NO. C15-1701-1

IN THE

SUPREME COURT OF THE UNITED STATES OF AMERICA

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 # 56
COUNSEL FOR PETITIONER

STATEMENT OF THE ISSUES

1. Whether the Republic of Arrakis Foreign Tax ("RAFT") formula sufficiently reached the Royal Harkonnen Oil Company's ("Harkonnen") net income when the tax allowed 95% of all deductions to offset the company's costs and expenses.

2. Whether the Inter-Sietch Fremen Independence League ("the League") properly levied taxes when the League was determined to be a part of Arrakis, and whether Harkonnen exhausted all effective and practical remedies when the Holy Royal Court made a final decision on Harkonnen's tax liability.

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

STATUTORY PROVISIONS

This case involves the application of I.R.C. § 901 (2012), which provides in pertinent part: "[T]he following amounts shall be allowed as the credit under subsection (a) . . . [i]n the case 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 . . . ." *See* Appendix A.

This case also involves the application of I.R.C. § 903 (2012), which provides that the terms "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 . . . ." *See* Appendix D.

STATEMENT OF JURISDICTION

This case is a petition from a judgment ordered by the United States Court of Appeals for the Fourteenth Circuit. R. at 19. The Supreme Court of the United States granted the petition for a writ of certiorari in the October 2014 Term. R. at 1. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1) (2012).

STATEMENT OF THE CASE

I. Factual Background

A. The Royal Harkonnen Oil Company ("Harkonnen")

Harkonnen is a U.S. based company, seeking to expand its foreign presence in the Republic of Arrakis ("Arrakis"). R. at 2. In March 2007, Harkonnen began conducting seismic and feasibility studies on the Caladan Oil Field ("Caladan Field") of Arrakis. R. at 2. Upon completion, Harkonnen concluded that the Caladan Field covered an area of 231,000 square miles and contained approximately 150B barrels of oil equivalents. R. at 3. Harkonnen was interested in the Caladan Field but not without reservations. R. at 3. Harkonnen reasoned that if Arrakis' demands outweighed the benefits from the use of the Caladan Field, then Harkonnen would abandon its potential activities in the Caladan Field. R. at 3. After several months of negotiations, Harkonnen and Arrakis signed a lease ("Arrakis Lease") granting Harkonnen exclusive rights to develop on the Caladan Field. R. at 7. The lease required Harkonnen to pay a one-time payment of $55M and an annual royalty of 15%. R. at 7.

In 2010, Harkonnen signed a lease with the Sietch State ("Sietch Lease"), granting the company rights to conduct its oil activities within the Sietch State. R. at 10. The lease required Harkonnen to pay a one-time payment of $5M and an annual royalty of 5%. R. at 10.

In 2011, Harkonnen signed a lease with the League ("League Lease"), granting the company rights to operate within the League's territory. R. at 13. The lease required Harkonnen to pay a one-time payment of $550k and an annual royalty of 5%. R. at 13. In addition, the League imposed a 2% tax on Harkonnen as a condition of carrying on its business. R. at 13. In 2011, Harkonnen paid all required taxes to Arrakis, the Sietch State, and the League. R. at 16. It then timely filed its tax forms in 2012, and claimed foreign tax credits against its taxes paid. R. at 16.

B. The Republic of Arrakis

Arrakis is a country built on two contrasting religions. R. at 4, 16 n.14. On one hand, there is the Arrakis Throne, and on the other, the Sietch Throne. R. at 3 n.4. The two thrones have existed since 439 A.D. R. at 16 n.14. They have frequently engaged in military conflicts, but in 1864, the two thrones engaged in a final war known as the "Bloody Ten Year War," which resulted in a victory for the Arrakis Throne. R. at 3 n.4. Following the resolution of the war, the Arrakis Throne claimed dominance over the entire land. R. at 3 n.4. Presently, President Jules Corrino ("President Corrino") is the sitting President of Arrakis. R. at 3. President Corrino holds his position for life. R. at 3.

Since the Bloody Ten Year War, the Sietch Throne continues to forge rebellions across the country. R. at 5-6, 8, 11. The first rebellion took place in April 2008, where the Sietch Throne began an uprising in the Sietch Dunes region ("Sietch Dunes") of Arrakis. R. at 5. The intent was to declare independence for the people residing in the Sietch Dunes. R. at 6. President Corrino dispatched the military to quell the rebellion. R. at 6. In May 2008, the rebellion was subdued and President Corrino withdrew the military. R. at 7.

The second rebellion took place in March 2010. R. at 8. This time, a group calling themselves the Independent People of Sietch ("IPS") declared independence for the region. President Corrino again mobilized the military to quell the rebellion. R. at 8. After less than one month of fighting, both sides suffered heavy casualties—the IPS more so than Arrakis. R. at 8. In response, the United States designated Arrakis as a "Dangerous State," which was later undesignated by the U.S. State Department. R. at 8, 10. In early April 2010, President Corrino, the IPS leader Paul Atreides ("Atreides"), the U.S. Ambassador, and Harkonnen met at the Arrakeen Peace Summit to resolve the military conflict. R. at 8. Ultimately, Arrakis and IPS reached a truce and executed the Sietch Dunes Peace Treaty ("Peace Treaty"). R. at 8.

The Peace Treaty contained a number of provisions: First, the Sietch Dunes would become an independent province of Arrakis—the Sietch State. R. at 8. Second, the Sietch State elects a vice president who would serve in President Corrino's cabinet. R. at 8-9. Third, the IPS becomes a political party of the Sietch State. R. at 9. Fourth, the Sietch State would send monetary tribute to Arrakis. R. at 9. Finally, the Sietch State vowed to *never seek independence again*. R. at 9 (emphasis added).

To give effect to the Peace Treaty, President Corrino amended the Arrakis Constitution to create a vice president position for the Sietch State. R. at 9. As a part of the amendment, the Vice President is tasked with upholding the provisions of the Peace Treaty. R. at 9. Among those provisions, the Vice President can create and enforce laws within the Sietch State such as police powers and collection tribute for Arrakis. R. at 9. The Vice President may also appoint ten individuals to form a Sietch Council (the "Council"). R. at 9. The Council conducted all judicial functions within the Sietch State. R. at 9. The Vice President could decree and levy a single tax but may only amend it with the approval of President Corrino. R. at 9. Lastly, President Corrino must accept all suggested policies of the Vice President before they become law. R. at 9. On April 2010, Atreides was elected as the Vice President of the Sietch State. R. at 9.

The third rebellion took place in December 2010. R. at 11. A group calling themselves the Inter-Sietch Fremen Independence League (the "League") launched a rebellion against Arrakis and the Sietch State. R. at 11. This rebellion was led by the League's leader, Jessica Mohiam ("Mohiam"). R. at 11. Mohiam was born into a terrorist organization known as the Bene Gesserit. R. at 11. At the age of eighteen, however, Mohiam rejected the organization as "an archaic organization with fundamentalist beliefs that have no place in a modern world." R. at 11. The League's purpose was to liberate and promote economic opportunities for all Sietchians within Arrakis. R. at 12. The League's political structure consisted of an annual election of a single Leader Elect. R. at 12. Mohiam has won unanimously each year since 2008. R. at 12.

In 2011, Al Dhanab, Anbus, France, and Russia all declared the League as a legitimate government. R. at 12-13. Shortly following this designation, the President of the United States issued Executive Order 14012, proclaiming that the League is "a sovereign friend of the United States, [with] whom we would like to establish trade relations []." R. at 14. Also, Arrakis' Holy Royal Court recognized the League as a part of Sietch. R. at 14.

