No. C15-1701-1

In The
Supreme Court of the United States

ROYAL HARKONNEN OIL COMPANY,
Petitioner,

v.

UNITED STATES OF AMERICA
Respondent.

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

BRIEF FOR RESPONDENT

Team 53
Counsel for Respondent

QUESTIONS PRESENTED

1. Sections 901 and 903 of the Internal Revenue Code allow domestic corporations to receive tax credits for "any income, war profits, and excess profits taxes paid . . . to any foreign country." From 2008 until 2011, Harkonnen Oil paid levies to the Republic of Arrakis in exchange for the right to extract and use resources from their land. At its enactment, this levy was calculated using Harkonnen Oil's gross receipts, with no deductions; however, some deductions were later permitted. Were Harkonnen Oil's payments to Arrakis creditable foreign tax credits under United States Tax Code?

2. Subsection (j) of 26 U.S.C. § 901 denies credits for taxes paid to certain foreign countries, including those whose governments "the United States does not recognize." The United States State Department classifies the Inter-Sietch Fremen Independence League as an independent splinter group of a known terrorist organization. Though it said it would consider the matter, the United States has never formally acknowledged any legitimacy of IFIL. Moreover, the Arrakis Constitution does not give IFIL the power to tax. Were Harkonnen Oil's payments to IFIL properly denied under United States Tax Code?

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The United States District Court for the Central District of New Tejas denied any tax credits to Petitioner for taxes paid abroad. The Record does not indicate that the district court issued a written opinion. R. at 2.

On appeal, the United States Court of Appeals for the Fourteenth Circuit affirmed the denial of tax credits to Harkonnen Oil in favor of the United States. The opinion of the Fourteenth Circuit is unpublished, but is reproduced on pages 2-21 of the Transcript of the Record.

JURISDICTIONAL STATEMENT

The district court had federal question jurisdiction to decide this case pursuant to 28 U.S.C. § 1331 (2012) because this case arises under two federal statutes, 26 U.S.C. § 901 (2012) and 26 U.S.C. § 903 (2012). The district court denied Petitioner's request for tax credits paid abroad; Petitioner appealed the final judgment to the Fourteenth Circuit Court of Appeals. That court had appellate jurisdiction pursuant to 28 U.S.C. § 1291 (2014) and affirmed the decision of the district court below on October 1, 2014. Harkonnen Oil timely filed a petition for a writ of certiorari, which was granted. This Court has appellate jurisdiction to hear this case under 28 U.S.C. § 1254 (2012).

STATUTORY PROVISIONS INVOLVED

The relevant statutory provisions in this case are 26 U.S.C. §§ 901 and 903 and Treasury Regulations §§ 1.901-2 and 1.903-1. These provisions are reproduced in the Appendix.

STATEMENT OF THE CASE

This case involves an American corporation, Royal Harkonnen Oil Company ("Harkonnen Oil"), which paid levies to the Republic of Arrakis ("Arrakis") and the Inter-Sietch Fremen League ("IFIL") in order to develop and extract oil from their lands. Harkonnen Oil now seeks tax credits for these levies paid abroad; the United States denies that either claimed credit is valid.

A. Harkonnen Oil pays Arrakis for exclusive rights to develop the Caladan Oil Field.

Arrakis is a foreign country created in 1952 when the Eternal Arrakis Empire conquered the Sietch Empire. R. at 3. It is bordered by the countries of Salusa Secundus, Al Dhanab, and Anbus. R. at 12. Arrakis' capital is Arrakeen, and its President is Jules Corrino. R. at 3, 8.

In March 2007, Harkonnen Oil began investigating the feasibility and profitability of extracting oil and natural gas from Arrakis' Caladan Oil Field ("the Field"). R. at 2. After several months, Harkonnen Oil concluded that oil and gas reserves could be profitably extracted from the Field, but because such extraction would require the use of new technologies and recovery techniques, any excessive levies would render potential profits null. R. at 3. On February 5, 2008, Harkonnen Oil began negotiations with President Corrino for exclusive rights to develop the Field, with much of the discussion naturally focusing on royalty payments. R. at 3-4. Negotiations continued for several months. R. at 4.

While negotiations were under way, the media covered tax implications for foreign countries because of their importance to the pending Field lease. R. at 4.

Significantly, then-current Arrakis Tax Code, which was rooted in ancient ancestral stratification, did not permit the taxation of foreign entities residing or doing business in Arrakis as they had no connection to either the historic Arrakis or Sietch thrones. *Id.* Indeed, this long-standing rule, codified over hundreds of years, was recently affirmed by Arrakis' highest court; The Holy Royal Court held in *Remmington v. Republic of Arrakis* that foreign citizens and entities were not subject to taxation. *Id.*

Just a month after negotiations began with Harkonnen Oil, on March 10, 2008, President Corrino amended ancient Arrakis Tax Code by enacting the Republic of Arrakis Foreign Value Tax ("Value Tax"). R. at 5. This Value Tax was to apply to all foreign entities operating machinery in Arrakis and was based on gross receipts. *Id.* Specifically, the tax was calculated by multiplying the gross receipts of the corporation's operations in Arrakis during a calendar year by a tax percentage, which was to be determined at a later, unspecified date. *Id.* Although Arrakis Tax Code provided robust tax deductions to its citizens—ones recognized by the United States Internal Revenue Service ("IRS") as comparable to deductions available under United States Tax Code—these same deductions were not available to foreign entities under the Value Tax. R. at 4-5.

To execute such taxation, the Value Tax mandated that all money earned in Arrakis be deposited into the Central Bank of Arrakis ("the Bank"), which would perform all calculations. R. at 5. The Bank would then distribute the taxed funds to the Arrakis Treasury and issue the remaining funds to the foreign corporation. *Id.* This procedure was to be completed within 90 days of each deposit. *Id.*

On April 12, 2008, Arrakis mobilized its military in the Sietch Dunes region to silence an uprising. R. at 5. The rebels sought return to an independent Sietch throne. *Id.* At one point, Arrakis secured a blockade of all supply routes to the Sietch Dunes. *Id.* Media coverage portrayed the conflict as violent and as containing potential human rights violations, but President Corrino rebuffed any such international concerns. R. at 6. This conflict ended one month later. R. at 7.

On June 30, 2008, President Corrino applied a 45 percent tax rate to the previously unvalued Value Tax. R. at 7. He also renamed the Value Tax the Republic of Arrakis Foreign Tax ("Foreign Tax"); calculation of the Foreign Tax is the same as that of the Value Tax. *Id.* That same day, negotiations between Harkonnen Oil and President Corrino concluded with the execution of the Arrakis Lease. *Id.* Harkonnen Oil agreed to pay 55 million dollars and 15 percent royalties in exchange for permission to develop the entire Caladan Oil Field. *Id.* Harkonnen Oil additionally agreed to pay the Value Tax. *Id.*

Harkonnen Oil produced its first barrels of crude oil on January 15, 2009. R. at 7. Nine months later, Harkonnen Oil was producing 858,000 barrels per day. *Id.*

On May 19, 2011, President Corrino lowered the Foreign Tax to 33 percent. R. at 15. Additionally, he issued Proclamation 102 permitting foreign corporations to take 95 percent of all tax deductions available to Arrakis citizens, citing religious reasons for the difference. *Id.*

B. The Sietch Dunes region becomes Sietch State and levies a single tax.

The Sietch Dunes are located in the northern region of Arrakis and include a 62,000 square mile portion of the Caladan Oil Field. R. at 5.

