No. C15-1701-1

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 2014

ROYAL HARKONNEN OIL COMPANY
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

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

BRIEF FOR RESPONDENT

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Counsel for Respondent
November 24, 2014

QUESTIONS PRESENTED

I. Did the Fourteenth Circuit properly hold that Harkonnen Oil's payment of taxes to the Republic of Arrakis was not a credible foreign tax credit under sections 901 or 903 of the Internal Revenue Code?

II. Did the Fourteenth Circuit correctly hold that Harkonnen Oil was not entitled to a foreign tax credit for all tax payments to the Inter-Sietch Fremen Independence League?

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JURISDICTIONAL STATEMENT

Petitioner's timely filed request for certiorari was granted for the October Term of 2014. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1) (2006).

OPINION BELOW

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

STANDARDS OF REVIEW

This Court reviews factual findings for clear error and interpretations of the Internal Revenue Code de novo. *See, e.g.*, *Adamowicz v. United States*, 531 F.3d 151, 156 (2d Cir. 2008).

STATUTORY PROVISIONS

This case concerns sections of the Internal Revenue Code addressing credible foreign tax credits for income taxes paid overseas or for taxes paid "in lieu of" income taxes. 26 U.S.C. §§ 901, 903 (2006). These statutes are reproduced in Appendix A.

STATEMENT OF THE CASE

Statement of the Facts

In early 2007, Royal Harkonnen Oil Company ("Petitioner")[1] began exploring the feasibility of extracting oil and gas deposits from the Caladan Oil Field in the Republic of Arrakis ("Arrakis"). R. at 2. After concluding that oil and gas reserves could be profitably extracted, Petitioner began negotiations with Arrakis for the exclusive right to develop the Caladan Oil Field. R. at 3. On February 5, 2008, Petitioner's Chief Executive Officer, Vladimir Harkonnen ("Harkonnen"), met with Arrakisian officials to sign and approve an oil and gas lease for the entire Caladan Oil Field. R. at 3-4. These negotiations lasted for several months and primarily focused on royalty payments demanded by Arrakis. R at 4.

[1] Petitioner is incorporated in the state of Delaware, while its primary place of business is in the state of New Tejas.

Arrakis is governed by Jules Corrino ("Corrino"), an autocratic president who was appointed for life through a hereditary inheritance system. R. at 3. This position was created in 1864, when the Eternal Arrakis Empire conquered the neighboring Sietch Empire. R. at 3. The Sietch Empire and the Eternal Arrakis Empire became a combined republic in 1952 through a proclamation by President Corrino's grandfather and sitting Emperor. R. at 3.

Arrakis' tax laws are based on historical religious norms that have been codified over a period of several centuries. R. at 4. Traditionally, a person or an entity would only be subject to the Arrakis Tax Code if their bloodlines were historically subjects under either the Sietch Empire or the Eternal Arrakis Empire. R. at 4. Individuals that were not subject to the tax code were not provided protections under Arrakisian law. R. at 4. However, in 2006, Arrakis passed the Foreign Protection Act, which provided limited due process rights and police protection to foreign individuals and entities. R. at 4. This precedent resulted in a tax code that applied to Arrakisian citizens, but rejected taxation for foreign entities and individuals residing or doing business in Arrakis. R. at 4. The highest court in Arrakis (the "Holy Royal Court") recently affirmed this principle in *Lord Remmington v. Republic of Arrakis*, when the court held that foreign citizens and entities could not be taxed because they were not entitled to legal protection beyond the Foreign Protection Act. R. at 4.

On March 10, 2008, President Corrino drafted and signed into law a new tax titled the "Republic of Arrakis Foreign Value Tax." R. at 5. This tax applies to all

foreign entities that operate machinery on sovereign territory of Arrakis. R. at 5. The tax is determined by calculating gross receipts generated through a corporation's operations in Arrakis by a tax rate that would be determined at a later time. R. at 5. When foreign entities earn money in Arrakis, they must deposit these funds into the Central Bank of Arrakis. R. at 5. The Central Bank then distributes taxable income directly to the Arrakis Treasury, and the bank returns remaining funds to the foreign entity. R. at 5.

In April of 2008, dissidents in the Sietch Dunes region of Arrakis staged a rebellion against the Arrakisian government. R. at 5. These dissidents declared independence for the Sietch Dunes region and called for a restoration of an independent Sietch throne. R. at 5-6. The Sietch Dunes region that was declared independent by dissidents included approximately one-quarter (62,000 square miles) of the Caladan Oil Fields. R. at 6. Although Harkonnen expressed some concern over the uprising, President Corrino clarified that the uprising only involved a small group of dissidents who were upset about the 1864 annexation and that the uprising would be resolved within one month. R. at 6.

On June 30, 2008, President Corrino applied a forty-five percent tax rate to the Republic of Arrakis Foreign Value Tax and renamed the tax the Republic of Arrakis Foreign Tax ("Foreign Tax"). R. at 7. That same day, Arrakis and Petitioner signed a lease to develop the entire Caladan Oil Field. R. at 7. This lease contained provisions for a one-time payment of fifty-five million dollars, a royalty of fifteen percent, and an agreement to pay the Foreign Tax. R. at 7. From

2008 to the present day, Petitioner has paid no other taxes to Arrakis. R. at 7. Petitioner began producing oil in early 2009, and by October of 2009, production equaled 858,000 barrels of oil per day. R. at 7.

On March 20, 2010, a splinter group called the Independent People of Sietch ("IPS") declared their independence from Arrakis and declared themselves to be the ruling political regime of an independent Sietch Dunes. R. at 8. After several weeks of fighting, the parties declared a ceasefire at the Sietch Dunes Peace Treaty on April 9, 2010. R. at 8. The terms of the ceasefire stated that the Sietch Dunes region would become an Important Province of Arrakis known as the "Sietch State," and the state would appoint a Vice-President to serve in the cabinet of the Arrakisian president. R. at 8-9. On April 13, 2010, President Corrino passed an amendment to the Arrakis Constitution that outlined the powers of the Vice-President. R. at 9. One of these powers allowed the Vice-President to "[d]ecree and levy a single tax" and gave the Vice-President the ability to "amend the tax with the approval of the sitting President of Arrakis." R. at 9.

Paul Atreides ("Atreides") was ultimately elected the Vice-President of Arrakis. R. at 9-10. On April 16, 2010, Atreides established a tax, where ten percent of all income generated in the Sietch State (regardless of citizenship) must be turned over to the Chief Accountant of the Sietch State. R. at 10. Petitioner paid all funds owed under the April 16, 2010 decree, and these payments did not impact Petitioner's tax obligations to the Republic of Arrakis under the Arrakisian Foreign Tax. R. at 10. On April 19, 2010, Petitioner executed an oil and gas lease with the

Sietch State where Petitioner paid the Sietch State a one-time bonus of five million dollars and an annual royalty of five percent. R. at 10.

On December 31, 2010, a rebellion was launched in the Sietch State by a splinter Group of the Bene Gesserit terrorist organization called the Inter-Sietch Fremen Independence League ("IFIL"). R. at 11. This group called for the resignation of Vice-President Atreides and declared that their leader, Jessica Mohiam ("Mohiam"), was the only legitimate Vice-President because she was the rightful heir to the Sietch throne. R. at 11. By March 2011, IFIL forcefully took control of a region of the Sietch State known as the Badlands. R. at 13. On March 20, 2011, IFIL expanded their territory beyond the Badlands and took control over a drilling station ("Unit #12") operated by Petitioner. R. at 13. Upon capturing Unit #12, Mohiam released a statement claiming that "Harkonnen Oil is slant drilling the Badlands and until they rectify their insolence and pay tribute, IFIL will control oil production from Unit #12." R. at 13.

