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 PETITIONER

TEAM 30
Attorneys for Petitioner

QUESTIONS PRESENTED

I. Whether Harkonnen Oil's payment of the Arrakis Foreign Tax is creditable under I.R.C. § 901 when the Arrakis Foreign Tax is an income tax that credibly reaches net gain; or whether the tax is creditable under I.R.C. § 903 when it was paid in lieu of the generally applicable Arrakis income tax.

II. Whether Harkonnen Oil's income tax payment to IFIL qualifies for a foreign tax credit when IFIL had the authority to levy the tax, the policy underlying the foreign tax credit is to encourage foreign commerce with governments recognized by the United States, and Harkonnen Oil exhausted all effective and practical remedies under foreign law.

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TO THE HONORABLE SUPREME COURT OF THE UNITED STATES:

Petitioner, Royal Harkonnen Oil Company—the plaintiff in the United States District Court for the Central District of New Tejas and the appellant before the United States Court of Appeals for the Fourteenth Circuit—respectfully submits this brief on the merits in support of its request that this Court reverse the judgment of the court of appeals.

OPINIONS BELOW

The opinion of the United States District Court for the Central District of New Tejas is unreported. The opinion of the United States Court of Appeals for the Fourteenth Circuit appears in the record on pages 2–21.

STATEMENT OF JURISDICTION

The United States Court of Appeals for the Fourteenth Circuit entered its final decision on October 1, 2014. (R. at 2). Petitioner timely appealed to this Court. This Court has jurisdiction under 28 U.S.C. § 1254 (2012).

STATUTORY PROVISIONS INVOLVED

This case involves interpretation of the Internal Revenue Code, I.R.C. § 901 (2012) and I.R.C. § 903 (2012).

STATEMENT OF THE CASE

I. Statement of Facts

Royal Harkonnen Oil Company ("Harkonnen Oil") is a United States corporation that has extracted oil and natural gas deposits in the Caladan Oil Field since 2009. (R. at 2 n.1, 7). The Caladan Oil Field is located in the Republic of Arrakis. (R. at 2).

Harkonnen Oil expended significant resources and almost two years of time to produce its first barrel of crude oil in the Caladan Oil Field. (R. at 2, 7). In March 2007, Harkonnen Oil expended resources to conduct a seismic and feasibility study to determine the profitability of extracting oil in the Caladan Oil Field. (R. at 2). In February 2008, Harkonnen Oil negotiated with the Republic of Arrakis to obtain rights to develop the Caladan Oil Field. (R. at 3). Finally, in January 2009, Harkonnen Oil was able to produce its first barrel of crude oil. (R. at 7).

A. Tax Payment to Arrakis

In June 2008, Harkonnen Oil and the Republic of Arrakis completed negotiations and signed a lease that gave Harkonnen Oil the rights to develop the entire Caladan Oil Field. (R. at 7). In the lease, Harkonnen Oil agreed to pay a one-time bonus payment of $55 million and a royalty of 15% in exchange for the rights to develop the Caladan Oil Field. (R. at 7). In addition, Harkonnen Oil would be subject to the Republic of Arrakis Foreign Tax. (R. at 7). The Arrakis Foreign Tax is the only tax that Harkonnen Oil has paid to the Republic of Arrakis since 2008. (R. at 7).

The Republic of Arrakis and its laws are founded on rich religious traditions. (R. at 4). At the time Harkonnen Oil began its initial negotiations with Arrakis regarding rights to extract oil in the Caladan Oil Field, the Republic of Arrakis only imposed taxes on "Arrakis citizens and rejected taxation of income earned by foreign individuals or entities residing or doing business in Arrakis." (R. at 4). This was due to the heavy influence of religious traditions on the Arrakis Tax Code. (R. at 4). The general tax imposed on Arrakisian citizens currently allows citizens to mitigate their tax burdens through available tax deductions, (R. at 4), and the United States Internal Revenue Service has stipulated that these tax deductions match the available deductions under the United States Tax Code. (R. at 4 n.7).

In an effort to modernize the Arrakis Tax Code, in March 2008, before Harkonnen Oil began oil production in Arrakis, President Corrino, who was and still is the President of the Republic of Arrakis, enacted the Republic of Arrakis Foreign Value Tax. (R. at 5). President Corrino enacted this tax under the authority vested in him by the Arrakis Constitution. (R. at 5 n.8). In June 2008, only a few months after enacting the new tax, President Corrino renamed the tax the "Republic of Arrakis Foreign Tax." (R. at 7). The Republic of Arrakis Foreign Tax applies to all foreign entities that operate machinery on the sovereign territory of Arrakis and is determined by calculating the gross receipts of a foreign entity and then multiplying that amount by a tax percentage. (R. at 5). For the tax year in question, the tax percentage was set at 33%. (R. at 15–16).

Under the Republic of Arrakis Foreign Tax, all foreign entities, like Harkonnen Oil, are required to deposit all monies earned in the Central Bank of Arrakis. (R. at 5). The Central Bank of Arrakis is tasked with determining the taxes owed and then remitting that amount to the Arrakis Treasury. (R. at 5). This requirement was put in place to ensure the proper enforcement of the tax. (R. at 5). After the Central Bank of Arrakis pays the applicable tax on behalf of the foreign entity, all remaining funds are disbursed to the foreign entity that originally deposited the funds. (R. at 5).

While initially the Republic of Arrakis Foreign Tax did not allow foreign entities to take any deductions, this changed in May 2011 when President Corrino issued Proclamation 102. (R. at 15). Proclamation 102 states that foreign entities, like Harkonnen Oil, are able to mitigate their tax liability through the same deductions available to Arrakisian citizens. (R. at 15). However, because of the religious influence on the Arrakis Tax Code, a foreign entity cannot be afforded the same benefits as a "true believer." (R. at 15). Accordingly, foreign entities' deductions are capped at 95% of the dollar value of deductions available to Arrakisian citizens. (R. at 15). Thus, if a foreign entity is entitled to $100 in deductions, the deduction will be capped at $95. (R. at 15 n.12).

Therefore, for 2011, which is the tax year in question, the Arrakis Foreign Tax was calculated as follows: (1) the gross receipts generated by a corporation's operations during the calendar year were determined, (2) the gross receipts from the calendar year were then reduced by any applicable deductions, and (3) this amount was multiplied by 33%. (R. at 5, 15–16). The equation can be broken down as follows: [gross receipts – (applicable deductions x 95%)] x 33% = taxes owed under the Arrakis Foreign Tax for the year 2011. (R. at 5, 15–16).

B. Tax Payment to the Sietch State

In March 2010, a group called the Independent People of Sietch ("IPS") declared independence from Arrakis and staked out territory in the Sietch Dunes region. (R. at 8). After several weeks of fighting between Arrakis and IPS, the leaders of Arrakis and IPS met with the U.S. Ambassador to Arrakis and Mr. Harkonnen, ultimately reaching a truce and signing the Sietch Dunes Peace Treaty. (R. at 8). Under the treaty, the Sietch Dunes region became a province of Arrakis, known as the Sietch State, which would have the power to elect the vice president of Arrakis. (R. at 8–9).

President Corrino amended the Arrakis Constitution after the treaty was signed, adding the position of vice president to the Arrakis government. (R. at 9). The amendment gave the vice president power to enact a single tax, (R. at 9), which was in addition to the single tax the Arrakis President had the right to enact each year. (R. at 5). After Paul Atreides was declared vice president of Arrakis and leader of the Sietch State, he enacted an income tax. (R. at 9). The tax was calculated by taking ten percent of income generated in the Sietch State and subtracting all the deductions available under the Arrakis Tax Code. (R. at 10). This tax did not change the amount of taxes owed to Arrakis. (R. at 10).

In April 2010, Harkonnen Oil signed an oil and gas lease with the Sietch State for its operations in the Sietch State's territory, agreeing to pay a $5 million bonus and a five percent annual royalty to the Sietch State. (R. at 10). The company also paid the income taxes owed to the Sietch State in 2010 and 2011. (R. at 10, 16).

C. Tax Payment to IFIL

In December 2010, the Inter-Sietch Fremen Independence League ("IFIL") began protesting the leadership of Paul Atreides in the Sietch State and pushing to have IFIL's leader, Jessica Mohiam, become the vice president. (R. at 11). Ms. Mohiam has been the elected leader of IFIL since 2008. (R. at 12). Almost immediately after beginning its protest, IFIL was recognized by the countries of Al Dhanab and Anbus, which neighbor Arrakis, as an independent state. (R. at 12). France and Russia also immediately recognized IFIL's legitimacy as a state. (R. at 13).

