No. C15-1701-1

In the
Supreme Court of the United States

ROYAL HARKONNEN OIL COMPANY,

Petitioner,

v.

UNITED STATES OF AMERICA

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Fourteenth Circuit

BRIEF FOR THE PETITIONER

Team #19

Counsels of Record

QUESTIONS PRESENTED

I. Whether Royal Harkonnen Oil Company is entitled to a foreign tax credit for payment of the Republic of Arrakis Foreign Tax under I.R.C. § 901 or I.R.C. § 903 where the tax is imposed on all foreign companies operating machinery in Arrakis and where the tax allows for ninety-five percent cost recovery.

II. Whether Royal Harkonnen Oil Company is entitled to a foreign tax credit for taxes paid to the Inter-Sietch Fremen Independence League where the group is a sovereign friend of the United States that imposed a tax on income from a drilling station in territory under its control.

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JURISDICTIONAL STATEMENT

The District Court had jurisdiction over this civil action for the recovery of illegally-assessed internal revenue tax under 18 U.S.C. § 1346(a)(1). After the District Court entered a final judgment for the government, Royal Harkonnen Oil Company filed a timely appeal to the U.S. Court of Appeals for the Fourteenth Circuit, which had jurisdiction under 28 U.S.C. § 1291. Petitioner timely requested a writ of certiorari, which this Court granted pursuant to 28 U.S.C. § 1254(1).

CONSTITUTIONAL OR STATUTORY PROVISIONS

Section 901 of the Internal Revenue Code provides in relevant part:

> (a) ALLOWANCE OF CREDIT. . . . the tax imposed by this chapter shall . . . be credited with the amounts provided in the applicable paragraph of subsection (b).
>
> (b) AMOUNT ALLOWED. . . . (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, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States.

Section 903 of the Internal Revenue Code provides: "For purposes of this part . . . 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 or by any possession of the United States."

STATEMENT OF THE CASE

This tax suit arose when the Internal Revenue Service (IRS) denied Royal Harkonnen Oil Company (Harkonnen) foreign tax credits for taxes it paid to three foreign entities for oil and gas extraction operations overseas in 2011. R. at 16–17. Harkonnen is a U.S. corporation incorporated in Delaware; its CEO is Vladimir Harkonnen. R. at 2 n.1, 3. In 2011, Harkonnen paid taxes to the Republic of Arrakis (Arrakis), Sietch State, and the Inter-Sietch Fremen Independence League (IFIL).

I. Taxes Paid to Arrakis

Arrakis is a foreign country with at least one oil-producing region, the 213,000 square mile tract known as the Caladan Oil Field. *Id*. Arrakis' capital is Arrakeen and its leader is President Jules Corrino. R. at 3, 8.

Arrakis' tax law is grounded in millennia-old religious principles that render foreigners ineligible to pay taxes under the general Arrakis Tax Code. R. at 4. The Holy Royal Court—Arrakis' highest court—recently reaffirmed this ineligibility in *Lord Remmington v. Republic of Arrakis*. *Id*. n.6. In March of 2008, however, President Corrino, acting under his constitutional authority to enact one new tax each year, created the Republic of Arrakis Foreign Tax (AFT). R. at 5.[1] The AFT applies to all foreigners operating machinery in Arrakis. *Id*. To ensure proper enforcement, the AFT requires that all revenue be deposited with the Arrakis Central Bank, at which point the Bank disburses taxes to the Arrakis treasury and the remainder to the taxpayer. *Id*. The AFT allows all of the same deductions

[1] The tax was originally styled a "value tax," but was renamed two months later in June 2008.

allowed by the U.S. tax code, capped at ninety-five percent of value; the sole purpose of the cap is to ensure compliance with Arrakis' religious law. R. at 15.

In June 2008, President Corrino and Mr. Harkonnen signed a lease for the Caladan Oil Field. R. at 7. The lease entitles Harkonnen to develop and extract oil and gas from the field in exchange for a one-time payment of fifty-five million dollars and a royalty of fifteen percent. *Id*. In the lease, Harkonnen also acknowledged that its revenue would be subject to the AFT. *Id*. In 2011, the AFT was set at thirty-three percent of gross receipts, less applicable deductions. R. at 16.

II. Taxes Paid to Sietch State

Sietch State is a recently formed political subdivision of Arrakis comprising a region known as the "Sietch Dunes" in northern Arrakis. R. at 8–9. The region's occupants have significant historical and religious differences from the rest of Arrakis. R. at 16 n.13. Sixty-two thousand square acres of the Caladan Oil Field lie in Sietch State territory. R. at 6.

Sietch State was formed in April 2010 after an uprising by a group called the Independent People of Sietch (IPS) resulted in several weeks of conflict during which the U.S. closed its embassy in Arrakeen and designated Arrakis a "dangerous state." R. at 8. The conflict ended with a peace treaty that recognized the Sietch State and designated it an Important Province of Arrakis. *Id*. The treaty granted the Province sole authority to appoint the Arrakis Vice President. *Id*. A subsequent amendment to the Arrakis Constitution granted the Vice President the power to "[d]ecree and levy a single tax and the power to amend the tax with the approval of the sitting President of Arrakis." R. at 8–9. The IPS thereafter staged an election and declared its leader, Paul Atreides, Vice President. R. at 9. Although the U.S. declared the election results questionable, it reopened its embassy in Arrakis, established a one-room consulate for Sietch State, and undesignated Arrakis as a "dangerous state." R. at 10.

Vice President Atreides decreed a single tax under his new constitutional powers (the Sietch State tax). R. at 10. This tax requires that ten percent of all revenue generated in the Sietch State, less deductions, be paid to the Chief Accountant of Sietch State. *Id*. Due to Sietch State's distinct religious heritage, no limits are placed on deductions for foreigners. R. at 16 n.13. Sietch State's available deductions are therefore identical to the deductions allowed by the U.S. income tax. R. at 10 n.11, 16 n.13. Harkonnen thereafter executed a lease with Sietch State, making a one-time payment of five million dollars and agreeing to a five percent royalty to extract oil and gas from the segment of the Caladan Oil Field in Sietch State territory. R. at 10.

III. Taxes Paid to IFIL

IFIL is an entity that, as of March 2011, physically controls part of Sietch State. R. at 13. Originally classified as an independent splinter group of the Bene Gesserit terrorist organization,[2] IFIL rejected the Bene Gesserit in 2005 and launched a rebellion challenging IPS for control of Sietch State in December 2010.

[2] The U.S. State Department has classified IFIL an independent splinter group of the Bene Gesserit, but the record is silent as to whether this designation postdates IFIL's documented rejection of the Bene Gesserit.

R. at 11. Its stated goal is to "promote economic development" in historic Sietchan territory. R. at 12.

IFIL has been recognized as a legitimate foreign government and independent state in the Sietch Dunes region by Al Dhanab and Anbus, two of Arrakis' neighboring nations, as well as France and Russia. R. at 12–13. Al Dahnab and Anbus provided financial support to IFIL and have an equal share in electing the IFIL Leader Elect, although individuals pledging membership IFIL members cast the tiebreaking vote. R. at 12. The IFIL governing structure is otherwise solely determined by the Leader Elect. *Id.*

IFIL's territory includes one of Harkonnen's drilling stations (Unit #12). R. at 13. After IFIL asserted its control over Unit #12, Mr. Harkonnen met with IFIL Leader Elect, Jessica Mohiam, and executed a lease. R. at 13. Under the lease, Harkonnen would make a one-time payment of $550,000 and pay a five percent royalty. *Id*. Mohiam also imposed a two percent tax on Unit #12 income (the IFIL tax), calculated by taking gross receipts from the station, allowing all deductions Sietch State allows—one hundred percent of American deductions—and multiplying the remainder by two percent. *Id*. Harkonnen protested the tax and petitioned the Holy Royal Court for a determination as to IFIL's status and its ability to levy taxes; the court held that "Arrakis recognizes IFIL as a part of Sietch." R. at 14. Harkonnen thereafter began paying the IFIL tax. *Id*.

IV. The Underlying Tax Suit

In May 2011, Mr. Harkonnen, President Corrino, Vice President Atreides, and Leader Elect Mohiam met for the First Annual Caladan Oil Field Conference at which the Arrakis, Sietch State, and IFIL leaders set the tax rates for the rest of 2011. R. at 15. Accordingly, during the remainder of 2011, Harkonnen paid: (1) the thirty-three percent AFT; (2) the ten percent Sietch State tax; and (3) the two percent IFIL tax. R. at 16.

On March 15, 2012, Harkonnen filed its Form 1120 U.S. Tax Return and Form 1118 claiming foreign tax credits for all three tax payments. *Id*. The IRS denied Harkonnen credit for taxes paid to Arrakis and IFIL but allowed credit for the Sietch State tax. *Id*. Harkonnen paid the full tax and demanded a refund. R. at 17.

V. Proceedings Below

Harkonnen filed a civil suit for a refund in the Central District of New Tejas. I.R.C. § 7422 (2012); R. at 17. Harkonnen alleged that the IRS had improperly denied it foreign tax credits for payment of the AFT and IFIL tax under §§ 901 and 903 of the Internal Revenue Code. R. at 17. After a trial, the District Court found in favor of the United States. *Id*.

Harkonnen timely filed notice of appeal to the U.S. Court of Appeals for the Fourteenth Circuit, which affirmed the District Court. R. at 2.

Harkonnen petitioned for writ of certiorari, which this Court granted. R. at 1.

INTRODUCTION

In our globalized society, it is increasingly common for U.S. citizens to build and grow businesses in foreign countries. This kind of investment can pay dividends at every level: it strengthens the American economy, generates jobs at home and abroad, and creates incentives for other nations to build ever-stronger friendships with the United States. These potential benefits are lost, however, when our citizens do not invest in foreign countries for fear of having their profits "double taxed"—first by the foreign country and then again by the United States.

