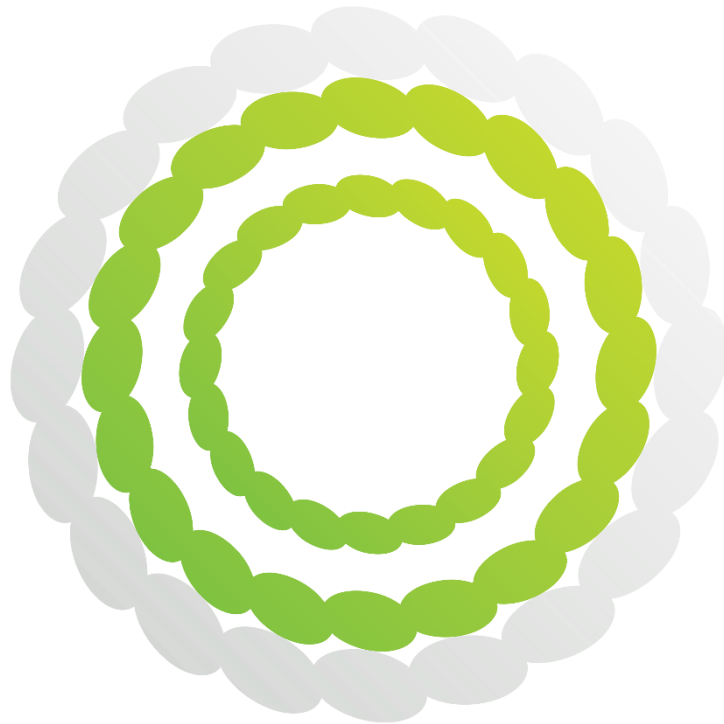




Tax Insights

High Court decides in favour of PepsiCo

On 13 August 2025, the Australian High Court decided in favour of PepsiCo, Inc (PepsiCo) and Stokely-Van Camp, Inc (SVC) in *Commissioner of Taxation v. PepsiCo, Inc* [2025] HCA 30.

This decision brings to an end the much-followed dispute involving PepsiCo in respect of the 2018 and 2019 years. This matter has been notable as it challenged some of the orthodoxy relating to the identification and characterisation of a “royalty” and also provided the first judicial analysis of the diverted profits tax (DPT). Although the decision involved both PepsiCo and SVC, for simplicity, this article refers only to PepsiCo.

The High Court decided on two broad issues (collectively “the grounds”)—two grounds related to royalty withholding tax (RWHT) and the third ground related to DPT:

- **Ground 1:** Did payments by Schweppes Australia Pty Ltd (SAPL) to PepsiCo Beverage Singapore Pty Ltd (PBS) under agreements to bottle and sell PepsiCo branded beverages include an amount paid “as consideration for” the use of intellectual property, within the definition of “royalty” in section 6(1) of the Income Tax Assessment Act 1936 (ITAA 1936)?
- **Ground 2:** If the answer to Ground 1 is “yes,” was the royalty component of the payments income “derived” by and “paid to” PepsiCo under section 128B(2B) of the ITAA 1936, such that withholding tax was payable under section 128B(5A) of the ITAA 1936?
- **Ground 3:** In the event that PepsiCo is not liable to withholding tax, was it liable to DPT under part IVA of the ITAA 1936?

The majority (Gordon, Edelman, Steward, and Gleeson JJ) rejected all of the appeals by the Commissioner of Taxation (“the Commissioner”). The minority (Gageler CJ, Jagot, and Beech-Jones JJ) accepted ground 1 and ground 3, while rejecting ground 2.

Background

PepsiCo, a US company within the PepsiCo Group, entered into an exclusive bottling agreement (EBA) with SAPL in 2009. The EBA allowed SAPL to bottle and distribute PepsiCo beverages in Australia. The terms of the EBA, inter alia, granted SAPL the right to use PepsiCo trademarks and intellectual property. The EBA did not stipulate that an amount would be payable for the use of trademarks or intellectual property.

The Commissioner issued notices for amounts of RWHT. The Commissioner’s notices were reliant on an argument that the payment of consideration by SAPL, under the terms of the EBA, was in exchange for two benefits—the acquisition of the concentrate and the right to use the PepsiCo intellectual property. The Commissioner also issued DPT notices of assessment.

