

FEDERAL COURT OF AUSTRALIA

PepsiCo, Inc v Commissioner of Taxation [2024] FCAFC 86

Appeal from: *PepsiCo, Inc v Commissioner of Taxation* [2023] FCA 1490

File numbers: VID 27 of 2024
VID 28 of 2024
VID 74 of 2024
VID 75 of 2024
VID 76 of 2024
VID 77 of 2024

Judgment of: **PERRAM, COLVIN AND JACKMAN JJ**

Date of judgment: 26 June 2024

Catchwords: **TAXATION** – royalty withholding tax – where non-resident taxpayers entered into exclusive bottling agreements (‘EBAs’) with an Australian company (‘Bottler’) for the bottling and sale of beverages in Australia – where EBAs provided for sale of concentrate by the taxpayers or their nominated seller to the Bottler – where EBAs included a licence of the taxpayers’ trademarks and other intellectual property but did not provide for a royalty – whether the taxpayers were liable to pay royalty withholding tax on part of the payments made by the Bottler under the EBAs – whether payments made by the Bottler were consideration for the right to use intellectual property – consideration of *Davis Investments Pty Ltd v Commissioner of Stamp Duties (NSW)* (1958) 100 CLR 392, *Chief Commissioner of State Revenue (NSW) v Dick Smith Electronics Holdings Pty Ltd* [2005] HCA 3; 221 CLR 496 and *Commissioner of State Revenue (Vic) v Lend Lease Development Pty Ltd* [2014] HCA 51; 254 CLR 142 – whether payments made by the Bottler were income derived by the taxpayers

TAXATION – diverted profits tax – consideration of s 177J of *Income Tax Assessment Act 1936* (Cth) – whether the taxpayers obtained a tax benefit in connection with a scheme – commercial and economic substance of the scheme and alternative postulates – results or consequences for the taxpayers of the scheme and alternative postulates – whether such postulates were reasonable alternatives to the scheme – whether the taxpayers entered into or carried out the scheme for a principal purpose of obtaining a tax benefit and reducing foreign tax liabilities

- Legislation:
- Acts Interpretation Act 1901* (Cth) ss 15AB(1)(b)(i), 15AB(2)(e)
- Diverted Profits Tax Act 2017* (Cth)
- Income Tax Assessment Act 1936* (Cth) ss 6(1), 26(f) (repealed), 128B(2B), 177C(1)(a), 177C(1)(bc), 177C(1)(g), 177CB(1)(e), 177CB(3), 177CB(4)(a)(i), 177CB(4)(a)(ii), 177CB(4)(b), 177CB(5), 177D(1)(b), 177D(2), 177J(1)(a), 177J(1)(b)(i), 177J(2)(a), 177J(2)(b), 177J(2)(c), 177J(2)(d), 177N(a), 177P(1)(a), 177P(2)(a), 255(1), 256 (repealed)
- Income Tax Assessment Act 1997* (Cth) Div 815
- International Taxation Agreements Act 1953* (Cth) s 17A(1)
- Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act 2013* (Cth)
- Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013* (Cth)
- Taxation Administration Act 1953* (Cth) s 14ZZO(b)(i), Part IVC
- Taxation Laws Amendment Act (No 5) 1992* (Cth)
- Trade Marks Act 1995* (Cth) ss 8, 20, 58, 88(2)(a), 92, 122(1)(e)
- Treasury Laws Amendment (Combating Multinational Tax Avoidance) Act 2017* (Cth)
- Cases cited:
- ABB Australia Pty Ltd v Federal Commissioner of Taxation* [2007] FCA 1063; 162 FCR 189
- Archibald Howie Pty Ltd v Commissioner of Stamp Duties (NSW)* (1948) 77 CLR 143
- Arthur Murray (NSW) Pty Ltd v Federal Commissioner of Taxation* (1965) 114 CLR 314
- Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCAFC 62; 251 FCR 40
- Chief Commissioner of State Revenue (NSW) v Dick Smith Electronics Holdings Pty Ltd* [2005] HCA 3; 221 CLR 496
- Commissioner of State Revenue (Vic) v Lend Lease Development Pty Ltd* [2014] HCA 51; 254 CLR 142
- Commissioner of Taxation v Guardian AIT Pty Ltd ATF Australian Investment Trust* [2023] FCAFC 3; 115 ATR 316
- Commissioner of Taxation v Hart* [2004] HCA 26; 217 CLR 216
- Commissioner of Taxation v Peabody* (1994) 181 CLR 359
- Commissioner of Taxation v Sleight* [2004] FCAFC 94; 136 FCR 211
- Commissioner of Taxation v SNF (Australia) Pty Ltd* [2011] FCAFC 74; 193 FCR 149
- Commissioner of Taxes (SA) v The Executor Trustee and*

Agency Company of South Australia Limited (1938) 63 CLR 108
Davis Investments Pty Ltd v Commissioner of Stamp Duties (NSW) (1958) 100 CLR 392
Dunn v Shapowloff (1978) 2 NSWLR 235
Electricity Generation Corporation v Woodside Energy Ltd [2014] HCA 7; 251 CLR 640
Freedom Foods Pty Ltd v Blue Diamond Growers [2021] FCAFC 86; 286 FCR 437
International Business Machines Corporation v Commissioner of Taxation [2011] FCA 335; 91 IPR 120
Minerva Financial Group Pty Ltd v Commissioner of Taxation [2024] FCAFC 28
Mount Bruce Mining Pty Ltd v Wright Prospecting Pty Ltd [2015] HCA 37; (2015) 256 CLR 104
PepsiCo v Commissioner of Taxation [2023] FCA 1490
Project Blue Sky Inc v Australian Broadcasting Authority [1998] HCA 28; 194 CLR 355
RCI Pty Ltd v Commissioner of Taxation [2011] FCAFC 104; 84 ATR 785
Roufeil as Trustee for the Bankrupt Estate of Tarrant v Tarrant Enterprises Pty Ltd as Trustee for the MRT Family Trust [2023] FCAFC 142; 299 FCR 204

Goode RM, *Payment Obligations in Commercial and Financial Transactions* (Sweet & Maxwell, 1983)

Division: General Division

Registry: Victoria

National Practice Area: Taxation

Number of paragraphs: 220

Date of hearing: 8-10 May 2024

VID 27 of 2024 and VID 28 of 2024:

Counsel for the Appellants: Mr EF Wheelahan KC with Ms CM Pierce

Solicitor for the Appellants: PricewaterhouseCoopers

Counsel for the Respondents: Ms K Deards SC with Ms T Phillips and Mr D Lewis

Solicitor for the Respondents: MinterEllison

VID 74 of 2024, VID 75 of

**2024, VID 76 of 2024 and
VID 77 of 2024:**

Counsel for the Appellants: Ms K Deards SC with Ms T Phillips and Mr D Lewis

Solicitor for the Appellants: MinterEllison

Counsel for the Respondents: Mr EF Wheelahan KC with Ms CM Pierce

Solicitor for the Respondents: PricewaterhouseCoopers

ORDERS

VID 27 of 2024

BETWEEN: **PEPSICO, INC**
 Appellant

AND: **COMMISSIONER OF TAXATION**
 Respondent

VID 28 of 2024

BETWEEN: **STOKELY-VAN CAMP, INC**
 Appellant

AND: **COMMISSIONER OF TAXATION**
 Respondent

VID 74 of 2024
VID 75 of 2024

BETWEEN: **COMMISSIONER OF TAXATION**
 Appellant

AND: **PEPSICO, INC**
 Respondent

VID 76 of 2024
VID 77 of 2024

BETWEEN: **COMMISSIONER OF TAXATION**
 Appellant

AND: **STOKELY-VAN CAMP, INC**
 Respondent

ORDER MADE BY: **PERRAM, COLVIN AND JACKMAN JJ**
DATE OF ORDER: **26 JUNE 2024**

THE COURT ORDERS THAT:

1. The parties provide a short minute of order to give effect to these reasons within 14 days.

Note: Entry of orders is dealt with in Rule 39.32 of the *Federal Court Rules 2011*.

REASONS FOR JUDGMENT

PERRAM AND JACKMAN JJ:

INTRODUCTION

- 1 The questions in these appeals are whether PepsiCo, Inc ('PepsiCo') and Stokely-Van Camp, Inc ('SVC') (together 'PepsiCo/SVC') are liable to pay royalty withholding tax under s 128B(2B) of the *Income Tax Assessment Act 1936* (Cth) ('ITAA 1936') and, if they are not, whether they are instead liable to pay diverted profits tax under s 177J of Part IVA of that Act. Section 177J was inserted into Part IVA by the *Treasury Laws Amendment (Combating Multinational Tax Avoidance) Act 2017* (Cth) and this litigation is the first occasion on which its operation has been considered. The detail of the facts and the relevant provisions are comprehensively set out in the reasons of the trial judge: *PepsiCo v Commissioner of Taxation* [2023] FCA 1490 ('TJ').
- 2 In broad outline, Schweppes Australia Pty Ltd was the sole distributor and bottler in Australia of the famous beverages Pepsi, Mountain Dew and Gatorade in the relevant income years ending 30 June 2018 and 30 June 2019. It is convenient to refer to Schweppes as the Bottler. It purchased concentrate to make the beverages from PepsiCo Bottling Singapore Pty Ltd ('the Seller') under a series of purchase orders totalling around \$240 million. The Seller was an Australian company although it maintained its offices at the Alfa Centre in Singapore. It was the Seller's responsibility to deliver the concentrate to the Bottler's plant in Western Sydney. The invoices issued by the Seller were, on their face, calculated by reference to specified rates for concentrate although they were broken down into the several different components which together comprised the concentrate (such as syrups and acidulants). In addition to those charges, the Bottler agreed to pay the freight, insurance and handling charges the Seller incurred in supplying the Bottler with the concentrate and it also agreed to be responsible for any customs duties or goods and services tax the Seller became liable to on the importation and supply of the concentrate (PepsiCo EBA cl 4(c) / SVC EBA cll 7.2(b), 7.3(b) and 14). The Bottler paid the amounts invoiced by the Seller into the Seller's bank account.
- 3 The Seller is a member of the PepsiCo group of companies, the ultimate parent of which is PepsiCo. The rates charged by the Seller to the Bottler were, however, not fixed purely by arrangement between them. Rather, the rates were dictated by other contractual arrangements the Bottler had with PepsiCo. The payments made by the Bottler to the Seller for the Pepsi and Mountain Dew concentrates were contemplated to be made under an exclusive bottling agreement between, inter alia, PepsiCo and the Bottler ('PepsiCo EBA'). On the other hand,

the payments made by the Bottler to the Seller for the Gatorade concentrate were made under a separate exclusive bottling agreement between SVC and the Bottler ('SVC EBA'). Like the Seller, SVC is a member of the PepsiCo group. Gatorade was dealt with under this separate EBA for reasons which are historical and which reflect the acquisition by PepsiCo of the SVC group of companies at an earlier juncture. Both EBAs were dated 3 April 2009. PepsiCo and SVC are resident in the United States of America.

- 4 The EBAs determined the price at which the concentrates were to be purchased. They left some flexibility as to the identity of the party which would eventually sell the concentrates to the Bottler by permitting, but not requiring, the nomination of an entity within the PepsiCo group as the seller (PepsiCo EBA cl 4(a) / SVC EBA cll 7.1(a) and 7.3(a)). The EBAs also included a grant by PepsiCo/SVC to the Bottler of the right to use the trade marks and other intellectual property associated with each beverage such as bottle and can designs. In the case of the PepsiCo EBA, it is uncontroversial that this licence was implied by law because the EBA bound the Bottler to distribute the beverages it made from the concentrates as Pepsi and Mountain Dew (cl 3(a)). In the case of the SVC EBA, however, a licence was granted in express terms (cl 4.1).
- 5 Neither EBA made any provision for the payment by the Bottler of a royalty for its use of the trade marks. Further, as already noted, whilst both EBAs contemplated that PepsiCo/SVC might themselves supply the Bottler with the relevant concentrates each also entitled them to appoint some other related entity to do so. This right was exercised by PepsiCo/SVC early in the life of the EBAs when they appointed another member of the PepsiCo group to be the seller of the concentrate. This company was Pepsi-Cola International, Cork, a company incorporated in Ireland. At the end of 2015 PepsiCo and SVC again exercised this right by replacing the Irish company with the current Singapore-based Seller. Thereafter, the Seller sold the concentrates to the Bottler in return for which the Bottler transferred sums of money to the Seller in apparent payment of invoices issued by it. The invoiced amounts were consistent with PepsiCo/SVC's obligations under the EBAs to sell the concentrates at fixed unit prices (PepsiCo EBA cll 4(a)-(b) / SVC EBA cll 7.2 and 7.3(b)-(c)). This is unsurprising since, in the event that PepsiCo/SVC nominated another seller, they had promised the Bottler under the relevant EBA to cause the nominated seller to comply with what would have been their obligations under the EBA had they themselves remained as the seller (PepsiCo EBA cl 22(b) / SVC EBA cl 15.2).

- 6 The Commissioner's two cases relate to the question of whether the payments made by the Bottler to the Seller for concentrate in fact included a royalty component for the licence to use the trade marks and other intellectual property associated with the beverages. His primary case is: (a) that the provisions of the EBAs, properly construed, show that the payments made by the Bottler to the Seller were, in part, in consideration for the use of the trade marks and other intellectual property; and (b) that the facts show that these royalties were income which was derived by PepsiCo/SVC. If the first of these contentions be correct then it will entail that the payments made by the Bottler to the Seller were in part 'as consideration for' the right to use the trade marks and other intellectual property as that phrase is used in the definition of 'royalty' in s 6(1) of the ITAA 1936. If so, the relevant part of the payments will satisfy that definition and to that extent the payments will be royalties. If the second contention is also made good then it will mean that those royalties will be 'income derived' by a non-resident within the meaning of s 128B(2B) and as such exigible to royalty withholding tax under that provision (recalling that PepsiCo and SVC are resident in the United States). In this case, royalty withholding tax is levied at the rate of 5%. This results from the operation of s 17A(1) of the *International Taxation Agreements Act 1953* (Cth) which limits the rate at which royalty withholding tax is imposed to any limit specified in a double taxation treaty. The double taxation treaty between the United States and Australia presently imposes a limit of 5% on royalty withholding taxes.
- 7 The Commissioner's secondary case takes as its point of embarkation the failure of his primary case so that on this alternative case it is a given that, on the proper construction of the EBAs, the amounts the Bottler paid to the Seller did not include a royalty for the use of the trade marks or other intellectual property. The Commissioner then alleges that by entering into EBAs on terms which did not include such a royalty, PepsiCo/SVC had entered upon a scheme which was subsequently carried into effect and which, speaking loosely for now, conferred upon them two tax benefits. The first tax benefit was that PepsiCo/SVC were not exigible to royalty withholding tax in Australia since there was no royalty upon which s 128(2B) could operate. The second tax benefit arose from the fact that no royalty could be brought to tax under the laws of the United States since there was no royalty upon which those foreign tax laws could operate either. The Commissioner then alleges that PepsiCo/SVC entered into these schemes with 'a principal purpose' of obtaining these tax benefits wherefor they are liable under s 177J of the ITAA 1936 to deferred profits tax at the rate of 35% (the awkward language of 'a principal purpose' being that of s 177J rather than that of the Commissioner or his advisers).

