NO. 15-1701-1

In the

Supreme Court of the United States

October Term, 2014

ROYAL HARKONNEN OIL COMPANY,

Petitioner,

v.

UNITED STATES,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Fourteenth Circuit

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BRIEF FOR PETITIONER

Team 82
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QUESTIONS PRESENTED

I. The Republic of Arrakis imposed a tax on gross receipts from Harkonnen Oil's operations within Arrakis, reduced by ninety–five percent of deductions comparable to those from the U.S. Tax Code. Is Harkonnen Oil's payment of taxes to the Republic of Arrakis a creditable foreign income tax under 26 U.S.C. § 901 or tax in lieu of an income tax under 26 U.S.C. § 903?

II. The Inter–Sietch Fremen Independence League ("IFIL") taxed net income from drilling operations in its territory pursuant to its authority as recognized by the governments of Arrakis and the United States. IFIL also satisfies the definition of foreign government under the Foreign Tax Credit statute. Is Harkonnen Oil's payment of taxes to IFIL creditable foreign income tax?

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The Central District Court of New Tejas ruled in favor of the United States. (R. at 17, ¶ 40.) The Fourteenth Circuit affirmed. (R. at 19, ¶ 44.)

STATUTORY & REGULATORY PROVISIONS INVOLVED

The statutory and regulatory provisions involved appear in the Appendix.

STANDARD OF REVIEW

The Federal District Court for the Central District of New Tejas heard this case at trial and ruled that neither the Arrakis Tax nor the IFIL Tax are creditable under Section 901 or Section 903 of Title 26 of the United States Code. The Federal Court of Appeals for the Fourteenth Circuit affirmed. This holding is treated as a ruling on a question of law under Fed. R. Civ. P. 44.1 and is reviewable *de novo*. *Riggs Nat'l Corp. v. Comm'r*, 163 F.3d 1363, 1368 (D.C. Cir. 1999).

STATEMENT OF THE CASE

Royal Harkonnen Oil Company ("Harkonnen Oil") is a United States company operating an oil field in the Republic of Arrakis. (R. at 2, ¶ 1 n.1.) This operation, the Caladan Oil Field, encompasses over 230,000 square miles within the Arrakis borders. (R. at 2-3, ¶ 1, n.2.) After lengthy negotiations with the Arrakisian president, Jules Corrino, Harkonnen Oil and Arrakis agreed upon a lease that included tax payments to Arrakis. (R. at 7, ¶ 13.)

The historical and religious norms of Arrakis shape this tax. (R. at 4, ¶ 4.) Because the Arrakis Tax Code originally applied only to bloodline descendants of those under the throne, foreign individuals or entities were not subject to taxation in Arrakis. *Id.* Recently, though, President Corrino modernized the Arrakis Tax

Code. (R. at 5, ¶ 5.) On March 10, 2008, President Corrino enacted the Republic of Arrakis Foreign Value Tax, applicable to all foreign entities operating machinery within the country. *Id.* This tax is calculated by multiplying the current tax percentage by a business's gross receipts earned in Arrakis. *Id.* The original percentage, set in June 2008, was forty-five percent. (R. at 7, ¶ 13.) President Corrino then lowered the rate to thirty-three percent in May 2011. (R. at 15, ¶ 35.) Foreign businesses may also apply deductions similar to those available in the United States. (R. at 15, ¶ 36.) The Arrakis government caps these deductions at ninety-five percent of the deductions available to Arrakisian citizens, due to the religious doctrine that a foreigner may not have benefits equal to those of true believers. *Id.* Harkonnen Oil paid the thirty-three percent tax minus deductions to Arrakis for the tax year 2011. (R. at 16, ¶ 37.)

In addition to paying the Arrakis tax, Harkonnen Oil has been subjected to two additional taxes. *Id.* Arrakis recognized the Sietch State as an Important Province of Arrakis. (R. at 8-9, ¶ 17.) A portion of Harkonnen's Caladan Oil Field falls within this political subdivision of Arrakis. (R. at 6, ¶ 7.) As a result, the Sietch State taxed ten percent of Harkonnen Oil's income from the Caladan Oil Field in 2011. (R. at 16, ¶ 37.) This tax is not in dispute. (R. at 17, ¶ 39.)

In addition to the Sietch tax, Harkonnen paid an income tax to the Inter-Sietch Fremen Independence League ("IFIL"). (R. at 13, ¶ 31.) IFIL forcefully took control of a portion of the Sietch State's land; IFIL has retained control of this region since March 2011, and other nations—including Al Dhanab, Anbus, France, and Russia—have recognized the IFIL government. (R. at 12-13, ¶¶ 28-29.) Both the United States and the United Nations agreed to consider the issue of recognizing IFIL (R. at 12-13, ¶ 28), and in Executive Order 14012 the U.S. President unequivocally described IFIL as a "'sovereign,'" declaring it a "'friend of the United States, whom we would like to establish trade relations with.'" (R. at 14, ¶ 34.)