In recognition of this, nearly a century ago the U.S. Congress created the foreign tax credit, which allows American taxpayers to receive credit for taxes paid to foreign countries. In this case, however, the IRS interpreted the credit provisions so strictly as to undermine their purpose. The end result is that Harkonnen is subjected to income tax twice: once by Arrakis or IFIL, and once again by the IRS. Moreover, by denying Harkonnen credit for payments to Arrakis and IFIL, the IRS has disrespected the form in which these foreign countries choose to tax revenue-generating activities within their borders. The resulting disincentive to economic ambassadorship undermines the positive effects of increased global trade and perpetuates a form of economic imperialism that undermines America's position abroad.

SUMMARY OF ARGUMENT

Harkonnen is entitled to foreign tax credits for payment of the AFT and the IFIL tax. Under §§ 901 and 903 of the Internal Revenue Code, U.S. corporations may receive credit for income taxes or taxes in lieu of income taxes paid to foreign countries.

Here, Harkonnen may take a credit for payment of the AFT because the tax is a § 901 income tax. The AFT is a tax because it is a compulsory payment imposed under Arrakis' taxation authority. The AFT is compulsory both because it does not exceed Harkonnen's legal liability under a reasonable interpretation of Arrakis law and because Harkonnen is required only to exhaust "effective and practical remedies" to reduce tax liability—not to litigate the validity of the AFT to the bitter end. It is imposed under Arrakis' taxation authority because it is not payment in exchange for any specific economic benefit that accrues to Harkonnen by virtue of AFT payments. The AFT is an *income* tax because it has the predominant character of a U.S. income tax: it is imposed when Harkonnen realizes its income on the company's gross receipts and allows for nearly total recovery of Harkonnen's costs and expenses.

Alternatively, the AFT qualifies as a tax imposed in lieu of a generally imposed income tax under § 903. The AFT is an "in lieu of" tax because foreign taxpayers like Harkonnen are exempted from the otherwise generally applicable Arrakis income tax, and because no subsequent income tax is imposed on Harkonnen's revenue. Thus, under either § 901 or § 903, Harkonnen is entitled to a tax credit for payments of the AFT.

Harkonnen is also entitled to credit for payment of the IFIL tax because IFIL is a foreign country within the meaning of § 901, either as an independent foreign state or as a political subdivision of Arrakis, and because the levy is a compulsory payment imposed pursuant to a foreign country's authority to levy a tax. IFIL is an independent foreign state under U.S. law because the President of the United States issued Executive Order 14012 recognizing IFIL's sovereignty and because IFIL controls a defined territory and population and engages in foreign relations. Alternatively, if IFIL is not an independent sovereign, it is a political subdivision of Arrakis under the tax's code broad definition of political subdivisions.

The IFIL tax is a compulsory payment because it is imposed pursuant to an act of state by a foreign sovereign. Even if the IFIL tax is not an act of state, Harkonnen reasonably interpreted the tax to be compulsory, and—by petitioning the highest executive and judicial authorities in Arrakis—exhausted all remedies under which it was likely to secure relief from the IFIL tax. Harkonnen may therefore receive credit for payment of the IFIL tax.

ARGUMENT

Royal Harkonnen Oil Company (Harkonnen) is entitled to foreign tax credits for payments of the Arrakis Foreign Tax (AFT) to Arrakis and of the two percent tax on Unit #12 income (IFIL Tax) to the Inter-Sietch Fremen Independence League (IFIL). U.S. corporations such as Harkonnen are entitled to receive a tax credit for certain taxes paid to a foreign country. I.R.C. § 901(a), (b)(1) (2012). The foreign tax credit serves as a mechanism for avoiding double taxation, thereby encouraging American investment abroad and facilitating foreign trade. *See generally* Richard E. Andersen, *Foreign Tax Credits* ¶ 1.01 (2014). Sections 901 and 903 of the Internal

Revenue Code implement this principle, shielding American corporations from tax liability in the U.S. for income taxes or taxes "in lieu of" income taxes the corporation pays to a foreign country.

Harkonnen is entitled to a tax credit for its payment of the AFT because the AFT is an income tax under § 901 or, alternatively, a tax paid in lieu of an income tax under § 903. Harkonnen is also entitled to credit under § 901 for the IFIL tax because IFIL is a foreign country for § 901 purposes and its imposition of a two percent income tax is pursuant to its taxation authority, whether as a sovereign state or as a political subdivision of Arrakis. The Fourteenth Circuit therefore erred in holding that the IRS properly denied Harkonnen foreign tax credits for both the AFT and IFIL tax. Accordingly, this Court should reverse the judgment of the Fourteenth Circuit and hold that Harkonnen may receive credits for both taxes.

I. Harkonnen is entitled to a foreign tax credit for payment of the Arrakis Foreign Tax because the tax is either an income tax under I.R.C. § 901 or a tax levied "in lieu of" an income tax under I.R.C. § 903.

A. <u>The Arrakis Foreign Tax is a creditable tax under § 901 because it is a tax imposed under Arrakis' authority to tax and has the predominant character of a U.S. income tax.</u>

Companies may receive tax credit for income taxes paid to foreign countries. I.R.C. § 901(a), (b)(1). A levy is an income tax if it is (1) a tax that (2) has the predominant character of an income tax "in the U.S. sense." Treas. Reg. § 1.901-2(a)(1) (1992). The AFT is a tax and not another type of levy because it is compulsory and imposed pursuant to Arrakis' sovereign authority to levy taxes. It has the predominant character of the U.S. income tax because it reaches net gain under the circumstances in which it normally applies; that is, it satisfies each of the realization, gross receipts, and net income requirements. Thus, the AFT is creditable under § 901.

1. *The Arrakis Foreign Tax is a tax because it is compulsory and was imposed pursuant to Arrakis' taxation authority and because it is not a penalty, fine, or customs duty.*

A foreign levy is a tax if it is compulsory, imposed pursuant to the foreign country's taxation authority, and not some other species of levy like a fine, penalty, or customs duty. § 1.901-2(a)(1)(i); *Exxon Corp. v. Comm'r*, 113 T.C. 338, 350 (1999), *acq. in result*, AOD-2001-04. Preliminarily, the AFT is not a fine, penalty, or customs duty because Harkonnen has engaged in no conduct that would subject it to those types of payments. Rather, like the Italian tax in *IBM v. United States*, which treated the foreign levy as a tax because it was imposed as a function of income earned in Italy, the AFT here is a simple tax that scales with Harkonnen's income in Arrakis. 38 Fed. Cl. 661, 668–69 (1997). Arrakis has at no time styled the AFT as anything other than a tax on Harkonnen's profits. Thus, the AFT is not a fine, penalty, or customs duty.

The AFT satisfies the other requirements to be treated as a tax under § 901 because it is compulsory and was established and imposed pursuant to President Corrino's authority to impose taxes under the Arrakis Constitution.

i. <u>The Arrakis Foreign Tax is compulsory.</u>

A levy is compulsory if payment does not exceed the taxpayer's tax liability under foreign law. § 1.901-2(e)(5)(i). A payment does not exceed the taxpayer's liability if two conditions are met. First, the taxpayer must have reasonably interpreted and applied foreign law. *Id.* Second, the taxpayer must have exhausted "all effective and practical remedies" to reduce its tax liability. *Id*. A taxpayer is not required, however, to have pursued and exhausted all opportunities to litigate the validity of the tax; it is enough that the taxpayer has invoked any available remedies likely to reduce its liability. *See id.*; *IBM*, 38 Fed. Cl. at 675.

Here, there is no credible argument that Harkonnen's AFT payment exceeds its liability. The company paid thirty-three percent tax on its gross receipts from the Caladan Oil Fields, less applicable deductions, per the rate set for the AFT at the First Annual Caladan Oil Field Conference. R. at 15, 16. This is the only reasonable interpretation of Arrakis tax law: the measure of tax liability is a simple percentage and Harkonnen paid that percentage. R. at 16.

Harkonnen has also exhausted "all effective and practical remedies." The company possessed no remedy under the AFT for reducing its base liability below thirty-three percent, nor does it have such a remedy under other Arrakis law or administrative procedure. The only "remedy" that would be available to Harkonnen is to attack the legitimacy of the AFT in the courts of Arrakis. Yet this kind of "litigation remedy" is neither "effective nor practical." *See IBM*, 38 Fed. Cl. at 675 (holding that taxpayer had exhausted its remedies even when it had not finished contesting its tax liability in foreign court); *see also* Part II.B.2.ii., *infra*. Just like the taxpayer in *IBM*, then, which had exhausted its remedies even though opportunities remained to litigate the extent of its foreign tax liability, Harkonnen has exhausted all non-litigation remedies. *See* 38 Fed. Cl. at 675.

ii. The Arrakis Foreign Tax was imposed pursuant to Arrakis' authority to levy taxes and is not a fee in exchange for a "specific economic benefit."

A compulsory levy is imposed pursuant to a foreign country's taxation authority as long as it does not constitute payment for a "specific economic benefit." § 1.901-2(a)(2)(i); *see Phillips Petroleum Co. v. Comm'r*, 104 T.C. 256, 295 (1995). While the foreign country's characterization of the levy as a tax is not dispositive, *see PPL Corp. v. Comm'r*, 133 S. Ct. 1897, 1902 (2013), "the declaration of the lawmaking power is entitled to much weight," *Phillips*, 104 T.C. at 295 (quoting *Flint v. Stone Tracey Co.*, 220 U.S. 107, 145 (1911), overruled on other grounds by *Brush v. Comm'r*, 300 U.S. 352, 370–73 (1937)); *see also Exxon*, 113 T.C. at 353–54.

