *Id.* Based on previous royalty payments to the State, the court concluded that the taxpayer's tax payments were not in exchange for any specific benefits related to North Sea productions and held that the tax was a creditable. *Id.* Similar to *Exxon Corp.*, while Harkonnen Oil is extracting oil and natural gas from the Caladan Oil Fields, its payments to Arrakis qualify as compulsory taxes as they are not for the specific economic benefit of oil extraction. This argument is supported by the fact that Harkonnen Oil is paying royalty and bonus fees in exchange for the right to extract oil from that region. (R. 7).

Harkonnen Oil's tax payments to Arrakis qualify for United States foreign tax credit as they mimic United States income tax principles and creditably reach net income. The tax code provides little guidance as to what constitutes a creditable income tax; however, regulations provide that a foreign tax is creditable if its "predominant character . . . is that of an income tax in the United States sense." Treas. Reg. § 1.901-2(a)(ii).

The lower court held that the Arrakis tax did not mimic United States income taxes as "the tax was named a value tax, with only the name of the tax being changed at later date." (R. 17). In *N.Y. & Hond. Rosario Min. Co. v. C.I.R.*, the Second Circuit directly refuted this argument in its holding that "[w]hat a tax is called does not determine whether it is an income tax," indicating that although the Arrakis tax was originally identified as a "value tax," the substance of the tax mimicked that of United States income taxes thereby qualifying the tax for creditability. 168 F.2d 745, 748 (2d Cir. 1948) (citing *Flint v. Stone Tracy Co.*, 220 U.S. 107, 145 (1911). Therefore, as "the controlling factor [of a foreign tax] is whether, if enacted in the United States, the tax would be an income tax," Arrakis' original or current title of the tax is moot. Fed. Sec. L. Rep. (CCH) ¶ 27,820.

B. <u>Harkonnen Oil's tax payments to Arrakis reach net gain under the predominant character standard and adequately allow for "significant cost recoveries"</u>

Based on its predominant character, the Arrakis tax mimics United States taxes in the United States law's sense of the term. Treas. Reg. § 1.901-2(a)(3). The predominant character of a foreign tax mimics that of a United States income tax if it is "likely to reach net gain under normal circumstances." Treas. Reg. § 1.901-2(a)(3)(i). The term "normal circumstances" indicates that because the determination is based on the tax's predominant character, some deviation is acceptable. Treas. Reg. § 1.901-2(b)(3)(i).

"This expansive standard is not infinitely elastic, however, and taxes predicated entirely on gross receipts or gross income do not satisfy it 'except in the rare situation where that tax is almost certain to reach *some* net gain.'" Joseph Isenbergh, *The Foreign Tax Credit: Royalties, Subsidies, and Creditable Taxes*, 39 Tax L. Rev. 227, 272 (1984) (quoting Treas. Reg. § 1.901-2(b)(4)(i)) (emphasis added). Under the predominant character standard, Harkonnen Oil's payments to Arrakis reach some net gain as required by the statute.

1. *The predominant character of Harkonnen Oil's tax payments to Arrakis reach net gain as the payments are made on realized income, are imposed on gross receipts, and creditably reach net income*

"A foreign tax is likely to reach net gain only if the tax, judged on the basis of its predominant character, satisfies three tests," the realization test, the gross receipts test, and the net income test. Treas. Reg. § 1.901-2(b). First, the Realization test requires that "[t]he foreign tax is imposed at the same time or after a realization event occurs that would result in realization of income for United States purposes." Treas. Reg. § 1.901-2(b)(2)(i)(A). In addition, the realization requirement also includes several occurrences prior to realization, specifically: "(1) the recovery or recapture of a previously allowed tax deduction or credit, (2) increases or decreases in the value of property, and (3) the 'physical transfer, processing, or export of readily marketable property' at any time." Isenbergh, *supra*, at 271 (quoting Treas. Reg. § 1.901-2(b)(2)(i)(C)).

The third rule applies in the instant situation as the Arrakis tax is triggered by the production and export of oil because "the alternative of waiting for a realization event in the United States sense (which in the case of a fully integrated oil company, for example, would be the sale of gasoline at the pump) is not practical." *Id.* Therefore, as the Arrakis tax is imposed on events, which fall within the expanded perception of realization, "the tax as a whole satisfies the realization requirement, even if it is also imposed on some events outside the range." *Id.*

Further, while "[t]he realization requirement tracks the American income tax principle that income is typically taxed only following a 'realization event,' usually 'when property is sold or exchanged' . . . '[g]enerally, the starting point for calculating income subject to a creditable foreign income tax must be actual gross receipts." *Entergy Corp. v. C.I.R.*, 683 F.3d 233, 235 (5th Cir. 2012) (quoting Boris I. Bittker & Lawrence Lokken, *Federal Taxation of Income, Estates & Gifts* ¶ 72.4.3 (2011)). Therefore Harkonnen Oil's foreign tax to Arrakis meets the first test in the predominant character standard as the Arrakis tax is based on "gross receipts generated by a corporation's operations occurring in Arrakis during the [] calendar year." (R. 5).

Second, the gross receipts test requires that a "tax imposed on the basis of estimated gross receipts will be acceptable if the method used to determine the estimate is likely to produce an amount not greater than fair market value." Treas. Reg. § 1.901-2(b)(3). Significantly, the "gross receipts requirement ensures a creditable income tax is [] computed 'begin[ning] from actual gross receipts, rather than nominal amounts.'" *Entergy Corp.*, 683 F.3d at 237 (quoting Bittker & Lokken, *supra*, ¶ 72.1).