1. Arrakis' Tax Structure

Arrakis' tax structure is largely based on religious norms. R. at 4. Historically, the Arrakis tax structure only applied to Arrakis citizens. R. at 4. Foreign citizens and entities were not liable for taxes. R. at 4. However, as an attempt to comport with modern tax law, President Corrino signed into law a new tax that established liability upon foreign entities operating within Arrakis. R. at 5. The tax, initially labeled as the Republic of Arrakis Foreign Value Tax ("RAFVT"), but was later renamed as the Republic of Arrakis Foreign Tax ("RAFT"). R. at 5, 7. The RAFVT was formulated as: gross receipts multiplied by the tax rate (T = GR x 0.45). R. at 5, 7. In contrast, the RAFT is formulated as: gross receipts less applicable deductions multiplied by the tax rate (T = (GR – D) x 0.33). R. at 5, 7, 15. The only limitation is that foreign entities are capped at 95% of applicable deductions. R. at 15.

2. The Sietch State's Tax Structure

Upon the amendment to the Arrakis Constitution, Vice President Atreides decreed and levied a tax for the Sietch State. R. at 9. The Sietch State's tax structure is nearly identical to the RAFT: total income less applicable deductions multiplied by the tax rate (T = (I – D) x 0.10). R. at 10. The only difference lies in the applicable deductions: a 100% deduction for the Sietch State versus the RAFT's 95% limitation.

3. The League's Tax Structure

The League's tax structure is just as simple as the RAFT and Sietch State's formulas: gross receipts less applicable deductions multiplied by the tax rate (T = (GR – D) x 0.02). R. at 13. The deductions allowed are identical to those of the Sietch State.

II. Procedural History

In 2012, the Commissioner of the Internal Revenue Service ("Commissioner" or "IRS") disallowed Harkonnen's foreign tax credit for taxes paid to Arrakis and the League. R. at 16-17. However, the IRS allowed a foreign tax credit for taxes paid to the Sietch State. R. at 17. Harkonnen then filed for a refund of foreign tax credits in the United States District Court for the Central District of New Tejas, and the court ruled in favor of the IRS. R. at 17.

On appeal, the Fourteenth Circuit affirmed the district court's decision. R. at 19. The circuit court held that the RAFT did not sufficiently reach net income, failing the predominant character test set out in the Treasury Regulations ("Regulations"). The circuit court found that the RAFT did not afford a recovery of significant costs and expenses. R. at 17. The circuit court further held that the League was not a legitimate taxing authority, dismissing the effect of the Executive

Order 14012 and a ruling from the Holy Royal Court. R. at 18. The circuit court labeled the League as a subservient entity within the Sietch State to which the provisions of the Peace Treaty applied. R. at 18. As such, the League's tax is a "second" tax that violated the Peace Treaty. R. at 18. Additionally, the circuit court reasoned that Harkonnen's failure to petition the Council on matters regarding taxes failed the exhaustion of remedies requirement. R. at 18.

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

SUMMARY OF THE ARGUMENT

This Court should reverse the decision of the Fourteenth Circuit concerning the RAFT because in substance, the formula adequately and sufficiently reaches net income despite the 95% limitation. This Court should also reverse the Fourteenth Circuit's decision concerning the League's authority to exact taxes because the League is a legitimate government of Arrakis. Moreover, Harkonnen exhausted all effective and practical remedies when it sought a decision from the Holy Royal Court.

The first issue involves whether the RAFT qualifies as a foreign tax credit. The Commissioner contends that the RAFT does not satisfy the tests under I.R.C. §§ 901, 903 (2012), and therefore, does not qualify as a foreign tax credit.

To qualify as a foreign tax credit, the foreign levy must be (1) a tax and (2) satisfy the predominant character test when interpreted in the U.S. sense. The RAFT is a tax because the Arrakis Constitution authorizes it and is enforced by the President of Arrakis. Additionally, the RAFT satisfies the predominant character test, which contains three elements: (1) that the RAFT is imposed prior to, upon, or subsequent to a realization event; (2) that the RAFT is based on gross receipts; and (3) that the RAFT reaches net income by allowing sufficient deductions against a company's costs and expenses. The RAFT satisfies all three elements.

First, the RAFT is imposed upon or subsequent to a realization event because Arrakis withheld taxes that applied to Harkonnen's gross receipts. Gross receipts occur when Harkonnen exchanges its barrels of oil on the market. Second, the

RAFT is on the based tax liability of gross receipts. Third, the RAFT is formulated in such a way that foreign entities are allowed 95% of recovery for costs and expenses. The 5% of non-recoverable costs and expenses had little to no effect on the calculation of net income. The 95% limitation, when compared to a maximum of 100%, has a potential effect of less than 1% on actual non-recoverable costs and expenses. Moreover, the Regulations require a foreign levy to allow for the recovery of *significant* costs and expenses. The 5% difference is insignificant in the recovery calculation. Therefore, the RAFT, in substance, satisfies the predominant character test and qualifies as a valid foreign tax credit.

Alternatively, the RAFT qualifies as a foreign tax credit under I.R.C. § 903 (2012) because the RAFT is also a tax in lieu of a generally imposed tax. Under the Arrakis tax structure, domestic citizens and entities are taxed and afforded full deductions. Conversely, the RAFT applies only to foreign entities operating in Arrakis. The RAFT also applies equally to all foreign taxpayers, and therefore, was a tax in lieu of a generally imposed tax.

The second issue involves whether the League is a proper taxing authority, and whether Harkonnen exhausted all effective and practical remedies by petitioning the Holy Royal Court on the League's tax.

First, the League is a sovereign entity with the authority to exact taxes because governmental bodies within Arrakis, other countries, and the President of the United States recognize it as a legitimate government. Importantly, Executive Order 14012 compels executive agencies to recognize the League as a "sovereign friend of the United States" and to establish trade relations with the League. Therefore, the League is a proper taxing authority to which foreign tax credits should be granted.

Finally, Harkonnen exhausted all effective and practical remedies when it petitioned the Holy Royal Court for a resolution on its protest on the League's tax. Courts do not strictly construe an exhaustion of all effective and practical remedies. The Holy Royal Court's final decision on Harkonnen's tax dispute with the League terminated any further avenues of relief.

Therefore, this Court should reverse the holding of the Fourteenth Circuit.

ARGUMENT

In 1918, Congress, having realized the evil of double taxation, enacted legislation to allow foreign tax credits for domestic companies operating abroad. Revenue Act of 1918, ch. 18, 40 Stat. 1057; *see also United States v. Goodyear Tire & Rubber Co.*, 493 U.S. 132, 139 (1989); *Am. Chicle Co. v. United States*, 316 U.S. 450, 451 (1942). A secondary purpose was to stimulate foreign trade. *Inland Steel Co. v. United States*, 677 F.2d 72, 80 (Ct. Cl. 1982). As such, Royal Harkonnen Oil Company ("Harkonnen") and other similarly situated companies have engaged in foreign commerce within foreign countries. However, the Commissioner of the Internal Revenue Service (the "Commissioner" or "IRS") denied Harkonnen's credit for taxes paid to the Republic of Arrakis ("Arrakis") and the Inter-Sietch Fremen Independence League (the "League"), but notably granted a foreign tax credit for taxes paid to the Sietch State.

The issues before this Court are (1) whether the RAFT, as designed, sufficiently reaches the net gain of foreign entities operating machinery in its territory,[1] and (2) whether Harkonnen properly paid taxes to the League and exhausted all effective and practical remedies when it sought a final resolution from the highest court of Arrakis. This Court should find that the RAFT formula necessarily reaches net income, and thus qualifies as a foreign tax credit under either I.R.C §§ 901 or 903. Likewise, this Court should also hold that the League is

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[1] Other issues such as credit limitations, I.R.C. § 904 (2012), or specials rules concerning foreign oil and gas income, § 907, will not be discussed because they are outside the scope of the issues on appeal.

a proper taxing authority because Arrakis' highest court and neighboring countries have recognized the League's legitimacy as a governmental body of Arrakis.