On April 12, 2010, following a period of rebellion by the Independent People of Sietch ("IPS"), President Corrino, along with Harkonnen Oil and the United States Ambassador to Arrakis, announced a truce with the IPS. R. at. 8. The Sietch Dunes Peace Treaty provided that the Sietch Dunes region become Sietch State and be designated an "Important Province of Arrakis." *Id.* Moreover, the treaty granted exclusive power to Sietch State to appoint the Arrakis Vice-President. *Id.* In return, Sietch State agreed to send monetary tribute to Arrakis and to never seek independence again. R. at 8-9.

On April 15, 2010, Sietch State exercised its right to elect a Vice-President and voted Paul Atreides to the position. R. at 9. Per the Arrakis Constitution, the Vice-President's powers included the power to "[d]ecree and levy a single tax." *Id.* Atreides decreed a single tax on April 16, 2010. R. at 10.

The Sietch Tax mandated that ten percent of all income generated in Sietch State, regardless of citizenship, be turned over to the Chief Accountant of Sietch State. R. at 10. Sietch State adopted all deductions available under Arrakis Tax Code, and applied them consistently to all income-generating entities. *Id.* The funds generated by this tax were used to pay tribute to Arrakis. *Id.*

On July 6, 2010, the United States State Department declared Sietch State to be a "Quasi-Autonomous Region" and agreed to establish diplomatic ties with it; the

United States Treasury Department declared it would accept transactions from Sietch State. R. at 10, 11. Additionally, the United States arranged for a temporary consulate in Arrakeen. R. at 10.

C. IFIL is a political group, not a sovereign land, and is controlled by neighboring countries of Al Dhanab and Anbus.

IFIL was created in 2008 by Jessica Mohiam. R. at 12. Mohiam's mother founded Bene Gesserit, a terrorist organization out of Salusa Secundus. R. at 11, 12. As such, IFIL has been classified by the United States State Department as a splinter group of Bene Gesserit. R. at 11. Although Mohiam has rebelled against her mother and the Bene Gesserit since March 2005, she previously associated with the organization for 18 years. *Id.*

Al Dhanab and Anbus provide financial support to IFIL. R. at 12. In exchange, Mohiam has promised to promote economic development in states where Sietchians reside. *Id.* Al Dhanab and Anbus also have significant—indeed, almost unanimous—control over the election of IFIL's "Leader Elect." Of the seven electoral votes, the royal families of Al Dhanab and Anbus, together, have six. *Id.* The final electoral vote is reserved for a majority election among all members of IFIL; notably, these members likely include citizens of both Al Dhanab and Anbus, as well as other non-Sietch State citizens, since some Sietchians live outside of Sietch State. *Id.* A candidate must only receive five electoral votes. *Id.* Thus, Al Dhanab and Anbus can, without any impact from the majority election, control any given election. In fact, in IFIL's six years of existence, Mohiam has been unanimously elected each year. R. at 12.

On December 31, 2010, IFIL began a rebellion in Sietch State, demanding Atreide's resignation and declaring Mohiam as the only legitimate Vice-President of Sietch State. R. at 11. Three days later, both Al Dhanab and Anbus declared IFIL to be a legitimate foreign government and an independent state of the Sietch Dunes region. R. at 12. They jointly petitioned the United States and the United Nations for recognition of IFIL. *Id.* The United States agreed to evaluate the matter, but never made a definitive or formal conclusion. R. at 12-13. Both Arrakis and Sietch State denied IFIL's legitimacy. R. at 13.

In March 2011, IFIL forcefully took control of two regions within Sietch State: the Badlands and Unit #12, which is a small drilling station operated by Harkonnen Oil. R. at 13. IFIL demanded that Harkonnen Oil pay IFIL for its use of the Badlands before it would relinquish control of Unit #12. R. at 13. Consequently, on March 22, 2011, Harkonnen Oil's CEO, Mr. Harkonnen, flew to Unit #12 to meet with Mohiam. R. at 13.

During their meeting, Mohiam and Mr. Harkonnen executed the IFIL Lease, providing that Harkonnen Oil would pay a bonus of 550 thousand dollars and five percent royalty to IFIL. R. at 13. Mohiam verbally added that income from Unit #12 would be taxed at two percent, accounting for all Sietch State deductions. *Id.* Mr. Harkonnen did not agree to the additional tax and left the negotiation. R. at 14.

Unsure how to handle IFIL's tax request, Mr. Harkonnen contacted President Corrino, who advised that all legal tax disputes in Arrakis are handled by the Holy

Royal Court. R. at 14. On March 23, 2011, Harkonnen Oil petitioned the Holy Royal Court for a determination of the status of IFIL and its ability to levy a tax. *Id.* One day later, the Court responded, offering that "Arrakis recognizes IFIL as a part of Sietch." *Id.*

On March 25, 2011, Harkonnen Oil paid the two percent tax to IFIL. R. at 14. All checks and funds were deposited into a Swiss bank account opened by the heir to the throne of Anbus for IFIL. *Id.* Mohiam paid 20 percent of IFIL's funds to the monarchies of Al Dhanab and Anbus, though the remaining 80 percent is unaccounted for. *Id.*

Sietch State had its second Vice-Presidential election on April 15, 2011. R. at 14. Both Atreides and Mohiam ran, with votes ending in a virtual tie. *Id.* Corrino declared Atreides the winner per his power as President of Arrakis. *Id.* Shortly after the election, the President of the United States issued Executive Order 14012 declaring IFIL a "sovereign friend" with whom "we would like to establish trade relations." *Id.*

D. The IRS denies Harkonnen Oil's claimed foreign tax credits, and Harkonnen Oil appeals.

On March 15, 2012, Harkonnen Oil claimed foreign tax credits for its payments made to Arrakis, Sietch State, and IFIL. R. at 16. After performing an audit, the IRS concluded that payments to Arrakis and IFIL were not creditable foreign tax credits, but that payments to Sietch State were creditable. R. at 16-17. Further negotiations with the IRS failed, so Harkonnen Oil paid the full tax, and then filed suit in the United States District Court for the Central District of New Tejas. R. at 17. The District Court affirmed the IRS' decision. *Id.*

A three-judge panel of the United States Court of Appeals for the Fourteenth Circuit affirmed the decision of the district court in a divided decision on October 1, 2014. R. at 2. The majority, Judges Wright and Herbert, held that the Arrakis levy was not a creditable foreign tax credit under either 26 U.S.C. § 901 or 26 U.S.C. § 903 because it was not akin to a United States income tax, because it did not credibly reach net income or provide for significant cost recoveries, and because it was not "in lieu of" an otherwise applicable income tax. R. at 17-18. Additionally, they found that the IRS properly denied Harkonnen Oil's claimed tax credits for payments to IFIL because IFIL was not a valid taxable entity, because the IFIL tax violated the Arrakis Constitution, and because Harkonnen Oil did not exhaust all available remedies to reduce its tax burden. R. at 18. In dissent, Judge Layton reasoned that deference should be given to the foreign perspective, which would lend validity to the Arrakis levy. R. at 20. He then argued that Harkonnen Oil did exhaust all remedies and that it should not be required to seek relief from every possible authority. R. at 21.