The AFT is imposed pursuant to Arrakis' taxation authority because it was created and implemented under President Corrino's constitutional power to enact taxes. R. at 5 n.8. Not only was President Corrino's act an unremarkable exercise of the legislative taxation authority the Arrakis constitution vests in him, his decision to act under his taxation power also reflects an intent that the AFT be a tax and not some other form of levy. *Id*. While Arrakis' chosen terminology is not dispositive, the Court should not "close its eyes" to the fact that the levy President Corrino created is entitled the Arrakis Foreign *Tax*. *Phillips*, 104 T.C. at 296.[3]

[3] While the Fourteenth Circuit correctly acknowledged that the levy's name is relevant to the determination of whether it is a tax, it erred in treating the name as dispositive. *See* R. at 17. As explained in Part I.A.2.ii., *infra*, the AFT is not a value tax even though it was originally named the

Furthermore, Harkonnen receives no specific economic benefit in exchange for paying the AFT. A specific economic benefit is a benefit that is not available on substantially similar terms to the foreign country's population or taxpayers in general. § 1.901-2(a)(2)(ii)(B). When a "dual capacity taxpayer" both receives an economic benefit from a foreign government and also pays a levy to it, the taxpayer must prove "based on all the relevant facts and circumstances" that the levy at issue was not paid in exchange for the benefit. § 1.901-2A(c)(2); *Exxon*, 113 T.C. at 350–51.

A levy like the AFT is therefore not a payment in exchange for a special economic benefit when the payment itself affords the taxpayer no special rights or benefits beyond those already secured by royalties, one-time payments, or other licensing fees. *See* § 1.901-2A(c)(2); *Exxon*, 113 T.C. at 350–51 (holding taxpayer's payment of a petroleum revenue tax was not in exchange for a specific economic benefit where its rights to the oil field were secured by a one-time fee and annual royalty payments).[4] Accordingly, where the right to the specific economic benefit is acquired via a license, contract, or royalty fee that provides "substantial and reasonable compensation" to the government, that license, contract, or royalty fee is treated as the source of the economic benefit—not the compulsory payment at issue. *Exxon*, 113 T.C. at 338.

"Arrakis Foreign Value Tax" because it taxes past income, not future revenue-generating potential reduced to market value. *See PPL*, 133 S. Ct. at 1905.

[4] The difference between taxes and other types of levies is rooted in the unique structure and purpose of taxes, which are compulsory exactions imposed unilaterally by a sovereign for public purposes; they confer no additional rights in exchange for payment. *See Phillips*, 104 T.C. at 295; *Exxon*, 113 T.C. at 353. By contrast, royalties are "share[s] of the product or profit reserved by an owner for permitting another to use a property." *Phillips*, 104 T.C. at 295.

The AFT is not a payment for a specific economic benefit because the payment of the AFT entitled Harkonnen to no additional rights beyond those already acquired through the one-time bonus payment and royalty.[5] In *Exxon*, the Tax Court rejected the Commissioner's claim that a special tax imposed by the United Kingdom on profits from oil drilling in the North Sea was paid in exchange for a specific economic benefit. *Id.* at 353. In doing so, the court noted that Exxon already paid the U.K. substantial license fees and royalties for the right to drill in the North Sea; the company obtained no additional rights by paying the tax. *Id.* Similarly, Harkonnen's right to develop the Caladan Oil Field derives from the lease it executed with Arrakis on June 30, 2008, for which the company made a one-time bonus payment of fifty-five million dollars and agreed to pay Arrakis a royalty of fifteen percent. R. at 7. Because payment of the AFT grants Harkonnen no additional rights to the Caladan Oil Field beyond those granted by the lease, the AFT is not in exchange for any specific economic benefits.

Nor does the fact that the AFT applies only to foreign corporations operating machinery in Arrakis mean that it is paid in exchange for a specific economic benefit. The "right to operate machinery in Arrakis" is akin to the "right to engage in business at all or in a certain form," which is explicitly excluded from the definition of specific economic benefit. § 1.901-2(a)(2)(ii)(B). In short, Arrakis "intended to impose a tax, did in fact impose a tax, structured the charge as a tax,

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[5] Indeed, Harkonnen executed a similar lease involving a one-time bonus payment and a royalty as a percentage with Sietch State for the portion of the Caladan Oil Field within Sietch State's territory. R. at 10. Harkonnen also pays the Sietch State tax on its income deriving from that portion of the oil well, but the IRS does not dispute the creditability of the Sietch State tax. R. at 17.

and administered it accordingly. If it quacks like a duck and waddles like a duck, it's a duck." *Phillips*, 104 T.C. at 297. Therefore, because the AFT is a compulsory payment imposed pursuant to Arrakis' authority to impose taxes, the AFT is a tax for § 901 purposes.

2. The Arrakis Foreign Tax has the predominant character of the U.S. income tax because it satisfies each of the realization, gross receipts, and net income requirements showing the tax is "likely to reach net gain."

A tax satisfies the second § 901 requirement that it have the predominant character of an income tax "in the U.S. sense" when it "is likely to reach net gain under the normal circumstances in which it applies." § 1.901-2(a)(3)(i); *PPL*, 133 S. Ct. at 1902. A tax is likely to reach net gain when, judged on the basis of its "predominant character," it satisfies each of the realization, gross receipts, and net income requirements. § 1.901-2(b)(1).

The foreign tax need only meet these requirements when judged on the basis of its "predominant character"; in other words, the tax need not be identical to the U.S. income tax. *See id.* Such a rigid construction cannot be squared with "the black-letter principle that 'tax law deals in economic realities, not legal abstractions.'" *PPL*, 133 S. Ct. at 1905 (quoting *Comm'r v. Southwest Exploration Co.,* 350 U.S. 308, 315 (1957)).[6] Properly considering the "economic realities" of Arrakis' tax laws, the AFT satisfies the realization, gross receipts, and net income

[6] The Fourteenth Circuit "[saw] no reason to move past the form of the Arrakis tax." R. at 18. Yet that is precisely what this Court has indicated is appropriate in determining whether a foreign tax qualifies as creditable. *PPL*, 133 S. Ct. at 1905 (rejecting the Commissioner's argument that "U.S. courts must take the foreign tax rate as written and accept whatever tax base the foreign tax purports to adopt" and algebraically rearranging the formula of a foreign tax to find it creditable).

requirements. It is therefore likely to reach net income and so has the predominant character of the U.S. income tax.

i. The Arrakis Foreign Tax satisfies the realization requirement.

The AFT satisfies the realization requirement because it is imposed simultaneously with the disbursal of Harkonnen's after-tax profits. While realization generally occurs when the taxpayer is paid in cash or in property, the core inquiry is whether the last step has been taken by which the taxpayer obtains the fruit of economic gain. *Helvering v. Horst*, 311 U.S. 112, 115 (1940) (citing *Old Colony Trust Co. v. Comm'r*, 279 U.S. 716 (1929)). A foreign tax satisfies the realization requirement if it is imposed "upon or subsequent to" a realization event as determined by U.S. income tax principles, § 1.901-2(b)(2)(i)(A), or upon the occurrence of a prerealization event under certain circumstances, § 1.901-2(b)(2)(i)(B)–(C).

Under the AFT's unique structure, Harkonnen deposits its gross receipts into the Central Bank of Arrakis. R. at 5. Harkonnen's Arrakis income is then realized when the Bank distributes the calculated taxes minus applicable deductions to the Arrakis Treasury and the remaining funds to Harkonnen. *See id.* Thus, realization and the imposition of the AFT occur simultaneously. *See id*. The AFT is thereby imposed upon the occurrence of the last step in Harkonnen receiving the fruit of economic gain, a realization event under U.S. income tax principles. § 1.901-2(b)(2)(i)(A); *Horst*, 311 U.S. at 115. Accordingly, the AFT satisfies the realization requirement.

ii. The Arrakis Foreign Tax satisfies the gross receipts requirement.

The AFT satisfies the gross receipts requirement because it is imposed on the basis of Harkonnen's gross receipts. "A foreign tax satisfies the gross receipts requirement if . . . it is imposed on the basis of gross receipts." § 1.901-2(b)(3)(i)(A). Here, that is precisely the method Arrakis uses to calculate the AFT: the thirty-three percent tax is levied against Harkonnen's gross receipts. R. at 5. Additionally, the fact that the AFT is imposed on the basis of Harkonnen's gross receipts underscores the Fourteenth Circuit's error in concluding that the AFT is a value tax.[7] As this Court noted most recently in *PPL*, a value tax is a levy on *future* revenue-generating potential, while the AFT—like the U.S. income tax—is a levy on *past* income in the form of realized gross receipts reduced by significant costs and expenses. 133 S. Ct. at 1905.

iii. The Arrakis Foreign Tax satisfies the net income requirement.

The AFT satisfies the net income requirement because it allows for the near-total recovery of Harkonnen's significant costs and expenses incurred in its operations in the Caladan Oil Field. A foreign tax satisfies the net income requirement if it allows for the recovery of significant costs and expenses attributable to gross receipts, § 1.901-2(b)(4)(i)(A), or an amount that approximates

[7] While it is true that the AFT was originally named the "Arrakis Foreign Value Tax," R. at 5, the foreign country's name for its levy is relevant but not dispositive in determining whether it is a tax with the predominant character of the U.S. income tax. *See* Part I.A.1.ii., *supra*. The relevant inquiry is "whether the tax, if enacted in the U.S., would be an income . . . tax." *PPL*, 133 S. Ct. at 1902.

or is greater than such significant costs and expenses,[8] § 1.901-2(b)(4)(i)(B); *see also Texasgulf, Inc. v. Comm'r*, 172 F.3d 209, 215 (2d Cir. 1999). In keeping with the functional "predominant character" analysis, the manner in which such significant costs and expenses are recovered need not be identical to the manner prescribed by the U.S. Internal Revenue Code. § 1.901-2(b)(4)(i); *see also Phillips*, 104 T.C. at 312 (citing *Santa Eulalia Mining Co. v. Comm'r*, 2 T.C. 241, 245 (1943)).