I. The RAFT qualifies as a foreign tax credit under § 901 when it is formulated, in substance, to be compulsory and its effect sufficiently reaches net gain.

While the tax structures between the Sietch State and Arrakis are identical, but for the nominal difference in allowed deductions, the Commissioner remarkably granted a foreign tax credit for the Sietch State taxes but denied those from Arrakis, claiming that such taxes failed to sufficiently reach net income. The Commissioner's conflicting position failed to correctly apply the Regulations. Therefore, this Court should hold that the RAFT reaches net gain and qualifies as a valid foreign tax credit.

A. The dual capacity taxpayer status is inapplicable where the RAFT is generally imposed on all foreign entities regardless of the foreign entities' business operations in Arrakis.

In analyzing whether a tax qualifies as a foreign tax credit, the initial inquiry is whether the taxpayer has a dual capacity status. In other words, did the taxpayer receive a specific economic benefit for paying the tax? Dual capacity taxpayer status does not apply because the RAFT is generally applied to all foreign entities, regardless of the type of activities the foreign entity conducts in Arrakis.

The Regulations state that a foreign levy is not considered an income tax when the "person subject to the levy receives . . . , directly or indirectly, a specific economic benefit . . . from the foreign country in exchange for payment pursuant to the levy." Treas. Reg. § 1.901-2(a)(2)(i) (2013). A specific economic benefit is, *inter alia*, a "right to use, acquire or extract resources . . . ." § 1.901-2(a)(2)(ii)(B).

However, if a levy applies to both dual capacity taxpayers and other taxpayers equally, then such levy is not considered paid in exchange for a specific economic benefit. § 1.901-2A(a)(1) (1983). Accordingly, the analysis of whether the RAFT is a qualified foreign tax credit should proceed under § 1.901-2(a)(1).

Example 2 of § 1.901-2A(a)(2) precisely explains the inapplicability of dual capacity taxpayer status to Harkonnen. Example 2 states that, in short, if country X levies an income tax of 40% for all corporations doing business in country X, and such corporations are allowed recovery of costs and expenses except for corporations engaged in the exploitation of minerals, then the mineral corporations are dual capacity taxpayers. § 1.901-2A(a)(2), Ex. 2; *see also* Appendix C. Example 2 further elaborates that where the mineral corporations and *all other* corporations are subject to the same income tax of 40% less applicable allowances and deductions, then the mineral corporations are not dual capacity taxpayers. *Id.*

Here, Arrakis has imposed a general income tax on *all* of its citizens and entities. Realizing that companies outside its borders were consuming the country's resources without bearing any tax liability, President Corrino enacted the RAFT. As drafted, the RAFT "applied to all foreign entities that operate machinery on sovereign territory of Arrakis." R. at 5. Whether a corporation engages in oil exploration or space exploration in Arrakis, all such companies are required to pay a tax of 33% on its gross receipts less applicable deductions. The fact that the RAFT is generally imposed exactly mirrors Example 2 of the Regulations.

Therefore, dual capacity taxpayer status analysis is inapplicable to foreign entities such as Harkonnen.

B. The Arrakis Constitution empowers the Arrakis Central Bank a confiscatory withholding of all foreign entities' gross receipts, and deducting applicable taxes before returning the net gain to such foreign entities.

The government of Arrakis operates under the authority of the Arrakis Constitution. The Arrakis Constitution grants its president the power to enact one new tax each year. Under such a structure, foreign entities are to turn over all gross receipts to the Central Bank, which in turn deducts applicable taxes from those gross receipts before disbursing the remainder back to the foreign entities. Foreign entities may petition the Holy Royal Court on all matters regarding tax disputes. The tax system of Arrakis, therefore, compels tax liability on foreign entities such as Harkonnen.

A foreign income tax is qualified for credit if it is (1) a tax[2] and (2) predominantly characteristic of a tax in the U.S. sense.[3] Treas. Reg. § 1.901-2(a)(1) (2013). The Regulations define a tax as a "compulsory payment pursuant to the authority of a foreign country." *Proctor & Gamble Co. v. United States*, No. 1:08-cv-00608, 2010 WL 2925099, at *5 (S.D. Ohio, July 6, 2010); *see also* § 1.901-2(a)(2). Compulsory payments do not include penalties, fines, interest, custom duties, or

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[2] A fair reading of the record reveals that the Commissioner does not contend that the Arrakis tax fails this element. For purposes of completeness, however, this Brief will discuss how this element is satisfied and favors Harkonnen.

[3] According to the record, the Commissioner contends, and the district court and Fourteenth Circuit affirmed, that the RAFT failed to reach net income, which is the third element of the predominant character test. R. at 16-17. This brief, however, will also discuss how the RAFT also satisfied the realization and gross receipts elements of the test because it is not clear whether the Commissioner contested those elements.

similar obligations. *IBM v. United States*, 38 Fed. Cl. 661, 668 (1997); *see also* § 1.901-2(a)(2). A payment is compulsory even when the taxpaying entity is tax-immune but overruled by authority of the foreign government. *See generally Riggs Nat'l Corp. & Subsidiaries v. Comm'r*, 163 F.3d 1363 (D.C. Cir. 1999) (holding that Brazil's tax was compulsory upon its own central bank when the bank assumed responsibilities from third party borrowers); *Amoco Corp. v. Comm'r*, 138 F.3d 1139 (7th Cir. 1998) (holding that the Egyptian General Petroleum Corporation, an entity of the Egyptian government, was liable for taxes). A tax is compulsory when a nation exacts it by way of its sovereign powers. *Phillips Petroleum Co. v. Comm'r*, 104 T.C. 256, 295 (1995). Essentially, "[i]t is a required contribution to the governmental revenue without [an] option to pay." *Id.* (citing *Cox v. Comm'r*, 41 T.C. 161, 164 (1963)).

In *Riggs*, the Brazilian government-controlled Central Bank ("CB") subsumed the position of the country's debtors that owed to foreign lenders. *Riggs*, 163 F.3d at 1365. The CB, by authority of the Brazilian Constitution, was a tax-immune entity of Brazil. *Id.* at 1366. However, because of the way the Brazilian system was set up, the "Minister of Finance—the highest ranking Brazilian authority on tax matters—obliged them" to taxes, negating the CB's tax immunity. *Id.* ("The ruling concluded that the [CB]—notwithstanding its tax-immune status—was required under Brazilian law to pay the tax obligation assumed from lenders . . . ."). The taxpayer claimed that tax payments made on its behalf by the CB were compulsory, and thus qualified it for foreign tax credits. *Id.* The circuit court agreed and relied on the act-of-state doctrine to substantiate its holding. *Id.* at 1367. In short, the act-of-state doctrine "directs United States courts to refrain from deciding a case when the outcome turns upon the legality or illegality of official action by a foreign sovereign performed within its own territory." *Id.* (citing *W.S. Kirkpatrick & Co. v. Envtl. Tectonics Corp.*, 493 U.S. 400, 406 (1990)). Because the Minister of Finance's ruling was legally binding under Brazil's laws, the tax was compulsory upon the CB and not voluntary until otherwise challenged and invalidated. *Riggs*,163 F.3d at 1368.

Here, the taxes paid to Arrakis were compulsory. First, the Arrakis Constitution allows the President of Arrakis to enact one new tax every year. The President also has the power to enforce the laws of Arrakis. The Holy Royal Court, which is the judicial branch of Arrakis, possesses exclusive jurisdiction over all tax matters within Arrakis. Like *Riggs*, President Corrino, by way of the Arrakis Constitution, is the highest ranking authority allowed to enact taxes, and his passage of the RAFT mandates that all foreign citizens and entities operating within Arrakis submit tax payments accordingly. This enactment was an "official action by a foreign sovereign performed within its own territory." *Riggs*, 163 F.3d at 1367. The only other body with authority over tax matters is the Holy Royal Court, which did not issue any decisions contrary to President Corrino's enactment.