After gaining control of the "Badlands" territory of the Sietch State, IFIL expanded and acquired control of Harkonnen Oil's Unit Number 12 drilling station. (R. at 13). Ms. Mohiam stated that IFIL would control production at the drilling station until IFIL received payment from Harkonnen Oil. (R. at 13). In March 2011, Mr. Harkonnen, the CEO of Harkonnen Oil, and Ms. Mohiam signed an oil and gas lease stipulating that Harkonnen Oil would pay IFIL a $550,000 bonus and a five percent royalty. (R. at 13). In addition, Ms. Mohiam stated that IFIL would tax Harkonnen Oil at two percent of its Unit Number 12 income. (R. at 13).

Unhappy with having to pay an income tax to IFIL, Mr. Harkonnen called Arrakis President Corrino, who explained that the Holy Royal Court of Arrakis handles all legal tax disputes in Arrakis. (R. at 14). Harkonnen Oil immediately petitioned the Holy Royal Court regarding IFIL's taxing authority. (R. at 14). The court ruled that IFIL was a recognized part of Sietch, (R. at 14), and a valid taxing entity. (R. at 21). Accordingly, Harkonnen Oil paid the income tax to IFIL in addition to the bonus and royalty. (R. at 14). IFIL's income tax is calculated by subtracting from receipts all the deductions allowed in the Sietch State and multiplying that by two percent. (R. at 13).

In May 2011, Mr. Harkonnen met with the leaders of Arrakis, the Sietch State, and IFIL (President Corrino, Vice President Atreides, and Ms. Mohiam, respectively), in the First Caladan Oil Field Conference. (R. at 16). At the conference, each of the leaders clarified or reiterated the tax rate imposed by their government: IFIL's tax remained a two percent income tax. (R. at 15). Harkonnen Oil paid the income tax to IFIL in 2011. (R. at 16).

While the U.S. State Department previously classified IFIL as a splinter group of the terrorist organization called the Bene Gesserit, (R. at 11), the United States President has since declared, in Executive Order 14012, that IFIL is "a sovereign friend of the United States, whom we would like to establish trade relations with." (R. at 14).

II. Nature of the Proceedings

The Internal Revenue Service

Harkonnen Oil timely filed a Form 1118 for tax year 2011, claiming a foreign tax credit for income tax payments to the Republic of Arrakis, the Sietch State, and IFIL. (R. at 16). After auditing Harkonnen Oil's tax returns for tax year 2011, the IRS credited the company's tax payment to the Sietch State, but denied the company foreign tax credits for tax payments to Arrakis and IFIL. (R. at 16, 17). The IRS declared that the tax payment to Arrakis did not qualify for a foreign tax credit because Arrakis' tax failed to sufficiently reach net income. (R. at 17). The IRS also declared that the tax payment to IFIL did not qualify for a foreign tax credit because IFIL was not a taxing authority, IFIL's tax violated the Sietch Dunes Peace Treaty's single-tax provision, and Harkonnen Oil failed to exhaust foreign remedies to challenge the tax. (R. at 17).

The District Court

In 2011, Harkonnen Oil filed a lawsuit against the United States in the United States District Court for the Central District of New Tejas. (R. at 17). Harkonnen Oil argued that the IRS improperly denied foreign tax credits for the taxes paid to Arrakis and IFIL. (R. at 17). The United States argued that the payment to Arrakis was not a creditable foreign tax payment because the payment failed to reach net income. (R. at 17). The government also argued that the payment made to IFIL did not qualify for a foreign tax credit because IFIL was not a proper taxing authority. (R. at 17). The district court ruled in favor of the United States. (R. at 17).

<u>The Circuit Court</u>

Harkonnen Oil appealed the district court's decision. (R. at 2). On October 1, 2014, the Fourteenth Circuit Court of Appeals affirmed the district court's decision by denying Harkonnen Oil's request for a refund. (R. at 2). The circuit court held that Harkonnen Oil's payment to Arrakis was not creditable under I.R.C. § 901 because Arrakis' tax is not similar to a U.S. income tax, does not credibly reach net income, and does not satisfy the "significant cost recoveries" requirement. (R. at 17–18). The court further held that the Arrakis tax was not a tax in lieu of an income tax under I.R.C. § 903. (R. at 18). Additionally, the circuit court held that the payment to IFIL was not a creditable foreign tax payment because IFIL is not a sovereign political entity with taxing authority, the tax violates the Arrakis Constitution, and Harkonnen Oil did not exhaust its foreign remedies. (R. at 18). The circuit court found that the district court properly denied a refund to Harkonnen Oil. (R. at 19).

SUMMARY OF THE ARGUMENT

This case concerns the tax payments made by Harkonnen Oil to the IRS stemming from Harkonnen Oil's operations in the Caladan Oil Field. Specifically, the IRS denied foreign tax credits to Harkonnen Oil for the tax payments made by Harkonnen Oil to both the Republic of Arrakis and IFIL. This Court should reverse the circuit court's finding that the taxes levied by Arrakis and IFIL were not creditable foreign taxes because the taxes are properly creditable.

I. Tax Payment to the Republic of Arrakis

This Court should reverse the circuit court and find that the payment of taxes made by Harkonnen Oil to the Republic of Arrakis is properly creditable. A taxpayer is able to claim a tax credit for the amount of any income taxes paid to a foreign country in a given year under I.R.C. § 901. Alternatively, if the taxpayer is unable to properly claim a credit under Section 901, it may claim a tax credit for taxes paid in lieu of an income tax that is otherwise generally imposed by the foreign country under Section 903.

For a taxpayer to properly claim a foreign tax credit for levy payments made to a foreign country under Section 901, the levy must be a "tax" and must have the predominant character of an income tax as it is understood in the United States. In the present case, the tax payment made to Arrakis under the Republic of Arrakis Foreign Tax properly qualifies as a "tax" because the payment was both compulsory and pursuant to Arrakis' authority to levy taxes. Moreover, the Republic of Arrakis Foreign Tax has the predominant character of an income tax because the tax is likely to reach net gain; specifically, the realization, gross receipts, and net income requirements are all satisfied by the tax. Therefore, this Court should reverse the circuit court's determination that Harkonnen Oil's tax payment to Arrakis fails to qualify as a creditable payment under Section 901.

In the alternative, this Court should find that the Arrakis Foreign Tax is a creditable foreign tax under Section 903 because Harkonnen Oil paid the Arrakis Foreign Tax in lieu of a generally applicable income tax. Harkonnen Oil paid the Arrakis Foreign Tax in lieu of a generally applicable income tax because (1) the Arrakis Foreign Tax applied to all foreign entities and thus was compulsory and falls within the definition of a tax under Section 901; and (2) the Arrakis Foreign Tax was imposed as a substitute for the generally imposed income tax on Arrakisian citizens. Even if this Court determines that the tax is a type of withholding tax, the Arrakis Foreign Tax is still creditable under Section 903 because it was a tax imposed in substitution for the generally imposed income tax. Additionally, the Central Bank of Arrakis' role in withholding and paying the Arrakis Foreign Tax on behalf of Harkonnen Oil does not preclude the tax from being creditable under Section 903 because Harkonnen Oil bore the legal liability to pay the tax. Accordingly, Harkonnen Oil's payment of the Arrakis Foreign Tax is creditable under Section 903, and this Court should reverse the lower court's judgment.

II. Tax Payment to IFIL

Furthermore, this Court should reverse the circuit court and find that Harkonnen Oil's tax payment to IFIL is properly creditable. Both the IRS and the lower court placed undue emphasis on IFIL's political status in denying the credit. However, it is IFIL's taxing authority, not its political status, that is relevant to determining whether the tax payment to IFIL is creditable. The lower court should have applied the act of state doctrine, which bars our courts from reviewing the official acts of recognized sovereign powers in their own territory, and recognized that IFIL had legal authority under its own laws to levy taxes on Harkonnen Oil. Moreover, our tax laws should treat IFIL as having taxing authority because our President recognizes IFIL as a sovereign friend of the United States. Therefore, the judicial branch should not undermine the executive branch's foreign policy decision by refusing to credit taxes paid to IFIL.

Additionally, the lower court should not have denied the tax credit for the income tax payment to IFIL based on the court's interpretation of the Arrakis Constitution because our courts must interpret U.S. law, not foreign law, to determine the creditability of a tax under the U.S. Tax Code. Finally, Harkonnen Oil properly exhausted all effective and practical remedies by petitioning Arrakis' Holy Royal Court regarding IFIL's ability to assess taxes because the Holy Royal Court is the only body that resolves tax disputes in Arrakis. Therefore, this Court should find that the income tax Harkonnen Oil paid to IFIL was creditable.

