

HIGH COURT OF AUSTRALIA

GAGELER CJ,
GORDON, EDELMAN, STEWARD, GLEESON, JAGOT AND BEECH-JONES JJ

Matter No M98/2024

COMMISSIONER OF TAXATION	APPELLANT
AND	
PEPSICO, INC.	RESPONDENT

Matter No M99/2024

COMMISSIONER OF TAXATION	APPELLANT
AND	
STOKELY-VAN CAMP, INC.	RESPONDENT

Matter No M100/2024

COMMISSIONER OF TAXATION	APPELLANT
AND	
PEPSICO, INC.	RESPONDENT

Matter No M101/2024

COMMISSIONER OF TAXATION	APPELLANT
AND	
PEPSICO, INC.	RESPONDENT

Matter No M102/2024

COMMISSIONER OF TAXATION

APPELLANT

AND

STOKELY-VAN CAMP, INC.

RESPONDENT

Matter No M103/2024

COMMISSIONER OF TAXATION

APPELLANT

AND

STOKELY-VAN CAMP, INC.

RESPONDENT

Commissioner of Taxation v PepsiCo Inc
Commissioner of Taxation v Stokely-Van Camp Inc
Commissioner of Taxation v PepsiCo Inc
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Commissioner of Taxation v Stokely-Van Camp Inc
Commissioner of Taxation v Stokely-Van Camp Inc
[2025] HCA 30

Date of Hearing: 2 & 3 April 2025

Date of Judgment: 13 August 2025

M98/2024, M99/2024, M100/2024, M101/2024, M102/2024 & M103/2024

ORDER

Matter No M98/2024

Appeal dismissed with costs.

Matter No M99/2024

Appeal dismissed with costs.

Matter No M100/2024

Appeal dismissed with costs.

Matter No M101/2024

Appeal dismissed with costs.

Matter No M102/2024

Appeal dismissed with costs.

Matter No M103/2024

Appeal dismissed with costs.

On appeal from the Federal Court of Australia

Representation

K J Deards SC with T L Phillips and R J May for the appellant (instructed by MinterEllison)

E F Wheelahan KC with C M Pierce SC and A M Haskett for the respondents (instructed by PricewaterhouseCoopers)

Notice: This copy of the Court's Reasons for Judgment is subject to formal revision prior to publication in the Commonwealth Law Reports.

CATCHWORDS

Commissioner of Taxation v PepsiCo Inc
Commissioner of Taxation v Stokely-Van Camp Inc
Commissioner of Taxation v PepsiCo Inc
Commissioner of Taxation v PepsiCo Inc
Commissioner of Taxation v Stokely-Van Camp Inc
Commissioner of Taxation v Stokely-Van Camp Inc

Income tax (Cth) – Notice of assessment – Royalty withholding tax – Diverted profits tax – Where non-resident companies entered into agreements with Australian company to bottle, sell and distribute beverages – Where agreements licensed intellectual property to Australian company – Where agreements did not provide for payment of royalty for use of intellectual property – Where no payment made by Australian taxpayer to non-resident companies – Where payment made to Australian subsidiary of non-resident companies for beverage concentrate – Whether payments to subsidiary included royalty for use of intellectual property owned by non-resident companies within meaning of s 6 of *Income Tax Assessment Act 1936* (Cth) ("ITAA 1936") – Whether payments paid or credited to or derived by non-resident companies within meaning of s 128B of ITAA 1936 – Whether non-resident companies liable to pay diverted profits tax under s 177J of ITAA 1936.

Words and phrases – "alternative postulate", "antecedent monetary obligation", "basis or condition", "consideration", "consideration for", "derived by", "diverted profits tax", "DPT", "DPT tax benefit", "exchange of promises", "income derived", "paid or credited", "payment by direction", "postulate", "principal purpose", "reasonable alternative", "reasonable expectation", "royalties", "royalty", "royalty withholding tax", "scheme", "single, integrated and indivisible transaction", "substance of the scheme", "tax benefit", "tax benefit in connection with the scheme".

Income Tax Assessment Act 1936 (Cth), ss 6, 128A, 128B, 177A, 177C, 177CB, 177D, 177F, 177H, 177J, 177N, 177P.

Taxation Administration Act 1953 (Cth), s 14ZZO.

Background

1 Two companies resident in the United States ("the US") within the PepsiCo group of companies ("the PepsiCo Group") – PepsiCo, Inc ("PepsiCo") owning the global brands "Pepsi" and "Mountain Dew" and Stokely-Van Camp, Inc ("SVC") owning the global brand "Gatorade" – each entered into contracts with a local manufacturer of soft drinks: Schweppes Australia Pty Ltd ("SAPL"), a company resident in Australia. The contracts provided for the US companies to sell or cause another member of the PepsiCo Group to sell to SAPL the concentrate needed to make the branded drinks. They also provided for the US companies to grant exclusive licences to SAPL to exploit the trade marks and other intellectual property rights sufficiently to enable SAPL to be the exclusive manufacturer, bottler, packager, seller and distributor of those branded drinks in Australia.

2 The contracts obliged SAPL to buy at least a specified minimum amount of the concentrate from the US companies or another nominated PepsiCo Group member at an agreed price. SAPL was to follow the US companies' directions in producing the branded drinks, maintain sufficient production capacity to sell and distribute sufficient quantities of the branded drinks throughout Australia, ensure appropriate standards for production of the branded drinks, sell the branded drinks at prevailing competitive market prices, use its reasonable endeavours to maximise the sale of the branded drinks throughout Australia, and enter into advertising and marketing and performance agreements with the US companies under which the parties would promote the marketing and maximisation of sales of the branded drinks in Australia.

3 Pursuant to the contracts, each US company nominated another PepsiCo Group member to be the seller of concentrate. SAPL paid the nominated PepsiCo Group member the agreed price for the sale of concentrate.

4 By paying the agreed price for the sale of concentrate, did SAPL pay a "royalty" as defined in s 6(1) of the *Income Tax Assessment Act 1936* (Cth) ("the ITAA")¹ to mean "any amount paid or credited, however described or computed ... to the extent to which it is paid or credited, as the case may be, as consideration for", relevantly, "the use of, or the right to use, any ... trade mark, or other like property or right" in respect of the branded drinks? This is question one. If so, did the US companies derive income from the payment of the royalty under s 128B(2B)(a) and (b)(ii) of the ITAA so that, by s 128B(5A) of that Act, those companies are liable to pay income tax (specifically, royalty withholding tax) on

1 As in force in the relevant income years ending 30 June 2018 and 30 June 2019.

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that derived income? This is question two. If the US companies are not so liable under s 128B(5A) of the ITAA, are they instead liable to pay diverted profits tax ("DPT") under ss 177J and 177P of that Act by reason of having entered into a scheme for a principal purpose of obtaining a tax benefit (in not being liable to pay royalty withholding tax) and reducing their liabilities to tax under a foreign law in connection with the scheme? This is question three.

5 The Commissioner of Taxation issued royalty withholding tax notices and DPT assessments to the US companies for the income years ending 30 June 2018 and 30 June 2019 on the basis that each of these questions should be answered in the affirmative, albeit that question three must be in the alternative to questions one and two (as if royalty withholding tax is payable DPT is not payable).

6 The US companies, in response, filed applications of two kinds. The first kind invoked s 39B(1A) of the *Judiciary Act 1903* (Cth), by which the Federal Court of Australia is vested with jurisdiction in any matter arising under laws of the Commonwealth Parliament. The US companies sought declarations to the effect that they are not liable to pay royalty withholding tax. The second kind invoked Pt IVC of the *Taxation Administration Act 1953* (Cth) ("the TAA"), by which a person may appeal against the Commissioner's taxation objection decision disallowing or only partly allowing a taxation objection.

7 The primary judge in the Federal Court of Australia (Moshinsky J) answered questions one and two in the affirmative and said that, had he not done so, he would have answered question three in the affirmative.² On appeal a majority of the Full Court of the Federal Court of Australia (Perram and Jackman JJ) held that the primary judge had erred and answered each of the questions in the negative.³ Colvin J, in dissent, answered question one in the affirmative⁴ and question two in the negative,⁵ resulting in the conclusion that the US companies were not liable to pay royalty withholding tax.⁶ Colvin J answered

2 *PepsiCo Inc v Commissioner of Taxation* (2023) 117 ATR 328 at 333-334 [18].

3 *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1 at 12-13 [37], 14 [44]-[46], 25-26 [101].

4 *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1 at 47 [203].

5 *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1 at 48 [206].

6 *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1 at 48 [207]-[208].

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question three in the affirmative, reflecting his conclusion that the US companies were liable to pay DPT.⁷

8 For reasons to be explained, we consider the answers given by Colvin J to have been correct. We would therefore allow the Commissioner's further appeals by special leave to this Court.

The agreements in more detail

9 The general structure of the contracts between the US companies, PepsiCo and SVC, and the local manufacturer, SAPL, has been described. To the extent more detail is required, it can be confined to the following essential matters.

10 The principal components of the contractual arrangements are contained in a so-called "Exclusive Bottling Appointment" or "Exclusive Bottling Agreement" ("EBA") executed in 2009. The EBAs replaced earlier agreements made from 2000 and 2001 onwards.

11 The parties to the PepsiCo EBA were PepsiCo, a company within the PepsiCo Group resident in Bermuda (and owner of some of the relevant intellectual property rights) referred to as CMCI, and SAPL. The parties to the SVC EBA were SVC and SAPL. The EBAs were mostly in terms sufficiently similar to involve no material legal distinction.

12 Under the EBAs PepsiCo and SVC appointed SAPL exclusively to bottle, sell and distribute the branded drinks under their trade marks in Australia.⁸ PepsiCo and SVC each agreed to "sell or cause to be sold" by it, or by a company in the PepsiCo Group nominated by it, to SAPL the units of concentrate required for SAPL to manufacture the branded drinks at an agreed price per unit subject to indexation.⁹ PepsiCo and CMCI and SVC warranted that they owned the trade marks and that SAPL's use of the trade marks according to the EBA would not infringe the rights of any other party.¹⁰

7 *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1 at 49 [218].

8 PepsiCo EBA, cl 3(a); SVC EBA, cl 3(a).

9 PepsiCo EBA, cl 4; SVC EBA, cll 7.1, 7.2 and 7.3.

10 PepsiCo EBA, cl 5; SVC EBA, cl 6.3.

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13 By each EBA SAPL agreed to comply with all manufacturing and quality control requirements of PepsiCo or SVC as relevant.¹¹ SAPL agreed, in effect, to maintain in Australia sufficient and adequate bottling plants to bottle, sell and distribute sufficient of the branded drinks in Australia,¹² such plants to be maintained at a required standard.¹³ SAPL agreed to use its reasonable endeavours to maximise the sale of the branded drinks throughout Australia, including through competitive pricing for the sale of the branded drinks.¹⁴

14 It is common ground that the PepsiCo EBA contained an implicit licence from PepsiCo and CMCI to SAPL to exploit the intellectual property rights necessary to enable SAPL to perform its obligations and exercise its rights under the PepsiCo EBA. The SVC EBA contained an express licence to the same effect in respect of that EBA.¹⁵ The exclusive licences gave SAPL no rights of ownership in the intellectual property or the goodwill accruing in those rights after the commencement of the EBAs. Rather, the licences granted rights of exploitation of the intellectual property in Australia to SAPL exclusive of third parties.¹⁶

15 In the PepsiCo EBA, PepsiCo and SAPL agreed to enter into co-operative advertising and marketing agreements and a performance agreement.¹⁷ The co-operative advertising and marketing agreements were entered into by SAPL and a PepsiCo Group company annually. They contained agreements about financial contributions to marketing, as well as marketing and advertising targets for sales of the branded drinks in Australia. The performance agreement, entered into in 2009, was between another company within the PepsiCo Group registered in Ireland and SAPL. Amongst other things, the performance agreement provided for minimum annual sales volumes, sales targets, distribution targets and distribution investments.

11 PepsiCo EBA, cll 6 and 7; SVC EBA, cl 5.

12 PepsiCo EBA, cl 8; SVC EBA, cl 5.4(a).

13 PepsiCo EBA, cl 9; SVC EBA, cl 5.4(b).

14 PepsiCo EBA, cl 11; SVC EBA, cll 9.1 and 9.2.

15 SVC EBA, cl 4.

16 PepsiCo EBA, cl 5; SVC EBA, cl 6.1.

17 PepsiCo EBA, cll 18 and 19.

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16 In the SVC EBA, SVC and SAPL agreed provisions relating to co-operative marketing under a "Marketing Program".¹⁸ The SVC EBA also provided that SAPL would use its reasonable endeavours to achieve minimum specified annual sales volumes.¹⁹

17 In respect of payments for units of concentrate to be sold to SAPL, the PepsiCo EBA provided that:²⁰

"All Units shall be delivered to [SAPL's] plant, with freight, insurance and handling charges to be prepaid by [PepsiCo or its related company supplying concentrate] and charged to [SAPL]. [SAPL] shall be responsible for paying customs duty and GST. [SAPL] will at its own cost and expense, and without any cost or expense to [PepsiCo or its related company supplying concentrate], obtain all import licenses and permits in relation to the Units. ... Title to all Units shipped by [PepsiCo or its related company supplying concentrate] to [SAPL] shall remain in [PepsiCo or its related company supplying concentrate] until the Units are paid by [SAPL] according to the provisions hereof. Payment in full for each order of Units shall be made by [SAPL] within 7 days of delivery."

18 The PepsiCo EBA provided that, in addition to all other rights and remedies of a party under the EBA, "in the event that the other party at any time has failed to make timely payment under [the EBA] or any related agreement, such party shall be liable for the payment of interest for any such amounts outstanding calculated at [a specified rate]".²¹

19 In respect of payments for units of concentrate to be sold to SAPL, the SVC EBA provided that:²²

"If the [concentrate] is supplied by a [SVC related company] the terms of [this EBA], to the extent that they are relevant, apply to transactions between [SAPL] and the [SVC related company] as if they were direct parties to [this EBA]."

18 SVC EBA, cll 10 and 11.

19 SVC EBA, cl 16.

20 PepsiCo EBA, cl 4(c).

21 PepsiCo EBA, cl 26(a).

22 SVC EBA, cl 7.1(b).

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20 The SVC EBA also provided that:²³

- "(f) [SAPL] must pay [the agreed prices] for the [concentrate] supplied by [SVC or its related company] within 28 days after the invoice, which shall be issued on the date of delivery of the [concentrate]. Unless the parties agree otherwise, payment shall be made by telegraphic transfer to such bank account in the U.S.A. as may be specified by [SVC or its related company] at any time.
- (g) Any failure by [SAPL] to make any payment required under [this EBA] when due shall be a breach of [this EBA] and without limiting [SVC's] other remedies:
 - (i) [SVC] may at its option require immediate payment to [SVC or its related company] of all [SAPL's] liabilities and other indebtedness outstanding to [SVC or its related company] regardless of previously agreed-upon terms of payment;
 - (ii) [SAPL] shall owe and pay to [SVC or its related company] as the case may be interest on such overdue payment at [a specified rate]."

21 The SVC EBA additionally provided that:²⁴

"Property and risk in the [concentrate] will pass to [SAPL] on completion of delivery to [SAPL] which shall occur upon [SAPL] or its agent or nominee taking custody of the goods at [SVC's] Warehouse."

Related transactions and other agreements

22 After execution of the EBA PepsiCo notified SAPL that the seller of the units of concentrate would be PepsiCo Beverage Singapore Pty Ltd ("PBS"), which, despite its name, was a company in the PepsiCo Group registered in Australia. SVC likewise notified SAPL that the seller of the concentrate would be PBS. PBS also notified SAPL of PBS's bank account details, referring to each EBA as relevant. It is common ground that between 1 July 2017 and 30 June 2019, SAPL made payments to PBS for the supply to SAPL of concentrate in accordance with both the EBAs and SAPL's purchase orders to PBS. That one or more than one act (in this case, ordering the concentrate from PBS and paying for it) may have

23 SVC EBA, cl 7.4(f) and (g).

24 SVC EBA, cl 7.5.

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several legal effects between different parties (that is, as between SAPL and PepsiCo or SVC under the EBAs and as between SAPL and PBS under the purchase orders) is commonplace.

- 23 On 1 January 2018 a Singapore company, Concentrate Manufacturing (Singapore) Pte Ltd ("CMSPL") (a member of the PepsiCo Group), and PBS entered into a concentrate distribution agreement in respect of concentrate ("CDA"). The CDA replaced an earlier CDA effective from 22 December 2015. The CDA defined "Concentrate" as the concentrated essence and other components used in making the branded drinks for sale in Australia.²⁵ PBS agreed to distribute Concentrate to "Bottlers" and "Approved Resellers" (in effect, companies authorised by PepsiCo or an affiliate of PepsiCo to produce the branded drinks in the Territory, which includes Australia²⁶) in such annual volumes as PBS and CMSPL agreed.²⁷ CMSPL agreed to use its best efforts to make Concentrate available at such volume per year as PBS and CMSPL agreed given PBS's volume requests.²⁸ PBS agreed to "purchase Concentrate from CMSPL at the price equal to PBS's sales prices less a distribution discount" (referred to as the distribution price) and the distribution discount was to constitute the "sole monetary consideration to PBS for distributing Concentrate".²⁹ The distribution price was to be an amount that would be provided by a seller to an unrelated purchaser under similar circumstances.³⁰ Title to the Concentrate was to pass from CMSPL to PBS at the point of manufacturing of the Concentrate at CMSPL's manufacturing facilities in Singapore.³¹

Onus of proof

- 24 In the proceedings under s 39B(1A) of the *Judiciary Act*, PepsiCo and SVC were the moving parties and therefore bore the onus of proof. In each proceeding under Pt IVC of the TAA, s 14ZZO(b)(i) of the TAA imposed on the appellant

25 CDA, s 1.5.

26 CDA, ss 1.2, 1.4, 1.16 and Sch A.

27 CDA, s 2.1.

28 CDA, s 2.2.

29 CDA, s 3.1.

30 CDA, s 3.2.

31 CDA, s 4.5.

(PepsiCo or SVC) the burden of proving, relevantly, that the assessment was excessive or otherwise incorrect.

Primary judge's key findings

25 The primary judge made several undisputed factual findings.

26 In the relevant income years ended 30 June 2018 and 30 June 2019 CMSPL supplied concentrate to PBS under the CDA. SAPL placed orders with PBS for the purchase of concentrate. PBS supplied the concentrate to SAPL in accordance with SAPL's purchase orders and invoiced SAPL for the concentrate that had been supplied. SAPL paid PBS into the nominated PBS bank account for the concentrate in accordance with those invoices. PBS transferred almost all the money received from SAPL to CMSPL, retaining only a small margin (which may be inferred to be the amount of the distribution discount under the CDA). PBS recorded the income from the sale of concentrate to SAPL in its Australian income tax returns and financial statements for the income years ended 31 December 2017, 31 December 2018 and 31 December 2019.³²

27 PepsiCo and its predecessor company, the Pepsi-Cola Company, have used a franchise model involving the sale of concentrate for their branded drinks to third parties to manufacture, bottle and sell since inception in the early 1900s. This model expanded in use from the United States to other countries.³³ The franchise model meant that the PepsiCo Group "gain[ed] access to the bottler's investment in bottling and distribution equipment and its capabilities, including its distribution network, sales force, leadership, relationships with the trade (such as supermarket executives) and local regulatory authorities".³⁴ Under the franchise model "there [was] considerable scope for variation in the terms of exclusive bottling agreements entered into by the PepsiCo Group".³⁵

28 The PepsiCo Group considered that "[t]he long-term success of our Franchise model comes from building strong brands".³⁶ Under the franchise model

32 *PepsiCo Inc v Commissioner of Taxation* (2023) 117 ATR 328 at 331 [7], 352 [119]-[125].

33 *PepsiCo Inc v Commissioner of Taxation* (2023) 117 ATR 328 at 356 [155]-[156], 357 [159].

34 *PepsiCo Inc v Commissioner of Taxation* (2023) 117 ATR 328 at 358 [168].

35 *PepsiCo Inc v Commissioner of Taxation* (2023) 117 ATR 328 at 359 [169].

36 *PepsiCo Inc v Commissioner of Taxation* (2023) 117 ATR 328 at 359 [173].

the sale of concentrate was always accompanied by a licence of the intellectual property rights as such rights were necessary to enable the EBA to operate. PepsiCo would never sell its concentrate for its branded drinks without also licensing the brand under which the finished beverage was to be sold – the concentrate and the brands "always [went] together".³⁷ Some aspects of the franchise model were therefore considered within the PepsiCo Group to be non-negotiable, such as exclusive purchase of the concentrate from the PepsiCo Group, quality control and PepsiCo Group control over the marketing of its brands. Other terms, including the price for sale of the concentrate, were negotiable.³⁸ The PepsiCo Group franchise team tried to simplify the franchise model and "what they call[ed] levers that markets can execute to build the brands" in the various markets, developed and emerging.³⁹ There was "considerable scope to negotiate the way in which the pricing term is expressed and ... such terms sometimes have a degree of complexity to them".⁴⁰

Question one: did SAPL pay a royalty?

The question in context

29 Question one is linked to question two. Whether SAPL paid a "royalty" (question one) is relevant to determining if PepsiCo and SVC are liable to pay withholding tax (question two).

30 By s 6(1) of the ITAA, a "royalty" includes "any amount paid or credited, however described or computed, ... to the extent to which it is paid or credited, as the case may be, as consideration for", relevantly, "the use of, or the right to use, any copyright, patent, design or model, plan, secret formula or process, trade mark, or other like property or right".

The reasoning of the Courts below

31 The primary judge characterised the payments made by SAPL for the concentrate as payments SAPL made "pursuant to" the PepsiCo EBA and the SVC

37 *PepsiCo Inc v Commissioner of Taxation* (2023) 117 ATR 328 at 359-360 [175].