Moreover, the RAFT compelled all foreign citizens and entities that were profiting within its borders to submit all gross receipts to the Central Bank where the Central Bank withheld applicable taxes. Under this system, Harkonnen had no option but to submit to the RAFT as a compulsory tax. Thus, the RAFT is a compulsory tax exacted by the sovereign powers of Arrakis.

C. Under the Regulations, the RAFT satisfies all three parts of the predominant character test.

In addition to proving that the RAFT is a tax, Harkonnen must also satisfy the three-part test of the Regulations known as the "predominant character" test. Treas. Reg. § 1.901-2(a)(1)(ii) (2013). "The predominant character of a foreign tax is that of an income tax in the U.S. sense if . . . the foreign tax is likely to reach net gain in the normal circumstances in which it applies." *Entergy Corp. & Affiliated Subsidiaries v. Comm'r*, 683 F.3d 233, 234 (5th Cir. 2012); *see also* § 1.901-2(a)(3)(i). When analyzing a foreign levy, courts should look to the *substance* of the tax and not strictly construe it according to form. *PPL Corp. v. Comm'r*, 133 S. Ct. 1897, 1899-900 (2013) (holding that when analyzing the predominant character test, courts should use the "commonsense approach that considers the substantive effect of the tax"); *Entergy Corp.*, 683 F.3d at 236 ("The label and form of [a] foreign tax is not determinative.") (citing *Inland Steel*, 677 F.2d at 80)). "[T]he black-letter principle [is] that tax law deals in economic realities, not legal abstractions." *PPL Corp.*, 133 S. Ct. at 1905; *see also Biddle v. Comm'r*, 302 U.S. 573, 579 (1938). Net gain is determined by (1) a realization event, (2) gross receipts, and (3) net income. § 1.901-2(b)(1).

1. The RAFT is designed to impose tax liability upon or subsequent to the realization of gross receipts.

"A foreign tax satisfies the realization requirement if, judged on the basis of its predominant character, it is imposed upon or subsequent to the occurrence of events that would result in the realization of income." Treas. Reg. § 1.901-2(b)(2)(i)(A)-(C) (2013). Under U.S. laws, realization occurs when there is an exchange of property for value. *See* Treas. Reg. § 1.1001-1(a) (2007) ("[T]he gain or loss realized from the conversion of property into cash, or from the exchange of property for other property differing materially either in kind or in extent, is treated as income or as loss sustained."); Bittker & Lokken, *Federal Taxation of Income, Estates & Gifts* ¶ 72.4.3 (2011) (a realization event generally occurs "when property is sold or exchange"); *Comm'r v. Glenshaw Glass Co.*, 348 U.S. 426, 430-31 (1955). The realization of gain does not have to be cash from a sale of an asset but can "occur as a result of exchange of property, payment of the taxpayer's indebtedness, relief from a liability, or other profit realized from the completion of a transaction." *Helvering v. Bruun*, 309 U.S. 461, 469 (1940). Additionally, the discovery of something of value from, for example, a treasure trove satisfies the realization event. *See Cesarini v. United States*, 428 F.2d 812, 813 (6th Cir. 1970).

Under the Regulations, a foreign levy satisfies the realization requirement when it is imposed prior to,[4] upon, or subsequent to the realization event. § 1.901-2(b)(2)(i)(A)-(C). In other words, realization occurs when a taxpayer sells oil in the

[4] The "prior to" provision is known as the "prerealization event," which is inapplicable to the present case because the RAFT does not tax income before a foreign entity realizes income. Therefore, this provision will not be discussed.

market and obtains cash in return. Consider, for example, that a foreign levy imposed taxes on the gross receipts of oil production for companies engaged in such activities. Under these circumstances, the tax would be considered a tax imposed "upon or subsequent to" a realization event of gross receipts. That is, the company has realized gains or losses at the point of exchange.

Here, the Arrakis tax was based on gross receipts. The gross receipts occurred only when Harkonnen produced and sold its barrels of oil. At the moment Harkonnen produced its barrels of oil, it has obtained potential value. Once that potential value is exchanged for actual monetary value, realization is satisfied. As such, Harkonnen incurred tax liability when it exchanged its barrels of oil on the market. The RAFT was designed precisely to impose tax liability at that point of exchange. Thus, the RAFT was imposed "upon or subsequent to" a realization event, and satisfies this requirement.

2. The RAFT bases liability upon a foreign entity's gross receipts.

To satisfy the gross receipts requirement, a foreign levy must be based on either (1) gross receipts, or (2) gross receipts computed under a method that is likely to produce an amount that is not greater than fair market value. Treas. Reg. § 1.901-2(b)(3)(i) (2013). The RAFT calculates tax liability as: gross receipts less applicable deductions multiplied by the tax percentage (T = (GR – D) x 0.33). Because the RAFT was based strictly on gross receipts, it has satisfied this requirement.

3. President Corrino's Proclamation 102 allows all foreign entities to recover a significant portion of costs and expenses.

While Arrakis initially founded its tax structure upon religious tenets, President Corrino enacted and revised the RAFT to comport with international standards. President Corrino issued Proclamation 102 to allow for the recovery of costs and expenses. Without Proclamation 102, the RAFT would surely fail to meet the requirements of net income for foreign tax credit purposes. However, where a foreign levy allows some measurable recovery of costs and expenses, it would satisfy the net income requirement and qualify as a foreign tax credit.

"A foreign tax satisfies the net income requirement if, judged on the basis of its predominant character, the base of the tax is computed by reducing gross receipts . . . to permit" either recovery of significant costs and expenses or "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." Treas. Reg. § 1.901-2(b)(4)(i)(A)-(B) (2013); *see also Exxon Corp. v. Comm'r*, 113 T.C. 338, 351-52 (1999). A foreign levy is creditable if it is substantially equivalent to income taxes in the U.S. sense. *See Comm'r v. Am. Metal Co.*, 221 F.2d 134, 136 (2d Cir. 1955). Foreign levies are income taxes when it is "designed to effectively reach some net gain or profit." *Bank of Am. Nat'l Trust & Savs. Ass'n v. United States*, 459 F.2d 513, 517-19 (Ct. Cl. 1972). When determining the method by which income taxes are computed, a foreign method need not strictly conform to the U.S. method. *See Santa Eulalia Mining Co. v. Comm'r*, 2 T.C. 241, 245 (1943). The analysis of non-recoverable costs and expenses can turn to either an aggregate or a return-by-return consideration. *See Texasgulf, Inc. & Subsidiaries v. Comm'r*, 172 F.3d 209, 215 (2d Cir. 1999).

In *Texasgulf*, the taxpayer corporation undertook mining operations in Canada. *Id.* at 210-11. Canada had imposed a tax called the Ontario Mining Tax ("Ontario Tax"), which applied to mining operations in various provinces of Canada. *Id.* at 211-12. A company subject to the Ontario Tax became liable for taxes when its production exceeded an allowable statutory amount. *Id.* at 211. The Ontario Tax further allowed certain recovery of costs and expenses, known as processing allowances. *Id.* at 212. For ten of the thirteen years, Texasgulf was subject to the Ontario Tax because its allowances exceeded its non-recoverable expenses. *Id.* at 213. The IRS disqualified claims for foreign tax credits for those three years because, it argued, the Ontario Tax failed to sufficiently reach net gain for those three years. *Id.* at 210. The Second Circuit rejected that argument and held that the Ontario Tax did sufficiently reach net gain. *Id.* at 217. In reaching its decision, the Second Circuit analyzed the language of the Regulations. Specifically, the court looked at the words "effectively compensate" and "approximates, or is greater than" to conclude that even though non-recoverable expenses did exceed allowances at times, overall, the allowances sufficiently compensated for expenses as required by the Regulations. *Id.* at 215-16.

