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Client Alert

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Australia: PepsiCo royalty and first DPT case - Taxpayer wins in Australia's highest court

In brief

On 13 August 2025, the High Court of Australia handed down its much-anticipated decision in *Commissioner of Taxation v. PepsiCo, Inc.* [2025] HCA 30.

By a majority of 4-3, the High Court found in favour of the taxpayer and dismissed each appeal by the Commissioner of Taxation. In this regard, the majority decision concluded that:

- No royalty withholding tax arose; and
- No Diverted Profits Tax (DPT) applied,

to the circumstances involving the inbound supply chain for PepsiCo's concentrate and arrangements with third party bottlers in Australia.

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Key takeaways

- The inbound supply chain into Australia and the contractual terms of the arrangements were respected. On a proper construction of the agreements, the payments made were for the concentrate only and did not include any component which was a royalty for the use of intellectual property.

- There was firm confirmation from the Court that although no part of the payment for the concentrate was payment for a license to use PepsiCo's Intellectual Property, the Bottler did not obtain the license for nothing. The right to use was part of a comprehensive commercial arrangement of which an essential element obliged the Bottler to advertise the Beverages and engage in sales promotion activities. This agreement on the Bottler's part had real value to PepsiCo. This was essentially non-monetary consideration in exchange for the grant of the use of intellectual property (e.g., marketing) which ultimately benefited PepsiCo as the owner of that intellectual property.

- The Court unanimously held that any payment was not paid or credited to or derived by PepsiCo in the US and therefore no royalty withholding tax was payable.

- By majority, the Court also held that PepsiCo did not obtain a tax benefit and did not have to pay DPT. In this context, the onus put on the taxpayer was clarified by the Court. The Court held that it does not follow that the only way a taxpayer can discharge its onus of proof in the DPT is to lead evidence of another reasonable postulate in which the taxpayer obtains no tax benefit. This was important for PepsiCo because it was strong in its defence to the DPT that no other alternative postulate (or counterfactual) existed to its inbound supply chain into Australia, being the sale of concentrate to a bottler (by its nominated subsidiary) for a price and the granting of an Intellectual Property license for no monetary consideration (which was supported by many years of consistently applying its model).

In depth

Overview of facts

- The case concerned PepsiCo entering into Exclusive Bottling Agreements ("**EBAs**") with Schweppes Australia (the "**Bottler**"), an unrelated third party. Under the EBAs, PepsiCo could nominate a related entity to sell the concentrate to the Bottler. PepsiCo nominated its Australian subsidiary ("**PBS**").
- The Bottler made payments to PBS which were stated to be for the supply of concentrate. The Bottler then used the concentrate to bottle and distribute Pepsi products in the Australian market, according to the terms of the EBAs.
- The EBAs also (expressly and impliedly) included a grant to the Bottler of the right to use the trademarks and other intellectual property associated with each beverage, such as bottle and can designs.

Key takeaways on the reasoning of the majority

Inbound distribution supply chain respected

The majority concluded that the use of a local third-party Bottler was mutually beneficial for both PepsiCo and the Bottler on the basis:

- The Bottler was able to leverage the Pepsi Group's innovation and marketing capabilities; and
- PepsiCo received the benefit of the Bottler's local investment in bottling and distribution equipment and capabilities.

The Bottler had accepted the appointment as the exclusive Bottler, seller and distributor of 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 (for no monetary value).

The Court noted that the exchange of promises was separate to the future agreements for the purchase of concentrate. Ultimately the Court held that the price paid by the Bottler to PBS for the concentrate did "not move the transfer of the intellectual property" from PepsiCo to the Bottler.

Royalty withholding tax

The majority found that the payments made by the Bottler were not 'consideration' for the use of the PepsiCo Intellectual Property and hence not a royalty for Australian tax purposes. This was on the basis that payments made by the Bottler were for concentrate and did not include any component which was a royalty for the use of the PepsiCo Intellectual Property.