8 The trial judge upheld the Commissioner's first case and therefore dismissed the second. His Honour did, however, indicate that had he not upheld the Commissioner's first case then he would have upheld his second. This was because on that hypothesis the terms of the EBAs would be 'contrived, in that payments that are ostensibly for concentrate alone are in substance for both concentrate and the licence of valuable intellectual property': TJ [465]. PepsiCo/SVC appeal from the orders dismissing the first case whilst the Commissioner, in case that appeal is allowed, appeals from the orders dismissing the second.

ROYALTY WITHHOLDING TAX

9 In summary, we conclude that the payments made by the Bottler to the Seller were for concentrate alone and did not include any component which was a royalty for the use of PepsiCo/SVC's intellectual property. The payments were in no part made in 'consideration for' the use of that intellectual property and they did not therefore include a 'royalty' within the definition of that term in s 6(1) of the ITAA 1936. Further, the payments were received by the Seller on its own account and they cannot be said to have been paid to PepsiCo/SVC. The Commissioner's attempts to bring PepsiCo/SVC to tax under s 128B(2B) therefore fails for two interrelated reasons: there was no 'royalty' as required by s 128B(2B)(b) and the payments made to the Seller by the Bottler cannot constitute 'income derived' by PepsiCo/SVC within the meaning of s 128(2B)(a). Our reasons for these conclusions are as follows:

Were the payments made by the Bottler to the Seller in part 'consideration for' the right to use intellectual property so that they were a royalty for the purposes of s 128B(2B)(b)?

10 In the context of stamp duties, it is established that the consideration for a conveyance or transfer of property is 'the money or value passing which moves the conveyance or transfer': *Archibald Howie Pty Ltd v Commissioner of Stamp Duties (NSW)* (1948) 77 CLR 143 ('*Archibald Howie*') at 152 per Dixon J (Rich J agreeing at 150). This question is to be answered by looking to what was received by the transferring party so as to move the transfers to the receiving party as stipulated in the relevant agreement: *Chief Commissioner of State Revenue (NSW) v Dick Smith Electronics Holdings Pty Ltd* [2005] HCA 3; 221 CLR 496 ('*Dick Smith*') at 518 [72] per Gummow, Kirby and Hayne JJ; *Commissioner of State Revenue (Vic) v Lend Lease Development Pty Ltd* [2014] HCA 51; 254 CLR 142 ('*Lend Lease*') at 159 [49] per French CJ, Hayne, Kiefel, Bell and Keane JJ. Consequently, to determine whether the payments made by the Bottler to the Seller were in part paid as consideration for the right to use the trade marks and other intellectual property, attention is to be confined to the terms of the contractual documents which, in this case, include at least the EBAs. It is unnecessary to determine whether the Seller and the Bottler entered into separate contracts for the sale of the

concentrates (evidenced by the purchase orders placed by the Bottler and the invoices issued by the Seller). Even if there were separate contracts, they were on terms dictated by the EBAs and, as between PepsiCo/SVC and the Bottler, the nature of the payments made by the Bottler could not be altered merely because PepsiCo/SVC exercised their option to nominate another entity to sell the concentrates rather than do so themselves.

11 The EBAs provided that the concentrate was to be sold to the Bottler by PepsiCo/SVC or their nominee at the price nominated in the EBAs (PepsiCo EBA cll 4(a)-(b) / SVC EBA cll 7.2 and 7.3(b)-(c)). It is established that where parties to a conveyance have agreed the purchase price for a transfer on sale then the consideration for the transfer is that agreed price: *Davis Investments Pty Ltd v Commissioner of Stamp Duties (NSW)* (1958) 100 CLR 392 (*‘Davis’*) at 408-409 per Dixon CJ.

12 The first question then is whether the EBAs fixed a price for the sale of concentrate. The answer to this question is dictated by the proper construction of the EBAs as contracts; that is to say, it is an orthodox exercise in contractual interpretation. In *International Business Machines Corporation v Commissioner of Taxation* [2011] FCA 335; 91 IPR 120 at 125 [19], Bennett J held that the question of whether payments are consideration for the right to use intellectual property rights, and therefore a ‘royalty’, for the purpose of s 128B of the ITAA 1936 is determined by the construction of the relevant agreement. Senior Counsel for both parties in the present case agreed that that was correct.

Construction of the EBAs

13 On their face, the price fixing provisions of the EBAs contemplated future sales of concentrate either by PepsiCo/SVC or their nominee at the unit rates specified therein. (A unit is an amount of concentrate sufficient to make one litre of beverage.) The EBAs themselves were neither contracts for the sale of goods (under which title passed immediately) nor agreements to sell goods (under which title passed subsequently on some event such as delivery). Rather, they contained provisions which contemplated future sales the price for which would be determined, once quantities were specified, by reference to the unit rates provided for in the EBAs. Until such time as an actual amount of concentrate was ordered, so that an actual price could be determined, the provisions lay dormant in that sense. Nevertheless, as a matter of ordinary language they suggested the presence of an agreement to enter upon future sales of concentrate at specified prices subject only to the question of quantity. The ordinary meaning of the language used by the parties therefore suggests that what was to be paid by the Bottler to

PepsiCo/SVC or their nominated seller was a price being paid for the concentrate and therefore ‘as consideration for’ the sale of the concentrate.

- 14 The Commissioner submits that the EBAs should not be construed in this fashion. His construction of these provisions is that they provide for a mechanism by which the amounts to be paid by the Bottler can be calculated but that those amounts should not be seen as being just the price paid for the concentrate. Rather, he submits, they should be seen as including a component for the price for the concentrate together with a component for the Bottler’s contractual entitlement to use the relevant trade marks and other intellectual property. There were two reasons for this. First, whilst the provisions did refer to the unit rate as the price for the concentrate they did not go so far as to say that that price was being paid only in consideration for the concentrate. It remained possible, on this view, that the price was being paid for other promises received by the Bottler under the EBAs and, in particular, that part of it was being paid for the right to use the trade marks and other intellectual property.
- 15 Secondly, if that approach were not taken to these provisions, it would entail that the right granted to the Bottler to use the relevant trade marks and intellectual property would have been given in effect for nothing. The brands associated with these beverages included some of the most valuable brands in the global beverage market (including the famous Pepsi brands) and it was unlikely that PepsiCo/SVC were giving away something so valuable for nothing.
- 16 The EBAs are commercial contracts. It is not in dispute that the meaning of their terms ‘is to be determined by what a reasonable businessperson would have understood those terms to mean’; or that its ascertainment will require ‘consideration of the language used by the parties, the surrounding circumstances known to them and the commercial purpose or objects to be secured by the contract’: *Electricity Generation Corporation v Woodside Energy Ltd* [2014] HCA 7; 251 CLR 640 at 656-657 [35] per French CJ, Hayne, Crennan and Kiefel JJ.
- 17 We do not agree with the Commissioner’s submission that the licence to the Bottler for the use of the trade marks and other intellectual property was otherwise being granted for nothing. The licence rights did not exist in isolation. Rather, they were intertwined with the Bottler’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 PepsiCo/SVC and in accordance with its detailed stipulations about how the trade marks were to be used.
- 18 The Commissioner’s submission proceeds on the overly simplistic assumption that the grant of the licence right to the Bottler was only of benefit to the Bottler. In fact, it was also a benefit

to PepsiCo/SVC. Further, the Commissioner's submission leaves out of account the significant restrictions placed upon the Bottler's entitlement to use the trade marks and other intellectual property.

19 In relation to the benefits which the licences conferred on the Bottler, the Bottler obtained the right to use the trade marks to distribute and sell beverages in Australia. The benefit consisted of the right to take advantage of the goodwill attaching to those marks which belonged to PepsiCo/SVC. The licence did not operate as an assignment of the goodwill from PepsiCo/SVC to the Bottler. On the contrary, the goodwill at all times remained with PepsiCo/SVC. The licence was not like the grant of a right to do the acts comprised in a copyright or the grant of a right to make products under a patent. Unlike those species of intellectual property rights, the licensor of a registered trade mark typically (although perhaps not invariably) maintains a commercial interest in the licensed mark through its continuing goodwill, and that was clearly the case with PepsiCo/SVC: c.f. ss 58, 88(2)(a) and 92 of the *Trade Marks Act 1995* (Cth). Thus the grant of the licence was also a significant benefit to PepsiCo/SVC. By means of the efforts of the Bottler to distribute the beverages under the trade marks in Australia their goodwill was maintained. To see the trade mark licence as simply a contractual grant of a right solely for the benefit of the grantee is significantly to misunderstand the nature of the rights involved. The correct view, if benefits are to be the lens, is that PepsiCo/SVC obtained the benefit of having their goodwill sustained and enhanced and the Bottler obtained the benefit of being able to exploit PepsiCo/SVC's goodwill to its own advantage. Whether these benefits were ultimately in favour of PepsiCo/SVC or the Bottler is unclear and likely in any event to be a close function of market dynamics. For example, in a new market it is quite possible that PepsiCo/SVC obtained more by way of benefit in having its brands established than the Bottler would obtain from utilising relatively weak brands. In a more mature market, the converse might be true. Nevertheless, if benefit were to be the metric it would be these offsetting benefits which would be a surer guide to the value of the trade mark licence.

20 In fact, however, benefit is not the entire picture. Whilst the Bottler may have obtained the benefit to which we have just referred (and leaving out of account the countervailing benefit obtained by PepsiCo/SVC), any such benefit was accompanied by significant restrictions. Unlike a copyright or patent licence, the Bottler was not permitted to use the trade marks for any purpose it liked. It could not for example sell its own cola under the Pepsi brand but was instead bound to use the trade marks only for the purpose of distributing PepsiCo/SVC's highly particular beverages (PepsiCo EBA cl 7 / SVC EBA cll 4.1-4.3). Further, it had no latitude in how it made these beverages but was instead hemmed about by the contractual necessity that

it make the beverages in the very precise way dictated by the EBAs (PepsiCo EBA cll 6-7 / SVC EBA cll 5.1-5.2). In short, it could use the trade marks but only for the purpose of selling the beverages, the nature of which was entirely controlled by PepsiCo/SVC. Further, it bound itself under the EBAs to permit PepsiCo/SVC to ensure that what was being sold was in fact the beverages. Rights of inspection, reporting and testing were conferred on PepsiCo/SVC so that they could be assured of that fact (PepsiCo EBA cll 13-16 / SVC EBA cl 12). Moreover, the Bottler's right to use the trade marks was circumscribed by a requirement that the manner in which the trade marks were used was likewise under the control of PepsiCo/SVC (PepsiCo cl 5(b) / SVC EBA cl 5.2(b)). The Bottler could not embark on its own interpretation of the brand strategy.

21 Thus a complete view of the licence granted by PepsiCo/SVC to the Bottler is one which acknowledges: (a) the benefits obtained by the Bottler in being permitted to use the goodwill attaching to the trade marks; (b) the restrictions both as to product and marketing imposed on the Bottler in its utilisation of that goodwill; (c) the burdens placed upon the Bottler in complying with testing and inspection regimes; and (d) the benefits obtained by PepsiCo/SVC in having the Bottler sustain and promote their good will in Australia. Once that is appreciated, the Commissioner's submission that PepsiCo/SVC were giving away the right to use the trade marks for nothing unless some element of the concentrate price was seen as embedding some value for it, must be rejected.

22 For completeness, it is necessary to note a remark made by the Full Court of this Court in *Freedom Foods Pty Ltd v Blue Diamond Growers* [2021] FCAFC 86; 286 FCR 437 ('*Freedom Foods*'). That case concerned a local licence to use the 'Almond Breeze' trade marks and associated intellectual property for the distribution of almond milk products. The question in the case was whether a licence agreement was subject to a regulation which governed franchising agreements. The licensor supplied a product known as 'almond base' to the licensee from which a range of almond milk products were then manufactured. The only fee which was payable under the agreement by the licensee to the licensor was for the supply of the almond base. One question in the case was whether the fees paid to the licensee were on a genuine wholesale basis which was one of the criteria for determining whether what was present was a franchising arrangement (c.f. *Franchising Code of Conduct* cl 5(d)(v)). In obiter, the Court expressed its agreement with the primary judge's conclusion that the fee paid was not on a genuine wholesale basis because it included an element for the licence of the trade marks. At [66] the Court said this:

It may be inferred that the price that Blue Diamond was to charge Freedom Foods for

the Almond Base was to include remuneration for the value of the brands (the value of which was to be further enhanced by the ongoing marketing expenditure to be incurred by Blue Diamond) or that there was no charge for the value of that intellectual property. The latter is such an unlikely commercial position that, in the absence of the Court being taken to evidence to the contrary, it may be inferred that the Almond Base price included remuneration not just for the supply of the Almond Base. The primary judge was correct in reaching that conclusion.

23 It is not obvious from the report of the decision whether the licensee submitted that the right to distribute almond milk products under the ‘Almond Breeze’ trade marks was of commercial benefit to the licensor, or whether attention was given to the restrictions and burdens imposed on the licensee in relation to the quality of the almond milk products or the manner in which the trade marks were used. Thus, we would not read [66] of *Freedom Foods* as determining the answer to the current issue. To the extent that the Full Court may have suggested that these other benefits and burdens were to be ignored in determining whether a licence was royalty free we would, however, respectfully differ from that view.

24 This leaves the Commissioner’s submission that the sale clauses of the EBAs did not specify that the price paid was the consideration for the purchase of the concentrate. There is nothing in this point. 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. If it could be said that the grant of the licences had been for nothing (which it cannot), a question may then have arisen as to whether the sale clauses of the EBAs might be construed in the manner suggested by the Commissioner. There may be cases where it is apparent that a price set under a contract for the transfer of property does include a component which, on the proper construction of the contract, must include an element for some other transfer under the contract. Reconciling the sale provisions with these other elements will present a conventional exercise in contractual interpretation and will turn on the language used by the parties. However, since it is not shown that the licences in this case were given in exchange for nil value no occasion arises to embark upon such an exercise. For completeness, the Commissioner did not submit, and we have no need to consider, that the price charged for concentrate was disproportionately high.

25 It follows that on their proper construction, the EBAs fixed a price for future sales of concentrate alone which did not include a component for the licence to use the trade marks and other intellectual property.

Consideration of Davis, Dick Smith and Lend Lease

26 That conclusion is not, however, the end of the matter. In *Davis* at 408 Dixon CJ said that where parties to a conveyance have agreed the purchase price for a transfer on sale then the

consideration for the transfer is that agreed price. However, the Commissioner submitted that that principle was qualified by the subsequent decisions of the High Court in *Dick Smith* and *Lend Lease*. It was submitted that those decisions established that the consideration for a transfer of property could be something different to that which the parties had agreed it to be.

27 It has of course long been accepted where the transfer involved is not one connected to a sale of identified property that one may look at the broader context in determining the consideration for the transfer. Justice Dixon's own judgment in *Archibald Howie* is an example of that kind of case. There Dixon J thought that the consideration for the transfer of shares needed to bring to account a reduction of capital which occurred at the same time. But in that case there was no sale of the shares and all the events which had occurred had taken place under the auspices of the articles of association and a resolution of the board. A similar problem arose in *Davis* but in that case there was an agreement which specified the price at which the shares were to be sold. Chief Justice Dixon distinguished his own decision in *Archibald Howie* on this basis at 408 ('But here, for their own purposes the parties have given the transaction the form of a sale at a price.'). He then said at 408-409:

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 cannot be denied that it is an attractive view that the consideration in money or money's worth "upon" which the transfers would be made consists of all the essential elements involved as it does the effectuation of pre-existing rights. But, notwithstanding some hesitation, I have reached the conclusion that, in the circumstances of the present case, it is the price which must for the purposes of stamp duty be regarded as the consideration upon which the transfers would be made.