After the court of appeals affirmed the denial of foreign tax credits, Harkonnen Oil petitioned this Court. Certiorari was granted and arguments were scheduled for January 2015. The United States of America respectfully requests that this Court affirm the judgment of the courts below.

SUMMARY OF THE ARGUMENT

The Fourteenth Circuit correctly held that Harkonnen Oil is not entitled to foreign tax credits for its payments to Arrakis or to IFIL. This court should affirm the decision below for two reasons. First, Harkonnen Oil's payments to the Republic of Arrakis are ineligible foreign tax credits because the Arrakis levy does not meet the requirements of either 26 U.S.C. § 901 or 26 U.S.C. § 903. Second, Harkonnen Oil's payments of taxes to IFIL are not creditable as foreign tax credits because IFIL is not a valid taxable entity.

I. Payments to Arrakis are not foreign tax credits under 26 U.S.C. § 901 or 26 U.S.C. § 903.

In order for a foreign levy to qualify for a United States foreign tax credit, the levy must meet the requirements designated in either 26 U.S.C. §§ 901 or 903. Because payments made in accordance with the Arrakis levy do not meet the requirements of either 26 U.S.C. § 901 or 26 U.S.C. § 903, this Court should find that any payments made by Harkonnen Oil to Arrakis are not credible for United States tax purposes.

Payments made under the Arrakis levy fail to meet the foreign tax credit qualifications set out in 26 U.S.C. § 901. First, the Arrakis levy is not a tax at all. Because Harkonnen Oil received a special economic benefit from their payments to Arrakis, the payment of the levy is disqualified as a "tax" under 26 U.S.C. § 901. Further, the predominant character of the Arrakis levy does not match that of an income tax in the U.S. sense. The levy does not reach net gain, as there is no reduction in gross receipts to permit recovery of significant costs, and there is no guarantee of profit offset. Arrakis' naming of the levy was appropriate; the levy taxes value, not income.

Payments made to Arrakis also fail to meet the qualifications of 26 U.S.C. § 903 because the Arrakis levy was not "in lieu of" a tax on income, war profits, or excess profits. Section 903 allows certain foreign taxes that fail section 901's test to nevertheless qualify as "income taxes" where they are specifically imposed in lieu of an income tax. Here, the Arrakis levy was not imposed in lieu of an income tax. It was levied in addition to other profit-based levies. Furthermore, it is not structured as a traditional income tax. Thus, the Arrakis levy fails to satisfy § 903.

There are no policy considerations so compelling as to require this Court to engage in legislative rule-making responsibilities. Sections 901 and 903 are clear: if a taxpayer wishes to benefit from United States foreign tax credits, then that taxpayer must adhere to a strict interpretation of the United States' carefully enacted laws.

In sum, this court should affirm the Fourteenth Circuit's denial of foreign tax credits for levies paid to Arrakis.

II. Payments to IFIL are not creditable foreign tax credits because IFIL is not a valid taxable entity.

Foreign tax credits may be denied for otherwise qualified taxes where the United States government does not recognize the government of the taxing foreign country or where the foreign country is not competent to levy a tax. Because the United States does not recognize the government of the IFIL, and because IFIL has no authority within Sietch State to exact a tax, this Court should find the IFIL tax to be invalid as a foreign tax credit.

First, the United States does not recognize the government of IFIL. To the extent that IFIL was manipulated by Al Dhanab and Anbus, the United States has never outwardly recognized the governments of those nations; otherwise, the United States has reserved its support of IFIL as an authority. Furthermore, historical application of the law would indicate that the United States should not acknowledge IFIL, as it has declined to recognize similar groups, like the Taliban.

Second, IFIL has no authority to levy a tax in Sietch State. Vice-President Atreides already levied a tax in Sietch State, and any secondary tax would be impermissible per the Arrakis Constitution. The Constitution of Arrakis clearly identifies those who are permitted to levy a tax and IFIL is absent from such list.

Moreover, Harkonnen Oil did not exhaust all practical and effective remedies to discover that IFIL was not a valid taxable entity. Harkonnen Oil did petition the Holy Royal Court for determination of IFIL's competency to tax, but it never received a pointed answer. Given that there was a potentially unnecessary tax at issue and that there was no indication that further research would have been futile, Harkonnen Oil had a duty to look into additional remedies to determine IFIL's status. Because it failed to exhaust all administrative remedies, this Court should preclude Harkonnen Oil from now challenging the denial of its foreign tax credit.

In sum, this court should affirm the Fourteenth Circuit's denial of foreign tax credits for levies paid to IFIL.

ARGUMENT

This Court should affirm the decision below. First, Harkonnen Oil's payments to Arrakis are ineligible foreign tax credits under both 26 U.S.C. § 901 and 26 U.S.C. § 903 because they were not income taxes or levies paid in lieu of income taxes. Second, Harkonnen Oil's payments to IFIL are ineligible foreign tax credits because IFIL was not a valid taxable entity. The standard of review for both issues on appeal is *de novo*. *PPL Corp. v. Comm'r*, 133 S. Ct. 1897 (2013).

I. Harkonnen Oil's payments to the Republic of Arrakis are ineligible foreign tax credits because the Arrakis levy does not meet the requirements of either 26 U.S.C. § 901 or 26 U.S.C. § 903.

Harkonnen Oil was denied foreign tax credit for payments made to Arrakis as neither the district court below nor the Fourteenth Circuit found them to be creditable under 26 U.S.C. § 901 or 26 U.S.C. § 903. Section 901 provides that domestic corporations can receive credit for "any income, war profits, and excess profits taxes paid . . . to any foreign country." 26 U.S.C. § 901(b)(1) (2012). Section 903 expands those taxes creditable under 901 to include taxes "paid in lieu of a tax on income, war profits, or excess profits." 26 U.S.C. § 903 (2012).

On June 30, 2008, Harkonnen Oil entered into the Arrakis Lease with the Republic of Arrakis and agreed to pay 55 million dollars, along with 15 percent royalties and a 45 percent Foreign Tax, to develop and extract oil from the Caladan Oil Field. R. at 7. The Foreign Tax was to be calculated using Harkonnen Oil's gross receipts, with no deductions. R. at 5. Later, the Foreign Tax was amended to provide for some deductions, but it did not account for all deductions available under United States tax law. R. at 4, 15.

This Court should affirm the Fourteenth Circuit's denial of foreign tax credit to Harkonnen Oil for three reasons. First, the Arrakis levy is not an "income tax" as required by 26 U.S.C. § 901. Second, it is not "in lieu of" an income tax per 26 U.S.C. § 903. Third, there are no policy considerations that indicate a need to depart from either §§ 901 or 903. Consequently, it is proper to deny any claimed foreign tax credits in favor of the United States of America.