ARGUMENT

This Court should review the lower court's judgment that Harkonnen Oil's tax payments to the Republic of Arrakis and IFIL were not creditable foreign tax payments *de novo* because legal determinations made by a lower court are reviewed under a *de novo* standard. *Entergy Corp. & Affiliated Subsidiaries v. Comm'r*, 683 F.3d 233, 235 (5th Cir. 2012); *Terrell v. Comm'r*, 625 F.3d 254, 258 (5th Cir. 2010). The lower court's ruling on the creditability of foreign tax payments is a legal determination. *Riggs Nat'l Corp. & Subsidiaries v. Comm'r,* 163 F.3d 1363, 1367 (D.C. Cir. 1999). Therefore, the issues presented in this case, specifically whether the tax payments made by Harkonnen Oil are creditable, are legal questions entitled to a *de novo* review.

I. HARKONNEN OIL'S TAX PAYMENT TO THE REPUBLIC OF ARRAKIS ENTITLES HARKONNEN OIL TO A FOREIGN TAX CREDIT UNDER THE UNITED STATES TAX CODE.

The foreign tax credit was put in place to allow certain taxpayers to offset their domestic tax liability in the United States with their tax liability incurred abroad. *Inland Steel Co. v. United States*, 677 F.2d 72, 79 (Ct. Cl. 1982). The credit was constructed to not only "mitigate the evil of double taxation," but also to encourage domestic corporations to engage in international commerce. *Burnet v. Chi. Portrait Co.*, 285 U.S. 1, 7–9 (1932).

United States domestic corporations are permitted to claim a tax credit for "the amount paid of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country." I.R.C. § 901(b)(1). Alternatively, if the taxpayer fails to meet the requirements of a credit under Section 901, the taxpayer is permitted to claim a tax credit for "a tax paid in lieu of a tax on income, war profits, or excess profits otherwise generally imposed by any foreign country." I.R.C. § 903.

In this case, Harkonnen Oil's tax payment to Arrakis under the Republic of Arrakis Foreign Tax is creditable under Section 901. Alternatively, if the tax payment to Arrakis fails to meet the requirements for creditability under Section 901, the payment is properly creditable under Section 903.

A. Harkonnen Oil Is Entitled to a Foreign Tax Credit Under Section 901 for the Payment Made Pursuant to the Arrakis Foreign Tax Because It Is a Tax Whose Predominant Character Is That of an Income Tax in the United States Sense.

A domestic corporation is permitted to claim a tax credit against its tax liability in the United States for "the amount of any income . . . taxes paid or accrued during the taxable year to any foreign country." I.R.C. § 901(b)(1). For a foreign tax to be creditable, it must be the substantial equivalent of an income tax as it is defined and understood in the United States. *E.g.*, *Biddle v. Comm'r*, 302 U.S. 573, 579 (1938). The determination of whether a foreign tax qualifies as an income tax for the purposes of Section 901 is based on criteria established under United States law. *Mo. Pac. R. Co. v. United States*, 392 F.2d 592, 597 (Ct. Cl. 1968). Additionally, as a general rule, "a tax either is or is not an income tax, in its entirety, for all persons subject to the tax." Treas. Reg. § 1.901-2(a)(1) (as amended in 2013). A foreign levy is considered an income tax if "(i) [i]t is a tax; and (ii) [t]he predominant character of that tax is that of an income tax in the U.S. sense." *Id.*

The Republic of Arrakis Foreign Tax is an income tax and properly creditable under Section 901 because (1) it is a tax, and (2) it has the predominant character of an income tax as it is understood in the United States. Thus, because Harkonnen Oil's tax payment to Arrakis properly constituted an income tax, that payment entitles Harkonnen Oil to a foreign tax credit.

1. *The Arrakis Foreign Tax Is a "Tax" Because It Is Compulsory and Pursuant to Arrakis' Authority to Levy Taxes.*

A foreign levy is properly classified as a "tax" when it "requires a compulsory payment pursuant to the authority of a foreign country to levy taxes." *Id.* § 1.901-2(a)(2)(i). The determination of whether a foreign levy is compulsory and pursuant to the foreign country's authority is based on principles of United States law, rather than the law of the foreign country. *Id.* In this case, Harkonnen Oil's levy payment to Arrakis under the Republic of Arrakis Foreign Tax is properly classified as a "tax" because the payment was both compulsory and pursuant to Arrakis' authority to levy taxes.

a. The Levy Was Compulsory Because It Did Not Exceed Harkonnen Oil's Liability Under the Arrakis Foreign Tax.

A foreign levy is not compulsory to the extent that the levy exceeds the tax liability of an entity under the applicable foreign tax law. *Id.* § 1.901-2(e)(5)(i). In applying the applicable foreign tax law, if the levy actually assessed exceeds the legal tax liability, the levy is not compulsory and thus is not considered a "tax" for the purposes of Section 901. *Id.* A levy does not exceed the tax liability of an entity if the amount of the payment is consistent with a reasonable interpretation and application of the foreign tax law. *Id.*

Turning to the facts of this case, Harkonnen Oil's payment under the Republic of Arrakis Foreign Tax is compulsory because the payment does not exceed Harkonnen Oil's liability under the tax. Harkonnen Oil's payment to Arrakis was calculated in a manner that is consistent with a reasonable interpretation and application of the Arrakis Foreign Tax. The tax liability of a foreign entity under the Arrakis Foreign Tax is calculated by reducing the gross receipts of the entity by applicable deductions and then multiplying this amount by the tax rate of 33%. (R. at 5, 15).

The calculation of Harkonnen Oil's tax liability under the Arrakis Foreign Tax was a reasonable interpretation and application of the tax because Harkonnen Oil's tax liability was determined in the exact manner in which the tax prescribes. Harkonnen Oil's tax liability for the year in question was calculated by reducing gross receipts by applicable deductions and multiplying this amount by the tax rate of 33%. (R. at 16). Thus, the payment made by Harkonnen Oil did not exceed its liability under the tax, making the payment compulsory.

b. Harkonnen Oil's Payment Was Pursuant to Arrakis' Authority to Levy Taxes.

To be classified as a "tax," the compulsory payment must be "pursuant to the authority of a foreign country to levy taxes." *Id.* § 1.901-2(a)(2)(i). A payment to a foreign country is not properly considered pursuant to its authority to levy taxes, and thus not a "tax," if the entity subject to the levy receives a specific economic benefit in exchange for the payment of the levy. *Id.* A specific economic benefit is defined as "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." *Id.* § 1.901-2(a)(2)(ii)(B). Specific economic benefits include the right to acquire or extract government owned or controlled natural resources, including petroleum. *Id.*

However, a taxpayer receiving a specific economic benefit can also be classified as a "dual capacity taxpayer," which is a taxpayer that receives a specific economic benefit from a foreign country and is subject to a levy within that country. *Id.* § 1.901-2(a)(2)(ii)(A). A levy payment made by a dual capacity taxpayer properly qualifies as a "tax" if the levy is a single levy that applies without distinction to dual capacity taxpayers and other taxpayers. Treas. Reg. § 1.901-2A(b)(1) (1983). Such a levy properly qualifies as a "tax" because it is not in exchange for the specific economic benefit provided by the country. *Id.*

In this case, Harkonnen Oil concedes that it received a specific economic benefit from Arrakis because Harkonnen Oil was granted the right to develop the entire Caladan Oil Field in exchange for bonus and royalty payments. Since Harkonnen Oil received a specific economic benefit from Arrakis and was subject to a levy by Arrakis, Harkonnen Oil can be properly considered a dual capacity taxpayer. However, the mere fact that Harkonnen Oil is a dual capacity taxpayer does not establish that the payment made pursuant to the Republic of Arrakis Foreign Tax does not qualify as a "tax" for the purposes of Section 901.

The Republic of Arrakis Foreign Tax applies to *all* foreign entities operating machinery in the sovereign territory of Arrakis. (R. at 5). This tax makes no distinction between dual capacity taxpayers and other taxpayers; the tax is applied equally to *all* foreign entities operating machinery in Arrakis. (R. at 5).

Additionally, in practice the tax applies in the same manner to both dual capacity taxpayers and other taxpayers. The only distinction the Arrakis Tax Code makes is related to the deductions that foreign entities are afforded. (R. at 15). Due to religious laws and practices in place in Arrakis, the allowable deductions for foreign corporations under the Arrakis Foreign Tax are capped at 95% of what Arrakis citizens receive. (R. at 15). But importantly, this restriction applies to both dual capacity taxpayers and other taxpayers subject to tax liability under the Arrakis Foreign Tax. (R. at 15).

In short, this foreign levy is a single levy that applies in the same manner to both groups of taxpayers and makes no distinction between the two groups in its application. Thus, despite Harkonnen Oil receiving a specific economic benefit from Arrakis, the 33% levy payment to Arrakis is not precluded from being classified as a "tax" under Section 901 because it was not in exchange for specific economic benefits. As such, Harkonnen Oil's levy payment to Arrakis is properly considered a "tax" because the payment was both compulsory and pursuant to Arrakis' authority to levy taxes.