Proper construction of the relevant agreements was required to determine whether the payments for concentrate were in part consideration for the right to use the PepsiCo Intellectual Property.

The majority considered the definition of "consideration" in stamp duty cases and considered these in the context of royalties:

> *"The phrase "consideration for" in the definition of "royalty" extends to the "basis", "purpose", or "condition" for a transaction by which one party confers a benefit upon another. 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****.*

The majority found that in PepsiCo's case, the giving of the promise to use intellectual property could not be seen to be the basis for, or a condition of, the receipt of the payment from the Bottler.

The fact that the contractual price paid by the Bottler under the arrangement was an arm's length price, or a fair price, or not a disproportionately high price, for the concentrate meant, in the view of the majority, that it could not be said that a part of the price paid for those goods was a payment of a royalty for the use of intellectual property applied to products partly made with those goods.

Significantly, the fact that the sale of the products produced using the concentrate benefited both parties was not proof that any amount of the Bottler's payment was for the use of the intellectual property.

The majority also firmly held that although no part of the payment for the concentrate was payment for a license to use PepsiCo's Intellectual Property, **the Bottler did not obtain the license for nothing.**

The right to use was part of a comprehensive commercial arrangement of which an essential element obliged the Bottler to advertise the Beverages and engage in sales promotion activities.

The majority rejected the Commissioner's repeated assertion that some part of the Bottler's payment had to be treated as for that license to use. Doing so would, in the majority's view, assign part of the fair price paid for goods to a different commercial bargain.

The majority further found that the royalty was not 'derived by' and 'paid or credited' to PepsiCo. This was on the basis that no monetary obligation was owed by the Bottler or payment made by the Bottler to PepsiCo for or in respect of the concentrate. This was not what was provided for in the EBA, in its terms, substance or effect. On a proper construction of the agreements, the EBA required the Bottler in the future to enter into a contracts to buy concentrate on the terms set out in the EBA. This obligation did not change the parties to the subsequent transactions for the sale of concentrate, which was between the PBS and the Bottler. To the extent the Bottler failed to pay for the concentrate, it was PBS that had an action for debt, not PepsiCo.

Diverted Profits Tax (DPT)

The majority held that the DPT did not apply. There were several takeaways:

Onus

One issue industry has been poised to obtain clarity on was the question of what a taxpayer must do to discharge its onus of demonstrating that it did not obtain a tax benefit in connection with the scheme. The Commissioner contended that to discharge that onus, Pepsi had to prove the existence of an alternative postulate in which it was not liable to pay any royalty withholding tax, and that this postulate had to be reasonable.

In addition, the Commissioner submitted that it was not sufficient to merely demonstrate that the alternative postulates were not reasonable. The Commissioner argued that the majority of the Full Federal Court was wrong in finding that a taxpayer could discharge the onus by showing no reasonable alternative postulate existed.

The High Court disagreed and held 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.

"*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 the scheme. 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"*.

True economic and commercial substance

The majority decision also emphasised a correct understanding of the economic substance of the contractual arrangement in applying the DPT. In identifying a tax benefit and determining whether an alternative postulate is reasonable, the parties must consider the substance of the scheme and any result or consequence for the taxpayer that is or would be achieved by the scheme.

The majority found that the true economic and commercial substance of the agreement was that the Bottler was appointed and accepted appointment as the exclusive Bottler, seller and distributor of the Beverages as part of a comprehensive arrangement which involved an exchange of promises on an arm's length basis. This included the promise to purchase concentrate at agreed prices as well as the conferral of the Intellectual Property rights. That conferral of rights did not take place for nothing. Rather, the exchange of promises in the EBA flowed in exchange for the PepsiCo Intellectual Property including the Bottler's obligation to advertise the Beverages and engage in sales promotion activities. This is consistent with the majority's analysis for royalty withholding tax.