On March 22, 2011, Harkonnen met with Mohiam, and they signed an oil and gas lease where Petitioner would pay a bonus of five hundred and fifty thousand dollars and a five percent royalty to IFIL. R. at 13. Mohiam later declared that income generated at Unit #12 would be taxed at two percent, but Harkonnen protested this tax and abandoned negotiations. R. at 13-14. On March 23, 2011, Petitioner asked the Holy Royal Court of Arrakis to determine the status of IFIL and their authority to levy taxes. R. at 14. On March 24, 2011, the Holy Royal Court ruled, "Arrakis recognizes IFIL as part of Sietch." R. at 14. On March 25,

2011, Petitioner paid IFIL the negotiated bonus, royalty, and the two percent tax. R. at 14.

On May 16, 2011, Harkonnen, Corrino, Atreides, and Mohiam all met at the First Annual Caladan Oil Field Conference. R. at 15. Atreides declared that the tax rate for companies operating in the Caladan Oil Field would remain at ten percent for all monies generated within the Sietch State. R. at 15. Mohiam also declared that IFIL's tax of Unit #12 would remain the same. R. at 15. However, President Corrino lowered the Republic of Arrakis Foreign Tax to thirty-three percent. R. at 15. Following the conference, President Corrino issued Proclamation 102, which allowed foreign corporations to take all tax deductions available to Arrakisian citizens, but capped deductions for foreign corporations at ninety-five percent of the dollar value of an Arrakisian citizen. R. at 15. This restriction for foreign corporations was based upon the religious laws and practices of Arrakis, which prohibit foreign entities from enjoying the same benefits as a true believer. R. at 15. However, Proclamation 102 did not affect the calculation of deductions by the Sietch State because the Sietch religion does not permit sanctions against non-believers. R. at 16.

Petitioner's oil production in the Caladan Oil Field continued unhindered for the remainder of the year. R. at 16. Petitioner timely paid (i) the thirty-three percent tax to Arrakis from total income generated in the Caladan Oil Field, (ii) the ten percent tax to the Sietch State for income generated in the portion of the

Caladan Oil Field within the Sietch Dunes region, and (iii) the two percent tax to IFIL for income generated at Unit #12. R. at 16.

Procedural History

On March 15, 2012, Petitioner timely filed a form 1120 United States Tax Return and a form 1118, claiming foreign tax credits for its tax payments to the Republic of Arrakis, the Sietch state, and IFIL.[2] R. at 16. The Internal Revenue Service ("IRS") flagged Petitioner's 2012 tax returns for irregularities and performed an audit on Petitioner's tax returns. R. at 16. The IRS determined that the claimed foreign tax credits sought for the tax payment to Arrakis did not qualify as a credible foreign tax credit under the Internal Revenue Code. R. at 16. Instead, the IRS determined that Petitioner's tax payments constituted an unqualified foreign tax credit because the foreign tax failed to sufficiently reach net income. R. at 16-17.

Although the IRS determined that Petitioner's payments to the Sietch State constituted a valid foreign tax credit, the IRS determined that Petitioner's payments to IFIL constituted an unqualified foreign tax because IFIL was not a proper taxing authority. R. at 17. The IRS also determined that Petitioner's payments to IFIL violated the Sietch Dunes Peace Treaty's requirement that only a single tax exist within the Sietch State. R. at 17. Furthermore, the IRS also determined that Petitioner failed to exhaust all of its remedies to challenge a foreign tax under the Sietch State's domestic laws. R. at 17.

[2] In prior tax years, Petitioner took its expenses from its Arrakis operations as deductions, rather than a tax credit.

After Petitioner's negotiations with the IRS ultimately failed, Petitioner paid the full tax – including applicable penalties and interest – and demanded a full refund. R. at 17. Petitioner then filed suit in the United States District Court for the Central District of New Tejas. R at 17. After a lengthy and well-publicized trial, the District Court ruled in favor of the United States. R. at 17. Petitioners then appealed to the United States Court of Appeals for the Fourteenth Circuit. R. at 2, 17.

On October 1, 2014, the Fourteenth Circuit Court of Appeals issued a ruling that affirmed the decision of the District Court. R. at 2, 19. The court held that the Arrakis tax was not a credible foreign tax under section 901 of the Internal Revenue Code because it was "not similar or akin to a United States Income Tax." R. at 17. The court noted that the tax was given the title of a "value tax," rather than an income tax, and the court held that the Arakisian tax did not credibly reach net income. R. at 17 (citing *Inland Steel Co. v. United States*, 677 F.2d 72, 80 (Ct. Cl. 1982)). The court also held that Arrakis' cap on foreign corporate tax deductions failed to satisfy the definition of "significant cost recoveries" under section 1.901-2 of the Treasury Department Regulations. R. at 17. Furthermore, the court held that Petitioner could not claim a tax credit under section 903 of the Internal Revenue code because Arrakis' tax did not exist "in lieu of" an otherwise applicable income tax, and the Central Bank's withholding of funds did not qualify as a "withholding tax." R. at 18.

The Fourteenth Circuit also held that the IRS correctly denied Petitioner's

foreign tax credit for payments to IFIL because IFIL is not a valid taxable entity. R. at 18. Additionally, the court held that IFIL's tax violated the Arrakis constitution because the Arrakis Constitution only allows for the existence of a single tax within the Sietch State, and IFIL's tax constituted an impermissible second tax. R. at 18. Finally, the court held that Petitioner could have petitioned the Sietch Council for a determination on the status of IFIL, and therefore Petitioner did not exhaust all available administrative remedies to reduce the burden imposed by IFIL's tax. R. at 18.

After the Fourteenth Circuit ruled in favor of the United States, Petitioner requested this Court grant certiorari to review the decision of the Fourteenth Circuit. R. at 2. This Court granted Petitioner's request for certiorari for the October Term of 2014. R. at 2.

SUMMARY OF ARGUMENT

The Arrakis Foreign Tax fails to qualify for the foreign income tax credit under section 901 of the Internal Revenue Code for two reasons. First, Petitioner agreed to pay the Arrakis Foreign Tax in the context of a negotiation for the right to develop the Caladan Oil Field, indicating that Petitioner's payments were not wholly pursuant to Arrakis' authority to levy taxes. Second, the Arrakis Tax Code limits the amount of foreign corporate deductions and thus prevents the Arrakis Foreign Tax from credibly reaching net income. Finally, public policy weighs against ignoring these shortcomings and carving out an exception to accommodate

Arrakis' archaic practice of imposing economic sanctions against religious minorities.

In addition, Petitioner does not qualify for a foreign tax credit under section 903 of the Internal Revenue Code because neither the Arrakis Foreign Tax nor the Central Bank's withholding function as a substitute for an income tax. Arrakis' policy of withholding revenue is not "in-lieu of" an otherwise applicable income tax because Petitioner is not subject to a general income tax. Moreover, the Central Bank of Arrakis' practice of withholding funds prior to remittance does not qualify as a "withholding tax."