28 Reasoning to substantially the same effect was given by McTiernan J (at 409-410) and Taylor J (at 419-421). By contrast, the dissenting judgment of Kitto J (at 414-415, with whom Webb J agreed) focused on 'the consideration which really passes, and not, if there be a distinction between them, the consideration appearing from the instrument'. Apart from the fact that it is the majority view which is binding, it is common ground between the parties, as indicated above, that the particular issue arising in the context of s 128B of the ITAA 1936 is determined by the construction of the relevant agreement, which is consistent with the majority in *Davis*.

29 In both *Dick Smith* and *Lend Lease* the Court, on the facts of the cases before it, was willing to do what Dixon CJ was not willing to do and 'prefer realism to formal expression'.

30 In *Dick Smith* the consideration which moved the transfer by the vendors to the purchaser of the shares was the performance by the purchaser of the several promises recorded in the agreement. The result of the performance by it of those several promises was that the vendors

received in total the sum of \$114,131,649. The majority reasoned (at 519 [75]) that ‘it was only in return for that total sum (paid by the various steps and in the various forms required by the Agreement) that the Vendors were willing to transfer to the Purchaser the bundle of rights which their shareholding in the Company represented’.

31 Similar reasoning underpins the Court’s conclusions in *Lend Lease*. That case concerned the redevelopment of the Docklands area in Melbourne by Lend Lease. The land was owned by VicUrban. The redevelopment was to occur in stages under the auspices of a development agreement. Clause 4.7 of the development agreement obliged Lend Lease to pay VicUrban sums of money at different stages of the redevelopment. The payments listed in cl 4.7 included payments made under ancillary agreements for the sale of land. But cl 4.7 included other payments which Lend Lease would make to VicUrban and these payments both antedated and post-dated the contracts for the sale of the land. For example, Lend Lease was to pay VicUrban sums of money in respect of costs incurred by VicUrban in remediating a gasworks site and developing certain infrastructure.

32 Citing *Dick Smith*, the Court reasoned that the consideration which moved the transfers to Lend Lease of each of the various parcels of land was the performance by Lend Lease of the several promises recorded in the development agreement in consequence of which VicUrban would receive the total of the several amounts set out in cl 4.7. Thus, as the Court observed at 159-160 [50], it ‘was only in return for the promised payment of that total sum, by the various steps recorded in the applicable agreement, that VicUrban was willing to transfer to Lend Lease the Land comprised in the relevant Stage’. For that reason, the consideration for the transfers of the land was not just the amounts which were specified as the sale prices of the parcels of land but instead the whole of the amounts which Lend Lease was bound to pay VicUrban under the development agreement.

33 In neither *Dick Smith* nor *Lend Lease* was *Davis* overruled. The challenge for an intermediate court of appeal is therefore to identify what *Dick Smith* and *Lend Lease* hold in light of the fact that this Court remains 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. We conclude that *Dick Smith* and *Lend Lease* apply when:

- (a) the parties to an agreement have agreed that an item of property or the conferral of a right is in return for a nominated price;
- (b) the agreement provides for the transfer of other items of property or the performance of other obligations for value;

- (c) on its proper construction the agreement shows that the transfer of the property in (a) can only be in return for all of the value in (a) and (b).

34 Thus in *Dick Smith* the Court said this (at 519 [75]):

The consideration which moved the transfer by the Vendors to the Purchaser of the Shares which they owned in the Company was the performance by the Purchaser of the several promises recorded in the Agreement in consequence of which the Vendors received the sum of \$114,139,649. It was only in return for that total sum (paid by the various steps and in the various forms required by the Agreement) that the Vendors were willing to transfer to the Purchaser the bundle of rights which their shareholding in the Company represented.

35 And in *Lend Lease* the pivotal conclusion was at 159-160 [50]:

In these cases, the consideration which moved the transfer by VicUrban to Lend Lease of each Stage was the performance, by Lend Lease, of the several promises recorded in the 2001 DA (or that agreement as later varied and supplemented), in consequence of which VicUrban would receive the total of the several amounts set out in the applicable agreement. It was only in return for the promised payment of that total sum, by the various steps recorded in the applicable agreement, that VicUrban was willing to transfer to Lend Lease the Land comprising the relevant Stage.

36 In this case, we do not think that the concentrate prices in the EBAs are of this kind. The price paid for concentrate was not part of what moved the right of the Bottler 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 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 the Bottler 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.

37 In that circumstance, the outcome is governed by *Davis*, and *Dick Smith* and *Lend Lease* are not apposite. It follows that the consideration for the purchase of the concentrate was the price the parties stipulated for it in the EBAs. As such, the payments made by the Bottler to the Seller did not include an element which was a royalty for the use of the trade marks (since the payments were not in consideration for the right to use the trade marks).

38 In the case of the SVC EBA this conclusion is underscored by the fact that it provided that the licence was to be royalty free (cl 4.1). This confirms the conclusion we have reached but is not necessary for that conclusion.

Were the payments income derived by PepsiCo/SVC?

39 That conclusion renders it strictly unnecessary to consider whether the amounts received by the Seller from the Bottler could be income which was derived by PepsiCo/SVC. On appeal the Commissioner was clear that he did not contend that the Seller was the agent for PepsiCo/SVC and he eschewed any suggestion that the moneys received by the Seller from the Bottler were held on trust by it for PepsiCo/SVC. His case was instead that the moneys had been paid to PepsiCo/SVC because there had been a payment by direction.

40 We do not accept this submission. It is well established that a direction by a creditor to a debtor to pay a third party constitutes a payment to the creditor. The authorities are, with respect, usefully collected by Jackman J (with whom Derrington and Abraham JJ agreed) in *Roufeil as Trustee for the Bankrupt Estate of Tarrant v Tarrant Enterprises Pty Ltd as Trustee for the MRT Family Trust* [2023] FCAFC 142; 299 FCR 204 at 212-214 [27]-[35]. Nevertheless, it is also recognised that there can be no payment by direction unless there is an antecedent monetary obligation owed by the Bottler to PepsiCo/SVC: *ABB Australia Pty Ltd v Federal Commissioner of Taxation* [2007] FCA 1063; 162 FCR 189 at 226 [166] per Lindgren J; Goode RM, *Payment Obligations in Commercial and Financial Transactions* (Sweet & Maxwell, 1983) at p 11.

41 The Commissioner submits that this monetary obligation arose from the EBAs. We do not see how this can be correct. The EBAs contemplated either a sale by PepsiCo/SVC or their nominee. Where a related entity was nominated as the seller the EBAs were clear that it was that related entity and not PepsiCo/SVC that would be selling the concentrate. It is true that PepsiCo/SVC remained contractually bound to the Bottler to ensure that the related entity did, in fact, sell the concentrate. It is also true that they assumed a contractual responsibility to the Bottler to ensure that that which the Seller delivered was in accordance with what would have been PepsiCo/SVC's obligations had they been the seller (PepsiCo EBA cl 22(b) / SVC EBA cll 7.1(c) and 7.3(d)). Thus, if the concentrate delivered was not of merchantable quality then the Bottler could sue PepsiCo/SVC directly. However, these matters cannot have the effect of making PepsiCo/SVC the vendor of the concentrate when the parties were explicit that the vendor was to be the nominated related entity.

- 42 During argument, the Commissioner accepted that there had been a sale of the concentrate by the Seller to the Bottler. He nevertheless maintained that there was a sale by PepsiCo/SVC. But PepsiCo/SVC had neither possession of nor title to the concentrate and they did not deliver the concentrate either actually or constructively.
- 43 The only way that PepsiCo/SVC could have sold the concentrate to the Bottler was if they had by some means become a party to the sale by the Seller to the Bottler. But, as we have noted, the Commissioner eschewed a case that the Seller was PepsiCo/SVC's agent for the purpose of the sale. As such, we do not accept that there can have been a sale by PepsiCo/SVC. And, if there was no sale of concentrate by PepsiCo/SVC it cannot be the case that the Bottler was ever obliged to pay them for something they were not selling. It follows that the EBAs did not give rise to any monetary obligation on the part of the Bottler to PepsiCo/SVC to pay them for the sale of concentrate by the Seller.
- 44 Since there was no antecedent monetary obligation, it is not possible that by paying the Seller the Bottler was paying PepsiCo/SVC. It is not necessary to determine in that circumstance whether the nominated direction to pay was in fact an effective direction to pay. Here the Commissioner submitted that the direction to pay from PepsiCo/SVC was constituted by the formal notices given to the Bottler in December 2015 that henceforth the seller of the concentrate would be the Seller and the subsequent provision by PepsiCo/SVC of the Seller's bank account details. It is not necessary to determine whether such notices could be directions to pay. However, on their face these notices do not appear to be directions to pay but rather directions under the EBA to buy concentrate from another entity.
- 45 In any event, the payments made by the Bottler to the Seller were not income derived by PepsiCo/SVC. The payments did not 'come home' to PepsiCo/SVC in the sense described by Dixon J in *Commissioner of Taxes (SA) v The Executor Trustee and Agency Company of South Australia Limited* (1938) 63 CLR 108 at 155 and by the Court in *Arthur Murray (NSW) Pty Ltd v Federal Commissioner of Taxation* (1965) 114 CLR 314 at 318. It is not necessary to determine what the answer to this question would have been if we had concluded that the payments made by the Bottler did, in fact, include a royalty for the use of the trade marks and other intellectual property. It is possible, although we draw no firm conclusions, that the royalty component of the payments might have been seen as belonging to PepsiCo/SVC. In that case, the receipt by the Seller of the royalty component might have given rise to some species of agency or trust as between PepsiCo/SVC and the Seller. It is not necessary to pursue this further, however, since the Commissioner did not advance his case on such a basis.

Conclusions on royalty withholding tax

46 The payments made by the Bottler to the Seller did not include any element for the licence to use the trade marks or other intellectual property and hence were not royalties within the meaning of s 6(1) of the ITAA 1936. They were also not income derived by PepsiCo/SVC for the purposes of s 128B(2B). PepsiCo/SVC are not liable to pay royalty withholding tax on the payments made by the Bottler to the Seller.

PART IVA

Introductory remarks

47 The trial judge concluded that royalty withholding tax was exigible because the EBAs provided for the payment of a royalty for the use of the trade marks and other intellectual property. The Commissioner's alternative case under Part IVA was that PepsiCo/SVC had entered into schemes which provided for the sale of concentrate but without the charging of any royalty for the right to use the intellectual property. On the trial judge's findings those schemes were not made out on the facts since the payments for concentrate had in fact been payments for both concentrate and the right to use the intellectual property. Consequently, he dismissed the Commissioner's alternative case under Part IVA. In light of our conclusion that the payments did not include a royalty component his Honour's conclusion that Part IVA could not apply was in error.

48 His Honour gave extensive reasons, in the alternative, for his conclusion that if the payments did not include a royalty component then Part IVA would have applied. These reasons, however, are not his Honour's dispositive reasons for dismissing the Part IVA case. Demonstration of error in his Honour's alternative reasons is not material to the orders his Honour in fact made. They are therefore not directly relevant to the exercise of this Court's appellate jurisdiction although, as will be seen, they do have an indirect relevance. In any event, it falls to this Court to determine for itself whether Part IVA applies to the schemes alleged by the Commissioner.

49 We should nevertheless record that we consider that his Honour's treatment of the case under Part IVA was heavily and perhaps understandably influenced by the factual findings he made in the royalty withholding tax case about the quantum of the royalties which had been paid (an issue of quantification his Honour was obliged to confront once he had concluded that the payments did in fact include such a royalty). There was valuation evidence before his Honour from Mr Malackowski (for the Commissioner) and Ms Wright (for PepsiCo). The trial judge felt that Mr Malackowski had 'considerably more experience' in valuing intellectual property

rights than Ms Wright did: TJ [272]. His Honour ultimately accepted Mr Malackowski's evidence that the appropriate royalty was 5.88% subject to a small downward adjustment: TJ [404]. However, both Mr Malackowski's and Ms Wright's opinions were expressly premised on an assumption that the concentrate price did include a royalty. The trial judge recorded the fact of this assumption at TJ [268].

50 As will be seen, the Commissioner's scheme case likewise assumed that the concentrate price included a royalty component. This was the same assumption that Mr Malackowski and Ms Wright had been asked to and did make. As we will explain, the difficulty which arises is that there was no evidence before the Court that this assumption was correct. Put another way, Mr Malackowski's valuation evidence determined what the value of the licence granted under the EBAs was but there was no corresponding evidence which showed that that value was being recovered through the concentrate price. Evidence of that kind would have required a detailed analysis of the economics of the EBAs and its relationship with the concentrate price. The Commissioner's scheme case lacked evidence of this kind.

51 Whilst this is by no means the same kind of issue which would arise in a transfer pricing case under Division 815 of the *Income Tax Assessment Act 1997* (Cth) (if only because PepsiCo and the Bottler were plainly operating at arm's length), the inquiry is similar to the extent that it involves a determination that a price charged for one thing in substance includes an economic transfer of value for something else. Such transactions may be varied. They include a transfer within a multinational group of losses from a higher taxation jurisdiction to a lower taxation jurisdiction by means of the pricing of intra-group product sales (*Commissioner of Taxation v SNF (Australia) Pty Ltd* [2011] FCAFC 74; 193 FCR 149) or equivalently the cost of intra-group financing arrangements: *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCAFC 62; 251 FCR 40. In this case, the Commissioner's scheme case begs the question of why the concentrate price should be understood as including a royalty. Establishing that the licence of the intellectual property was valuable is only half of the necessary inquiry. The missing other half involves the concentrate price and all of the other burdens and benefits flowing from the EBAs.

The schemes

52 The schemes for PepsiCo and SVC are relevantly identical and attention may be confined to the scheme alleged in the case of PepsiCo. Unless necessary, this section of the reasons will eschew further reference to SVC. The schemes relied on by the Commissioner are identified in his amended appeal statements in the diverted profits tax proceedings. The PepsiCo scheme

is set out at [67.1] of the amended appeal statement and was reproduced by the trial judge at TJ [32].

67. [The] Commissioner contends that PepsiCo entered into a scheme comprising some or all of the following (the Scheme):

67.1. effective from 3 April 2009, PepsiCo entered into the [PepsiCo] EBA with SAPL whereby:

- (a) SAPL was appointed as the sole and exclusive licensee to bottle, sell and distribute trademarked PepsiCo Group carbonated soft drink beverages. (The beverage brands the subject of the [PepsiCo] EBA, apart from the Seven Up brands, are referred to below as the Pepsi Beverages);
- (b) SAPL agreed to purchase concentrate for the manufacture of the Pepsi Beverages from PepsiCo or one of its appointed subsidiaries; and
- (c) SAPL obtained, under the [PepsiCo] EBA and/or the agreements referred to within it, including the Co-op A&M Agreements:
 - i. the use of, or rights to use, certain intellectual property owned by PepsiCo in the bottling, sale and distribution of the Pepsi Beverages;
 - ii. technical, industrial or commercial knowledge or information in relation to the Pepsi Beverages; and/or
 - iii. assistance ancillary to and furnished as a means of enabling the application or enjoyment of such intellectual property or knowledge or information.
- (d) no royalty was paid for the items set out at (c) above.