2. *The Predominant Character of the Republic of Arrakis Foreign Tax Is That of an Income Tax in the United States Sense Because It Is Likely to Reach Net Gain.*

For a foreign levy to be classified as an income tax and properly creditable under Section 901, the levy must not only be a "tax," but the "predominant character of that tax [must be] that of an income tax in the U.S. sense." Treas. Reg. § 1.901-2(a)(1)(ii). A foreign tax meets the predominant character requirement if it is not dependent on the availability of a tax credit in another country—in other words, not considered a "soak-up" tax—and if it is likely to reach net gain. *Id.* § 1.901-2(a)(3). In this case, the Republic of Arrakis Foreign Tax is not dependent on the availability of a tax credit in another country and is not considered a "soak-up" tax. The Arrakis Foreign Tax was separate and independent from the taxes paid to the other taxing authorities, and the tax paid by Harkonnen Oil to Arrakis was not impacted by the taxes paid to the Sietch State.[1] (R. at 10).

As to the net gain requirement, a foreign tax is likely to reach net gain if, judged on the basis of the tax's predominant character, it satisfies the realization, gross receipts, and net income requirements. *Id.* § 1.901-2(a)(3). These tests "indicate that net gain consists of realized gross receipts reduced by significant costs and expenses attributable to such gross receipts." *PPL Corp. v. Comm'r*, 133 S. Ct. 1897, 1902 (2013). All three of these requirements must be satisfied for a foreign tax to be found likely to reach net gain. *See, e.g.*, *Texasgulf, Inc. & Subsidiaries v. Comm'r*, 172 F.3d 209, 215 (2d Cir. 1999). In this case, the Republic of Arrakis Foreign Tax is likely to reach net gain because the tax, based on its predominant character, satisfies the realization, gross receipts, and net income requirements.

[1] Liability for a foreign tax is dependent on the availability of a credit in another country if "the foreign tax would not be imposed on the taxpayer but for the availability of such a credit." Treas. Reg. § 1.901-2(c). In this case, there is nothing to suggest that the Republic of Arrakis Foreign Tax would not be imposed against Harkonnen Oil but for the availability of a credit in another country.

a. The Tax Satisfies the Realization Requirement Because It Was Imposed Subsequent to Harkonnen Oil's Realization of Income.

A foreign tax satisfies the realization requirement if, judged on its predominant character, the tax is imposed "upon or subsequent to the occurrence of [realization] events that would result in the realization of income under the income tax provisions of the Internal Revenue Code." Treas. Reg. § 1.901-2(b)(2)(i)(A). The tax must be imposed by the taxing authority upon or subsequent to the realization event. In other words, the tax must not be imposed prior to the realization event. *Id.*

Under the United States Tax Code, income tax law concerns only that income that is realized by the taxpayer. A taxpayer may only be taxed on income, derived from any source, that is realized. *Blassie v. Comm'r*, 394 F.2d 628, 630 (8th Cir. 1968). Income is considered realized when it is actually or constructively received by the taxpayer. *Driscoll v. Exxon Corp.*, 366 F. Supp. 992, 993 (S.D.N.Y. 1973). A corporation has realized income and is thus liable for taxes when it has earned income from its operations. *Kimbrell v. Comm'r*, 371 F.2d 897, 902 (5th Cir. 1967).

However, income is not considered actually or constructively received by the taxpayer until the taxpayer enjoys an unconditional right to the income and the amount is subject to its control. *Blassie*, 394 F.2d at 630. Whether a taxpayer enjoys an unconditional right to the income and whether the amount is subject to its control is a question of whether the taxpayer has a guaranteed right of keeping the money. *Comm'r v. Indianapolis Power & Light Co.*, 493 U.S. 203, 210 (1990).

In *Indianapolis Power*, this Court determined that a power utilities company did not realize income on payment deposits made by its customers. *Id.* In that case, certain customers of the power company were required to make deposits in order to ensure payment on future utility bills. *Id.* at 204. However, the customers could retrieve the deposit from the company upon termination of services or prior to termination if the customer subsequently demonstrated acceptable credit and a prompt payment history. *Id.* at 204–05. This Court determined that the power company did not realize income on these deposits, reasoning that the power company did not have a guaranteed right to the money because the customer determined the fate of the deposit. *Id.*

Here, the Republic of Arrakis Foreign Tax is imposed upon or subsequent to the realization of income under principles of United States tax law. Determining the tax liability of a foreign entity operating machinery in Arrakis involves multiplying the gross receipts generated by the operations of the entity by the applicable tax rate. (R. at 5). To ensure proper enforcement of the tax, the government mandates that the monies earned in Arrakis by the foreign entity be deposited into the Central Bank of Arrakis. (R. at 5). Then, once the funds are deposited into the bank, the bank calculates the applicable taxes and distributes the remaining funds to the foreign entity. (R. at 5).

This deposit and distribution process with the Central Bank of Arrakis does not negate the fact that the Arrakis Foreign Tax is not imposed until or subsequent to the realization of income by foreign entities. The tax is not imposed on foreign entities, such as Harkonnen Oil, until the entity *earns* the money. (R. at 5). In other words, the tax is not imposed until the company realized income due to its guaranteed right to the money stemming from its operations within the country. The Arrakis Foreign Tax is consistent with United States realization principles: Arrakis would not tax funds like those in *Indianapolis Power* that were not yet *earned* or realized. Thus, the Republic of Arrakis Foreign Tax satisfies the realization requirement because the tax is not imposed until or subsequent to realization events that would result in realized income under United States tax principles.

b. The Tax Satisfies the Gross Receipts Requirement Because It Is Imposed on the Basis of Gross Receipts.

When judged on the basis of its predominant character, a foreign tax satisfies the gross receipts requirement if the tax is "imposed on the basis of gross receipts." Treas. Reg. § 1.901-2(b)(3)(i). A tax is deemed to be imposed on the basis of gross receipts when the tax is based on the total earnings of a taxpayer in a given period of time. *See id.* For example, in *Texasgulf, Inc.*, the tax at issue was deemed to be based on gross receipts because the tax was based on the total earnings of the company within the foreign country during the year. 172 F.3d at 215. However, a tax is deemed not to be imposed on the basis of gross receipts when the basis of the tax is computed on an amount that is substantially greater than the fair market value of the actual gross receipts. Treas. Reg. § 1.901-2(b)(3)(ii)(ex. 2).

In this case, the Republic of Arrakis Foreign Tax is imposed on the basis of gross receipts. Determining the tax liability of a foreign entity under the Arrakis

Foreign Tax requires calculating the *gross receipts* generated by an entity's operation in Arrakis during the calendar year and multiplying those gross receipts by the applicable tax rate. (R. at 5). Like the tax in *Texasgulf, Inc.*, the Arrakis Foreign Tax is based on the total earnings—gross receipts—of an entity within the country during the given year; it is not based on an amount that is substantially greater than an entity's actual gross receipts.

c. The Tax Satisfies the Net Income Requirement Because It Sufficiently Allows for Significant Cost Recoveries.

A foreign tax satisfies the net income requirement if the base of the tax is calculated by reducing gross receipts to allow for the "recovery of the significant costs and expenses attributable, under reasonable principles, to such gross receipts." Treas. Reg. § 1.901-2(b)(4)(i)(A). In other words, a foreign tax satisfies the net income requirement if the tax allows the taxpayer to recover significant costs by way of deductions or allowances. *Id.* The tax must only satisfy the net income requirement in its predominant character. *Id.*

i. The name of the tax is irrelevant to whether the tax reaches net income.

As a preliminary matter, Arrakis' initial characterization of the tax as the "Republic of Arrakis Foreign Value Tax," (R. at 5), is not determinative of whether the tax is similar or akin to a United States income tax. A government's characterization of a particular tax is not the determining factor in this analysis. *PPL Corp.*, 133 S. Ct. at 1905. Rather, "tax law deals in economic realities, not legal abstractions." *Comm'r v. Sw. Exp. Co.*, 350 U.S. 308, 315 (1956). In *PPL Corp.*, this

Court rejected the Commissioner's argument that the foreign country's characterization of the tax as a "value tax" was fatal to the tax being creditable under Section 901. 133 S. Ct. at 1905. In so finding, the Court reasoned that such a rigid application was unwarranted and the proper approach was to "follow substance over form." *Id.*

In the court below, one of the primary reasons for finding that the Republic of Arrakis Foreign Tax failed to reach net income was that the tax was originally named the "Republic of Arrakis Foreign Value Tax." (R. at 17). However, as this Court established in *PPL Corp.*, the characterization of the tax by the foreign government is not determinative of the tax's similarity to a U.S. income tax. *Id.* It makes no difference that the Arrakis tax was originally named a value tax—the determining factor is the substance of the tax.

ii. The substance of the tax satisfies the net income requirement.