The Internal Revenue Service also properly denied Petitioner's claimed foreign tax for all tax payments to the Inter-Sietch Fremen Independence League because IFIL cannot establish itself as a sovereign political entity under United States law. IFIL does not have the legal authority to levy a tax because it is not a valid taxable entity. Furthermore, Petitioner's payments to IFIL violated the Sietch Dunes Peace Treaty's limitation of a single tax within the Sietch State. Accordingly, any tax demanded by IFIL was an impermissible second tax in violation of Arrakis law. Finally, Petitioner did not petition the Sietch Council for a determination on the status of IFIL, and therefore did not exhaust all of its available remedies to reduce the IFIL tax burden.

ARGUMENT

I. PETITIONER'S PAYMENT OF TAXES TO THE REPUBLIC OF ARRAKIS FAILS TO QUALIFY AS A CREDIBLE FOREIGN TAX UNDER THE INTERNAL REVENUE CODE.

The Internal Revenue Code allows United States citizens and domestic corporations to claim a credit against federal income-tax liability for income taxes paid overseas or for taxes paid "in lieu of" income taxes. 26 U.S.C. §§ 901, 903 (2006). The purpose of these tax credits is to reduce the likelihood that foreign income will be taxed twice. *Burnet v. Chicago Portrait Co.*, 285 U.S. 1, 7 (1932); *see also Operation of the Foreign Tax Credit in the Petroleum Industry*, 15 Vir. J. Int'l L. 421, 423 (1975). Some scholars also suggest that this credit system was designed, in part, to encourage foreign investment. Julie Hayward Biggs, *Foreign Policy Implications of the Abolition of the Foreign tax Credit for Oil Companies*, 4 J. Corp. L. 339, 339 (1979).

However, the legislative history of the foreign tax credit system indicates that this framework "embodies the principle that the country in which a business activity is conducted (or in which any income is earned) has the first right to tax that income arising from activities in that country." Senate Report No. 94-938, Part I, Tax Reform Act of 1976, P.L. 94-445, § 1031(a). In recent years, some scholars have advocated for the abolition the foreign tax credit system entirely. J. Clifton Fleming, Jr., Robert J. Peroni & Stephen E. Shay, *Fairness in International Taxation: The Ability-To-Pay Case for Taxing Worldwide Income*, 5 Fla. Tax Rev. 299, 353 (2001). These scholars claim that the system does not promote economic

growth and that the system is not conducive to achieving fundamental fairness among taxpayers. *Id.* Indeed, this Court should interpret these foreign tax provisions narrowly to ensure that corporations do not use foreign tax credits as a loophole to escape domestic tax liability. *See* Martin N. Van Brauman, *Federal Tax Considerations in Foreign Oil and Gas Operations by Domestic Oil Companies*, 9 J. Nat. Resources & Envtl. L. 31, 72 n.273 (1994).

A. Arrakis' Foreign Tax Fails to Qualify as a Credible Foreign Income Tax Under Section 901 Because It Lacks the Predominant Character of an Income Tax Under the Internal Revenue Code.

Section 901 of the Internal Revenue Code permits United States corporations to claim a tax credit against their United States income taxes for "the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country." 26 U.S.C. § 901(b)(1). When evaluating foreign tax creditability under section 901, this Court looks at whether a foreign tax is functionally equivalent to an "income tax" under United States law. *Biddle v. Comm'r of Internal Revenue*, 302 U.S. 573, 579 (1938); *see also* Treas. Reg. §§ 1.901-2, *et seq.* (as amended in 2013). This standard is met if "the foreign tax is likely to reach net gain in the normal circumstances in which it applies." Treas. Reg. § 1.901-2(a)(3)(i); *see also Inland Steel Co. v. United States*, 677 F.2d 72, 79 (Ct. Cl. 1982) (holding that the credit provisions in section 901 are to be strictly construed).

There are two reasons why the Republic of Arrakis Foreign Tax cannot be compared to a United States federal income tax. First, Treasury Department Regulations require that the foreign tax must possess the "predominant character"

of "an income tax in the U.S. sense," and the actual operation and effect of the Arrakis Foreign Tax indicates otherwise. Treas. Reg. § 1.901-2(a)(1). Second, the regulations provide a three-part, conjunctive test for comparability – the realization test, the gross receipts test, and the net income test – and the Arrakis Foreign Tax fails the net income test by not providing for significant recovery of costs and expenses related to the taxed income. *Id.* at § 1.901-2(b).

1. Petitioner agreed to pay the Republic of Arrakis Foreign Tax in the context of a larger negotiation for the benefit of developing the Caladan Oil Field, indicating that the payments were not wholly pursuant to Arrakis' authority to levy taxes.

A foreign tax has the predominant character of an income tax in the United States sense when the foreign tax is "a compulsory payment pursuant to the authority of a foreign country to levy taxes." Treas. Reg. § 1.901-2(a). If a specific economic benefit is received in exchange for a payment to a foreign government, the payment lacks the predominant character of a tax because it is not collected pursuant to the government's taxing power. *Id.* at § 1.901-2(a)(2)(i). Furthermore, a specific economic benefit is "an economic benefit that is not made available on substantially the same terms to substantially all persons" subject to the foreign country's general income tax. *Id.* at § 1.901-2(a)(2)(ii)(B).

Foreign governments often collect money from oil companies through royalties, but these royalties do not have the character of an income tax under the terms of the Internal Revenue Code and Treasury Regulations. *See The Foreign Tax Credit and Treatment of Payments by the Petroleum Industry to Foreign Governments*, 91 Harv. L. Rev. 844, 853 (1978) ("Royalties are not taxes"). In fact,

Treasury Department Regulations recognize that a "concession to extract government-owned petroleum is a specific economic benefit," rather than an income tax, because the government is necessarily selective in granting such concessions. Treas. Reg. § 1.901-2(a)(2)(i).

A royalty would be deducted as a cost of doing business, but a credible foreign income tax can be used in its entirety to offset a company's United States tax liability. 26 U.S.C. § 901(b)(1). When oil-producing countries agree to call some royalties income taxes, they allow oil companies to take a bigger slice off their United States tax bill. Sometimes, it is unclear whether a payment that an oil company made was in exchange for an economic benefit (royalty) or not. Temi Kolarova, *Oil and Taxes: Refocusing the Tax Policy Question in the Aftermath of the BP Oil Spill*, 42 Seton Hall L. Rev. 351, 363-64 (2012). Thus, oil companies like Petitioner may get improper benefits by relying on the foreign tax credit. *See* State Department. Envtl. Law Inst., *Estimating U.S. Government Subsidies to Energy Sources: 2002-2008* 10 (2009) (noting that oil-producing countries have reclassified royalties from United States oil companies as income taxes and continue to charge oil companies higher tax rates). For the period between 2002 and 2008, the estimated revenue losses from such practices were $15.3 billion. *Id*. at 7. Consequently, courts should evaluate the substance of the tax and the tax's predominant character through the tests provided by Treasury Department Regulations, rather than accept foreign government labeling at face value.

In our present case, the Republic of Arrakis Foreign Tax applies to all entities that operate machinery on sovereign territory of Arrakis. R. at 5. However, Petitioner entered into negotiations with the Republic of Arrakis specifically to secure exclusive rights to minerals in the Caladan Oil Field. R. at 3-4. Indeed, Petitioner agreed to pay this tax in conjunction with their mineral lease. R. at 7, 16. These facts indicate that the Arrakisian Foreign Tax operates as a partial payment for the specific economic benefit of developing the Caladan Oil Field, rather than an income tax.