38 *PepsiCo Inc v Commissioner of Taxation* (2023) 117 ATR 328 at 359-360 [174]-[176].

39 *PepsiCo Inc v Commissioner of Taxation* (2023) 117 ATR 328 at 362-363 [186]-[188].

40 *PepsiCo Inc v Commissioner of Taxation* (2023) 117 ATR 328 at 362 [182].

EBA respectively, which were, "to some extent, consideration for the use of" the intellectual property rights the subject of licence to SAPL by those EBAs.⁴¹

32 The Full Court majority considered that the "ordinary reading of a provision that says that an item is to be sold for a price is that the price is the consideration for the purchase".⁴² In contrast, where "the transfer involved is not one connected to a sale of identified property ... one may look at the broader context in determining the consideration for the transfer".⁴³ Their Honours considered that the decision in *Archibald Howie Pty Ltd v Commissioner of Stamp Duties (NSW)*⁴⁴ compared to the decision in *Davis Investments Pty Ltd v Commissioner of Stamp Duties (NSW)*⁴⁵ supported this distinction. Their Honours synthesised these decisions with the subsequent decisions in *Chief Commissioner of State Revenue (NSW) v Dick Smith Electronics Holdings Pty Ltd*⁴⁶ and *Commissioner of State Revenue (Vic) v Lend Lease Development Pty Ltd*⁴⁷ on the basis that, as the latter two decisions did not overrule *Davis*, their Honours were bound to "apply Dixon CJ's statement in *Davis* that the consideration for the transfer of property effected under an agreement for its sale is the price the parties have agreed for that sale".⁴⁸

33 According to the Full Court majority:⁴⁹

"The price paid for concentrate was not part of what moved the right of [SAPL] to use the trade marks and other intellectual property. The right to use trade marks and other intellectual property was not the central property disposition or transaction which they contemplated. Rather, the central

41 *PepsiCo Inc v Commissioner of Taxation* (2023) 117 ATR 328 at 376-377 [244], [245] (emphasis added and omitted).

42 *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1 at 10 [24].

43 *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1 at 10 [27].

44 (1948) 77 CLR 143.

45 (1958) 100 CLR 392.

46 (2005) 221 CLR 496.

47 (2014) 254 CLR 142.

48 *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1 at 12 [33].

49 *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1 at 12 [36].

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bargain under the EBAs was the establishment of an exclusive arrangement to distribute PepsiCo/SVC's beverages in Australia. What the purchaser in *Dick Smith* ultimately wished to acquire were the shares in the company. What Lend Lease ultimately wished to acquire (and then sell) was the land at Docklands. In this case, what [SAPL] ultimately wanted to acquire was not the right to use trade mark and other intellectual property rights but rather the right to distribute famous beverages in Australia. Of course, the right to use trade marks and intellectual property was a necessary element in the transaction. But what the parties were centrally seeking to achieve was not a contract for the licensing of trade marks and intellectual property. It was a distribution arrangement of which the licensing of intellectual property was merely a part."

34 Colvin J, in contrast, considered that to determine the monetary consideration for a transaction or dealing recorded by agreement based upon its proper construction: "(1) it is first necessary to discern from the whole of the terms of the agreement the nature of the transaction or dealing that is provided for by the agreement; and (2) the monetary consideration is that which is actuating or moving the whole of that dealing or transaction".⁵⁰ On this approach, Colvin J concluded that "regard to the whole of the terms of the EBAs" revealed that, upon the proper construction of the EBAs, the prices to be paid were not simply consideration for the concentrate, but were "also consideration moving in favour of PepsiCo for the right to use the valuable brands that are conferred by the terms of the EBAs", from which it followed that "the amounts provided for by the EBAs as the prices for units of concentrate were partly amounts in consideration for the use of the trade marks which [SAPL] was licensed to use".⁵¹

35 Colvin J's analysis of this issue should be accepted. As will be explained, the Full Court majority's correct acceptance that the intellectual property licences granted by the EBAs were a "necessary element" of the agreements to distribute the "famous beverages" means that SAPL's promise to pay for what was said in the EBAs to be the concentrate must to some extent be part of what moved PepsiCo and SVC to grant SAPL the intellectual property licences equally necessary for SAPL to make and sell the branded drinks.

50 *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1 at 45 [193].

51 *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1 at 45-46 [197].

Consideration

36 The Full Court's synthesis of *Archibald Howie* and *Davis* treats the decisions as inconsistent. We disagree.

37 In *Archibald Howie*, Dixon J said that while in the law of simple contracts "consideration" may be merely a consequence of offer and acceptance, in the then relevant provision of the stamp duties legislation "'consideration' should receive the wider meaning or operation that belongs to it in conveyancing rather than the more precise meaning of the law of simple contracts", so that under the relevant provision, "the consideration is rather the money or value passing which moves the conveyance or transfer".⁵²

38 In *Davis*, Dixon CJ said that he did not "recede at all from" what he had said in *Archibald Howie*. His Honour explained that in *Archibald Howie* the transaction was in pursuit of a company resolution and order for reduction of capital which were the "method of effectuating the rights of shareholders", the shares to be distributed *in specie* at the book value. The consideration in that case, however, was "the full value of the assets", not the book value (which was lower than the shares' true value), "because no more was done [to effect the transfer of the shares *in specie*] than to satisfy the absolute right of the shareholders arising from the resolution and order". In *Davis*, however, the agreement for the transfers to the shareholder of shares, whilst forming part of a wider plan for the re-allocation of interests, "was thrown by the parties into the form of a sale at a price".⁵³ In that context, Dixon CJ said:⁵⁴

"No doubt, when a transfer or other assurance of property is expressed to be made for a nominal consideration, for many purposes it is open to prove a further consideration not being inconsistent with the nominal consideration expressed therein. And this may be so although there is no mention of the real consideration. ...

But here, for their own purposes the parties have given the transaction the form of a sale at a price. ... [W]ithin the meaning of the

52 *Archibald Howie Pty Ltd v Commissioner of Stamp Duties (NSW)* (1948) 77 CLR 143 at 152.

53 *Davis Investments Pty Ltd v Commissioner of Stamp Duties (NSW)* (1958) 100 CLR 392 at 407-408.

54 *Davis Investments Pty Ltd v Commissioner of Stamp Duties (NSW)* (1958) 100 CLR 392 at 408-409.

words in s 66(3A) [of the *Stamp Duties Act 1920-1949* (NSW)] would the consideration moving the transfers – the consideration 'upon' which the transfers are made – be anything but the price the parties chose to adopt? After all we are dealing with a transfer on sale. To go beyond the price may be to prefer realism to formal expression, but it means going to the circumstances warranting the parties in fixing the price they chose and that is not necessarily the same thing as consideration. ... It is a transaction of purchase and sale. ... But considered as a transfer on sale it is a transfer for a price. The price is fixed by the parties for the sale, that is for the transfer. It is not supplied by the surrounding or accompanying circumstances, however essential the elements discoverable therein may be to the legal and economic efficacy of the transaction as a whole. In the end it is for that reason that the consideration must be confined to the price for the purpose of ascertaining the *ad valorem* stamp duty."

39 Dixon CJ's observation that "[t]o go beyond the price may be to prefer realism" is to be understood in a context where the only relevant contractual stipulation was the sale of shares for an agreed price. There was no other obligation assumed or right forgone by the purchaser or the seller under the agreement in *Davis* which could be said to have moved the transfer of the shares or the payment of the price. This reasoning does not suggest that his Honour intended to distinguish between contracts for sale of one item of property and other contracts so that, in the former, the consideration is necessarily the price specified by the parties but, in the latter, the consideration may not be confined to the price specified by the parties.

40 Nor does the reasoning in *Dick Smith* or *Lend Lease* support that distinction. In *Dick Smith*, Gummow, Kirby and Hayne JJ emphasised that "consideration", in the stamp duty context, could not be confined to consideration sufficient to support a contract, as dutiable transactions extended beyond transactions effected by contract. That is why, in context, "consideration" had to mean the "money or value passing which moves the conveyance or transfer".⁵⁵ On that basis, the consideration that moved the transfer of shares to the purchaser in *Dick Smith* was not only the stipulated sale price but rather that price plus an amount that the purchaser had agreed to pay to fund a dividend that the company to be sold was obliged to pay to the vendors before completion.⁵⁶ In *Lend Lease*, French CJ,

55 *Chief Commissioner of State Revenue (NSW) v Dick Smith Electronics Holdings Pty Ltd* (2005) 221 CLR 496 at 518 [71]-[72], quoting *Archibald Howie Pty Ltd v Commissioner of Stamp Duties (NSW)* (1948) 77 CLR 143 at 152.

56 *Chief Commissioner of State Revenue (NSW) v Dick Smith Electronics Holdings Pty Ltd* (2005) 221 CLR 496 at 514 [58]-[59], 518 [72]-[73].

Hayne, Kiefel, Bell and Keane JJ applied the same approach. In that case the transaction, comprising a suite of agreements to effect both the sale and development of the subject land, was "single, integrated and indivisible" so that the consideration was the total of the full amounts the purchaser was obliged to pay and paid under the suite of agreements, not the price stipulated in the contracts for sale of the land.⁵⁷

41 The difference between the outcomes in *Davis* and the other cases did not depend on a distinction between a contract for the sale of one item at a specified price and other contracts. Even in the case of a contract for the sale of one item at a specified price, Dixon CJ accepted that the consideration might include some other amount not inconsistent with the price. That latter qualification establishes that his Honour accepted that a specified price under a simple contract for sale might not be the total consideration even if there is no suggestion that the contract price involved a sham. The difference in the outcomes between *Davis* and the other cases involves only the objective characterisation of each transaction. The principle remains the same in all cases – if the transaction is characterised as the sale of property, the price of the sale is the consideration, but, if the transaction is characterised as the sale of property and other elements, the consideration is that which moved the sale of the property and those other elements. Importantly, the outcome in each case results from the objective characterisation of the transaction and not any inquiry into the parties' subjective perceptions of the value to them of parts of the transaction.

42 Given this, it is not the case that the question whether there has been any amount paid or credited in consideration for the use of intellectual property rights is to be answered by reference to "the central property disposition or transaction", the "central bargain", or "what the parties were centrally seeking to achieve" in the transaction. It goes without saying that a transaction may involve more than one central item of property or central bargain and may have more than one central object. Further, even if a transaction involves only one central item of property, one central bargain, and one central object, subsidiary or ancillary items of property, bargains and objects, if they exist, remain relevant to the question whether there has been any amount paid or credited in consideration for the use of intellectual property rights.

57 *Commissioner of State Revenue (Vic) v Lend Lease Development Pty Ltd* (2014) 254 CLR 142 at 159-163 [49]-[62].

43 In *Archibald Howie* and *Davis* the applicable statutory definition referred to "consideration in money or money's worth".⁵⁸ In *Dick Smith* and *Lend Lease* the applicable statutory definition referred to "the amount of a monetary consideration or the value of a non-monetary consideration".⁵⁹ The relevant consideration in the definition of "royalty" in the present case is "any amount paid or credited, however described or computed". For present purposes, there is no material distinction between these provisions. An amount may be "computed" by any method of calculation including by the ascribing of objective market value to any description. This means that there is no relevant distinction between the concepts of "money's worth", "the value of a non-monetary consideration", or an "amount paid or credited, however described or computed".

44 It follows that an amount may be consideration for the use of intellectual property so as to meet the definition of "royalty" without the amount itself being labelled as a "royalty", and indeed without an "amount" being specified at all, provided an amount can be "computed" to be an amount in money. Nor need the amount be paid or payable. It suffices if the amount is credited in any way. The words "paid or credited", "however described or computed", and "to the extent to which it is paid or credited" in the definition of "royalty" ensure that the definition of "royalty" can extend to: (1) amounts in fact transferred and amounts not in fact transferred but credited in any way; (2) such amounts not described as relating to any of the matters specified in the definition; (3) a formula or description from which such an amount can be "computed"; and (4) any part of any such amount, all irrespective of the labels or descriptions used by the parties.

45 The need for an "amount" in money (in the sense described) to be paid or credited in the definition of "royalty" is exposed by the extrinsic material amending that definition. Before 1 May 1980, the definition referred to a "payment, whether periodical or not, and however described or computed, to the extent to which it is paid as consideration for" the specified items. The *Income Tax Assessment Amendment Act 1980* (Cth), amongst other things, amended the definition to its

58 *Archibald Howie Pty Ltd v Commissioner of Stamp Duties (NSW)* (1948) 77 CLR 143 at 151; *Davis Investments Pty Ltd v Commissioner of Stamp Duties (NSW)* (1958) 100 CLR 392 at 406.

59 *Chief Commissioner of State Revenue (NSW) v Dick Smith Electronics Holdings Pty Ltd* (2005) 221 CLR 496 at 516 [67]; *Commissioner of State Revenue (Vic) v Lend Lease Development Pty Ltd* (2014) 254 CLR 142 at 147 [1].

current form.⁶⁰ The Second Reading Speech⁶¹ and Explanatory Memorandum explained that the amendment was required "to remedy two deficiencies exposed by a Victorian Supreme Court decision in the case of *Aktiebolaget Volvo v Federal Commissioner of Taxation*^{62]}" which had held that the definition did not include an amount credited but not in fact paid.⁶³

46 The Commissioner contended that part of the payment of money said to be payable under the EBAs for the concentrate was in fact a payment of an amount in consideration for the use of the intellectual property rights. The Full Court majority considered that the Commissioner's submission – that if the price said in the EBAs to be payment for the concentrate did not include a component for the licences of the intellectual property rights, PepsiCo and SVC would be giving away those highly valuable rights for nothing, which was unlikely in the extreme – overlooked the full nature of the bargain of the parties. In that bargain there were numerous cross-promises involving intertwined costs and benefits to both parties, one part of which was specified in the EBAs to be the sale of the concentrate at the agreed prices, another part of which was the licences, and other parts of which enabled PepsiCo and SVC (respectively) and SAPL, to their mutual benefit, to maximise the sales of the branded drinks and, thereby, the sales of the concentrate necessary to make those branded drinks. The Full Court majority said, therefore, that the "Commissioner's submission proceeds on the overly simplistic assumption that the grant of the licence right to [SAPL] was only of benefit to [SAPL]. In fact, it was also a benefit to PepsiCo/SVC."⁶⁴

47 The Full Court majority considered that a "complete view" of the intellectual property licences granted under the EBAs involved: "(a) the benefits obtained by [SAPL] in being permitted to use the goodwill attaching to the trade marks; (b) the restrictions both as to product and marketing imposed on [SAPL] in its utilisation of that goodwill; (c) the burdens placed upon [SAPL] in complying

60 *Income Tax Assessment Amendment Act 1980* (Cth), s 3(1).

61 Australia, House of Representatives, *Parliamentary Debates* (Hansard), 20 March 1980 at 1030.

62 (1978) 36 FLR 334.

63 Australia, House of Representatives, *Income Tax Assessment Amendment Bill 1980* and *Income Tax (International Agreements) Amendment Bill 1980*, Explanatory Memorandum at 5.

64 *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1 at 8 [18].

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with testing and inspection regimes; and (d) the benefits obtained by PepsiCo/SVC in having [SAPL] sustain and promote their goodwill in Australia".⁶⁵

48 So much may be accepted. What remains, however, is the critical point that the components comprising this "complete view" of the EBAs, as the Full Court majority recognised, are interlocking and indivisible. It is within this overall context that the question – is the payment said in the EBAs to be payable for the concentrate to any extent a payment of an amount for the right to use the intellectual property – is to be answered.

49 Having correctly rejected the Commissioner's submission that, unless the price said to be payable for the concentrate in the EBAs included consideration for the right to use the intellectual property, PepsiCo and SVC were giving those valuable rights to SAPL for nothing, the Full Court majority implicitly found such consideration to be in the value of SAPL's other promises to PepsiCo and SVC under the EBAs. The problem with this reasoning is that the Full Court majority having also correctly recognised the EBAs to each constitute a "single, integrated and indivisible" transaction of which the intellectual property licences form a necessary part,⁶⁶ it follows that to characterise the price payable as consideration only for the sale of concentrate purportedly subdivides the indivisible.

50 The sale of concentrate contemplated by the EBAs in the future is no different from the many other promises made between the parties to the EBAs which involved future performance. That PepsiCo and SVC reserved the right either to sell the concentrate or to cause the concentrate to be sold by a member of the PepsiCo Group does not make that part of the overall transaction separate from the balance. Without that promise, the EBAs would be pointless. Equally, the EBAs would be pointless without the intellectual property licences and other interlocking promises.

51 The proper construction (and consequent characterisation) of a commercial agreement, in accordance with orthodox principles,⁶⁷ does not enable a court to subdivide that which is objectively characterised as a single, integrated and indivisible transaction. As in *Lend Lease*, in such cases there is no rational

65 *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1 at 9 [21].

66 *Commissioner of State Revenue (Vic) v Lend Lease Development Pty Ltd* (2014) 254 CLR 142 at 163 [62].

67 eg, *Electricity Generation Corporation v Woodside Energy Ltd* (2014) 251 CLR 640 at 656-657 [35].

objective criterion upon which such a subdivision of promises may be based.⁶⁸ Accordingly, in this case, that which was paid for the use of or the right to use intellectual property (that is, a "royalty") must be determined as a matter of objective characterisation on the basis of the mutuality of the exchange of promises which comprise the entire transaction. The consideration is not to be determined by attributing intentions to each party to the transaction and still less by attributing to one party an intention relating to some aspects of the transaction (for example, SAPL intending to pay for the concentrate alone) and to another some other intention (for example, PepsiCo and SVC granting to SAPL the intellectual property licences in exchange for SAPL paying both for what is said to be the concentrate and for intellectual property in the licences).

52 The EBAs each provided for an exchange of promises to effect the sale by PepsiCo or SVC or another PepsiCo Group member of the concentrate needed to make and the intellectual property rights needed to sell the branded drinks. As such, the future sales of that concentrate at the agreed rates (including the agreed minimum sales targets per year, which would drive the purchase of units of concentrate) were as much an indivisible part of the transactions as the grant of the necessary intellectual property licences enabling SAPL to fulfil its obligations in respect of those branded drinks under the EBAs, including the obligation and right to sell those drinks to retailers and consumers. What cannot be done is to separate the part from the whole or to attribute to each party intentions based on the perceived value to them of any individual promise. Once it is accepted that within the contractual scheme SAPL's payment for the concentrate in part moved the grant of the intellectual property licences, the answer that the payment included a royalty component is unavoidable.

53 The Full Court majority, having rightly found the transaction to involve an integrated and interlocking series of exchanges of promises and grants of rights, were wrong then to engage in a process of subdivision in which the payment (said to be for concentrate) attached to the concentrate and the other exchanges of value attached to other aspects of the agreement. That approach necessarily diverts the court from asking what objectively and as between the parties moved the grants of the intellectual property licences. The answer cannot be one thing for PepsiCo and SVC and another thing for SAPL, as that which moved the grants of the intellectual property licences is both necessarily objectively mutual and part of the indivisible whole. The answer is that the promise to pay imposed on SAPL under the EBAs for the concentrate to some extent moved the grants of the intellectual property licences, the relevant promises forming part of a single and indivisible whole.

68 *Commissioner of State Revenue (Vic) v Lend Lease Development Pty Ltd* (2014) 254 CLR 142 at 155 [33].

Accordingly, the payment for the concentrate is to some extent a payment for the grants of the intellectual property licences.

54 The approach of the Full Court majority, as Colvin J recognised,⁶⁹ overlooked that "where an amount is required to be paid under an agreement, the parties to that agreement may have no concern to identify precisely the consideration for which the amount is payable" so that "it is quite likely that amounts that are agreed to be paid may not be separated into components that correspond to different aspects of the consideration for which the amount is paid because there would be no commercial need to do so". The corollary, as Colvin J also explained, is that where parties to an agreement have attached a label to a payment it may be no more than "a convenient rateable measure of the commercial value of the whole of the consideration moving under the agreement" so that the "use of that unit does not mean that the consideration is paid for that product and nothing else".⁷⁰

55 That the price said to be allocated to the item to be sold (in this case, the concentrate) is not or is not proved to be artificially inflated is not to the point. Indeed, any focus on the question whether the price paid for the concentrate was "disproportionately high"⁷¹ would involve a fruitless attempt to ascertain "the circumstances warranting the parties in fixing the price they chose and that is not necessarily the same thing as consideration", the very approach disclaimed by Dixon CJ in *Davis*.⁷²

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.

69 *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1 at 37 [158].

70 *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1 at 37 [158].

71 *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1 at 10 [24].

72 *Davis Investments Pty Ltd v Commissioner of Stamp Duties (NSW)* (1958) 100 CLR 392 at 408.

57 Moreover, a consequence of a purported division of a single, integrated and indivisible transaction would be to make it practically impossible to identify any royalty for the grant of rights to use intellectual property in the transaction unless the parties had expressly labelled some part of a payment or credit as consideration for the grant. If, however, the label the parties attach to the sale of concentrate is accepted at face value, that would have the effect of immunising the payment from being in part consideration for the use of the intellectual property. Such an approach is contrary to the language of the definition of "royalty", which involves any amount paid or credited, however described or computed.

58 The Commissioner therefore is correct to have submitted that the "majority's finding ... that the EBAs ultimately secured the right to distribute the famous beverages of which the use of intellectual property was a necessary element *required* a conclusion that part of the payments made by SAPL was for the use of PepsiCo/SVC's intellectual property" (emphasis added). That requirement flows from the proper characterisation of the transaction as single, integrated and indivisible.