At first instance, in *PepsiCo, Inc v. Commissioner of Taxation* [2023] FCA 1490, the primary judge ruled in favour of the Commissioner. On appeal, in *PepsiCo, Inc v. Commissioner of Taxation* [2024] FCAFC 86, the majority overturned the first instance decision. The minority (Colvin J), found in favour of the Commissioner in respect of the DPT.

Ground 1: Paid “as consideration for”

The majority concluded that the payments made by SAPL to PBS were for concentrate only and were not consideration for the PepsiCo intellectual property. In reaching their conclusion the majority held that whether an amount paid was “consideration for” the rights to use the PepsiCo intellectual property turned on an objective construction of the entire agreement which variously involved the SAPL bottler, seller, and distribution agreement (which included the EBA) as well as the contracts for the sale and purchase of concentrate.

The majority rejected the Commissioner’s contention that the EBA should be “construed as recording the true bargain of the parties” whereby SAPL made one payment for concentrate and the use of intellectual property. The majority held that the Commissioner’s contention “oversimplifies what the parties agreed and misconceives the overall arrangement.” It was further added that the Commissioner “seeks to isolate the performance of the promise given by SAPL, and wrongly seeks to allocate the performance of that promise as the consideration for all that SAPL obtained.”

The majority, at paragraphs [148], [162-163] said that the SAPL bottler, seller, and distribution agreement (under which PepsiCo licensed the PepsiCo intellectual property, and in respect of which PBS was not a party) “was separate from” the contracts between SAPL and PBS for the sale and purchase of concentrate.

The majority concluded that consideration for the PepsiCo intellectual property was given by SAPL in “the performance of monetary and non-monetary undertakings by SAPL under the composite SAPL Bottler, Seller and Distribution Agreement.” Most importantly, the majority noted that the Commissioner at no point disputed that the payment for the concentrate amounted to a non-arm’s length price or that it was disproportionately high. The majority concluded:

“[174] ...When the price paid for goods has those characteristics [arm’s length, fair price and not disproportionately high] are at an arm’s length price, it cannot be said that part of the price paid for those goods is a payment of a royalty for the use of intellectual property applied to products partly made with those goods.”

Ground 2: Income “derived” by and “paid to”

The majority concluded that no antecedent monetary obligation was owed by SAPL to PepsiCo and accordingly no part of the payments made by SAPL to PBS for concentrate “was derived by” or “paid or credited” to PepsiCo.

The Commissioner argued that “SAPL’s liability to make payments was owed at all times to PepsiCo and that when the payments were made by SAPL to PBS, those payments were made at the direction of PepsiCo.” The Commissioner further relied on an interpretation that the PepsiCo EBA did not establish an obligation that SAPL would pay PBS, rather it established a timeframe for payment and that PepsiCo controlled where the money might go.

The majority held that the Commissioner’s submission failed on the basis that the EBA was “an umbrella agreement which governed the relations of the parties going forward, and which contemplated the entry into further agreements, such as ... the contracts for the sale of concentrate.” No monetary obligation was owed by SAPL, or payment made by SAPL, to PepsiCo. The PepsiCo EBA did not alter the fact that the parties to the sale of concentrate were SAPL and PBS, not PepsiCo.

As a result of ground 1 and ground 2 being rejected by the majority, the Commissioner’s appeals in relation to RWHT were rejected.

The minority concluded on their construction of the arrangements that SAPL did pay a royalty; however, similar to the majority, concluded that PepsiCo did not derive any such royalty.

Ground 3: DPT

The Commissioner sought to further rely on the DPT provisions which were introduced:

- To ensure that the Australian tax payable by significant global entities properly reflects the economic substance of the activities that those entities carry on in Australia; and
- To prevent those entities from reducing the amount of Australian tax they pay by diverting profits offshore through contrived arrangements between related parties.

The Commissioner’s DPT assessments were reliant on a scheme, being the entry by PepsiCo into the PepsiCo EBA with SAPL on terms where SAPL bought concentrate and was licensed to use the PepsiCo intellectual property but paid no royalty for the use of the PepsiCo intellectual property.