In exchange for paying the Arrakisian Foreign Tax, Petitioner receives benefits from the Republic of Arrakis that are not available to all taxpayers. Specifically, Petitioner received the right to develop the Caladan Oil Field when it entered the Arrakis Lease and agreed to pay the Republic of Arrakis Foreign Tax. R. at 7. This transaction satisfies the definition of an exchange for a "specific economic benefit" that, generally, is not a tax. Treas. Reg. § 1.901-2(a)(2)(i). Consequently, Petitioner qualifies as a "dual capacity taxpayer," who both receives a specific economic benefit from a foreign government and pays a tax to the country providing the benefit. Treas. Reg. § 1.901-2(a)(2)(ii)(A).

As a dual capacity taxpayer, Petitioner bears the burden of establishing that the levy they pay is a tax under all of the requirements of applicable Treasury Department Regulations. Treas. Reg. § 1.901-2A(b) (1983) (stating the burden of proof for dual capacity taxpayers). A payment by a dual capacity taxpayer only qualifies as a tax if it is made pursuant to a single foreign levy that applies to both

dual capacity and other taxpayers. Treas. Reg. § 1.901-2A(a) (stating the separate levy rules that apply to dual capacity taxpayers). Furthermore, a payment only qualifies when no distinction is made, either explicitly or in practice, when applying the levy to these two groups. *Id*. Petitioner fails to demonstrate that their payments satisfy both of these conditions. Nor can Petitioner isolate the payment of the tax from its payment for benefits due to the inclusion of both in the June 30, 2008 agreement with Arrakis. R at 7. Therefore, Petitioner cannot use the full amount of its payments pursuant to the Arrakis Foreign Tax as a credit against its United States tax liability.

2. The cap on deductions provided for under the Arrakis Tax Code precludes the Arrakis Foreign Tax from satisfying the net income test and qualifying as a credible foreign income tax.

Even if this court finds that Petitioner's payments to Arrakis serve as a tax payment, the significant restriction on deductions under Arrakis' Tax Code precludes these tax payments from satisfying the net income test and qualifying for the foreign tax credit under section 901. Under the "net income test" provided by the Treasury Regulations, a foreign tax serves as an income tax in the United States sense if "the foreign tax is likely to reach net gain in the normal circumstances in which it applies." *PPL Corp. v. Comm'r of Internal Revenue*, 133 S. Ct. 1897, 1902 (2013) (citing Treas. Reg. § 1.901–2(a)). These regulations indicate that net gain consists of realized gross receipts reduced by significant costs and expenses attributable to those receipts, in combination known as net income. *Id.* (citing Treas. Reg. § 1.901–2(b)). To reach net income, the base of the tax must

be computed by reducing gross receipts to permit either: (i) the recovery of significant costs and expenses attributable to the gross receipts, or (ii) the recovery of significant costs and expenses in a manner that approximates recovery under reasonable principles. Treas. Reg. § 1.901-2(b) (explaining this "net income test.") Arrakis' cap on foreign corporation tax deductions precludes the Arrakis Foreign Tax from satisfying the definition of "significant cost recoveries" under either prong of this net income test.

Arrakis determines the amount of payment due under the Arrakis Foreign Tax in a manner that is designed to fall short of allowing for significant cost recoveries. Due to the effect of Proclamation 102 on Arrakis' Tax Code, foreign corporations like Petitioner only receive ninety-five percent of the dollar value of deductions available to any Arrakisian citizen. Although Arrakisian citizens receive deductions equivalent to those available under United States tax law, Petitioner and other foreign corporations cannot receive these deductions. This cap on deductions substantially diminishes all foreign corporations' abilities to recover the kind of capital expenditures that a foreign tax must allow to qualify for a tax credit. *See Am. Metal Co. v. Comm'r of Internal Revenue*, 221 F.2d 134 (2d Cir. 1955) (permitting levying on value of the mineral extracted without an allowance for expenses). Five percent of all deductible expenses proves significant in light of the substantial capital expenditures associated with foreign oil ventures. Generally, crown royalties represent significant expenses. *See* I.R.S. Priv. Ltr. Rul. 94-290-19 (July 22, 1994). Here, royalties paid in accordance with the Arrakis and Sietch

leases consume twenty percent of Petitioner's income.[3] In light of the capital generally involved in oil ventures, including such hefty royalties in this case, a five percent denial of recovery precludes recovery of significant expenses that would be allowed under the United States Tax Code.

Whether it is based on allowing a percentage of deductions or a category of deductions, a significant restriction on recovery prevents a tax from satisfying the first prong of the net income test. *Exxon Corp. v. Comm'r of Internal Revenue,* 113 T.C. 338 (1999); *accord Texasgulf, Inc. v. United States*, 17 Cl. Ct. 275, 280 (1989). In *Texasgulf*, the Ontario Mining Tax disallowed "significant" deductions, including interest, depletion, and royalties. 17 Cl. Ct. at 282. Consequently, the Mining Tax fell short of qualifying as an income tax cognizable under United States law and could not be included in the taxpayers' foreign tax credit. *Id.*

Likewise, in *Exxon Corporation,* the Tax Court addressed a single categorical restriction on deductions. 113 T.C. 338 (1999). In computing net profits, the Tax Court allowed the taxpayer to deduct significant costs and expenses, except interest

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[3] In 2009, daily production reached 858,000 barrels of oil per day, and nothing in the record suggests this production had slowed by 2011, the calendar year at issue. R. at 7. In 2011, oil cost around $100 per barrel. *Oil and Gas Incentives and Rising Energy Prices: Hearing Before the United States Senate Committee on Finance*, 112 Cong. 1 (2011) (opening statement of Hon. Max Baucus, Chairman, S. Comm. on Finance). Based on this data, Petitioner's Caladan Oil Field operations should have generated roughly $85.8 million in gross receipts and paid around $17.16 million in royalties. A five percent cap on deductions, applied to otherwise deductible royalties alone, actually amounts to approximately $858,000 in unrecoverable expenses. This calculation does not even consider other numerous expenses associated generally with oil ventures or Petitioners' $5 million payment to the Sietch State. R. at 10.

expenses, which were excluded from deductions to prevent the use of intercompany debt as a means of avoiding or minimizing liability under the tax. *Exxon Corp.*, 113 T.C. 338 (1999). This would have been fatal under the first prong of the net income test, but one critical fact saved the taxpayer in *Exxon Corporation* under the second prong: the tax considered permitted allowances, reliefs, and exemptions that effectively compensated for non-deductibility of certain oil company expenses, particularly interest. *Id*. Applying the net income test, the Tax Court found the purpose, administration, and structure of the tax indicated that it constituted an income or excess profits tax in the United States sense. *Id*.

In contrast, no alternative method of recovery compensates for the five percent impairment on deductions that corporations suffer under the Arrakis Tax Code. A foreign tax law that provides allowances that effectively compensate for that non-recovery is considered to permit recovery of such costs or expenses. Treas. Reg. § 1.901-2. For example, in *Texasgulf, Inc. v. Commissioner of Internal Revenue*, the Ontario Mining Tax satisfied the net income test of the section 901 regulations and constituted a creditable income tax. 107 T.C. 51 (1996), aff'd, 172 F.3d 209 (2d Cir. 1999). A special processing allowance available to taxpayers in computing liability under the Ontario Mining Tax adequately compensated for significant non-deductible costs, including interest. In that case, the processing allowance exceeded the amount of significant nondeductible costs. *Id.* at 66. In contrast, Petitioners cannot identify any such alternative that would satisfy the second prong of the net income test. There is no mention of any such allowance in

the record. Consequently, the restriction of deductions precludes the Arrakis Foreign Tax from qualifying for the Foreign Tax Credit under section 901.