53 The term ‘scheme’ is defined in the ITAA 1936 but there is no dispute that the Commissioner’s scheme satisfies that definition. It will be noted that the scheme relied upon by the Commissioner does not in any way depend on the prices at which the concentrate was to be sold. An immediate problem flowing from that is that the scheme relied upon operates regardless of the concentrate price and, in particular, even where that price does *not* reflect the value which Mr Malackowski placed upon the intellectual property licence. As in a transfer pricing case, it is not possible to conduct the kind of inquiry implicit in the Commissioner’s scheme case without detailed analysis of the pricing under the EBA.

The issues

54 There are two statutory issues between the parties. The first concerns whether PepsiCo obtained a tax benefit in relation to that scheme. The second is whether it did so for a principal purpose that included a purpose of obtaining a tax benefit and of reducing its liability to tax under the law of the United States.

- 55 These questions arise in an elaborate statutory context. The central provision is s 177J of the ITAA 1936. It is one of the anti-avoidance provisions contained in Part IVA. It deals with, but does not impose, a ‘diverted profits’ tax. We will return to the text of s 177J but, for present purposes, it is to be noted that the opening words of s 177J(1) are ‘This Part also applies to a scheme...if...’ which are then followed by various provisions which are conditions precedent to the satisfaction of that conditional statement. The word ‘also’ refers to the fact that other provisions in Part IVA, not presently germane, may also lead to the conclusion that Part IVA applies to a scheme (e.g. ss 177D-177F). The end point of a successful invocation by the Commissioner of s 177J(1) is a conclusion that Part IVA applies to a scheme.
- 56 The legal relevance of a conclusion that Part IVA applies to the scheme emerges from ss 177N(a) and 177P(1)(a). Relevantly they provide:

177N Diverted profits tax – consequences

If this Part applies to a scheme because of section 177J:

- (a) section 177P applies to the relevant taxpayer mentioned in section 177J;

...

177P Diverted profits tax – liability

- (1) The relevant taxpayer is liable to pay tax at the rate declared by the Parliament on:

- (a) if this Part applies to a scheme in respect of the relevant taxpayer for the year of income mentioned in paragraph 177J(1)(a), in relation to one DPT tax benefit—the DPT base amount for that DPT tax benefit;

...

Note: The tax is imposed by the *Diverted Profits Tax Act 2017* and the rate of the tax is set out in that Act.

- (2) The DPT base amount for a DPT tax benefit is:

- (a) if the DPT tax benefit is a tax benefit mentioned in paragraph 177C(1)(a), (b), (ba) or (bc)—the amount of the DPT tax benefit

- 57 As will be seen, the tax benefit involved in this case is the tax benefit mentioned in s 177C(1)(bc). Thus the effect of s 177P(2)(a) is to make the DPT base amount the tax benefit mentioned in s 177C(1)(bc). As the note suggests, the rate of the tax is set by the *Diverted Profits Tax Act 2017* (Cth) at 40%. Thus if s 177J(1) results in the conclusion that Part IVA applies, tax will be applied at that rate to the amount of the tax benefit identified in s 177C(1)(bc). Section 177C(1) is a definition provision which defines the concept of ‘the obtaining by a taxpayer of a tax benefit in relation to a scheme’ across a multitude of circumstances including those dealing with withholding taxes such as the royalty withholding

tax imposed by s 128B(2B). Where the tax involved is a withholding tax, the relevant definition is supplied by the provision to which reference has been made above, s 177C(1)(bc). Relevantly s 177C(1)(bc) provides:

- (1) Subject to this section, a reference in this Part to the obtaining by a taxpayer of a tax benefit in connection with a scheme shall be read as a reference to:

...

- (bc) 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

58 There are two limbs to this definition turning respectively on what (but for the scheme) would have happened or what (but for the scheme) might reasonably be expected to have happened. On appeal, the Commissioner sought to rely on the second limb only so that the inquiry in this Court is not into what would have happened but for the scheme but rather what might reasonably be expected to have happened but for the scheme. The trial judge in his alternative reasons in relation to Part IVA explained why the first ‘would’ limb could not apply and both parties to the appeal proceeded on the basis that his Honour’s conclusion about this was correct. The appeal is to be approached therefore on the basis that it is the second limb which is to be applied. The dichotomy inherent in the two limbs of s 177C(1)(bc) persists in subsequent provisions reflecting their different inquiries. We will only deal with those provisions insofar as they relate to the second limb given the way the parties have approached the appeal.

59 Returning then to s 177C(1), the provision next goes on to specify the amount of that tax benefit in s 177C(1)(g):

- (1) and, for the purposes of this Part, the amount of the tax benefit shall be taken to be:

...

- (g) in a case to which paragraph (bc) applies—the amount referred to in that paragraph

60 As a definition provision, s 177C(1)(bc) contains no statement of any legal rule. However, as we have pointed out, s 177P(1)(a) imposes the diverted profits tax at 40% on the amount of the tax benefit mentioned in s 177C(1)(bc) which by s 177C(1)(g) is the amount referred to in s 177C(1)(bc). There is only one amount referred to in s 177C(1)(bc) and, on the way the Commissioner puts his case, it is the amount upon which the taxpayer might reasonably be supposed to have been liable to pay royalty withholding tax but for the scheme. 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. Referring to this as a tax benefit is conceptually confusing but, as will be seen, the provisions operate harmoniously, if somewhat counterintuitively, to ensure an outcome which is rational, if perhaps poorly expressed.

61 At this point it is useful to set out s 177J(1)(a), the first of the contested subsections of s 177J(1):

- (1) 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

62 As already noted, the tax benefit is not the amount of royalty withholding tax to which PepsiCo did not become liable but rather the amount of the royalty which it did not receive. If that concept alone were reintroduced directly back into the question posed by s 177J(1)(a) then the provision appears not to operate since, by definition, PepsiCo did not obtain the royalty and hence did not obtain that tax benefit. However, the concept used by s 177J(1)(a) is not the idea of a tax benefit in isolation, but rather the concept defined in s 177C(1)(bc); namely, the obtaining of a tax benefit in connection with a scheme. As will be recalled from the discussion above, that definition makes clear that PepsiCo will be taken to have obtained a tax benefit in connection with the scheme if it was not liable to pay royalty withholding tax where, but for the scheme, it might reasonably be expected to have been liable to pay that tax. This is the more appropriate definition to apply in s 177J(1)(a) since the application of the other renders the provision pointless. Neither party suggested to the contrary.

63 Thus the first question posed in s 177J(1)(a) will be answered in the affirmative if the definition in s 177C(1)(bc) is satisfied. On the way the Commissioner puts the case, that question is to be answered in the manner dictated by ss 177CB(1)(e), (3), (4) and (5). They provide:

- (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;
 - ...
- (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 177DA or 177J; or
 - (b) for the purposes of determining whether this Part applies to the scheme because of section 177DA or 177J.

64 The definition in s 177C(1)(bc) will be satisfied only if there is a postulate that is a reasonable alternative to the scheme. If there is no such postulate then a decision may not be made that the tax effect might reasonably be expected to have occurred in the absence of the scheme (recalling that the tax effect in this case is, by s 177CB(1)(e), the liability of PepsiCo to pay royalty withholding tax in the absence of the scheme). In determining the answer to that question the Court is to disregard any taxation consequences under the ITAA 1936 and any taxation consequences arising under foreign law: ss 177CB(4) and (5).

65 In determining whether the postulate is reasonable the Court is to have ‘particular regard’ to the matters in s 177CB(4)(a). Two implications flow from this. First, it is an indication of statutory intent in relation to weight; that is to say, the considerations are not merely relevant but particularly so. Secondly, the fact that the considerations in s 177CB(4)(a) are particularly relevant implicitly demonstrates that the matters which can be taken into account are not limited by s 177CB(4) although tax consequences are excluded by ss 177CB(4)(b) and (5).

66 The Commissioner puts forward two postulates which he says satisfy s 177CB(3). The trial judge set these out at TJ [430]:

- (a) the relevant EBA would or 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 would or 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 trademarks and other intellectual property (whether or not the amount of the royalty was specified).

- 67 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: s 14ZZO(b)(i) of the *Taxation Administration Act 1953* (Cth). Proving that the Commissioner's postulates are unreasonable does not in itself discharge that burden. It remains the burden of the taxpayer to show on all of the evidence that the tax benefit would not reasonably be expected to have been obtained if the schemes had not been entered into: *Commissioner of Taxation v Guardian AIT Pty Ltd ATF Australian Investment Trust* [2023] FCAFC 3; 115 ATR 316 ('*Guardian AIT*') at 351 [156]-[157] per Hespe J (Perry and Derrington JJ agreeing at [1] and [2]); *RCI Pty Ltd v Commissioner of Taxation* [2011] FCAFC 104; 84 ATR 785 at 842-843 [128]-[131] per Edmonds, Gilmour and Logan JJ.
- 68 What this means in practice in a proceeding such as the present is that PepsiCo must show that there is no reasonable postulate for the purposes of s 177CB(3). Naturally this will include demonstrating that the Commissioner's postulates are not reasonable but PepsiCo must also demonstrate on the evidence that there is no other reasonable postulate.
- 69 As to the Commissioner's two postulates, the first was that the EBAs might reasonably be expected to have expressed the payments made by the Bottler to be for all of the property provided by (and promises made by) the PepsiCo group entities (rather than for the concentrate alone). The second was that the EBAs might reasonably be expected to have expressly provided that the payments made by the Bottler to the Seller would include a royalty for the use of the trade marks and other intellectual property.
- 70 Notable features of these postulates include the fact that they eschew 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 the intellectual property licence. That may perhaps reflect the fact that there was no evidence before the trial judge from which such a conclusion could have been drawn.
- 71 To determine whether either of these postulates is reasonable, one must begin therefore with the particularly relevant matters in s 177CB(4)(a). The first of these is the substance of the scheme. Here PepsiCo submitted that the postulates represented a departure from the scheme

(s 177CB(4)(a)(i)) and do not achieve the same commercial results or consequences as the schemes: s 177CB(4)(a)(ii).

The substance of the scheme: s 177CB(4)(a)(i)

- 72 It is not immediately obvious from the language of s 177CB(4)(a)(i) what the substance of a scheme might be. It could mean the legal substance of a scheme but it could equally mean its commercial and economic substance. In that sense the word ‘substance’ is ‘ambiguous’ within the meaning of s 15AB(1)(b)(i) of the *Acts Interpretation Act 1901* (Cth). Consequently, resort to material not forming part of the ITAA 1936 is authorised by that provision. The permissible materials include, by s 15AB(2)(e), any explanatory memorandum that was laid before or furnished to the members of either House by a Minister when the provision was enacted. Section 177CB(4) was inserted into the ITAA 1936 by the *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act 2013* (Cth).
- 73 The *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013* (Cth) was introduced into Parliament by the then Treasurer who circulated an explanatory memorandum to its members. That memorandum observed at [1.103] that the reference to the substance of the scheme ‘requires a consideration of its commercial and economic substance as distinct from its legal shape or form’. In that regard, the diverted profits tax provisions were evidently intended to continue the approach taken to questions of substance in the context of other similar scheme provisions in Part IVA: see e.g. *Commissioner of Taxation v Sleight* [2004] FCAFC 94; 136 FCR 211 at 233 [81] per Hill J and *Commissioner of Taxation v Hart* [2004] HCA 26; 217 CLR 216 (‘*Hart*’) at 245 [71] per Gummow and Hayne JJ. The substance of the scheme emerges therefore from a consideration of its commercial and economic substance.
- 74 Apart from having particular regard to it, s 177CB(4)(a)(i) provides little guidance on what the Court is to do with the substance of the scheme once identified. However, the explanatory memorandum goes on to observe at [1.106] that for a postulate to constitute a reasonable alternative it ‘should correspond to the substance of the scheme’.
- 75 In this case, the Court must therefore assess the commercial and economic substance of the scheme and the commercial and economic substance of each postulate and reach a conclusion as to whether they correspond. It is necessary therefore to assess the commercial and economic substance of the scheme, on the one hand, and that of the first and the second postulates, on the other.

The commercial and economic substance of the scheme

76 PepsiCo submitted that the commercial and economic substance of the EBAs was that the price paid by the Bottler was for the concentrate. As it was put in argument, the price was not bifurcated and any such bifurcation would require a valuation of the relevant items. The Commissioner contended that the commercial and economic substance of the scheme was that the amount of money paid by the Bottler was for the concentrate and for the licence granted to the Bottler to use the trade marks and other intellectual property; that is to say, the commercial and economic substance of the scheme was that the payments for concentrate included a royalty for the use of the trade marks and other intellectual property.

77 There is nothing in the terms of the scheme from which this may be inferred and there is no evidence which could support the Commissioner's submission.

78 As to the scheme, it is useful to recall its relevant components. Paragraph 67.1(a) of the Commissioner's amended appeal statement states that the Bottler was appointed as the 'sole and exclusive licensee to bottle, sell and distribute trademarked PepsiCo Group carbonated soft drinks'. Paragraph 67.1(c) states that the Bottler obtained, inter alia, the right to use the intellectual property owned by PepsiCo in the bottling, sale and distribution of PepsiCo beverages. Paragraph 67.1(d) states that no royalty was paid for the grant of those rights.

79 The scheme does not include any 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 value.

80 As to the evidence, both Mr Malackowski and Ms Wright proceeded on an assumption that the concentrate price included a royalty. Their evidence did not, however, establish the correctness of that assumption. Whilst Mr Malackowski placed a value on the licence there was nothing in the evidence which could sustain a conclusion that the price charged for the concentrate included that value and, indeed, neither expert was invited to consider that question. To reach the conclusion that the concentrate price included a royalty it would be necessary to analyse the economics of the EBA, including the cost to PepsiCo of manufacturing the concentrate and the other benefits and burdens flowing to it under the EBA, and to have shown in light of those matters that the price paid by the Bottler necessarily included the value of the licence. Such an exercise was not undertaken. There was therefore no evidence which would have sustained a scheme including elements (a) and (b).

81 Consequently, neither the scheme advanced by the Commissioner nor any of the evidence provides material from which it may be inferred that the commercial and economic substance of the scheme was that the concentrate price included a royalty for the licence of the intellectual property.

82 In that circumstance, there is no basis upon which we could conclude that the price for concentrate in the scheme included a royalty component. The commercial and economic substance of the scheme was that the price agreed for concentrate was for concentrate.

83 We do not say that a case could not be imagined in which a concentrate price did, as a matter of commercial and economic substance, include a royalty. However, we do not see how this can be done without engaging in an analysis of the economics of the EBA. These economic questions are likely to be influenced not only by the value of the intellectual property involved but also by the other benefits and burdens flowing from the relevant EBA. As we have explained when dealing with the royalty withholding tax issue, it is not the case that PepsiCo derived no benefit from the grant of the licence to use the intellectual property. The determination of the extent of benefits of that kind is likely to involve at least an examination of the extent of the goodwill attaching to the relevant marks and PepsiCo's market share in Australia in relation to the brands in question. Given the complexity of the bargain expressed in the EBA, there may well be many other relevant considerations.

The commercial and economic substance of the first postulate

84 Under the first postulate the relevant EBA is expressed so that the payments by the Bottler are for all of the property provided by (and promises made by) the PepsiCo group entities. It may be assumed in favour of the Commissioner that the grant of the licence to use the trade marks and other intellectual property was either property or a promise (although this may perhaps be doubted as a matter of intellectual property law since the licence operates as an authorisation for the purposes of the *Trade Marks Act 1995* (Cth) so as to provide a defence to an action for infringement: see ss 8, 20 and 122(1)(e)).