A. The Arrakis levy is not an "income tax" under 26 U.S.C. § 901.

Foreign tax credits under § 901 are not universal; they only apply to particular types of taxes. Specifically, such taxes include "income, war profits, and excess profits taxes." 26 U.S.C. § 901(b)(1). These tax credits are a "privilege extended by legislative grace" and as such, qualification under § 901 is to be strictly construed. *Texasgulf, Inc. & Subsidiaries v. Comm'r*, 172 F.3d 209, 214 (2d Cir. 1999) (internal quotations omitted). A foreign levy is an "income tax" if and only if it is a tax, and the predominant character of that tax is that of an "income tax in the U.S. sense." Treas. Reg. § 1.901-2 (2013).

The Arrakis levy is not an income tax as it fails both requirements of Treasury Regulation § 1.901-2. First, it is not a tax. Second, even if it were a tax, its predominant character is not that of United States income tax. Therefore, payments made by Harkonnen Oil are not a qualified foreign tax credits under § 901.

1. The Arrakis levy is not a tax and thus does not constitute an "income tax" for the purposes of foreign tax credit.

The Arrakis levy is not a tax. A foreign levy is a tax "if it requires a compulsory payment pursuant to the authority of a foreign country to levy taxes." Treas. Reg. § 1.901-2(a)(2)(i). However, a levy is not a tax if the payor receives a special economic benefit from the foreign country in exchange for payment of the levy. *Id.*

A special economic benefit is a benefit "not made available on substantially the same terms to substantially all persons subject to the generally imposed income tax." Treas. Reg. § 1.901-2(a)(2)(ii)(B). It includes "property, . . . a fee, . . . or *a right to use, acquire, or extract resources*." *Id.* (emphasis added). As a concrete example, the Treasury Regulation provides that "a concession to extract government-owned petroleum" is a special economic benefit, contrasting "the right to travel or to ship freight on a government-owned airline," which are made generally available on substantially the same terms. *Id.*

In *Exxon Corp. v. Comm'r*, 113 T.C. 338, 340 (1999), Exxon challenged the IRS's characterization of its Petroleum Revenue Tax ("PRT") payments to the United Kingdom as a specific economic benefit. Exxon already had licenses to explore and develop commercial oil and gas reserves in the North Sea; however, as oil prices began to rise, the United Kingdom sought to ensure their receipt of adequate profits and enacted the PRT. In arguing the PRT's creditability as a foreign tax credit under § 901, Exxon conceded that the licenses it originally purchased to access North Sea resources were specific economic benefits. Indeed, the parties negotiated the terms of the licenses at arm's length, and royalties paid under the licenses constituted "reasonable and substantial compensation" for use of the North Sea region. *Id.* at 343.

The PRT, however, was not found to be a specific economic benefit. The United States Tax Court reasoned that the PRT granted Exxon no additional rights in the North Sea region, as its rights to explore and develop were rooted in the original license. Moreover, the PRT was not negotiated by the parties, but imposed unilaterally, as is characteristic of taxes.

As expressly contemplated by the Treasury Regulation and confirmed by *Exxon*, "concession to extract government-owned petroleum is a specific economic benefit." Treas. Reg. § 1.901-2(a)(2)(ii)(B). Because oil and gas are expendable resources, licenses or leases to explore and develop reserves cannot, inherently, be "made available on substantially the same terms to substantially all persons." *Id.* Individual use by one party is necessarily to the exclusion of all others, unlike the right to travel on a government-owned airline, for example. *Id.*

Like the original Exxon licenses, Harkonnen Oil's payments under the Arrakis Lease, which included payment of royalties and the March 10, 2008 Value Tax, do not constitute a tax as they were made in exchange for special economic benefits. Specifically, Harkonnen Oil received exclusive rights to develop the Caladan Oil Field in exchange for its payments to Arrakis. R. at 7. Like the Exxon licenses, the terms of the Arrakis Lease were negotiated by the parties—here, for nearly five months—and the terms were presumably reasonable, given Harkonnen Oil's initial concern for reasonable terms, R. at 3, and its subsequent "agree[ment]." R. at 7. Contractual liability is simply not the same as a tax burden. *See Phillips Petroleum Co. v. Comm'r*, 104 T.C. 256, 295 (1995) ("A tax is compulsory, an exaction of sovereignty rather than something derived by agreement."). Therefore, payments to Arrakis were not taxes, but rather contracted-for compensation in exchange for Harkonnen Oil's special economic benefit.

To be sure, the Arrakis levy is not comparable to the PRT tax because it was enacted concurrently and conjunctively with the royalty and bonus payment under the Arrakis Lease. R. at 7. Here, it was not the case that there was a pre-existing license by which Harkonnen Oil already had exclusive rights to the Field as in *Exxon*. Instead, the Arrakis levy was part and parcel of the original Arrakis Lease; the ability to extract oil was inextricably tied to payment of the Arrakis levy. R. at 7. Moreover, payments to Arrakis were not imposed unilaterally as taxes—like PRT—often are, but rather were negotiated for months. R. at 4.

Harkonnen Oil's lease to extract oil was a special economic benefit offered in exchange for its payment of levies to Arrakis. Because Harkonnen Oil received a special economic benefit, the levy is not a tax; therefore, the levy cannot be deemed an "income tax" under 26 U.S.C. § 901, as it fails one of the two requirements.

2. The Arrakis levy does not have the predominant character of an income tax in the U.S. sense and thus does not constitute an "income tax" for the purposes of foreign tax credit.

Even if the Arrakis levy were deemed to be a tax, the predominant character of such a tax would not be that of an "income tax in the U.S. sense." Treas. Reg. § 1.901-2(a)(1)(ii). The predominant character requirement is met if "the foreign tax is likely to reach net gain in the normal circumstances in which it applies," meaning where the tax satisfies each of the realization, gross receipts, and net income requirements when judged on the basis of its predominant character. Treas. Reg. §§ 1.901-2(a)(2)(ii)(E)(3)(i), 1.901-2(b)(1). Only the net income requirement is at issue in this appeal. R. at 17.

A foreign tax satisfies the net income requirement if the "base of the tax is computed by reducing gross receipts to permit recovery of significant costs and expenses." Treas. Reg. § 1.901-2(b)(4)(i). Recovery of significant costs and expenses can be exact or reasonably approximated. Treas. Reg. §§ 1.901-2(b)(4)(i)(A)-(B); *see also*, *Texasgulf*, 172 F.3d at 217 (holding that because the OMT provided an allowance that "effectively compensates for the nonrecoverable expenses," it met the net income requirement). A tax cannot be an "income tax" in the U.S. sense if it does not, in fact, tax income or that which is earned. *See* Black's Law Dictionary 831 (9th ed. 2009) (defining income as that which is earned profit); *see also*, *Bank of Am. Nat'l Trust & Sav. Ass'n v. Comm'r*, 61 T.C. 752, 760 (1974) (declining to qualify the tax in question as an "income tax," since it taxed both successful, income-generating banks and unsuccessful, no income-generating banks equally).

Thus, if the tax reaches net income, it may be paralleled to an income tax and thus acceptable under § 901, assuming it meets other applicable statutory requirements.