3. Public policy supports the conclusion that Arrakis' Foreign Tax fails to qualify as a credible foreign income tax under section 901.

As an exemption from tax, "a privilege extended by legislative grace," the credit provisions of section 901 are to be strictly construed. *Texasgulf, Inc. and Subsidiaries v. Comm'r of Internal Revenue*, 172 F.3d 209, 214 (2d Cir. 1999). Essentially, this mechanism provides preferential tax treatment to foreign income tax paid or accrued by a United States corporation in the form of a foreign tax credit compared to a foreign tax deduction. Paul K. Marineau, *International Corporate Tax Reform: It's Time to "Walk-the-Talk" (No More Platypuses, Please),* 40 Syracuse J. Int'l L. & Com. 29, 37 (2012). Income tax provisions that provide benefits to favored taxpayers at the expense of government revenue are the functional equivalent to direct spending by the government and are viewed as a mechanism for achieving "budget policy objectives." Staff of the Joint Comm. on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2009-2013* 3 (2010), available at http:// www.jct.gov/publications.html?func=startdown&id=3642. Oil companies like Petitioner already enjoy substantial tax incentives – the industry saves an estimated $4 billion in taxes per year – that make scrutinizing industry loopholes especially important. Temi Kolarova, *Oil and Taxes: Refocusing the Tax Policy Question in the Aftermath of the BP Oil Spill*, 42 Seton Hall L. Rev. 351, 352

(2012) (citing David Kocieniewski, *As Oil Industry Fights a Tax, It Reaps Subsidies*, N.Y. Times, July 3, 2010, at A1).

No policy objective justifies government spending to credit Arrakis' Foreign Tax against Petitioner's United States tax liability. Moreover, carving out an exception to accommodate Arrakis' archaic practice of imposing economic sanctions against religious minorities proves a bad policy in light of the United States' constitutional mandate against the establishment of religion. U.S. Const. amend. I. An equivalent income tax enacted in the United States would conflict with the constitutional prohibition against forms of federal or state assistance that create an establishment of religion, including forms of preferential tax treatment. U.S. Const. Amend I; *see also* Victor Thuronyi, *Tax Expenditures: A Reassessment*, 1988 Duke L.J. 1155, 1202 (1988). Notwithstanding the misguided rationale expressed by the dissenting opinion in the Fourteenth Circuit, no policy objective justifies federal government spending to credit Arrakis' Foreign Tax. Justice Layton's dissent erred in stating that the United States government should incentivize payments pursuant to a Tax Code that establishes religion and discriminates against non-believers. Accordingly, this Court should affirm the decision of the Fourteenth Circuit.

B. Petitioner Cannot Claim a Foreign Tax Credit Under Section 903 Because Petitioner Is Not Subject to a General Income Tax and the Central Bank's Withholding Does Not Tax at an Equivalent Rate as the Foreign Tax.

In addition to income taxes paid overseas, taxes paid "*in lieu of* a tax on income" may also satisfy the Internal Revenue Code's definition of a credible foreign tax credit. 26 U.S.C. § 903 (emphasis added). Like section 901, the purpose of

section 903 is to prevent double taxation. *Burnet*, 285 U.S. at 7. However, this credit only applies when the foreign tax "was levied by the foreign country in place of or instead of or as a substitute for some existing income or profits tax." *Metro. Life Ins. Co. v. United States*, 375 F.3d 835, 839 (Ct. Cl. 1967) (internal quotations and citations omitted).

If this Court determines that Petitioner's payments to the Republic of Arrakis were a royalty rather than a tax, this Court need not consider whether section 903 is satisfied. *See* Rev. Rul. 76-215, 1976-1 C.B. 194 (ruling that payments to the Indonesian government under production-sharing contracts were royalties and not taxes, and consequently, section 903 of the Internal Revenue Code did not apply). However, even if this Court were to consider Petitioner's claims under section 903, Petitioner's claims fail because the practice of withholding funds does not exist as a substitute for an income tax, and the withholding of funds does not qualify as a withholding tax.

1. Arrakis' policy of withholding revenue is not "in-lieu of" an otherwise applicable income tax because Petitioner is not subject to a general income tax.

When determining whether a foreign tax is imposed "in lieu of a tax upon income," courts should look to the "characterization of the tax" according to the laws of the United States, rather than the laws of foreign statutes and decisions. *Nw. Mut. Fire Ass'n v. Comm'r of Internal Revenue*, 181 F.2d 133, 134 (9th Cir. 1950). The "predominant character" of the substitute tax must be that of an income tax. *See, e.g.*, *Helvering v. Campbell*, 139 F.2d 865, 870 (4th Cir. 1944) (internal citations

omitted). In general, taxes that "run parallel to a tax upon income generally imposed, is not a tax 'in lieu' of the income tax." *Guantanamo & W. R.R. Co. v. Comm'r of Internal Revenue*, 31 T.C. 842, 857 (1959) (internal citations omitted). However, a credible "in lieu of" tax must bear some resemblance to an income tax. *See, e.g.*, *Lanman & Kemp-Barclay & Co. of Colom. v. Comm'r of Internal Revenue*, 26 T.C. 582, 587 (1956).

Treasury Department Regulations state that a tax must satisfy three conditions to qualify for the "in lieu of" credit under section 903. Treas. Reg. § 1.903-1(a) (1983); *see also United States v. Occidental Life Ins. Co. of Cal.*, 385 F.2d 1, 11 n.21 (9th Cir. 1967) (upholding the aforementioned regulations). First, there must be a general income tax in effect in the foreign country. Treas. Reg. § 1.903-1(a). Second, the taxpayer would be subject to this general tax were it not for the "in lieu of" tax. *Id.* Third, the income tax cannot be imposed in addition to the substituted tax. *Id.*

In our present case, the Central Bank's policy of withholding revenue does not function as a substitute for an income tax because it fails the conditions stated in the Treasury Department Regulations. First of all, Petitioner is not subject to a general income tax; instead, Petitioner makes payments in exchange for the right to extract minerals, and this exchange functions as a royalty. Treas. Reg. § 1.901-2(a)(2)(i); *see also The Foreign Tax Credit and Treatment of Payments by the Petroleum Industry to Foreign Governments*, 91 Harv. L. Rev. 844, 853 (1978) ("Royalties are not taxes"). Furthermore, courts generally consider taxes paid only

by non-residents to *not* be a general income tax, and that section 903 is not applicable to these taxes. *See, e.g.*, *Metro. Life In. Co.*, 375 F.2d at 842 (holding that "[i]t would distort the application and aims of the 'in-lieu' portion of the foreign tax credit to characterize [a non-resident tax] as an 'income tax generally imposed'"). Consequently, Petitioner is not entitled to a foreign tax credit under Section 903 of the Internal Revenue Code.

2. The Central Bank of Arrakis' practice of withholding funds prior to remittance does not qualify as a "withholding tax."