59 The answers of PepsiCo and SVC to these matters, that "a tax Act must take the result of the taxpayer's activities as it finds them" and the "relevant transactions were sales of goods for a price", expose the flaw in their case. In objectively construing and characterising an agreement, the court is not bound to accept any label the parties attach to any aspect of their dealings. Nor are the EBAs properly characterised as a sale of goods for a price. While, as PepsiCo and SVC said, a "process of characterisation of a payment must commence with a correct identification of the legal rights and obligations attending the transaction giving rise to the payment", part of that process of characterisation involves identifying if the transaction is single, integrated and indivisible or not, having regard to its text, structure and purpose. If it is, it cannot thereafter be divided into its component parts for the purpose of identifying any royalty component.

60 For these reasons, question one is to be answered in the affirmative.

Question two: did PepsiCo and SVC derive income?

The question in context

61 Question two is whether PepsiCo and SVC derived income from the payment of a royalty as referred to in s 128B(2B) of the ITAA, thereby making PepsiCo and SVC liable to pay income tax (specifically, royalty withholding tax) under s 128B(5A) of that Act, which states that:

"A person who derives income to which this section applies that consists of a royalty is liable to pay income tax upon that income at the rate declared by the Parliament in respect of income to which this subsection applies."

62 Relevantly, s 128B "applies" to income "derived" by a non-resident, in this case PepsiCo and SVC, during the 1993-1994 income year or later,⁷³ that "consists of a royalty" which is "paid to" the non-resident by a person to whom the section applies, namely a resident, in this case SAPL.⁷⁴

The reasoning of the Courts below

63 The primary judge concluded that, being the parties to the EBAs, each of PepsiCo and SVC were entitled to receive the payments from SAPL under those agreements. As the primary judge put it, "[t]his follows as a matter of contract from the fact that PepsiCo and SVC were the parties to the EBAs and SAPL's payment obligations under the EBAs were owed to them. This remained the case even though PepsiCo and SVC nominated PBS as the seller of the concentrate. PBS was not, and did not become, a party to the EBAs."⁷⁵ The primary judge therefore characterised the nomination of PBS as the seller of the concentrate under the respective EBAs as a "direction to SAPL to pay PBS rather than PepsiCo or SVC (as applicable)", so that the payments by SAPL to PBS were income derived by each of PepsiCo and SVC.⁷⁶

64 The Full Court majority and Colvin J disagreed. The majority considered that, as "there can be no payment by direction unless there is an antecedent monetary obligation owed" by the payer to the creditor, it could not be that the nomination of PBS as the seller by each of PepsiCo and SVC constituted a direction to satisfy the debt owed to them by payment to PBS. Rather, the nomination of PBS as the seller by each of PepsiCo and SVC involved PBS having the status of seller under the EBAs by reason of which SAPL would be obliged to pay PBS the agreed price for the concentrate and essential base ingredients as applicable.⁷⁷

73 ITAA, s 128B(2B)(a).

74 ITAA, s 128B(2B)(b)(i).

75 *PepsiCo Inc v Commissioner of Taxation* (2023) 117 ATR 328 at 378 [255].

76 *PepsiCo Inc v Commissioner of Taxation* (2023) 117 ATR 328 at 378 [256].

77 *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1 at 13 [40]-[41].

Consideration

65 "Income derived" by a taxpayer or putative taxpayer is understood to involve "gains" that have "come home" to the taxpayer in "a realized or immediately realizable form".⁷⁸ The required "gains" are not net gains as "the topic under discussion is assessable income, that is to say gross income".⁷⁹ Further, the gains must be received beneficially and therefore "may properly be counted as gains completely made, so that there is neither legal nor business unsoundness in regarding them without qualification as income derived".⁸⁰

66 The Commissioner having disavowed any relationship of agency between each of PepsiCo and SVC (as relevant) and PBS or notion of PBS having received money by way of payment from SAPL on trust for each of PepsiCo and SVC (as relevant), the Full Court's analysis of the legal status of those payments is persuasive. The EBAs enabled PepsiCo and SVC (as relevant) to constitute themselves or (in effect) another member of the PepsiCo Group as the seller of the concentrate. PepsiCo and SVC each having nominated PBS as the seller, each was bound to "cause to be sold" by PBS to SAPL the concentrate. Being obliged to cause to be sold to SAPL the concentrate is not the same as selling to SAPL the concentrate. It is clear from the EBAs that if PepsiCo and SVC nominate a seller other than themselves it is that entity which is the seller. That SAPL promised PepsiCo and SVC, amongst other things, to buy from the seller the concentrate at the agreed prices, and that PepsiCo and SVC (not PBS)⁸¹ could enforce this promise, does not convert the promise into one by which SAPL was bound to make payment to anyone other than PBS as the nominated seller.

67 The subsequent transactions accord with this characterisation of the EBAs. After PepsiCo and SVC nominated PBS to be the seller PBS, by agreement, placed itself in a position whereby it could sell the concentrate at the price agreed in the EBAs to SAPL. SAPL placed orders for the concentrate and essential base ingredients with PBS. PBS supplied the concentrate to SAPL at the price agreed under the EBAs. PBS held title to and risk in the concentrate until SAPL paid for

78 *Commissioner of Taxes (SA) v Executor Trustee and Agency Co of South Australia Ltd* (1938) 63 CLR 108 at 155.

79 *Arthur Murray (NSW) Pty Ltd v Federal Commissioner of Taxation* (1965) 114 CLR 314 at 318.

80 *Arthur Murray (NSW) Pty Ltd v Federal Commissioner of Taxation* (1965) 114 CLR 314 at 318.

81 Subject to cl 7.1(b) of the SVC EBA.

it under the PepsiCo EBA. PBS held title to and risk in the concentrate until SAPL or its agent or nominee took custody of the concentrate at PBS's warehouse under the SVC EBA. Neither PepsiCo nor SVC held title to the concentrate at any time. PBS invoiced SAPL for the quantity of concentrate supplied to SAPL and SAPL paid to PBS amounts so invoiced.

68 Nothing supports giving these facts a legal character contrary to their appearance.

69 For these reasons, the better characterisation of the facts is that neither PepsiCo nor SVC derived income from the payment of a royalty as referred to in s 128B(2B) of the ITAA. Question two is to be answered in the negative.

Question three: liability to pay diverted profits tax

The question in context

70 Question three is in the alternative to questions one and two. Question three concerns the application of the statutory provisions relating to DPT located in the "anti-avoidance" provisions of Pt IVA of the ITAA. Part IVA, headed "Schemes to reduce income tax", applies to a "scheme" in relation to a "tax benefit" (a "DPT tax benefit") in a year of income⁸² if provisions in respect of a principal purpose component are also satisfied. If the tax benefit and principal purpose requirements are both satisfied, the taxpayer is obliged to pay, for the relevant year of income, tax at a particular rate on the "DPT base amount for that DPT tax benefit".⁸³

Tax benefit

71 If PepsiCo and SVC had been liable to pay royalty withholding tax under s 128B(5A) of the ITAA they could not also have obtained "a tax benefit in connection with a scheme"⁸⁴ as described in s 177C(1)(bc) of the ITAA, to the effect that "a reference in this Part [Pt IVA] to the obtaining by a taxpayer of a tax benefit in connection with a scheme shall be read as a reference to: ... the taxpayer not being liable to pay withholding tax on an amount where the taxpayer either would have, or might reasonably be expected to have, been liable to pay

82 ITAA, s 177J(1)(a).

83 ITAA, s 177P(1)(a).

84 A "scheme" means "(a) any agreement, arrangement, understanding, promise or undertaking, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings; and (b) any scheme, plan, proposal, action, course of action or course of conduct": ITAA, s 177A(1).

withholding tax on the amount if the scheme had not been entered into or carried out". It would then have followed that there was no "scheme" to which Pt IVA could apply to give rise to a liability of PepsiCo and SVC to pay DPT for any "DPT tax benefit" as provided for in s 177P(1) of the ITAA.

72 As PepsiCo and SVC are not liable to pay royalty withholding tax under s 128B(5A) of the ITAA they may be liable to pay DPT under Pt IVA of that Act. According to s 177H(1) of the ITAA the primary objects of the DPT provisions⁸⁵ within Pt IVA are "(a) 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 (b) to prevent those entities from reducing the amount of Australian tax they pay by diverting profits offshore through contrived arrangements between related parties".

73 Liability to pay DPT under Pt IVA depends on the operation of a series of interlinked provisions. As noted, by s 177C(1)(bc) a reference in Pt IVA to "the obtaining by a taxpayer of a tax benefit in connection with a scheme" is to be read as "the taxpayer not being liable to pay withholding tax on an amount where the taxpayer either would have, or might reasonably be expected to have, been liable to pay withholding tax on the amount if the scheme had not been entered into or carried out". By s 177C(1)(g), for the purposes of Pt IVA, the amount of the tax benefit shall be taken to be "in a case to which paragraph (bc) applies – the amount referred to in that paragraph".

74 By s 177CB(1)(e), to determine if a taxpayer "either would have, or might reasonably be expected to have, been liable to pay withholding tax" the provisions of s 177CB are to be applied. By s 177CB(2) a "decision that a tax effect would have occurred if the scheme had not been entered into or carried out must be based on a postulate that comprises only the events or circumstances that actually happened or existed (other than those that form part of the scheme)". By s 177CB(3) a "decision that a tax effect might reasonably be expected to have occurred if the scheme had not been entered into or carried out must be based on a postulate that is a reasonable alternative to entering into or carrying out the scheme". By s 177CB(4), in "determining for the purposes of subsection (3) whether a postulate is such a reasonable alternative" it is necessary to: (a) "have particular regard to" (i) the substance of the scheme; and (ii) any result or consequence for the taxpayer that is or would be achieved by the scheme (other than a result in relation to the operation of the ITAA); and (b) "disregard any result in relation to the operation of [the ITAA] that would be achieved by the postulate for any person (whether or not a party to the scheme)".

85 Defined in ITAA, s 177A(1) to include ss 177H, 177J, 177N and 177P.

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75 As noted, the taxpayer bears the onus of proving the assessments are excessive under s 14ZZO(b)(i) of the TAA. As a result, PepsiCo and SVC accepted that to determine if a taxpayer might reasonably be expected to have been liable to pay withholding tax the taxpayer must prove both that "the Commissioner's postulates are not reasonable ... [and] ... that there is no other reasonable postulate".⁸⁶ The Commissioner did not accept that description of the operation of the onus but, as will be explained, it is unnecessary to resolve that aspect of the dispute.

76 The Explanatory Memorandum to the *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013* (Cth), which relevantly inserted s 177CB(3) and (4), said that:⁸⁷

"The amendment [the introduction of s 177CB(3) and (4)] makes it clear that when postulating what might reasonably be expected to have occurred in the absence of a scheme, it is not enough to simply assume the non-existence of the scheme – the postulate must represent a reasonable alternative to the scheme, in the sense that it could reasonably take the place of the scheme.

Such a postulate will necessarily require speculation about the state of affairs that would have existed if the scheme had not been entered into or carried out. This may include speculation about the way in which connected transactions would have been modified if they had had to accommodate the absence of the scheme."

77 This approach reflects the approach in *Federal Commissioner of Taxation v Peabody* that a "reasonable expectation requires more than a possibility. It involves a prediction as to events which would have taken place if the relevant scheme had not been entered into or carried out and the prediction must be sufficiently reliable for it to be regarded as reasonable".⁸⁸

86 *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1 at 20 [67]-[68], referring to *Federal Commissioner of Taxation v Guardian AIT Pty Ltd* (2023) 115 ATR 316 at 351 [156]-[157] and *RCI Pty Ltd v Federal Commissioner of Taxation* (2011) 84 ATR 785 at 842-843 [128]-[131].

87 Australia, House of Representatives, *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013*, Explanatory Memorandum at 21 [1.86]-[1.87].

88 (1994) 181 CLR 359 at 385.

78 Concerning s 177CB(4)(a)(i) and (ii) (have particular regard to the substance of the scheme and any result or consequence for the taxpayer that is or would be achieved by the scheme), the Explanatory Memorandum said that the reference to the substance of the scheme in s 177CB(4)(a)(i) "requires a consideration of its commercial and economic substance as distinct from its legal form or shape" and that for a postulate to constitute a reasonable alternative it "should correspond to the substance of the scheme".⁸⁹ Further, "[i]t would be expected that a postulate that is a reasonable alternative to the entering into and carrying out of a scheme would achieve for the taxpayer non-tax results and consequences that are comparable to those achieved by the scheme itself".⁹⁰

Principal purpose

79 As noted, Pt IVA also imposes a requirement of principal purpose (meaning *a* principal purpose, which need not be the sole or dominant purpose).⁹¹ The "inquiry required by Pt IVA is an objective, not subjective, inquiry".⁹² As noted, by s 177J(1) Pt IVA applies to a "scheme, in relation to a tax benefit (the **DPT tax benefit**) if" certain specified conditions are satisfied. The conditions in dispute are those in s 177J(1)(a) and (b), it being common ground that the specified conditions are otherwise satisfied. Section 177J(1)(a) and (b) provide:

"This Part also applies to a scheme, in relation to a tax benefit (the **DPT tax benefit**) if:

- (a) a taxpayer (a **relevant taxpayer**) has obtained, or would but for section 177F obtain, the DPT tax benefit in connection with the scheme, in a year of income; and
- (b) it would be concluded (having regard to the matters in subsection (2)) that the person, or one of the persons, who entered into or carried

89 Australia, House of Representatives, *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013*, Explanatory Memorandum at 24 [1.103], [1.106].

90 Australia, House of Representatives, *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013*, Explanatory Memorandum at 25 [1.110].

91 See Australia, House of Representatives, *Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2017* and *Diverted Profits Tax Bill 2017*, Explanatory Memorandum at 21 [1.45]-[1.47].

92 *Federal Commissioner of Taxation v Hart* (2004) 217 CLR 216 at 233 [37].

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out the scheme or any part of the scheme did so for a principal purpose of, or for more than one principal purpose that includes a purpose of:

- (i) enabling the relevant taxpayer to obtain a tax benefit, or both to obtain a tax benefit and to reduce one or more of the relevant taxpayer's liabilities to tax under a foreign law, in connection with the scheme; or
- (ii) enabling the relevant taxpayer and another taxpayer (or other taxpayers) each to obtain a tax benefit, or both to obtain a tax benefit and to reduce one or more of their liabilities to tax under a foreign law, in connection with the scheme;

whether or not that person who entered into or carried out the scheme or any part of the scheme is the relevant taxpayer or is the other taxpayer or one of the other taxpayers; and

...".

80 Section 177F(1), referred to in s 177J(1)(a), provides that, where Pt IVA applies to a scheme in connection with which a tax benefit has been obtained, or would but for s 177F be obtained, the Commissioner, relevantly, may "(a) in the case of a tax benefit that is referable to an amount not being included in the assessable income of the taxpayer of a year of income – determine that the whole or a part of that amount shall be included in the assessable income of the taxpayer of that year of income".

81 "[S]ubsection (2)", referred to in s 177J(1)(b), is s 177J(2). Section 177J(2) provides that:

"For the purposes of paragraph (1)(b), have regard to the following matters:

- (a) the matters in subsection 177D(2);
- (b) without limiting subsection 177D(2), the extent to which non-tax financial benefits that are quantifiable have resulted, will result, or may reasonably be expected to result, from the scheme;
- (c) the result, in relation to the operation of any foreign law relating to taxation, that (but for this Part) would be achieved by the scheme;
- (d) the amount of the tax benefit mentioned in paragraph (1)(b)."

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82 Section 177D(2), referred to in s 177J(2)(a), specifies the following matters:

- "(a) the manner in which the scheme was entered into or carried out;
- (b) the form and substance of the scheme;
- (c) the time at which the scheme was entered into and the length of the period during which the scheme was carried out;
- (d) the result in relation to the operation of this Act that, but for this Part, would be achieved by the scheme;
- (e) any change in the financial position of the relevant taxpayer that has resulted, will result, or may reasonably be expected to result, from the scheme;
- (f) any change in the financial position of any person who has, or has had, any connection (whether of a business, family or other nature) with the relevant taxpayer, being a change that has resulted, will result or may reasonably be expected to result, from the scheme;
- (g) any other consequence for the relevant taxpayer, or for any person referred to in paragraph (f), of the scheme having been entered into or carried out;
- (h) the nature of any connection (whether of a business, family or other nature) between the relevant taxpayer and any person referred to in paragraph (f)."

83 By s 177N, if Pt IVA applies to a scheme because of s 177J then (a) s 177P applies to the relevant taxpayer; and (b) the Commissioner cannot make a determination under, relevantly, s 177F(1). By s 177P(1), however, the relevant taxpayer is liable to pay tax at the rate declared by the Parliament on the DPT tax benefit as specified. Further, as the Full Court majority explained, the applicable DPT provisions are concerned with "the amount upon which the taxpayer might reasonably be supposed to have been liable to pay royalty withholding tax but for the scheme", so that the "amount referred to in s 177C(1)(bc) and brought to tax under ss 177P(1) and (2)(a) is therefore the amount of the royalty which did not come into existence because of the scheme. It is not the amount of royalty withholding tax that would have been due on that royalty."⁹³

93 *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1 at 18 [60].

84 Again, as the onus is on the taxpayer to prove that the assessments are excessive, PepsiCo and SVC must prove the lack of the requisite principal purpose specified in s 177J(1)(b).

The "schemes" and the Commissioner's alternative postulates

85 The "scheme" in each case is the entry into the EBA, which, in this aspect of the case, is to be understood as an agreement under which each of PepsiCo and SVC granted to SAPL an exclusive licence to use intellectual property rights of substantial value without requiring payment of a royalty for the licence. The Commissioner proposed that PepsiCo and SVC each obtained a tax benefit in connection with a scheme by the EBAs in that they were thereby not liable to pay royalty withholding tax on an amount each might reasonably be expected to have been liable to pay on the amount if the respective schemes had not been entered into or carried out (s 177C(1)(bc)).

86 Under s 177CB(3) the Commissioner proposed two postulates as reasonable alternatives to the entering into or carrying out of these schemes to support the Commissioner's contention that a tax effect might reasonably be expected to have occurred if the schemes had not been entered into or carried out. These postulates (shorn of the irrelevant "would have" component to which s 177CB(2), not s 177CB(3), would apply) are: (a) the relevant EBA might reasonably be expected to have expressed the payments to be made by SAPL to be for all of the property provided by (and promises made by) the PepsiCo Group entities (rather than for concentrate only); or (b) the relevant EBA might reasonably be expected to have expressly provided for the payments to be made by SAPL to include a royalty for the use of, or the right to use, the relevant trade marks and other intellectual property (whether or not the amount of the royalty was specified).⁹⁴

87 The Explanatory Memorandum to the *Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2017* (Cth), which inserted s 177J(1), said in respect of the requisite principal purpose that:⁹⁵

"The 'principal purpose or more than one principal purpose' threshold is lower than the 'sole or dominant purpose threshold', which is used in subsection 177D(1) of the ITAA 1936. Consistent with the

94 *PepsiCo Inc v Commissioner of Taxation* (2023) 117 ATR 328 at 415 [430].

95 Australia, House of Representatives, *Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2017* and *Diverted Profits Tax Bill 2017*, Explanatory Memorandum at 21 [1.45]-[1.46].

multinational anti-avoidance law, the relevant principal purpose need not be the sole or dominant purpose of a person or persons who entered into or carried out the scheme, but must be one of the main purposes, having regard to all the facts and circumstances.

This recognises that a scheme or part of a scheme may be entered into or carried out for a number of purposes, some or all of which are principal purposes. The scheme will be caught under section 177J of the ITAA 1936 as long as one of those principal purposes satisfies the tax benefit requirements of the principal purpose test."

The reasoning in the Courts below

88 Applying, as required, s 177CB(4) of the ITAA, the primary judge accepted the Commissioner's first postulate (each EBA might reasonably be expected to have expressed the payments to be made by SAPL to be for all of the property provided by (and promises made by) the PepsiCo Group entities (rather than for concentrate only)) to be a reasonable alternative to entering into or carrying out the schemes. The primary judge therefore concluded that "each of PepsiCo and SVC obtained a tax benefit in connection with the relevant scheme" as set out in s 177J(1)(a) of the ITAA.⁹⁶

89 The primary judge said further that "it would be concluded that one of the principal purposes of each of PepsiCo and SVC in entering into or carrying out the relevant scheme was to obtain a tax benefit (namely not being liable to pay Australian royalty withholding tax) and to reduce foreign tax (namely, US tax on their income)", observing that "the terms of the EBAs are contrived, in that payments that are ostensibly for concentrate alone are in substance for both concentrate and the licence of valuable intellectual property".⁹⁷ On this basis, the primary judge concluded that if the royalty withholding tax provisions did not apply, the DPT provisions would apply.⁹⁸

90 As the Full Court majority considered that the schemes represented by the EBAs did not include elements to the effect that "(a) the grant of the licence to use the intellectual property had an economic value from PepsiCo's perspective having regard to all of the terms of the EBA; and (b) the concentrate price included that

96 *PepsiCo Inc v Commissioner of Taxation* (2023) 117 ATR 328 at 417 [443] (emphasis omitted).

97 *PepsiCo Inc v Commissioner of Taxation* (2023) 117 ATR 328 at 421 [465].