Beginning in March 2011, IFIL imposed a two percent income tax upon Harkonnen's Unit 12 drilling station. (R. at 13, ¶ 31.) IFIL calculates this tax by subtracting allowable deductions from Unit 12's income and multiplying the resulting figure by two percent. *Id.* Harkonnen immediately protested the tax and sought President Corrino's direction on the matter. (R. at 14, ¶ 31.) President Corrino instructed Harkonnen to present the issue to the Holy Royal Court of Arrakis, which handles "all legal tax disputes in Arrakis." *Id.* The Holy Royal Court heard the case and declared that "'Arrakis recognizes IFIL as part of Sietch.'" (R. at 14, ¶ 32.) Harkonnen then proceeded to pay the IFIL income tax and timely claimed foreign tax credits for the tax payments it had made to Arrakis, the Sietch State, and IFIL. (R. at 16, ¶¶ 37-38.)

SUMMARY OF THE ARGUMENT

I. The Arrakis Tax is creditable under the Foreign Tax Credit.

Congress designed the U.S. Foreign Tax Credit to offset income taxes paid to foreign countries in order to relieve American taxpayers of the burden of double taxation. As it became apparent that there is a wide variety of foreign tax codes, Congress expanded the coverage of the Foreign Tax Credit to effect its goals of preventing double taxation and supporting foreign trade. Consistent with Congress's expansive view of the Foreign Tax Credit, Courts construe the provisions of the credit broadly.

The Arrakis Tax is the product of a concerted effort by Arrakis to design a tax code that allows for ease of international trade while still complying with tenets of Arrakisian religion. As such, the tax mirrors the structure of the U.S. income tax in every relevant respect. Whatever remaining differences still allow the Arrakis Tax to qualify for the Foreign Tax Credit. To hold otherwise would be to construe provisions of the Foreign Tax Credit contrary to surrounding provisions and to Congressional intent.

II. The IFIL Tax is creditable under the Foreign Tax Credit.

IFIL meets the plain language requirements of the Foreign Tax Credit to qualify as a valid taxing authority. This is true whether IFIL is an independent sovereign state or a political subdivision of Arrakis. In addition, a decree of the highest court in Arrakis and an order of the U.S. Executive Branch have both recognized the IFIL government and its taxing authority. Refusal to respect the decree of the foreign court or the political role of the U.S. Executive violates the Act of State Doctrine, which is a doctrine of judicial restraint. The highest and most appropriate authority to determine the validity of the IFIL Tax and IFIL's taxing power has already issued its binding ruling. Thus, Harkonnen Oil has exhausted its available remedies in challenging the validity of the IFIL Tax.

ARGUMENT

I. The Arrakis Tax is creditable because it emulates the United States Income Tax.

Harkonnen Oil paid to Arrakis a tax that substantively amounts to an income tax. Accordingly, Harkonnen Oil properly claimed a credit against this tax under the Foreign Tax Credit, 26 U.S.C. § 901 (2012). Respondent asks this Court to discard its own precedent by refusing to look beyond the name of a tax to determine its creditability. The Fourteenth Circuit reasoned that the Arrakis Tax is not "similar or akin to a United States Income Tax" because its original name was the "Republic of Arrakis Foreign Value Tax." (R. at 17, ¶ 41.) Yet this Court plainly rejected reliance on titles in *PPL Corp. v. Commissioner*, 133 S. Ct. 1897, 1902 (2013). To do so would subject domestic tax credits to the whims of classifications by foreign countries. *Id.* Thus, courts must analyze a tax according to its substance—not its form. *Id.*

The Treasury Regulations themselves govern this analysis. An "income tax," as used in the Foreign Tax Credit, is (i) a tax, which (ii) bears the predominant character of a U.S. income tax. Treas. Reg. § 1.901–2(a) (1983). The Fourteenth Circuit did not deny that the Arrakis Tax was, in fact, a tax. To share the same predominant character as a U.S. income tax, a tax must likely reach net gain under normal circumstances, and a tax is creditable only to the extent that it does not depend on the availability of an offsetting credit in another country. § 1.901–2(a)(3). No portion of the Arrakis tax depends on creditability of the tax in another country.

To reach net gain as the Treasury Regulation requires, a tax must satisfy requirements regarding (i) realization, (ii) gross receipts, and (iii) net income. § 1.901–2(b). No one disputes that the Arrakis Tax meets the first requirement, because Arrakis imposed the tax at the appropriate time relative to a realization event. *See* § 1.901–2(b)(2). No one disputes, either, that Arrakis imposes its tax based on gross receipts and thus satisfies the second requirement. *See* § 1.901–2(b)(3). The dispute, then, centers on the third (net income) requirement—that the tax calculation reduce gross receipts to permit "[r]ecovery of significant costs and expenses . . . attributable, under reasonable principles, to such gross receipts." § 1.901–2(b)(4)(A). Alternatively, the calculation may reduce gross receipts to permit recovery of significant losses and expenses using a method that is "likely to produce an amount that approximates, or is greater than, recovery of" significant costs and expenses attributable to gross receipts. § 1.901–2(b)(4)(B).

The Arrakis Tax meets the net income requirement for three reasons. First, Congress intended to allow the Foreign Tax Credit for businesses like Harkonnen Oil to survive. Second, the Arrakis Tax is sufficiently similar to the U.S. income tax. Finally, the Arrakis tax deductions mirror U.S. tax deductions in kind. Even if this Court were to find that the Arrakis Tax does not meet net gain, the tax qualifies for the Foreign Tax Credit as a tax in lieu of an income tax under 26 U.S.C. § 903 (2012).