85 The commercial and economic substance of the first postulate is that payment made by the Bottler for the concentrate would also be for the use of the trade marks and other intellectual property together with all of the other property and promises conferred on the Bottler under the EBAs.

86 Consequently, the commercial and economic substance of the scheme and the first postulate are quite different and do not correspond.

The commercial and economic substance of the second postulate

87 The second postulate differs from the first in that it provides that the payments by the Bottler include a royalty for the use of the trade marks. The second postulate does not require that the amount of the royalty be specified. The commercial and economic substance of the second postulate is that the payments made by the Bottler would be for concentrate and the rights to use the trade marks and other intellectual property. Again, this does not correspond to the commercial and economic substance of the scheme.

Any result or consequence for PepsiCo that is or would be achieved by the scheme (other than as a result of the ITAA 1936 or the operation of foreign law): ss 177CB(4)(a)(ii) and (5)

88 The difference between a result and a consequence is not self-evident. The 2013 explanatory memorandum does not contain any material throwing light on the difference. It ought not lightly be concluded that these two words are synonyms (*Project Blue Sky Inc v Australian Broadcasting Authority* [1998] HCA 28; 194 CLR 355 at 382 [71] per McHugh, Gummow, Kirby and Hayne JJ) as one should assume that Parliament intended from its use of different words that there was some difference. No occasion arises in this appeal, however, to consider what that difference might be.

89 As a matter of ordinary language ‘result or consequence’ would include all financial and non-financial results or consequences. This understanding of the meaning of ‘result and consequence’ in s 177CB(4)(a)(ii) means that the Court should consider any consequence or result for the taxpayer (apart from tax consequences or results). Again, it is necessary to consider the scheme and the two postulates separately.

The scheme

90 The result for PepsiCo of the scheme is that the Bottler pays an amount of money for concentrate. The scheme does not identify any particular price.

The first postulate

91 The result for PepsiCo of the first postulate is that the Bottler pays an amount of money but this time for concentrate and all of the other property and promises under the EBAs. Again, the postulate does not fix on any price but it may be assumed, as it was by the trial judge, that the price under the postulate is the same as the price under the scheme. Making that assumption, the amount of money received by PepsiCo under the first postulate is the same amount of money as it received under the scheme.

The second postulate

- 92 Making the same assumption, the result for PepsiCo of the second postulate is that the Bottler pays the same amount but this time for the concentrate and as a royalty for the right to use the intellectual property.

Whether first or second postulate are reasonable alternatives to the scheme

- 93 The fact that the substance of the scheme and the postulates do not correspond is indicative that the postulates are not reasonable alternatives to the scheme. On the other hand, the fact that the results and consequences for PepsiCo under the scheme and the postulates are the same tends to a conclusion that the postulates are reasonable alternatives.

- 94 The question posed by s 177CB(3) requires the Court to assess whether entry into either of the postulates is a reasonable alternative to entering into and giving effect to the scheme. It is not clear from s 177CB(3) how the reasonableness of the postulate as an alternative is to be gauged. The 2013 explanatory memorandum at [1.86]-[1.87] throws some light on this issue:

The amendment 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.

- 95 This clarifies that the inquiry is into what might reasonably be expected to have occurred in the absence of the scheme. Thus a postulate will be a reasonable alternative to the scheme if it may reasonably be expected that, but for the scheme, the taxpayer would have entered into or carried out the postulate. This is an exercise in prediction. This case is concerned with the concept of obtaining a tax benefit in connection with a scheme under s 177C(1)(bc) but the more general operation of that concept appears from s 177C(1)(a) which provides that a reference to the obtaining of a tax benefit in connection with a scheme shall be read as a reference to:

an amount not being included in the assessable income of the taxpayer of a year of income where that amount would have been included, or might reasonably be expected to have been included, in the assessable income of the taxpayer of that year of income if the scheme had not been entered into or carried out

- 96 It will be observed that this provision also calls for an assessment of what might reasonably be expected to have occurred in the absence of a scheme and uses the same language of ‘might

reasonably be expected' as s 177CB(3). Of that concept the High Court observed in *Commissioner of Taxation v Peabody* (1994) 181 CLR 359 ('*Peabody*') at 385:

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 [citing *Dunn v Shapowloff* (1978) 2 NSWLR 235 at 249 per Mahoney JA].

- 97 This is the approach which ought to be taken to s 177CB(3). In effect, the role of the postulate under s 177CB(3) is similar in kind to the prediction referred to in *Peabody*. In assessing the reasonableness of the postulate one must therefore ask whether it is reasonable to think that, but for the scheme, the taxpayer would have entered upon and carried into effect the postulate.
- 98 The same difficulty which afflicts the Commissioner's assessment of the commercial and economic substance of the schemes at this point resurfaces. If the scheme included elements from which it could be inferred as a matter of commercial and economic substance that the payments for concentrate included a royalty then it might well be obvious that in the absence of the scheme PepsiCo would have sought to recoup the value of that royalty. This would entail either that the price for concentrate was expressed to be for the licence as well (the first postulate) or by the specification of a separate royalty whether quantified or not (the second postulate).
- 99 However, where the scheme does not permit the conclusion to be drawn that the concentrate price included a royalty, this conclusion is not reasonably open. We therefore conclude that neither postulate is a reasonable alternative to the scheme for the purposes of s 177CB(3). It is not necessary in that circumstance to deal with PepsiCo's submission that separating out the licence fee would have complicated the negotiations between it and the Bottler.

Other postulates

- 100 As we have explained, since PepsiCo remains bound to prove that the assessments to diverted profits tax are excessive, it bears the burden not only of showing, as it has, that the Commissioner's postulates are not reasonable alternatives but also that there are no reasonable alternative postulates. The only postulates which can bring the payments to tax are ones in which the Bottler's payments for concentrate can be seen as being made in part for the grant of the rights in [67.1(c)] of the Commissioner's amended appeal statement. For the reasons we have given, no such postulate can be a reasonable alternative given the terms of the scheme and the state of the evidence. It follows that there are no other reasonable postulates in addition

to those put forward by the Commissioner and PepsiCo therefore discharges its burden under s 14ZZO(b)(i) of the *Taxation Administration Act 1953* (Cth).

Conclusions on tax benefit

101 Having regard to the matters in ss 177CB(4) and (5), it follows for the purposes of s 177CB(3) that ‘a decision that a tax effect might reasonably be expected to have occurred if the scheme had not been entered into’ cannot be made since there is no postulate which is a reasonable alternative to the scheme. There is therefore no ‘tax effect’ for the purposes of s 177CB(1)(e) and hence for the purposes of s 177C(1)(bc) it is not the case that, if the scheme had not been entered into or carried out, the taxpayer might reasonably be expected to have been liable to pay royalty withholding tax on the amounts paid by the Bottler for concentrate. It follows that the definition wrought by the opening words of s 177C(1) (defining when a taxpayer obtains a benefit in connection with a scheme) is not satisfied and PepsiCo is not taken to have obtained a tax benefit in connection with a scheme. Returning, at length, to the primary taxing provision – s 177J(1) – it follows that PepsiCo did not obtain a tax benefit (and hence the DPT tax benefit) ‘in connection with a scheme’ for the purposes of s 177J(1)(a). On the evidence before the Court and the terms of the scheme advanced by the Commissioner, PepsiCo therefore demonstrates that the payments for concentrate are not to be brought to tax under ss 177P(1) and (2)(a).

102 This makes irrelevant the question of whether PepsiCo, in entering into and carrying out the scheme, had ‘a principal purpose’ of enabling itself to obtain a tax benefit and of reducing its liability to tax under a foreign law for the purposes of s 177J(1)(b). It is nevertheless useful to consider that question.

Purpose

103 Section 177J(1)(b) is as follows:

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

...

(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

- (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

104 In his alternative reasons, the trial judge considered the secondary materials which accompanied the introduction of s 177J into the ITAA 1936 by the *Treasury Laws Amendment (Combating Multinational Tax Avoidance) Act 2017* (Cth). He concluded that a principal purpose was a purpose which was prominent, leading or main and that there could be more than one such purpose: TJ [447]. Neither party took issue with this approach with which we too agree.

105 The Court is required to approach the question posed by s 177J(1)(b) on the basis specified in s 177J(2):

(2) 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).

106 Section 177D is the general scheme provision and contains a list of eight matters to be taken into account in assessing whether a scheme of that kind was entered into for the purpose of obtaining a tax benefit. The effect of s 177J(2)(a) is to pick up and make those general considerations applicable to schemes relating to diverted profits tax and to add to them the three additional matters in ss 177J(2)(b)-(d).

107 It is necessary at this point to note that the purpose referred to in s 177J(1)(b) is an objectively determined construct. The actual purposes of PepsiCo are not relevant to the exercise. The objective nature of the inquiry emerges from the language of s 177J(1)(b): ‘it would be concluded (having regard to the matters in subsection (2)) that the person...who entered into or carried out the scheme...did so for a principal purpose...’. It is underscored by the objective nature of the eleven matters which are to be considered in reaching a conclusion on the question of purpose. Thus, the actual subjective intentions of the taxpayer are not under examination. This approach to purpose under s 177D(2) is well established: *Minerva Financial Group Pty*

Ltd v Commissioner of Taxation [2024] FCAFC 28 (*Minerva*) at [60(11)] per Besanko, Colvin and Hespe JJ citing *Hart* at 243 [65] per Gummow and Hayne JJ ('it does not require, or even permit, any inquiry into the subjective motives of the relevant taxpayers').

108 Although s 177D(2) does not in terms say that the Court is to have regard to any postulate which is a reasonable alternative to the scheme it is nevertheless also established that 'to draw a conclusion about purpose from the eight matters identified in s 177D(b) will require a consideration of what other possibilities existed' (noting that the former s 177D(b) is now 177D(1)(b)): *Hart* at 243-244 [66]; *Minerva* at [60(12)]. Since we have concluded that there is no postulate which is a reasonable alternative to the scheme, such an analysis cannot readily be undertaken on our dispositive conclusions.

109 For the purposes of this discussion, it is necessary therefore to assume that our conclusion that there are no postulates that are reasonable alternatives to the scheme is incorrect. To do that it becomes necessary to assume that there was evidence that as a matter of commercial and economic substance the payments made by the Bottler included a royalty for the use of the trade marks and other intellectual property. It is also necessary to assume that the Commissioner's scheme incorporates that analysis in its terms.

110 As it happens, this was the basis upon which the trial judge approached the matter for his Honour found that the substance of the scheme was that the price of the concentrate included an element for the use of the trade marks and other intellectual property. Since this part of his Honour's reasons is not dispositive and because the assumptions which are necessary in order to permit the issue to be examined are somewhat artificial, we do not think that the question of purpose warrants overly close attention. However, having made the necessary assumptions we would be disposed to reach the same conclusion his Honour reached in his alternative reasons; namely, that the answer to the question posed by s 177J(1)(b)(i) was yes and that it was to be concluded that PepsiCo had the purpose of obtaining a tax benefit and also of obtaining a reduction in its liability to US tax.

111 If one takes as a starting point that the price of the concentrate did, as a matter of commercial and economic substance, include a royalty payment then many of the trial judge's conclusions are unremarkable and we would agree with them. His Honour thought that four of the eleven considerations favoured the Commissioner and in one case did so strongly.

The four matters favouring the Commissioner: ss 177D(2)(b), 177D(2)(e), 177J(2)(c) and 177J(2)(d)

- 112 Largely, although not entirely, we respectfully agree with the trial judge's conclusions on these four matters. The most important of these is the comparison between the form and substance of the scheme and that of the postulates in accordance with s 177D(2)(b) (the comparison requirement flowing from *Hart* at 243-244 [66]). Here the scheme took the form of an agreement to sell concentrate in the future at pre-determined rates but its substance was, on the present hypothesis, that it included an element which was a royalty payment. By contrast both postulates recognise the payment of an actual royalty. As the trial judge correctly observed at TJ [453] this was a matter which, on that hypothesis, weighed heavily in favour of the Commissioner.
- 113 The second matter favouring the Commissioner was the matter in s 177D(2)(e) which was 'any change in the financial position of the relevant taxpayer that has resulted, or will result, or may reasonably be expected to result, from the scheme'. Here the trial judge thought that the scheme resulted in PepsiCo not receiving any income by way of royalty whereas under the postulates it would. Thus, PepsiCo would be liable to pay royalty withholding tax on that royalty income under the postulates but not under the scheme.
- 114 Under the present hypothesis, we agree with the trial judge that this is a matter which might well weigh in favour of the Commissioner. However, the extent of the royalty has never been assayed on the Commissioner's scheme or the evidence. In particular, in the absence of an economic analysis of the EBA it is impossible to assume that the hypothesised royalty was the amount determined by Mr Malackowski. The best that one can say is that the royalty could not be more than that amount. It is thus not possible to determine the change in PepsiCo's financial position because the amount of royalty withholding tax not paid remains unknown. This underscores the difficulties which the Commissioner's scheme presents. We are unable to assess this matter precisely but we are prepared to assume in favour of the Commissioner that as a result of the scheme PepsiCo did not become liable to pay an unidentifiable amount of royalty withholding tax. In that circumstance, we conclude that the matter favours the Commissioner although the extent to which it does so is unclear.
- 115 The third matter which the trial judge regarded as favouring the Commissioner was the consideration in s 177J(2)(c) which was 'the result, in relation to the operation of foreign law relating to taxation that (but for this Part) would be achieved by the scheme'. For reasons which are not in dispute before us the effect of the scheme, as opposed to the postulates, was to reduce PepsiCo's effective tax rate under US tax law from 13.125% to 10.5%. Again, without knowing

what the extent of the royalty was it is not possible to assess this matter with any precision. As with s 177D(2)(e) we conclude that the matter favours the Commissioner although to an unclear extent.

116 The fourth matter favouring the Commissioner was that in s 177J(2)(d); namely, the amount of the tax benefit referred to in s 177J(1)(b). As the trial judge correctly noted, this must be a reference to the amount of royalty not received rather than the amount of royalty withholding tax not paid on that non-received royalty. The trial judge thought that it was more relevant to have regard to the amount of the tax not paid than the amount of the royalty. To that extent, we respectfully differ from his Honour. Section 177D(2)(d) when read with s 177C(1)(g) makes the tax benefit the amount of the royalty. We do not think it appropriate to proceed on the basis that it says something else. Whilst it is perhaps a little unnatural to regard the non-receipt of the royalty as a tax benefit, this is what the provision requires.

117 The trial judge had assessed the amount of the royalty at \$48 million. However, that finding was based on the trial judge's conclusion that the royalty was 5.88% (with a minor downward adjustment). This evidence was based on Mr Malackowski's evidence which assumed that the concentrate price included a royalty. Whilst for the purposes of this branch of the reasons we assume that the concentrate price did include a royalty, there is no evidence which permits any assessment of its quantum. Thus, whilst we agree with the trial judge that this is a matter which favours the Commissioner, it is impossible to determine its extent. As such we would conclude that this is a matter which favours the Commissioner to an indeterminate degree.