Treas. Reg. § 1.901–2 reflects the critical distinction between actual receipts and notional amounts, as "creditable foreign taxes must be based on either actual income or an imputed value not intended to reach more than actual gross receipts." *Id.* Therefore, Harkonnen Oil meets this second test because the fair market value of extracted oil does not exceed the *actual* gross receipts taxed by Arrakis. (R. 3).

Finally, the net income test, "is satisfied by a tax imposed on gross receipts reduced by either: significant costs and expenses, including capital expenditures, attributable to gross receipts; or significant costs and expenses under a method likely to produce an amount that approximates or is larger than recovery of those costs and expenses." Treas. Reg. § 1.901-2(b)(4).

The central issue in identifying whether net income is met, is determining "which expenses are significant and when (if ever) will the nondeductibility of significant expenses be tolerated." 1 Philip F. Postlewaite & Samuel A. Donaldson, *International Taxation: Corporate and Individual* § 6.07 (4th ed. 2003). Therefore, even if the foreign tax is not granted recovery of a significant cost, the tax may be creditable if there is an allowance that effectively compensates for the denial. Additionally, a foreign tax on gross receipts may still be creditable if the tax is almost certain to reach some net gain because the expense of producing income will almost never be so high as to offset gross receipts. Treas. Reg. § 1.901-2(b)(4).

In a few early holdings regarding net gain, the Board of Tax Appeals "took an expansive view of creditable foreign income taxes, requiring neither a tax base corresponding precisely to United States notions of net income nor an event of [strict] realization." Isenbergh, *supra*, at 234. For example, in *Keen v. C.I.R.*, the Board permitted the credit of a French tax enforced on an estimated tax base equal the rental value of a home maintained by a French nondomiciliary. 15 B.T.A. 1243 (1929). In *Burk Bros. v. C.I.R.*, the Board labeled a tax as creditable that was implemented by India for the export of goat hides based on the value of the hides reduced by significant costs, even though there was no event of realization under United States tax concepts. 20 B.T.A. 657 (1930).

These holdings "contain no elaborate discussion of the issues. Rather, they seem to proceed from the assumption that there are a number of ways a tax can be said to reach [net] income and that notions of income under foreign law have some force in this determination." Isenbergh, *supra*, at 235.

Nonetheless, the United States Supreme Court's holding in *Biddle v. C.I.R.*, stated "[i]ncome taxes paid . . . ha[ve] for most practical purposes a well understood meaning to be derived from an examination of the statutes which provide for the laying and collection of income taxes. It is that meaning which must be attributed to [the predecessor of § 901]," indicating that creditable taxes must fall within the United States tax concepts. 302 U.S. 573, 579 (1938).

In that case, the issue was whether a corporate shareholder was entitled to credit under § 901's predecessor for foreign taxes on corporate earnings. While the holding intended to require foreign taxes to mimic I.R.C. § 901 of the United States tax code in order to qualify for creditability, the case further muddled the requirements of reaching net gain as some foreign taxpayers are still "taxed under the Code on gross, rather than net income from sources within the United States." Isenbergh, *supra*, at 235.

The court in *Bank of Am. Nat'l Trust & Sav. Ass'n v. U.S.* addressed this issue directly when it established a doctrine which insisted that "the term 'income tax' in § 901(b)(1) covers all foreign income taxes *designed* to fall on some net gain or profit, and includes a gross income tax if, but only if, that impost is almost sure, or very likely, to reach some net gain because costs or expenses will not be so high as to offset the net profit." 459 F.2d 513, 523 (Ct. Cl. 1972).

In *Bank of Am. Nat'l Trust & Sav. Ass'n*, the court evaluated whether a bank that conducted business at foreign branches incurred net income or gross taxes. The Court of Claims insisted that net income taxes are the only creditable taxes under I.R.C. § 901 as the foreign tax must be the "substantial equivalent" of a United States income tax. *Id.* at 515. The court concluded that limiting creditability to net income taxes conformed with the United States tax system and upheld Congressional intent to prevent double taxation. *Id.*

In its opinion, the court in *Bank of Am. Nat'l Trust & Sav. Ass'n* ultimately refuted precedent including *Seatrain Lines, Inc. v. C.I.R.*, 46 B.T.A. 1076 (1942), and *Santa Eulalia Mining Co. v. C.I.R.*, 2 T.C. 241 (1943), which awarded credit to gross income taxes by insisting that those courts encountered unusual circumstances where the foreign tax was "very highly likely, or was reasonably intended, always to reach some net gain in the normal circumstances in which it applies." *Id.* at 520-21; incorporated in Treas. Reg. § 1.910-2(a)(3)(i).

While paramount in establishing this area of law, *Bank of Am. Nat'l Trust & Sav. Ass'n* was discussed and reassessed in the landmark decision of *PPL Corp. v. C.I.R.*, 133 S. Ct. 1897, 1901 (2013) (citing *Bank of Am. Nat'l Trust & Sav. Ass'n*, 459 F.2d at 513). The Justices of the United States Supreme Court granted certiorari to resolve a split between the Third Circuit, the progeny of *PPL Corp.*, and the Fifth Circuit in which the court held that a foreign tax was creditable in the companion case, *Entergy Corp.*, 683 F.3d at 233.

In *PPL Corp.*, the United States Supreme Court held that a U.K. tax on excess profits was a creditable foreign income tax even though it was predominately based on the difference between the company's purchase price valuation and the price-to-earnings performance ratio. *PPL Corp.*, 133 S. Ct. at 1904. While the levy on its face did not appear to tax net profits or to meet other United States income tax criteria, the difference between the two valuations was based on net income qualifying it as excess profits tax understood in United States tax law. *Id.* at 1907.