Similarly, *Exxon* involved a United Kingdom Petroleum Revenue Tax ("Petroleum Tax") imposed upon oil companies engaged in oil exploration, production, refining, and sale. *Exxon Corp.*, 113 T.C. at 338. Under the Petroleum

Tax, interest income was nondeductible, but allowances for uplift could exceed the nondeductible interest. *Id.* at 347. In the aggregate, the uplift allowances totaled $12.4B pounds as opposed to the nondeductible interest expenses of $8.6B pounds. *Id.* at 347-48. According to the court's appendix, the nondeductible interest expense exceeded the uplift allowances in years 1977 and 1979. *Id.* at 361.

The tax court ruled that the Petroleum Tax satisfied the net income requirement because the uplift allowances, in the aggregate, "significantly exceeded" the disallowed interest expenses. *Id.* at 357. The court further claimed that even if a company-by-company analysis were to be used, Exxon would still satisfy the net income requirement because the company was one out of five that paid approximately 75% of the total Petroleum Tax. *Id.* at 359.

Under the present facts, the RAFT satisfied the net income requirement because Proclamation 102 allowed all foreign companies to take deductions from their gross receipts. While the empirical numbers are limited in the record, it could be presumed that the allowed deductions effectively and approximately compensated for costs and expenses incurred by Harkonnen. Assume, for example, the two sets of hypotheticals below. The first set juxtaposes an instance where the RAFT allowed for 100% of deductions compared to a 95% limitation:

The RAFT at **100%** Allowable Deductions	
Gross receipts	$50M
Costs & Expenses	**$10M**
Tax =	($50M-$10M)*(0.33)
	$13.2M

The RAFT at **95%** Allowable Deductions	
Gross receipts	$50M
Costs & Expenses	$10M-$0.50M = **$9.5M**
Tax =	($50M-$9.5M)*(0.33)
	$13.365M

The practical effect of the 95% limitation is a difference of approximately $165k ($13.365M - $13.2M), which when compared to the gross receipts, is nominal. However, in the case where Harkonnen does not incur $10M of costs and expenses but instead has $1M of costs and expenses, then the difference becomes inconsequential when compared to the company's gross receipts:

The RAFT at **100%** Allowable Deductions	
Gross receipts	$50M
Costs & Expenses	**$1M**
Tax =	($50M-$1M)*(0.33)
	$16.17M

The RAFT at **95%** Allowable Deductions	
Gross receipts	$50M
Costs & Expenses	$1M-$0.05M = **$0.95M**
Tax =	($50M-$0.95M)*(0.33)
	$16.18M

The effect of the 95% limitation in the second set is approximately $10k ($16.18M - $16.17M), an amount so insignificant that it has no real impact on the calculation of net income. *Cf. Texasgulf*, 172 F.3d at 214 (finding that non-recoverable expenses were at least 1% compared to gross receipts but satisfied the net income requirement nonetheless). Under the first set of the hypotheticals where Harkonnen incurred $10M of costs and expenses, the non-recoverable expenses difference was less than 0.33%. The second set of hypotheticals where Harkonnen incurred $1M of costs and expenses, the non-recoverable expenses difference was 0.02%.[5] Having assumed these figures, the RAFT is designed in such a way that the 95% limitation on allowable deductions has no real impact on calculating net income. The operative words in the Regulations include "*approximates*, or is greater than." § 1.901-2(b)(4)(i)(B) (emphasis added). For the 95% limitation on deductions to have an effect on net income, Harkonnen's costs and expenses would have to be so astronomically high that no real company could continue to operate from year to year.

Moreover, the Regulations demand a recovery of "significant" costs and expenses. § 1.901-2(b)(4)(i)(A)-(B). The 95% limitation on deductions realistically reduces costs and expenses to the point of being so "insignificant" that when compared to the amount of gross receipts, net income is almost always reached. Accordingly, the deduction *approximately* allows for the recovery of costs and expenses that, when computed, the limitation has no measurable impact on the determination of net income. Therefore, this Court should find that the RAFT satisfies all three parts of the predominant character test and qualifies as a foreign tax credit.

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[5] The figures were presented to illustrate the fact that net income is almost always reached under the Arrakis tax structure. In reality, companies like Harkonnen produce gross receipts well above the hypothetical numbers so as to make the disparity between gross receipts and costs and expenses greater than those in the hypotheticals.

D. Alternatively, the RAFT's structure qualifies as a tax in lieu of a generally imposed domestic tax.

A foreign levy that fails to qualify as a foreign tax credit under I.R.C. § 901 (2012) can qualify as a foreign tax credit under § 903 if it is (1) a tax[6] (2) paid in lieu of a generally imposed tax. § 903. To satisfy this section, the Regulations instruct that the tax is a tax within the meaning of Treasury Regulations § 1.901-2(a)(2) (2013), and that it meets the substitution requirement. § 1.903-1(a) (1983). Moreover, a foreign levy would fail this section if it was dependent upon the availability of a tax credit against the income tax liability of another country—"soak-up taxes." § 1.903-1(b)(2).

An example where a foreign levy satisfies the substitution requirement is as follows:

> Country X has a tax on realized net income that is generally imposed except that nonresidents are not subject to that tax. Nonresidents are subject to a gross income tax on income from country X that is not attributable to a trade or business carried on in country X. The gross income tax imposed on nonresidents satisfies the substitution requirement set forth in this paragraph (b).

§ 1.903-1(b)(3), Ex. 1. This example nearly mirrors the present case. Arrakis has two types of levies. The first Arrakis tax is generally imposes a tax upon its citizens. R. at 4. It was not until 2008 that President Corrino enacted a second tax: the RAFT. The RAFT applied only to foreign entities operating machinery within Arrakis' borders—a class entirely separate from Arrakis citizens. Moreover, foreign

[6] The analysis of whether the RAFT is a tax under § 903 is identical to the analysis under § 901. Please refer to section I.B of the brief for an analysis of whether the RAFT is a valid tax.

entities are not subject to the generally imposed Arrakis tax. As such, the RAFT qualifies as a foreign tax credit under both §§ 901 and 903.

II. The laws of Arrakis recognize the sovereignty of the League, which in turn may exact taxes upon citizens and entities within its territory.

The validity of a foreign tax credit requires that the foreign entity to which taxes are paid possesses the proper authority to impose taxes in the first place. While certain provisions of the foreign tax credit continue to change, one provision has remained consistent since 1932: foreign countries or their political subdivisions may exact taxes that are creditable when done so in accordance with their sovereign powers.

The governmental structure of Arrakis is as follows: the country of Arrakis is the overall governing body; the Sietch State is a political subdivision that gained its independence in 2010; the League is a second political subdivision that gained its independence in 2011. As a result, each individual body possesses sovereign powers—including taxing powers—to govern individuals within its borders.

The issues here are whether the League's imposition of a 2% tax was creditable when executed pursuant to its sovereign authority, and whether Harkonnen exhausted all effective and practical remedies when it sought a final resolution from the Holy Royal Court. Because the League obtained independence, which the Holy Royal Court affirmed, and was legitimately recognized by various countries, this Court should hold that the League is a proper taxing authority. Likewise, this Court should also hold that Harkonnen exhausted all effective and practical remedies when it sought a tax decision from the Holy Royal Court.