98 *PepsiCo Inc v Commissioner of Taxation* (2023) 117 ATR 328 at 421 [466].

value",⁹⁹ it followed that, by reference to s 177CB(4)(a)(i), the "commercial and economic substance of the scheme[s]" and the Commissioner's two postulates were "quite different" and did "not correspond", which indicated that the postulates were not reasonable alternatives to the schemes.¹⁰⁰

91 The Full Court majority also considered that there were no reasonable alternative postulates because the "only postulates which can bring the payments to tax are ones in which [SAPL's] payments for concentrate can be seen as being made in part for the grant of the [intellectual property] rights" but "no such postulate can be a reasonable alternative given the terms of the scheme[s] and the state of the evidence".¹⁰¹ From this it followed that it was not the case, as provided for in s 177C(1)(bc), that if the schemes had not been entered into or carried out, the taxpayers might reasonably be expected to have been liable to pay royalty withholding tax on the amounts paid by SAPL for concentrate.¹⁰² That is, there was no tax benefit. On this basis, for the Full Court majority, the requisite principal purpose under s 177J(1)(b)(i) did not exist.¹⁰³ Otherwise, the Full Court majority, on what for them would be the "highly artificial" contrary assumption that under the EBAs the price of concentrate included a royalty, "would have concluded that the requisite purpose under s 177J(1)(b)(i) had been established".¹⁰⁴

92 Colvin J agreed with the Full Court majority that if the amounts to be paid by SAPL under the EBAs did not include a royalty, the requisite principal purpose under s 177J(1)(b)(i) did not exist.¹⁰⁵ If, however, those amounts included a royalty (as Colvin J concluded they did) then, as his Honour put it, "it is the mechanism by which [under the EBAs] the Related Entity [PBS] could be nominated as the Seller (and be the party to whom payment would be made) that means that there is no income in the form of a royalty that may be the subject of a withholding tax

99 *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1 at 22 [79].

100 *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1 at 23 [86]-[87], 24 [93].

101 *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1 at 25 [100].

102 *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1 at 25-26 [101].

103 *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1 at 26 [101]-[102].

104 *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1 at 32 [133].

105 *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1 at 48 [209].

liability on the part of PepsiCo or SVC".¹⁰⁶ On that basis, "the EBAs resulted in a tax benefit because, if the EBAs had not been entered into, then a reasonable postulate was that the EBAs would have provided for the royalty to be paid to PepsiCo or SVC (as the case may be) as the holder of the rights to the trade mark[s]".¹⁰⁷ Colvin J observed that this accorded with the Commissioner's second postulate,¹⁰⁸ but it should be accepted that it is a refinement of that postulate. According to Colvin J, as the Full Court majority reasoned, the requisite principal purpose under s 177J(1)(b)(i) should be found to have existed based on this reasonable alternative postulate.¹⁰⁹

93 Again, and as will be explained, the reasoning of Colvin J in this regard should be accepted.

Consideration

Tax benefit

94 Consistently with the reasoning of Colvin J, on their proper construction and characterisation, the EBAs each provide for a single, integrated and indivisible transaction of which the sale of concentrate by PepsiCo or SVC (as applicable) or their nominated PepsiCo Group member to SAPL forms one inseparable part, from which it follows that the price said to be for the sale of concentrate has within it a component for the transfer of the intellectual property rights (the royalty). Once that is accepted, it also follows that PepsiCo and SVC have not discharged their onus by negating the reasonable alternative postulate to the schemes that PepsiCo and SVC would be the nominated sellers under the EBAs in circumstances where, as discussed, the price payable by reference to units of concentrate to be sold included a royalty for the use of the intellectual property rights granted by PepsiCo and SVC to SAPL under the EBAs. On this reasonable alternative postulate to the schemes under s 177CB(3), PepsiCo and SVC each obtained a tax benefit (s 177C(1)(bc)) as, but for the schemes, each might reasonably be expected to have been liable to pay withholding tax on the amount if the scheme had not been entered into or carried out (s 177C(1)(g)).

95 Section 177CB(3) (the requirement for a postulate that is a reasonable alternative to entering into or carrying out the scheme) is to be applied having

106 *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1 at 48 [210].

107 *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1 at 49 [215].

108 *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1 at 49 [217].

109 *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1 at 49 [218].

particular regard to the matters in s 177CB(4). This means that the specified matters are to be a centrally relevant consideration in and focal point of the court's decision-making process.¹¹⁰ The required focus on the "substance of the scheme" (s 177CB(4)(a)(i)) should exclude from the range of potential reasonable alternative postulates hypothesised dealings that conflict with or bear no resemblance to the commercial and economic essence of the scheme. The relevant Explanatory Memorandum, in saying that a reasonable alternative "should *correspond* to the substance of the scheme",¹¹¹ is to be understood as indicating no more than that a reasonable alternative postulate, in its commercial and economic substance or essence, should generally accord with the scheme, in its commercial and economic substance or essence. In the present case, the postulate Colvin J proposed (that, but for the schemes, the EBAs would have provided for the royalty to be paid to PepsiCo or SVC as relevant, being the holders of the rights to the intellectual property) accords with the commercial and economic essence of the schemes. The change is that PepsiCo and SVC would each be the seller at the agreed prices said in the EBAs to be payable for the concentrate in consideration for the sale of concentrate and the grant of the intellectual property licences, a position for which the EBAs each expressly provided. At the least, PepsiCo and SVC did not discharge their onus of proving that this would not be a reasonable alternative postulate, essentially for the same reasons the primary judge gave in accepting the Commissioner's two postulates as reasonable alternatives to the schemes.

96 The required focus on any result or consequence for the taxpayer that is or would be achieved by the scheme (other than a result in relation to the operation of the ITAA) (s 177CB(4)(a)(ii)) should exclude from the range of potential reasonable alternative postulates hypothesised dealings that are inconsistent with or undermine important non-tax objects of the taxpayer that the scheme achieves. In this case, the focus of PepsiCo and SVC was on the objective of ensuring simplicity in the pricing model for franchising and that the postulates would involve complex discussions and conflict with the simplicity of the franchising model. As the primary judge concluded, however, in circumstances where the onus of proof was on PepsiCo and SVC, the evidence indicated that there "is considerable scope to negotiate the pricing terms and that such terms can have a

110 *R v Hunt; Ex parte Sean Investments Pty Ltd* (1979) 180 CLR 322 at 329; *Port of Newcastle Operations Pty Ltd v Glencore Coal Assets Australia Pty Ltd* (2021) 274 CLR 565 at 601 [113].

111 Australia, House of Representatives, *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013*, Explanatory Memorandum at 24 [1.106] (emphasis added).

degree of complexity to them"¹¹² and that "there is considerable scope for variation in exclusive bottling agreements, including pricing terms, and that the pricing terms can have some complexity".¹¹³ In any event, the price would not change under Colvin J's postulate; only the option for PepsiCo and SVC to nominate another seller within the PepsiCo Group would change.

97 Otherwise, and contrary to submissions for PepsiCo and SVC, it is not the case that the Commissioner included as an element of the scheme under each EBA that "no royalty was paid" for the intellectual property. 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. *Peabody*, in saying that a reasonable alternative postulate must involve a "sufficiently reliable" prediction of what might reasonably be expected to have happened but for the scheme,¹¹⁴ does not support that sweeping proposition.

98 Once it is accepted that the payments under the EBAs were to any extent consideration for the intellectual property licences (and subject to the principal purpose requirement being satisfied, as discussed below), the question becomes one of valuation, which was not an issue in these appeals. It may be noted, however, that the primary valuation methods of both valuation experts proceeded on the basis that the payments said to be for the concentrate in the EBAs were, *to some extent*, consideration for the intellectual property licences.¹¹⁵ This accords with our reasoning.

99 For these reasons, the primary judge was correct to conclude that "each of PepsiCo and SVC obtained a tax benefit in connection with the relevant scheme".¹¹⁶ Accordingly, it is unnecessary to consider the Commissioner's further submission that the Full Court majority erred in their approach to the onus of proof

112 *PepsiCo Inc v Commissioner of Taxation* (2023) 117 ATR 328 at 416 [438].

113 *PepsiCo Inc v Commissioner of Taxation* (2023) 117 ATR 328 at 417 [439].

114 *Federal Commissioner of Taxation v Peabody* (1994) 181 CLR 359 at 385.

115 *PepsiCo Inc v Commissioner of Taxation* (2023) 117 ATR 328 at 380 [269].

116 *PepsiCo Inc v Commissioner of Taxation* (2023) 117 ATR 328 at 417 [443] (emphasis omitted).

as it applies to s 177C(1)(bc) of the ITAA by contemplating that a taxpayer may discharge that onus by proving that there is no reasonable alternative to a scheme.

Requisite principal purpose

100 The requisite principal purpose is of enabling the relevant taxpayer to obtain a tax benefit, or both to obtain a tax benefit and to reduce one or more of the relevant taxpayer's liabilities to tax under a foreign law, in connection with the scheme (s 177J(1)(b)(i)). The question posed by s 177J(1)(b) is: would it be concluded (having regard to the matters in s 177J(2)) that the taxpayer who entered into or carried out the scheme or any part of the scheme did so for a principal purpose of, or for more than one principal purpose that includes, that requisite purpose?

101 No error is apparent in the reasoning of the primary judge that the considerations in s 177J(2) (which include those specified in s 177D(2)) weigh in favour of the existence of the requisite principal purpose on the part of PepsiCo and SVC. Several considerations the primary judge identified carry substantial weight in reaching that conclusion, particularly when assessed in the context of PepsiCo and SVC being the parties bearing the onus of proof and being the only parties capable of adducing evidence of all circumstances relevant to the statutory question of purpose. In giving little weight to the somewhat vague and over-generalised evidence that PepsiCo and SVC did adduce in that regard, the primary judge was doing no more than giving effect to the orthodox approach that "all evidence is to be weighed according to the proof which it was in the power of one side to have produced, and in the power of the other to have contradicted".¹¹⁷

102 First, as the primary judge concluded, there was "no detailed and comprehensive evidence as to why, as at 2009, the PepsiCo Group generally adopted that pricing structure in its exclusive bottling agreements" and it "would not be safe to assume that tax considerations did not have a role to play".¹¹⁸ It followed that the evidence that the PepsiCo Group franchising model had been in place since the early 1900s and that simplicity of the model was desirable provided only slight support for the contention of PepsiCo and SVC against their principal purpose being that specified in s 177J(1)(b) of the ITAA.¹¹⁹ This remains an effective answer to the submissions for PepsiCo and SVC that the franchising model was instituted at a time when royalty withholding tax could not have been

¹¹⁷ *Blatch v Archer* (1774) 1 Cowp 63 at 65 [98 ER 969 at 970].

¹¹⁸ *PepsiCo Inc v Commissioner of Taxation* (2023) 117 ATR 328 at 418 [452].

¹¹⁹ *PepsiCo Inc v Commissioner of Taxation* (2023) 117 ATR 328 at 418 [452].

a consideration and that it therefore should be assumed that this has continued to be the case.

103 Second, referring to s 177D(2)(b), the primary judge rightly concluded that there was a disconnect between the form and substance of the EBAs in that in form the payments to be made by SAPL were for the concentrate alone and not for the licence of the trade marks and other intellectual property but, in substance, the payments to be made by SAPL were for both the concentrate and the licence of the trade marks and other intellectual property.¹²⁰

104 Third, referring to s 177D(2)(e), the primary judge said that while the amount of withholding tax that PepsiCo and SVC did not have to pay is "not large in the context of the total payments under the EBAs", this change in financial position resulting from the schemes "tends to support the Commissioner's position as to requisite purpose".¹²¹

105 Fourth, referring to s 177J(2)(c), the primary judge considered that, on the evidence, the schemes would have achieved a reduction in US tax for PepsiCo and SVC and that the reduction "would appear to be substantial" for the period prior to 31 December 2017. The primary judge said that this "supports the Commissioner's position as to requisite purpose".¹²²

106 Fifth, referring to s 177J(2)(d), the primary judge accepted that the amount of the tax benefit was not large in the context of the total payments under the EBAs but considered it sufficiently material to support the Commissioner's position as to requisite purpose.¹²³

107 Sixth, in response to a submission for PepsiCo and SVC as to the fact that the amounts SAPL paid to PBS to purchase concentrate were included in PBS's assessable income in Australia and that, after claiming deductions for the purchase of the concentrate, PBS paid tax in Australia on the margin it earned, the primary judge observed that it needed to be understood that the deductions claimed by PBS for purchase of concentrate from CMSPL represented almost the entirety of the amounts PBS received from SAPL, therefore PBS paid only a small amount of tax

120 *PepsiCo Inc v Commissioner of Taxation* (2023) 117 ATR 328 at 418-419 [453].

121 *PepsiCo Inc v Commissioner of Taxation* (2023) 117 ATR 328 at 419 [457].

122 *PepsiCo Inc v Commissioner of Taxation* (2023) 117 ATR 328 at 420 [463].

123 *PepsiCo Inc v Commissioner of Taxation* (2023) 117 ATR 328 at 421 [464].

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and it was likely that CMSPL paid little tax on the payments it received for concentrate from PBS in Singapore, Singapore being a low or no tax jurisdiction.¹²⁴

108 Otherwise, it is not a matter of finding the requisite principal purpose to have existed merely because another means of achieving the same or a similar outcome which results in more tax payable can be identified.¹²⁵ To the extent PepsiCo's and SVC's notices of contention so asserted, the assertion is unsustainable. It is the commercial and economic substance of the schemes, in which the parties to the EBAs have executed an indivisible transaction involving interlocking promises including the sale of concentrate and the grant of the intellectual property licences along with other promises of value, which drives the outcome. Within that indivisible transaction, there is no doubt that the intellectual property licences are of fundamental importance and substantial value. The evidence exposes that, without them, SAPL would have no interest in buying the concentrate and, indeed, PepsiCo and SVC would not sell SAPL the concentrate to enable it to market the drinks under different brands. The entire object of the EBAs was to enable and to maximise the sale in Australia of the drinks *as branded* under the globally famous trade marks. This objective character of the transactions drives the conclusion that SAPL's promise in respect of the purchase of and payment for concentrate, to some extent, included consideration for the intellectual property licences.

109 The submissions for PepsiCo and SVC that, if the material disadvantages of all alternative postulates were not accepted to make those postulates unreasonable, those alternatives were at best commercially and economically "neutral", with the consequence that, as PepsiCo and SVC put it, it equates to a "conceded absence of anything commercially to commend them", elide two separate concepts: the effect of the postulates and their commercial desirability. If these submissions were correct, there would also be nothing commercially to commend the schemes in the EBAs. Yet the EBAs have existed in one form or another since 2009 (and continue to exist) so there is something commercially to commend them to the parties. The point is that the reasonable alternative postulates, contrary to the case for PepsiCo and SVC, do not substantially alter the features of the EBAs that commercially commended them to the parties.

124 *PepsiCo Inc v Commissioner of Taxation* (2023) 117 ATR 328 at 419 [456].

125 *Minerva Financial Group Pty Ltd v Federal Commissioner of Taxation* (2024) 302 FCR 52 at 66 [60(4)-(6)], 73 [99].

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110 For these reasons, the primary judge correctly concluded that, if the royalty withholding tax provisions did not apply, the DPT provisions would apply.¹²⁶ In these appeals, accordingly, as the royalty withholding tax provisions do not apply, the DPT provisions do apply. As no issue was taken with the primary judge's valuation, the orders to be made should reflect the primary judge's conclusions in that regard.

Orders

111 The orders which should be made in the withholding tax appeal involving PepsiCo are:

- (1) Appeal dismissed.

112 The orders which should be made in the withholding tax appeal involving SVC are:

- (1) Appeal dismissed.

113 The orders which should be made in the DPT appeal involving PepsiCo for the year ended 30 June 2018 are:

- (1) Appeal allowed.
- (2) Set aside the orders made by the Full Court of the Federal Court of Australia on 16 July 2024 in proceeding VID 74 of 2024 and in their place order that:
 - (a) the appeal be allowed;
 - (b) the notice of amended diverted profits tax assessment dated 6 March 2023 for the year ended 30 June 2018 be varied so as to reflect the respondent's liability to pay diverted profits tax in the amount of \$7,133,336 for the year ended 30 June 2018;
 - (c) the respondent (PepsiCo, Inc) pay the appellant's (Commissioner of Taxation) costs.
- (3) There be no order as to costs in respect of this proceeding, being M100/2024.

126 *PepsiCo Inc v Commissioner of Taxation* (2023) 117 ATR 328 at 421 [466].

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- (4) The respondent (PepsiCo, Inc) pay the appellant's (Commissioner of Taxation) costs in relation to special leave application proceeding M69/2024.

114 The orders which should be made in the DPT appeal involving SVC for the year ended 30 June 2018 are:

- (1) Appeal allowed.
- (2) Set aside the orders made by the Full Court of the Federal Court of Australia on 16 July 2024 in proceeding VID 76 of 2024 and in their place order that:
 - (a) the appeal be allowed;
 - (b) the notice of amended diverted profits tax assessment dated 6 March 2023 for the year ended 30 June 2018 be varied so as to reflect the respondent's liability to pay diverted profits tax in the amount of \$1,559,552 for the year ended 30 June 2018;
 - (c) the respondent (Stokely-Van Camp, Inc) pay the appellant's (Commissioner of Taxation) costs.
- (3) There be no order as to costs in respect of this proceeding, being M102/2024.
- (4) The respondent (Stokely-Van Camp, Inc) pay the appellant's (Commissioner of Taxation) costs in relation to special leave application proceeding M71/2024.

115 The orders which should be made in the DPT appeal involving PepsiCo for the year ended 30 June 2019 are:

- (1) Appeal allowed.
- (2) Set aside the orders made by the Full Court of the Federal Court of Australia on 16 July 2024 in proceeding VID 75 of 2024 and in their place order that:
 - (a) the appeal be allowed;
 - (b) the notice of amended diverted profits tax assessment dated 6 March 2023 for the year ended 30 June 2019 be varied so as to reflect the respondent's liability to pay diverted profits

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tax in the amount of \$7,718,552 for the year ended 30 June 2019;

(c) the respondent (PepsiCo, Inc) pay the appellant's (Commissioner of Taxation) costs.

(3) There be no order as to costs in respect of this proceeding, being M101/2024.

(4) The respondent (PepsiCo, Inc) pay the appellant's (Commissioner of Taxation) costs in relation to special leave application proceeding M70/2024.

116 The orders which should be made in the DPT appeal involving SVC for the year ended 30 June 2019 are:

(1) Appeal allowed.

(2) The orders made by the Full Court of the Federal Court of Australia on 16 July 2024 in proceeding VID 77 of 2024 be set aside and in their place order that:

(a) the appeal be allowed;

(b) the notice of amended diverted profits tax assessment dated 6 March 2023 for the year ended 30 June 2019 be varied so as to reflect the respondent's liability to pay diverted profits tax in the amount of \$1,553,568 for the year ended 30 June 2019;

(c) the respondent (Stokely-Van Camp, Inc) pay the appellant's (Commissioner of Taxation) costs.

(3) There be no order as to costs in respect of this proceeding, being M103/2024.

(4) The respondent (Stokely-Van Camp, Inc) pay the appellant's (Commissioner of Taxation) costs in relation to special leave application proceeding M72/2024.

117 GORDON, EDELMAN, STEWARD AND GLEESON JJ. The PepsiCo Group operates a global beverage business. Two companies resident in the United States of America form part of the PepsiCo Group – PepsiCo, Inc ("PepsiCo") and Stokely-Van Camp, Inc ("SVC"). PepsiCo is the owner of a world-wide portfolio of trade marks, designs, and other rights and assets relating to the Pepsi and Mountain Dew brands. On or about 3 April 2009, a Restated and Amended Exclusive Bottling Appointment ("the PepsiCo EBA") was entered into between PepsiCo, the Concentrate Manufacturing Company of Ireland ("CMCI") and Schweppes Australia Pty Ltd ("SAPL"), an Australian company owned by Asahi Breweries, under which PepsiCo appointed SAPL "to bottle, sell and distribute" certain beverages, and CMCI appointed SAPL "to bottle, sell and distribute" other beverages, in each case as its sole and exclusive licensee within the Commonwealth of Australia ("the Territory").

118 SVC is the owner of a world-wide portfolio of trade marks, designs, and other rights and assets relating to the Gatorade and Propel brands. There were separate arrangements between SVC and SAPL recorded in a Restated and Amended Exclusive Bottling Agreement under which SVC appointed SAPL to "manufacture, package, distribute and sell" certain beverages as its exclusive licensee within the Territory ("the SVC EBA"). Throughout these reasons, the world-wide portfolio of trade marks, designs, and other rights and assets owned by PepsiCo and SVC will be collectively referred to as "the PepsiCo Intellectual Property". Similarly, the beverages the subject of the PepsiCo EBA and the SVC EBA will be collectively referred to as "the Beverages".

119 Central to these appeals is that the PepsiCo EBA, and separately the SVC EBA, provided that PepsiCo or SVC respectively would sell (or cause to be sold by one of its subsidiaries) to SAPL the flavour concentrates for the manufacture of the Beverages by SAPL. At the relevant times, SAPL bought concentrate from, and paid, PepsiCo Beverage Singapore Pty Ltd, a PepsiCo subsidiary incorporated in Australia ("PBS"). SAPL made no payments to PepsiCo or SVC. No provision was made in either EBA for the payment by SAPL to PepsiCo or SVC respectively of a royalty for its use of the PepsiCo Intellectual Property.

120 In December 2020 and January 2022, the appellant ("the Commissioner") issued notices of assessment to each of PepsiCo and SVC for the years ended 30 June 2018 and 30 June 2019.¹²⁷ The notices were issued on the basis that part

127 The Commissioner issued amended notices of royalty withholding tax to PepsiCo and SVC on 6 March 2023. The Commissioner also issued amended notices of diverted profits tax assessments on 3 December 2021 to PepsiCo and on 6 March 2023 to PepsiCo and SVC.

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of the payments made by SAPL to PBS for the supply of concentrate was a royalty paid to or derived by PepsiCo or SVC on which withholding tax was payable under s 128B(2B) of the *Income Tax Assessment Act 1936* (Cth) ("the ITAA 1936"), and, in the alternative, effected a diversion of profit which accrued to PepsiCo or SVC for which they were liable to pay diverted profits tax ("DPT") under s 177J in Pt IVA of the ITAA 1936.