The AFT allows Harkonnen to recover its significant costs and expenses because Harkonnen may obtain deductions for every single deduction it would have available under the U.S. tax code. R. at 4 n.7, 15. This system of cost recovery is identical to the U.S. system and affords taxpayers precisely the same deductions. R. at 4 n.7. The sole limitation in the AFT—designed to give effect to national religious beliefs—is that Harkonnen's cost recovery is capped at ninety-five percent. R. at 15. This ninety-five percent cap does not, as the Fourteenth Circuit erroneously held, preclude "significant" cost recovery: the plain meaning of the regulation, the economic realities of the AFT, and the policy goals of the foreign tax credit all argue against such a blinkered reading of § 1.901-2.

First, as this Court has recognized, the plain language of § 1.901-2 indicates that recovery of "significant" costs and expenses does not require recovery of *total* costs and expenses. *See PPL*, 133 S. Ct. at 1905. The clearest indicators of the meaning of § 1.901-2 are the words of the regulation themselves. *Cf. Williams v. Taylor*, 529 U.S. 420, 431 (2000) ("We start, as always, with the plain language of

[8] "Significant costs and expenses" do not include other income taxes paid on the same income. *See* § 1.901-2(b)(4)(iv) Ex. 5. Accordingly, the AFT need not include a deduction for the Sietch State's income tax in order to satisfy the net income requirement. *See* R. at 20.

the statute.”). Because the regulations contain no definition of “significant,” the term must be construed “in accordance with its ordinary use or natural meaning.” *Smith v. United States*, 508 U.S. 223, 228 (1993). Merriam-Webster defines “significant” in relevant part as “of a noticeably or measurably large amount.” *Significant Definition*, Merriam-Webster.com, http://www.merriam-webster.com/dictionary/significant (last visited Nov. 20, 2014). The definition of “significant” does not include “total,” which is defined as “comprising or constituting a whole; entire.” *Total Definition*, Merriam-Webster.com, http://www.merriam-webster.com/dictionary/total (last visited Nov. 20, 2014).

While total recovery certainly constitutes significant recovery, the government errs in treating the converse as true: significant recovery does *not* require total recovery. If the Treasury had wanted to require recovery of total costs and expenses, it would have used the word “total” in promulgating its regulations. *Cf. Connecticut Nat’l Bank v. Germain*, 503 U.S. 249, 253–54 (1992) (the “one, cardinal canon before all others” is that “courts must presume that a legislature says in a statute what it means and means in a statute what it says there.”). In using “significant” instead, it indicated that some amount less than one hundred percent satisfies the net income requirement.

Second, the economic realities of the AFT caution against assuming “significant” means “total.” Indeed, numerous courts—including this Court—have noted that the text of § 1.901-2 calls for a functional analysis that centers on the “economic realities” the tax creates for the taxpayer. *PPL Corp.*, 133 S. Ct. at 1905;

see also Texasgulf, 172 F.2d at 216–17; *Exxon*, 113 T.C. at 357. In *Texasgulf*, the Second Circuit ruled that the Ontario Mining Tax (OMT) satisfied the net income requirement because its "processing allowance" allowed for the recovery of significant costs and expenses even though the allowance was not specifically designed to permit such recovery. *Texasgulf*, 172 F.3d at 216. In doing so, the court noted that one of the primary innovations of the § 1.901-2 regulations was to emphasize the actual effects of the foreign tax on the taxpayer instead of the form of the tax. *Id.* at 216–217. Accordingly, the court rejected the emphasis on form that had led other courts to hold that the OMT did not satisfy the net income requirement before the adoption of § 1.901-2. *Id.* (citing *Inland Steel Co. v. United States*, 230 Ct. Cl. 314, 338 (1982) (holding the OMT failed the net income requirement because it did not allow for recovery of the specific costs and expenses allowed by the U.S. tax code)); *accord. Exxon*, 113 T.C. at 357 ("Although a deduction is not allowed for interest expense related to North Sea operations, uplift, oil, safeguard, and tariff receipts allowances provide sufficient relief to offset for nonallowance of a deduction for interest expense.").

Third, holding that ninety-five percent recovery of costs and expenses is not significant would undermine the dual policy goals of the foreign tax credit: encouraging Americans to invest abroad without fear of double taxation while avoiding undue interference with the political decisions of our neighbors in the community of nations. As Judge Layton noted in dissent below, the government's formalist position would preclude tax credit for any citizen paying taxes in a country that has not adopted tax code virtually identical to that of the United States. *See* R. at 20 ("The brazen truth is that most countries develop their tax codes in order to generate U.S. foreign tax credits for U.S. [c]ompanies because they need U.S. [c]ompanies to help fund or jump start economic growth."). By emphasizing the function of foreign taxes over whatever form they happen to take, § 1.901-2 avoids such economic imperialism and grants other nations appropriately wide latitude in determining how best to tax the revenue-generating activities that occur within their borders. *See Phillips*, 104 T.C. at 297 (declining to "dispute Norway's wisdom as to how to tax its petroleum industry).

Such considerations apply with added force when the foreign country's tax code is crafted around sincerely held religious beliefs, which have always received special consideration in our constitutional tradition. *See, e.g.*, *Lee v. Wesiman*, 505 U.S. 577, 590 (1992) ("The First Amendment's Religion Clauses mean that religious beliefs and religious expression are too precious to be either proscribed or prescribed by the State."). According to religious laws and traditions dating back at least 1,500 years, true believers in Arrakis must pay a lower tax rate than foreign entities such as Harkonnen—a belief so integral to the Arrakis faith that it caused the split with the Sietch faith in 439 A.D. R. at 15–16 & n.14. The record indicates that President Corrino has made a good faith effort to accommodate the United States' concerns about undertaxation within Arrakis' millennia-old religious framework. The IRS's position, by contrast, would completely foreclose the possibility that a U.S. taxpayer could *ever* receive a foreign tax credit for taxes paid to Arrakis. To paraphrase

Judge Layton, forcing Arrakis to violate its sincerely held religious tenets to recapture a nominal 5% interest would be unconscionable. R. at 20. Fortunately, § 1.901-2's purposely functional approach is designed precisely to avoid that result. For these reasons, the AFT allows "significant" cost recovery under § 901. It is therefore a tax likely to reach net income. *See* § 1.901-2(a)(1), (b). Harkonnen is thus entitled to take credit for payment of the AFT under § 901.

B. In the alternative, the Arrakis Foreign tax is a creditable tax under § 903 because it is a tax levied "in lieu of" an income tax.

Even if a foreign levy is not a creditable income tax under § 901, U.S. taxpayers may nevertheless receive credit for the levy when it is a tax imposed "in lieu of" an otherwise generally imposed income tax. I.R.C. § 903. Section 903, then, applies to a foreign levy like the AFT if (1) it is a tax under the § 901 regulations and (2) it meets the "substitution requirement" that the tax is imposed instead of an income tax. Treas. Reg. § 1.903-1(a). Section 903, then, strikes a balance. It respects a foreign country's prerogative to tax revenue-generating activities within their borders through a vehicle other than an income tax while honoring the purpose of foreign tax credits: to avoid double taxation for those who pay taxes in the United States and abroad. *See generally Missouri Pac. R.R. Co. v. United States*, 392 F.2d 592, 600 (Ct. Cl. 1968) (noting that the "primary consideration" of the foreign tax credit provisions "was the avoidance of double taxation of the earnings of American companies in foreign countries").

Here, the AFT is a tax and it is the only tax Arrakis imposes on Harkonnen's revenue. Indeed, Harkonnen is exempt from the other provisions of Arrakis' tax code, including its general income tax. Thus, even if the AFT is not a creditable § 901 income tax, Harkonnen paid the AFT "in lieu of" an income tax and is entitled to a credit under § 903.

1. The Arrakis Foreign Tax is a tax under § 903.

A foreign levy is a tax under § 903 if it satisfies the § 901 regulations: the levy must be a "compulsory payment pursuant to a foreign country's authority to levy taxes." *See* §§ 1.901-2(a)(2), 1.903-1(a)(1). A levy that is a tax under § 901, therefore, is also a tax under § 903. *See, e.g.*, *IBM*, 38 Fed. Cl. at 667–68 (applying § 1.901(a)(2) identically for § 901 and § 903 claims). Thus, the AFT is a § 903 tax for the same reasons it is a tax under § 901: it is a compulsory payment exacted pursuant to Arrakis' taxing authority. *See* Part I.A.1., *supra*.

2. The Arrakis Foreign Tax satisfies § 903's substitution requirement.

A tax satisfies the substitution requirement when it "operates as a tax imposed in substitution for, and not in addition to, an income tax . . . otherwise generally imposed." *See* § 1.903-1(b)(1). A foreign country's income tax is "otherwise generally imposed" when it applies to all taxpayers except those for whom an exemption has been crafted. *See, e.g.*, *Equitable Life Assurance Soc'y v. United States*, 366 F.2d 967, 974 (Ct. Cl. 1966) (treating Canada's income tax as one "generally" imposed where it applied in the absence of an exemption such as the exemption for life insurance companies).[9]

[9] *Equitable Life* is one of four nearly identical cases before the Court of Federal Claims, all of which held that the Canadian and Canadian provincial premiums tax imposed on mutual life insurance companies satisfied the substitution requirement because the insurance companies were otherwise exempt from Canadian and provincial income tax. *See Equitable Life*, 366 F.2d at 975; *see also Metro.*

Thus, when a taxpayer is exempt from a foreign country's general income tax regime but subject to another tax that reaches its revenue, that other tax "operates as a tax imposed instead of . . . an income tax otherwise generally imposed" and satisfies the substitution requirement. *See* § 1.903-1(b)(1); *Equitable Life*, 366 F.2d at 973–74 (holding that Canadian and Canadian provincial taxes on life insurance premiums satisfied the substitution requirement where mutual life insurance companies were exempted from income taxes); *see also Missouri Pac. R.R.*, 392 F.2d at 600–01 (holding that a Mexican tax on railroad car rental revenue was a substitute for income tax because the railroad taxpayer was exempt from Mexico's general income tax).