A. The Holy Royal Court, neighboring countries, and the United States per Executive Order 14012 have recognized the League as a sovereign entity capable of levying taxes.

The issue here is whether the League's tax failed as a compulsory tax because it was not imposed pursuant to the authority of a legitimate foreign country.[7] The League is an independent political subdivision within Arrakis, and thus, is a proper taxing authority.

A tax is compulsory if levied pursuant to a foreign country's proper taxing authority. Treas. Reg. § 1.901-2(a)(2)(i) (2013). "Foreign country" is defined as "any foreign state, . . . and any political subdivision of any foreign state . . . ." § 1.901-2(g)(2); *see also Procter & Gamble Co.*, 2010 WL 2925099, at *9 (holding that the municipality of South Korea was a political subdivision). Foreign country, state, or political subdivision is "used in the sense of government." *Burnet v. Chi. Portrait Co.*, 285 U.S. 1, 7 (1932) ("The word 'country' is manifestly used in the sense of government."). A foreign government may be viewed on the larger scale—an "international person with the rights and responsibilities under international law of a member of the family of nations"—or a smaller scale—"authority over a particular area or subject-matter." *Id.* at 5; *see also* Internal Rev. Serv., *Publication 514, Foreign Tax Credit for Individuals* 6 (Jan. 14, 2014), *available at* http://www.irs.gov/pub/irs-pdf/p514.pdf ("A foreign country includes . . . a foreign

[7] A foreign tax credit is satisfied if it is (1) a tax and (2) predominantly characteristic of a tax in the U.S. sense. The issues of whether a foreign country is a valid taxing authority and whether the taxpayer exhausted all practical remedies are all contained under the first part of the foreign tax credit analysis. The IRS and lower courts only focused on the first part of the foreign tax credit analysis. Therefore, the predominant character analysis will not be discussed.

city or province.”). A foreign country’s authority to exact a levy turns on whether that government is competent to lay a tax. *Chi. Portrait Co.*. 285 U.S. at 10.

However, even if a government falls within the definition of “foreign country,” it can still be disqualified as a foreign tax credit due to a non-recognition of or severed relations with the United States. I.R.C. § 901(j)(2) (2012). Taxpayers operating in “blacklisted” countries may nonetheless obtain a foreign tax credit if that foreign country has received a United States Presidential waiver in accordance with § 901(j)(5). The President, prior to issuing such a waiver, must report to Congress. § 901(j)(5)(B). The President of the United States grants such waivers when he or she determines that it is in the “national interest of the United States and will expand trade and investment opportunities for U.S. companies in such country.” Rev. Rul. 2005-3, 2005-1 C.B. 334. In contrast, the President may issue executive orders, directing agencies of the executive branch to perform certain actions. *See United States v. Borja*, 191 F. Supp. 563, 566-67 (D. Guam. 1961). Executive orders have the force and effect of law. *See Harris v. United States*, 19 F.3d 1090, 1093 (5th Cir. 1994). Additionally, the Commissioner is an arm of the executive branch, and must comply with executive orders issued by the President. *See* I.R.C. § 7803(a)(1)(D) (2012) (“The Commissioner may be removed at the will of the President.”).

In *Chicago Portrait*, the issue revolved around whether, for purposes of a foreign tax credit, the term “foreign country” was strictly construed to include only the larger political body of government. *Chi. Portrait Co.*, 285 U.S. at 4. The

Chicago Portrait Company ("CPC") owned a majority of stock in a foreign corporation. *Id.* As a result of its stock ownership, the CPC received dividends from the foreign corporation. *Id.* The foreign corporation paid taxes on the dividends and the CPC sought credit on those taxes. *Id.* The Commissioner allowed tax credits for the Commonwealth of Australia and the Dominion of New Zealand (countries in the continent), but denied credits for the State of New South Wales (a state of the Commonwealth of Australia). *Id.*

In determining whether New South Wales was a "foreign country" for purposes of a foreign tax credit, the Court analyzed the purpose of the foreign tax credit legislation. *Id.* at 7. The Court found that the legislative purpose was to "give greater not less relief." *Id.* at 15. It reasoned that a "foreign country" was an expansive term and included smaller units of a centralized government. *See id.* at 9-10. The Court stated that the "controlling consideration" was the competency of the government to lay taxes, irrespective of its international standing. *Id.* at 10-11, 17 (stating that "it was enough that [New South Wales] had authority to require payment as a condition to carrying on business") (internal quotations omitted). Because New South Wales was a political subdivision of the Commonwealth of Australia, and the levy imposed was within its authority, the Court concluded that New South Wales fell within the definition of "foreign country." *Id.* at 21.

In the present case, the League is a political subdivision of Arrakis. First, the League has been functioning as an independent political regime since 2008. The League's political structure involves an annual vote for a Leader Elect. There are seven electoral votes cast by three parties: the Al Dhanab family, the Anbus family, and individuals pledging membership to the League. Subsequent to the Sietch State's independence, the League launched its own independence campaign within Arrakis. In 2011, the League obtained control of an area within the Sietch Dunes known as the Badlands—setting it apart from the Sietch State. Second, Al Dhanab, Anbus, France, and Russia all recognized the legitimacy of the League's independence. Third, when Harkonnen petitioned the Holy Royal Court for a determination of the League's legitimacy and authority to tax, the Holy Royal Court held that "Arrakis recognizes [the League] as a part of Sietch." R. at 14. Fourth, both Arrakis and the Sietch State implicitly recognized the League's independence by agreeing to establish a permanent location for the League's headquarters. Lastly and most importantly, the President of the United States issued Executive Order 14012, directing that the League is a friend of the United States and that the United States would like to establish trade relations with the League.

It is important to consider Executive Order 14012. Pursuant to the powers vested in the President of the United States, he issued the Order to recognize the sovereignty of the League. The Commissioner cannot reject Executive Order 14012 as it is issued with the force of law, and because the Commissioner is an agency of the executive branch, the Commissioner must comply with the Order. This Order is permissible as opposed to a Presidential waiver because the League was never blacklisted. The President's Order carries more weight than those made by the U.S. State Department, which is a subordinate agency to the President. On June 2010, the State Department established trade relations with the Sietch State, declaring it "A Quasi-Autonomous Region." R. at 10. As a result, the Sietch State's taxes qualified as a foreign tax credit. The President's Order is synonymous with the State Department's actions, and accords the League the same treatment as the Sietch State. Therefore, the Commissioner is bound by Executive Order 14012, which qualifies the League's taxes as valid foreign tax credits.

Arguably, the Commissioner could contend that regardless of whether other countries recognize the League, Arrakis and the Sietch State have explicitly denied the League's legitimacy. If the League is recognized as a political subdivision of the Sietch State, the Commissioner may also contend that the League's tax is in violation of the Peace Treaty because it allows only one tax within the Sietch State. In addition, the Commissioner may argue that § 901(j)(2)(A)(iv) rejects any foreign tax credits from countries with ties to terrorist organizations.

While the Commissioner's first point may carry some merit, the Holy Royal Court's decision regarding the League's legitimacy supersedes Arrakis' and the Sietch State's rejection. Subsequently, both Arrakis and the Sietch State took measures to establish a permanent location for the League. The Commissioner's second point also fails because the League is not a subdivision of the Sietch State. Rather, the League is a political subdivision of Arrakis, making it a second state of Arrakis. Therefore, the League's tax does not violate the Peace Treaty, which applied only to the Sietch State.

Lastly, any contention that the League is connected to the Bene Gesserit terrorist organization is misplaced because "fear is the mind killer." *See* Frank Herbert, *Dune* 19 (1965). Section 901(j)(2)(A)(iv) requires that a country "repeatedly" harbors international terrorism. The facts are clear that the League's only relation to the Bene Gesserit is through Mohiam's mother, of whom Mohiam has rejected since she turned eighteen. For the Commissioner to fear the League's association with terrorism through the right of birth is unwarranted.