121 These appeals arise from proceedings brought by PepsiCo and SVC in the Federal Court of Australia challenging the assessments.¹²⁸ The primary judge held that "the payments were, to some extent, *consideration for* the use of, or the right to use, the relevant trademarks and other intellectual property"¹²⁹ on which royalty withholding tax was payable, and, alternatively, that DPT was payable. A majority of the Full Federal Court allowed the appeals brought by PepsiCo and SVC.

122 The Commissioner pursued three grounds of appeal before this Court: first, that the Full Federal Court ought to have found that payments made by SAPL to PBS included a "royalty" paid "as consideration for" the use of or right to use the PepsiCo Intellectual Property licensed to SAPL, within the meaning of the definition of "royalty" in s 6(1) of the ITAA 1936; second, and related to the first appeal ground, that the Full Federal Court ought to have found that the "royalty" was income "derived" by and "paid to" PepsiCo or SVC under s 128B(2B) of the ITAA 1936, and that withholding tax was therefore payable under s 128B(5A); third, and in the alternative, that if no royalty withholding tax was payable by PepsiCo or SVC, the Full Federal Court ought to have found that PepsiCo and SVC were liable for DPT for the purposes of ss 177J and 177P of the ITAA 1936.

123 The Commissioner's argument ultimately depended on two related ideas: first, that PepsiCo and SVC had licensed SAPL to use the PepsiCo Intellectual Property; and second, that, unless part of the price SAPL paid to PBS for concentrate was a royalty paid to or derived by PepsiCo or SVC, SAPL obtained the licence to use the PepsiCo Intellectual Property for nothing. As these reasons will show, although SAPL did obtain a licence to use the PepsiCo Intellectual Property, no part of the price for the concentrate was payment for that licence. But SAPL did not obtain the licence for nothing. The right to use the PepsiCo Intellectual Property was part of a comprehensive commercial arrangement,

128 Under Pt IVC of the *Taxation Administration Act 1953* (Cth), s 14ZZO(b)(i), PepsiCo and SVC had the burden of proving that each assessment was excessive or otherwise incorrect.

129 Emphasis in original.

an essential element of which obliged SAPL to build PepsiCo's and SVC's brands and strengthen the PepsiCo Intellectual Property. The more successful SAPL was, the more valuable the PepsiCo Intellectual Property became. SAPL's agreement to build the brands was of real value to PepsiCo and SVC. It was not "nothing". The Commissioner was wrong to assert that part of the arm's length price paid by SAPL to PBS for concentrate had to be treated as payment from SAPL to PepsiCo or SVC for the right of SAPL to use the PepsiCo Intellectual Property. There is no legal or economic reason to make that leap in logic. To do so would involve assigning part of the fair price paid for goods to a different commercial bargain. The Commissioner's appeals to this Court should be dismissed.

124 Critical to the resolution of these appeals is the proper construction of the agreements between SAPL and PepsiCo, and between SAPL and SVC. Importantly, the agreements either acknowledged or contained positive obligations upon SAPL to bottle, market, promote, distribute, and sell the Beverages. The PepsiCo EBA recorded that a Performance Agreement regarding the operation of SAPL had been entered into between Pepsi-Cola International, Cork, a subsidiary of PepsiCo, and SAPL ("the Performance Agreement"). The PepsiCo EBA also recorded that SAPL would actively advertise the Beverages and vigorously engage in sales promotion activities for the Beverages in the Territory, and that SAPL and PepsiCo (or one of its subsidiaries) would enter into a Co-operative Advertising and Marketing Agreement which would govern all matters relating to the advertising and marketing of Beverages in the Territory. A representative annual Co-operative Advertising and Marketing Agreement between PBS and SAPL dated 1 January 2017 ("the 2017 Annual Co-op A&M Agreement") was provided to the Court by the parties. The Performance Agreement recorded that the Performance Agreement, the PepsiCo EBA and the annual Co-operative Advertising and Marketing Agreement contained the entire agreement between the parties. That entire agreement will be referred to as "the SAPL Bottler, Seller and Distributor Agreement".

125 It was common ground that the SVC EBA included within it, rather than by separate agreement, obligations in not dissimilar terms to those found in the Performance Agreement and the 2017 Annual Co-op A&M Agreement. Consistent with the manner in which the parties argued these appeals in this Court, these reasons will address PepsiCo and the SAPL Bottler, Seller and Distributor Agreement and refer only to SVC and the SVC EBA where necessary to do so. These reasons should be taken to apply to SVC and the SVC EBA except where otherwise noted. It is necessary to address the terms of the SAPL Bottler, Seller and Distributor Agreement in some detail.

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SAPL Bottler, Seller and Distributor Agreement

126 The SAPL Bottler, Seller and Distributor Agreement was a composite agreement recorded in three agreements, to be read together: the PepsiCo EBA, the Performance Agreement, and the 2017 Annual Co-op A&M Agreement. The specific contractual rights and obligations of the parties to the SAPL Bottler, Seller and Distributor Agreement are to be construed objectively, by reference to the language used, circumstances addressed and commercial purpose or objects to be secured.¹³⁰

127 The PepsiCo EBA restated and amended an earlier Exclusive Bottling Appointment dated 6 December 2000 between SAPL, PepsiCo and CMCI. Under the PepsiCo EBA, SAPL was exclusively appointed by PepsiCo "to bottle, sell and distribute" certain beverages under the trade marks PEPSI, PEPSI MAX, PEPSI LIGHT, PEPSI LIGHT CAFFEINE FREE and MOUNTAIN DEW and by CMCI "to bottle, sell and distribute" certain beverages under the trade mark SEVEN-UP ("the Trade Marks") within the Territory, for ultimate resale within the Territory, on the terms of the PepsiCo EBA.¹³¹ SAPL accepted the appointment "to bottle, sell and distribute" the Beverages on the terms of the PepsiCo EBA and agreed that it would do so only for ultimate resale to consumers in the Territory.¹³² Nothing in the PepsiCo EBA created or was deemed to create any relationship of agency, partnership or joint venture between SAPL and PepsiCo.¹³³ As will be seen, SAPL's appointment is multifaceted and interconnected – to "bottle, sell and distribute". It is necessary to address each aspect of that appointment.

Bottling

128 Mr Lovorn, the General Manager of PepsiCo Global Concentrate Solutions, whose evidence the primary judge relevantly accepted, gave evidence that bottlers mostly use a standardised and well-known "cold fill process" which involves pouring the ingredients and blends from a concentrate kit into a mixer and adding water, and sometimes sugar or a sweetener, and blending it. That mixture is then put in a bottle or can with carbon dioxide and enclosed in the approved packaging.

130 See *Mount Bruce Mining Pty Ltd v Wright Prospecting Pty Ltd* (2015) 256 CLR 104 at 116 [46]-[47].

131 PepsiCo EBA, cll 3(a) and 3(c).

132 PepsiCo EBA, cl 3(c).

133 PepsiCo EBA, cl 21.

Mr Lovorn described the bottling process as "compared to baking a cake using store-bought cake mix because it involves taking a product which is homogenous, blended in specific proportions, engineered to produce a particular kind of cake with a familiar taste, to which the home baker usually adds basic ingredients". Put in different terms, PepsiCo took away all the complexity from the process. PepsiCo provides the ingredient; PepsiCo provides the proprietary formulations; and PepsiCo works with the suppliers in qualifying ingredients that the bottler buys from PepsiCo's qualified suppliers. The bottler manufactures the beverage.

129 The first aspect of the PepsiCo EBA was the supply of concentrate required for the manufacture of the Beverages. This aspect was the focus of the Commissioner's case against PepsiCo. Under cl 4(a) of the PepsiCo EBA, PepsiCo agreed to "sell or cause to be sold by one of its subsidiaries" ("the Seller") to SAPL and SAPL agreed to "buy only from [the] Seller" all units of concentrate required for the manufacture of the Beverages by SAPL.

130 That obligation in cl 4(a), properly construed, was a promise by PepsiCo to sell or cause to be sold by the nominated Seller, and a promise by SAPL to buy from PepsiCo or the nominated Seller, concentrate in the future. Contrary to the submissions of the Commissioner, it was not a "sale clause". It was a promise to enter into future agreements for the sale and purchase of concentrate.

131 It may be accepted that the PepsiCo EBA dictated some of the terms of those future sales of concentrate between SAPL and the Seller. For example, the prices per unit of concentrate for the 2009 calendar year were set out in cl 4(a) of the PepsiCo EBA¹³⁴ and the Seller was required to be paid in full for each order of concentrate within seven days of delivery.¹³⁵ Although the PepsiCo EBA dictated some of the terms of those future sales of concentrate, cl 4 did not provide for or conclude a sale. Instead, it spoke of obligations (or their terms) in the future: PepsiCo "will sell or cause to be sold" and SAPL will "buy only from [the] Seller ... all units of concentrate".

132 In the case of the SVC EBA, that proposition is even clearer. Clause 7.1(b) provided: "If the [concentrate] is supplied by a Related Corporation of [SVC] or a Company Affiliate, the terms of this Agreement, to the extent that they are relevant, apply to transactions between [SAPL] and the Related Corporation of [SVC] or Company Affiliate". The reference to "transactions" and to such

134 Clause 4(b) of the PepsiCo EBA also recorded that those prices were to be adjusted annually based on the Australian Consumer Price Index.

135 PepsiCo EBA, cl 4(c).

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transactions being governed by "terms" self-evidently contemplates a series of future contracts for the sale of concentrate.

133 Consistent with cl 4(a) of the PepsiCo EBA, on 8 December 2015 SAPL was notified that, with effect from 1 January 2016, the Seller of the concentrate would change to PBS and that "all purchase orders should be sent to [PBS]". On 11 January 2016, PBS provided SAPL with its bank account details. From that point, SAPL sent purchase orders to PBS to buy specified quantities of concentrate and SAPL was invoiced by PBS for the concentrate supplied. Properly construed, each purchase order and invoice evidenced a contract for the supply of concentrates between PBS and SAPL.

134 SAPL paid PBS for the concentrate invoiced by making payments to PBS' nominated bank account. PBS' financial statements recorded a profit of \$59,000 for the year ended 31 December 2018 and a profit of \$231,000 for the year ended 31 December 2019. On total sales of concentrate during that period of approximately \$240 million, PBS' margin was 0.05 per cent.

135 PBS, in turn, purchased the concentrate from concentrate manufacturers and, during the relevant period, purchased the concentrate under a separate Concentrate Distribution Agreement ("the CDA") between PBS and Concentrate Manufacturing (Singapore) Pte Ltd ("CMSPL"), a member of the PepsiCo Group incorporated in Singapore. Under the CDA, effective 1 January 2018, CMSPL produced the concentrate and supplied that concentrate to PBS for distribution to bottlers in Australia, the Republic of Korea, Vietnam and Thailand. PBS purchased the concentrate from CMSPL at the price equal to PBS' sales price less a "Distribution Discount". The Distribution Discount constituted the sole monetary consideration to PBS for distributing the concentrate.¹³⁶

136 PepsiCo licensed certain intellectual property rights to CMSPL for use in connection with the Beverages in the Territory (together "the CDA Intellectual Property"). Subject to the terms of the CDA (including any and all applicable Specifications and Style Standards), and to enable PBS to perform its obligations under the CDA, under s 5.1 of the CDA CMSPL granted PBS a "royalty-free, limited, revocable, temporary ... sub-licensable licence to use and/or to authorize its Approved Resellers^[137] to use the [CDA] Intellectual Property within

136 CDA, s 3.1.

137 Defined to mean "[a]ny party in the Territory to whom PBS may sell Concentrate, as CMSPL may agree to in writing": CDA, s 1.2.

the Territory solely in connection with Distribution Activities^[138]". PBS agreed with CMSPL that any agreement that PBS entered into with a Bottler and/or Approved Reseller would bind the Bottler and/or Approved Reseller to the same obligations that bound PBS under Art 5 of the CDA in relation to intellectual property.¹³⁹

137 Pausing at this point, the agreements which have been described show that the objective, unchallenged evidence was that SAPL placed orders for and paid for concentrate in accordance with invoices for the sale of concentrate issued by PBS. The concentrate sold by PBS had been purchased by PBS from CMSPL. In Australia, PBS returned and reported amounts paid by SAPL to PBS in its Australian income tax returns as income derived by it.

138 But the purchase of the concentrate is not the end of the analysis in relation to the manufacture and bottling of the Beverages. As Mr Lovorn explained, PepsiCo necessarily retained significant control over the manufacture and bottling of the Beverages. SAPL was required to follow "all instructions and directions issued by [the] Seller ... for preparing and bottling Beverages".¹⁴⁰ Moreover, SAPL, "in preparing, bottling, selling and distributing" Beverages, was required to use only the concentrate purchased from PBS and the packaging specified by PepsiCo.¹⁴¹ PepsiCo was required to provide to SAPL, from time to time, reasonable specifications on all other materials required for the Beverages (including bottles, cartons, cases and containers) and SAPL was required to only use those materials in preparing, bottling, selling and distributing Beverages.¹⁴²

139 In addition to being required to follow all instructions and directions issued by PepsiCo for preparing and bottling Beverages, SAPL was required to "maintain and operate in the Territory one or more bottling plants, properly and adequately equipped and staffed to bottle, sell and distribute sufficient Beverages".¹⁴³ SAPL was required to conform to the standards dictated by PepsiCo in other ways.

138 Defined to mean "[a]ll distribution, sale, and related activities and materials concerning the Beverages within the Territory": CDA, s 1.7.

139 CDA, s 5.7.

140 PepsiCo EBA, cl 6.

141 PepsiCo EBA, cl 7 read with cl 11.

142 PepsiCo EBA, cl 7.

143 PepsiCo EBA, cl 8(a).

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For example, SAPL was required to keep the bottling plant or plants and all equipment used in a clean and sanitary condition¹⁴⁴ and to filter all water used in bottling the Beverages through a method specified in the PepsiCo EBA or from time to time by PepsiCo.¹⁴⁵ SAPL was also required to provide PepsiCo with adequate samples of the Beverages and of the water used in bottling the Beverages;¹⁴⁶ to permit agents of PepsiCo to enter SAPL's plant to inspect the facilities, equipment and materials used in preparing, bottling, selling and distributing the Beverages, to check operations and methods and to take samples;¹⁴⁷ to keep complete records of all tests made of the bottling, sale and distribution of the Beverages;¹⁴⁸ and to maintain sufficient inventory of bottles, cartons, containers and cases as may be required "to meet [PepsiCo's] standards of quality and appearance as may be reasonably specified to [SAPL] from time to time".¹⁴⁹

Selling and distributing

140 Under the PepsiCo EBA, SAPL was appointed as a seller and distributor of the Beverages. In discharging its appointment as seller and distributor, SAPL was required to "sell Beverages in the Territory in agreed packages and proprietary packages as [PepsiCo] may from time to time specify".¹⁵⁰ PepsiCo anticipated that SAPL would sell the Beverages in the Territory at prevailing competitive market prices.¹⁵¹ SAPL was required: to use its "reasonable endeavours to maximise the sale of Beverages throughout the Territory", including using its reasonable endeavours to "fully meet and increase the demand and share of market for Beverages throughout the Territory"; to "fully exploit new packages, new package sizes and new Beverage opportunities"; to "service all accounts with frequency adequate to keep them at all times fully supplied with Beverages"; to use its own

144 PepsiCo EBA, cl 9(a).

145 PepsiCo EBA, cl 9(b).

146 PepsiCo EBA, cl 13.

147 PepsiCo EBA, cl 14.

148 PepsiCo EBA, cl 15.

149 PepsiCo EBA, cl 12.

150 PepsiCo EBA, cl 11(a).

151 PepsiCo EBA, cl 11(b).

salespeople and trucks; and to "cooperate in [PepsiCo's] cooperative advertising and sales promotion programs and campaigns".¹⁵²

141 SAPL's permitted activities were to "sell and distribute Beverages under the Trade [M]arks" and SAPL was to make only such representations concerning the Beverages as had been previously authorised in writing by PepsiCo.¹⁵³ The decision of PepsiCo on all matters concerning the Trade Marks was final and conclusive and not subject to question by SAPL.¹⁵⁴ PepsiCo agreed to protect and defend the Trade Marks at its sole cost and expense.¹⁵⁵ Despite the SAPL Bottler, Seller and Distributor Agreement, and the PepsiCo EBA in particular, not expressly licensing SAPL to use the PepsiCo Intellectual Property, it was common ground that the agreement contained an implied licence to this effect. As the primary judge held, the agreement could not operate otherwise.¹⁵⁶

142 The PepsiCo EBA recorded that SAPL would actively advertise the Beverages and vigorously engage in sales promotion activities for the Beverages in the Territory.¹⁵⁷ To ensure consistency of image, SAPL could use only advertising strategies for the Beverages that PepsiCo developed for the Territory and SAPL could use only advertising and promotion materials furnished or caused to be furnished by PepsiCo or approved by PepsiCo.¹⁵⁸

143 The PepsiCo EBA also recorded that the Performance Agreement regarding the operation of SAPL had been executed.¹⁵⁹ The Performance Agreement was between a subsidiary of PepsiCo and SAPL. It set minimum annual sales

152 PepsiCo EBA, cl 11(e).

153 PepsiCo EBA, cl 17(a) read with cl 5.

154 PepsiCo EBA, cl 5(b).

155 PepsiCo EBA, cl 5(b).

156 cf SVC EBA, cl 4.1, which expressly grants an "exclusive royalty-free licence" to use the PepsiCo Intellectual Property.

157 PepsiCo EBA, cl 18.

158 PepsiCo EBA, cl 20.

159 PepsiCo EBA, cl 19.

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volumes,¹⁶⁰ distribution targets,¹⁶¹ and quality standards for the Beverages.¹⁶² To facilitate SAPL meeting the performance targets and maximising the sales of PepsiCo products, the Performance Agreement¹⁶³ (like the PepsiCo EBA¹⁶⁴) provided that, during each calendar year, PepsiCo (or a subsidiary of PepsiCo) and SAPL would discuss in good faith with the intention of entering into a Co-operative Advertising and Marketing Agreement (relevantly, the 2017 Annual Co-op A&M Agreement).

144 The 2017 Annual Co-op A&M Agreement was between PBS and SAPL, being the agreement required under the PepsiCo EBA¹⁶⁵ and the Performance Agreement,¹⁶⁶ and governed all matters related to the advertising and marketing of Beverages in the Territory.¹⁶⁷ The 2017 Annual Co-op A&M Agreement specifically recorded that in consideration of the "mutual promises contained" in the agreement, PBS and SAPL agreed, among other things, to "contribute financially towards the advertising and marketing of the Beverages in the Territory"¹⁶⁸ and to a Target Annual Sales Volume and minimum volume of Beverages in the Territory.¹⁶⁹ The 2017 Annual Co-op A&M Agreement also recorded the total target amount to be spent by PBS on advertising and marketing of the Beverages in 2017¹⁷⁰ as well as the current proposed allocation of

160 Performance Agreement, cl 3.

161 Performance Agreement, cl 5.

162 Performance Agreement, cl 6.

163 Performance Agreement, cl 7.2.

164 PepsiCo EBA, cl 18.

165 PepsiCo EBA, cl 18.

166 Performance Agreement, cl 7.2.

167 PepsiCo EBA, cl 18.

168 2017 Annual Co-op A&M Agreement, cl 2.

169 2017 Annual Co-op A&M Agreement, cl 3(a) and (b).

170 2017 Annual Co-op A&M Agreement, cl 3(d).

expenditure by SAPL.¹⁷¹ In addition to expenditure on marketing, the 2017 Annual Co-op A&M Agreement recorded that PBS may furnish SAPL with advertising materials relating to the Beverages and that the cost of those materials together with the cost of packaging and shipping such materials to SAPL would form part of PBS' share of the expenditure.¹⁷² SAPL agreed not to use any art work depicting images of PepsiCo brands which had not been approved by PBS.¹⁷³ The agreement also contained processes for reconciliation of spending to ensure no party incurred a "disproportionate share" of expenditure.¹⁷⁴

145 Clause 16 of the 2017 Annual Co-op A&M Agreement provided that "[SAPL] acknowledges that its contribution to the Expenditure is for the purposes of improving its sales of the Beverages, not to build the brands of the Beverages". As PepsiCo submitted, this was a "lawyer's clause" inserted to protect PepsiCo, similar to and consistent with the terms of cl 5(d) of the PepsiCo EBA, which provided that nothing in the PepsiCo EBA was to be construed as conferring upon SAPL any right or interest in the Trade Marks used in connection with the Beverages. Contrary to the Commissioner's contention, cl 16 of the 2017 Annual Co-op A&M Agreement did not support the proposition that SAPL specifically acknowledged that, when making contributions pursuant to those arrangements, it was doing so in a way that "does not constitute a payment for the use of the brands". That proposition is otherwise inconsistent with the SAPL Bottler, Seller and Distributor Agreement.

Termination

146 The mutuality of the promises in the SAPL Bottler, Seller and Distributor Agreement necessarily gave rise to the ability to terminate for breach. So, for example, cl 22(b) of the PepsiCo EBA provided that PepsiCo, not PBS, indemnified SAPL from any loss resulting from any breach of or deemed breach of the PepsiCo EBA, the 2017 Annual Co-op A&M Agreement or the Performance Agreement by PepsiCo or PBS including "any breach of the warranty contained in clause 5(a) [dealing with the Trade Marks] or resulting from defective concentrate", provided that the indemnity in respect of the concentrate would arise only if SAPL had strictly complied with PepsiCo's instructions for the handling,

171 2017 Annual Co-op A&M Agreement, cl 8 and Appendix B.

172 2017 Annual Co-op A&M Agreement, cl 9.

173 2017 Annual Co-op A&M Agreement, cl 9.

174 2017 Annual Co-op A&M Agreement, cll 11, 12, 14.