Even if this Court were to hold that the Arrakis Foreign Tax qualified as a general income tax, Petitioner would still fail the second requirement in the Treasury Regulations because the Central Bank's withholdings do not constitute a "withholding tax" in lieu of a general income tax. If the general income tax is levied *in addition to* a withholding tax, then the withholding tax does not function as a substitute for the general income tax. *See Metro. Life Ins. Co.*, 375 F.2d at 841. In our present case, the Foreign Tax is applied after the initial withholding by the Central Bank, so the withholding cannot function as a substitute for the Foreign Tax. R at 5.

Furthermore, if the tax rate of a withholding is significantly higher than the rate of a general income tax, then the withholding does not function as a substitute for the general income tax. *Compania Embotelladora Coca-Cola S.A. v. United States*, 139 F.Supp. 953, 955 (Ct. Cl. 1956). In our present case, the withholding reaches all income generated in Arrakis, rather than the thirty-three percent tax rate that is withheld through the Foreign Tax. R at 5, 15. Consequently, the

Central Bank's withholding is not a tax "in lieu of" a general income tax, and Petitioner is not eligible for a foreign tax credit under section 903 of the Internal Revenue Code.

II. THE INTERNAL REVENUE SERVICE PROPERLY DENIED PETITIONER'S CLAIMED FOREIGN TAX CREDIT FOR ALL TAX PAYMENTS TO THE INTER-SIETCH FREMEN INDEPENDENCE LEAGUE.

The framework for disposition of this issue is the handwritten oil and gas lease stating that Petitioner would pay a bonus of five hundred and fifty thousand dollars and a five percent royalty to the Inter-Sietch Fremen Independence League. R at 13. In addition, Petitioner agreed to pay IFIL's tax of Unit #12 of two percent. R. at 13. In our present case, Petitioner's tax payments to IFIL constituted an unqualified foreign tax because (i) IFIL was not a proper taxing authority; (ii) Petitioner's payments to IFIL violated the Sietch Dunes Peace Treaty's limitation of a single tax within the Sietch State; and (iii) Petitioner failed to exhaust all of its remedies to challenge a foreign tax under Sietch's domestic law.

A. The Internal Revenue Service Properly Denied the Foreign Tax Credit on Payments to IFIL Because IFIL Is Not a Valid Tax Entity.

The question of whether Petitioner is entitled to foreign tax credits is to be determined by applying principles of domestic tax law. *United States v. Goodyear Tire & Rubber Co.*, 493 U.S. 132, 143 (1989). Under the Internal Revenue Code, a domestic corporation is allowed a credit against its federal income tax in the amount of any taxes paid or accrued during the taxable years to any *foreign country*. *See Am. Chicle Co. v. United States*, 316 U.S. 450, 452 (1992).

First, when determining whether or not the Internal Revenue Service properly denied the foreign tax credit on payments to IFIL, this Court should examine whether or not IFIL is a "foreign country" within the meaning of the applicable statute. This Court has previously described the word "country," in the term of "foreign country," as inherently ambiguous. *Burnet v. Chi. Portrait Co*., 285 U.S. at 5; *see also Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130, 145-46 (1982) (distinguishing between the role of an Indian Tribe as a commercial partner and the role of an Indian tribe as a sovereign nation). This Court reasoned that this term may be understood to mean foreign territory or a foreign government. *Burnet*, 285 U.S. at 5. If taken to mean "territory," it may encompass all the territory subject to a foreign sovereign power. *Id.* If taken to mean a "government," this Court explained that "foreign country" may describe a foreign state in the global sense. *Id*

The expression "foreign country" is not scientific or contrived, and this Court has stated that the sense in which it is used in a statute "must be determined by reference to the *purpose* of the particular legislation." *Id.* at 6 (emphasis added). For example, in the case of tariff acts, courts have construed the word "country" to be considered as "embracing all the possessions of a foreign state, however widely separated, which are subjected to the same executive and legislative authority." *The Recorder*, 27 F.Cas. 718, 719 (S.D. N.Y. 1847). For example, when the Treaty of Peace was signed by the United States and Spain after the Spanish-American War, Puerto Rico and the Philippines ceased to be part of a "foreign country" under the

tariff laws. *De Lima v. Bidwell*, 182 U.S. 1, 21 (1901); *In re Fourteen Diamond Rings*, 183 U.S. 176, 179 (1900).

In a different context, when interpreting the purpose behind legislation providing for the deportation of aliens "to the country whence they came, the place of emigration affords the dominant consideration." *Burnet*, 285 U.S. at 7. Therefore, under the Immigration Act of 1917, this Court stated, "an alien emigrating from Grodno, then a part of Russia, was properly deported to Poland, because at the time Grodno was a part of Poland." *Id.* Subsequently, this Court held that the expression "country," was used in the statue "to designate, in general terms, the state which, at the time of deportation, includes the place from which the alien came." *Mesevich v. Tod*, 264 U.S. 134, 136 (1924). Thus, the apparent purpose of the statute determined the meaning to be attached to the expression.

In the instant case, the question is one of credit for income taxes paid to any foreign country. Because this Court has concluded that the term "foreign country" is ambiguous, it should examine whether the IRS's interpretation of the statute was permissible when it determined that Petitioner's tax payments to IFIL constituted an unqualified foreign tax. *Burnet*, 285 U.S. at 5; R. at 16. In doing so, this Court must remember that it gives great deference to the interpretation of the Commissioner of the Internal Revenue Service. *United States v. Mead Corp.*, 533 U.S. 218 (2001) (citing *Chevron, U.S.A., Inc., v. Natural Res. Def. Council, Inc.*, 457 U.S. 837, 842 (1984)); *Dobson v. Comm'r of Internal Revenue*, 320 U.S. 489, 494 (1943) (establishing that bases for tax adjustments were unreviewable questions of

fact for the Tax Court to determine, rather than questions of law that a court of appeals could examine); *see also Mayo Found. For Med. Educ. & Research v. United States*, 131 S.Ct. 704, 713 (2011) ("The principles underlying our decision in Chevron apply with full force in the tax context."); Leandra Lederman, (*Un)Appealing Deference to the Tax Court*, 63 Duke L. J. 1835, 1893 (2014) ("Tax Court[s] have the last word in a large number of tax cases . . . .").

When evaluating the reasonableness of a decision issued by the IRS, this Court should assess "whether the regulation harmonizes with the language, origins, and purpose of the statute." *Bankers Life & Cas. Co v. United States*, 142 F.3d 973, 983 (7th Cir. 1998). In addition, this Court should also consider that exclusions from income are narrowly construed. *See Comm'r of Internal Revenue v. Schleier*, 515 U.S. 323, 328 (1995). In the instant case, the IRS's definition of "foreign country" is consistent with the congressional purpose underlying the exclusion.