From June 30, 2008, when the Arrakis Value Tax was enacted, until May 19, 2011, Harkonnen Oil paid taxes to Arrakis based on the gross receipts it generated in Arrakis. R. at 5. There were no deductions of any kind offered by the Value Tax during this time. *Id.* Nor were there allowances or other credits which would have "effectively compensated" Harkonnen Oil for its expenses. *Texasgulf,* 172 F.3d at 217. Thus, on its face, the Arrakis levy failed to meet the net income requirement of the predominant character test because it failed to reduce gross receipts by significant costs and recoveries.

However, a foreign tax whose base is gross receipts *may* satisfy the net income requirement in the limited circumstance where it reaches net gain because costs and expenses are so low that they barely affect the gross receipts and because the rate of the tax is such that after being paid that there almost certainly remains net gain. Treas. Reg. § 1.901-2(b)(4)(i). For example, a tax on gross earnings from interest and dividends is still creditable because that type of passive investment income involves little, if any, expenses of production. *See Inland Steel Co. v. United States*, 677 F.2d 72 (Ct. Cl. 1982), *but see Keasbey & Mattison Co. v. Rothensies*, 133 F.2d 894 (3d Cir. 1943) (holding a tax that restricted allowable deductions to include only costs incurred in mining operations of an active asbestos quarry to be noncreditable as such costs were not negligible).

These rare circumstances are not present in the current case. First, the costs and expenses of developing the Caladan Field are hardly minimal. The U.S. Energy Information Administration measured the cost of oil and gas production in foreign countries to cost, on average, $25.08 per barrel in 2009. *See How much does it cost to produce crude oil and natural gas?*, U.S. Energy Information Administration, (Nov. 19, 2014), http://www.eia.gov/tools/faqs/faq.cfm?id=367&t=6. Thus, by October 30, 2009, Harkonnen Oil was spending 21.5 million dollars per day[1] on oil production expenditures alone; this does not include costs of insurance against explosions or leaks. R. at 7. Like maintenance of an active quarry, oil and gas extraction can fairly be characterized as costly; it is far from a passive investment.

Second, it cannot be said that the rate of the tax is such that after being paid, there almost certainly remains net gain that can predictably offset losses. *See* Treas. Reg. § 1.901-2(b)(4)(ii) (identifying consolidation of profits and losses as a relevant factor). Recall that the tax was set at a lofty 45 percent. R. at 7. Moreover, there is no indication that oil activities within Arrakis are stable enough that after the payment of taxes, there will remain a definitive net gain. Foreign entities attempting to establish themselves within a country ripe with uprisings often have complications; political instability presents a significant obstacle. *See* Ian Bremmer, *Managing Risk in an Unstable World*, Harv. Bus. Rev., June 2005 (detailing the tumultuous change of power in Russia when Sergei Kiriyenko

[1] This value is calculated by multiplying 858,000 barrels of oil per day, R. at 7, by the EIA's estimated $25.08 cost per barrel of oil.

replaced Viktor Chernomyrdin as prime minister in March 1998 and the resultant fiscal crisis and plummeting oil prices).

At the time Harkonnen Oil sought to establish itself, there was political unrest in Arrakis. Not only was the President rapidly altering the well-founded taxation system on whims, but the nation was also attempting to handle Sietch uprisings and fallout from possible human rights violations. With so many obstacles on both a national and international scale, it would be more than optimistic to assume that the oil industry would bring steady and consistent receipts large enough to ensure net gain. Therefore, it cannot be said that the Arrakis levy falls within the net income exception, so it does not constitute an "income tax in the U.S. sense."

On May 19, 2011, the Foreign Tax was amended to provide for some tax deductions. R. at 15. Such deductions included those historically available to Arrakis citizens, which match available deductions under United States Tax Code. R. at 4. However, these deductions were capped at 95 percent. R. at 15. Although five percent might not seem like a significant diminution in value, given the expenses incurred by Harkonnen Oil, it can be significant. Using the same daily cost of production figure as before, the 95 percent cap causes Harkonnen Oil to lose approximately 1.08 million dollars per day,[2] or around 270 million per year,[3] assuming it works five days a week and does not increase production. Moreover,

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[2] This value is calculated by multiplying 21.5 million dollars by five percent.

[3] This value is calculated by multiplying 1.08 million dollars by 250, the approximate number of workdays in any given year.

given Harkonnen Oil's capital investment of 55 million dollars, which is to be considered under Treas. Reg. § 1.901-2(b)(4)(i)(A), and due royalties, it cannot be said that the 95 percent deductions will adequately compensate Harkonnen Oil for it significant costs and expenses.

The United States deemed those tax deductions offered to Arrakisians, in their entirety, to be comparable deductions applicable in United States Tax Code. But, by eliminating a portion of their compensation, the 95 percent deductions no longer offer the same, whole protection. As such, the Arrakis levy cannot be said to be sufficiently similar to a United States income tax.

Though a foreign government's characterization of a tax is not dispositive for credibility purposes, it is nevertheless helpful when considering its true character. *PPL*, 133 S. Ct. at 1902. To that end, the Arrakis levy was enacted under the name "Foreign Value Tax." R. at 5. And it taxed the total value of in-State operations rather than Harkonnen Oil's net income. *Id.* The Value Tax was only renamed the Foreign Tax once negotiations with Harkonnen Oil came to a close. Recognizing that it is the economic effect of the tax that ultimately determines the status of the tax, it cannot be overlooked that it appears the Value Tax was in fact enacted to serve as exactly that: a value tax.

The Arrakis levy failed to satisfy the net income requirement as it did not provide—initially, any, and later, sufficient—deductions from gross receipts. As such, its predominant character cannot be characterized as that of a United States income tax.

B. The Arrakis levy is not an “income tax” under 26 U.S.C. § 903.

Section 903 expands the definition of “income, war profits, and excess profits taxes” to include “a tax paid in lieu of a tax on income, war profits, or excess profits otherwise generally imposed by any foreign country.” This section serves as a safe harbor, protecting taxes that are intended to be income taxes under § 901, but that fail to satisfy all of its requirements. A foreign levy is a tax in lieu of an income tax if and only if it is a tax, per Treas. Reg. § 1.901-2(a)(2), and it “in fact operates as a tax imposed in substitution for, and not in addition to, an income tax generally imposed.” Treas. Reg. § 1.903-1(b)(1) (2013).

The Arrakis levy fails to satisfy both of these requirements, and as such, it cannot be classified as a tax in lieu of an income tax. As discussed above, the Arrakis levy is not a tax, because it is a payment given in exchange for a specific economic benefit—use of the Caladan Oil field to extract oil and gas. However, even if the Arrakis levy is deemed to be a tax, it was not imposed in place of an income tax otherwise generally imposed.

Despite § 903’s allowance, there are exacting limitations to its generosity and courts construe it strictly. Specifically, a tax which runs parallel to a tax upon income generally imposed is not a tax “in lieu” of, or a substitution of, an income tax. *Guantanamo & W. R. Co. v. Comm’r*, 31 T.C. 842 (1959) (finding a gross sales and receipts tax imposed on Cubans to be an unqualified tax credit since the taxes were imposed in addition to profits taxes and not “in lieu” thereof).