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storage, and usage of the concentrate, and for the bottling of the Beverages. On the other hand, the PepsiCo EBA, for example, could be terminated by one month's written notice to SAPL if SAPL failed to perform or comply with one or more of the material terms or conditions of the PepsiCo EBA and such failure was not remedied¹⁷⁵ and, in addition to that right and all other rights and remedies under the PepsiCo EBA, in the event that any party "failed to make timely payment under [the PepsiCo EBA] or any related agreement", that party was liable for the payment of interest for any such amounts outstanding.¹⁷⁶

Conclusion

147 In sum, the use of a local bottler such as SAPL was mutually beneficial for both PepsiCo and the bottler. SAPL was able to leverage the PepsiCo Group's innovation and marketing capabilities and PepsiCo received the benefit of SAPL's local investment in bottling and distribution equipment and capabilities. Another mutually beneficial aspect of the SAPL Bottler, Seller and Distributor Agreement was described by Mr Williams, who had worked for the PepsiCo Group in marketing and bottling franchise-related roles for over 35 years and ultimately became President of the PepsiCo Group's Global Beverage Group and the Franchise Team. Mr Williams said in evidence that the bottler helped build the brand of the Beverages. Under the SAPL Bottler, Seller and Distributor Agreement, 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 in cl 4(a) to purchase concentrate at agreed prices which were not disproportionately high, as well as the conferral of intellectual property rights.

148 The exchange of promises in the SAPL Bottler, Seller and Distributor Agreement between PepsiCo and SAPL was separate from the future agreements that may be, and were, entered into by SAPL for the sale and purchase of concentrate. Indeed, as the PepsiCo EBA contemplated, the future contracts for the purchase of concentrate by SAPL were not with PepsiCo but were with PBS, as the nominated Seller. PBS, which had no need for the PepsiCo Intellectual Property other than to sell the concentrate to SAPL, sold the concentrate to SAPL with a margin of 0.05 per cent. The Commissioner did not allege that the transactions for the sale of concentrate by PBS to SAPL were a sham or that PBS received any part of the payments from SAPL for the concentrate as agent or trustee for PepsiCo.

175 PepsiCo EBA, cl 24(a)(i).

176 PepsiCo EBA, cl 26(a).

The price paid by SAPL to PBS for the concentrate did not move the transfer of the PepsiCo Intellectual Property from PepsiCo to SAPL.

149 It is then necessary to consider the two issues – royalty withholding tax and DPT.

Royalty withholding tax

150 Division 11A of Pt III of the ITAA 1936 imposes, amongst other things, royalty withholding tax on non-residents. A non-resident who derives income which consists of a "royalty" that is paid to the non-resident by a person to whom s 128B in Div 11A applies¹⁷⁷ and is not an outgoing wholly incurred by that person in carrying on business in a foreign country is liable to pay income tax in Australia.¹⁷⁸ A "royalty" is "deemed to have been paid by a person to another person although it is not actually paid over to the other person but is ... otherwise dealt with on behalf of the other person or as the other person directs".¹⁷⁹

151 The legislative machinery is not in dispute. Rather, what is in dispute is whether, as the Commissioner contended, part of the payments made by SAPL to PBS for concentrate constituted a royalty derived by PepsiCo for the use by SAPL of the PepsiCo Intellectual Property. The answer to that question turns upon the definition of the words "royalty" and "royalties" in s 6(1) of the ITAA 1936, which relevantly is in the following terms:

"royalty or royalties includes any amount paid or credited, however described or computed, and whether the payment or credit is periodical or not, to the extent to which it is paid or credited, as the case may be, as consideration for:

(a) the use of, or the right to use, any copyright, patent, design or model, plan, secret formula or process, trade mark, or other like property or right;

...

177 By ITAA 1936, s 128B(1A): "a reference to a person to whom this section applies is a reference to ... a person who is, or persons at least 1 of whom is, a resident".

178 ITAA 1936, s 128B(5A) read with sub-ss (2B)(a) and (2B)(b)(ii).

179 ITAA 1936, s 128A(2); cf *Income Tax Assessment Act 1997* (Cth), s 6-5(4).

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- (d) the supply of any assistance that is ancillary and subsidiary to, and is furnished as a means of enabling the application or enjoyment of, any such property or right as is mentioned in paragraph (a) ..."

There was no dispute that if, properly construed, SAPL's obligation to pay for concentrate under the SAPL Bottler, Seller and Distributor Agreement included, in part, a payment which was consideration for the use of the PepsiCo Intellectual Property, then such a payment would be a "royalty" within the meaning of that defined term in s 6(1) of the ITAA 1936.

152 There were therefore two questions. First, were the payments made by SAPL to PBS "consideration for" the use of the PepsiCo Intellectual Property and therefore a "royalty" within the meaning of that defined term in s 6(1) of the ITAA 1936 and, second, if so, was that "royalty" "derived by" and "paid or credited" to PepsiCo?

Decisions below

153 In relation to the first question, the primary judge held that 5.88 per cent of the amounts paid was a royalty. The primary judge primarily relied on decisions of this Court in *Chief Commissioner of State Revenue (NSW) v Dick Smith Electronics Holdings Pty Ltd*¹⁸⁰ and *Commissioner of State Revenue (Vic) v Lend Lease Development Pty Ltd*.¹⁸¹ It will be necessary to address those decisions below.

154 The primary judge's conclusion that 5.88 per cent of the amounts paid by SAPL was a royalty was explained by reference to the following matters: one of the parties to the PepsiCo EBA – PepsiCo – was the owner of the PepsiCo Intellectual Property whereas the Seller of the concentrate, PBS, was not a party to the PepsiCo EBA; the PepsiCo EBA contained an implied licence by PepsiCo to SAPL to use the PepsiCo Intellectual Property; the licence of the PepsiCo Intellectual Property was fundamental to the PepsiCo EBA because, without the licence, SAPL would not be able to package and sell the Beverages; a failure by SAPL to perform its payment obligations could result in the termination of the PepsiCo EBA and therefore the licence; and it would be "very surprising" if PepsiCo would be willing to license the PepsiCo Intellectual Property, which is

¹⁸⁰ (2005) 221 CLR 496.

¹⁸¹ (2014) 254 CLR 142.

some of the strongest and most valuable in the global beverage industry, "for nothing".

155 In relation to the second question – whether the royalty income had been derived by and paid to PepsiCo for the purposes of s 128B(2B) – the primary judge dismissed PepsiCo's submission that it had not derived the relevant income. The primary judge also considered that, because PepsiCo had nominated PBS as the Seller of the concentrate, PepsiCo had thereby directed SAPL to pay PBS and, as a result, the royalty components were "dealt with on behalf of [PepsiCo]" or dealt with "as [PepsiCo] directs". The primary judge therefore held that the relevant portions of the payments were deemed to have been paid to PepsiCo.

156 In the Full Federal Court, the majority rejected the proposition that SAPL obtained the benefit of the PepsiCo Intellectual Property "for nothing" on the basis that a complete view of the licence granted by PepsiCo to SAPL was one which acknowledged not merely (a) the benefits obtained by SAPL in being permitted to use the goodwill attaching to the Trade Marks but also (b) the restrictions as to both product and marketing imposed on SAPL in its utilisation of that goodwill, (c) the burdens placed upon SAPL in complying with testing and inspection regimes, and (d) the benefits obtained by PepsiCo in having SAPL sustain and promote its goodwill in Australia. In short, the licence obtained by SAPL was part of a package involving substantial obligations upon SAPL and substantial benefits to PepsiCo and not merely benefits to SAPL. The majority found that, once that complete view of the licence was appreciated, the Commissioner's submission that PepsiCo was giving away the right to use the PepsiCo Intellectual Property for nothing, unless some element of the price for the concentrate was seen as embedding some value for the licence, must be rejected. The decisions in *Dick Smith* and *Lend Lease* were distinguished by the majority. Those cases, it was said, concerned agreements where multiple promises for the payment of money or for the performance of other obligations constituted, in aggregate, the consideration for the transfer of shares (in *Dick Smith*) and parcels of land (in *Lend Lease*). In contrast, the majority construed SAPL's promise to pay for concentrate as a promise for the transfer of those goods, and for nothing else.

157 Given the conclusion reached on the first question, the majority recognised that it was strictly unnecessary for them to consider whether any amount received by PBS from SAPL could be income which was derived by PepsiCo. Nevertheless, the majority held that PepsiCo did not derive any of the amounts paid by SAPL to PBS. The majority accepted that a direction by a creditor to a debtor to pay a third

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party constitutes a payment to the creditor¹⁸² but held that there can be no payment by direction unless there is an antecedent monetary obligation.¹⁸³ The majority held that there was no antecedent monetary obligation owed by SAPL to PepsiCo and that, properly construed, the PepsiCo EBA did not create a monetary obligation owed by SAPL to PepsiCo. Rather, the PepsiCo EBA contemplated that PepsiCo would be the Seller of concentrate, or would cause one of its subsidiaries or company affiliates to be the Seller of concentrate, the latter of which is what happened when PBS sold concentrate to SAPL. In addition, the majority held that the payments made by SAPL to PBS were not income derived by PepsiCo because the payments did not "come home" to PepsiCo.¹⁸⁴

158 In this Court, the Commissioner sought to reargue both questions. For the reasons that follow, the answer to both questions should be "No". The payments made by SAPL to PBS were for concentrate and did not include any component which was a "royalty" for the use of the PepsiCo Intellectual Property. The payments made by SAPL to PBS were not made "as consideration for" the use of the PepsiCo Intellectual Property and therefore did not include a "royalty" within the definition of that term in s 6(1) of the ITAA 1936. And, in any event, the payments were received by PBS on its own account. The payments were not paid to and cannot be said to have been paid to PepsiCo. Put simply, the payments made by SAPL to PBS were not brought to tax under s 128B(2B) because there was no "royalty" as required by s 128B(2B)(b) and the payments made by SAPL to PBS were not "income ... derived by" PepsiCo within the meaning of s 128B(2B)(a). Each question will be considered in turn.

Payment not "consideration for" right to use PepsiCo Intellectual Property

159 Whether the payments for concentrate from SAPL to PBS were in part "consideration for" the right of SAPL to use the PepsiCo Intellectual Property turns on the proper construction of the whole SAPL Bottler, Seller and Distributor Agreement of which the PepsiCo EBA formed a part – what the parties had agreed,

182 See, eg, *Roufeil v Tarrant Enterprises Pty Ltd* (2023) 299 FCR 204 at 212-214 [27]-[35].

183 *ABB Australia Pty Ltd v Federal Commissioner of Taxation* (2007) 162 FCR 189 at 226 [166], citing Goode, *Payment Obligations in Commercial and Financial Transactions* (1983) at 11.

184 *Commissioner of Taxes (SA) v Executor Trustee and Agency Co of South Australia Ltd* (1938) 63 CLR 108 at 155; *Arthur Murray (NSW) Pty Ltd v Federal Commissioner of Taxation* (1965) 114 CLR 314 at 318.

ascertained objectively.¹⁸⁵ Did the parties bargain that the payments made by SAPL to PBS for concentrate were in part to be a recompense to PepsiCo for the right to use the PepsiCo Intellectual Property?

"Consideration for"

160 The word "consideration" has multiple meanings and shades of meaning. In the modern law of contract, "consideration" has developed as a concern with reciprocity,¹⁸⁶ or a "*quid pro quo*" between an offered promise and acceptance.¹⁸⁷ But another meaning of consideration which applied in circumstances broader than modern contracts, such as a conveyance or the making of a payment, was a "moving cause" or a "material cause" for the payment.¹⁸⁸ In this broader, alternative sense, the "consideration" for a payment was the "purpose" of the payment or conveyance,¹⁸⁹ or the "basis" or "condition" upon which it is made.¹⁹⁰

161 In *Archibald Howie Pty Ltd v Commissioner of Stamp Duties (NSW)*, Dixon J explained that in s 66 of the *Stamp Duties Act 1920-1940* (NSW) the word "consideration" refers to the "money or value passing which moves the conveyance or transfer",¹⁹¹ not simply a consequence or aspect of an offer and acceptance. Similarly, the phrase "consideration for" in the definition of "royalty" in s 6(1) of the ITAA 1936 is unlikely to be confined to whether there is a *quid pro quo* in the making of an offer and acceptance of that offer. The definition of "royalty" refers to an amount "however described or computed" and to an amount "to the extent to which" it is paid as consideration for the right to use intellectual property. The phrase "consideration for" in the definition of "royalty" in s 6(1) of

185 *Mount Bruce Mining* (2015) 256 CLR 104 at 116 [46]-[47].

186 Ibbetson, *A Historical Introduction to the Law of Obligations* (2006) at 141-145.

187 *Australian Woollen Mills Pty Ltd v The Commonwealth* (1954) 92 CLR 424 at 456-457.

188 Simpson, *A History of the Common Law of Contract: The Rise of the Action of Assumpsit* (1987) at 424-426, 485.

189 *Roxborough v Rothmans of Pall Mall Australia Ltd* (2001) 208 CLR 516 at 556-557 [102]-[103], quoting *Martin v Andrews* (1856) 7 El and Bl 1 at 4 [119 ER 1148 at 1149].

190 *Redland City Council v Kozik* (2024) 98 ALJR 544 at 579 [183]; 418 ALR 1 at 44.

191 (1948) 77 CLR 143 at 152.

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the ITAA 1936 extends to the "basis", "purpose", or "condition" for a transaction by which one party confers a benefit upon another.¹⁹² Of course, whether a payment is a basis, purpose or condition "for" the conferral of the use of intellectual property will always depend upon what the parties have agreed. In that respect, the word "for" connotes a causal connection between the making of a promise to pay or confer some other benefit and the receipt of a right to use the intellectual property. That connection will be satisfied when the giving of the promise can be seen to be the basis for, or a condition of, that receipt. In the present case, it cannot.

SAPL Bottler, Seller and Distributor Agreement

162 The composite SAPL Bottler, Seller and Distributor Agreement, including the PepsiCo EBA, was not an agreement for the sale of goods or an agreement to sell goods in the future.¹⁹³ It was an agreement that SAPL would manufacture, bottle, sell and distribute the Beverages in the Territory and, to facilitate those functions, PepsiCo licensed SAPL to use the PepsiCo Intellectual Property.¹⁹⁴ By way of contrast, the contracts between SAPL and PBS, at arm's length, were for the sale and purchase of concentrate.

163 Although the licence for the PepsiCo Intellectual Property was a significant part of the architecture of the entire SAPL Bottler, Seller and Distributor Agreement, the Commissioner's contention that the payments for concentrate from SAPL to PBS were in part "consideration for" the right of SAPL to use the PepsiCo Intellectual Property must be rejected. There was no basis for concluding that the PepsiCo Intellectual Property was given away for "nothing", or that PepsiCo was not being properly compensated for the use of the PepsiCo Intellectual Property. The "consideration" in the sense of the basis for, or a condition of, the use by SAPL of the PepsiCo Intellectual Property was the performance of the monetary and non-monetary undertakings by SAPL under the composite SAPL Bottler, Seller and Distributor Agreement, including the performance of undertakings or exchange of promises in cl 4 of the PepsiCo EBA, one of which was SAPL's promise to pay agreed unit prices for concentrate.¹⁹⁵

192 cf *Redland City Council* (2024) 98 ALJR 544 at 579 [183]; 418 ALR 1 at 44.

193 See [130]-[131] above.

194 See [141] above.

195 See [128]-[148] above.

164 The Commissioner submitted that the PepsiCo EBA should be construed as recording the true bargain of the parties with part of the payments made by SAPL to PBS being the consideration for the use of the PepsiCo Intellectual Property. Any other construction, the Commissioner submitted, would be commercially unrealistic given that SAPL made one payment but received in return both the concentrate and the use of the PepsiCo Intellectual Property; without the latter, it was emphasised, SAPL would not have a viable business. This argument was reflected in the following reasons of Colvin J, in dissent below:

"Importantly, the trade marks are known to the parties to be strong and valuable. That is to say they have considerable existing goodwill. If the amount that is required to be paid under the EBAs is for the concentrate alone then the right to distribute the branded products is being afforded without any part of the monetary consideration being attributable to the licence to use the valuable brands of PepsiCo. That is a commercially unreasonable view of the terms of the EBAs considered as a whole."

165 In the case of the PepsiCo EBA, the Commissioner principally relied on three textual considerations. The first was that cl 4 of the PepsiCo EBA did not expressly confine the listed prices as being the consideration for the acquisition of concentrate. The second was that cl 24(a)(i) gave PepsiCo a right to terminate the contract on the failure by SAPL, amongst other things, to make the payments specified by cl 4. And the third was cl 27(a), which provided that, upon termination, SAPL would be unable to use any of the "Trade [M]arks, marks, names, symbols, slogans, emblems, insignia or other designs". These clauses demonstrated, it was submitted, a clear link between the making of the cl 4 payments and the continuing right of SAPL to use the PepsiCo Intellectual Property. It followed, the Commissioner submitted, that the parties must have agreed to make the payments a condition of the grant of the intellectual property rights.¹⁹⁶

166 That analysis oversimplifies what the parties agreed and misconceives the overall arrangement and hence the basis or condition for the licence to SAPL to use the PepsiCo Intellectual Property. The SAPL Bottler, Seller and Distributor Agreement constituted a complex exchange of valuable promises. Clause 4(a) of the PepsiCo EBA contained one such exchange of promises. As its heading stated, this clause was concerned with the supply of concentrate. It was clearly forward looking. It provided that PepsiCo "will sell or cause to be sold by one of its subsidiaries" and SAPL "will buy" "units of concentrate" "at the following prices", which were then specified on a per unit basis. Such language contradicts the

196 Similar clauses existed in the SVC EBA, cll 4.1, 7.4(f), 18.2(a), 18.5(b)(ii).

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Commissioner's case. It reflects a bargain made, within the context of the broader exchange of promises contained in the SAPL Bottler, Seller and Distributor Agreement, as to what the prices for concentrate would be and no more. In other words, it specified the monetary condition for the transfer of units of concentrate by PepsiCo (or the nominated Seller) to SAPL.

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. Clause 4(b) provided for those prices to be adjusted annually. Clause 4(c) addressed the delivery of the units and allocated responsibility for the payment of customs duty, GST, import licences and permits. Clause 4(d) obliged SAPL to carry a certain inventory of minimum units. Self-evidently, the subject matter of these clauses was the sale of concentrate and nothing else.

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 Flavor" 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. In the circumstances here, and in the absence of evidence to the contrary, they may be taken to be the accurate business records of PBS,¹⁹⁷ and, as such, they contradict the Commissioner's case.

169 SAPL also agreed to make annual payments for the marketing of the Beverages in circumstances where the marketing enhanced the ongoing value of the PepsiCo Group business and its brands but did not permanently enhance the value of SAPL's business as SAPL could not own the brands and related intellectual property. Indeed, it was agreed that upon termination of the PepsiCo EBA SAPL would lose the right to use or have any interest in the PepsiCo Intellectual Property. That was to be expected. Why, in such circumstances, would the PepsiCo EBA be construed as requiring the payment of a royalty? As the majority of the Full Federal Court correctly observed below:

"The licence rights did not exist in isolation. Rather, they were intertwined with [SAPL's] obligations to distribute the beverages in Australia under the Pepsi, Mountain Dew and Gatorade trade marks using PepsiCo/SVC's can and bottle designs and to do so under the strict quality control of

197 *Corporations Act 2001* (Cth), s 1305.

PepsiCo/SVC and in accordance with its detailed stipulations about how the trade marks were to be used."

Duties Act cases

170 This Court's decisions in *Dick Smith* and *Lend Lease* require no contrary conclusion. *Dick Smith* concerned the taxation of a dutiable transaction for the purposes of the *Duties Act 1997* (NSW), being a sale of shares. That Act charged duty on the dutiable value of dutiable property;¹⁹⁸ under the Act, the dutiable value was determined, relevantly, as the consideration for the dutiable transaction.¹⁹⁹ The issue was whether the performance of two distinct promises made by the purchaser in favour of the vendors constituted the consideration for the transfer of shares. Applying the broader meaning of the word "consideration" in conveyancing rather than the sense in simple contracts, a majority of this Court held that the performance of both promises was needed to "move" the transfers.²⁰⁰

171 *Lend Lease* was another State *Duties Act* case. The dutiable transaction was the sale of parcels of land. The purchaser had made a number of contractually distinct promises to pay the vendor. Once again, the issue for determination was the correct identification of the consideration for those sales.²⁰¹ This Court decided that the consideration which moved the transfers by the vendor to the purchaser was the performance, by the purchaser, of all the promises it had given to pay the vendor.²⁰²

172 The Commissioner relied on those cases to contend that it was necessary for the Court to look beyond the construction of the agreement to the whole of the arrangement and commercial dealing between the parties, including the value of the PepsiCo Intellectual Property and the pricing model adopted in other jurisdictions for other products, in order to characterise the consideration.

198 *Duties Act 1997* (NSW), s 19.

199 *Duties Act 1997* (NSW), s 21(1)(a).

200 *Dick Smith* (2005) 221 CLR 496 at 519 [75].

201 *Duties Act 2000* (Vic), s 20(1)(a).

202 *Lend Lease* (2014) 254 CLR 142 at 159-160 [50].

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Both cases turn upon an application of a State *Duties Act* to their particular facts.²⁰³ And neither case involved looking outside the terms of the arrangements and the transactions involved. Neither case supports the Commissioner's contentions.

173 The consideration given by SAPL for the licence to use the PepsiCo Intellectual Property was *not* the payments SAPL made to PBS for the sale and supply of concentrate. The basis or condition for those payments was only the receipt of the concentrate. But, the basis or condition that moved PepsiCo to provide the licence for SAPL to use the PepsiCo Intellectual Property was the performance of monetary and non-monetary undertakings by SAPL under the SAPL Bottler, Seller and Distributor Agreement, including the entry by SAPL into separate arrangements for the sale and purchase of concentrate from PepsiCo or a nominated Seller. Contrary to the approach taken in *Dick Smith* and *Lend Lease*, it is the Commissioner who here seeks to isolate the performance of one of the promises given by SAPL, and wrongly seeks to allocate the performance of that promise as the consideration for all that SAPL obtained. *Dick Smith* and *Lend Lease* do not support such a narrow approach.