For example, the Seventh Circuit reasoned that when Congress replaced the deduction for foreign earned income established by the Foreign Earned Income Act of 1978 with the current exclusion, it did so as a "part of a legislative enactment intended to promote economic growth." *Arnett v. Comm'r of Internal Revenue*, 473 F.3d 790, 795 (7th Cir. 2007) (citing Staff of the Joint Committee on Taxation, *General Explanation of the Economic Recovery Tax Act of 1981*, J. Comm. Print 17 (1981)). As the result of the 1981 Act, the Commissioner issued a new Treasury Regulation, section 1.911-2(h), clarifying the definition of foreign country: "The term 'foreign country' . . . includes any territory under the sovereignty of a government

other than that of the United States . . . [including] the territorial waters of the foreign country . . . [and] the air space over the foreign country . . . ." Treas. Reg. § 1.911-2(h) (1985). The court noted that Congress "believed that American companies, in order to remain competitive overseas, would resort to hiring nationals of the countries in which they sought to compete, and these nationals would, in turn, purchase fewer American-made goods than an American citizen in the same position overseas." *Arnett*, 473 F.3d at 795. The court went on to explain that, given these legislative purposes, "the Commissioner reasonably could have concluded that, because there would not be similar tax burdens in territories outside of the sovereignty of a foreign nation, limiting the definition of 'foreign country' to those geographic areas under the sovereignty of a foreign nation would advance the goal of Congress." *Id.*

Similarly, here, the Fourteenth Circuit affirmed the IRS's determination and noted that, while on its face, it appears that IFIL is a valid "foreign country" based on Executive Order 4012 and a ruling by the Holy Royal Court, neither of these facts establish IFIL to be a "sovereign political entity" within the Sietch State. R. at 18. This is because IFIL has been classified by the State Department as an independent splinter group of the Bene Gesserit, a terrorist organization that operates in the countries surrounding Arrakis. R. at 11. In addition, from 2008 to the present, IFIL has not exercised exclusive rights, in accordance with international law, over any particular land, territorial waters, or air space, but

rather, has consistently moved from place to place throughout the region. *Arnett*, 473 F.3d at 795; R. at 12.

IFIL came to power by rebelling against the Independent People of Sietch, who declared their independence from Arrakis and declared the IPS to be the controlling political regime of an independent Sietch Dunes. R. at 8. However, even after the Sietch Dunes Peace Treaty was signed, the President of Arrakis only gave the leader of the IPS, Paul Atreides, the power to create and enforce laws in the Sietch State. R. at 9. These powers are limited to (i) policing the state and (ii) collecting the State tribute for Arrakis. R. at 9. Furthermore, all policies of the Sietch State must be accepted by the sitting Arrakis President before enactment. R. at 9.

Accordingly, the IPS never exercised *exclusive* rights, over any particular land located within the Sietch State. Therefore, when IFIL launched a rebellion against the IPS in the Sietch State and forcefully acquired control of a region of the Seitch State known as the "Badlands," they were not, by law, in exclusive control of the area. R. at 9-12. This is because Arrakis and the Sietch State still exercised some level of authority over the area. R. at 9-12.

On March 20, 2011, IFIL expanded beyond the Badlands and took physical control of the small drilling station identified as Unit #12 operated by Petitioner. R. at 13. However, they never actually acquired legal control of this land. On April 15, 2011, the Sietch State held its second election and Paul Atreides and Jessica Mohiam of IFIL finished in a "virtual tie." R. at 14. President Corrino declared

Paul Atreides of IPS the winner as part of "the rights of the sitting President of the Republic of Arrakis." R. at 14. The United States declared the election over. R. at 14. By May 16, 2011, the leader-elect of IFIL and Vice-President-in-Protest merely declared IFIL's tax of Unit #12 would remain the same. R. at 15.

However, IFIL never had the ability to levy a tax because it never held exclusive rights over any area of the Sietch State, let alone Unit #12. This is because the President of Arrakis still exercised ultimate control over the area pursuant to the Sietch Dunes Peace Treaty, which only created a post of Vice-President, but never recognized the Sietch State as a sovereign nation. R. at 9. Because IFIL cannot establish any facts to constitute a "sovereign political entity" within the Sietch State, it cannot be evaluated as a "foreign country" under the section 1.911-2(h) of the Treasury Regulations. Thus, because IFIL cannot establish itself as a "foreign country" pursuant to section 901 of the Internal Revenue Code, Petitioner should not be allowed a credit against its federal income tax in the amount of any taxes paid or accrued during the taxable years to IFIL. Accordingly, this Court should affirm the decision of the Fourteenth Circuit.

B. Petitioner's Payments to IFIL Violated the Sietch Dunes Peace Treaty's Limitation of a Single Tax Within the Sietch State.

While this Court should determine that IFIL is not a sovereign political entity under the law of the United States, this is only part of the inquiry. In addition to applying the domestic law, this Court must also look "to the law of the foreign state in order to determine the nature of the obligations and rights which form the basis of the claim of a foreign tax credit." *Amoco Corp. v. Comm'r of*

Internal Revenue, T.C. Memo. 1996-159 at *23 (U.S. Tax Ct. 1996), aff'd, 138 F.3d 1139 (7th Cir. 1998). For instance, in *Amoco*, the court framed the dispute as a question of whether, under Egyptian law, the Egyptian General Petroleum Corporation was entitled to claim a credit against its income taxes for the payments made on account of Amoco Egypt, an Indiana corporation's, income taxes. *Id*. at *25. Here, the first dispute between the IRS and Petitioner involves the question of whether, under the law of Arrakis, IFIL, as part of the Sietch State, has the territorial taxing authority to levy a tax over the small drilling station operated by Petitioner known as Unit #12. R. at 13.

This Court should find that any tax levied by IFIL is an unlawful second tax and, as such, is in violation of the Arrakis Constitution. This is because following the signing of the Sietch Dunes Peace Treaty, President Corrino drafted an amendment to the Arrakis Constitution creating the post of "Vice-President" of the Sietch State. R. at 9. The amendment went into effect on April 13, 2010. R. at 9. The amendment itself included a listing of powers and requirements for the Vice-President, including the fourth provision, "to decree and levy *a single* tax." R. at 9 (emphasis added). On April 15, 2010, Paul Atreides was declared Vice-President of the Sietch State. R. at 9. On April 16, 2010, as his first official act, Vice-President Atreides decreed a single tax under the fourth provision of his Vice-President Powers. R. at 10. According to the decree, ten percent of all income generated in the Sietch State (regardless of citizenship), less any applicable deductions, must be turned over to the Chief Accountant of the Sietch State. R. at 10.

However, a violation of Arrakis law occurred when IFIL forcefully acquired control of Unit #12 and demanded that Petitioner "rectify their insolence and pay tribute" in the amount of a bonus of five hundred and fifty thousand dollars and a five percent royalty to IFIL. R. at 12-13. IFIL further declared that Unit #12 would have its income taxed at two percent. R. at 13. This tax was calculated by taking the receipts generated by Unit #12, and allowing for all deductions authorized by the Sietch State, and then multiplying that by two percent. R. at 13. On March 24, 2011, the Holy Royal Court declared, "Arrakis recognizes IFIL *as a part of* Sietch." R. at 4 (emphasis added). On March 25, 2011, Petitioner paid IFIL the negotiated bonus and royalty amount and, by separate check, paid IFIL the two percent tax indicating on the memo line, "Income Tax to IFIL." R. at 14.

The leader-elect of IFIL continued to demand an illegal tax on Unit #12, despite the fact that Vice-President Atreides was declared the winner of the Sietch State in its second election and had in the previous year decreed a single tax under his fourth provision powers. R. at 13-15. Furthermore, on May 16, 2011, Vice-President Atreides stated that the new tax rate to be paid by foreign companies operating on portions of the Caladan Oil Field within the Sietch State would remain at ten percent. R. at 15. Because the amendment to the Arrakis Constitution was unambiguous, granting the Sietch State the power "to decree and levy a *single* tax," the tax by IFIL, as part of the Sietch State, is an impermissible second tax. Therefore, Petitioner was under no legal obligation to pay IFIL the tax under Arrakisian law. Without this obligation, Petitioner has no basis for the claim of a

foreign tax credit and this Court should affirm the decision of the Fourteenth Circuit.