A. Congress designed the Foreign Tax Credit to protect taxpayers from double taxation and to encourage international business activities.

It is unfair to tax a business or individual twice on income derived from foreign trade. The Foreign Tax Credit embodies this principle. *Burnet v. Chi. Portrait Co.*, 285 U.S. 1, 7 (1932) ("[T]he primary design of the provision was to mitigate the evil of double taxation."). Double taxation hamstrings foreign enterprise by American businesses because it forces a substantial disadvantage on the businesses' ability to maintain profitability. *Id.* at 9, n. 7 (reviewing legislative intent from H.R. Rep. No. 67–350, at 8 (1921)). If faced with double taxation, these businesses would likely reincorporate in foreign countries to remain competitive, which would deprive the United States of other revenue and economic contributions. *Id.*

For these compelling reasons, Congress expanded the Foreign Tax Credit to apply to foreign taxes paid "in lieu of" an income tax. 26 U.S.C. § 903 (2012). Courts construe § 903 broadly, meaning that foreign taxes are creditable if governments impose them in lieu of income taxes for any reason. *E.g.*, *Metro. Life Ins. Co. v. United States*, 375 F.2d 835, 838–39 (Ct. Cl. 1967). Although tax exemptions extended as privileges by legislative grace are construed strictly, *Texasgulf, Inc. and Subsidiaries v. Comm'r*, 172 F.3d 209, 214 (2d Cir. 1999), the purpose of the Foreign Tax Credit necessitates broad construction. Thus, the policy against double taxation must influence substantive consideration of the Foreign Tax Credit.

B. The Arrakis Tax satisfies the requirements of 26 U.S.C. § 901 because it taxes net income.

1. The Arrakis Tax reaches net income in form because President Corrino's conduct shows intent to conform to United States tax norms.

The Arrakis Tax took on the form and substance of an income tax by the tax year 2011. Respondent not only places too much significance on the form of the Arrakis Tax, but also mistakes how Arrakis characterizes its tax. True, the Arrakis Tax, as originally conceived in 2008, bore the moniker of "Foreign Value Tax." (R. at 5, ¶ 5.) At inception, the tax equaled a percentage of gross receipts. (R. at 5, ¶ 5). Because foreign companies could not avail themselves of Arrakis tax deductions, (R. at 4, ¶ 4), the Arrakis Foreign Value Tax of 2008 did not reach net gain and was not creditable under the Foreign Tax Credit. Thus, Harkonnen Oil properly deducted its foreign tax payments in lieu of claiming credits for tax years prior to 2011. (R. at 16, ¶ 38.)

The 2011 Arrakis Tax, however, is an entirely different matter. The Arrakis Tax did not transform into an income tax overnight, but evolved over time as part of President Corrino's purposeful efforts to shape the tax to "comport with new international treaties and obligations." (R. at 5, ¶ 5.) Between 2008 and 2011, President Corrino renamed the tax the "Republic of Arrakis Foreign Tax," (R. at 7, ¶ 13), set a forty–five percent tax rate, (R. at 7, ¶ 13), reduced the tax percentage to thirty–three percent, (R. at 15, ¶ 35), and granted foreign corporations leave to claim deductions, (R. at 15, ¶ 36). Each step brought the Arrakis Tax closer to an income tax, in the U.S. sense, and reflected President Corrino's desire to impose an income tax. As a result, as of the 2011 tax year, the Arrakis Tax qualifies as an income tax for purposes of the Foreign Tax Credit.

2. The Arrakis Tax reaches net income because significant costs and expenses are allowable as deductions in the Arrakis Tax Code.

In order to reach net income, the base of a tax must equal gross receipts reduced to permit:

> (A) [r]ecovery of the significant costs and expenses (including significant capital expenditures) attributable, under reasonable principles, to such gross receipts; or
>
> (B) [r]ecovery of such significant costs and expenses computed under a method that is likely to produce an amount that approximates, or is greater than, recovery of such significant costs and expenses.

Treas. Reg. § 1.901–2(b)(4) (1983). Deductions are an acceptable form of recovery of costs and expenses, according to the Treasury Regulations. § 1.901–2(b)(4)(iii), ex. 4 (acknowledging creditability of a tax equal to forty–eight percent of gross receipts after deduction applied for costs and expenses).

Courts must judge a foreign tax's creditability by the tax's predominant character. § 1.901–2(b)(4). United States income tax laws are "a product of complex political, administrative, and economic factors, many of which are unique to the United States." Boris I. Bittker & Lawrence Lokken, Fed. Taxation of Income, Estates, and Gifts, ¶ 72.4.1 (2014), *available at* 2001 WL 460956, 1. As such, it is unreasonable to require a creditable foreign tax to correspond precisely to a U.S. income tax. *Id.* Rather, the foreign tax's predominant nature must be to tax net income in principle, not necessarily net income as calculated for U.S. taxes. The Treasury Regulations explain that a creditable foreign tax does not need to reduce gross receipts by *every* cost and expense, but by *significant* costs and expenses. § 1.901–2(b)(4)(i). Significant nonrecoverable costs and expenses might not even preclude creditability if other allowances offset those costs and expenses. *Id.* ("Principles used in the foreign tax law to attribute costs and expenses to gross receipts may be reasonable even if they differ from principles that apply under the Internal Revenue Code.").