The Commissioner contended that had the scheme not been entered into or carried out, there were two alternative postulates.

- **Alternative postulate 1:** The PepsiCo EBA would or might reasonably be expected to have expressed the payments by SAPL to be for all the property provided by and promises made by the PepsiCo Group entities rather than for concentrate only; or
- **Alternative postulate 2:** The PepsiCo EBA would or might reasonably be expected to have expressly provided for the payment by SAPL for the concentrate to include a royalty for the provision to SAPL of the PepsiCo intellectual property.

The majority identified that the central question is the economic and commercial substance of the scheme, as distinct from its legal shape or form. The economic and commercial substance analysis flowed from the requirements of section 177CB of the ITAA 1936.

The Commissioner contended that the economic and commercial substance of the scheme was that, in return for the consideration paid by SAPL to PBS, SAPL received two valuable benefits—the concentrate and the PepsiCo intellectual property. By extension, the Commissioner submitted that the allocation of the total contract price to concentrate, and only concentrate, was not the substance of the scheme but was only a means and form to give it effect.

The majority disagreed, stating that the Commissioner's contention "misconceives and oversimplifies the composite SAPL Bottler, Seller and Distributor Agreement." The majority held that the conferral of rights did not take place "for nothing" and that:

"[216] The true economic and commercial substance of the composite SAPL Bottler, Seller and Distributor Agreement was that SAPL was appointed and accepted appointment as the exclusive bottler, seller and distributor of the Beverages as part of a comprehensive arrangement involving an exchange of promises, *on an arm's length basis*, which included the promise to purchase concentrate at agreed prices which were not disproportionately high, as well as the conferral of intellectual property rights." (emphasis added)

Ultimately the majority held that neither of the Commissioner's alternative postulates were reasonable as they departed from the economic and commercial substance of the scheme. The majority referenced a critical finding of the Full Federal Court, "[t]he commercial and economic substance of the [S]cheme was that the price agreed for concentrate was for concentrate." The suggestion that the PepsiCo EBA ought to be adjusted to provide for some part of the price to also be a royalty would result in a "fundamentally different arrangement."

The majority continued, although unnecessary given the conclusion on counterfactuals, to make observations in respect of principal purpose, specifically the manner of entry into the scheme and the form and substance of the scheme.

When determining that there was not a principal purpose of enabling a tax benefit, the majority identified three significant features about the manner of the scheme: (i) it was the product of an arm's length negotiation between experienced and large commercial enterprises; (ii) it produced a price payable for concentrate that was not disproportionately high; and (iii) it followed broadly a pre-existing and entirely commercial way of doing business.

ATO response

On 13 August 2025, the Australian Taxation Office (ATO) issued a media release which acknowledged the High Court decision confirming that the taxpayers are not liable to pay RWHT nor DPT in the matters in dispute. The media release said that the ATO welcomes the High Court's clarification of these important areas of law, and that the ATO is "currently considering this decision including any broader impact it may have on the reasoning set out in draft Taxation Ruling TR 2024/D1 Income tax: royalties—character of payments in respect of software and intellectual property rights."

Deloitte Australia observations

A lack of evidence

An issue in the Commissioner's case seems to be the lack of evidence to establish that the price paid by SAPL to PBS, where that price is in substance for concentrate only, was non-arm's length or inflated. The majority at paragraph 167 and 168 provided:

"[167] Critically, the Commissioner did not contend that these prices were incorrect or had been inflated to hide some secret royalty outlay. Different Beverages were, unsurprisingly, listed at different prices...

"[168] The invoices sent by PBS to SAPL do not support the Commissioner's argument. A sample was produced to this Court. They show a detailed breakdown of different unit prices for different concentrates, such as "Pepsi Flavour" and "Black Raspberry" flavour. It was never contended that these prices, which inferentially accord with the prices set out in the PepsiCo EBA (as adjusted), were inflated or had embedded in them some form of royalty."

The majority's acceptance of the taxpayer's evidence that the prices set out in the PepsiCo EBA were arm's length is particularly influential in the consideration of the DPT.

Evidence establishing non-arm's length pricing or inflated prices may result in different outcomes. If the Commissioner is motivated to test similar arrangements, it remains to be seen whether the Commissioner will pursue additional arguments reliant on the transfer pricing provisions.