Indicating that precision is not necessary to reach net gain, the Court in *PPL Corp.* asserted that "[t]ax law deals in economic realities, not legal abstractions." *Id.* at 1905 (quoting *C.I.R. v. Sw. Exploration Co.,* 350 U.S. 308, 315 (1956)). To permit otherwise, "would seriously impair the effective administration of the tax policies of Congress." *C.I.R. v. Ct. Holding Co.,* 324 U.S. 331, 334 (1945); *see also H.J. Heinz Co. v. U.S.,* 76 Fed. Cl. 570, 580 (Fed. Cl. 2007). Therefore, just as the Court in *PPL Corp.* held that the abstract tax payments reached net income, Harkonnen Oil's payments to Arrakis qualify as creditable income tax as they reach net income under the "economic realities" set forth by Arrakis. *PPL Corp.,* 133 S. Ct. at 1905.

2. *Arrakis' ninety-five percent cap on foreign corporation tax deductions adequately allows for "significant cost recoveries" under Treas. Reg. § 1.901-2(4)(i)(b)*

In regards to the third test in reaching net gain, while Harkonnen Oil's payments to Arrakis may not appear to reach net income on its face, they may still be identified as a creditable income tax. The Regulations highlight that "the foreign tax must permit the recovery of the *more significant costs* incurred in producing the product." Postlewaite & Donaldson, *supra*, § 6.12 (citing Treas. Reg. § 1.901-2(b)(4)(i)). Read literally, Arrakis' ninety-five percent deduction complies with the "more significant costs," required by the Regulation because while the deductions may not exceed the company's costs and expenses, they approximate total recovery. *Id.*

The Regulation establishes that net income is reached when "[r]ecovery of such significant costs and expenses [are] computed under a method that is likely to produce an amount that approximates, or is greater than, recovery of such significant costs and expenses." Treas. Reg. § 1.901-2(b)(4)(i)(B). While a corporation may not be entitled to one hundred percent of all cost recoveries, the tax code further clarifies that "[a] foreign tax law that does not permit recovery of one or more significant costs or expenses, but that provides allowances that effectively compensate for nonrecovery of such significant costs or expenses, is considered to permit recovery of such costs or expenses." Treas. Reg. § 1.901-2(b)(4)(i).

In regards to this Regulation, the United States may rely on the court's holding in *Inland Steel Co.* to argue how a tax appropriately reaches net gain. 677 F.2d at 86. In that case, a Canadian tax was imposed on a mining company's unrealized gross income for the operating expenses of the mine. *Id.* However, no deductions were afforded for interest paid to a private lender, for the royalty payments to owners of the extracted minerals, for the depletion of the mineral resources, or for capital expenditures made before the extraction process. *Id.*

Appling the *Bank of Am. Nat'l Trust & Sav. Ass'n* doctrine, the court held that because the tax was on unrealized gross income and as a range of significant costs were not awarded as deductions, the tax was not identified as creditable stating, "when the mass of the omitted items in the [Ontario tax] are considered together and in combination as applied to plaintiff's mining business, it is clear to us that that tax does not seek to reach, or necessarily reach, any concept of net gain from the mining business which would be recognized as such in this country. . . . The exclusions are far too widespread and important to permit the conclusion that some net gain is sure to be reached." *Id.* at 85.

While seemingly persuasive on its face, a deeper analysis of *Inland Steel Co.* indicates that it may be distinguished as it was decided before the promulgation of

Treas. Reg. § 1.901-2 in 1983, a Regulation argued to have been intended to clarify the *Inland Steel Co.* holding. Additionally, the decision was wrongly decided based on the restrictions introduced by the court in *Biddle*, and by the resurrection of the distinction between "income taxes" and "privilege taxes" as originally silenced by the court in *Bank of Am. Nat'l Trust & Sav. Ass'n*, 459 F.2d at 523.

Post-1983 cases rely heavily on Treas. Reg. § 1.901-2 which invites the admission of extrinsic evidence to determine whether the tax in question is creditable, especially to assess the predominant character. This was affirmed by the Second Circuit in *Texasgulf, Inc.*, a case in which the court ultimately held that "the language of Treas. Reg. § 1.901-2 – specifically, 'effectively compensate' and 'approximates, or is greater than' – suggests that quantitative empirical evidence may be just as appropriate as qualitative analytic evidence in determining whether a foreign tax meets the net income requirement," thereby identifying a foreign tax as creditable by satisfying the predominant character standard. 172 F.3d at 216.

In *Texasgulf, Inc.*, the court analyzed the Regulation and clarified that the definition of significant cost recoveries is calculated by reducing gross income from the total operating expenses. *Id.* In that case, a foreign mining tax did not allow a taxpayer to deduct specific mining expenses, but did permit it to deduct a fixed processing allowance. *Id.* at 211–13. Citing the Regulation, the taxpayer asserted that the tax was creditable as the allowance was an attempt to reach net income by using "a method 'that is likely to produce an amount that approximates, or is greater than, recovery of such significant costs and expenditures.'" *Id.* at 215 (quoting Treas. Reg. § 1.901–2(b)(4)(i)(B)).

In support of its argument, the taxpayer presented extrinsic evidence that eighty-five percent of companies facing mining tax liability held nonrecoverable expenses less than the processing allowance. *Id.* at 215–16. Accordingly, the court recognized that the Regulation clearly establishes that "[a] foreign tax law that does not permit recovery of one or more significant costs or expenses, but that provides allowances that effectively compensate for non-recovery of such significant costs or expenses, is considered to permit recovery of such costs or expenses." *Id.;* Treas. Reg. § 1.901-2(b)(4)(i).