Conclusion

174 The contractual price paid by SAPL to PBS for the concentrate was the price paid for goods sold and delivered. The Commissioner did not dispute that it was an arm's length price, or a fair price, or that it was not disproportionately high. When the price paid for goods has those characteristics, it cannot be said that a part of the price paid for those goods is payment of a royalty for the use of intellectual property applied to products partly made with those goods. Observing that the sale of the products produced using the goods increased the value of the PepsiCo Intellectual Property does not show that SAPL paid any part of the amount paid for concentrate to, or for the benefit of, PepsiCo for using the PepsiCo Intellectual Property. The majority of the Full Federal Court were correct to conclude the amounts paid by SAPL to PBS for concentrate were not "consideration for" the use of the PepsiCo Intellectual Property.

Payments not derived by, or paid or credited to, PepsiCo

175 Irrespective of whether part of the payments made by SAPL to PBS for concentrate was a "royalty" within the definition of that term in s 6(1) of

203 The same observation may be made about the Commissioner's reliance upon *Freedom Foods Pty Ltd v Blue Diamond Growers* (2021) 286 FCR 437 at 453 [66] in the courts below; those dicta concerned the terms of the particular licence agreement.

the ITAA 1936, no part of those payments was "derived by", or "paid or credited" to, PepsiCo, that latter requirement being an essential element of liability for royalty withholding tax in s 128B(2B) in Div 11A of Pt III of the ITAA 1936, read with the definition of "royalty" in s 6(1).

Commissioner's contentions

176 The Commissioner did not deny that all payments were made by SAPL to PBS and that no relevant payment was made to PepsiCo. Instead, the Commissioner reagitated his contention 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 within the meaning of s 128A(2) of the ITAA 1936. In this Court, the Commissioner accepted that, for a payment to be made under direction, there must be an antecedent obligation between PepsiCo and SAPL. The Commissioner submitted such an obligation existed.

177 Central to that contention, it was contended, was that the contract for sale of the concentrate was the PepsiCo EBA, to which PBS was not a party, and that there had never been any contract or contracts for the sale of concentrate under which PBS was entitled to payment from SAPL. In support of that contention, the Commissioner relied on the fact that cl 4(a) of the PepsiCo EBA contained no promise by SAPL to pay PBS and, indeed, cl 4(c) merely provided for payments to be made within seven days without specifying to whom they were to be made. In short, PepsiCo controlled where the money might go. In addition, the Commissioner relied upon the fact that a failure by SAPL to make payments as required gave PepsiCo a right to terminate the PepsiCo EBA and any failure to make timely payment gave rise to a liability to pay interest, presumably to the counterparty, namely PepsiCo.²⁰⁴ In this sense, the Commissioner submitted it would make no commercial sense for PepsiCo to be entitled to be compensated for a late payment if it did not have an underlying entitlement to be paid. All of this was said by the Commissioner to evidence an existing antecedent monetary obligation owed by SAPL to PepsiCo, as SAPL was contractually obliged to make payment to PepsiCo, or as it directed.

No antecedent monetary obligation owed by SAPL to PepsiCo

178 Once again, the proper construction of the SAPL Bottler, Seller and Distributor Agreement provides a complete answer. Contrary to

204 PepsiCo EBA, cl 26(a).

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the Commissioner's contention, there was no antecedent monetary obligation owed by SAPL to PepsiCo.

179 Under the SAPL Bottler, Seller and Distributor Agreement, once PepsiCo nominated a Seller, SAPL was under an obligation to buy from that entity. That remained the case even though some of the terms of that sale were fixed under the SAPL Bottler, Seller and Distributor Agreement.²⁰⁵ It did not matter that PBS was not a party to the SAPL Bottler, Seller and Distributor Agreement. PBS was the nominated Seller. At no point did PepsiCo have title to the concentrate.²⁰⁶ The attempts by the Commissioner to contend there was an antecedent monetary obligation owed by SAPL to PepsiCo cannot sit with the fact that the SAPL Bottler, Seller and Distributor Agreement allowed PepsiCo to sell the concentrate itself *or* nominate a subsidiary to do so, and that PepsiCo nominated PBS.

180 It is necessary to address the specific matters relied upon by the Commissioner. First, the Commissioner submitted that, as cl 4(c) of the PepsiCo EBA required payment to be made in full within seven days of delivery of the concentrate and did not identify to whom payment was to be made, the obligation to pay must be properly read as owed to PepsiCo as the counterparty to the PepsiCo EBA. That argument impermissibly took and construed cl 4(c) in isolation, rather than as part of cl 4 as a whole, which was titled "Supply of Concentrate" and which identified that concentrate would be sold by the nominated Seller (cl 4(a)), for certain prices (cl 4(b)).²⁰⁷ Under cl 4, there was no ambiguity regarding to whom payment was to be made.

181 Second, the Commissioner made a similar submission in respect of cl 26(a) of the PepsiCo EBA, which provided for interest for late payments.²⁰⁸ Once again, the submission impermissibly read that part of the clause in isolation, ignoring that it provided for interest where a party "has failed to make timely payment under [the PepsiCo EBA] or any related agreement", recognising that interest would be owed in the context of the composite SAPL Bottler, Seller and Distributor Agreement, subsequent related agreements and the identity of the Seller.

205 See [131] above.

206 PepsiCo EBA, cl 4(c).

207 See [166] above.

208 See [146] above.

182 Two aspects particular to the SVC EBA were emphasised by the Commissioner. The Commissioner submitted that cl 7.4(f) of the SVC EBA, which stated that payment should be made by telegraphic transfer to a USA bank account as specified by SVC or a company affiliate unless the parties agreed otherwise, meant that SVC was free to nominate the recipient of the payment and could direct SAPL to pay any third party nominated. Once again, that submission misconstrues the text and operation of the SVC EBA. It was PBS, as the company affiliate, who provided its bank account details to SAPL. In any event, the owner of the bank account does not transform the nature of the transaction between PBS and SAPL. The conclusion that there is no antecedent monetary obligation owed by SAPL is further strengthened by cl 7.1(b) of the SVC EBA, which stated that, if concentrate was supplied by someone other than SVC, then the terms of the SVC EBA (to the extent they were relevant) applied to transactions between SAPL and the nominated company as if they were parties to the SVC EBA.

183 Next, the letter sent by PepsiCo to SAPL in 2015 nominating PBS as the Seller of the concentrate²⁰⁹ did not, contrary to the submissions of the Commissioner, constitute a direction by PepsiCo to pay for the purposes of s 128A(2) of the ITAA 1936. Consistently with the terms of the SAPL Bottler, Seller and Distributor Agreement,²¹⁰ the letter was notification by PepsiCo of an intention to satisfy its obligations under the PepsiCo EBA to sell or cause to be sold concentrate to SAPL by causing a subsidiary, namely PBS, to make such sales. That is why the letter stated that "the Seller of [concentrate] will change to [PBS]". Thereafter it was PBS, and not PepsiCo, that gave SAPL the details of its own bank account because it was, to use the language of PBS' letter to SAPL, the "Seller of [concentrate] from 1 January 2016". Indeed, each contract for the sale of concentrate between PBS and SAPL was evidenced by SAPL giving purchase orders to PBS, by the giving of invoices by PBS, by the transfer of concentrate by PBS to SAPL, by PBS giving to SAPL its bank account details, and by the payment by SAPL of funds into PBS' bank account in accordance with the invoices it received.²¹¹ The objective facts evidence a manifestation of mutual assent between PBS and SAPL to be legally bound to those essential elements of

209 See [133] above.

210 See [130]-[131] above.

211 See [133] above.

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a contract for the sale of concentrate.²¹² From the sale of the concentrate, PBS thereby derived the payments made into its bank account by SAPL and correctly returned such income as Australian assessable income for income tax purposes.²¹³

184 The Commissioner contended that PepsiCo had never pleaded the existence of contracts of sale between PBS and SAPL, and that it should not now be permitted to assert their existence. He submitted that PepsiCo had always contended that sales had taken place under the terms of the PepsiCo EBA. He referred, for example, to the PepsiCo amended statement of claim, which pleaded that the sales took place "in performance of the EBA". The Commissioner's point has no merit. The pleading went on to state that PepsiCo caused PBS to sell units of concentrate to SAPL and that SAPL purchased units from PBS and made payments to PBS. That all of this took place in accordance with the EBA may not be doubted. But that was not the end of the analysis. The PepsiCo EBA was not a contract *of* the sale of concentrate, but a contract, amongst other things, *for* the making of such sales in the future, and, if necessary, by PepsiCo causing its subsidiary to be the Seller. The EBA was, in a sense, an umbrella agreement which governed the relations of the parties going forward, and which contemplated the entry into of further agreements, such as the Performance Agreement, and the contracts for the sale of concentrate. In that respect, PepsiCo correctly conceded that sales of concentrate took place under and in accordance with the PepsiCo EBA, which gave valuable remedies to PepsiCo. But that conclusion did not deny the entry into contracts *of* sale of concentrate as between SAPL and PBS.

Conclusion

185 No monetary obligation was owed by SAPL, or payment made by SAPL, to PepsiCo for or in respect of the concentrate. That was not what cl 4 of the PepsiCo EBA provided in its terms, substance or effect. Title to the concentrate was never with PepsiCo; title transferred from PBS to SAPL. The Commissioner's reliance on cll 4(a) and 4(c) of the PepsiCo EBA does not alter the fact that, on the proper construction of the SAPL Bottler, Seller and Distributor Agreement, cl 4 of the PepsiCo EBA required SAPL in the future to enter into a contract to buy

212 *Realestate.com.au Pty Ltd v Hardingham* (2022) 277 CLR 115 at 132-134 [43]-[45]; see also 147-148 [82]-[86]. See also *Construction, Forestry, Maritime, Mining and Energy Union v Personnel Contracting Pty Ltd* (2022) 275 CLR 165 at 231-232 [177].

213 See [137] above.

concentrate where that contract had to include at least the terms set out in the PepsiCo EBA. That clause – imposing those obligations on SAPL – did not change the parties to the subsequent transactions for the sale of concentrate, namely PBS and SAPL. If SAPL failed to pay for the concentrate supplied by PBS, it was PBS as the contracting party that had an action for debt under those sale transactions. Under the PepsiCo EBA, PepsiCo only had an action for specific performance.

186 The Commissioner's appeal grounds in relation to royalty withholding tax are rejected.

Diverted profits tax

187 If no royalty withholding tax was payable by PepsiCo or SVC, the Commissioner then sought to reagitate the contention that PepsiCo and SVC were liable under the DPT provisions of Pt IVA of the ITAA 1936. That appeal ground must also be rejected.

Legislation

188 The DPT provisions²¹⁴ are anti-avoidance provisions introduced into Pt IVA of the ITAA 1936 by the *Treasury Laws Amendment (Combating Multinational Tax Avoidance) Act 2017* (Cth). Section 177H(1) in Pt IVA states that the primary objects of the DPT provisions are "(a) 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 (b) to prevent those entities from reducing the amount of Australian tax they pay by diverting profits offshore through contrived arrangements between related parties".²¹⁵

189 Section 177J(1) states that Pt IVA applies to a scheme, in relation to a tax benefit, defined as "the DPT tax benefit", if a number of elements are met,²¹⁶ relevantly:

214 ITAA 1936, ss 177H-177R read with, among other provisions, ss 177D and 177F.

215 See Australia, Senate, *Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2017* and *Diverted Profits Tax Bill 2017*, Revised Explanatory Memorandum at 8 [1.10].

216 See ITAA 1936, s 177A(1) definition of "DPT tax benefit".

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- "(a) a taxpayer (a **relevant taxpayer**) has obtained, or would but for section 177F obtain, the DPT tax benefit in connection with the scheme, in a year of income; and
- (b) it would be concluded (having regard to the matters in subsection (2)) that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for a principal purpose of, or for more than one principal purpose that includes a purpose of:
- (i) enabling the relevant taxpayer to obtain a tax benefit, or both to obtain a tax benefit and to reduce one or more of the relevant taxpayer's liabilities to tax under a foreign law, in connection with the scheme; or

...

whether or not that person who entered into or carried out the scheme or any part of the scheme is the relevant taxpayer ..."

A tax benefit can be, relevantly, a taxpayer not being liable to pay withholding tax on an amount where the taxpayer either would have, or might reasonably be expected to have, been liable to pay withholding tax on the amount if the scheme had not been entered into or carried out.²¹⁷

190 Section 177CB sets out the bases for identifying tax benefits and relevantly provides:

- "(1) This section applies to deciding, under section 177C, whether any of the following (**tax effects**) would have occurred, or might reasonably be expected to have occurred, if a scheme had not been entered into or carried out:

...

- (e) the taxpayer being liable to pay withholding tax on an amount;

...

²¹⁷ ITAA 1936, s 177C(1)(bc) read with s 177C(1)(g).

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- (3) A decision that a tax effect might reasonably be expected to have occurred if the scheme had not been entered into or carried out must be based on a postulate that is a reasonable alternative to entering into or carrying out the scheme.
- (4) In determining for the purposes of subsection (3) whether a postulate is such a reasonable alternative:
 - (a) have particular regard to:
 - (i) the substance of the scheme; and
 - (ii) any result or consequence for the taxpayer that is or would be achieved by the scheme (other than a result in relation to the operation of this Act); but
 - (b) disregard any result in relation to the operation of this Act that would be achieved by the postulate for any person (whether or not a party to the scheme).
- (5) Subsection (4) applies in relation to the scheme as if references in that subsection to the operation of this Act included references to the operation of any foreign law relating to taxation:
 - (a) if this Part applies to the scheme because of section ... 177J; or
 - (b) for the purposes of determining whether this Part applies to the scheme because of section ... 177J."

191 Section 177J(2) then specifies the matters to which regard must be had in applying s 177J(1)(b), namely:

- "(a) the matters in subsection 177D(2);
- (b) without limiting subsection 177D(2), the extent to which non-tax financial benefits that are quantifiable have resulted, will result, or may reasonably be expected to result, from the scheme;
- (c) the result, in relation to the operation of any foreign law relating to taxation, that (but for this Part) would be achieved by the scheme;
- (d) the amount of the tax benefit mentioned in paragraph (1)(b)."

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192 In ascertaining the principal purpose of a taxpayer, s 177J(2)(a) requires consideration of the factors listed in s 177D(2). Those factors are:

- "(a) the manner in which the scheme was entered into or carried out;
- (b) the form and substance of the scheme;
- (c) the time at which the scheme was entered into and the length of the period during which the scheme was carried out;
- (d) the result in relation to the operation of this Act that, but for this Part, would be achieved by the scheme;
- (e) any change in the financial position of the relevant taxpayer that has resulted, will result, or may reasonably be expected to result, from the scheme;
- (f) any change in the financial position of any person who has, or has had, any connection (whether of a business, family or other nature) with the relevant taxpayer, being a change that has resulted, will result or may reasonably be expected to result, from the scheme;
- (g) any other consequence for the relevant taxpayer, or for any person referred to in paragraph (f), of the scheme having been entered into or carried out;
- (h) the nature of any connection (whether of a business, family or other nature) between the relevant taxpayer and any person referred to in paragraph (f)."

Factors (a) and (b) were the focus of the parties' submissions.

193 Unlike the other aspects of Pt IVA, the DPT provisions do not turn upon the Commissioner making a determination.²¹⁸ Section 177N(a) provides that, if Pt IVA applies to a scheme because of s 177J, s 177P applies to the relevant taxpayer mentioned in s 177J. Section 177P then creates the liability to pay the DPT at the rate declared by Parliament, namely 40 per cent of the profit diverted.²¹⁹

218 cf ITAA 1936, s 177F.

219 *Diverted Profits Tax Act 2017* (Cth), s 4.

Scheme, alternative postulates and issues

194 The identified schemes for PepsiCo and SVC are relevantly identical. Consistent with the approach in the Full Federal Court, although these reasons should be understood to apply to both PepsiCo and SVC, for ease and unless otherwise specified this section of the reasons will be confined to the scheme alleged in the case of PepsiCo.

195 The Commissioner's identified scheme was, in substance, 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 Scheme"). There was no issue about the identification of the Scheme.²²⁰

196 The Commissioner's case was that, had the Scheme not been entered into or carried out, there were two alternative postulates. The first alternative postulate was that 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. The second alternative postulate was that 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. On either basis, the Commissioner contended that a royalty would or might reasonably be expected to have been paid by SAPL to PepsiCo or to another entity on PepsiCo's behalf, or as PepsiCo directed. PepsiCo contended that neither postulate was reasonable within the meaning of s 177CB(3).

197 There were two issues: whether PepsiCo obtained a tax benefit in connection with the Scheme for the purposes of s 177J(1)(a) of the ITAA 1936, and, if so, whether it would be concluded, having regard to the matters in s 177J(2), that the person, or one of the persons, who entered into or carried out the Scheme or any part of the Scheme did so for the principal purpose, or for more than one principal purpose that includes a purpose, of enabling PepsiCo to obtain a tax benefit, or both to obtain a tax benefit and to reduce PepsiCo's liability to tax under a foreign law, in connection with the Scheme.

Decisions below

198 The primary judge held that it was reasonable to expect that, but for the Scheme, PepsiCo would have been liable to pay royalty withholding tax.

220 ITAA 1936, s 177A(1) definition of "scheme".

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His Honour considered that each of the Commissioner's alternative postulates was reasonable for a number of reasons. First, the substance of each postulate was the same as the substance of the PepsiCo EBA. Second, the financial and other consequences for PepsiCo under the postulates were comparable to those resulting from the PepsiCo EBA. Third, given the importance of using the brands for SAPL's business, an alternative that provided more clearly for the payment of a royalty as consideration for the use of the PepsiCo Intellectual Property was reasonable. Much of this reasoning was premised on his Honour's view that the PepsiCo EBA in fact required the payment of a royalty.

199 In assessing the principal purpose of PepsiCo in entering into and carrying out the Scheme, the primary judge considered that the expression "principal purpose" in s 177J(1)(b) referred to a purpose that is a prominent, leading or main purpose and noted also that there can be more than one such purpose. Neither party disagreed with this. It is also unnecessary to set out his Honour's analysis of each of the factors under s 177D(2). Suffice to say, some favoured PepsiCo, some favoured the Commissioner and yet others were characterised as "neutral". The primary judge reasoned that, in the absence of evidence detailing why the pricing structure was adopted by the parties in 2009, it "would not be safe to assume that tax considerations did not have a role to play". What role they played, and whether they were Australian or American tax considerations, was not set out.

200 The primary judge took into account, as required by s 177J(2)(c), the result, in relation to the operation of any foreign law relating to taxation, that (but for Pt IVA) would be achieved by the Scheme. In that respect, PepsiCo conceded that the Scheme achieved a reduction in the amount of income tax payable in the United States by PepsiCo arising from the non-derivation in that country of royalty income. The primary judge found that this supported the Commissioner's contentions concerning purpose. The primary judge ultimately concluded that the terms of the PepsiCo EBA were "contrived" because "payments that [were] ostensibly for concentrate alone [were] in substance for both concentrate and the licence of valuable intellectual property". That conclusion could only have been reached on the assumption that the primary judge's earlier conclusion concerning the actual substance of the PepsiCo EBA was correct. As we have seen, it was not.

201 The majority of the Full Federal Court found that the Scheme had been entered into and carried out for the principal purpose of obtaining the tax benefit identified by the primary judge, but nonetheless held that PepsiCo had discharged its onus of demonstrating that it had not obtained any tax benefit. Critical to the reasoning of the majority was that the commercial and economic substance of the Scheme was "that the price agreed for concentrate was for concentrate".

That differed from the substance of the two alternative postulates relied upon by the Commissioner, where part of what SAPL might reasonably have been expected to have paid would have been a royalty. It was observed that notable features of these alternatives were that they eschewed either identifying the actual price of the concentrate or advancing an element from which it might be inferred that the concentrate price reflected the value of a licence to use the PepsiCo Intellectual Property. In those circumstances, the majority decided that the Commissioner's postulates were not reasonable, in the sense required by s 177CB(3), and that PepsiCo had discharged its onus of showing that no reasonable alternative postulate existed which conformed to the commercial substance of the Scheme identified by the Commissioner.

202 On the question of purpose, the majority considered that it did not warrant "overly close attention" because that part of the primary judge's reasons was not dispositive and because the assumptions that needed to be made in order to permit the issue to be examined were "somewhat artificial", namely that the alternative postulates to the Scheme were reasonable and that as a matter of commercial and economic substance the payments made by SAPL included a royalty for the use of the PepsiCo Intellectual Property. Having made those assumptions, however, the majority would have reached the same conclusion as the primary judge and affirmatively answered the question posed by s 177J(1)(b)(i) on the basis that PepsiCo had the purpose of obtaining a tax benefit and also of obtaining a reduction in its liability to tax in the United States.

Issues on appeal

203 The two issues in this Court were: (1) did PepsiCo obtain a "DPT tax benefit" in connection with a scheme within the meaning of s 177J(1)(a); and (2) even if PepsiCo obtained a tax benefit, was the condition in s 177J(1)(b) regarding "principal purpose" satisfied in relation to the scheme in the relevant year of income? The Commissioner's case fails at the first question – PepsiCo did not obtain a tax benefit in connection with the Scheme.

Tax benefit

204 Whether there is a "tax benefit" in connection with a scheme is to be established as an objective fact.²²¹ The inquiry directed by Pt IVA requires a

²²¹ *Federal Commissioner of Taxation v Peabody* (1994) 181 CLR 359 at 382.