C. Petitioner Did Not Exhaust All of Its Available Remedies to Reduce the IFIL Tax Burden.

The IRS properly denied Petitioner's claimed foreign tax credit for all payments to IFIL because Petitioner failed to exhaust all of their available remedies to challenge a foreign tax under Sietch's domestic law. Here, Petitioner sought judicial review after the IRS denied Petitioner's claim for a foreign tax credit for all payments made to IFIL. However, the Fourteenth Circuit agreed with the IRS and noted Petitioner could have petitioned the Sietch Council for a determination on the status of IFIL and, therefore, did not exhaust all of its available remedies to reduce the IFIL tax burden. R. at 18.

As part of the analysis, this Court should look towards the doctrine of exhaustion of administrative remedies. *McKart v. United States*, 395 U.S. 185, 193 (1969). The doctrine stipulates "that no one is entitled to judicial relief for a supposed or threatened injury until the prescribed administrative remedy has been exhausted." *Myers v. Bethlehem*, 303 U.S. 41, 50 (1938). This doctrine reflects the long-standing principles of comity within this Court's administrative procedure jurisprudence. *See, e.g.*, *San Remo Hotel, L.P. v. City and Cnty. of S.F., Cal.*, 545 U.S. 323, 347 (2005) ("[W]e have recognized limits to plaintiffs' ability to press their federal claims in federal courts."); *Fair Assessment in Real Estate Ass'n, Inc. v. McNary*, 454 U.S. 100, 116 (1981) (holding that taxpayers are barred by principles of comity from asserting actions against the validity of state tax systems in federal

courts); *McKart*, 395 U.S. at 193 ("The doctrine of exhaustion of administrative remedies is well established in the jurisprudence of administrative law.").

Courts have interpreted this doctrine to apply to tax disputes where the taxing authorities have exclusive jurisdiction and the taxpayers must exhaust their administrative remedies before seeking judicial review. *See, e.g.*, *MAG-T, L.P. v. Travis Cent. Appraisal Dist.*, 161 S.W. 3d 617, 625 (Tex. 2005); *Proctor & Gamble Co. v. United States*, 2010 WL 2955099 at *7 (S.D. Ohio 2010). Moreover, Treasury Department Regulations require taxpayers to "exhaust all effective and practical remedies including invocation of competent authority procedures available under applicable tax treaties . . . ." Treas. Reg. § 1.901-2(e)(5)(i). Accordingly, this Court should affirm the Fourteenth Circuit's decision because Petitioner, like the taxpayer in *MAG-T, L.P.*, failed to exhaust all of their remedies under a foreign jurisdiction.

First, Petitioner flew to Unit #12 and met with IFIL once it released the statement that "Harkonnen Oil is slant drilling the Badlands and until they rectify their insolence and pay tribute, IFIL will control oil production from Unit #12." R. at 13. Petitioner protested the tax demand during the negotiations and subsequently left. R. at 14. However, the primary remedy Petitioner sought was telephoning President Corrino of Arrakis and asking him how they should handle IFIL's tax request. R at 14. In response to President Corrino's advice, Petitioner only appealed to the Holy Royal Court of Arrakis for a determination of the status of IFIL and its ability to levy a tax. R. at 14. The Holy Royal Court merely declared, "Arrakis recognizes IFIL as a part of Sietch." R. at 14. This holding did not

affirmatively recognize IFIL's right to tax. In fact, the Holy Royal Court's ruling may be interpreted to mean that IFIL, as a part of the Sietch State, cannot tax without violating the Arrakis Constitution. A subsequent tax from IFIL, as part of the Sietch State, was an improper second tax in violation of the Arrakis Constitution. At least, this holding strongly suggested that Petitioner should defer to Sietch State legal authority.

For instance, Petitioner could have petitioned the Sietch Council for a determination on the status of IFIL. The Sietch Council likely would have alerted Petitioner that IFIL lacked the authority to levy a tax because Vice-President Atreides already decreed the single tax permitted under Arrakis law. R. at 10. Instead, however, Petitioner interpreted the declaration that "Arrakis recognizes IFIL as a part of Sietch," to signify IFIL's ability to levy a tax. This was an inaccurate assumption. Petitioner should have sought out other remedies in order to ensure they were paying taxes to the proper authority.

In addition, while courts have recognized exceptions to the exhaustion of administrative remedies doctrine, Petitioner does not fall under any recognized exception. For instance, there is an exception to the doctrine of exhaustion of administrative remedies when the administrative remedies are inadequate or an aggrieved party will suffer irreparable harm. *MAG-T, L.P.*, 161 S.W. 3d at 625. Petitioner has made no such assertion. Petitioner would have suffered seemingly no apparent harm by petitioning the Sietch Council for a determination on the status of IFIL. In addition, the Fourteenth Circuit held that petitioning the Sietch

Council for a determination on the status of IFIL was an adequate remedy. R. at 18. Accordingly, this Court should affirm the decision by the IRS and the Fourteenth Circuit and find that Petitioner did not exhaust all of its available remedies to reduce the IFIL tax burden.

CONCLUSION

The Fourteenth Circuit correctly held that the Arrakis Foreign Tax fails to qualify for the foreign income tax credit under section 901 of the Internal Revenue Code. Petitioner agreed to pay the Arrakis Foreign Tax in the context of a negotiation for the right to develop the Caladan Oil Field, and these payments were outside the scope of Arrakis's tax authority. Furthermore, the Arrakis Tax Code limits the amount of foreign corporate deductions. This prevents the Arrakis Foreign Tax from credibly reaching net income, and the tax therefore does not have the character of a United States income tax. Finally, public policy weighs against recognition of the tax credit because United States laws should not – and cannot – accommodate Arrakis' archaic practice of imposing economic sanctions against religious minorities.

Likewise, Petitioner does not qualify for a foreign tax credit under section 903 of the Internal Revenue Code because neither the Arrakis Foreign Tax nor the Central Bank's withholding function as a substitute for an income tax. Arrakis' policy of withholding revenue is not a substitute for an otherwise applicable income tax because Petitioner is not subject to a general income tax. Additionally, the Central Bank of Arrakis' practice of withholding funds prior to remittance does not

qualify as a "withholding tax" because the tax rate is significantly higher than that which would be withheld under the Arrakis Foreign tax.

The Fourteenth Circuit also properly denied Petitioner's claimed foreign tax for all tax payments to the Inter-Sietch Fremen Independence League because IFIL cannot establish itself as a sovereign political entity under United States law. IFIL does not have the legal authority to levy a tax because it is not a valid taxable entity. Furthermore, Petitioner's payments to IFIL violated the Sietch Dunes Peace Treaty's Limitation of a single tax within the Sietch State; any tax demanded by IFIL was an impermissible second tax in violation of Arrakis law. Finally, Petitioner did not petition the Sietch Council for a determination on the status of IFIL, and therefore did not exhaust all of its available remedies to reduce the IFIL tax burden.

For the aforementioned reasons, this Court should AFFIRM the decision of the Fourteenth Circuit and find in favor of the United States.

Dated: November 24, 2014

Respectfully Submitted,

/s/ Team # R 23

Team # R 23
Counsel for Respondent

APPENDIX A

United States Internal Revenue Code

26 U.S.C. § 901 – Taxes of Foreign Countries and Possessions of the 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.

26 U.S.C. § 903 – Taxes of Foreign Countries and Possessions of the United States:

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.