The neutral matters

118 The trial judge regarded a number of matters as neutral; namely, those set out in ss 177D(2)(c), (d), (f)-(h) and 177J(2)(b). We agree with his Honour's analysis of those matters but we would make this remark in relation to s 177D(2)(d). That matter is 'the result in relation to the operation of the Act that, but for this Part, would be achieved by the scheme'. On the hypothesised postulates, it is apparent that but for the scheme PepsiCo would be liable to pay royalty withholding tax. As has often been pointed out, the mere fact that a taxpayer could have arranged their affairs in a way which would have resulted in their paying more tax, does not in itself bespeak the kind of purposes with which Part IVA is centrally concerned: see *Guardian AIT* at 359 [208] per Hespe JJ (with whom Perry and Derrington JJ agreed). Thus, by itself the current circumstance is a neutral matter. However, whilst neutral by itself it is to be taken into account in the overall assessment called for by (in this case) s 177J(1)(b)(i). The trial judge thought it was 'in itself' neutral which is consistent with this analysis.

119 We would respectfully differ from the conclusions of the trial judge on s 177D(2)(a). His Honour reasoned this way at TJ [452]:

Section 177D(2)(a) refers to “the manner in which the scheme was entered into or carried out”. There is no detailed evidence about the negotiation of the EBAs in 2009. The PepsiCo parties emphasise that the EBAs reflected the FOBO model, which had been in place since the early 1900s, and the standard pricing structure under that model, which had also been in place since the early 1900s (as evidenced by the Charlottesville EBA). The PepsiCo parties submit that these matters point strongly against PepsiCo/SVC having a principal purpose as described in s 177J(1)(b). I accept that these matters point, to some extent, against the presence of a principal purpose as described in s 177J(1)(b). However, in my opinion, they do not take matters very far. There is no detailed and comprehensive evidence as to why, as at 2009, the PepsiCo Group generally adopted that pricing structure in its exclusive bottling agreements (or, for that matter, why some others in the beverage industry also adopted that structure). It would not be safe to assume that tax considerations did not have a role to play. Insofar as Mr Williams gave evidence that the pricing model was adopted because it was “simple”, I have difficulties with that evidence. The sample exclusive bottling agreements in evidence show that there was considerable complexity in the pricing terms in some agreements. I therefore consider that this matter supports the PepsiCo parties’ position on purpose, but only slightly.

120 We would differ from his Honour’s conclusion that this factor slightly favoured the position of PepsiCo and conclude that it was a matter which was neutral. Section 177D(2)(a) requires regard to be had to the manner in which the scheme was entered into or carried out. It is important to emphasise again that this provision demands an objective analysis. The question posed is not concerned with the subjective reasons PepsiCo entered into the EBAs. It is the objective determination of the manner in which the scheme (through the EBAs) was entered into and carried out.

121 The PepsiCo EBA was entered into on 3 April 2009. It included a clause prescribing the prices for future sales of concentrate to the Bottler. An internal memorandum dated 31 March 2009 was sent by the persons who had negotiated the EBA (Messrs Latif, Nichol and Phaesity) to the person whose approval was necessary in order for the EBA to be entered into on behalf of PepsiCo, a Mr Walsh. None of these persons was called to give evidence. The memorandum deals in detail with the various contractual terms of the proposed EBA. Under the heading ‘2. Business Model’ this statement appears: ‘Business Model (Franchise) remains consistent with existing operations’. Internal sign off was sought by 2 April 2009 with the proposed execution suggested to be, as eventually it was, 3 April 2009.

122 The memorandum included as an attachment a detailed analysis of the economics of the EBA both from its perspective and that of the Bottler. These included incentives to the Bottler to increase the volume of beverages being sold. A statement appears that one of the merits of the proposed EBA was that it ‘builds on existing strong EBA’. There are several statements

attached to the email concerning the negotiation of the terms of the EBAs. These statements are consistent with the integrated bargain to which we have referred. Armed with the additional fact that the Bottler had recently been acquired by the Asahi interests one passage in an email dated 21 December 2008 is representative of the negotiations:

All final terms are ‘at or better’ our line in the sand; in particular Richard was able to force Asahi to accept volume minimums on both CSD’s [carbonated soft drinks] and Sports, and cross-linked volume rebates and bottler funds that protect us from any NOPBT [net operating profit before tax] downside if they fail to grow our brands. In addition he and the team were able to strengthen change in control provisions in both EBA’s. The one structural change vs the line in the sand document was the final structure of the A-M step up on Sports. As you will recall we had suggested a 65% concentrate increase in exchange for PI assuming 100% of the ATL [above the line marketing] on Gatorade (Cadbury was contracted to spend \$4.5mm this year); Richard was able to accomplish the same outcome (a step up in ATL) by reducing the concentrate price increase to 10%, but increasing the ATL burden on Asahi to a minimum \$7mm per year on ATL. The structure was more acceptable to Asahi and the outcome the same for us.

- 123 From the memorandum two inferences may be drawn about the manner in which the scheme was entered into. First, it was the result of tough negotiations on the concentrate price to further PepsiCo’s commercial objectives. Secondly, the business model for the EBA was to be the same business model formerly used so that the terms of the EBA built on the strong terms of the pre-existing EBA.
- 124 PepsiCo conducts two business models. The first is known as a franchise-owned bottling operation (‘FOBO’). The second is known as the company-owned bottling operation (‘COBO’). PepsiCo’s international operations are largely conducted on the FOBO model. Since 2009 80% of PepsiCo’s bottling in the United States has been conducted on the COBO model following the acquisition by PepsiCo of two of its largest bottlers. The deployment of the FOBO model internationally began in the 1950s but began in the United States in the early 1900s.
- 125 PepsiCo called as a witness Mr Williams who was not involved in the negotiation of the particular EBAs but who had knowledge of the operation of the FOBO model internationally. Evidence was adduced from him as to the terms of a large number of EBAs from around the world. The terms of these EBAs confirm that under the FOBO model the basic business structure has consisted of the supply of concentrate to franchise bottlers at specified prices and the grant to them of exclusive rights of manufacture and distribution together with manufacturing and distribution obligations. This structure has also included an exclusive licence of PepsiCo’s intellectual property for which no separate royalty has been charged.

126 During the hearing of the appeal the Commissioner took the Court to three agreements in which a royalty was in fact charged for the right to use a trade mark. The first of these concerned the distribution of a product known as Aquafina in Vietnam. Aquafina is a water product and does not involve the supply of concentrate by PepsiCo. The second was a similar EBA for the distribution of Aquafina in Thailand. A third agreement concerned the distribution of a juice product in Korea under the name Tropicana. As with the Aquafina product this did not include the supply by PepsiCo of concentrate. It is unsurprising that these agreements included a royalty for the right to use PepsiCo's trade marks since in the absence of sales of concentrate this was the only available property from which it could generate revenue.

127 The Commissioner submitted that these agreements showed that the right to license PepsiCo's trademarks was something for which it in fact charged. It may be accepted that these agreements show that when PepsiCo does not supply concentrate it derives value from licensing its trade marks. We do not think, however, that it throws much light on the more complex bargain inherent in a FOBO EBA where concentrate is supplied.

128 From this evidence two further matters may be inferred: first, the FOBO model had been in place in PepsiCo's international operations since the 1950s and in the United States since the early 1900s; secondly, that model involved charging for concentrate without a separate fee for the grant of any intellectual property rights.

129 PepsiCo submitted that this was a matter which strongly favoured it since it showed the FOBO model predated the introduction of the royalty withholding tax in 1992 on the passage of the *Taxation Laws Amendment Act (No 5) 1992* (Cth). We do not accept this submission. The original form of the ITAA 1936 imposed a tax on royalties by s 26(f) which provided:

The assessable income of a taxpayer shall include –

...

(f) any amount received as or by way of royalty.

130 At the same time, a royalty withholding tax was imposed by s 256:

(1) Every person who is liable under any contract to pay money as or by way of royalty to a non-resident shall, before making any payment to or on behalf of that non-resident, furnish to the Commissioner a statement of the amount of royalty due to the non-resident, whether such royalty became due either before or after the passing of this Act, and ascertain from the Commissioner the amount, if any, to be retained in respect of tax due, or which may become due, by the non-resident.

(2) The last preceding section shall apply in respect of payments of royalty referred to in this section.

131 This must be read alongside s 255(1):

- (1) With respect to every person having the receipt control or disposal of money belonging to a non-resident, who derives income from a source in Australia or who is a shareholder, debenture holder, or depositor in a company deriving income from a source in Australia, the following provisions shall, subject to this Act, apply:
 - (a) he shall when required by the Commissioner pay the tax due and payable by the non-resident;
 - (b) he is hereby authorized and required to retain from time to time out of any money which comes to him on behalf of the non-resident so much as is sufficient to pay the tax which is or will become due by the non-resident;
 - (c) he is hereby made personally liable for the tax payable by him on behalf of the non-resident to the extent of any amount that he has retained, or should have retained, under the last preceding paragraph; but he shall not be otherwise personally liable for the tax;
 - (d) he is hereby indemnified for all payments which he makes in pursuance of this Act or of any requirement of the Commissioner.

132 These provisions came into effect on 2 June 1936. Thus, at the time that the FOBO model was introduced by PepsiCo into its international operations in the 1950s (including, we assume, in Australia) royalty withholding tax existed. We do not accept therefore that the 2009 EBA merely repeated a business structure which had existed since before the imposition of the royalty withholding tax. In that circumstance, we conclude that this is a neutral matter.

Conclusions on purpose

133 Having regard to those matters, and on the highly artificial assumption we must make that the price of concentrate included a royalty, we would have concluded that the requisite purpose under s 177J(1)(b)(i) had been established. The trial judge expressed this conclusion by saying (at TJ [465]) 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’. Whilst we agree with his Honour’s observation about the substance of the EBAs (on the assumptions we must make for the present discussion), the reference to the EBAs being contrived is not one which s 177J(1)(b)(i) calls for having regard to the objective purpose with which the provision is concerned. Nevertheless, we do agree with his Honour’s overall conclusions on purpose. It follows that if the Commissioner’s postulates had been shown to be reasonable alternatives to the scheme, we would have reached the conclusion that s 177J(1)(b)(i) was engaged.

Conclusions on Part IVA

134 Because there are no postulates which are reasonable alternatives to the scheme the Commissioner's Part IVA appeal fails.

CONCLUSIONS AND ORDERS

135 PepsiCo/SVC's appeals in the royalty withholding tax proceedings should be allowed, the orders made by the trial judge set aside and in lieu thereof there should be orders setting aside the notices of assessment for royalty withholding tax. The Commissioner's appeals in the Part IVA proceedings should be dismissed. PepsiCo/SVC should have their costs in both sets of appeals as taxed, assessed or otherwise agreed. The parties should bring in a minute of order giving effect to these conclusions within 14 days.

I certify that the preceding one hundred and thirty-five (135) numbered paragraphs are a true copy of the Reasons for Judgment of the Honourable Justices Perram and Jackman.

Associate:

Dated: 26 June 2024

REASONS FOR JUDGMENT

COLVIN J:

- 136 These appeals concern agreements by which the holders of intellectual property in established and valuable beverage brands agreed to supply to a buyer the essential (and secret) components to make the beverages so that the buyer could make and sell the branded beverages to its own customers. The issue at the heart of the appeals is whether any part of the amounts of money paid by the buyer under the agreements was paid as consideration for the use of the brands or would have been but for a scheme in the form of the agreements.
- 137 I have the considerable advantage of being provided with a draft of the joint reasons of Perram and Jackman JJ. Respectfully, in certain respects, I have reached a different view. These reasons are confined to those matters of difference. Save in one respect, I adopt the same defined terms as the joint reasons. In the joint reasons the term Seller is used to refer to the supplier, in fact, of the concentrate, being the essential components used to make the beverages. In these reasons, the term Seller is used in the same manner as in the agreements in issue (EBAs) to refer to the supplier of the concentrate irrespective of whether it may be PepsiCo or SVC (as the case may be) or a related entity nominated as the supplier in accordance with the terms of the EBAs.
- 138 As has been explained in the joint reasons, the EBAs were entered into between each of PepsiCo and SVC on the one hand and the Bottler on the other hand. Broadly speaking, there are two aspects to the appeal proceedings. The first concerns whether the agreed price paid for concentrate as provided for by the EBAs included royalties which were derived by PepsiCo and SVC as income such that they were liable to pay withholding tax on the royalty amounts. The second, which arises only if there is no withholding tax liability, concerns whether entry into each of the EBAs was a scheme that gives rise to a diverted profits tax liability. As to the withholding tax aspect there were two main issues, namely:
- (1) Whether, upon the proper construction of the EBAs (and in the manner in which they were performed), the agreed price was not payable in consideration for the concentrate alone but was payable as to part as a royalty.
 - (2) Whether amounts paid to the related party supplier of the concentrate under the terms of the EBAs constituted income derived by PepsiCo and SVC even though not received by them.

139 In the reasons which follow, references to PepsiCo should be read as also describing the position in relation to SVC unless otherwise stated. I will also generally use the terms brands or trade marks as a shorthand for the intellectual property that the EBAs impliedly or expressly authorised the Bottler to use.

Key aspects of the EBAs

140 The relevant provisions of the EBAs are referred to in the joint reasons. In summary, by the terms of the EBAs:

- (1) PepsiCo appointed the Bottler to bottle, sell and distribute, branded beverages under trade marks owned by PepsiCo;
- (2) PepsiCo (impliedly) and SVC (expressly) licensed the Bottler to use the trade marks;
- (3) PepsiCo agreed to sell ‘or cause to be sold by [a **Related Entity**]’ (in either case, the selling party being referred to in the EBAs as ‘the Seller’) to the Bottler all units of concentrate required for the manufacture of the beverages by the Bottler;
- (4) the Bottler agreed to buy the required concentrate ‘only from the Seller’;
- (5) a price per unit at which the Bottler agreed to buy the concentrate from the Seller was specified;
- (6) no monetary consideration other than the price per unit for concentrate was specified;
- (7) the Bottler was required to sell the beverages in the territory under the trade marks;
- (8) the Bottler was restricted as to the extent to which it could sell certain other beverages; and
- (9) there were terms governing the permitted advertising by the Bottler of beverages produced from the concentrate and sold using the trade marks as well as certain other matters relating to the sale of the beverages by the Bottler.

141 The EBAs dealt with much more than the supply of concentrate to the Bottler. Due regard to the terms of the EBAs as a whole reveals a dealing between the parties pursuant to which the Bottler was to bottle, sell and distribute branded beverages. The EBAs also dealt with the territory in which that could occur, the extent to which other beverages could be sold by the Bottler and significant aspects of the Bottler’s business activities in distributing beverages bearing PepsiCo’s brands.

142 As to the brands, the unchallenged finding of the trial judge was as follows (at TJ[248]):

I note also that the Pepsi brand is one of the strongest and most valuable brands in the global beverage industry. The Mountain Dew and Gatorade brands are also strong and

valuable brands in that industry.

143 Based upon that finding, the trial judge reasoned that: ‘In these circumstances, it would be very surprising if PepsiCo and SVC were prepared to licence the relevant trade marks for nothing’. That further reasoning is challenged. However, it is not suggested in the appeal that there was any error in the finding by the trial judge that the brands were strong and valuable. That is to say, it is not suggested that the provisions of the EBAs concerned with the use of the trade marks were dealing with intellectual property that was of little or no commercial value, or which was in need of the support of a good distributor in order to be able to secure sales. On the evidence the PepsiCo brands were already strong and valuable. Indeed, in other unchallenged findings, the trial judge determined a commercial royalty rate for the use of the trade marks by the Bottler.