The majority opined that the Commissioner had misconceived the economic and commercial substance of the Scheme in arriving at his alternative postulates. The payments made by the Bottler were not for the receipt of two benefits, but rather for the concentrate only. Adjusting the relevant agreements and EBA to specifically provide that the price included a royalty component would mean entering into a fundamentally different arrangement.

The majority did partially confine this finding to PepsiCo's specific facts, including the fact that the Scheme was a product of arm's length dealings between unrelated parties. That is not to say that the outcome would have been different between related parties within a multinational group, but it may require an inquiry into the arm's length nature of such arrangements. Further, the absence of a royalty was considered market standard and a substantive element of the business model that was adopted by the Pepsi Group. This model required joint investment by both PepsiCo and the Bottler to develop, manufacture, bottle and distribute the beverages and also to market to promote sales such that the Bottler made substantial contributions to the local advertising and marketing. It remains to be seen whether the High Court would take a different view if the mutually beneficial arrangement between the Bottler and PepsiCo was not part of a well-established business model for the Group. On this basis, the majority found that no different arrangement might reasonably be expected to have been entered into.

The majority went on to make observations on the DPT principal purpose test. Of particular note was confirmation that taking tax outcomes into account when negotiating the form of a transaction did not necessarily justify an application of Part IVA or imposition of the DPT.

Reasoning of the minority

The minority decision took a different interpretation of the substance of the arrangements, with the view that payments for the concentrate were to some extent payments for the grant of the intellectual property licences. This recognised the characterisation of the 'single, integrated and indivisible' nature of the transaction, such that it would be practically impossible to identify any royalty for the grant of rights to use the intellectual property unless the parties had expressly labelled some part of the payment as consideration for that grant.

This characterisation, in the minority's view, required a conclusion that part of the payments made by the Bottler was for the use of the intellectual property.

However, the minority opined that due to the contracting structure, PepsiCo did not derive income from the payment of a royalty. On this basis only, the royalty withholding tax provisions were not considered to apply.

The minority agreed with the primary judge that if the royalty withholding tax provisions did not apply, the DPT provisions would apply for the following reasons:

- PepsiCo had obtained a tax benefit in connection with the Scheme, in not being liable to pay royalty withholding tax.

- The Commissioner's reasonable alternative postulates were viewed as not substantially altering the features of the EBAs.

- The minority concluded that PepsiCo was the party that bore the onus of proof of negativing the reasonable alternative postulates to the Scheme, and it had not done so. Further, they found the commercial and economic substance of the schemes was that the parties had 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.

- The principal purpose test would be satisfied on the assumption that there was a reasonable alternative postulate. In particular, the view was that there was no detailed and comprehensive evidence why PepsiCo generally adopted the pricing structure in its exclusive bottling agreements and it was "not safe to assume that tax considerations did not have a role to play".

What's next for the royalty saga?

The Commissioner has no further pathways for appeal in this case.

We anticipate the Commissioner will issue a Decision Impact Statement and seek to confine the application of the decision to the unique facts and circumstances of the case.

The Commissioner will likely need to update its draft ruling on software and IP distribution arrangements (TR 2024/D1) for the Court's view on "consideration for". Based on views previously expressed, the Commissioner is not likely to consider this case disturbs the arguments on royalties on software in TR 2024/D1.

It's uncertain whether the Commissioner will issue guidance on trademark use in distribution arrangements that are "mutually beneficial" to both the distributor and IP owner - particularly where non-monetary consideration is involved. However, such guidance may be considered, as the High Court's reasoning broadly aligns with OECD commentary (Article 12, paragraph 10), which distinguishes between royalty payments and purchase prices in branded goods transactions. In these cases, the distributor markets the goods but does not pay for the trademark use. It would not be unreasonable for industry to hope this encourages future cases adopting – in a software context - a commercially realistic approach, focusing on the substance of supply chains and the true nature of payments (for example, consistent with Paragraph 14.4 of the OECD Commentary on Article 12).

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