Two cases illustrate the latitude foreign governments have to design creditable taxes. The first, *Texasgulf, Inc.*, shows that the formula for the income tax does not need to show specific offsetting allowances. 172 F.3d 209, 211–17 (2d Cir. 1999). In that case, Ontario had imposed a mining tax based on profit excess over a flat statutory exemption amount. *Id.* at 211–12. The tax provided allowances in the form of percentages of the capital cost of the processing assets. *Id.* at 212. These allowances did not always offset expenses that were attributable to gross receipts but were not recoverable under the Ontario Mining Tax—defined as unrecoverable expenses—because the allowances were not calculated based on unrecoverable expenses. *Id.* at 213. The taxpayer offered data showing that its tax allowances were greater than its unrecoverable expenses over the tax year and aggregated over the past thirteen years. *Id.* The same offset status applied to the majority of taxpayers in a representative cross section of tax returns. *Id.*

The commissioner insisted that statistical correlation is not a sufficient basis on which to qualify the mining tax for creditability. *Id.* at 216. The Second Circuit rejected this argument, reasoning that because the Treasury Regulations allowed for recovery of expenses that approximated or exceeded those expenses attributable to gross receipts, "quantitative empirical evidence may be just as appropriate as quantitative analytic evidence" in considering creditability. *Id.* (construing Treas. Reg. § 1.901–2(b)(4)(i)(B) (1983)). The commissioner also argued that prior case law established that the Ontario Mining Tax was not creditable. *Id.* at 216–17 (citing *Inland Steel Co. v. United States*, 677 F.2d 72, 87 (Ct. Cl 1982) (holding that the Ontario Mining Tax did not fit the U.S. "concept of an income tax" and thus failed the common–law net income test then in effect)). But the Second Circuit pointed out that the Treasury issued its Regulation § 1.901–2 the year after *Inland Steel*, and the regulation included an explicit test for net income that replaced the common–law test. *Texasgulf*, 172 F.3d at 216. The regulation also includes broader language than that of *Inland Steel*, and provided for offsetting allowances and difference in tax policies between the United States and foreign countries. *Id.* at 216–17.

In light of the regulation superseding *Inland Steel* and the supporting empirical data provided by the taxpayer, the Second Circuit held the Ontario Mining Tax creditable. *Id.* Notably, the Fourteenth Circuit relied on *Inland Steel* when it rejected the Arrakis Tax's creditability. (R. at 17, ¶ 41.)

Arrakis offers tax deductions that "match available deductions under the United States Tax Code." (R. at 4, ¶ 4, n. 7.) Because the religious tenets of Arrakis forbid provision of equal benefits to foreign entities and true believers, foreign entities can only claim up to ninety–five percent of the deductions afforded to true believers. (R. at 15, ¶ 36.) The regulations do not explicitly say what level of expense recovery qualifies as "significant." But it defies logic and, more importantly, the goals of the Foreign Tax Credit to assert that the Arrakis Tax does not provide significant cost and expense recoveries.

Harkonnen Oil now faces the exact evil that Congress expected to eliminate with the Foreign Tax Credit. Arrakis has taxed Harkonnen Oil on its income from the Caladan Oil Field operations, the Sietch State has taxed Harkonnen Oil on its income from some of those same operations, and even IFIL has taxed Harkonnen Oil for income from part of the operations subject to tax from the other two entities. (R. at 16, ¶ 37.) In the case of Unit 12, Harkonnen will suffer quadruple taxation now that the United States has demanded its tribute. It would be disingenuous to assert that duplicate taxation had not occurred when the United States taxed gross receipts minus deductions and Arrakis taxed gross receipts minus ninety–five percent of the same deductions. Arrakis, the Sietch State, and IFIL have taxed forty–five percent of the net income from Unit 12 already. (R. at 16, ¶ 37.) Demanding duplicate taxes from Harkonnen Oil is like stripping away a rower's last oar: she cannot compete in the race anymore and will likely switch to a different race with fairer rules.

Further, President Corrino has done all he can to design a creditable income tax without violating his religious beliefs—indeed the sincere religious beliefs that the religious leader of Arrakis has sanctioned. (R. at 15–16, ¶ 36.) Granted, Arrakis's categorization of its tax is not a dispositive factor. *See PPL Corp. v. Comm'r*, 133 S. Ct. 1897, 1902 (2013). Yet the Fourteenth Circuit swept aside all meaningful signs of President Corrino's intent and concluded that the Arrakis Tax is not an income tax because, for three months in 2008, the tax's name included the word "value." (R. at 5, 7, 17, ¶¶ 5, 13, 41.)

The only way to construe the regulations in Respondent's favor is to equate "significant" to "entire." Were that the case, then the Arrakis Tax would not be creditable under 26 U.S.C. § 901 because ninety–five percent of cost and expense deductions will never equal one hundred percent of cost and expense deductions. This construction would, however, appear nonsensical given the regulation's allowance for reductions that *approximate* related costs and expenses. *See* § 1.901–2(b)(4)(i)(B). Similar dissonance exists between a requirement that deductions be available at one hundred percent of their values when the regulation states that not all costs and expenditures must reduce gross income. *See* § 1.901–2(b)(4)(i).