The League's circumstances, under the *Chicago Portrait* analysis, is a textbook example of satisfying both competent powers to tax, as well as an international recognition to tax. Thus, this Court should hold that the League is a valid "foreign country" or political subdivision of Arrakis, that has the authority to impose taxes, because the League is recognized by its country's laws as a legitimate entity and is supported as a sovereign entity on an international level.

B. Harkonnen exhausted all effective and practical remedies by petitioning the Holy Royal Court for a resolution on its taxes to the League.

The issue here is whether Harkonnen exhausted all effective and practical remedies prior to paying taxes to the League. The Council is a judicial body of the Sietch State with the powers to only decide matters for the Sietch State. The Holy Royal Court, like the Supreme Court of the United States, is the highest court of Arrakis, and it has exclusive jurisdiction on "all legal tax disputes." R. at 14. Therefore, the Holy Royal Court's decision on Harkonnen's tax matter was the exhaustion of all effective and practical remedies.

The exhaustion of all effective and practical remedies element falls under the definition of non-compulsory payments, which states: (1) taxpayer's determination of tax liability must be based on the interpretation of the foreign law, (2) interpretation must be reasonable, and (3) *the taxpayer exhausted all effective and practical remedies*. *IBM Corp.*, 38 Fed. Cl. at 668 (emphasis added) (deducing the three elements from the Regulations); Treas. Reg. § 1.901-2(e)(5)(i) (2013). Interpretation of a foreign levy is satisfied where the taxpayer has taken steps to determine whether there is tax liability. *IBM Corp.*, 38 Fed. Cl. at 669-72. Reasonableness is established upon a "good faith" reliance from a "competent foreign tax advisor[ ]." § 1.901-2(e)(5)(i). Finally, an exhaustion of all effective and practical remedies includes the "invocation of competent authority procedures available under applicable tax treaties." *Id.*

In *IBM*, the plaintiff was the parent corporation of a group of corporations operating in Italy. *IBM*, 38 Fed. Cl. at 662. The plaintiff paid the revised Italian tax and filed for a credit with the Commissioner. *Id.* at 663-64. The Italian tax, prior to its revision, did not apply to the plaintiff. *See id.* at 663. The Commissioner disallowed the credit, claiming, *inter alia*, that the Italian tax was not a tax. *See id.* at 667-69. The Federal Claims court analyzed all three elements of the non-compulsory payment test. *See id.* at 670-675. First, the court found that the plaintiff had interpreted the revised Italian tax by obtaining advice from an Italian tax expert, who in turn, obtained his knowledge from an interpretation set out by the taxing authority of Italy. *Id.* at 669, 671. Next, the court found that the interpretation was reasonable because the plaintiff relied on a tax expert. *Id.* at 673. Moreover, the plaintiff relied in good faith on the interpretation from the tax expert. *Id.* Lastly, the plaintiff exhausted all effective and practical remedies because there was no competent authority that governed its issue—the court dismissed the Commissioner's contention that the plaintiff's Italian litigation has not concluded, and thus was not an exhaustion of remedies. *Id.* at 673-75 (stating that "the final regulations could have specified that exhaustion of 'all practical and effective litigation' meant exhaustion of all litigation, including the appellate process"). The court found that the Commissioner supported the position that taxpayers engaged in tax liability litigation in foreign jurisdictions could claim a credit but must later report to the Secretary of Treasury if a refund occurs. § 901(c); Rev. Rul. 70-290, 1970-1 C.B. 160 ("A corporation is not deprived of the right to obtain credit for foreign taxes because it contests the validity of the statutes under which the taxes were paid or protests the assessment and has made application for a refund.").

Here, the Commissioner contends that Harkonnen failed to exhaust all effective and practical remedies because it failed to raise a claim with the Council. The Commissioner's argument is misplaced for two reasons. First, the Council is a judicial body established to handle judicial affairs for the Sietch State. The League, however, is a separate entity and not bound to the Sietch State's jurisdiction. Second, even if Harkonnen had to go before the Council first, the Council's decision is not final because it is a lower judicial body. The Holy Royal Court handles all tax matters and is the highest court of the land. Thus, requiring Harkonnen to bounce between courts is both ineffective and impractical. Because the Holy Royal Court has made a determination on the League's status, its decision, as an act-of-state, cannot be questioned. *See Riggs Nat'l Corp. & Subsidiaries*, 163 F.3d at 1363.

Harkonnen also satisfied the remaining two elements. Harkonnen interpreted the liability of the League's tax by petitioning an answer from the Holy Royal Court. Since the Holy Royal Court decided all matters pertaining to taxes, it is a competent authority to interpret the issue. Harkonnen also relied in good faith on the court's interpretation of the League's imposed tax. Following the court's decision, Harkonnen relied on the court's decision and paid the League the mandated tax. Harkonnen has satisfied the three elements of the test, particularly the exhaustion issue. Therefore, this Court should hold that Harkonnen exhausted all effective and practical remedies.

CONCLUSION

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

Respectfully Submitted,

/s/ Counsel for Petitioner
Counsel for Petitioner

APPENDIX A

I.R.C. § 901 (2012)

§ 901. Taxes of Foreign Countries and of Possessions of United States

(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; and

* * *

(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.

(5) Waiver of denial.—

(A) In general.—Paragraph (1) shall not apply with respect to taxes paid or accrued to a country if the President—

(i) determines that a waiver of the application of such paragraph is in the national interest of the United States and will expand trade and investment opportunities for United States companies in such country; and

(ii) reports such waiver under subparagraph (B).

(B) Report. —Not less than 30 days before the date on which a waiver is granted under this paragraph, the President shall report to Congress—

(i) the intention to grant such waiver; and

(ii) the reason for the determination under subparagraph (A)(i).

APPENDIX B

Treas. Reg. § 1.901-2 (2013). Income, War Profits, or Excess Profits Tax Paid or Accrued

(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.

* * *

(2) Tax--(i) In general. A foreign levy is a tax if it requires a compulsory payment pursuant to the authority of a foreign country to levy taxes. A penalty, fine, interest, or similar obligation is not a tax, nor is a customs duty a tax. Whether a foreign levy requires a compulsory payment pursuant to a foreign country's authority to levy taxes is determined by principles of U.S. law and not by principles of law of the foreign country. Therefore, the assertion by a foreign country that a levy is pursuant to the foreign country's authority to levy taxes is not determinative that, under U.S. principles, it is pursuant thereto. Notwithstanding any assertion of a foreign country to the contrary, a foreign levy is not pursuant to a foreign country's authority to levy taxes, and thus is not a tax, to the extent a person subject to the levy receives (or will receive), directly or indirectly, a specific economic benefit (as defined in paragraph (a)(2)(ii)(B) of this section) from the foreign country in exchange for payment pursuant to the levy. Rather, to that extent, such levy requires a compulsory payment in exchange for such specific economic benefit. If, applying U.S. principles, a foreign levy requires a compulsory payment pursuant to the authority of a foreign country to levy taxes and also requires a compulsory payment in exchange for a specific economic benefit, the levy is considered to have two distinct elements: A tax and a requirement of compulsory payment in exchange for such specific economic benefit. In such a situation, these two distinct elements of the foreign levy (and the amount paid pursuant to each such element) must be separated. No credit is allowable for a payment pursuant to a foreign levy by a dual capacity taxpayer (as defined in paragraph (a)(2)(ii)(A) of this section) unless the person claiming such credit establishes the amount that is paid pursuant to the distinct element of the foreign levy that is a tax. See paragraph (a)(2)(ii) of this section and § 1.901–2A.