Here, the Arrakis levy was imposed *in addition to* other profits taxes. Harkonnen Oil was also required to pay a 15 percent royalty tax on top of the Arrakis levy of 45 percent. R. at 7. By its very nature, a royalty tax is dependent on profits. Black's Law Dictionary 1445 (9th ed. 2009) (defining "royalty" in the oil and gas context as a "share of the profit from real property"). Thus, because the lease required multiple payments dependent upon profits, the Arrakis levy is not "in lieu of" an income tax under 26 U.S.C. § 903.

Moreover, the Bank's practice of holding funds prior to remittance does not qualify as a "withholding tax" sufficient to generate a § 903 foreign tax credit. A withholding tax is defined as "a portion of income tax that is subtracted from salary, wages, dividends, or other income before the earner receives payment." Black's Law Dictionary 1598 (9th ed. 2009). Generally, a withholding tax applies to an employee's income from an employer, not a corporation's. *Id.*

While the format of the Arrakis levy is similar to that of a withholding tax, the levy itself cannot be maintained as a withholding tax. The Arrakis levy mandated that Harkonnen Oil deposit all monies earned in Arrakis into the Bank. R. at 5. The Bank was to calculate applicable taxes, and distribute all taxed funds directly to the Arrakis Treasury. Remaining funds were to be issued back to Harkonnen Oil within 90 days. *Id.*

The Arrakis levy does not withhold similarly to an income tax structure because foreign corporations must deposit their own money into the Bank prior to the levy being applied; the money does not originate with the State, but rather is private income generated by a private company. This interrupts any assertion that the Arrakis levy is merely an ordinary withholding tax. Possessing the structure of a withholding tax does not change the true nature of the levy. Therefore, the Arrakis levy is not an income tax under § 903.

C. There are no policy reasons that would implore this Court to look beyond the texts of sections 901 and 903 when determining whether there is a foreign tax credit available to Harkonnen Oil.

Petitioner urges this Court to usurp the role of the legislature and move beyond the language of the statutes to decide that the Arrakis levy is credible for foreign tax purposes. Not only would such action be inappropriate, it would be economically unwise and dangerous. The legislature is clear and generous in its granting of limited foreign tax credits under 901 and 903. There are no policy considerations so strong as to require this Court to assume Congress' constitutional power to tax.

Congress carefully laid out circumstances in which foreign taxes can meet the requirements of utilization as a foreign tax credit. Those situations, as described by applicable Treasury Regulations, have been widely used and widely accepted. *See, e.g., Bank of Am. Nat. Trust & Sav. Ass'n v. United States,* 459 F.2d 513 (Ct. Cl. 1972); *Texasgulf, Inc. v. United States*, 17 Cl. Ct. 275 (1989); *Inland Steel*, 677 F.2d at 74; *PPL*, 133 S. Ct. at 1897. Congress regularly maintains such regulations. Thus, primary proof of Congress' intent is the pure language of the statute itself. *See United States v. Aguilar, 21 F.3d 1475* (9th Cir. 1994). This Court should be cautious to remain within the scope of the statutes and regulations as they currently stand.

In his dissent, Judge Layton offers several policy concerns, pleading that this Court "move past the literal application of the rules and focus our decision on the practical policy concerns." R. at 19. Specifically, it identifies double taxation and foreign trade as concerns under the tax code. Indeed, these are laudable and noble goals that the United States should not absently dismiss. But, the United States has not absently dismissed these goals; rather, it is precisely because of its concern for international trade and double taxation that Congress has passed § 901 and § 903. *See Procter & Gamble Co. v. United States*, No. 1:08-CV-00608, 2010 WL 2925099, at *8 (S.D. Ohio July 6, 2010) ("The availability of a tax credit for foreign taxes ameliorates the burdens of double taxation on American corporations and fosters international trade."); *Int'l Bus. Machs. Corp. v. United States*, 38 Fed. Cl. 661, 668 (1997) ("The foreign tax credit provisions of the Internal Revenue Code protect against the double taxation of foreign income."). Because these policy concerns have been addressed, there is no need—indeed, it would be improper—to move beyond the stated provisions.

Allowing corporations or individuals to sneak underneath the statute's protection violates legislative intent. The legislature was generous in providing these privileges, but it is incongruous to assert that any taxpayer that pays any type of levies in a foreign nation should be allowed protection under the statute. The code does not require the United States to allow every claimed credit. *See, e.g.*, *Procter & Gamble*, 2010 WL 2925099, at *8 (holding that the United States is not required to "foot the bill through the credit system" by paying all claimed tax credits). Allowing foreign tax credits is a "privilege extended by legislative grace, and the exemption must be strictly construed." *Inland Steel*, 677 F.2d at 79, *citing Keasbey*, 133 F.2d at 898.

The notion that it is unfair or inequitable for taxpayers to have to abide by United States law when seeking United States tax credits is farcical. Taxpayers are on notice as to the requirements of the United States Tax Code, as United States laws are accessible to the public. American companies are free to work around the world. However, if a domestic corporation seeks to take advantage of taxation benefits, it must ensure that the taxation of its host country is compatible with such legislative graces.

When seeking credits from the United States, taxpayers must play by the United States' rules. There is nothing unscrupulous about foreign nations writing their tax codes in a way which complements United States requirements. Governments are empowered to make decisions about their country's economic future, and choosing whether to create a tax system that complements the United States Tax Code is simply one of those many decisions.

The language contained in both 26 U.S.C. § 901 and 26 U.S.C. § 903 shows that the lower courts correctly denied the extension of a foreign tax credit to Harkonnen Oil. There are no policy considerations sufficiently compelling to dictate swaying from the statutes' stated requirements. If taxpayers do not wish to abide by the United States' carefully enacted laws, the taxpayers affirmatively opt out of any privileges offered under those provisions.

For these reasons, this Court should affirm the decision of the Fourteenth Circuit and hold that payments to Arrakis are not creditable under either § 901 or § 903.

II. Harkonnen Oil's payments of taxes to IFIL were properly denied as foreign tax credits because IFIL is not a valid taxable entity.

Harkonnen Oil was denied foreign tax credit for payments made to IFIL as neither the district court below nor the Fourteenth Circuit found IFIL to be a valid taxable entity. Subsection (j) of § 901 disqualifies from tax creditability "any income, war profits, or excess profits taxes" paid to any foreign country "the government of which the United States does not recognize." 26 U.S.C. § 901(j)(2)(A)(i) (2012). Additionally, Treasury Regulation § 1.901-2(g)(2) defines "foreign country" to include "any foreign state" or "any political subdivision of any foreign state."

IFIL was created as a political splinter group of Bene Gesserit, a known terrorist organization, in 2008.[4] R. at 11. In December 2010, IFIL launched a rebellion in Arrakis, challenging its Vice-President. *Id.* Al Dhanab and Anbus provided financial support and political guidance to IFIL and held it out as legitimate. R. at 12. The United States has taken no official position on its legitimacy, other than to say that IFIL is a "sovereign friend" of the United States.

[4] The record indicates that IFIL opposes the beliefs of the Bene Gesserit, though it does not expressly indicate what beliefs or tenets IFIL does in fact hold. R. at 11.

R. at 12, 14. Similarly, Arrakis and Sietch State have made no formal declarations of acceptance or recognition; they did however, affirmatively deny IFIL's legitimacy in March 2011. R. at 13, 15. The Holy Royal Court holds that "IFIL is a part of Sietch." R. at 14.