At bottom, Arrakis imposes its tax on gross income minus significant costs and expenses. President Corrino intended the tax to operate as an income tax (within the bounds of Arrakisian religious practices). The tax base is identical to the U.S. income tax but for a five percent differential in deductions. And a narrow construction of the Foreign Tax Credit requirements works absurdity into the regulations and hardship on taxpayers who wish to engage in foreign trade.

C. Even if the Arrakis Tax does not reach net gain, because Arrakis imposed it "in lieu of" an income tax, the tax is creditable.

Creditable foreign taxes include taxes paid "in lieu of a tax on income." 26 U.S.C. § 903 (2012). This addition to the Internal Revenue Code further expanded the category of creditable taxes. The primary goal of the amendment may initially have been to capture foreign taxes that could not correspond to U.S. income taxes but that nonetheless served as income tax substitutes. *Metro. Life Ins. Co. v. United States*, 375 F.2d 835, 838 (Ct. Cl. 1967). Courts have not limited § 903 to apply only to those cases where administrative difficulty has prevented creditability, though. The Court of Claims observed that Congress could have listed specific requirements for comparable income taxes instead of providing coverage of taxes paid "in lieu of" income taxes. *Id.* at 839. Even a tax on an arbitrary basis may be "in lieu of" an income tax and should be creditable to avoid double taxation. *Id.* at 838.

Even if the Arrakis Tax does not meet formal requirements for reaching net gain, the tax is creditable because it is "in lieu of" an income tax. The record does not indicate that Arrakis imposed any other tax intended to tax income. To the contrary, President Corrino's conduct reflects purposeful efforts to design an income tax. The Arrakis Tax's structure looks like an income tax—gross receipts minus specified deductions. This is far from a case of taxing on an arbitrary basis, and crediting the Arrakis Tax would avoid double taxation. In other words, it looks like an income tax, it acts like an income tax, and if it cannot be called an income tax then it makes a good stand–in for one. In accordance with the clear congressional purpose of the Foreign Tax Credit and the broad construction that accompanies that purpose, the Arrakis Tax is creditable against Harkonnen Oil's U.S. tax.

II. The IFIL Tax is creditable because Arrakis recognizes the authority of IFIL and because the IFIL Tax is a valid tax.

Harkonnen Oil is stuck between a rock and a hard place. The rock: IFIL is taxing Harkonnen Oil on income from Unit 12—creating triple taxation—and Arrakis law has declared the tax valid. The hard place: the United States is taxing Harkonnen Oil on income from Unit 12—creating quadruple taxation—and argues that the IFIL Tax is invalid.

A. IFIL is a valid taxing authority.

1. The plain text of the Foreign Tax Credit statute supports recognition of IFIL's taxing authority.

The Foreign Tax Credit allows a credit to offset income taxes paid to a "foreign country." 26 U.S.C. § 901(b)(1) (2012). The Foreign Tax Credit denies a credit only with respect to "certain foreign countries" in subsection (j) of the statute. The excluded countries are listed in four narrow categories: foreign countries (i) the government of which the United States does not recognize; (ii) with respect to which the United States has severed diplomatic relations; (iii) with respect to which the United States does not conduct diplomatic relations; and (iv) which the Secretary of State has designated as a country that repeatedly supports acts of international terrorism.

2. IFIL is a political subdivision of Arrakis, which undisputedly qualifies as a foreign country under the Foreign Tax Credit.

A "foreign country," as used in § 901, includes any foreign state or any political subdivision of a foreign state. Treas. Reg. §1.901–2(g) (1983) (defining foreign country). As a political subdivision of Arrakis, a recognized foreign country, IFIL is not an unrecognized foreign country in the first category of excluded countries. The United States has neither severed nor refused diplomatic relations with Arrakis or IFIL, so the second and third categories of excluded countries do not apply. In fact, the President of the United States has welcomed trade relations with IFIL, (R. at 14, ¶ 34), and diplomatic relations with Arrakis have assisted the progress of peace in the area, (R. at 8, ¶ 16). Lastly, the U.S. Secretary of State has not designated either Arrakis or IFIL as a supporter of international terrorism. Although the U.S. State Department classifies IFIL as a splinter group of the Bene Gesserit terrorist organization, IFIL is an independent group that has worked against the interests of the Bene Gesserit. (R. at 11, ¶ 25.) Thus, IFIL is not included in any of the categories of excluded foreign countries that Congress explicitly provided. Rather, IFIL qualified as a foreign country for the 2011 tax year and the U.S. Department of State did not make a determination to the contrary. In fact, the Fourteenth Circuit provided no authority to support its refusal to apply the plain language of the statute and regulations. This result upsets taxpayer expectations for those who reasonably relied on the statutory wording to support their tax credits. It also conflicts with the declaration of the Holy Royal Court of Arrakis: "Arrakis recognizes IFIL as a part of Sietch." (R. at 14, ¶ 32.)