(ii) Dual capacity taxpayers

(A) In general. For purposes of this section and §§ 1.901–2A and 1.903–1, a person who is subject to a levy of a foreign state or of a possession of the United States or of a political subdivision of such a state or possession and who also, directly or indirectly (within the meaning of paragraph (a)(2)(ii)(E) of this section) receives (or will receive) a specific economic benefit from the state or possession or from a political subdivision of such state or possession or from an agency or instrumentality of any of the foregoing is referred to as a "dual capacity taxpayer." Dual capacity taxpayers are subject to the special rules of § 1.901–2A.

(B) Specific economic benefit. For purposes of this section and §§ 1.901–2A and 1.903–1, the term "specific economic benefit" means an economic benefit that is not made available on substantially the same terms to substantially all persons who are subject to the income tax that is generally imposed by the foreign country, or, if there is no such generally imposed income tax, an economic benefit that is not made available on substantially the same terms to the population of the country in general. Thus, a concession to extract government-owned petroleum is a specific economic benefit, but the right to travel or to ship freight on a government-owned airline is not, because the latter, but not the former, is made generally available on substantially the same terms. An economic benefit includes property; a service; a fee or other payment; a right to use, acquire or extract resources, patents or other property that a foreign country owns or controls (within the meaning of paragraph (a)(2)(ii)(D) of this section); or a reduction or discharge of a contractual obligation. It does not include the right or privilege merely to engage in business generally or to engage in business in a particular form.

* * *

(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;

* * *

(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.

APPENDIX C

Treas. Reg. § 1.901-2A (1983). Dual Capacity Taxpayers

(a) Application of separate levy rules as applied to dual capacity taxpayers

(1) In general. . . . . However, if the application of the levy is neither different by its terms nor different in practice for dual capacity taxpayers from its application to other persons, or if the only difference is that a lower rate (but the same base) applies to dual capacity taxpayers, then, in accordance with § 1.901–2(d), such foreign levy as applicable to dual capacity taxpayers and such levy as applicable to other persons together constitute a single levy. In such a case, no amount paid (as defined in § 1.901–2(g)(1)) pursuant to such levy by any such dual capacity taxpayer is considered to be paid in exchange for a specific economic benefit, and such levy, as applicable in the aggregate to such dual capacity taxpayers and to such other persons, is analyzed to determine whether it is an income tax within the meaning of § 1.901–2(a)(1) or a tax in lieu of an income tax within the meaning of § 1.903–1(a). Application of a foreign levy to dual capacity taxpayers will be considered to be different in practice from application of that levy to other persons, even if no such difference is apparent from the terms of the levy, unless it is established that application of that levy to dual capacity taxpayers does not differ in practice from its application to other persons.

(2) Examples. The provisions of paragraph (a)(1) of this section may be illustrated by the following examples:

Example 1. Under a levy of country X called the country X income tax, every corporation that does business in country X is required to pay to country X 40 percent of its income from its business in country X. Income for purposes of the country X income tax is computed by subtracting specified deductions from the corporation's gross income derived from its business in country X. The specified deductions include the corporation's expenses attributable to such gross income and allowances for recovery of the cost of capital expenditures attributable to such gross income, except that under the terms of the country X income tax a corporation engaged in the exploitation of minerals K, L or M in country X is not permitted to recover, currently or in the future, expenditures it incurs in exploring for those minerals. In practice, the only corporations that engage in exploitation of the specified minerals in country X are dual capacity taxpayers. Thus, the application of the country X income tax to dual capacity taxpayers is different from its application to other corporations. The country X income tax as applied to corporations that engage in the exploitation of minerals K, L or M (dual capacity taxpayers) is, therefore, a separate levy from the country X income tax as applied to other corporations. Accordingly, each of (i) the country X income tax as applied to such dual capacity taxpayers and (ii) the country X income tax as applied to such other persons, must be analyzed separately to determine whether it is an income tax within the meaning of § 1.901–2(a)(1) and whether it is a tax in lieu of an income tax within the meaning of § 1.903–1(a).

Example 2. The facts are the same as in example 1, except that it is demonstrated that corporations that engage in exploitation of the specified minerals in country X and that are subject to the levy include both dual capacity taxpayers and other persons. The country X income tax as applied to all corporations is, therefore, a single levy. Accordingly, no amount paid pursuant to the country X income tax by a dual capacity taxpayer is considered to be paid in exchange for a specific economic benefit; and, if the country X income tax is an income tax within the meaning of § 1.901–2(a)(1) or a tax in lieu of an income tax within the meaning of § 1.903–1(a), it will be so considered in its entirety for all corporations subject to it.

APPENDIX D

I.R.C. § 903 (2012)

§ 903. Credit for Taxes in Lieu of Income, etc., Taxes

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.

APPENDIX E

Treas. Reg. § 1.903-1 (1983). Taxes in Lieu of Income Taxes

(a) In general. Section 903 provides that the term "income, war profits, and excess profits taxes" shall include a tax paid in lieu of a tax on income, war profits, or excess profits ("income tax") otherwise generally imposed by any foreign country. For purposes of this section and §§ 1.901–2 and 1.901–2A, such a tax is referred to as a "tax in lieu of an income tax"; and the terms "paid" and "foreign country" are defined in § 1.901–2(g). A foreign levy (within the meaning of § 1.901–2(g)(3)) is a tax in lieu of an income tax if and only if—

> **(1)** It is a tax within the meaning of § 1.901–2(a)(2); and
>
> **(2)** It meets the substitution requirement as set forth in paragraph (b) of this section.

The foreign country's purpose in imposing the foreign tax (e.g., whether it imposes the foreign tax because of administrative difficulty in determining the base of the income tax otherwise generally imposed) is immaterial. It is also immaterial whether the base of the foreign tax bears any relation to realized net income. The base of the tax may, for example, be gross income, gross receipts or sales, or the number of units produced or exported. Determinations of the amount of a tax in lieu of an income tax that is paid by a person and determinations of the person by whom such tax is paid are made under § 1.901–2(e) and (f), respectively, substituting the phrase "tax in lieu of an income tax" for the phrase "income tax" wherever the latter appears in those sections. Section 1.901–2A contains additional rules applicable to dual capacity taxpayers (as defined in § 1.901–2(a)(2)(ii)(A)). The rules of this section are applied independently to each separate levy (within the meaning of §§ 1.901–2(d) and 1.901–2A(a)) imposed by the foreign country. Except as otherwise provided in paragraph (b)(2) of this section, a foreign tax either is or is not a tax in lieu of an income tax in its entirety for all persons subject to the tax.

(b) Substitution

> **(1) In general.** A foreign tax satisfies the substitution requirement if the tax in fact operates as a tax imposed in substitution for, and not in addition to, an income tax or a series of income taxes otherwise generally imposed. However, not all income derived by persons subject to the foreign tax need be exempt from the income tax. If, for example, a taxpayer is subject to a generally imposed income tax except that, pursuant to an agreement with the foreign country, the taxpayer's income from insurance is subject to a gross receipts tax and not to the income tax, then the gross receipts tax meets the substitution requirement notwithstanding the fact that the taxpayer's income from other activities, such as the operation of a hotel, is

subject to the generally imposed income tax. A comparison between the tax burden of this insurance gross receipts tax and the tax burden that would have obtained under the generally imposed income tax is irrelevant to this determination.

* * *

(3) **Examples.** The provisions of this paragraph (b) may be illustrated by the following examples:

Example 1. Country X has a tax on realized net income that is generally imposed except that nonresidents are not subject to that tax. Nonresidents are subject to a gross income tax on income from country X that is not attributable to a trade or business carried on in country X. The gross income tax imposed on nonresidents satisfies the substitution requirement set forth in this paragraph (b).