

## Episode 147: Summary

**Episode name:** Fizz, Tax, and Legal Facts: Unpacking *PepsiCo v Commissioner of Taxation*

**Guest(s):** Paul McNab

**What area(s) of law does this episode consider?**

Tax; contracts; intellectual property; international transactions; trade.

**Why is this topic relevant?**

The ongoing *PepsiCo* case has sparked significant interest this year, and for good reason. At its core, it's a dispute about how Australia taxes certain payments between multinational corporations and their subsidiaries.

This case has already gone through the Full Federal Court, who decided in favour of PepsiCo in June of 2024, overturning the Federal Court's earlier decision which had ruled in favour of the Commissioner. Now, with the most recent update in November that the High Court has granted the Commissioner special leave to appeal, there's a chance we'll see some further clarity - or a shake-up - in how these payments are regulated under Australia's tax law.

For professionals advising multinational corporations, this case is a big deal. It brings into question how cross-border arrangements are structured and scrutinised, and it underscores the need to balance legal precision with commercial realities. Whether you're in tax law, corporate advisory, or simply interested in global business, there's a lot to unpack here.

**What legislation is considered in this episode?**

*Income Tax Assessment Act 1936* (Cth) (**ITAA**)

**What cases are considered in this episode?**

[\*PepsiCo, Inc. v Commissioner of Taxation\* \[2024\] FCAFC 86](#)

- In this case, PepsiCo and Stokely-Van Camp, both belonging to the PepsiCo Group, entered into Exclusive Bottling Agreements (**EBAs**) with Schweppes Australia Pty Ltd (**Schweppes**). The EBAs provided that PepsiCo and SVC (or a seller they nominated) agreed to sell concentrate to Schweppes for PepsiCo branded beverages, as well as the exclusive license to use PepsiCo's trademarks and other intellectual property necessary to bottle, distribute and sell PepsiCo branded beverages in Australia (namely, the popular beverages Pepsi, Mountain Dew and Gatorade). Notably, the EBAs did not specify any separate royalty payments for the use of this intellectual property. Payments were then made by Schweppes to PepsiCo Bottling Singapore Pty Ltd (the **Seller** nominated by PepsiCo), who then passed those payments (minus a small margin) along to the Singapore-based producer of the concentrate, which was also another subsidiary of PepsiCo. The Commissioner of Taxation

(**Commissioner**) argued that part of Schweppe's payments should be classified as royalty payments for the use of PepsiCo's trademarks and IP, and therefore should be subject to Royalty Withholding Tax (**RWT**) under the *ITAA*. Further, the Commissioner argued that if PepsiCo and SVC were not liable to pay RWT, then they should be subject to Diverted Profits Tax (**DPT**) under the *ITAA*, which applies to multinational corporations whose profits have been diverted offshore to avoid Australian tax, arguing that they had structured the EBAs for the principal purpose of avoiding tax.

At first instance, the Federal Court held that part of the payments Schweppes made for the concentrate constituted royalties under the *ITAA* and as a result, PepsiCo and SVC were liable for RWT on a portion of the sales. The Court also found that, if RWT was not applicable, the arrangement was for the principal purpose of obtaining a tax benefit, and as such PepsiCo and SVC would have been liable for DPT. However on appeal, the Full Federal Court (**FFC**) overturned the decision. It unanimously ruled that the payments from Schweppes to the Seller were not subject to RWT. Additionally, a majority of the FFC held that if the payments were not royalties, the DPT would not apply. Most recently at the time of writing, in November 2024, the High Court granted the Commissioner special leave to appeal the FFC's decision.

[Oracle Corporation Australia Pty Ltd v Commissioner of Taxation \(Stay Application\) \[2024\] FCA 1262](#)

- Oracle Australia purchased software and hardware from Oracle Ireland under complex contractual arrangements, making sublicense fee payments for rights including the use of copyrighted programs. The key issue was whether these payments constituted 'royalties' under the Australia-Ireland double taxation agreement, which would trigger a withholding tax obligation. The Federal Court declined to stay proceedings, citing the need for a judicial determination on the definition of 'royalty' due to its implications for multiple taxpayers and international tax relations, particularly the dispute between the United States and Australian Treasury.
- PepsiCo may prompt distributors to review their distribution agreements to determine who bears the cost of withholding tax, potentially leading to a reevaluation of cost allocation between distributors and offshore sellers. This decision could pose practical challenges for anyone involved in cross-border trade, particularly in terms of passing on additional costs to the original seller.
- International treaties exist to prevent companies from paying tax twice on profits through a network of withholding tax agreements between countries.

**What are the main points?**

- The concept of a royalty in tax is defined as a payment for the use of intellectual property. IP lawyers may not understand this concept as it is a tax concept rather than an IP law concept. Courts have determined that giving someone permission to do something restricted by IP law qualifies as a use of the relevant intellectual property.
- Australia has General Anti-Avoidance provisions, found in Part IVA of the *ITAA*, allowing the Commissioner to set aside transactions done to avoid tax and reinstate the correct ones. This provision grants the commission significant power, including the DPT, with this being the first case involving the DPT rules in Australia.
- The DPT targets the behaviour of large multinational corporations, imposing penalties and restrictions on access to dispute resolution processes. It includes a 40% penalty, a one-year waiting period before accessing courts or arbitrators, and an evidentiary sanction preventing the introduction of evidence not produced during the waiting period in court proceedings.
- The system involves determining the answer under domestic law and then assessing if it is influenced by a treaty. Despite some variations in definitions, the consideration for trademark use remains crucial in both contexts, indicating similarities rather than major distinctions in this particular matter.
- The *Oracle* decision acknowledges a broad range of international commentary beyond traditional sources, including new OECD directives on Base Erosion and Profit Shifting. International tax lawyers face the challenge of sifting through this growing body of commentary to determine its relevance to interpreting treaties like the US-Australia treaty, which may continue to evolve in meaning even after execution.
- Australia is facing a tension between participating in an OECD process that influences international laws and asserting its own domestic position, which may lead to inconsistency. It is important to consider how this balance can significantly impact the interpretation and application of laws.
- Several important rulings involving the ATO, including the *PepsiCo* and *Oracle* decisions, have demonstrated the importance of bundling up commercial arrangements and viewing them as a whole to determine consideration. It is essential to gather all relevant documents and interpret them collectively to understand the totality of the agreements involved.
- The Commissioner emphasises that these cases should provide guidance to many taxpayers, but small factual differences can greatly affect the outcome.

### What are the practical takeaways?

This suggests that there may be limitations to the applicability of such guidance.

- Parties are recognising the broader risks in agreements and are taking commercial steps to manage them, particularly in terms of recovery against the other party. This has led to a renewed focus on traditional risk management approaches and addressing issues around passing risk back and forth in contractual terms.
- Consolidating all relevant documents, considering intellectual property, engaging in the process, and reflecting on pricing and terms can help assess tax risks and determine risk management strategies.
- To progress your career development, it is important to consider the type of work and clients you have access to in your role to ensure you are working with a suitable level of complexity. Additionally, focus on topics that interest you in a multidisciplinary sense.

[Show notes](#)

[Australian Taxation Office. Practical Compliance Guideline 2018/5 \*Diverted profits tax\*](#)