Respondent asks this Court to disregard the declaration of the Holy Royal Court and deny IFIL's taxing authority. But, Respondent ought not seek to litigate this issue here because this Court has established a doctrine of restraint—the Act of State Doctrine—holding that the judiciary will not inquire into official acts of foreign nations out of respect for foreign authority and the role of the U.S. Executive Branch. *Underhill v. Hernandez*, 168 U.S. 250, 252 (1897).

The Act of State Doctrine "directs courts to refrain from deciding a case when the outcome turns upon the legality or illegality (whether as a matter of U.S., foreign, or international law) of official action by a foreign sovereign performed within its own territory." *Riggs Nat'l Corp. & Subsidiaries v. Comm'r*, 163 F.3d 1363, 1367 (D.C. Cir. 1999) (internal citation omitted). As stated in the foundational case *Underhill*, the Act of State Doctrine stands for the principle that sovereign states must respect each other's independence, and that courts must respect the acts of a foreign government within its own territory. 168 U.S. at 252. This principle does not leave a citizen without redress against acts of a foreign government but instead channels it through constitutionally appropriate avenues of interaction between the two governments. *Id.* In the United States, the executive branch is the appropriate party to address these acts—not the judiciary. *Id.*; *see, e.g.*, *United States v. Curtiss-Wright Export Corp.*, 299 U.S. 304, 320 (1936) (describing the executive branch's "very delicate, plenary and exclusive power . . . as the sole organ of the federal government in the field of international relations").

Although a mere interpretation of foreign law would not qualify as an act of state, a valid, binding order from a government entity is an act of state. *Riggs*, 163 F.3d at 1368. In March 2011, an act of state established Arrakis's recognition of IFIL's authority to tax. President Corrino confirmed that the Holy Royal Court of Arrakis exercised jurisdiction over Harkonnen Oil's dispute with IFIL. (R. at 14, ¶ 31.) The Holy Royal Court then recognized IFIL as a part of Sietch. (R. at 14, ¶ 32.) Arrakis recognized IFIL as a political subdivision within Arrakis, then, because Sietch is a province of Arrakis. (*See* R. at 8, ¶ 17.)

3. Even if IFIL is not a subdivision of Arrakis, IFIL is a valid taxing authority.

IFIL can stand on its own as a valid taxing authority because it meets the plain text definition of foreign country from the Foreign Tax Credit and because the United States recognizes IFIL's sovereignty. As established in Part II(A)(2), IFIL does not fall into any of the four narrow categories of excluded foreign countries listed in the statute. *See* 26 U.S.C. § 901(j) (2012). The President of the United States also acknowledged IFIL as a "sovereign friend" in Executive Order 14102. (R. at 14, ¶ 34.) Indeed, it is the Executive Branch that is empowered to recognize a foreign government. *United States v. Belmont*, 301 U.S. 324, 328-30 (1937). The lower courts cited no support for their refusal to recognize IFIL's authority as a foreign country (or even a political subdivision of a foreign country), but ample support exists for recognition.

B. The IFIL Tax is a valid tax.

Subsequent to the Holy Royal Court's declaration recognizing IFIL, Harkonnen Oil paid the IFIL tax. (R. at 14, ¶ 32-33.) Respondent asserts, however, that the Holy Royal Court of Arrakis, the highest court in Arrakis, (R. at 4, ¶ 4, n.6), wrongly interpreted the Arrakis Constitution. For the same reasons that denying IFIL's taxing authority contravenes the Act of State Doctrine, second–guessing the determination of the IFIL Tax's constitutionality is improper for the judiciary.

Respondent also asserts, incredibly, that Harkonnen Oil should have appealed the decision to the Sietch Council—the judiciary of an Arrakisian province, (R. at 8–9, ¶¶ 17–18). However, tax disputes within Arrakis are in the jurisdiction of the Holy Royal Court of Arrakis. (R. at 14, ¶ 31.) Similarly, there is no higher judicial authority to rule on issues of the Arrakis Constitution than the Holy Royal Court. (*See* R. at 4, ¶ 4, n. 6.) As Judge Layton from the Fourteenth Circuit pointed out, forcing a taxpayer to "seek relief from every possible competent court is not practical, cost efficient, or warranted." (R. at 21, ¶ 49.) (J. Layton, dissenting). As such, Harkonnen has exhausted all available remedies to challenge the validity of the IFIL tax. Without any viable means of avoiding tax liability, Harkonnen faces multiple taxation on its operations from Unit 12 as long as the United States refuses to honor the plain language meaning of the Foreign Tax Credit statute or the authority of a recognized sovereign authority to enforce its own laws.

<u>CONCLUSION</u>

Principles of fairness to businesses engaging in foreign trade and respect for the independence of sovereign states demand that the Arrakis Tax and IFIL Tax be creditable against Harkonnen Oil's U.S. income tax. Basic canons of statutory construction further support the taxes' creditability. For these reasons, Petitioner respectfully requests that this Court REVERSE the ruling of the Fourteenth Circuit.