Here, the AFT operates as a tax imposed instead of Arrakis' income tax because Arrakis exempts Harkonnen, like all foreign entities, from paying its income tax and taxes the company's revenue solely through the AFT. R. at 4 & n.6. Just like the insurance premiums tax in *Equitable Life*, which operated as a tax imposed instead of Canadian national and provincial income taxes because mutual life insurance companies were exempt from such taxes, the AFT similarly acts as a substitute for the imposition of Arrakis income tax on Harkonnen. *See* 366 F.2d at 974. Moreover, like the Canadian premiums tax in *Equitable Life*, which was enacted specifically to raise revenue from income tax-exempt insurance companies, the AFT was enacted in 2008 in order to reach foreign companies like Harkonnen that were historically exempt from Arrakis' income tax. R. at 4–5; *see* 366 F.2d at

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Life Ins. Co. v. United States, 375 F.2d 835 (Ct. Cl. 1967); *Prudential Ins. Co. v. United States*, 337 F.2d 651 (Ct. Cl. 1964); *Prudential Ins. Co. v. United States*, 319 F.2d 161 (Ct. Cl. 1963).

973–74. Thus, because the AFT reaches revenue not otherwise taxable under Arrakis income tax, it operates as a tax imposed instead of an income tax.

Even though the Arrakis income tax exemption for all foreigners appears broader than exemption for life insurance companies in *Equitable Life*, the Arrakis income tax is nevertheless “generally imposed” under § 903. Like the Canadian income tax in *Equitable Life*, the Arrakis income tax applies categorically to all taxpayers except for those singled out for differential treatment. In *Equitable Life*, the Canadian government made a policy decision that, to help life insurance companies expand their operations in Canada, Equitable Life and other life insurance companies would be excused from paying income tax. *See* 366 F.2d at 973–74. Canada later chose to implement a different and substantially simpler premiums tax for those companies. *Id*. Similarly, Arrakis has historically exempted foreign taxpayers from the Arrakis income tax and recently reaffirmed that exemption in *Lord Remmington v. Republic of Arrakis*. R. at 4, n.6. Additionally, the court in *Equitable Life* showed no interest in the breadth of the Canadian exemption: it recognized that Canada, like Arrakis here, had made a deliberate policy decision to tax a segment of its tax base through a special tax rather than through its income tax. *See* 366 F.2d at 974. Thus, Arrakis’ income tax is no less “generally imposed” than Canadian income tax merely because its exemption may excuse a larger or broader category of potential taxpayers.

Finally, recognizing the AFT as a legitimate substitute for Arrakis’ income tax appropriately respects its historically and religiously-grounded income tax exemption for foreigners while avoiding double taxation for companies who, like Harkonnen, pay taxes to Arrakis and the United States on the same revenue. Accordingly, because the AFT operates as a tax imposed instead of Arrakis' generally imposed income tax, the AFT satisfies the substitution requirement. Harkonnen is therefore entitled to § 903 foreign tax credit for payments made to Arrakis under the AFT.

C. <u>Arrakis is not a § 901(j) blacklisted foreign country.</u>

Finally, Arrakis is a sovereign nation recognized by the United States and is not subject to the "blacklist" of I.R.C. § 901(j). That section provides that no credit is provided for taxes paid to certain countries: those whom the United States does not recognize, those with whom the United States has severed diplomatic relations or does not conduct such relations, or those whom the Secretary of State has deemed to support international terrorism. § 901(j)(2)(A)(i)–(iv).

Although the United States temporarily designated Arrakis as a "dangerous state" and withdrew its embassy, R. at 8, the United States undesignated Arrakis as a dangerous state and restored its embassy in Arrakeen followed the successful conclusion of the Sietch Dunes Peace Treaty. R. at 8–11. There is no evidence in the record that the United States and Arrakis have enjoyed anything less than cordial diplomatic relations since then. Thus, by 2011, the year in which Harkonnen made the AFT payments at issue here, there were no facts suggesting that Arrakis could be blacklisted for § 901(j) purposes.

II. Harkonnen is entitled to a foreign tax credit for payment of the IFIL tax under I.R.C. § 901 because the levy was an income tax imposed by a foreign country.

Section 901 also entitles Harkonnen to take credit for payment of the IFIL tax. This provision allows U.S. corporations to receive credit for income taxes paid to a "foreign country." To be creditable, then, the payment to IFIL must be an income tax that was paid to a "foreign country" within the meaning of § 901(b)(1).

The IFIL levy was an income tax as long as it was a "tax" that had the "predominant character of an income tax, in the U.S. sense." § 1.901-2(a)(1)(ii). Here, the IRS did not contest that the IFIL levy has the predominant character of an income tax. The IFIL tax operates in the same manner as the Sietch State tax for which the IRS allowed a credit: it applied to Harkonnen's realized gross receipts from Unit #12 and allowed for the same cost recovery that would be available in the U.S. R. at 13–14, 16–17.[10] The IFIL tax therefore meets the realization, gross receipts, and net income requirements necessary for the levy to have the predominant character of a U.S. income tax. *See* § 1.901-2(b)(1); *see also* Part I.A.2., *supra*, for additional background.

Therefore, the only questions the Court must resolve are (A) whether IFIL is a "foreign country" to which a creditable tax might be paid under § 901(b)(1); (B) whether the IFIL tax is a "tax" within the meaning of § 1.901-2(a)(2); and (C) whether IFIL is a blacklisted country under § 901(j). Here, IFIL is a foreign country because it is either an independent foreign state or a political subdivision of

[10] Neither the IFIL or Sietch State tax caps cost recovery at ninety-five percent like the AFT. R. at 10 n.11, 16.

Arrakis. The IFIL tax is a tax for § 901 purposes because it is a compulsory payment imposed by IFIL in its taxation authority as a sovereign or political subdivision of Arrakis and because it was not paid in return for a specific economic benefit. Finally, IFIL is not a blacklisted country under 901(j). Because IFIL is a foreign country for § 901 purposes and because the levy was an income tax, therefore, the Fourteenth Circuit erred in holding that the IRS properly denied Harkonnen credit for payment of the IFIL tax.

A. <u>IFIL is a foreign country under § 901 where it is either an independent foreign state or a political subdivision of Arrakis treated as a foreign country under § 1.901-2(g)(2).</u>

The term "foreign country" in § 901(b)(1) includes both foreign states as well as political subdivisions of foreign states. § 1.901(g)(2); *see also* Rev. Rul. 74-435, 1974-2 C.B. 204 (ruling that a Swiss canton is a § 901 foreign country because it is a political subdivision of Switzerland). Here, IFIL is a § 901 foreign country under U.S. law because the President of the United States has recognized it as a foreign state and because it satisfies the judge-made test articulated in the Restatement (Third) of the Foreign Relations Law of the United States (1987). In the alternative, if IFIL is not a foreign state, it is nevertheless a § 901 foreign country because it qualifies as a political subdivision of Arrakis.

1. *IFIL is an independent foreign state because the President of the United States recognized IFIL as a sovereign government and that recognition is binding on the IRS.*

i. <u>The President of the United States recognized IFIL as a foreign state.</u>

An international entity is an independent foreign state when the President recognizes its government as a sovereign authority. *See Baker v. Carr*, 369 U.S. 186, 213 (1962) (asserting that "it is the executive that determines a person's status as representative of a foreign government"). Although Presidents once recognized foreign states through an express declaration of recognition like an exequatur, it has become far more common in the last sixty years for recognition to be implied through less formal statements and conduct. *See Zivotofsky ex rel. Zivotofsky v. Sec'y of State*, 725 F.3d 197, 205 (D.C. Cir. 2013), *cert. granted sub nom. Zivotofsky ex rel. Zivotofsky v. Kerry*, 134 S. Ct. 1873 (2014); *see generally* Mary Beth West & Sean D. Murphy, *The Impact on U.S. Litigation of Non-Recognition of Foreign Governments*, 26 Stan. J. Int'l L. 435, 436, 456 (1990) (describing the shift from express toward implied recognition).

Recognition is implied when presidential statements or conduct indicate that the U.S. accepts the foreign state's sovereignty—the "country's independent authority and the right to govern itself." *See generally Zivotofsky*, 725 F.3d at 205; *Sovereignty Definition*, Merriam-Webster.com, http://www.merriam-webster.com/dictionary/sovereignty (last visited Nov. 23, 2014) Accordingly, Presidents have recognized new foreign states merely by entering into negotiations with the state, exchanging diplomatic agents, or through an official writing ending

U.S. domination over the foreign state. *See Zivotofsky*, 725 F.3d at 205; Office of the Historian, U.S. Dep't of State, *A Guide to the United States' History Of Recognition, Diplomatic, And Consular Relations, By Country, Since 1776: Palau*, https://history.state.gov/countries/palau (last visited Nov. 20, 2014) (hereinafter *History of Recognition: Palau*) (describing how U.S. recognition of Palau became effective when President Clinton issued proclamation 6726 ending U.S. trusteeship of Palau).