This Court should affirm the Fourteenth Circuit's denial of foreign tax credit to Harkonnen Oil for three reasons. First, the United States does not recognize the government of IFIL. Second, IFIL has no authority to levy a tax in Sietch State. Third, Harkonnen Oil did not exhaust all practical and effective remedies to discover that IFIL was not a valid taxable entity.

A. The United States does not recognize the government of IFIL.

Foreign tax credits may be denied for otherwise qualified taxes where the United States government does not recognize the government of the taxing foreign country. For example, in *Martin v. Comm'r*, the court held that Antarctica was not a foreign country with taxing powers, because it had no sovereign government recognized by the United States. 50 T.C. 59, 62 (1968). Similarly, in *Souza v. Comm'r*, the court found that water within three miles of the Peruvian coastline constituted a foreign country as it was under Peru's sovereignty, which was recognized by the United States. 33 T.C. 817, 818 (1960). However, waters beyond three miles were not deemed a foreign country, as they were without the sovereignty of Peru, despite Peru's assertions to the contrary. *Id.*

IFIL is not a foreign country for the purposes of foreign tax credits, because it does not have a sovereign government recognized by the United States. To the extent that IFIL even has a formal government—manifested by a single Leader Elect—it is managed and controlled by Al Dhanab and Anbus. IFIL is merely a "puppet" for accomplishing their international goals. Not only do Al Dhanab and Anbus contribute all finances to IFIL, but they also control majority voting of the Leader Elect. Importantly, the United States does not affirmatively recognize the governments of these countries.

Although the United States was petitioned to recognize the IFIL's government, it never officially did so. R. at 12. The United Nations, too, withheld affirmative recognition of IFIL, lending support to the United States' hesitation. That the IFIL government is recognized by other countries—namely, Al Dhanab, Anbus, France, and Russia—is not material to the United States' individual determination of sovereignty. See, e.g., *Souza,* 33 T.C. at 818.

Compare the United States' non-recognition of IFIL to its recognition of Sietch State. After signing the Sietch Lease, the United States declared Sietch State to be a "Quasi Autonomous Region," the State Department agreed to establish diplomatic ties with Sietch State, and the United States Treasury Department declared that it would "accept transactions from the Sietch State." R. at 10-11. Moreover, the United States established a temporary consulate in the United States Embassy. In that case, the United States unequivocally declared its recognition and support of Sietch State. Consequently, taxes paid to Sietch State were found to be valid foreign tax credits. R. at 17.

With respect to IFIL, however, there has been no formal recognition whatsoever. Even when given the opportunity to affirmatively declare its support, the United States did not do so. R. at 12. It is clear that the United States perceives the government of Sietch State quite differently, at least for the time being, than that of the IFIL.

The President's statement that IFIL is a "sovereign friend" of the United States should not be taken to mean that the United States recognizes the government of IFIL. R. at 14. A foreign country deemed to be on the section (j) "blacklist" can only be removed when the "Secretary of State certifies to the Secretary of the Treasury that such country [no longer qualifies for exclusion]." 26 U.S.C. § 901 (j)(2)(B)(ii). Thus, the President's statement on April 15, 2011 does not suffice to clear the status of IFIL.

Historical application, too, confirms that the United States does not recognize the government of IFIL. For many years, the United States has refused to grant foreign tax credits to foreign countries engaging in humanitarian violations and discrimination. At various points in time, numerous governments have been unrecognized by the United States, including Afghanistan, for the actions of the Taliban and a corrupt government; Cambodia, for the atrocities committed by the Khmer Rouge; Syria and Iraq, for acts of ISIS; and South Africa, with the onset of Apartheid. Rev. Rul. 90-53, 1990-2 C.B. 178; *see generally* Joel D. Kuntz & Robert J. Peroni, *¶ B4.06 Special Limits and Exclusion for Taxes that May Be Credited*, *in* US International Taxation 10 (2014). Indeed, the revenue regulations are replete with examples in which the foreign tax credit was denied to nations engaged in similar humanitarian violations. *See generally* Joel D. Kuntz & Robert J. Peroni, *¶ B4.04 Specific Foreign Taxes that Have (or Have Not) Qualified for Foreign Tax Credit*, *in* US International Taxation 1-12 (2014).

Just as Apartheid bestowed greater rights on the basis of race in South Africa, IFIL affords greater rights on the basis of ancestry and personal beliefs. R. at 12. Under the IFIL voting structure, three electoral votes are granted to each of the Al Dhanab royal family and Anbus royal family. Persons that cannot trace their bloodlines to either royal family—but who demonstrate their affiliation with the group—may vote in a majority election, which counts as one electoral vote. Id. There is not political recognition of those that do not align with IFIL.

Undoubtedly, IFIL violence has not yet risen to the level of that exerted by the Khmer Rouge or ISIS. Nevertheless, it has engaged in similar rebellion against an established government, R. at 11, implemented military takeovers using similar force, R. at 12, and linked its foundation to another fundamentalist group. R. at 11. Rewarding Harkonnen Oil with a foreign tax credit for conducting business with the IFIL implies support for IFIL's activities. Given the historical application and unequivocal command of § 901, this Court should find that IFIL is not valid taxable entity and deny the claimed foreign tax credit.

B. IFIL has no authority to levy a tax in Sietch State.

The definition of "foreign country" includes "any foreign state" and "any political subdivision of any foreign state." Treas. Reg. § 1.901-2(g)(2). A political subdivision is further defined as a "division of a state that exists primarily to discharge some function of local government." Black's Law Dictionary 1277 (9th ed. 2009). Despite these offerings, this Court has held that these terms are, in fact, "ambiguous." *Burnet v. Chicago Portrait Co.*, 285 U.S. 1, 5 (1932).

It is a known cannon of statutory interpretation that when the language of a statute is not plain and unambiguous, the court should consider Congress' intent in passing the statute. *United States v. Irvin*, 2 F.3d 72, 76-77 (4th Cir. 1993). Here, the purpose of § 901 is clear: to "mitigate the evil of double taxation" and encourage international trade. *Burnet*, 285 U.S. at 8; *see also Procter & Gamble*, 2010 WL 2925099, at *8 (holding § 901 "ameliorates the burdens of double taxation on American corporations and fosters international trade."). In effectuating these purposes through foreign tax credits, "the controlling consideration was the fact that the income tax was *paid to a foreign government competent to lay the tax*, and not the international status of that government." *Burnet*, 285 U.S. at 10 (emphasis added).

Here, IFIL has no authority to levy a tax. The Arrakis Constitution permits Sietch State to have territorial taxing authority over a "single" tax within Sietch State. R. at 9. On April 16, 2010, Vice-President Atreides decreed a tax pursuant to that power, which has subsequently been upheld as valid. R. at 10, 17. Moreover, the Holy Royal Court, Arrakis' equivalent to this Court, held that "IFIL [is] a part of Sietch." R. at 14. Thus, as a part of Sietch, IFIL has no authority to levy a second tax, as this would be an unconstitutional second tax in Sietch State.