Similarly, in *Exxon Corp.*, the Tax Court evaluated whether the predominant character of the levy met the net income requirement despite the fact that the tax did not allow for a reduction of an interest expense – a significant expense – and therefore failed the net income test. 113 T.C. at 338. However, the court evaluated extrinsic evidence, which indicated that based on industry data, although the interest expense was not deductible, additional expense allowances sufficiently offset the non-allowance thus complying with the net income tax requirement. *Id.* While Harkonnen Oil has not been granted additional allowances to offset one hundred percent of its expenses, just as the court in *Exxon Corp.* indicated, extrinsic evidence of the surrounding circumstances is admissible to establish creditability. *Id.*

Therefore, as the courts in *Texasgulf, Inc.* and *Exxon Corp.* indicate, extrinsic evidence may clearly establish whether a corporation is entitled to a tax credit for significant cost recoveries under the predominant character test. In the instant case, by implementing a ninety-five percent cost recovery program, President Corrino demonstrated a clear intent to approximate significant cost recoveries as closely as the religious laws of Arrakis would allow. Accordingly, while Arrakis' tax is calculated on gross income, the intent was to tax the predominant character – or the net gain – of Harkonnen Oil's expenses by implementing ninety-five percent deductions, which adequately allow for significant cost recoveries. (R. 15).

C. Should the tax payments made to Arrakis not be deemed creditable under I.R.C. § 901, I.R.C. § 903 awards tax credit for payments made in-lieu-of generally imposed income tax regardless of whether they are withheld and submitted by a withholding agent

Regardless of whether I.R.C. § 901 permits Harkonnen Oil credit for Arrakis' tax, I.R.C. § 903 affords relief because Arrakis' tax qualifies as a tax "in-lieu of" an otherwise applicable income tax. Legislative history indicates Congressional intent to liberally apply I.R.C. § 903 amongst a variety of payments. *See* S. Rep. No. 77-1631, at 130-33 (1942) (Conf. Rep.). Further, the Central Bank of Arrakis' practice of comingling Harkonnen Oil's funds prior to remittance does not disqualify the tax payment's creditability.

1. *Payments made by Harkonnen Oil to Arrakis qualify as in-lieu-of taxes as they are based on gross receipts*

According to the Register, to qualify as an "in-lieu-of" income tax, the foreign levy must be a tax and must be "imposed in substitution for, and not in addition to, an income tax or series of income taxes otherwise generally imposed." 26 C.F.R. § 1.903-1(a) (2014) [hereinafter Treas. Reg. § 1.903-1]. In other words, to qualify as an in-lieu-of tax, the foreign country must have a general income tax that would apply to the taxpayer but for the in-lieu-of tax, and the general income tax is not imposed on the taxpayer because of the in-lieu-of tax. Treas. Reg. § 1.903-1(a).

Legislative history indicates that Congress intended in-lieu-of taxes to include more than approximates of income taxes. The Senate Finance Committee expresses this concern by concluding that:

> [I]f a foreign country in imposing income taxation authorized, for reasons growing out of the administrative difficulties of determining net income for taxable basis within that country, a United States domestic corporation doing business in such country to pay a tax in-lieu-of such income tax but measured, for example, by gross income, gross sales or the number of units produced within the country, such tax has not heretofore been recognized as a basis for a credit. *Your Committee has deemed it desirable to extend the scope of this section.*

S. Rep. No. 77-1631, at 130 (1942) (Conf. Rep.). Read in conjunction with the statute itself, this Congressional intent indicates that in-lieu-of taxes are intended to encompass a wide breadth of payments.

The most applicable case on point is *Seatrain Lines, Inc.*, in which the court held that a tax on gross income qualified as an in-lieu-of tax based on Congress's intent for in-lieu-of taxes to include more than those imposed solely as approximations of existing income taxes. 46 B.T.A. at 1078. In that case, a Cuban income tax stated that "foreign shipping companies . . . engaged in transporting freight and passengers between [Cuba] and foreign ports shall be exempt from the Tax on Profits and shall, in-lieu-thereof, pay a tax of [three percent] of the gross income obtained for freight and passengers." *Id.* at 1078. The Board of Tax Appeals found that this tax on gross income was a creditable foreign tax under the *Biddle* approach, reasoning that it reflected "an approximation of the deductions allowed in arriving at net income and was adopted as a compromise measure in order to avoid the complex and vexatious allocation and calculation of the deductible items peculiar to the petitioner's business." *Id.* at 1080.

Similarly, the tax Harkonnen Oil pays to Arrakis applies to any foreign corporation operating in Arrakis and is generally imposed on the gross receipts of all nonresident corporations attributable to a trade or business carried out in Arrakis. (R. 5). While gross receipts differ from a net income tax, according to the Regulation, a gross base income tax imposed on foreign corporations as a substitute for a general net base income tax, that is applied to all domestic corporations, qualifies as an in-lieu-of tax that is creditable. Treas. Reg. § 1.903-1(b)(3). Therefore, the nature "of the base upon which the tax is levied – gross income, receipts, units exported, and the like – will not preclude creditability under I.R.C. § 903." Postlewaite & Donaldson, *supra*, § 6.12 (citing Treas. Reg. §1.903-1(a)).

As Arrakis' tax on Harkonnen Oil is based on gross receipts, it "stands a better chance of being credited under I.R.C. § 903 than under I.R.C. § 901 given that the base of the tax need not bear any relationship to realized net income" thereby simplifying the qualification standards. *Id.* § 6.12. Accordingly, should this Court fail to recognize the predominant character of Harkonnen Oil's payments as reaching net income, I.R.C. § 903 fundamentally protects the company's foreign tax creditability.