Respectfully submitted,

<u>Team 82</u>
Attorneys for Petitioner

APPENDIX

FEDERAL STATUTORY PROVISIONS

Internal Revenue Code

26 U.S.C. § 901 (2012)

(a) Allowance of credit. If the taxpayer chooses to have the benefits of this subpart, the tax imposed by this chapter shall, subject to the limitation of section 904, be credited with the amounts provided in the applicable paragraph of subsection (b) plus, in the case of a corporation, the taxes deemed to have been paid under sections 902 and 960. Such choice for any taxable year may be made or changed at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by this chapter for such taxable year. The credit shall not be allowed against any tax treated as a tax not imposed by this chapter under section 26(b).

(b) Amount allowed. Subject to the limitation of section 904, the following amounts shall be allowed as the credit under subsection (a):

> **(1) Citizens and domestic corporations.** In the case of a citizen of the United States and of a domestic corporation, the amount of any income, 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;

. . .

(j) Denial of foreign tax credit, etc., with respect to certain foreign countries.

> **(1) In general.** Notwithstanding any other provision of this part—
>
> > **(A)** no credit shall be allowed under subsection (a) for any income, war profits, or excess profits taxes paid or accrued (or deemed paid under section 902 or 960) to any country if such taxes are with respect to income attributable to a period during which this subsection applies to such country, and
> >
> > **(B)** subsections (a), (b), and (c) of section 904 and sections 902 and 960 shall be applied separately with respect to income attributable to such a period from sources within

such country.

(2) Countries to which subsection applies.

(A) In general. This subsection shall apply to any foreign country—

(i) the government of which the United States does not recognize, unless such government is otherwise eligible to purchase defense articles or services under the Arms Export Control Act,

(ii) with respect to which the United States has severed diplomatic relations,

(iii) with respect to which the United States has not severed diplomatic relations but does not conduct such relations, or

(iv) which the Secretary of State has, pursuant to section 6(j) of the Export Administration Act of 1979, as amended, designated as a foreign country which repeatedly provides support for acts of international terrorisms.

(B) Period for which subsection applies. This subsection shall apply to any foreign country described in subparagraph (A) during the period—

(i) beginning on the later of—

(I) January 1, 1987, or

(II) 6 months after such country becomes a country described in subparagraph (A), and

(ii) ending on the date the Secretary of State certifies to the Secretary of the Treasury that such country is no longer described in subparagraph (A).

Internal Revenue Code

26 U.S.C. § 903 (2012)

For purposes of this part and of sections 164(a) and 275(a), the term "income, war profits, and excess profits taxes" shall include a tax paid in lieu of a tax on income, war profits, or excess profits otherwise generally imposed by any foreign country or by any possession of the United States.

Treasury Regulation to the Internal Revenue Code

26 C.F.R. § 1.901-2(a)(1), (3); (b); (b), ex. 4 (1983)

(a) Definition of income, war profits, or excess profits tax.

(1) In general. Section 901 allows a credit for the amount of income, war profits or excess profits tax (referred to as "income tax" for purposes of this section and §§1.901-2A and 1.903-1) paid to any foreign country. Whether a foreign levy is an income tax is determined independently for each separate foreign levy. A foreign levy is an income tax if and only if—

(i) It is a tax; and

(ii) The predominant character of that tax is that of an income tax in the U.S. sense.

Except to the extent otherwise provided in paragraphs (a)(3)(ii) and (c) of this section, a tax either is or is not an income tax, in its entirety, for all persons subject to the tax. Paragraphs (a), (b) and (c) of this section define an income tax for purposes of section 901. Paragraph (d) of this section contains rules describing what constitutes a separate foreign levy. Paragraph (e) of this section contains rules for determining the amount of tax paid by a person. Paragraph (f) of this section contains rules for determining by whom foreign tax is paid. Paragraph (g) of this section contains definitions of the terms "paid by," "foreign country," and "foreign levy." Paragraph (h) of this section states the effective date of this section.

. . .

(3) Predominant character. The predominant character of a foreign tax is that of an income tax in the U.S. sense—

(i) If, within the meaning of paragraph (b)(1) of this section, the foreign tax is likely to reach net gain in the normal circumstances in which it applies,

(ii) But only to the extent that liability for the tax is not dependent, within the meaning of paragraph (c) of this section, by its terms or otherwise, on the availability of a credit for the tax against income tax liability to another country.

(b) Net gain.

(1) In general. A foreign tax is likely to reach net gain in the normal circumstances in which it applies if and only if the tax, judged on the basis of its predominant character, satisfies each of the realization, gross receipts, and net income requirements set forth in paragraphs (b)(2), (b)(3) and (b)(4), respectively, of this section.

(2) Realization.

(i) In general. A foreign tax satisfies the realization requirement if, judged on the basis of its predominant character, it is imposed—

(A) Upon or subsequent to the occurrence of events ("realization events") that would result in the realization of income under the income tax provisions of the Internal Revenue Code;

(B) Upon the occurrence of an event prior to a realization event (a "prerealization event") provided the consequence of such event is the recapture (in whole or part) of a tax deduction, tax credit or other tax allowance previously accorded to the taxpayer; or

(C) Upon the occurrence of a prerealization event, other than one described in paragraph (b)(2)(i)(B) of this section, but only if the foreign country does not, upon the occurrence of a later event (other than a distribution or a deemed distribution of the income), impose tax ("second tax") with respect to the income on which tax is imposed by reason of such prerealization event (or, if it does impose a second tax, a credit or other comparable relief is available against the liability for such a second tax for tax paid on the occurrence of the prerealization event) and—

(1) The imposition of the tax upon such prerealization event is based on the difference in the values of property at the beginning and end of a period; or

(2) The prerealization event is the physical transfer, processing, or export of readily marketable property (as defined in paragraph (b)(2)(iii) of this section).