Proper construction of relevant agreements

The Commissioner evidently took a too narrow and seemingly oversimplified approach to constructing the agreements [173]. The contention that either (i) a component of the concentrate payment must be consideration for use of the intellectual property, or (ii) the intellectual property was provided for "nothing," was not supported by the facts. Rather, it was held that upon proper construction of the agreements, various monetary and non-monetary undertakings [163, 173] were provided between the parties as part of the "quid pro quo" resulting from the arm's length commercial negotiations, and such undertakings did not include the amount paid under the sale of concentrate contracts.

The majority's decision, in respect of all three grounds, highlights the importance of determining the objective characterisation of the totality of the arrangements between the parties. It serves as a warning against adopting a narrow or overly focused view of isolated clauses or promises exchanged between the parties.

When is a postulate reasonable?

The majority's decision confirmed that a taxpayer has the onus of establishing that the Commissioner's postulates are unreasonable and "more usually" may also demonstrate the absence of a tax benefit on the basis that there is no reasonable alternative other than the scheme undertaken.

The postulates considered must be reasonable ones and reasonableness must have regard to the substance of the scheme. The majority and minority did not align on the substance of scheme and interestingly the minority made the following observation about the intended operation of the DPT:

"[97] As Colvin J recognised and these reasons confirm, in fact a royalty was paid for the intellectual property, and the price for concentrate SAPL paid to PBS included that royalty to some extent. *In any event, it does not follow that, if the scheme included no royalty payment, a reasonable alternative postulate must not include a royalty payment. If that were so, the DPT provisions could never operate.*" (emphasis added)

It remains to be seen whether the majority's interpretation and application of section 177CB(4) of the ITAA 1936 has broader implications for other DPT matters and part IVA more generally. There now appears to be uncertainty about the extent to which a reasonable postulate can depart from the substance of the scheme.

Implications for TR 2024/D1 Income tax: royalties—character of receipts in respect of software (TR 2024/D1) and PCG 2025/D4 Low-risk payments relating to software arrangements—ATO compliance approach (PCG 2025/D4)

The ATO had deferred finalisation of the draft ruling (TR 2024/D1) pending the High Court's decision. The ATO immediately indicated that it is currently working through the implications for TR 2024/D1 as currently drafted. This decision may also result in the Commissioner amending the draft practical compliance guidance [PCG 2025/D4 Low-risk payments relating to software arrangements—ATO compliance approach](#) having only been released the week prior to the High Court decision.

PCG 2025/D4 relies on the term "undissected payment" which is said to arise where no portion of a cross-border payment is expressly stated to be a royalty by the instrument under which it is paid. This term has been previously adopted in paragraph 18 of TR 2024/D1, where the ATO states:

"18. If an undissected amount is paid as consideration for matters all of which are sufficiently connected with the things mentioned in the definition of royalty, *the whole amount of the payment will be taken to be a royalty in the first instance.*" (emphasis added)

As stated above, the majority found that there was no evidence to support the Commissioner's contention that the consideration paid by SAPL to PBS was in exchange for two benefits being the concentrate and the PepsiCo intellectual property. The minority did however conclude that the proper construction of the arrangements as a "single, integrated and indivisible" transaction meant that the payment for the concentrate is "to some extent" a payment for the grant of the intellectual property rights. Such an approach requires an apportionment.

Despite the minority's conclusion, and with acknowledgement that software arrangements will depart from the facts of the PepsiCo decision, the Commissioner may need to consider whether its "first instance" approach, as outlined in paragraph 18 of TR2024/D1, remains the correct view of the law. The minority's comments below may also challenge this approach.

"[56] This also explains why it is not to the point that it cannot be said that the EBAs involved a "sham" or that the transactions between SAPL and PBS did so. *Nor did the Commissioner's approach involve artificially treating the whole of the price said to be for the concentrate as consideration for the grant of the intellectual property licences.* Rather, the Commissioner's case was that the payments said to be for the concentrate under the EBAs were to some extent consideration for the intellectual property licences. That is simply to recognise the "single, integrated and indivisible" nature of the transaction." (emphasis added)

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