2. *The Central Bank of Arrakis' practice of withholding tax payments before remittance does not revoke creditability*

The Central Bank of Arrakis' act of holding funds prior to remittance complies with the requirements of a "withholding tax." A foreign withholding tax requiring that the payor withhold and submit payment to a foreign state is a classic illustration of a creditable income tax or an in-lieu-of tax. *See* Stanley I. Langbein, *Federal Income Taxation of Banks & Financial Institutions* ¶ 12.04[2][h] (2014) ("Foreign withholding taxes have . . . always been understood to be creditable. The regulations achieve this result by including withholding taxes among taxes imposed in-lieu-of income taxes.").

The fact that the Central Bank of Arrakis withholds Harkonnen Oil's tax payments before remittance does not affect their qualification for creditability under I.R.C. § 903. According to Treas. Reg. § 1.901-2(f)(1), "'[t]he person by whom tax is considered paid for purposes of [I.R.C.] section[] 901 . . . is the person on whom foreign law imposes legal liability for such tax, even if another person (e.g., a withholding agent) remits such tax." *Guardian Indus. Corp. v. U.S.*, 477 F.3d 1368, 1371 (Fed. Cir. 2007). "The regulation on its face distinguishes between two situations. In one the person paying the tax is merely a withholding agent (or similarly, a remittance agent) and is paying the tax on behalf of another person who is legally liable for the tax. In the other, the person paying the tax is the person with "legal liability for such tax." *Id.* (citing Treas. Reg. § 1.901-2(f)(1)). Therefore, in the instant case, the Central Bank of Arrakis' role as a withholding agent does not affect Harkonnen Oil's eligibility for United States tax credit.

This assertion is further supported by the fact that "[t]he foreign tax credit is not based on taxes withheld by a foreign country . . . since such amounts are not necessarily the legal and actual liability of the taxpayer." Rev. Rul. 57-516, 1957-2 C.B. 435; *Norwest Corp. v. C.I.R.*, 69 F.3d 1404 (8th Cir. 1995) (a United States bank was entitled to foreign tax credit on withholding taxes on interest income despite the fact that the borrower withheld and remitted the tax on the interest as the United States bank was liable for the foreign tax). Therefore, while all payments – including taxes, royalties, and bonuses – are withheld by the Central Bank of Arrakis prior to transmittal, the United States income tax code clarifies that this action does not render the qualifying payments ineligible for United States tax credit as the tax payments may be credited separately.

D. <u>Harkonnen Oil's tax payments to Arrakis must be recognized as creditable in order to uphold Congressional intent to prevent double taxation</u>

In order to prevent Harkonnen Oil from paying double taxes for its extraction services, it must be entitled to United States income tax credit protection under the clear statutory language of I.R.C. §§ 901 and 903. The Congressional intent in enacting these statutes was to mitigate double taxation when United States taxpayers are subject to foreign taxes on foreign source income. *American Chicle Co. v. U.S.*, 316 U.S. 450, 451 (1942), *see also Guardian Indus. Corp.*, 477 F.3d at 1374-75; *U.S. v. Goodyear Tire and Rubber Co.*, 493 U.S. 132, 139 (1989) (demonstrating that the purpose of the foreign tax credit was to serve as "protection against double taxation").

The foreign tax credit provisions were Congress's answer to the concern that high tax rates in foreign countries, in addition to the taxes levied in the U.S., would place a severe burden upon United States taxpayers. *See* H.R. Rep. No. 65-767, at 212 (1918) (Conf. Rep.). This policy essentially ensures that every dollar paid to a foreign tax equals a dollar paid for United States income tax. *Id.*

Precedent also indicates that the purpose of I.R.C. § 901 "was to encourage domestic corporations to do business abroad without having to operate through a foreign corporation, the inducement being that their income from operations abroad should be taxed only once." *N.Y. & Honduras Rosario*, 168 F.2d at 749. Therefore, as United States foreign tax credit provisions were created to limit high tax rate burdens on United States taxpayers, should the United States refuse Harkonnen Oil's income tax credit, it would directly rebut Congress's intent to reduce domestic companies subjection to high tax rates in foreign countries and would set a negative policy precedent that would motivate similar domestic corporations to refrain from engaging in international business activities or global trade in the future. *See* H.R. Rep. No. 65-767, at 212 (1918) (Conf. Rep.).

Additionally, numerous courts have also held that "the primary object of all governments is to provide for the welfare of its citizens. For that purpose laws are enacted to foster the health, morals, and safety of the people. To carry that out[,] taxes are levied," indicating that income tax credits are intended to "mitigate the evil of double taxation of" domestic companies on foreign income while simultaneously ensuring that the foreign countries hosting United States corporations are repaid for the loss of their natural resources. Singer & Singer, *supra*, § 66:1 (citing *Burnet v. Chi. Portrait Co.*, 285 U.S. 1, 7 (1932)). Therefore, as Harkonnen Oil's oil extraction services deplete the natural oil found within Arrakis borders, Arrakis is inherently entitled to Harkonnen Oil's payment of taxes and should be awarded United States tax credit to promote the continuance of these positive international relations in the future.

II. HARKONNEN OIL'S PAYMENTS TO IFIL ARE CREDITABLE FOREIGN TAXES AS THEY ARE LEVIED BY A PROPER TAXING AUTHORITY, AS THE HOLY ROYAL COURT OF ARRAKIS PREVIOUSLY RECOGNIZED IFIL'S VALIDITY, AND AS HARKONNEN OIL EXHAUSTED ALL REMEDIES IN SEEKING TO REDUCE ITS TAX BURDEN

I.R.C. § 901(j), states that foreign income tax credits are applicable for any foreign country except the following: (1) "the government of which the United States does not recognize, unless such government is otherwise eligible to purchase defense articles or services under the Arms Export Control Act," (2) "with respect to which the United States has severed diplomatic relations," (3) "with respect to which the United States has not severed diplomatic relations but does not conduct such relations, or," (4) "which the Secretary of State has, pursuant to section 6(j) of the Export Administration Act of 1979, as amended, designated as a foreign country which repeatedly provides support for acts of international terrorism." § 901(j)(2)(A)(i)-(iv).