A foreign tax "whose base, judged on the basis of its predominant character, is computed by reducing gross receipts by [significant cost recoveries] satisfies the net income requirement *even if* gross receipts are not reduced by some [significant cost recoveries]." Treas. Reg. § 1.901-2(b)(4)(i) (emphasis added). Not all significant costs need to be recoverable, provided that most of the significant costs are recoverable. *Id.*

Accordingly, the expenses and costs that are actually recoverable under a foreign tax must be considered in deciding whether the tax reaches net income. *Inland Steel*, 677 F.2d at 80. Ultimately, the court must determine whether the goal or effect of the tax is the taxation of net gain. *Id.* The important factor is whether the tax is attempting to reach net gain rather than simply gross income. *Bank of Am. Nat'l Trust & Sav. Ass'n v. United States*, 459 F.2d 513, 519 (Ct. Cl. 1972). *Bank of America* involved special banking levies that were imposed on the income of the taxpayer. *Id.* at 514–15. These banking levies failed to allow for the recovery of *any* costs or expenses attributable to the production of the income. *Id.* Because the levies did not permit recovery of costs and expenses, the court determined that the ultimate goal of the levies was to reach gross income, rather than net gain, and the levies were not properly creditable under Section 901. *Id.* at 523–24.

When exclusions of significant cost recoveries are far too widespread and important, the foreign levy will fail to reach net gain. *Inland Steel*, 677 F.2d at 85. In *Inland Steel*, the foreign tax at issue was a mining tax in Ontario, Canada. *Id.* at 79. The mining tax excluded recoveries of many significant costs directly related to the gross receipts of an entity subject to the tax. *Id.* at 82. There were fifteen categories of significant costs that were unrecoverable under the tax, including costs of acquiring lands, costs of meetings, and taxes of all kinds. *Id.* The court determined that due to the extensive exclusions, the tax did not seek to reach net gain as it is understood in the United States. *Id.* at 85. When such a large chunk of significant costs is unrecoverable, the tax fails to reach net gain, making it a tax on gross income. *Id.*

In this case, the Republic of Arrakis Foreign Tax properly reaches net gain because it allows for the recovery of significant costs for those foreign entities subject to the tax. Proclamation 102 permits foreign companies subject to the Arrakis foreign tax to take all the deductions that are available to the citizens of Arrakis. (R. at 15). As the IRS stipulates, the deductions available to Arrakisian citizens under the Arrakis Tax Code are identical to the available deductions under the United States Tax Code. (R. at 4). Thus, because the citizens of Arrakis are allowed the same deductions as provided under the United States Tax Code, Proclamation 102 enables foreign entities subject to the Arrakis Foreign Tax to claim deductions identical to the deductions under the United States Tax Code.

The fact that some significant costs are unrecoverable under a foreign tax does not mean the tax fails to reach net gain. Treas. Reg. § 1.901-2(b)(4)(i). While the deductions available to foreign entities operating in Arrakis are capped at 95% of the dollar value available to an Arrakisian citizen, (R. at 15), this is not fatal. The cap on deductions available to foreign entities was one of the lower court's primary rationales for finding that the tax fails to reach net gain. (R. at 17). But the appropriate analysis is to determine the ultimate goal of the Arrakis Foreign Tax by considering the costs and expenses that are recoverable under the tax.

The ultimate goal of the Arrakis Foreign Tax is to reach net gain. Unlike the tax in *Bank of America*, which allowed *no* significant cost recoveries, the Arrakis Foreign Tax allows almost *all* significant costs to be recovered, making its purpose and objective to reach net gain. Additionally, unlike the tax in *Inland Steel*, the exclusions of cost recoveries under the Arrakis Foreign Tax are not too widespread. In *Inland Steel*, there were fifteen categorical exclusions to significant cost recoveries, which is far more broad than a five percent exclusion of cost recoveries. (R. at 15).

If this Court were to find that the Arrakis Foreign Tax fails to reach net income due to the cap on deductions, one of two results will obtain: (1) Arrakis will have to violate its religious principles to rewrite its tax code, or (2) U.S. companies will refuse to operate in Arrakis. Both results are unjustifiable. The cap on deductions in Arrakis is not in place for economic reasons—it is in place for purely religious reasons. As Judge Layton pointed out in the dissenting opinion of the lower court's decision, effectively forcing a country to violate its religious laws and practices to satisfy our government's fear of under taxation is unconscionable. (R. at 20).

Harkonnen Oil's payment of the Republic of Arrakis Foreign Tax is properly creditable under Section 901. The levy is a "tax" because the payment was both compulsory and pursuant to Arrakis' authority to levy taxes. Moreover, the Arrakis Foreign Tax has the predominant character of an income tax in the U.S. sense because the tax, in its predominant character, satisfies the net gain requirement. Thus, this Court should find that Harkonnen Oil's tax payment to Arrakis was creditable under Section 901.

B. Alternatively, Harkonnen Oil Is Entitled to a Foreign Tax Credit Under Section 903 Because Harkonnen Oil Paid the Arrakis Foreign Tax in Lieu of an Income Tax.

If this Court finds that Section 901 is inapplicable, it should find that the Arrakis Foreign Tax is a creditable foreign tax under Section 903. Under Section

903, a foreign tax qualifies for a foreign tax credit if the tax was paid "in lieu of a tax on income, war profits, or excess profits otherwise generally imposed." I.R.C. § 903. Congress, in an effort to expand the availability of the foreign tax credit, enacted Section 903 because it was "concerned that the provisions of [Section 901] provided too narrow a base for determining the availability of the foreign tax credit." *Bank of Am. Trust & Sav. Ass'n v. Comm'r*, 61 T.C. 752, 761 (1974). Accordingly, it was Congress' intent for a credit under Section 903 to extend to any foreign tax in lieu of an income tax "for whatever reason the other country might consider [the substitution] proper." *Metro. Life Ins. Co. v. United States*, 375 F.2d 835, 838 (Ct. Cl. 1967). Contrary to Section 901, a foreign tax is creditable under Section 903 even if the foreign tax is not based on realized net income. Treas. Reg. § 1.903-1(a)(2) (1983). Even a foreign tax that is based on gross income or gross receipts can be creditable under Section 903. *Id.*

To qualify as a creditable foreign tax under Section 903, the tax must be paid "in lieu of" a tax on income. *Id.* A foreign tax is considered "in lieu of" an income tax if (1) the tax falls within the definition of a tax under Section 901 and (2) the tax meets the substitution requirement. *Id.* The Arrakis Foreign Tax satisfies both of these elements, and therefore, the tax was paid in lieu of an income tax. Accordingly, this Court should find that the Arrakis Foreign Tax is a creditable foreign tax under Section 903 and reverse the lower court's decision.

1. *The Arrakis Foreign Tax Falls Within the Definition of a Tax Under Section 901 Because It Requires Harkonnen Oil to Make Compulsory Payments to the Republic of Arrakis.*

The Arrakis Foreign Tax qualifies as a "tax" as defined in Section 901 because it is a "compulsory payment pursuant to the authority of a foreign country to levy taxes." Treas. Reg. § 1.901-2(a)(2)(i). The Arrakis Foreign Tax was enacted pursuant to President Corrino's authority under the constitution of the Republic of Arrakis. (R. at 5 n.8). All foreign entities, like Harkonnen Oil, that are conducting business in Arrakis are subject to the Arrakis Foreign Tax. (R. at 5). Therefore, since the tax applies to all foreign entities, Harkonnen Oil did not voluntarily pay the Arrakis Foreign Tax in exchange for a specific economic benefit. Instead, Harkonnen Oil's payment of the Arrakis Foreign Tax was compulsory. Because the Arrakis Foreign Tax required Harkonnen Oil to make compulsory payments to Arrakis pursuant to Arrakis' authority to impose such a tax, the tax falls within the meaning of Section 901 and therefore satisfies the first element required to claim a credit under Section 903.