There is no evidence that IFIL has ever been granted the power to tax. *See Procter & Gamble*, 2010 WL 2925099 (finding evidence of a municipality's authority to tax in Tax Director's declarations and other formal documents). The Constitution of Arrakis is clear when it authorizes taxing power within its borders. For example, the Constitution clearly provides that the President of Arrakis is "allowed the right to enact one new tax every year." R. at 5. And the Constitution was amended when Sietch State became recognized to grant it taxing authority. R. at 9. However, the Constitution omits any recognition of taxing authority for IFIL, and it has never been amended to include it. Absent indicia that IFIL was competent to levy a tax, especially amongst express provisions for other entities, Harkonnen Oil's payments to IFIL cannot be considered valid foreign tax credits.

That four other countries have recognized IFIL's sovereignty is not sufficient evidence to establish IFIL's taxing authority. This Court will search in vain for any authority asserting that it must recognize a foreign country's authority to tax merely because other countries have done so. In sum, to insist that IFIL has authority to levy a tax in Sietch State would simultaneously undermine United States jurisprudence and the Constitution of Arrakis. Accordingly, this Court should find that IFIL is not a valid taxable entity.

C. Harkonnen Oil did not exhaust all practical and effective remedies to discover that IFIL was not a valid taxable entity.

Federal courts have repeatedly emphasized "the requirement that taxpayers exhaust their remedies before claiming a foreign tax credit." *Procter & Gamble*, 2010 WL 2925099, at *8 (calling exhaustion of remedies a "core component of the statutory foreign tax credit scheme" since an unregulated system would cause "moral hazard"). By exhausting one's remedies, a taxpayer ensures that his liability for foreign tax is accurate and minimized. Treas. Reg. § 901-2(e)(5)(i). A taxpayer is not required to seek relief from every possible competent court; rather, a remedy is deemed "effective and practical" where its cost, taking into account the risk of offsetting or additional tax liability, is reasonable "in light of the amount at issue and the likelihood of success." *Id.* Harkonnen Oil's petition to the Holy Royal Court did not satisfy this requirement.

In *Schering Corp. v. Comm'r*, the corporation failed to petition a five percent withholding tax in either the Swiss Tax Administration or the Swiss Tax Court. 69 T.C. 579, 601-602 (1978). However, the court reasoned that because the corporation took other steps to ascertain the position of the Swiss tax authorities, namely obtaining advice from Swiss counsel that the tax was valid, he had satisfied his duty. Similarly, in *Int'l Bus. Machs. ("IBM")*, the court held that IBM's guidance from an Italian tax advisor that further litigation was "a near certain loser" was sufficient to conclude any further requests for a remedy. 38 Fed. Cl. at 661; *but see Procter & Gamble*, 2010 WL 2925099, at *21 (finding available remedies where the corporation sought the opinion of Korean tax counsel on the likely success of a Korean remedy, which did not indicate the likelihood of success of remedies in Japan).

Harkonnen Oil's petition to the Holy Royal Court did not exhaust all reasonable remedies. It is true that Harkonnen Oil did in fact petition the Holy Royal Court to determine IFIL's "ability to levy a tax." However, the response it received, was far from conclusive; the Holy Royal Court simply stated that "Arrakis recognizes IFIL as a part of Sietch." R. at 14. This is not at all an answer to Harkonnen Oil's posed question.

Unlike Schering or IBM, no competent authority advised Harkonnen Oil that the IFIL tax was valid or that a further petition would be a "near certain loser." In fact, no competent authority advised Harkonnen Oil at all. The illusory nature of invoking advice from the Holy Royal Court should not carry the day, as no advice on the matter was given.

Certainly, petitioning the Sietch Council for clarification would not outweigh the cost of surrendering a two percent tax to IFIL, especially where, as here, the two percent applied to funds already taxed by the Sietch State. There is no direct cost for petitioning the Sietch Counsel, and any indirect cost caused by a delay in signing the IFIL Lease would have already accrued at the Holy Royal Court petition. Moreover, Harkonnen Oil had no indication, positive or negative, whether the tax was likely to be deemed valid which could weigh against the practicality of seeking further clarification. Because petitioning the Sietch Council would not outweigh the amount at issue or the likelihood of success, Harkonnen Oil failed to exhaust all available and practical remedies to challenge the IFIL tax.

Absent a demand that American companies effectively and practically reduce their foreign tax payments, taxpayers would have no incentive to challenge foreign taxes, regardless of whether they were properly imposed. Although double taxation would be avoided in such a case, the United States Treasury cannot be left to unquestioningly "foot the bill" of what may in fact be unnecessary or unreasonable taxes. Paul Rooney & Nathan Suit, *Competent Authority*, 49 Tax. Law. 675, 682–83 (1996). Because Harkonnen Oil failed to exhaust all available administrative remedies to challenge the IFIL tax , Harkonnen Oil cannot—now that its foreign tax credit is being denied—claim that its payments to IFIL were valid and creditable. United States tax law requires more accountability than this.

For these reasons, this Court should affirm the decision of the Fourteenth Circuit and hold that IFIL is not a valid taxing entity

CONCLUSION

For the foregoing reasons, the United States of America respectfully requests that this Court affirm the judgment of the United States Court of Appeals for the Fourteenth Circuit and deny foreign tax credits to Harkonnen Oil for payments made to the Republic of Arrakis and the IFIL.

APPENDIX

26 U.S.C. § 901 reads, in pertinent part:

(b)(1) In the case of a citizen of the United States and of a domestic corporation, [they may receive a foreign tax credit in] the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States.

(j)(1)(A) Notwithstanding any other provision of this part, 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.

(2)(A) 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.

26 U.S.C. § 903 reads:

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.

Treas. Reg. 1.901-2 reads, in pertinent part:

(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. . . .

(2)(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 . . . 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 . . . 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. . . .

(ii)(B) For purposes of this section . . . "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 . . . 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.

(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 . . . .

(4) Net income—

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

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

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

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

(e)(5)(i) In general. An amount paid is not a compulsory payment, and thus is not an amount of tax paid, to the extent that the amount paid exceeds the amount of liability under foreign law for tax. An amount paid does not exceed the amount of such liability if the amount paid is determined by the taxpayer in a manner that is consistent with a reasonable interpretation and application of the substantive and procedural provisions of foreign law (including applicable tax treaties) in such a way as to reduce, over time, the taxpayer's reasonably expected liability under foreign law for tax, and if the taxpayer exhausts all effective and practical remedies, including invocation of competent authority procedures available under applicable tax treaties, to reduce, over time, the taxpayer's liability for foreign tax (including liability pursuant to a foreign tax audit adjustment). . . . An interpretation or application of foreign law is not reasonable if there is actual notice or constructive notice (e.g., a published court decision) to the taxpayer that the interpretation or application is likely to be erroneous. In interpreting foreign tax law, a taxpayer may generally rely on advice obtained in good faith from competent foreign tax advisors to whom the taxpayer has disclosed the relevant facts. A remedy is effective and practical only if the cost thereof (including the risk of offsetting or additional tax liability) is reasonable in light of the amount at issue and the likelihood of success. . . .

Treas. Reg. 1.903-1 reads, in pertinent part:

(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. . . ."foreign country" [is] 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. . . .

(b)(1) Substitution—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.