144 As to the terms of the EBAs that concerned the supply of the concentrate, the Bottler promised to PepsiCo to buy the concentrate at the specified unit prices ‘only from the Seller’. However, it was entirely up to PepsiCo whether ‘the Seller’ was PepsiCo or a Related Entity. The EBA could be performed with PepsiCo as the Seller of the concentrate or with a Related Entity as the Seller. Apart from the provision which allowed PepsiCo to perform the EBA by causing a Related Entity to sell the concentrate to the Buyer, all other terms of the agreement required performance by PepsiCo on the one hand and the Bottler on the other hand. Even where PepsiCo caused a Related Entity to be the Seller, there was still a promise in the EBA by the Bottler to PepsiCo to buy from the Seller at the agreed unit prices. That is to say, in such a case, failure to pay the Seller would be a breach of any supply terms established as between the Related Entity (as Seller) and the Bottler, but would also be a breach of the EBA that would give rise to remedies that could be exercised by PepsiCo directly against the Bottler. All of which is to expose the way in which the buying of concentrate by the Bottler from a Related Entity as Seller should not be viewed as performance of an obligation that does not subsist as between the Bottler and PepsiCo. Quite the contrary.

145 The EBA to which SVC was a party had additional provisions concerned with delivery of the concentrate, provision of estimates of its concentrate requirement, passing of property and risk and an express obligation to pay SVC or the Related Entity ‘within 28 days after the invoice, which shall be issued on the date of delivery’. That is to say, in the case of the EBA with SVC there were more detailed promises in favour of SVC concerning the terms of supply of the concentrate that also applied irrespective of whether the supply was by SVC or a Related Entity as Seller.

146 As has been indicated, the EBA with SVC provided expressly for the grant to the Bottler of a licence to use the intellectual property described in the EBA (particularly, the trade marks for the beverages). That provision referred to the grant of ‘an exclusive royalty-free licence’. The trial judge found that the way the licence was described in the EBA with SVC was not determinative of the characterisation of the amounts agreed to be paid under the EBA: TJ[249]. For reasons given below, that conclusion must be correct. The label or description given by SVC to the amounts that were required to be paid under the EBA could not be determinative. As is explained below, the relevant inquiry concerned what the agreed amounts to be paid under the EBAs were ‘consideration for’.

Key aspects of the manner in which the EBAs were performed as to the supply of concentrate

147 The way in which the concentrate was supplied to the Bottler under the terms of the EBAs is dealt with in the joint reasons. Those reasons reflect the unchallenged findings of the trial judge as to how the concentrate was supplied: TJ[7]. In summary:

- (1) concentrate was produced in Singapore by a subsidiary of PepsiCo;
- (2) the concentrate was supplied to an Australian subsidiary of PepsiCo;
- (3) PepsiCo nominated the Australian subsidiary as the Relevant Entity to be the Seller of the concentrate under the EBAs;
- (4) the Australian subsidiary supplied concentrate to the Bottler and invoiced the Bottler for the concentrate; and
- (5) the Bottler paid the Australian subsidiary for the concentrate in accordance with those invoices.

148 The amounts invoiced by the Australian subsidiary to the Bottler for the concentrate reflected the unit prices for concentrate agreed in the EBAs. When the invoices were paid by the Bottler to the Australian subsidiary no part was as monies received on behalf of PepsiCo. Instead, the Australian subsidiary paid an ‘arm’s length price’ to the producer of the concentrate retaining a small margin. Profits on the sale of the concentrate were earned by the manufacturer of the concentrate (another PepsiCo entity, which was incorporated in Singapore). No amounts were paid to PepsiCo or SVC even though those parties were the ones granting the right to use the trade marks.

149 Significantly, as is explained in the joint reasons, the arrangements by which the Australian subsidiary supplied the concentrate involved direct dealings as between the Australian subsidiary and the Bottler. Those dealings were conducted in a way in which the full amount

agreed as the price per unit of concentrate under the terms of the EBA was invoiced by the Australian subsidiary as the price for the supply of the concentrate.

The nature of the proceedings before the trial judge

- 150 The Commissioner issued assessments for royalty withholding tax. PepsiCo brought proceedings seeking declaratory relief to the effect that there was no liability to pay royalty withholding tax in the relevant years. It was for PepsiCo to demonstrate a basis for that relief.
- 151 The Commissioner also issued diverted profits tax assessments. He only sought to rely upon the appeals under Part IVC of the *Taxation Administration Act 1953* (Cth) in respect of those assessments. As explained in the joint reasons, in those appeals the burden was on PepsiCo to demonstrate that the assessments were excessive.
- 152 The trial judge found that there was liability to pay royalty withholding tax on part of the amounts paid for the concentrate. Alternatively, if that view was wrong, the trial judge would have found that the appeal against the diverted profits tax assessments should not be allowed.
- 153 PepsiCo and SVC appealed against the decision of the trial judge as to withholding tax. The Commissioner brought appeals against the decision of the trial judge as to the diverted profits tax. The Commissioner's appeals were predicated on success by PepsiCo and SVC in its appeals.

The withholding tax appeals

Whether part of the amounts paid by the Bottler were 'as consideration for' the relevant intellectual property?

- 154 The relevant statutory provisions are addressed in the joint reasons. As there explained, s 128B of ITAA 1936 imposes withholding tax on income that includes a royalty. Relevantly for present purposes, a royalty includes 'any amount paid or credited, however described or computed ... to the extent which it is paid or credited ... as consideration for ... the use of, or the right to use, any ... secret formula or process, trade mark, or other like property or right': s 6(1) of ITAA 1936. Amongst other circumstances, the withholding tax provision for royalties applies to income derived by a non-resident that consists of a royalty that is paid to the non-resident: s 128B(2B).
- 155 Each of PepsiCo and SVC are non-residents incorporated in the United States. By reason of the terms of the definition of royalty, in determining whether income derived by a non-resident 'consists of a royalty', it does not matter how the amount paid or credited to the non-resident is described or computed: see s 6(1) of the ITAA 1936.

- 156 Significantly, the definition of royalty in the ITAA 1936 does not direct attention to the terms in which an amount is described. Rather, it focusses upon whether an amount is paid *as consideration for* relevant intellectual property. The manner in which an amount is described or computed cannot answer that question. It may have relevance, but it could not be determinative. Therefore, the express language in the definition that includes an amount ‘however described or computed’ if it is paid as consideration for relevant intellectual property makes explicit that which would be the case even without those words. That is to say, neither the labels used to describe the consideration nor the way in which the consideration is calculated could determine whether an amount was paid *as consideration for* relevant intellectual property.
- 157 The same concept of payments ‘to the extent to which they *are consideration for* the use of or the right to use [relevant intellectual property, including trade marks]’ is used in the international tax agreement to define the term royalties. As explained by the trial judge, the royalty withholding tax provisions in the ITAA 1936 only apply to United States corporations to the extent that the international agreement treats the amount paid as a royalty: TJ[233]-[235]. The international agreement provides that royalties as defined in the international agreement ‘may be taxed in the [State] in which they have their source, and according to the law of that State’. PepsiCo’s appeal was conducted on the basis that a conclusion that there was a royalty withholding tax liability under the ITAA 1936 would mean that PepsiCo was taxable as to those royalties according to Australian tax law. That is to say, it was not contended that there may be circumstances in the present case where the Australian law applied but there was no liability because of the extent to which the international agreement treated amounts paid as a royalty.
- 158 It may be observed 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. Indeed, 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. Equally, an agreement may provide for an amount to be calculated and paid by reference to some relevant unit of product being supplied under the agreement as a convenient rateable measure of the commercial value of the whole of the consideration moving under the agreement. The use of that unit does not mean that the consideration is paid for that product and nothing else.

159 For example, say an agreement is reached with a prospective tenant to both lease premises and to conduct a business from the premises using a well-known name belonging to the landlord in circumstances where the name has considerable associated goodwill. There may be no commercial reason for the parties to separately identify a part of the ‘rent’ that is attributable to the right to use the business name. Views may differ as between the landlord and the tenant as to the appropriate allocation even where they can agree on the overall ‘rent’. In consequence, the only payment agreed may be for the payment of monthly ‘rent’. If so, despite the use of the term rent, an issue would arise as to whether, on the proper construction of the agreement, the rent was to be paid ‘for’ possession of the premises or ‘for’ possession of the premises as well as the use of the name. In such a case, the inclusion of an express promise that the tenant also has the right to use the business name for the term of the lease may found a conclusion that the agreed rent included consideration for the grant of that right. That may be so even where the only provision in the agreement as to payment of money is a provision that the landlord agrees to lease the premises to the tenant for the amount of the rent. That is to say, it is not necessary for the term conferring the right to use the business name to state expressly that it is also given in consideration for payment of the rent in order for that to be the case.

160 If the question is approached as a matter of contractual construction, then there may be ambiguity as to whether the specified monetary consideration is for the lease of the premises or whether it is for the lease and the use of the name. Resolution of that ambiguity may justify resort to surrounding circumstances known to the parties such as the fact that the goodwill associated with the name was very valuable or that the prevailing market rent for the premises was less than half the agreed ‘rent’.

161 In such a case, absent any such evidence, the fact that the agreement (a) uses the term ‘rent’; (b) expresses the amount of the rent as being paid for the lease of the premises; and (c) does not expressly refer to the grant of the right to use the name as also being conferred in consideration for the rent to be paid under the agreement, may lead to the conclusion that the monetary consideration (in the amount of the rent) is paid only for the promise to lease the premises. All would depend upon what might be concluded from the words used in the agreement.

162 As noted in the joint reasons, in the present case, both PepsiCo and the Commissioner approached the question whether the prices paid by the Bottler to buy concentrate as required by the terms of the EBAs were amounts paid in consideration for the use of relevant intellectual property on the basis that it was to be resolved as a matter of construction. The Commissioner

called in aid the principles concerned with construing commercial instruments so as not to cause an uncommercial result: *Mount Bruce Mining Pty Ltd v Wright Prospecting Pty Ltd* [2015] HCA 37; (2015) 256 CLR 104 at [51] (French CJ, Nettle and Gordon JJ). He submitted that the EBAs should be construed in the light of their applicable business and commercial context, relying upon *Electricity Generation Corporation v Woodside Energy Ltd* [2014] HCA 7; (2014) 251 CLR 640 at [35] (French CJ, Hayne, Crennan and Kiefel JJ). This had been the approach of the trial judge: TJ[240]. As has been explained, a key aspect of the reasoning by the trial judge was the fact, known to the parties, that the PepsiCo brands were strong and valuable.

163 Respectfully, it is difficult to see why an answer to the question posed by the terms of s 128B of the ITAA 1936 as to whether an amount was paid as consideration for use of relevant intellectual property would be determined solely by reference to the express terms of the agreement (that is by applying principles developed to determine the nature and extent of the rights and obligations that are enforceable as promises according to the law of contract) and without regard to other evidence. Whether an amount has been paid ‘as consideration for’ relevant intellectual property (and is therefore a royalty as defined) is a statutory question. On the face of the provision, it is a question to be determined having regard to all of the evidence as to the circumstances in which the amount is paid. In a case, like the present, where the amount has been paid under the terms of an agreement then the answer to that question could not ignore the terms of the agreement. Further, absent some claim that the agreement was a sham, any conclusion would have to conform to the legal character of the agreement (that is to say, the nature and extent of the contractual obligations giving rise to the payment of the amount). So, it could not be posited that the consideration was for the benefit of some form of promise not to be found in the agreement or on the basis that ‘in substance’ the agreement was for something that was not provided for by the terms of the agreement. However, that is a different thing to resolving the entire question as a matter of construction of the terms of the agreement.

164 Accordingly, in my view, in the example given above, I would not reject the possibility that evidence that the amount paid substantially exceeds the market rental value of the premises might be relevant even if there was no suggestion that the market rental value was commonly known to the parties at the time they made their agreement. Likewise, evidence to the effect that the rent was expressly determined on the basis that the right to use the business name was of significant monetary value to the tenant or evidence as to the extent of the market value of the goodwill associated with the name may well be relevant. At the very least, it seems to me

that there is uncertainty as to whether the statutory terminology requires singular focus upon the proper construction of the agreement where the relevant amount is paid under the agreement.

165 In the present case, the Commissioner did advance written submissions which appeared to rely upon evidence of that broader kind (but seemingly on the basis that there could be regard to that evidence as being relevant to the proper construction of the EBAs). For example, reliance was placed upon evidence that supply of the concentrate and the brands ‘always go together’ for PepsiCo and other evidence to the effect that a royalty was charged as a way of generating revenue for a bottling arrangement for the Aquafina trade mark where there was no concentrate to be supplied. However, in oral submissions, the position put by the Commissioner was that the issue whether there was a royalty was to be determined upon the proper construction of the EBAs.

166 The submissions for PepsiCo, on the other hand, were squarely put on the basis that the question concerning whether the amount was paid as consideration for the use of relevant intellectual property was to be determined on the basis of the proper construction of the EBAs and the manner in which they were performed when it came to the supply of the concentrate. Other evidence was referred to in the context of purpose as relevant to the diverted profits tax appeals by the Commissioner. However, no reliance was placed upon that evidence when it came to s 128B of the ITAA 1936.

167 In those circumstances, as no case was put to the effect that evidence beyond that admissible to resolve ambiguity in the terms of the EBAs may be relied upon, I express no concluded view as to whether it is possible to have regard to matters beyond the terms of the EBAs as properly construed in reaching a conclusion as to whether the price paid by the Bottler was as consideration for anything more than the concentrate, specifically a licence to use the trade marks of PepsiCo. I also approach the resolution of that question in the same manner as the parties, namely as a question of construction applying contractual principles. In effect, by their common approach, the parties agreed to confine the evidence that might be considered in resolving the statutory question and focussed upon what might be discerned from the terms of the EBAs having regard to the fact that they were performed by the concentrate being supplied by a Related Entity and not by PepsiCo (or SVC as the case may be).

168 As the joint reasons explain, there are authorities that have dealt with the proper approach where the task to be undertaken is the identification of the consideration for an amount paid

under an agreement in the context of taxing provisions imposing duty on the dealing the subject of the agreement. I deal with those authorities below.

169 First, there is the decision of Bennett J in *International Business Machines Corporation v Commissioner of Taxation* [2011] FCA 335. In that case, her Honour considered applications for declarations that certain corporations were not liable to pay withholding tax on the full amount of certain payments (referred to as **Payments**) made to each of them under the terms of software licence agreements. The Commissioner contended that the whole of the Payments were royalties. The corporations contended that only part of the Payments were of that kind: at [17]. Her Honour was concerned with the proper construction of the term ‘royalty’ as used in an international agreement (which operated to limit the circumstances in which the Australian royalty withholding tax provisions might apply to United States corporations). It too deployed a definition of royalty that applied to payments to the extent to which they ‘are consideration for the use’ of relevant intellectual property rights: at [18].

170 As noted in the joint reasons, her Honour expressed the view that the question whether the Payments were ‘for’ the use of relevant intellectual property rights ‘is determined by the construction of the [agreements pursuant to which the Payments were made]’: at [19], see also [41]-[42]. Her Honour rejected a submission to the effect that any part of the consideration was paid for distribution rights for the software, thereby finding that the whole of the Payments were for royalties.

171 The case for the corporations involved an attempt to characterise the software licence agreements as distributor agreements. They contended that the provision in the agreements whereby fees were payable for the rights granted under the agreement (which included a non-exclusive right to ‘license and distribute copies’ of software) were also paid for rights which were not intellectual property rights (which it sought to characterise as distributorship rights).