A foreign tax that, judged on the basis of its predominant character, is imposed upon the occurrence of events described in this paragraph (b)(2)(i) satisfies the realization requirement even if it is also imposed in some situations upon the occurrence of events not described in this paragraph (b)(2)(i). For example, a foreign tax that, judged on the basis of its predominant character, is imposed upon the occurrence of events described in this paragraph (b)(2)(i) satisfies the realization requirement even though the base of that tax also includes imputed rental income from a personal residence used by the owner and receipt of stock dividends of a type described in section 305(a) of the Internal Revenue Code. As provided in paragraph (a)(1) of this section, a tax either is or is not an income tax, in its entirety, for all persons subject to the tax; therefore, a foreign tax described in the immediately preceding sentence satisfies the realization requirement even though some persons subject to the tax will on some occasions not be subject to the tax except with respect to such imputed rental income and such stock dividends. However, a foreign tax based only or predominantly on such imputed rental income or only or predominantly on receipt of such stock dividends does not satisfy the realization requirement.

(3) Gross receipts.

(i) In general. A foreign tax satisfies the gross receipts requirement if, judged on the basis of its predominant character, it is imposed on the basis of—

(A) Gross receipts; or

(B) Gross receipts computed under a method that is likely to produce an amount that is not greater than fair market value.

A foreign tax that, judged on the basis of its predominant character, is imposed on the basis of amounts described in this paragraph (b)(3)(i) satisfies the gross receipts requirement even if it is also imposed on the basis of some amounts not described in this paragraph (b)(3)(i).

(4) Net income.

(i) In general. A foreign tax satisfies the net income requirement if, judged on the basis of its predominant character, the base of the tax is computed by reducing gross receipts (including gross receipts as computed under paragraph (b)(3)(i)(B) of this section) to permit—

(A) Recovery of the significant costs and expenses (including significant capital expenditures) attributable, under reasonable principles, to such gross receipts; or

(B) Recovery of such significant costs and expenses computed under a method that is likely to produce an amount that approximates, or is greater than, recovery of such significant costs and expenses.

A foreign tax law permits recovery of significant costs and expenses even if such costs and expenses are recovered at a different time than they would be if the Internal Revenue Code applied, unless the time of recovery is such that under the circumstances there is effectively a denial of such recovery. For example, unless the time of recovery is such that under the circumstances there is effectively a denial of such recovery, the net income requirement is satisfied where items deductible under the Internal Revenue Code are capitalized under the foreign tax system and recovered either on a recurring basis over time or upon the occurrence of some future event or where the recovery of items capitalized under the Internal Revenue Code occurs less rapidly under the foreign tax system. A foreign tax law that does not permit recovery of one or more significant costs or expenses, but that provides allowances that effectively compensate for nonrecovery of such significant costs or expenses, is considered to permit recovery of such costs or expenses. Principles used in the foreign tax law to attribute costs and expenses to gross receipts may be reasonable even if they differ from principles that apply under the Internal Revenue Code (e.g., principles that apply under section 265, 465 or 861(b) of the Internal Revenue Code). A foreign tax whose base, judged on the basis of its predominant character, is computed by reducing gross receipts by items described in paragraph (b)(4)(i)(A) or (B) of this section satisfies the net income requirement even if gross receipts are not reduced by some such items. A foreign tax whose base is gross receipts or gross income does not satisfy the net income requirement except in the rare situation where that tax is almost certain to reach some net gain in the normal circumstances in which it applies because costs and expenses will almost never be so high as to offset gross receipts or gross income, respectively, and the rate of the tax is such that after the tax is paid persons subject to the tax are almost certain to have net gain. Thus, a tax on the gross receipts or gross income of businesses can satisfy the net income requirement only if businesses subject to the tax are almost certain never to incur a loss (after payment of the tax). In determining whether a foreign tax satisfies the net income requirement, it is immaterial whether gross receipts are reduced, in the base of the tax, by another tax, provided that other tax satisfies the realization, gross receipts and net income requirements.

Example 4. Country X imposes a tax at the rate of 48 percent of the "taxable income" of nonresidents of country X who furnish specified types of services to customers who are residents of country X. "Taxable income" for purposes of the tax is defined as gross receipts received from residents of country X (regardless of whether the services to which the receipts relate are performed within or outside country X) less deductions that permit recovery of the significant costs and expenses (including significant capital expenditures) attributable under reasonable principles to such gross receipts. The country X tax satisfies the net income requirement.

Treasury Regulation to the Internal Revenue Code

26 C.F.R. § 1.901-2(g)(2) (1983)

The term "foreign country" means any foreign state, any possession of the United States, and any political subdivision of any foreign state or of any possession of the United States. The term "possession of the United States" includes Puerto Rico, the Virgin Islands, Guam, the Northern Mariana Islands and American Samoa.