2. *The Arrakis Foreign Tax Satisfies the Substitution Requirement Because Harkonnen Oil Paid the Tax as a Substitute for a Generally Applicable Income Tax.*

The substitution requirement is satisfied if the tax "operates as a tax imposed in substitution for, and not in addition to, an income tax." Treas. Reg. § 1.903-1(b)(1). Furthermore, to satisfy the substitution requirement, a foreign tax cannot be a soak-up tax, which means that the tax cannot be contingent on the availability of a foreign tax credit in another country. *Id.* § 1.903-1(b)(2). Two matters regarding this issue can be addressed quickly. First, whether the Arrakis Foreign Tax was paid "in addition to" an income tax is not at issue, as it was the only tax that Harkonnen Oil paid to the Republic of Arrakis. (R. at 7). Second, the Arrakis Foreign Tax is not a soak-up tax because it was not contingent on the availability of a foreign tax credit in any other country. Thus, the only issue this Court must decide to determine whether the Arrakis Foreign Tax satisfies the substitution requirement is whether the Arrakis Foreign Tax operates as a substitute for a generally applicable income tax.

The Arrakis Foreign Tax operates as a substitute for an income tax for foreign entities conducting business in Arrakis. A foreign tax operates as a substitute for an income tax if the tax is paid in lieu of a generally imposed income tax. Treas. Reg. § 1.903-1(b)(1). Before the Arrakis Foreign Tax was enacted, the Arrakis Tax Code only applied to "Arrakis citizens [and] rejected taxation of income earned by foreign individuals or entities" because of the religious beliefs in the country. (R. at 4). However, in order to modernize Arrakis' tax code, President Corrino established the Arrakis Foreign Tax. (R. at 5). Therefore, the Arrakis Foreign Tax was enacted with the intention that it operate as a substitute for the generally applicable income tax applying to Arrakisian citizens. Furthermore, the Arrakis Foreign Tax allows foreign entities, like Harkonnen Oil, to claim tax deductions that are similar to those allowed under the generally imposed income tax. (R. at 15). The similarities between Arrakis' generally applicable tax and the Arrakis Foreign Tax further indicate that the latter was enacted as a substitute for the generally imposed income tax. Because the Arrakis Foreign Tax operates as a substitute for, and not in addition to, a generally imposed income tax, the tax satisfies the substitution requirement of Section 903.

Even if this Court agrees with the lower court and finds that the Arrakis Foreign Tax is akin to a withholding tax, this Court should still find that the Arrakis Foreign Tax is creditable under Section 903 because it was paid as a substitute for the generally imposed income tax of Arrakis. A withholding tax can qualify for a foreign tax credit. *See, e.g.*, *Nissho Iwai Am. Corp. v. Comm'r*, 89 T.C. 765, 774 (1987) (finding that a Brazilian withholding tax was potentially creditable); Rev. Rul. 75-164, 1975-1 C.B. 233 (finding that an Australian withholding tax was a creditable foreign tax); Rev. Rul. 74-525, 1974-2 C.B. 411 (finding that a Belgian withholding tax on dividends and interest was a creditable foreign tax). Consequently, whether the Arrakis Foreign Tax is indeed a withholding tax is irrelevant to determining if the tax is creditable under Section 903. Rather, this Court must determine whether the Arrakis Foreign Tax operates as a substitute for the generally imposed income tax. Therefore, even if this Court determines that the Arrakis Foreign Tax is akin to a withholding tax, Harkonnen Oil is still entitled to a foreign tax credit under Section 903.

3. *The Central Bank of Arrakis' Role in Withholding and Paying the Arrakis Foreign Tax on Behalf of Harkonnen Oil Does Not Preclude the Tax from Being a Creditable Tax Under Section 903.*

"The person by whom a tax is considered paid for purposes of sections 901 and 903 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." Treas. Reg. § 1.901-2(f)(1). Accordingly, a foreign tax can still be creditable even if a foreign bank pays the foreign tax on behalf of the domestic corporation claiming the tax credit. *Riggs Nat'l Corp. & Subsidiaries*, 163 F.3d at 1365–66, 1368–69. In *Riggs*, the Brazilian government required a bank within its country to withhold and pay taxes on behalf of a domestic corporation. *Id.* at 1365–66. The court found that, even though the foreign bank was withholding and paying taxes on behalf of the domestic corporation, the domestic corporation still bore the tax liability and therefore could still claim those taxes as creditable foreign taxes. *Id.* at 1365–66, 1368–69.

Harkonnen Oil bore the legal liability for the Arrakis Foreign Tax even though the Central Bank of Arrakis withheld and paid the Arrakis Foreign Tax on behalf of Harkonnen Oil. As a result, Harkonnen Oil can still claim a foreign tax credit under Section 903. Arrakis requires all foreign entities, like Harkonnen Oil, to submit any money earned in Arrakis to the Central Bank of Arrakis. (R. at 5). Similar to *Riggs*, where the government required the foreign bank to determine the taxes owed by the domestic corporation and then pay the taxes on behalf of the domestic corporation, the Central Bank of Arrakis determined the taxes that Harkonnen Oil owed and paid the taxes directly to Arrakis on behalf of Harkonnen Oil. (R. at 5). Furthermore, like the domestic corporation in *Riggs*, Harkonnen Oil still bore the tax liability even though the Central Bank of Arrakis paid the taxes on Harkonnen Oil's behalf. Thus, this Court should find that the Central Bank's role in remitting tax payments on behalf of Harkonnen Oil does not preclude the tax from being a creditable foreign tax.

Because the Arrakis Foreign Tax required a compulsory payment of Harkonnen Oil, and because the Arrakis Foreign Tax was paid in substitution of an income tax, this Court should find that the Arrakis Foreign Tax is a creditable tax under Section 903, and thus, it should reverse the lower court's decision.

II. THE IRS AND THE LOWER COURT IMPROPERLY DENIED HARKONNEN OIL A FOREIGN TAX CREDIT FOR THE TAX PAYMENT TO IFIL.

Foreign tax creditability is principally about the substance of the tax at issue and its similarity to a U.S. income tax. *Bank of Am. Nat'l Trust*, 61 T.C. at 761. The IRS and the lower court placed undue emphasis on IFIL's political status and on foreign law in interpreting the tax code and regulations to deny Harkonnen Oil a tax credit for payments to IFIL. To honor Congress' intent to prevent double taxation with the foreign tax credit, Section 901 and its accompanying regulations should be interpreted in a way that reduces the risk of double taxation. *See United States v. Goodyear Tire & Rubber Co.*, 493 U.S. 132, 143 (1989) (adopting an interpretation under I.R.C. § 902 that was most likely to reduce double taxation). Accordingly, this Court should find that the taxes Harkonnen Oil paid to IFIL were creditable.

A. This Court Should Recognize IFIL as Having Taxing Authority to Effectuate Congress' Intent in Creating the Foreign Tax Credit.

The lower court improperly denied Harkonnen Oil a credit for tax payments to IFIL by concluding that IFIL is not a sovereign political entity with taxing power.

The U.S. foreign tax credit benefits domestic corporations that pay taxes to "any foreign country or any possession of the United States." I.R.C. § 901(b)(1). "Foreign country" includes foreign states, possessions of the United States, and political subdivisions of either. Treas. Reg. § 1.901-2(g)(2).

The term "foreign state" is ambiguous, and therefore the definition of "foreign country" is also ambiguous. Discussing the Foreign Sovereign Immunities Act, this Court defined "foreign state" as a "body politic that governs a particular territory." *Samantar v. Yousuf*, 560 U.S. 305, 314 (2010). This Court has also defined a sovereign state as one with warmaking and international diplomacy powers and the power to claim territory. *United States v. Curtiss–Wright Export Corp.,* 299 U.S. 304, 318–19 (1936). Under international law, a "state" has three components: a defined territory, a permanent population, and the ability to conduct foreign relations. *Morgan Guar. Trust Co. v. Republic of Palau*, 924 F.2d 1237, 1243–44 (2d Cir. 1991).

Because the meaning of "foreign state" is ambiguous, this Court should focus on Congress' intent in creating the foreign tax credit to determine whether payments to IFIL are creditable. *See Amalgamated Transit Union Local 1309 v. Laidlaw Transit Servs., Inc.*, 448 F.3d 1092, 1094 (9th Cir. 2006) (stating that even where the plain language of a statute is unambiguous, courts are bound to effectuate the intent of Congress in interpreting the statute, and where the plain meaning contravenes Congress' intent, the latter controls). For the purposes of the foreign tax credit, it should not matter whether IFIL is considered a sovereign state or a political subdivision of Arrakis or the Sietch State. *See Burnet*, 285 U.S. 1.

In *Burnet*, the question before this Court was whether New South Wales was a "foreign country" under the U.S. Tax Code, which at the time did not expressly include "political subdivisions" in its definition of "foreign country." *Id.* at 7. The Court looked beyond the express definition of "foreign country" and made its decision based on two policies underlying the foreign tax credit: (1) mitigating "the evil of double taxation" and (2) encouraging international commerce. *Id.* at 8–9. This Court held that "foreign country" was not limited to foreign states as defined under international law, but included any foreign government with authority to impose a tax. *Id.* at 21. The Court reasoned that

> [t]he burden upon the domestic corporation was the same whether the foreign government had international standing or was a lesser political entity which nevertheless had authority to impose the exaction upon the corporation or its subsidiary. And if credit was to be allowed here by reason of the payment of the income tax abroad, it made no difference to the Government of the United States whether the payment abroad was made to the one sort of foreign government or the other. The reasons underlying the allowance of the credit were applicable in either case.