Accordingly, this statute permits Harkonnen Oil, a domestic corporation, to credit its tax payments to IFIL as the United States officially recognized and commenced diplomatic relations with IFIL on April 16, 2011, and as IFIL does not provide support for acts of international terrorism. (R. 11-2, 14). Since the IFIL tax contains identical calculations and deductions as the Sietch State tax, which the I.R.S. stipulates properly mimics income tax in the United States sense; the creditability of the IFIL tax is not in question. (R. 4). Rather, the issues are whether IFIL qualifies as a proper taxing authority, the constitutionality of the tax under the Arrakis Constitution, and whether Harkonnen Oil properly exhausted available remedies in seeking to reduce its tax burden.

A. <u>IFIL satisfies the criteria for Statehood, as established by the Montevideo Convention on Rights and Duties of States, as it has defined territory, permanent population, an operational and effective government, and the capacity to enter into relations with other states</u>

The determination of IFIL's statehood is central to the analysis of its taxing authority. "Courts have noted that 'the power of taxation is inherent in every independent government,'" therefore the recognition of IFIL as an independent state is tantamount to the recognition of IFIL as a proper taxing authority. Singer & Singer, *supra*, § 66:1. The determination of statehood is a matter of international law. In 1933, the legal requirements for Statehood were established in Article 1 of the Montevideo Convention on Rights and Duties of States of which the United States was a signatory. Montevideo Convention, *supra*, art. 1.

Article 1 of the Montevideo Convention lists four requirements for statehood, which the United States later codified, nearly verbatim, in § 201 of the Restatement (Third) of the Foreign Relations Law of the U.S. "Under international law, a state is an entity that has a defined territory and a permanent population, under the control of its own government, and that engages in, or has the capacity to engage in, formal relations with other such entities." Restatement (Third) of the Foreign

Relations Law of the U.S. § 201 (1987).

However, as a matter of international law, statehood is conferred once an entity receives recognition as a state from other states. "Whether an entity satisfies the requirements for statehood is ordinarily determined by other states when they decide whether to treat that entity as a state. Ordinarily, a new state is formally recognized by other states . . . but a decision to treat an entity as a state may be manifested in other ways." Restatement (Third) of the Foreign Relations Law of the U.S. § 201 cmt. h (1987). Formal recognition of an entity as a state is an acknowledgement that the entity in question satisfies the requirements for statehood. Alternatively, the lack of recognition does not necessarily equate to a belief that the entity fails to satisfy the qualifications for statehood. While an affirmative formal recognition of an entity as a state should be taken as an acknowledgement of an entity's satisfaction of the requirements for statehood, the absence of such an acknowledgement cannot be construed as a denial of an entity's statehood.

IFIL has been formally recognized as a sovereign state by several nations including: Russia, France, Al Dhanab, and Anbus. Further, the United States declared IFIL a "sovereign friend" who it "would like to establish trade relations with." (R. 14). Such wide ranging recognition serves as an affirmation from the international community that IFIL satisfies the statehood requirements of having defined territory, permanent population, operational and effective government, and the capacity to enter into relations with other states.

1. *IFIL maintains exclusive control over a defined natural territory*

The Montevideo Convention requires no threshold amount of territory to satisfy the defined territory criterion. The entity must possess some natural territory as the population and the size of the defined borders will not exclude those territories with small populations or boundaries. 1 L. Oppenheim, *International Law: A Treatise* § 169 (8th ed. 1955) ("A [s]tate without a territory is not possible, *although* the necessary territory may be very small, as in the case of the Vatican City, the Principality of Monaco, the Republic of San Marino, or the Principality of Leichtenstein." *Id.* § 108.).

Furthermore, it is not necessary that the exact boundaries of the territory be defined, so long as it possesses *some* definite territory. "An entity may satisfy the territorial requirement for statehood even if its boundaries have not been finally settled, if one or more of its boundaries are disputed, or if some of its territory is claimed by another state." Restatement (Third) of the Foreign Relations Law of the U.S. § 201 cmt. b (1987). The defined territory of IFIL is composed of a portion of the Sietch Dunes regions, known as the Badlands, as well as the territory on which Harkonnen Oil's Twelfth drilling unit is located. (R. 13). The Badlands and Unit Twelve are under the exclusive and effective control of IFIL thereby satisfying the defined territory requirement. (R. 13).

In regards to IFIL's acquisition of the Badlands and Unit Twelve, the United States may argue that it has an obligation not to recognize IFIL as a State because its territory was acquired forcefully. Pursuant § 202(2) of the Restatement (Third) of the Foreign Relations Law of the United States, "[a] state has an obligation not to recognize or treat as a state an entity that has attained the qualifications for statehood as a result of a threat or use of armed force." Restatement (Third) of the Foreign Relations Law of the U.S. § 202(2) (1987). However, a distinction must be made between lawful and "unlawful . . . use of force." Restatement (Third) of the Foreign Relations Law of the U.S. § 202(2) n. 5 (1987). If the force is justified, then the obligation of non-recognition does not apply.

Lawful force may be used to enforce the right to self-determination where "forcible action has been taken" to suppress such right. Malcolm N. Shaw, *Self-Determination and the Use of Force, in Minorities, People, and Self-Determination, Essays in Honour of Patrick Thornberry* 45 (Nazila Ghanea & Alexandra Xanthanaki eds., 2005). In the recent past, two separate groups within the Sietch Dunes region attempted to annex themselves from Arrakis – both of which were met with overwhelmingly violent responses. (R. 5-8). IFIL's acquisition, although forceful, was not illegal. IFIL had a reasonable expectation that its acquisition of the Badlands would be met with similar force. Therefore, IFIL's use of force was justifiable.

