FEDERAL COURT OF AUSTRALIA

PepsiCo, Inc v Commissioner of Taxation [2023] FCA 1490

SUMMARY

In accordance with the practice of the Federal Court in cases of public interest, importance or complexity, the following summary has been prepared to accompany the orders made today. This summary is intended to assist in understanding the outcome of this proceeding and is not a complete statement of the conclusions reached by the Court. The only authoritative statement of the Court's reasons is that contained in the published reasons for judgment which will be available on the internet at www.fedcourt.gov.au together with this summary.

These proceedings were commenced by PepsiCo, Inc (**PepsiCo**), a United States company, and Stokely-Van Camp, Inc (**SVC**), also a United States company, against the Commissioner of Taxation to challenge royalty withholding tax notices, and diverted profits tax assessments, in respect of the years of income ended 30 June 2018 and 30 June 2019 (the **relevant years**).

At all relevant times, the PepsiCo group of companies (the **PepsiCo Group**) operated a global beverage business. PepsiCo was the owner of a world-wide portfolio of trademarks, designs and other rights and assets relating to the Pepsi and Mountain Dew brands, and SVC was the owner of a world-wide portfolio of trademarks, designs and other rights and assets relating to the Gatorade brand.

The proceedings focus on two exclusive bottling agreements (**EBAs**) that relate to the Australian market. The first EBA was between PepsiCo and Schweppes Australia Pty Ltd (**SAPL**), an Australian company that was owned by Asahi Breweries. This related to carbonated soft drinks including those sold under the Pepsi and Mountain Dew brands. The second EBA was between SVC and SAPL and related to non-carbonated beverages, including those sold under the Gatorade brand.

Under the EBAs: PepsiCo or SVC (as the case may be) agreed to sell, or cause a related entity to sell, beverage concentrate to SAPL; the concentrate was to be mixed by SAPL with other ingredients in accordance with formulas, specifications and other information provided by the PepsiCo Group to produce finished beverages for retail sale in Australia; and PepsiCo or SVC (as the case may be) granted SAPL the right to use in Australia trademarks and other intellectual

property to enable SAPL to manufacture, bottle, sell and distribute the finished beverages in branded PepsiCo Group packaging.

The EBAs provided for SAPL to pay for the concentrate. They did not expressly provide for the payment of a royalty for the right to use the intellectual property.

During the relevant years:

- Concentrate Manufacturing (Singapore) Pte Ltd (**CMSPL**), a member of the PepsiCo Group incorporated in Singapore, produced concentrate according to a recipe or formula provided by, and with flavour keys supplied by, PepsiCo and SVC;
- CMSPL supplied the concentrate to PepsiCo Beverage Singapore Pty Ltd (**PBS**), a member of the PepsiCo Group that was (despite its name) incorporated in Australia;
- PBS was nominated as the "Seller" by PepsiCo and SVC under the EBAs;
- PBS supplied concentrate to SAPL and invoiced SAPL for the concentrate that had been supplied;
- SAPL paid PBS for the concentrate in accordance with those invoices. In total, SAPL made payments of approximately A$240 million to PBS during the relevant years; and
- PBS transferred almost all of the money received from SAPL to CMSPL, retaining only a small margin.

The Commissioner relies on two alternative contentions in relation to the facts and matters outlined above:

- The Commissioner's primary contention is that each of PepsiCo and SVC is liable for royalty withholding tax under the *Income Tax Assessment Act 1936* (Cth) (**ITAA 1936**), which is subject to Art 12 of the double tax agreement between Australia and the United States (**US DTA**).
- The Commissioner's alternative contention (which only arises if PepsiCo and SVC are not liable for royalty withholding tax) is that the diverted profits tax provisions of Pt IVA of the ITAA 1936 apply.

The following is a summary of the Court's conclusions in the reasons for judgment handed down today:

(a) In relation to the royalty withholding tax issue, the Court has concluded that:

(i) the payments made by SAPL under the EBAs were, to some extent, *consideration for* the use of, or the right to use, the relevant trademarks and other intellectual property;

(ii) the relevant portions of the payments were *income derived* by PepsiCo or SVC (as applicable) for the purposes of s 128B(2B)(a) of the ITAA 1936 and amounts to which they were *beneficially entitled* for the purposes of Art 12 of the US DTA; and

(iii) the relevant portions of the payments are deemed to have been paid by SAPL to PepsiCo or SVC (as applicable) by virtue of s 128A(2) of the ITAA 1936.

It follows from the above that the payments made by SAPL under the EBAs in the relevant years were, to an extent, "royalties" and PepsiCo and SVC are liable to pay royalty withholding tax at the rate of 5% on those royalties.

(b) In relation to the *amount* of the royalties, subject to one matter, the Court has concluded that the amount of the royalties is 5.88% of SAPL's net revenue from sales of the relevant products during the relevant years. The one matter is that the Court has concluded that one licence agreement (contained in the set of comparable transactions) that was treated as non-exclusive (and therefore the subject of an adjustment) should have been treated as exclusive. Accordingly, the Court has concluded that that agreement should not have been the subject of an adjustment. The Court has concluded that the figure of 5.88% needs to be revised (downwards) in light of that matter. This would appear to be a mathematical exercise based on material already in evidence.

(c) In light of the above conclusions, it is unnecessary to consider the diverted profits tax issue. However, the Court has considered this issue for the sake of completeness. The Commissioner's diverted profits tax case is predicated on the royalty withholding tax provisions *not* applying. Therefore, in dealing with the diverted profits tax issue, the Court has proceeded on the assumption that (contrary to the conclusion outlined above), the royalty withholding tax provisions *do not apply*. On that assumption, the Court has concluded that:

(i) each of PepsiCo and SVC obtained a tax benefit in connection with the relevant scheme; and

(ii) having regard to the matters in s 177J(2) of the ITAA 1936, 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).

It follows that, had the Court not concluded that the royalty withholding tax provisions applied, the Court would have concluded that the diverted profits tax provisions apply.

At this stage, the Court will make orders to the effect that: within 14 days, the parties provide to the Court any agreed minute of proposed orders to give effect to the Court's reasons for judgment, and in relation to costs; and, if the parties cannot agree, then within 21 days each party file and serve a minute of proposed orders to give effect to the Court's reasons for judgment, and in relation to costs, together with a short submission.

The Court's reasons for judgment will remain confidential to the parties and Asahi for a period of seven days to enable them to review the judgment and make any application for confidentiality over parts of the reasons for judgment.

MOSHINSKY J
30 NOVEMBER 2023