Id. at 10.

The Treasury Regulations that interpret the tax code also emphasize that "authority" to levy taxes is the crucial requirement. "A foreign levy is a tax if it requires a compulsory payment pursuant to the authority of a foreign country to levy taxes." Treas. Reg. § 1.901-2(a)(2)(i). This Court, then, should consider whether IFIL has the authority to levy taxes, regardless of its political status. As this Court recognized in *Burnet*, if the policies that animate the foreign tax credit are applicable to the tax payments made to a foreign government, it should make no difference what kind of foreign government it is.

The IRS and the lower court incorrectly determined that IFIL did not have taxing authority. (R. at 17, 18). Neither the Treasury Regulations nor the Code establish rules to guide a judicial decision about whether a foreign government has taxing authority. The Treasury Regulations discuss taxing "authority" only to the extent of distinguishing it from a payment for a specific economic benefit. Treas. Reg. § 1.901-2(a)(2)(i). While the Regulations state that principles of U.S. law are used to determine whether a payment is made "pursuant to the foreign country's authority to levy taxes," that rule is used to contrast different kinds of authority (taxing authority and authority to demand payment for a specific economic benefit), rather than to determine whether the government has taxing authority in the first place. *Id.*

In the absence of express statutory or regulatory guidance for deciding whether a foreign power has taxing authority, the statute as a whole should guide the decision about what tax payments are creditable. *See Samantar*, 560 U.S. at 319 (reiterating the canon of statutory construction that requires a statute to be read as a whole). The statute's interpretive regulations require the taxpayer to determine whether the tax is compulsory by making a reasonable interpretation of foreign law. Treas. Reg. § 1.901-2(e)(5)(i). Because the regulations require the taxpayer to assess the taxing authority of the foreign government under its own laws, the foreign government's authority under its laws should be relevant to a court's decision about whether the government actually has taxing authority. Furthermore, Congress intended the foreign tax credit to encourage domestic corporations to engage in foreign commerce with governments the United States recognizes and considers friendly. Thus, the United States' recognition of the foreign government should be relevant to whether that government is treated as having taxing authority for the purpose of the foreign tax credit. In this case, the tax payment to IFIL should be creditable because IFIL has legal taxing authority in its territory and the United States recognizes IFIL as a sovereign friend.

1. *The Act of State Doctrine Requires Deference to Arrakis' Recognition of IFIL's Taxing Authority.*

The ruling of the Holy Royal Court of Arrakis demonstrates that IFIL has taxing authority, and our courts should not reinterpret Arrakis' law in deciding whether the tax payment to IFIL is creditable. Under the act of state doctrine, courts in this country cannot sit in judgment of official acts performed by recognized sovereign powers in their own territory. *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398 (1964). As a policy matter, the act of state doctrine is about international comity and preservation of the separation of powers. *W.S. Kirkpatrick & Co. v. Envtl. Tectonics Corp., Int'l*, 493 U.S. 400, 404–05 (1990). "Official action" under the act of state doctrine is action that only a sovereign has the power to take. *Mckesson Corp. v. Islamic Republic of Iran*, 672 F.3d 1066, 1073 (D.C. Cir. 2012). Examples of actions that can only be taken by sovereign governments include licensing decisions over nationally controlled resources and orders by the government to pay taxes. *Id.*

In *Riggs*, the court applied the act of state doctrine to a denial of a foreign tax credit by the Commissioner. 163 F.3d 1363. In that case, the taxpayer got a private letter ruling from the highest tax authority in Brazil—the Minister of Finance—confirming that taxes paid on behalf of the taxpayer were obligatory under Brazilian law. *Id.* at 1366. The Commissioner and the tax court denied the taxpayer a foreign tax credit, reasoning that under Brazilian law, despite the Minister of Finance's ruling, the taxes were not compulsory. *Id.* at 1367. Rejecting that decision, the D.C. Circuit held that the Minister of Finance's ruling that the income tax was obligatory was an act of state shielded from review in our courts. *Id.* at 1368. In a later case explaining this holding, the D.C. Circuit stated that the application of the act of state doctrine to the Minister of Finance's ruling means that "American courts must accept as given that the Brazilian government levied a compulsory tax payment on the Central Bank." *PNC Fin. Servs. Grp., Inc. v. Comm'r*, 503 F.3d 119, 127 (D.C. Cir. 2007).

In this case, the lower court should have applied the act of state doctrine to determine that the ruling by the Holy Royal Court of Arrakis was shielded from a judgment as to its validity by our courts. Like the Minister of Finance in *Riggs*, who had authority to issue binding rulings about tax disputes, the Holy Royal Court handles all legal tax disputes in Arrakis. (R. at 14). Further, the Holy Royal Court's decision was an "official action" because a private individual or entity would not have the power to issue rulings about tax disputes. That court recognized IFIL as part of Sietch, (R. at 14), and determined it was a valid taxing entity. (R. at 21). The act of state doctrine does not mandate that our courts treat foreign law as dispositive of the question of whether our tax laws recognize a foreign government's taxing authority. However, it does mandate that our courts treat foreign law as dispositive of whether a foreign government has legal taxing authority in its own territory. The lower court should have recognized that as a matter of law in Arrakis, IFIL had the authority to tax Harkonnen Oil.

2. *IFIL Should Be Treated as Having Taxing Authority Because Our President Recognizes IFIL as Sovereign.*

IFIL is not the kind of government with which Congress intended to discourage commercial relationships under tax law. In Section 901, Congress addressed the status of taxing entities in one instance, prohibiting foreign tax credits for payments made to a specific list of governments. I.R.C. § 901(j). That list includes governments that the United States does not recognize, that we do not conduct diplomatic relations with, and that support international terrorism. *Id.* § 901(j)(2)(A). Congress has thus indicated which governments it does not want to encourage foreign commerce with. IFIL is not on that list. To the contrary, the United States expressly recognizes IFIL as a sovereign friend. (R. at 14).

This Court has acknowledged that taxing authority is an inherent power of a sovereign. *Cook v. Tait*, 265 U.S. 47, 56 (1924). Therefore, to the extent that the Respondent would argue that taxing authority must be legislatively or constitutionally derived, this Court has long recognized that taxing power is a necessary attribute of government that arises automatically with sovereignty. *Soc'y* *for Sav. v. Coite*, 73 U.S. 594, 606 (1867). Consequently, once a foreign power is deemed "sovereign," it presumptively has the authority to tax.

Recognition of a foreign sovereign is a power of the executive branch. *Sabbatino*, 376 U.S. at 410. When the executive branch recognizes the sovereignty of a foreign government, the judicial branch may not choose to make its own determination as to the sovereignty of that government. *Can v. United States*, 14 F.3d 160, 163 (2d Cir. 1994). In this case, Executive Order 14012 recognizes IFIL as sovereign. (R. at 14). The President's order recognizing IFIL as sovereign mandates that our courts treat IFIL as having the authority of a sovereign, which includes the inherent authority to levy taxes. The lower court expressly undermined the executive power to recognize foreign governments by stating that the President's order did not establish that IFIL is a sovereign political entity.

Treating IFIL as having sovereign taxing authority for the purposes of U.S. tax law creates good policy because it defers to the judgment of the President on matters of international relations. The President expressly declared that the United States would like to establish trade relations with IFIL. (R. at 14). By denying foreign tax credits in IFIL, the Court would discourage businesses from operating there, directly undermining the President's goals. If there were sound reasons under the Code for doing so, the result may be justified. But the policies animating the foreign tax credit, including encouraging international commerce and eliminating double taxation, support a decision making tax payments to IFIL creditable, since IFIL is a government with which the U.S. undoubtedly wants to encourage domestic corporations to engage in commercial relationships.

B. Harkonnen Oil's Tax Payment to IFIL Was Compulsory.

To receive a foreign tax credit, a taxpayer must have paid a foreign tax that was compulsory. Treas. Reg. § 1.901-2(e)(5)(i). "An amount paid is not a compulsory payment, and thus is not an amount of tax paid, to the extent that the amount paid exceeds the amount of liability under foreign law for tax." *Id.* The lower court incorrectly found that the tax payment to IFIL exceeded Harkonnen Oil's liability under foreign law. The court reasoned that (1) the tax violated the Arrakis Constitution and (2) Harkonnen Oil failed to exhaust its available remedies under foreign law. (R. at 18). However, the tax's compliance with the Arrakis Constitution is not relevant to whether the tax is creditable in the U.S., and Harkonnen Oil properly exhausted its foreign law remedies by petitioning the only court with the authority to address the issue of the IFIL tax.