Here, the President recognized IFIL through a formal written declaration that explicitly references IFIL's sovereignty. On April 16, 2011, the President issued Executive Order (EO) 14012, which proclaimed that "IFIL [is] a sovereign friend of the United States." R. at 14. A sovereign is, by its plain meaning and dictionary definition, "one possessing or held to possess supreme political power." *Sovereign Definition*, Merrian-Webster.com, http://www.merriam-webster.com/dictionary/sovereign (last visited Nov. 23, 2014). EO 14012, then, is like President Clinton's proclamation ending U.S. trusteeship of Palau: it is an official, written declaration unambiguously acknowledging IFIL's ability to self-govern.

Moreover, such a written pronouncement of IFIL's sovereignty is a far more explicit means of recognition than merely opening negotiations with a foreign state, a means of effective recognition noted in *Zivotofsky*. 725 F.3d at 205. EO 14012 also references the President's intent to open trade relations with IFIL, further underscoring her recognition of IFIL's ability to negotiate on its own behalf in trade dealings. R. at 14. Finally, it is immaterial that the EO is a less formal or explicit declaration of recognition than the old practice of issuing exequaturs to newly-recognized nations: such ritualistic recognition is long out of practice. *See Nat'l Petrochemical Co. of Iran v. M/T Stolt Sheaf*, 860 F.2d 551, 554 (2d Cir. 1988) (citing *Diplomatic Relations*, 77 State Dep't Bull. 462-63 (Oct. 10, 1977)) ("[T]he absence of formal recognition cannot serve as the touchstone for determining whether the Executive Branch has 'recognized' a foreign nation for the purpose of granting that government access to United States courts."). Therefore, because the U.S. President has explicitly acknowledged IFIL's sovereignty, IFIL is a foreign state under U.S. law.

ii. <u>The President's plenary power to recognize foreign sovereigns is binding on the IRS.</u>

The President has exclusive and plenary Constitutional authority to recognize or not to recognize a foreign state. *United States v. Pink*, 315 U.S. 203, 228-29 (1942); *Banco Nacional de Cuba v. Sabbatino,* 376 U.S. 398, 461 (1964); Restatement (Third) of Foreign Relations Law § 204 (1987). This authority is not subject to the advice and consent of the Senate, and presidential recognition of sovereignty is binding on courts. *Pink*, 315 U.S. at 228–29; *Guar. Trust Co. of New York v. United States*, 304 U.S. 126, 138 (1938).

The IRS is bound by the President's recognition of IFIL as a foreign state. As an executive agency, the IRS is not empowered to second-guess the executive's recognition. *See generally* I.R.C. § 7801 (establishing that IRS authority is derived from the Secretary of the Treasury, a member of the presidential cabinet). Thus, the

IRS' judgment that IFIL is not a foreign state is impermissibly inconsistent with the President's recognition of IFIL. *See Pink*, 315 U.S. at 229 ("[Recognition] certainly is a modest implied power of the President who is the 'sole organ of the federal government in the field of international relations'"(quoting *U.S. v. Curtiss-Wright Export Corp.*, 299 U.S. 304, 320 (1936))).

Furthermore, to the extent that the IRS is merely interpreting the term "foreign country" in § 901, the IRS is afforded no judicial deference for unreasonable interpretations of the Internal Revenue Code. *Arnett v. Comm'r*, 473 F.3d 790, 794-95 (7th Cir. 2007) (applying *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984)). "An interpretation of a statute that is unconstitutional, is by definition unreasonable." *Lattab v. Ashcroft*, 384 F.3d 8, 20 n.5 (1st Cir. 2004). Because the Constitution vests the recognition power solely in the President, and because the IRS' determination contravenes the President's recognition of IFIL, the IRS' interpretation holding that IFIL is "not a proper taxing authority" is entitled to no deference. Thus, the President's recognition of IFIL is binding on the IRS, and IFIL is a § 901 foreign country under U.S. law.

2. Even if the President has not recognized IFIL, it is still an independent foreign state under § 201 of the Restatement (Third) of the Foreign Relations Law of the United States.

Courts are bound by presidential recognition of foreign states. *Nat'l Petrochemical Co. of Iran v. M/T Stolt Sheaf*, 860 F.2d 551, 554 (2d Cir. 1988). In the absence of presidential recognition, however, courts apply § 201 of the Restatement (Third) of the Foreign Relations Law of the United States (1987) (hereinafter Restatement) to judge whether an international entity is a foreign country for the purposes of U.S. law. *See, e.g.*, *Kadic v. Karadzic*, 70 F.3d 232, 244 (2d Cir. 1995); *Morgan Guar. Trust Co. of New York v. Republic of Palau,* 924 F.2d 1237, 1243 (2d Cir. 1991)*; First Am. Corp. v. Al-Nahyan*, 948 F. Supp. 1107, 1121 (D.D.C. 1996). Under the Restatement, "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." § 201.[11]

Here, IFIL is a state because (i) it has a defined territory with a permanent population, (ii) IFIL maintains general and exclusive control over its territory and population; and (iii) IFIL can and does engage in formal relations with other states.

i. <u>IFIL has a defined territory with a permanent population.</u>

IFIL has a defined territory because it took and maintains physical control of the Badlands region and the area encompassing Unit #12. IFIL's territory is no less defined merely because it is a new nation with newly acquired territory, even if Sietch State or Arrakis also claim all or part of its territory. *See* Restatement § 201 cmt. b ("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.").

Furthermore, although the record is silent as to the size of IFIL's population, it does indicate that its territory has a permanent population. *See* R. at 12, 14. The

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[11] The Restatement definition is also well established in international law. Restatement § 201 cmt. a; *see also* Montevideo Convention on the Rights and Duties of States art. 1, Dec 26, 1933, 49 Stat. 3097, 165 L.N.T.S. 19.

record references IFIL's population when it describes the voting rights of "all individuals who pledge membership to IFIL." R. at 12. It also implies that this population makes up approximately half of Sietch State because IFIL's leader finished in a "virtual tie" in an election against the sitting Vice President of Sietch State. R. at 14. The magnitude of its population, however, is largely irrelevant: there is no minimum size for the population requirement. *See Americans United for Separation of Church & State v. Reagan*, 786 F.2d 194, 198 (3d Cir. 1986) (holding that the Vatican was a state despite its thousand-person population and noting that an entity can be a state "however small its size and population"). Therefore, because IFIL has actual a defined territory and population, IFIL meets the defined territory and population requirement.

ii. <u>IFIL maintains general and exclusive control over its territory and population.</u>

An entity meets the control requirement when its government is "in general control of its territory, maintaining at least a modicum of law and order." *Ungar v. Palestine Liberation Org.*, 402 F.3d 274, 290 (1st Cir. 2005). The entity's territory, then, must be under the control of its government and not subject to legal or de facto control of another political entity. *See Knox v. Palestine Liberation Org.*, 306 F. Supp. 2d 424, 437 (S.D.N.Y. 2004) (holding the Palestine Liberation Organization (PLO) did not meet the control requirement because Israel and not the PLO controlled movement, security, and the economy in PLO territory); *see also Morgan Guar. Trust Co. of New York v. Republic of Palau*, 924 F.2d 1237, 1245 (2d Cir. 1991) (holding that Palau, as a trustee of the United States, was not a state and noting that "a political entity whose laws may be suspended by another cannot be said to be possessed of sovereignty of any kind, de facto or de jure.").

IFIL controls the Badlands region and Unit #12 because it is a governing body that, to the exclusion of others, maintains law and order in its territory. IFIL has a governing structure with a sophisticated electoral process for selecting its leader. R. at 12. It dictates economic policy to some degree, as evidenced by the fact that its lawfully elected leader executed a lease with and imposed the tax on Harkonnen for the use of Unit #12. R. at 13. Indeed, Leader Elect Mohiam's stated goal is to "promote economic development" in historic Sietchan territory. R. at 12. IFIL captured its territory through military conquest, evidencing its ability to secure its borders. *Id*. Even on the sparse record before the Court, IFIL therefore exercises "a modicum of law and order."

Moreover, IFIL's control is exclusive. Unlike the PLO in *Knox*, IFIL controls the security and economy of its territory. *Knox*, 306 F. Supp. 2d at 437. Neither Arrakis nor Sietch State exercises de facto or de jure power to control the destiny of IFIL's territory or to suspend its laws. This further distinguishes IFIL from the PLO, which shared control of its territory with Israel. *Knox*, 306 F. Supp. 2d at 437. Nor is IFIL subject to the kind of de jure or de facto foreign control at issue in *Palau*. Unlike Palau, which was a trustee of the United States and therefore could not make final determinations of law as to its own territory, IFIL is not subject to direct control by any other political entities. *Palau*, 924 F.2d at 1245.

Although Al Dhanab and Anbus did have a role in IFIL's electoral process, neither nation has de jure or de facto control over IFIL's ongoing governing functions. *See* R. at 12. Instead, IFIL is more like Palau after Palau's trusteeship was discharged in 1994. *See History of Recognition: Palau* (describing how Palau became a state immediately upon discharge of its Trusteeship Agreement). Even though Leader Elect Mohiam was elected in part by Al Dhanab and Anbus—similar to how the U.S. set up Palau's sovereign government—neither country controls IFIL's governing structure. *See id.*; R. at 12 ("The IFIL governing structure rests solely with a single Leader Elect."). In short, external influence over the establishment of a regime does not preclude that regime from exercising governmental control of its territory. Because IFIL has exclusive power to maintain law and order in the Badlands and Unit #12, therefore, it controls its territory.

iii. <u>IFIL can and does engage in formal relations with other states.</u>

An entity must be capable of or actually engage in formal relations with other states to satisfy Restatement § 201. *See Doe v. Islamic Salvation Front (FIS),* 993 F. Supp. 3, 9 (D.D.C. 1998); *see also United States v. Curtiss–Wright Export Corp.,* 299 U.S. 304, 318 (1936) (finding that the power to maintain diplomatic relations with other sovereigns is a "necessary concomitant" of statehood). States are incapable of engaging in formal diplomatic relations when they lack the resources necessary "to implement the obligations that normally accompany formal participation in the international community." *Klinghoffer v. S.N.C. Achille Lauro Ed Altri-Gestione*

Motonave Achille Lauro in Amministrazione Straordinaria, 937 F.2d 44, 48 (2d Cir. 1991) (holding that the PLO failed the formal relations requirement).