2. *The population of IFIL sufficiently satisfies the requirement of significance and permanence*

"To be a state an entity must have a population that is significant and permanent . . . [regardless of whether] large numbers of nomads move in and out of the territory." Restatement (Third) of the Foreign Relations Law of the U.S. § 201 cmt. c (1987). Under international law "there is no set minimum number of inhabitants required to constitute a state." Matthew N. Bathon, *The Atypical International Status of the Holy See*, 34 Vand. J. Transnat'l L. 597, 609 (2001) (stating, "[a]pproximately 500 people reside in the Vatican City, of whom 165 have citizenship in the Vatican. Under international law there is no set minimum number of inhabitants required to constitute a state." *Id.*). The population of IFIL maintains its own government and effectively and peacefully controls the territory of the Badlands and Unit Twelve, which sufficiently satisfies the mores of international law.

In international law there are two traditional ways in which citizenship is derived, "*jus soli*," right of soil, or birthplace, and "*jus sanguinis*," right of blood, or blood-line. *See U.S. v. Wong Kim Ark*, 169 U.S. 649 (1898). The population of IFIL does not derive its citizenship *jus soli*, from birthplace, but rather *jus sanguinis*, from blood-line. (R. 11). The doctrine of *jus sanguinis* awards citizenship based upon the citizenship of one's parents, regardless of where one is born. Although traditionally nomadic, the people of IFIL meet the requirement that the population be permanent, as they have persisted in the region for centuries. (R. 3). The doctrine of *jus sanguinis* permits the Sietch people to maintain their heritage and nationality although they are dispersed among nations. While the IFIL population has survived displacement over distance and time, for the purposes of the Montevideo Convention, it is both significant and permanent. (R. 12).

3. *The government structure of IFIL maintains effective and organized control over its own territory and population*

The Montevideo Convention further explains that, "[a] state need not have any particular form of government, but there must be some authority exercising governmental functions which are able to represent the entity in international relations." Restatement (Third) of the Foreign Relations Law of the U.S. § 201 cmt. d (1987). IFIL's supreme leader, the Leader-Elect, is elected annually from an electoral college made up of the royal family of Al Dhanab, the royal family of Anbus, and the IFIL population at large. (R. 12). However, analysis of whether an entity satisfies the Montevideo Convention's government requirement does not hinge on the structure of the entity's government, but whether it performs all necessary functions. Restatement (Third) of the Foreign Relations Law of the U.S. § 201 cmt. d (1987).

The government criterion of the Montevideo Convention requires that a state maintain "effective control over the territory and its population." John Cerone, *The UN and the Status of Palestine – Disentangling the Legal Issues,* 15 Am. Soc'y Int'l L. Insights 26 (2011). The governing structure of IFIL has demonstrated its ability to strategically organize its own members for purposes of self-determination and has received royalty payments for the extraction of natural resources within its boundaries. (R. 13). Therefore, the government of IFIL maintains effective control over its territory, satisfying the Montevideo Convention's third requirement.

4. *IFIL's capacity to engage in formal relations was demonstrated by its contractual agreements with foreign corporations and states and by the United States' expressed desire to engage in trade relations*

Restatement (Third) of Foreign Relations Law states that an entity having the capacity to enter into relations with other states will have "competence within its constitutional system," to do so. Restatement (Third) of the Foreign Relations Law of the U.S. § 201 cmt. e (1987). IFIL demonstrated its capacity and competency to engage in relations with other states by entering into contracts with foreign entities including Al Dhanab, Anbus, and Harkonnen Oil. (R. 13). United States courts have recognized the capacity to enter into contracts as "well-established indicia of sovereignty." *Morgan Guar. Trust Co. of N.Y. v. Rep. of Palau*, 924 F.2d 1237, 1245 (2d Cir. 1991). In that case, the court determined the Republic of Palau to be a trusteeship of the United States and not a foreign sovereign. *Id.* at 1246. This determination was based upon the fact that the Republic of Palau failed to enter into an enforceable contract with a number of foreign entities. *Id.*

The court acknowledged that its holding "well may have been different had [the contract] been fully approved by the parties. . . . Such approval would have marked the entry of Palau into the final stage of its transition to self-government and would have signaled the *certain* and *unavoidable* termination of the Trusteeship." *Id.* at 1247 (citing *U.S. v. Covington,* 783 F.2d 1052, 1056 (9th Cir. 1985)) (emphasis added). Based on this precedent, as the individual contracts between Al Dhanab, Anbus, Harkonnen Oil and IFIL were fully approved by all parties, IFIL effectively demonstrated its capacity to enter into foreign relations with other states. (R. 12-3).

IFIL's competency is further evidenced by Executive Order 14012, in which the President of the United States recognized IFIL as a sovereign friend and expressed a desire to enter into trade relations. (R. 14). Under the Montevideo

Convention "[t]he recognition of a state . . . signifies that the state which recognizes it accepts the personality of the other with all the rights and duties determined by international law. Recognition is unconditional and irrevocable." Montevideo Convention, *supra*, art. 6. Further, "The recognition of a state may be express or tacit. The latter results from *any* act which implies the intention of recognizing the new state." *Id.* at 7 (emphasis added). Executive Order 14012 effectively implied recognition of IFIL as a sovereign state. As such, IFIL is entitled to all the rights and duties of a state determined by international law, including the right to tax operations conducted within its territory.