1. *The Lower Court Placed Undue Emphasis on the Arrakis Constitution in Interpreting the Creditability of the Tax Payment to IFIL.*

The lower court applied the wrong law when it decided that the tax payment to IFIL was not creditable because it violated the Arrakis Constitution.[2] The Arrakis Constitution's single-tax provision limits the taxing power of the Arrakis vice president such that he or she can only levy one tax. (R. at 9). The lower court

[2] The IRS incorrectly concluded that the tax by IFIL violated a single-tax limit in the Sietch Dunes Peace Treaty. (R. at 17). The Peace Treaty contains no such tax limit. (R. at 8–9). Rather, the lower court was correct that the single-tax limit appears in the Arrakis Constitution. (R. at 9).

should not have treated its own interpretation of foreign law as dispositive of the question as to whether Harkonnen Oil's tax payment to IFIL was creditable.

In determining whether a tax payment is creditable, U.S. courts should not rely on their own interpretation of foreign law. Treas. Reg. § 1.901-2(a)(2)(i); *Riggs*, 163 F.3d at 1369. Instead, as a corollary of the act of state doctrine, they should accept the foreign government's interpretation of its own law and decide whether the tax is creditable in the United States. *Riggs*, 163 F.3d at 1369. In *Riggs*, discussed above, the court reasoned that the Commissioner should not have denied the taxpayer's foreign tax credit based on an interpretation of whether the tax was compulsory under Brazilian law because such an interpretation is not what the U.S. Tax Code requires. *Id.* Rather, the Code requires analysis of how the foreign tax law should be treated under U.S. tax principles. *Id.*

While U.S. courts should not decide whether a tax violates foreign law, the taxpayer itself is required to reasonably interpret foreign law in deciding whether a tax is compulsory. Treas. Reg. § 1.901-2(e)(5)(i). In this case, the only reasonable interpretation for Harkonnen Oil was that the tax payment to IFIL was compulsory. If Harkonnen Oil did not pay IFIL the two percent tax, IFIL was going to retain control of a drilling station into which Harkonnen Oil had already invested significant time, money, and resources. (R. at 13). Standing alone, that would be insufficient to make IFIL's tax compulsory. However, before Harkonnen Oil paid the tax, both Sietch State leader Atreides and Arrakis president Corrino were aware of the tax and raised no objections to it. (R. at 15). Therefore, Harkonnen Oil was faced with the leaders of three governments (Arrakis, the Sietch State, and IFIL) treating the tax as legitimate, the leader of our country treating IFIL as a legitimate foreign government, and Arrakis' only tax court officially declaring that IFIL had the power to levy the tax.

2. *Harkonnen Oil Exhausted All Effective and Practical Remedies Under Foreign Law.*

The Treasury Regulations require a taxpayer to act reasonably in paying foreign taxes and to pursue all "effective and *practical* remedies." Treas. Reg. § 1.901-2(e)(5)(i) (emphasis added). Effectiveness and practicality are determined by weighing the cost of pursuing the remedy against the potential that the remedy will result in reduced tax liability. *Id.* Taxpayers only have to exhaust remedies that carry reasonable costs. *Id.* The policy behind this rule is to discourage taxpayers from tacitly paying taxes that are not compulsory and then claiming a U.S. foreign tax credit, making the U.S. subsidize the taxpayer's foreign operations. *Procter & Gamble Co. v. United States*, No. 1:08cv00608, 2010 WL 2925099, at *8 (S.D. Ohio July 6, 2010). Harkonnen Oil exhausted all effective and practical remedies by requesting a ruling from the taxing authority in Arrakis regarding IFIL's power to assess a tax.

Seeking a decision from a taxing authority in a foreign country satisfies exhaustion of remedies in the foreign tax credit context. *Schering Corp. v. Comm'r*, 69 T.C. 579, 587 (1978). For example, in *Schering Corp.*, a company doing business in Switzerland requested and received a ruling from the head of the audit department at the Swiss Federal Tax Administration concluding that the company was liable for certain taxes under Swiss law. *Id.* The company did not challenge that determination in the Swiss legal system. *Id.* On review, a United States tax court concluded that the taxpayer had exhausted its foreign remedies and would not be denied a foreign tax credit based on that requirement. *Id.* at 602.

Requesting the advice of competent legal counsel in the foreign country also satisfies the exhaustion requirement. Treas. Reg. § 1.901-2(e)(5)(i); *Procter & Gamble*, 2010 WL 2925099, at *10. In *Procter & Gamble*, the company Procter & Gamble claimed a foreign tax credit for taxes paid by its affiliate on the same stream of income for sales in both Korea and Japan. 2010 WL 295099, at *2. Originally, only Japan assessed taxes on the income, but the Korean taxing authority eventually audited the affiliate and also assessed taxes on the same income. *Id.* After receiving advice from a Korean law firm that the Korean taxes were properly assessed, Procter & Gamble chose not to appeal the tax in Korea. *Id.* at *4. The court held that the taxes paid to Korea were creditable but the taxes to Japan were not because the company did not exhaust its remedies to appeal the taxes in Japan after learning that the Korean taxes were valid. *Id.* at *10. Thus, the holding in *Procter & Gamble* was based on a conclusion that the taxpayer had satisfied the exhaustion requirement in Korea by seeking advice from a Korean law firm about its tax liability in that country, but was also required to satisfy exhaustion under the separate laws of another country for separate tax payments on the same income there.

In this case, Harkonnen Oil properly exhausted all practical and effective remedies by petitioning the Holy Royal Court of Arrakis for a determination of IFIL's ability to tax. Because the Holy Royal Court handles all legal tax disputes in Arrakis, (R. at 14), it was both reasonable and practical for Harkonnen Oil to petition that court for a ruling on IFIL's tax. A ruling from the court was at least as authoritative as the ruling from the auditor in *Schering Corp.* that the tax court deemed sufficient for exhaustion. And it was certainly more authoritative than the advice of a law firm that was deemed sufficient to satisfy the exhaustion requirement for the Korean tax in *Procter & Gamble*. In fact, because the Treasury Regulations permit a taxpayer to simply rely on advice from a foreign tax advisor to satisfy exhaustion, pursuing a legal remedy in a foreign court should more than suffice.

While *Procter & Gamble* may require a taxpayer to exhaust remedies in multiple sovereign states if it seeks a tax credit for payments made on the same income to those states, no court has ruled that a taxpayer must pursue remedies in the political subdivision of a state after receiving a ruling from the state itself. Unlike *Procter & Gamble*, where the court ultimately concluded that the taxpayer should have challenged its Japanese tax liability in Japan, the lower court in this case ruled that Harkonnen Oil should have challenged its IFIL tax liability in the Sietch State. This ruling is problematic for several reasons. First, the Sietch State is a province of Arrakis that is subject to the Arrakis Constitution. (R. at 8–9). If the only court with authority to settle tax disputes in Arrakis had already ruled on

IFIL's taxing power, it would not be practical or effective for Harkonnen Oil to petition a subordinate council on the same issue. Second, it is not clear that the Sietch Council has any authority to determine whether the tax in IFIL was compulsory or valid. The lower court would require a private company operating in a state with a complicated political atmosphere to second guess the official ruling of a court in that state by challenging it before a council in a subordinate province.

Moreover, the Treasury Regulations expressly provide that a taxpayer does not have to change the way it does business or "the form of any business transaction" to reduce foreign tax liability. Treas. Reg. § 1.901-2(e)(5)(i). But that is exactly what the lower court's ruling would compel Harkonnen Oil to do. The company would have to abandon operations at Unit Number 12 to avoid paying taxes to IFIL. Harkonnen Oil was already in the midst of a foreign territorial dispute, tethered there by expensive investments in Arrakis and the Sietch State. As a private company and not a diplomatic expert, Harkonnen Oil acted reasonably by relying on a declaration by the court that handles tax disputes in Arrakis and by paying the taxes assessed by a government the U.S. itself recognizes as a sovereign friend. The company's conduct is not the tacit compliance with foreign taxes that the exhaustion requirement is in place to prevent. Accordingly, this Court should reverse the lower court's decision to deny Harkonnen Oil a foreign tax credit for the tax paid to IFIL.

CONCLUSION

For the foregoing reasons, Harkonnen Oil respectfully requests that this Court reverse the lower court's judgment and find that Harkonnen Oil is entitled to foreign tax credits for the income tax payments made to both Arrakis and IFIL in tax year 2011.

Respectfully Submitted,

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