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comparison between the scheme and an alternative postulate.²²² Courts must be careful to avoid the false dichotomy between a rational commercial decision and obtaining a tax benefit.²²³ As the inquiry involves events and circumstances that did not actually happen, "[a] decision that a tax effect might reasonably be expected to have occurred if the scheme had not been entered into or carried out must be based on a postulate that is a reasonable alternative to entering into or carrying out the scheme".²²⁴

Onus

205 The majority of the Full Federal Court correctly understood that PepsiCo at all times bore the onus of proving that it had not obtained a tax benefit in connection with the Scheme. As their Honours observed:

"Whilst the Commissioner identifies two postulates which he says are reasonable alternatives to the entry into or carrying out by PepsiCo of the scheme, the question in this Court is not whether the postulates he suggests are unreasonable. In review proceedings of the present kind, it is the taxpayer which bears the burden of proving that the assessments are excessive ... Proving that the Commissioner's postulates are unreasonable does not in itself discharge that burden."

The question, however, is what a taxpayer must do to discharge the onus, cast upon it by s 14ZZO of the *Taxation Administration Act 1953* (Cth) ("the TAA"), of demonstrating that it did not obtain a tax benefit in connection with the scheme. The Commissioner contended that, to discharge that onus, PepsiCo had to prove the existence of an alternative postulate in which it was *not* liable to pay royalty withholding tax, and that this postulate had to be reasonable in the sense required by s 177CB(3). It was not sufficient, the Commissioner submitted, for PepsiCo merely to demonstrate that the Commissioner's alternative postulates were not reasonable.

222 *Federal Commissioner of Taxation v Hart* (2004) 217 CLR 216 at 243 [66]. See also *Federal Commissioner of Taxation v Guardian AIT Pty Ltd* (2023) 115 ATR 316 at 350-351 [155].

223 *Hart* (2004) 217 CLR 216 at 243 [64]; *Federal Commissioner of Taxation v Macquarie Bank Ltd* (2013) 210 FCR 164 at 224-225 [216]. See also *Federal Commissioner of Taxation v Spotless Services Ltd* (1996) 186 CLR 404 at 415.

224 ITAA 1936, s 177CB(3).

206 The Commissioner submitted that the majority of the Full Federal Court misidentified the operation of the onus of proof imposed by s 14ZZO of the TAA in the event that no reasonable alternative to a scheme could be identified on the evidence before the Court. The Commissioner submitted that the majority of the Full Federal Court erred in finding that a taxpayer could discharge the onus by showing that no reasonable postulate existed. That submission should not be accepted, having regard to both the text of s 177CB(3) and authority.

207 The use of the word "must" in s 177CB(3), namely that "[a] decision that a tax effect might reasonably be expected to have occurred if the scheme had not been entered into or carried out *must* be based on a postulate that is a reasonable alternative to entering into or carrying out the scheme",²²⁵ mandates that there cannot be a tax benefit if there is no postulate that is a reasonable alternative to a scheme. Put another way, reaching a decision that a "tax effect" in s 177C(1)(bc) might reasonably be expected to have occurred if the scheme had not been entered into or carried out "must" be based and only based on a postulate or postulates that is or are "reasonable". If none exist, no relevant "tax effect" can be demonstrated.

208 The Commissioner also relied upon a number of authorities, including *Federal Commissioner of Taxation v Trail Bros Steel & Plastics Pty Ltd*,²²⁶ *RCI Pty Ltd v Federal Commissioner of Taxation*,²²⁷ and the more recent decision in *Federal Commissioner of Taxation v Guardian AIT Pty Ltd*,²²⁸ in support of the contention that PepsiCo had to prove the existence of an alternative postulate in which PepsiCo was not liable to pay royalty withholding tax, and this postulate had to be reasonable in the sense required by s 177CB(3). Those authorities do not support the Commissioner's contention.

209 In *Trail Bros*, the plurality of the Full Federal Court observed, in relation to s 177C, that "[t]he legislation requires a comparison between the relevant scheme and an alternative postulate" and that "[t]he alternative postulate requires a 'prediction as to events which would have taken place if the relevant scheme had not been entered into or carried out and that prediction must be sufficiently reliable

225 Emphasis added.

226 (2010) 186 FCR 410.

227 (2011) 84 ATR 785.

228 (2023) 115 ATR 316.

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for it to be regarded as reasonable".²²⁹ As their Honours stated, "[a] reasonable expectation requires more than a possibility".²³⁰

210 In the later decision of the Full Federal Court in *RCI*, the Court put the correct position in these terms:²³¹

"Even if a taxpayer establishes that the Commissioner's counterfactual is unreasonable, it will not necessarily follow that [the taxpayer] has established that the assessment is excessive. That is because the issue is not whether the Commissioner puts forward a reasonable counterfactual or not; it is a question of the court determining objectively, and on all of the evidence, including inferences open on the evidence, as well as the apparent logic of events, what would have or might reasonably be expected to have occurred if the scheme had not been entered into."

211 It can be accepted that a taxpayer who merely demonstrates that the postulate relied upon by the Commissioner is unreasonable does not demonstrate that it has not obtained a tax benefit. But it does not follow that the only way a taxpayer can discharge its onus of proof is to lead evidence of another reasonable postulate in which the taxpayer obtains no tax benefit. The question, relevantly posed by s 177C(1)(bc), is whether the taxpayer would have, or might reasonably be expected to have, been liable to pay withholding tax if the scheme identified by the Commissioner had not been entered into or carried out. As the Full Federal Court said in *RCI*, that is a question to be determined objectively on all of the evidence "including inferences open on the evidence, as well as the apparent logic of events", and it is for the taxpayer to answer it.²³²

212 In that respect, it can be accepted that a taxpayer may more usually demonstrate the absence of a tax benefit by identifying, on the evidence, a postulate or counterfactual which shows what it might reasonably be expected to have done, had it not entered into or carried out a relevant scheme. Such a postulate must be

229 (2010) 186 FCR 410 at 418 [25]-[26] (emphasis omitted), quoting *Federal Commissioner of Taxation v Lenzo* (2008) 167 FCR 255 at 278 [122], in turn quoting *Peabody* (1994) 181 CLR 359 at 385.

230 *Trail Bros* (2010) 186 FCR 410 at 418 [26], quoting *Lenzo* (2008) 167 FCR 255 at 278 [122], in turn quoting *Peabody* (1994) 181 CLR 359 at 385.

231 (2011) 84 ATR 785 at 843 [130].

232 (2011) 84 ATR 785 at 843 [130].

a reasonable one, its reasonableness being measured, in accordance with s 177CB(4), by reference to the substance of the scheme, and any result or consequence for that taxpayer achieved by the scheme. Nevertheless, in unusual cases, a taxpayer may demonstrate the absence of a tax benefit by establishing that there is no postulate that is a reasonable alternative to entering into or carrying out the scheme.

Substance of the Scheme

213 The DPT provisions direct attention to the "economic substance" of the activities in Australia of "significant global entities" and the diversion by such entities of profits offshore "through contrived arrangements between related parties" with a consequential reduction in Australian tax.²³³

214 A correct understanding of the economic substance of the contractual arrangements is important to an application of the DPT provisions. It is important in relation to the identification of a tax benefit because in determining, for the purposes of s 177CB(3), whether a given postulate is a reasonable alternative, s 177CB(4) requires a consideration of the "substance of the scheme"²³⁴ and "any result or consequence for the taxpayer that is or would be achieved by the scheme".²³⁵ It is also important in relation to the question of purpose because s 177D(2)(b) requires the form and substance of a scheme to be considered.

215 In these appeals, the central question is the economic and commercial substance of the Scheme, as distinct from its legal shape or form.²³⁶ The Commissioner submitted that the economic and commercial substance of the Scheme was that, in return for the making of each payment from SAPL to PBS, SAPL received two valuable benefits – the concentrate and the PepsiCo Intellectual Property. In this respect, the Commissioner submitted that the allocation of the total contract price to concentrate was not the substance of the Scheme but was only a means and form to give it effect. As explained above,

233 ITAA 1936, s 177H(1).

234 ITAA 1936, s 177CB(4)(a)(i).

235 ITAA 1936, s 177CB(4)(a)(ii).

236 See Australia, House of Representatives, *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013*, Explanatory Memorandum at 24 [1.103]; see also *Hart* (2004) 217 CLR 216 at 245 [71].

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that misconceives and oversimplifies the composite SAPL Bottler, Seller and Distributor Agreement.

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. That conferral of rights did not take place "for nothing". Under the SAPL Bottler, Seller and Distributor Agreement, other monetary and non-monetary consideration, including the exchange of promises in cl 4 of the PepsiCo EBA, flowed in exchange for the PepsiCo Intellectual Property.²³⁷ In particular, SAPL agreed to build the PepsiCo brands. The PepsiCo Intellectual Property was essential for SAPL to perform that obligation including for the benefit of PepsiCo.

Commissioner's alternative postulates not reasonable

217 It is then necessary to consider the Commissioner's two identified alternative postulates, which the Commissioner contended were reasonable because they exhibited the same commercial and economic substance as that which he contended subsisted under the PepsiCo EBA. In sum, the Commissioner submitted that under the identified alternative postulates SAPL receives the same property (the concentrate and the PepsiCo Intellectual Property) and pays the same amounts as under the PepsiCo EBA. The only difference, it was said, between the PepsiCo EBA and the alternative postulates is a minor textual change in the form of the clauses dealing with payment. In contrast, it was said, the majority below confused the economic substance of the Scheme with the form or mechanism by which the Scheme was implemented. It was also said that the majority ignored the Commissioner's expert who opined that, given that the intellectual property was of value, it was reasonable to expect that appropriate compensation would have been paid for it.

218 As just explained, the problem with the Commissioner's position, and the reason that his alternative postulates were not reasonable, is that he misconceived the economic and commercial substance of the Scheme. As the majority of the Full Federal Court rightly observed, for a postulate to be a reasonable alternative it "should correspond to the substance of the scheme". It was not the case that the payments made by SAPL to PBS were consideration for

237 See [128]-[148] above.

the receipt of two benefits. Rather, as the majority below correctly concluded, "[t]he commercial and economic substance of the [S]cheme was that the price agreed for concentrate was for concentrate". Adjusting the SAPL Bottler, Seller and Distributor Agreement, and the PepsiCo EBA in particular, to provide for some part of that price to be also a royalty involves far more than a simple textual change. It involves the entry into a fundamentally different arrangement.

219 Critical facts, unique to these appeals, enabled PepsiCo to demonstrate that there were no other reasonable alternative postulates and therefore no relevant tax effect. The first is that the substance of the Scheme (as properly construed and characterised) included that the price paid for concentrate was for concentrate and nothing else. The second is that the Scheme was a product of arm's length dealings between unrelated parties.

220 Third, the absence of a royalty was market standard, a substantive element of the business model which was adopted by the PepsiCo Group.²³⁸ There was evidence before the primary judge, largely accepted by his Honour, that PepsiCo (and other beverage competitors) used a "franchise-owned bottling operation" or "FOBO" model. This commenced in the early 1900s when the Pepsi-Cola Company started to sell Pepsi syrup to third party bottling companies within the United States.

221 The FOBO model requires joint investment by both PepsiCo and the bottler to develop, manufacture, bottle and distribute the beverages and to engage in marketing to promote sales, using both "push" and "pull" strategies. Generally speaking, the franchise bottler makes substantial contributions to the cost of local advertising and marketing and is responsible for "pushing" the brand in the local stores, by addressing the pricing, the display of the product, and its location in stores, as well as trade promotions. In contrast, the PepsiCo Group is responsible for strategies that encourage the consumer to "pull the brand off the shelf". This includes advertising, sponsorship and sampling. The foregoing permits the PepsiCo Group to carry out what it does best, such as the innovation and development of the "brands", which includes the trade marks, the get-up, and the shape of the bottle, leaving the local bottler to focus on the business of bottling, selling and distributing finished beverages. These features of the FOBO model are carefully reflected in the terms of the SAPL Bottler, Seller and Distributor Agreement and, as explained above, benefit both PepsiCo and SAPL.

238 cf *Commissioner of Taxation v Mochkin* (2003) 127 FCR 185 at 209 [102], 216 [136], [137].

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222 Under the FOBO model, it could not be doubted that the PepsiCo brands were critical to the sale of the Beverages. As the primary judge accepted, the concentrate and the brands "always go together". PepsiCo got the benefit of SAPL's knowledge of the local market and access to its distribution equipment, capacities and network, sales force, leadership, and relationships with traders and regulators. In return, SAPL got access to the PepsiCo Group's innovation and marketing capabilities, and the benefit of its brand recognition in the local market. Nonetheless, the terms of the SAPL Bottler, Seller and Distributor Agreement – including that SAPL could only purchase concentrate from a nominated Seller and could not, subject to express exclusions, bottle and distribute any rival product – protected the PepsiCo brands and reputation.

223 The primary judge found, however, and this was not challenged, that the FOBO model did not deploy a fixed template. The evidence showed that there was considerable scope for variation in exclusive bottling agreements, including pricing terms, and that the pricing terms could have some complexity. In that respect, the Commissioner relied upon three bottling agreements in which a royalty was charged by the PepsiCo Group for the right to use the intellectual property in Vietnam, Thailand and Korea. Although a royalty was charged in those agreements, none of them involved the sale of concentrate. Rather, they involved the sale of a water product and of juice. The relevance of these alternative contracts, concerning as they do the sale of different products, is doubtful, and cannot in any event be the basis for any analogy without an analysis of the full suite of contracts and legislative arrangements in those countries.²³⁹ The fact remains that PepsiCo used a FOBO model and the essential features of that model were deployed here with the appointment of SAPL under the SAPL Bottler, Seller and Distributor Agreement as bottler, seller and distributor. That agreement, as the primary judge found, was a contemporary example of the application of PepsiCo's standard way of conducting a beverage business internationally, namely FOBO.

224 Based on those facts, and also the logic of the events, PepsiCo showed that it was probable that no different arrangement might reasonably be expected to have been entered into. PepsiCo demonstrated that any postulate in which the payments for concentrate are seen as made in part for the grant of the right to use the PepsiCo Intellectual Property was not a reasonable expectation. As this Court observed in *Federal Commissioner of Taxation v Peabody*, "[a] reasonable expectation requires more than a possibility".²⁴⁰ In other words, the only postulate here that

239 cf *Federal Commissioner of Taxation v Orica Ltd* (1998) 194 CLR 500 at 531 [70].

240 (1994) 181 CLR 359 at 385.

might have exhibited the same substance and achieved the same results as that found in the Scheme was the SAPL Bottler, Seller and Distributor Agreement. Where the substance of the Scheme does not permit the conclusion to be drawn that the price for concentrate included a royalty, that conclusion is not reasonably open.

225 For those reasons the majority of the Full Federal Court were correct in concluding that PepsiCo obtained no tax benefit.

Principal purpose

226 Given the conclusions reached in relation to the lack of reasonable alternative postulates, it is unnecessary to address the question of principal purpose or the notices of contention filed by PepsiCo and SVC seeking to contend that the Full Federal Court's decision that Pt IVA of the ITAA 1936 did not apply to the Scheme should be affirmed on the additional or alternative ground that, even if PepsiCo obtained a "DPT tax benefit" in connection with the Scheme within the meaning of s 177J(1)(a), the condition in s 177J(1)(b) (regarding "principal purpose") was not satisfied in relation to the Scheme in the relevant year of income. It is, however, appropriate to make the following observations.

227 In considering whether a scheme was entered into for the principal purpose of enabling the taxpayer to obtain the tax benefit as required by s 177J(1)(b)(i), the Court has regard to the matters in ss 177J(2) and 177D(2). The parties' submissions primarily focussed on two matters – (1) the manner of entry into the scheme (s 177D(2)(a)) and (2) the form and substance of the scheme (s 177D(2)(b)).

Manner in which the Scheme was entered into or carried out

228 The primary judge found that the manner in which the Scheme was entered into or carried out supported PepsiCo's case, "but only slightly". The Commissioner's submissions on this issue may be characterised as having been faintly put. He submitted that the historical practices of the PepsiCo Group, including the FOBO model, were not relevant in seeking to identify the principal purpose of the Scheme on the basis that the Scheme was entered into in 2009 at a time when the royalty withholding tax provisions were in place. The Commissioner, in that respect, embraced the primary judge's observation that it would not be safe to assume that tax considerations did not have a role to play here.

229 The primary judge's observation is plainly correct. It would be unthinkable to suppose that sophisticated commercial operators did not take tax outcomes into

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consideration in negotiating the form of a transaction. As this Court observed in *Federal Commissioner of Taxation v Spotless Services Ltd*, "tax laws are one part of the legal order within which commerce is fostered and protected".²⁴¹ But taking tax outcomes into account does not necessarily justify an application of Pt IVA of the ITAA 1936, or, indeed, the imposition of DPT. The choice of leasing rather than buying business premises, as described by Gleeson CJ and McHugh J in *Federal Commissioner of Taxation v Hart*,²⁴² illustrates that reality.

230 The most significant features about the manner in which PepsiCo entered into and carried out the Scheme are three-fold. First, the Scheme was the product of an arm's length negotiation between experienced and large commercial enterprises. Second, the Scheme produced a price payable for concentrate that was not disproportionately high and which was paid to an Australian resident taxpayer. Third, the Scheme followed broadly a pre-existing and entirely commercial way of doing business: namely the FOBO model. It follows that a consideration "of the way in which and method or procedure by which the particular scheme in question was established"²⁴³ and then carried out does not support the conclusion that PepsiCo had a principal purpose of enabling it to obtain a tax benefit.

Form and substance of the Scheme

231 The Commissioner submitted that the form and substance of the Scheme did not match and that this difference strongly supported the Scheme having been entered into for the principal purpose of enabling PepsiCo to obtain the tax benefit. He contended that the substance of the Scheme was a commercial bargain under which SAPL was provided with the means to manufacture and sell the Beverages for which SAPL paid amounts of money. By way of contrast, it was said, the form of the Scheme was that SAPL paid amounts as consideration for concentrate alone, and no part of that payment was for the right to use the PepsiCo Intellectual Property even though those intellectual property rights were indispensable to SAPL's business.

232 For the reasons already given, the Commissioner's argument is flawed because it misstates the true economic and commercial substance of the Scheme. In reality, because the price agreed for concentrate was for concentrate and nothing else, the form and substance of the Scheme were the same. In other words,

²⁴¹ (1996) 186 CLR 404 at 416.

²⁴² (2004) 217 CLR 216 at 227 [15].

²⁴³ *Spotless* (1996) 186 CLR 404 at 420.

the composite SAPL Bottler, Seller and Distributor Agreement was a correct and accurate record of the bargain ultimately struck by the parties. It follows that this factor strongly favours the conclusion that the Scheme was not entered into for the principal purpose of enabling PepsiCo to obtain the tax benefit.

Other s 177D(2) matters

233 The other matters set out in s 177D(2) were not the subject of oral argument and assumed less importance in the written submissions. Indeed, no submissions were made by the Commissioner concerning the result in relation to the operation of the ITAA 1936 that would be achieved but for an application of Pt IVA (s 177D(2)(d)) and neither party made any submission about the time when the scheme was entered into and carried out (s 177D(2)(c)). As for the former, as PepsiCo submitted, the royalty withholding tax said to have been avoided represented about one percent of the total payments made by SAPL; this is a negligible sum for such large commercial enterprises. That fact militates strongly against the presence of the required principal purpose. As for the issue of timing, it was not suggested that when the composite SAPL Bottler, Seller and Distributor Agreement was entered into was affected by considerations about withholding tax.

234 As for any change in financial position of the relevant taxpayer or any person who has or has had any connection with the relevant taxpayer (s 177D(2)(e) and (f)), PepsiCo submitted that the composite SAPL Bottler, Seller and Distributor Agreement was a restated exclusive bottling appointment which did not result in any immediate financial change as it provided for the continuation of an existing business arrangement. The Commissioner submitted that under this factor a comparison should be made with the financial position under the alternative postulates he posed.²⁴⁴ However, as these are not reasonable alternative postulates, such a comparison is of no utility. This factor favours PepsiCo.

235 As for the nature of any connection between the relevant taxpayer and any person who has had a change in financial position as a result of the scheme (s 177D(2)(h)), the Commissioner accepted that SAPL was independent of PepsiCo, but nonetheless submitted that the parties did not act at arm's length in relation to the allocation of the amounts paid by SAPL as being for concentrate only. The Commissioner referred to *Collis v Federal Commissioner of Taxation*.²⁴⁵ It is unnecessary to address that decision as the Commissioner's contention was

²⁴⁴ cf *Guardian AIT* (2023) 115 ATR 316 at 359 [210]-[212].

²⁴⁵ (1996) 33 ATR 438.

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not supported by any finding made by the primary judge or by the Full Federal Court that the parties had not dealt with the issue of pricing of concentrate at arm's length, and it was squarely contradicted by the Commissioner not disputing that it was an arm's length price, or a fair price, or a price that was not disproportionately high. Otherwise this factor, which highlights the arm's length dealing which had taken place between the parties, favours PepsiCo's position.

236 It should finally be noted that the Commissioner also relied upon a finding below that less tax was paid in the United States by PepsiCo. The relevance of any reduction in foreign tax is mandated by s 177J(1)(b). As has been explained, a saving in tax in the United States was conceded by PepsiCo, but no actual amount of tax saved was determined below, save that the savings before December 2017 were said to appear to be "substantial". It follows that this factor must favour the Commissioner.

237 All of the s 177D(2) factors, save for the last, strongly support the conclusion that the principal purpose of PepsiCo in entering into and carrying out the Scheme was not to obtain the tax benefit identified by the Commissioner. In any event, for the reasons already given no such tax benefit was ever obtained.

Conclusion and orders

238 For those reasons, each appeal is dismissed with costs.