B. Alternatively, IFIL is capable of levying a creditable tax as it meets the definition of "foreign country" as established by relevant case law

While IFIL satisfies the criteria for independent statehood, should this Court find the argument for IFIL's international status unpersuasive, Harkonnen Oil's tax payments to IFIL may still be found creditable as IFIL meets the definition of "foreign country." This assertion was discussed thoroughly in *Burnet*, a case in which the United States Supreme Court held that although foreign tax credits are only granted on income taxes paid to a "foreign country," the latter term is not strictly confined to a government with international status. 285 U.S. at 5.

In that case, the Court acknowledged the ambiguous nature of the term "foreign country" as it appears in the tax code. *Id.* In doing so, the Court held that "[t]he term 'foreign country' is not a technical or artificial one, and the sense in which it is used in a statute must be determined by reference to the purpose of the particular legislation." *Id.* at 6. The purpose of the creation of the foreign tax credit within the code was to reduce vexatious double taxation of United States corporations operating abroad, and in keeping with that purpose; the Court liberally applied the meaning of "foreign country" under the code. *Id.* The Court reasoned that the domestic corporation was liable to the taxing entity whether it was defined as a state with international status or merely a political entity without international standing. *Id.* Therefore, based on this persuasive authority, as a "foreign country" capable of levying a tax, Harkonnen Oil's tax payments to IFIL are justifiably creditable.

C. <u>In accordance with the doctrine of international comity, evaluation of the IFIL tax's validity is beyond this Court's jurisdiction</u>

Far better suited to analyze complex questions of regional authority, the Holy Royal Court of Arrakis previously recognized IFIL as a legitimate part of Sietch. (R.14). Such a holding, absent a finding that the IFIL tax violated the Arrakis Constitution, which allows only one tax to be levied from the Sietch State Province, properly infers recognition of a distinction between the Province of Arrakis and the ancient Sietch people who make up IFIL's population. (R. 14).

As the Holy Royal Court of Arrakis is the final arbiter of matters concerning interpretation of the Arrakis Constitution, this Court does not have jurisdiction to evaluate the validity of the IFIL tax under the Arrakis Constitution. (R. 4). "The doctrine of international comity denotes the deference that courts of the United States should give to the acts of foreign governments and their courts." *Pan E. Exploration Co. v. Hufo Oils*, 798 F.2d 837, 839 (5th Cir. 1986) (citing *Hilton v. Guyot*, 159 U.S. 113, 163 (1895); *Laker Airways, Ltd. v. Sabena, Belg. World*

Airlines, 731 F.2d 909, 937 (D.C. Cir. 1984)). In fact:

> [T]he central precept of comity teaches that . . . the decisions of foreign tribunals should be given effect in domestic courts, since recognition fosters international cooperation and encourages reciprocity, thereby promoting predictability and stability through satisfaction of mutual expectations. . . . Comity is a necessary outgrowth of our international system of politically independent, socio-economically interdependent nation states . . . no nation can expect its laws to reach further than its jurisdiction to prescribe, adjudicate, and enforce. . . . Thus, comity compels national courts to act at all times to increase the international legal ties that advance the rule of law within and among nations.

Laker Airways Ltd., 731 F.2d at 937-44. Therefore, as Arrakis is a foreign sovereign capable of interpreting its own Constitution, this Court must defer to Arrakis precedent.

The Holy Royal Court of Arrakis held that the tax IFIL levied on Harkonnen Oil was legitimate – acknowledging that the tax did not violate the Arrakis Constitution. (R. 14). Based on the relevant case law and the applicable Arrakis precedent, this Court should defer to the decision of the Holy Royal Court of Arrakis as any further interpretation on such matter requires an evaluation beyond this Court's jurisdiction.

D. <u>Harkonnen Oil exhausted all effective and practical remedies in seeking to reduce its tax burden by petitioning the Holy Royal Court of Arrakis for determination on the legitimacy of IFIL</u>

In its appeal to the Holy Royal Court of Arrakis for the determination of the legitimacy of IFIL to levy a tax, Harkonnen Oil exhausted all effective and practical remedies for reduction of its tax burden. (R. 14). In determining foreign tax creditability, this Court must conduct an analysis of whether the party exhausted "all effective and practical remedies . . . in a manner that is consistent with a reasonable interpretation and application of the substantive and procedural provisions of foreign law." Treas. Reg. § 1.901-2(e)(5)(i). In other words, the taxpayer "is not required to take futile additional administrative steps and thus . . . is not precluded from the foreign tax credit for its failure to do so." *Schering Corp v. C.I.R.*, 69 T.C. 579, 602 (1978). As Harkonnen Oil sought relief from the Holy Royal Court of Arrakis, seeking further remedies from another court would have been ineffective and impractical as all legal tax disputes are to be decided by the highest court in Arrakis. (R. 14). Therefore, because Harkonnen Oil sufficiently exhausted all remedies required by the code, the IFIL income tax should not be disqualified for failure to seek further remedy.

CONCLUSION

Harkonnen Oil's tax payments to Arrakis are creditable United States income taxes under I.R.C. §§ 901 and 903 as they are compulsory payments that mimic income taxes in the United States sense, as the predominant character of the tax sufficiently reaches net gain, and as the payments are arguably made "in-lieu-of" an otherwise applicable income tax. Further, Harkonnen Oil's tax payments to IFIL are worthy of United States foreign tax credit because the taxes were levied by a proper taxing authority, as the Holy Royal Court of Arrakis has previously recognized IFIL's validity, and as Harkonnen Oil exhausted all effective and practical remedies for reduction of its tax burden.

For these reasons, this Court should reverse all issues.

Respectfully submitted,

/s/ Team 14

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