IFIL has the necessary control over its territory to meet obligations that arise from international diplomacy. IFIL has sufficient tax revenue to make payments to Al Dhanab and Anbus, presumably repaying the financial support those countries provided in 2007 and 2008. R. at 12. It also has sufficient control over the resources in its territory to support its leader's participation at the First Annual Caladan Oil Fields Conference. *See* R. at 15. At the Conference Leader Elect Mohiam engaged the President and Vice President of Arrakis regarding issues of regional economic significance while reasserting its sovereign authority to levy the IFIL tax. *Id*. IFIL, then, is unlike the PLO, which had insufficient control over its territory to must the resources necessary to meet debt, diplomatic or other obligations that commonly arise from international relations. *See Klinghoffer*, 937 F.2d at 48. Additionally, the U.S. President has expressed an interest in conducting trade relation with IFIL. R. at 14.

Finally, at the request of IFIL's sovereign friends and neighbors, France and Russia both recognized IFIL as a legitimate state, showing that IFIL is *capable* of engaging in formal relations with those countries moving forward. *See* Restatement § 201. Therefore, because IFIL already does engage in diplomatic relations with Arrakis, Al Dhanab, and Anbus, and is capable of doing so with, at minimum, France and Russia, it meets the foreign relations requirement. Thus, because IFIL satisfies the Restatement § 201 test, even if the President has not recognized IFIL it is nevertheless a § 901 state under U.S. law.

3. In the alternative, if IFIL is not an independent foreign state, it is nevertheless a § 901 foreign country as a political subdivision of Arrakis.

An entity is a political subdivision if it is subject to the supreme executive and legislative control of a foreign state. *Burnet v. Chicago Portrait Co.*, 285 U.S. 1, 6 (1932) (holding the Australian state of New South Wales was a political subdivision for the purposes of the U.S. Tax Code where it was a governing authority subject to the control of the foreign state of Australia). An entity cannot be a political subdivision absent some governing body exercising sovereignty over it. *See Arnett*, 473 F.3d at 798 (holding that Antarctica was not a "foreign country" for U.S. tax law purposes because no entity exercises sovereign control over the glacial continent).

Assuming *arguendo* that IFIL is not an independent foreign state, it nevertheless qualifies as a political subdivision of Arrakis because under one reading of the facts, IFIL is subject to Arrakis' governing authority. Like New South Wales in *Burnet*, which Australia claimed and controlled, the Holy Royal Court of Arrakis declared IFIL a part of Sietch, which is itself a part of Arrakis. 285 U.S. at 21; R. at 14. Even if Arrakis has less control over the law in IFIL territory than Australia did over New South Wales, Arrakis could reasonably be said to be consenting to a high level of delegation to IFIL's governing body. 285 U.S. at 21.

Under *Burnet*, IFIL meets the § 901 definition of foreign country if IFIL is a governing authority that is subject to Arrakis' legislative and executive authority. *Id*. But the government would have its cake and eat it too. On one hand, the government argues that the IFIL tax violates the Arrakis Constitution, which would require that IFIL is subject to Arrakis law. R. at 17, 18. On the other hand, the government contends that IFIL is not a "proper taxing authority"—that it is not a political subdivision of Arrakis. R. at 17, 18. These two positions cannot coexist.

At best, the government's position violates basic international law principles that that tie sovereignty to government control of a defined territory and population. *See* Part II.A.2., *supra* (explaining necessary and sufficient conditions for statehood under international law); *see also Arnett*, 473 F.3d at 798. It ignores the fact that IFIL exercises de facto control over the Badlands and Unit #12 territory, arguing that IFIL is nevertheless neither an independent state nor politically subordinate to Arrakis. Both international law and common sense suggest that IFIL must be one or the other.

The policy purpose underlying § 901 is the elimination of double taxation. *Assoc. Tel. & Tel. Co. v. United States,* 306 F.2d 824, 832 (2d Cir. 1962). The Fourteenth Circuit's interpretation of "foreign country" patently contravenes the legislative purpose of mitigating double taxation. Despite the President's explicit goal of promoting trade relations with IFIL, the Fourteenth Circuits adopts an interpretation that would inhibit trade by requiring U.S. taxpayers who do business in IFIL's territory to pay income taxes to both IFIL and the U.S. on the income generated by Unit #12. *See* R. at 14, 18.

B. The IFIL tax is a tax under § 901 because it is a compulsory payment imposed pursuant to IFIL's authority to levy taxes.

A foreign levy is creditable under § 901 when it is a compulsory payment imposed pursuant to a foreign country's authority to levy taxes. Treas. Reg. § 1.901-2(a)(2). Here, the IFIL tax meets both requirements. First, it is compulsory whether this Court finds that IFIL is an independent foreign state or a political subdivision of Arrakis. Second, the IFIL tax is imposed under IFIL's authority to tax and not in exchange for a specific economic benefit.

1. Because IFIL is an independent foreign state, the IFIL tax is compulsory under the Act of State doctrine.

Under the Act of State doctrine, sovereign acts of foreign states are presumed valid and are not subject to review by U.S. courts. *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 401 (1964); *see also Malewicz v. City of Amsterdam*, 517 F. Supp. 2d 322, 336 (D.D.C. 2007). For the reasons discussed in Part II.A.1., *supra*, IFIL is an independent foreign state. An order to pay a tax issued by an executive official of an independent foreign is presumed to be an act of state. *See Riggs Nat'l Corp. & Subsidiaries v. Comm'r*, 163 F.3d 1363, 1368 (D.C. Cir. 1999) (holding an order by a Minister of Finance to be an act of state); *see also Malewicz v. City of Amsterdam*, 517 F. Supp. 2d 322, 336 (D.D.C. 2007) (distinguishing between orders by an executive official in his official capacity and an official's non-sovereign act of purchasing a painting); *cf. Credit Suisse v. U.S. Dist. Court for Cent. Dist. of*

California, 130 F.3d 1342, 1347 (9th Cir. 1997) (holding an order to freeze assets to be an act of state).

Leader Elect Mohiam's imposition of the IFIL tax is more clearly an official act by an executive officer of a foreign state than was the order to pay taxes in *Riggs*. There, the Act of State doctrine precluded consideration of the legality of the Brazilian Minister of Finance's order for the Brazilian Central Bank to pay taxes on interest it paid to Riggs Bank. 163 F.3d at 1366. The Internal Revenue Code required Riggs to declare both the interest and the Brazilian taxes paid by the Brazilian bank as income on Riggs's U.S. tax return but also allowed Riggs to claim the tax payments under the foreign tax credit. *Id*. The IRS denied credit to Riggs, however, ruling that the Brazilian bank's tax payments were voluntary because the Brazilian constitution expressly exempts the Brazilian Central Bank from paying taxes. *Id.* at 1363–65.

The D.C. Circuit disagreed, noting that the Brazilian Minister of Finance—"Brazil's highest tax authority"—had declared that the Central Bank must pay the taxes. *Id.* at 1366. Even if, the court held, the Minister of Finance's ruling essentially allowed the Central Bank to take "a free lunch at the American treasury's expense," *id.* at 1369 (internal punctuation marks omitted), the separation of powers concerns undergirding the Act of State doctrine precluded the court from inquiring into whether the minister's ruling was a correct interpretation of Brazilian law. *See id.* at 1368. Accordingly, the Central Bank's tax payments were compulsory under the minister's order and Riggs could claim the payments as valid foreign tax credits. *See id.* at 1369.

The IFIL tax here is imposed under substantially similar circumstances. Indeed, the primary difference between this case and *Riggs* is that the IFIL tax was imposed by an even higher authority than a government minister. The IFIL tax was imposed by Leader Elect Mohiam, IFIL's highest authority, who is capable of exercising sole control over IFIL's governing structure. R. at 13. Her orders, then, are even more clearly those issuing from a foreign state than the Brazilian Minister of Finance's ruling in *Riggs*. Leader Elect Mohiam's order imposing the IFIL tax is therefore an act of state, and Harkonnen's payment of the IFIL tax was compulsory.

2. Even if IFIL is not an independent foreign state, the IFIL tax is compulsory under § 901 because it did not exceed Harkonnen's liability under Arrakis law.

A tax is compulsory and does not exceed a taxpayer's liability if the taxpayer (i) has reasonably interpreted and applied foreign law and (2) has exhausted "all effective and practical remedies" to reduce its tax liability. Here, Harkonnen reasonably interpreted the IFIL tax as compulsory under Arrakis law because it accepted the Holy Royal Court's recognition of IFIL. It also exhausted its practical remedies for reducing its liability by petitioning President Corrino and the Holy Royal Court to determine the validity of the IFIL tax.

i. <u>Harkonnen reasonably interpreted the Holy Royal Court's order as sanctioning the IFIL tax, regardless of the IRS' finding that the tax violates Arrakis law.</u>

A taxpayer's interpretation of foreign law is reasonable to the extent that taxpayers rely on advice obtained in good faith from competent foreign tax advisors. § 1.901-2(e)(5)(i); *IBM*, 38 Fed. Cl. at 673. An interpretation is unreasonable when the taxpayer has actual or constructive notice that advice is likely erroneous. § 1.901-2(e)(5)(i); *IBM*, 38 Fed. Cl. at 668.

Harkonnen reasonably interpreted Arrakis law because it relied on the holding of the Holy Royal Court and because President Corrino informed Mr. Harkonnen that the court handles "all legal tax disputes in Arrakis." R. at 14. Like in *IBM*, Harkonnen relied on advice from "competent foreign tax advisors." In that case, the court interpreted the taxpayer's reliance on its advisors as evidence of the reasonableness of its interpretation, quoting a memo and four pages of deposition testimony from the taxpayer's foreign advisors in the opinion. 38 Fed. Cl. at 670–73. Here, Harkonnen relied on advice from a considerably higher tax authority in Arrakis than the advisers reasonably relied upon in *IBM*. *See id*. On the same day that IFIL declared its tax, Mr. Harkonnen called Arrakis' head of state, President Corrino, and inquired about the validity of the tax. R. at 14. Relying on advice from President Corrino, Harkonnen petitioned the Holy Royal Court, the final arbiter of Arrakis tax disputes, for a determination of IFIL's ability to levy a tax. R. at 14.

The Holy Royal Court responded to Harkonnen's request for a determination of whether IFIL has authority to levy taxes by stating that IFIL is "part of Sietch [State]." R. at 14. Having petitioned both the highest executive official and the highest court of Arrakis about the validity of the IFIL tax, Harkonnen reasonably interpreted the Holy Royal Court's order as declaring the IFIL tax valid as a matter of Arrakis law. Even though the court did not specifically address the relationship between IFIL's authority to levy taxes and the provision of the Arrakis constitution granting the Vice President the authority to levy "a single tax," as the highest tax court in Arrakis, the Holy Royal Court likely rendered its decision in full knowledge of the "single tax" provision. R. at 10. Moreover, that provision is purely an affirmative grant of power to the Vice President to levy a tax in Sietch State; on its face, the provision is silent as to whether entities other than the Vice President—such as IFIL—may levy taxes. *See id*. Accordingly, in adhering to the advice of Arrakis' president and highest tax court, Harkonnen reasonably interpreted Arrakis law as requiring it to pay the IFIL tax.

Furthermore, the IRS' determination that the IFIL tax violates Arrakis law was improper because the IRS was well outside its authorization when it engaged in Arrakis constitutional interpretation. The Internal Revenue Code and accompanying regulations sometimes authorize the IRS to inquire into whether a U.S. taxpayer has reasonably interpreted foreign law, but they do not permit the IRS to itself create binding interpretations of foreign law. *See* § 1.901-2(e)(5)(i).

The difference between inquiring into the reasonableness of an interpretation of foreign law and issuing conclusive rulings on foreign constitutional law has significant implications for foreign policy. Treasury regulations carefully circumscribe how the IRS should engage with foreign law. *See, e.g.*, § 1.901-2(e)(5)(i). These regulations only authorize the IRS to inquire into whether the taxpayer's interpretation is reasonable, and tellingly, they explicitly permit taxpayers to rely on the opinions of foreign tax advisors in interpreting foreign law. *See id*.

This limited role for the IRS helps preserve the intended effect of the foreign tax credits to mitigate the harm done by double taxation while respecting foreign sovereignty. *See Burnet*, 285 U.S. at 6. The IRS is undoubtedly less well equipped to analyze and interpret foreign tax law than are tax experts in the foreign country. Moreover its attempt to do so inherently undermines Arrakis' sovereignty, not solely because it violates comity among nations, but also because it injects a U.S. agency into the Holy Royal Court's effort to reconcile Arrakis' policies with those of IFIL. R. at 14, 15. In the midst of these efforts, it is inappropriate for U.S. courts to declare that the IFIL Tax violates Arrakis law. See R. at 18. This kind of adverse consequence is precisely what mechanisms such as the reasonable interpretation requirement and the Act of State doctrine are designed to prevent. *See Sabbatino*, 376 U.S. at 436–37. Thus, in spite of the IRS' improper determination to the contrary, Harkonnen reasonably interpreted Arrakis law as acceding to the IFIL tax.

ii. <u>Harkonnen exhausted its practical and effective remedies under the IFIL tax to reduce its tax liability by petitioning President Corrino and the Holy Royal Court.</u>

A levy is compulsory only if a taxpayer has exhausted all effective and practical remedies to reduce its liability for that levy. § 1.901-2(e)(5)(i); *IBM,* 38 Fed. Cl. at 673. A remedy is effective and practical only if the cost is reasonable in light of the amount at issue and the likelihood of success. § 1.901-2(e)(5)(i). The taxpayer must also invoke procedures under all applicable tax treaties, although here, the record contains no evidence of any tax treaties applicable to this case or any procedures arising out of such treaties. *See id.*; R. at 8–9.[12]

Exhaustion of all practical and effective remedies does not require a taxpayer to exhaust every possible litigation procedure. *IBM*, 38 Fed. Cl. at 675 (adopting Rev. Rul. 70-290, 1970-1 C.B. 160 (1970)); R. at 21 (Layton, J., dissenting). Thus, a taxpayer may exhaust its remedies even without litigating the validity of a foreign levy to its bitter end. *See IBM*, 38 Fed. Cl. at 675 (holding that taxpayer had exhausted its remedies even when it had not finished contesting its tax liability in foreign court); *see also Proctor & Gamble Co. v. United States*, No. 1:08–cv–00608, 2010 WL 2925099, at *7 (S.D. Ohio July 6, 2010) (holding taxpayer did not exhaust remedies where there was a basic ambiguity as to whether income was subject to tax and could have sought administrative redetermination of its liability); I.R.S. C.C.A. 200532044 (Aug. 12, 2005) (advising that where a basic ambiguity exists as to whether taxpayer is liable and there is an administrative means to resolve that ambiguity, exhaustion requires pursuit of the administrative remedy).

Harkonnen has exhausted its only practical remedies under Arrakis law: it sought rulings from President Corrino and the Holy Royal Court. Just like the

[12] *But see* R. at 17 (finding that that IFIL tax violates the Sietch Dunes Peace Treaty). Other than this unsupported finding, the record does not indicate that the Sietch Dunes Peace Treaty refers to taxes. *See* R. at 8–9. The Fourteenth Circuit seems to have interpreted the IRS finding as a finding that the IFIL tax violated the Arrakis Constitution. *See* R. at 18. This is consistent with the record at page 9. Petitioners follow the Fourteenth Circuit's interpretation of the IRS finding throughout this Brief.

taxpayer in *IBM*, which had exhausted its remedies even though opportunities remained to litigate the extent of its foreign tax liability, Harkonnen has pursued the remedies most likely to result in reduced liability—appeal to Arrakis' highest authorities. *See* 38 Fed. Cl. at 675. Just as in *IBM*, then, it is immaterial that Harkonnen did not pursue *every* opportunity to attack the validity of the IFIL tax by not challenging it before the Sietch Council. *Id*.

Further, requiring *all* taxpayers claiming tax credits to litigate the validity of *all* foreign tax laws they pay before *all* competent courts is "not practical, cost efficient, or warranted." *See* R. at 21 (Layton, J., dissenting). It also contravenes the IRS' own finding in Rev. Rul. 70-290, 1970-1 C.B. 160 (1970), ruling that a taxpayer's remedies can be exhausted prior to litigation. Such mandatory litigiousness undermines § 901's goals of facilitating foreign trade and allowing American citizens and "corporations to be sterling guests to our neighbors across the globe." R. at 19 (Layton, J., dissenting); *see also* Richard E. Andersen, *Foreign Tax Credits* ¶ 1.01. Therefore, even if the opportunity to litigate before the Sietch Council did remain, Harkonnen's appeals to President Corrino and the Holy Royal Court exhausted its "effective and practical" remedies.

3. The IFIL tax was imposed pursuant to IFIL's authority to levy taxes because Harkonnen received no specific economic benefit in exchange for paying it.

Harkonnen receives no specific economic benefit in exchange for paying the IFIL tax because the benefit of operating Unit #12 is secured not by the IFIL tax but rather by the one-time bonus payment of $550,000 and the five percent royalty fee. R. at 13; *see also* Part I.A.1.ii., *supra* (explaining why the AFT is similarly not a payment in exchange for any specific economic benefit). Payment of the IFIL tax grants Harkonnen no additional rights to Unit #12. R. at 13; *see also Exxon*, 113 T.C. 350–51. Finally, the IFIL tax is not paid as a "penalty or fine" for slant drilling, *see* § 1.901-2(a)(1)(i), because Harkonnen's liability for the IFIL tax continued even after Leader Elect Mohiam declared all payments required for slant drilling satisfied by Harkonnen. R. at 15. Therefore, the IFIL tax was imposed not as payment for the use of Unit #12, but rather pursuant to IFIL's authority to impose taxes.

C. IFIL is not a 901(j) blacklisted foreign country.

Finally, IFIL is a sovereign friend of the United States and is not subject to the "blacklist" of I.R.C. § 901(j). R. at 14. As discussed in Part I.C., § 901(j) provides that no credit is provided for taxes paid to certain countries: those whom the United States does not recognize; those with whom the United States has severed diplomatic relations or does not conduct such relations; and those whom the Secretary of State has deemed to support international terrorism. § 901(j)(2)(A)(i)–(iv).

Although the U.S. State Department originally classified IFIL as a splinter group of the Bene Gesserit terrorist organization, Leader Elect Mohiam has since totally repudiated the Bene Gesserit as "an archaic organization with fundamentalist beliefs that have no place in a modern world." R. at 11. That repudiation—coupled with the recognition of IFIL by numerous other countries around the world, *see* R. at 12–13—indicates that IFIL is not an organization that engages in or supports international terrorism. Moreover, the President has declared IFIL a sovereign friend of the United States and stated her intention to establish trade relations with IFIL, R. at 14, illustrating that IFIL is not a nation with which the U.S. has severed or does not conduct relations. *Cf. History of Recognition: Palau, supra* (establishing diplomatic relations via presidential proclamation).

CONCLUSION

For the foregoing reasons, this Court should reverse the holding of the Fourteenth Circuit.