172 After considering the competing contentions of the parties and the terms of the software licence agreements, Bennett J concluded at [52]:

Taking the whole of the [software licence agreement] into account, it is in my view clear that the [software licence agreement] grants to [the corporations] such IP rights as are necessary for distribution of the relevant products by [the corporations]. It is not a distribution agreement which confers distribution rights independently of the grant of IP rights. The detail of the [software licence agreement] concerns the definition of IP and IP rights. There is no such detail with respect to distribution rights.

173 To reason in that manner was to construe the terms of the software licence agreement in order to characterise the nature of the commercial dealing recorded in the agreement, having regard to all of its terms, so as to reach a conclusion as to the consideration for which the fees provided for by the agreement were payable. On her Honour's approach, the inquiry does not end with what the terms of the agreement say (on their proper construction). It requires regard to the whole of the terms of the agreement (as properly construed) to characterise the nature of the commercial dealing effected by the agreement before reaching a conclusion, based upon an understanding of the nature of that dealing, as to whether the monetary consideration moving from one party to another was paid (in whole or in part) as consideration for the use of relevant intellectual property.

174 Applying the same approach to the present case, regard to the whole of the terms of the EBAs reveals that they are not properly characterised as agreements for the supply of the concentrate that is needed to make the beverages. Nor are the EBAs as a whole properly described as agreements by which a commitment is secured from the Bottler to buy its concentrate requirements from PepsiCo or a Related Entity. Rather, by the EBAs, the Bottler is appointed to bottle, sell and distribute the branded beverages in the territory for the term of the agreement. The EBAs include a mechanism by which PepsiCo may nominate a Related Entity to be the Seller (and the recipient of the monetary consideration provided for by the EBAs). As has been explained, the nomination occurred in this case so there is the additional question whether the fact that PepsiCo exercised the right to perform the EBA in that way (by the concentrate being supplied by a Related Entity) might have a bearing upon a conclusion as to whether the amount, when paid, was consideration for the trade marks. The significance of these matters is addressed below.

175 The important matter to note at this point, is that the approach outlined by Bennett J requires an understanding of the nature of the commercial dealing expressed by the terms of the agreement in order to reach a conclusion as to what an amount was paid 'as consideration for' where that amount was paid under the terms of the agreement.

176 The rest of the authorities referred to by the parties do not deal with a question of the kind posed by the present case. Rather, they are directed to identifying the amount of the consideration for a dutiable transaction or dealing. Nevertheless, they provide some insight into the way in which an analysis of the commercial character of the overall dealing or transaction recorded by the agreement forms part of the reasoning process by which a conclusion as to what amounts paid under the agreement are paid for (as well as whether those

amounts represent full value for that for which they are paid) is reached based upon a proper construction of the terms of the agreement.

- 177 The authorities begin with the decision in *Archibald Howie Pty Ltd v Commissioner of Stamp Duties (NSW)* (1948) 77 CLR 143. In that case, shares were transferred to give effect to an order made approving a reduction in capital. The question was whether, for stamp duty purposes, the transfer was made ‘upon a bona-fide consideration in money or money’s worth of not less than the unencumbered value of the property conveyed’. The reduction in capital was effected by distribution of property in specie (in the form of shares held by the company) and a small amount of cash. The value of the property received by shareholders was greater than the amount of capital that had been contributed.
- 178 Dixon J (Rich J agreeing and Williams J concurring) described the transaction as both (a) ‘an effectuation or realization of the rights obtained by the acquisition of the share in the same way is the distribution of a dividend’; and (b) a discharge of rights in company law to share in the assets (including those in excess of share capital contributed) to be distributed in proportion to the shareholding: at 152-153. In the view of Dixon J, it was significant that the reduction in capital was not expressed as a reduction that was to be effected by paying a specified amount to the shareholder (being the capital contributed) which ‘would have doubtless been regarded as the acquisition of assets for a consideration expressed in money’. Instead, he described the reduction in the particular case as being effected by direct allocation of assets for distribution according to the proportionate interest of the shareholder in those assets.
- 179 In the course of that reasoning, Dixon J said that in the context of that case, ‘the word “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’. His Honour said that under the relevant stamp duty provision ‘the consideration is rather the money or value passing which moves the conveyance or transfer’: at 152.
- 180 Therefore, as the consideration moving the transfer was not an obligation to pay a particular price but rather was the allocation of assets to which the shareholder was entitled in that capacity, the consideration given was as to the whole of that right not just to the extent of the amount of capital as originally contributed. In consequence there was no transfer at the price originally subscribed for the shares and no transfer at an undervalue.
- 181 For present purposes it may be noted that the analysis in *Archibald Howie* was undertaken by focussing upon the legal nature of the transaction revealed by a proper construction of the agreement and analysing the nature of the consideration actually moving the transaction.

Properly analysed the transaction was not the return of the amount of money that had been subscribed by the shareholder but was the discharge of the whole of the right which the shareholder had to receive a share in the assets held by the company in proportion to the shareholding. As applied to the present circumstances, such an approach requires an evaluation as to whether the transaction recorded in the EBAs which gave rise to the obligation to pay the agreed price per unit of concentrate was such that the monetary consideration actually moving the transaction included a royalty for the use of the trade marks. On the approach in *Archibald Howie* the answer to that question requires a proper characterisation of the transaction undertaken by reference to the terms of the EBAs construed in the context of relevant surrounding circumstances.

182 Next there are the three High Court cases referred to in the joint reasons, namely *Davis*, *Dick Smith* and *Lend Lease*.

183 In *Davis* the High Court was concerned with the application of stamp duty provisions where 57 shares held by a company were transferred to its holding company. As explained by Dixon CJ (at 405):

... the transaction is expressed as a sale and purchase of the shares in the other companies at prices which are in fact par, that is to say at £1 each. But the value of the fifty-seven shares is not £57: it is £54,382 ... What the transfer meant to the holding company was a change of the form of property containing this value. That is to say, by the transfers that company would become the immediate owner of the shares which theretofore were the property of the company whose share capital it held.

184 The issue for the High Court in *Davis* concerned what was the consideration for the transfers for the purposes of stamp duty (not what the consideration was for). If the consideration was equal to the full value (by reason that the holding company did not accrete any additional value through the transaction) then the stamp duty was low. However, if the consideration for the transfer was the price of £57 then the stamp duty was considerable. Dixon CJ described the relevant inquiry as being ‘whether the consideration for the transfers if and when executed would be what is nominated in the agreement as the price or would be the full value’: at 406. As to the answer to that question, his Honour said (at 406-407):

Neither the nature nor the effect of the transaction is open to much question. The matter is really one of ‘characterisation’. Must the price be characterised as the consideration or is it proper to characterise the further elements in the transaction which determine or govern its real effect the consideration? Assuming, as I think we should, that the transfer of the shares would not deprive the transferor company of assets representing paid-up share capital, the shares to be transferred must contain, in point of value, either accumulated trading profits or some accretion to capital over and above the equivalent of the paid-up share capital of the company. Such a ‘fund’, whether real or notional, would be ‘distributable’. In any case to sell and transfer these

shares to the only shareholder of the company at a price which must amount to a nominal or book price effects a ‘distribution’ of the trading or capital profit contained in or represented by the shares. It places in the shareholder’s hands the trading or capital profit contained in or represented by the shares.

185 His Honour went on to analyse the nature of the transaction effected by the parties. The earlier decision in *Archibald Howie* was distinguished on the basis that it ‘dealt with a transfer made wholly in pursuance of a resolution and order for the reduction of capital ... [as] a method of effectuating the rights of shareholders’ and that was the full extent of the transaction. As to the case at hand, his Honour reasoned that the transaction having been cast as a sale and purchase of shares it could not be recast as a means of effectuating the rights in the shares. As the nature of the dealing was a sale and purchase of shares, the consideration was the price as fixed by the parties for the sale and purchase. Therefore, it was £57.

186 The reasoning in *Davis* reveals that the conclusion was reached because the legal nature of the agreement reached was one in which shares were to be transferred for a price. Applied to the present case, reasoning of that kind would only lead to the conclusion that the amounts paid in the present case were not paid as consideration for the trade marks if the EBAs were confined to expressing the terms of supply of concentrate to PepsiCo. They are not. As has been explained, the EBAs provide for much more. Therefore, *Davis* does not assist in resolving a case like the present where the agreement has other dimensions, save that (like *Archibald Howie*) it places an emphasis upon understanding the precise character of the commercial dealing effected by the terms in which the agreement is expressed.

187 In *Dick Smith*, the issue again concerned the consideration for the purposes of a dutiable transaction which involved the transfer of shares. The shares were transferred under an agreement which defined the purchase price as a specified amount ‘minus the Dividend Amount’. The ‘Dividend Amount’ was to be all retained earnings which the company was able to pay to shareholders before settlement on the purchase of the shares. Clause 5 of the agreement provided for the sales of the shares for the purchase price as defined. As to that provision, the majority (Gummow, Kirby and Hayne JJ) said at [54]:

It would be a misstatement of the operation of the Agreement, and of the transaction for which it provided, to refer simply to cl 5 and the statement therein that the Purchaser will purchase the Shares for the Purchase Price, for the conclusion that it was the receipt by the Vendors of that payment alone which supplied the monetary consideration *actuating or moving the transfer of the Shares* by the Vendors to the Purchaser. It is necessary to look further into the provisions of the Agreement.

(emphasis added)

188 The relevant statutory provision levied duty on the ‘dutiable property’ by reference to the greater of ‘the consideration (if any) for the dutiable transaction’ and ‘the unencumbered value of the dutiable property’.

189 Their Honours began at [71] by referring to *Archibald Howie* and *Davis* as authority for the proposition that the reference to ‘consideration’ was not to be read ‘as requiring identification of the consideration sufficient to support a contract’. Rather, it should receive its wider conveyancing meaning as ‘the money or value passing which moves the conveyance or transfer’ (quoting from Dixon J in *Archibald Howie*). They explained that the reference to ‘consideration for’ the transaction looks to ‘what was received by the Vendors so as to move the transfers to the Purchaser as stipulated in the Agreement’: at [72].

190 Regard to the terms of the agreement led the majority to conclude that the consideration which moved the transfer was the whole of the purchase price as agreed (not the amount, net of the dividend, the payment of which was required to be funded by the Purchaser by loan to the company): at [75].

191 In the present case the issue is of a different character. There is no dispute between the parties that the extent of the monetary consideration which was to ‘move’ under the terms of the EBAs was the agreed price per unit of concentrate. The issue concerns what moved that consideration. Was the amount of that consideration, when paid, just for the concentrate or was it paid, in part, for a licence to use the trade marks? The resolution of that question, in the manner in which the case was presented by the parties, turns upon the proper construction of the EBAs and the fact that they were performed by making payments to a Related Entity as Seller. It requires a conclusion to be reached as to whether, in those circumstances, the amount paid as the ‘price’ was only for concentrate and did not include any component for use of the trade marks.

192 In *Lend Lease* the High Court was again concerned with a dutiable transaction. In the Court’s reasons in that case it was emphasised that: ‘The search is for “what was received by the [vendor] so as to move the transfers to the [purchaser] *as stipulated in the Agreement*”’: at [51]. It concluded that the consideration for the land transfers that were in issue included promises of payment in the development agreement in performance of which those sales were effected and was not confined to the consideration expressed for the transfer. It was that additional consideration ‘which moved each transfer’: at [62]. The High Court reached that conclusion on the basis that the land sale contracts were made pursuant to a ‘single, integrated and indivisible’ transaction as recorded in the development agreement: at [50]-[53].

193 For present purposes, I would draw two propositions from these authorities when it comes to determining the monetary consideration for a transaction or dealing recorded by agreement based upon its proper construction, namely:

- (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.

194 Turning then to the present circumstances, the amounts that are required to be paid are specified as a price per unit of concentrate. There is an obligation on the part of the Bottler to buy its requirements of concentrate only from PepsiCo (or, as has been explained, a Related Entity). However, regard to the whole of the terms of the EBAs makes plain that it is not an agreement to supply concentrate. The nature of the transaction or dealing recorded in the agreement is one in which PepsiCo appoints the Bottler to bottle, distribute and sell branded beverages. It deals with the extent of the territory for that activity. By the EBAs, the Bottler secures the licence to be able to sell branded products to its customers. The only payment that it makes for that right is the per unit price for concentrate specified in the EBA.

195 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.

196 Finally, the operative provision of the EBAs pursuant to which the concentrate is sold and bought is a provision that binds PepsiCo on the one hand and the Bottler on the other. True it is that it allows for the Seller to be either PepsiCo or a Related Entity nominated by PepsiCo as the party who will perform that obligation and receive the amounts to be paid, but there is no agreement by the Bottler with the Related Entity recorded in the EBAs. If the Bottler ceased buying concentrate during the term, it is PepsiCo that would have a claim. Similarly, if there was a failure to pay for concentrate, the terms of the EBA meant that PepsiCo could sue to require payment to be made because failure to pay the Related Entity would be a breach of the term of the EBA by which the Bottler agreed with PepsiCo to buy the concentrate. It may be that the Related Entity could also claim on the basis of terms voluntarily agreed as between the Bottler and the Related Entity (or on some restitutionary basis in the absence of such an

agreement). However, when it comes to considering who is entitled to performance of the promise to pay the specified prices in the EBAs, it is PepsiCo that is entitled to performance of that provision.

197 In those circumstances, regard to the whole of the terms of the EBAs reveals that the prices to be paid under the terms of the EBAs are not simply consideration for the concentrate. Rather they are also consideration moving in favour of PepsiCo for the right to use the valuable brands that are conferred by the terms of the EBAs. They are properly construed as agreements to bottle, sell and distribute branded products, not as agreements for the supply of concentrate. It follows in my view 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 the Bottler was licensed to use.

198 The fact that the EBAs included a provision by which PepsiCo as the Seller could nominate a Related Entity to be the Seller does not alter the commercial character of the EBAs that is evident from a consideration of the whole of the terms of the agreements. Nor does the fact that in the manner in which the EBAs were performed a Related Entity was nominated as the Seller and the amounts provided for by the terms of the EBAs came to be paid to the Related Entity. Rather, the part of the price specified for concentrate, remained consideration for the use of the trade marks. Which is not to say that, when received by the Related Entity, it was received *by that party* as a royalty. The price as agreed between PepsiCo and the Bottler in the EBA could be in consideration (as to part) for the right to use the trade marks, but when an amount calculated in the same manner is paid to the nominated Related Entity as the supplier of the concentrate it could be in consideration for the concentrate. Nor is it to say that when received by the Related Entity in return for the supply of the concentrate that the monies in the hands of the Related Entity included an amount received for and on behalf of PepsiCo. As explained in the joint reasons, the Commissioner's case was silent as to any aspect of that kind. However, it does mean that part of the amount which was to be paid to the Related Entity as a consequence of the Related Entity being nominated by PepsiCo as the Seller for the purposes of performance of the obligation to sell concentrate under the terms of the EBA, was still an amount of money that was agreed to be paid by the Bottler partly in consideration for the use of the trade marks.

199 In *Freedom Foods Pty Ltd v Blue Diamond Growers* [2021] FCAFC 86; (2021) 286 FCR 437, I was a member of a Full Court (with Allsop CJ and Anastassiou J) that reached a similar conclusion in respect of a different agreement for different statutory purposes. The issue in

that case was whether an agreement was a franchise agreement for certain regulatory purposes. The agreement in that case was an agreement by which Freedom Foods was licensed by Blue Diamond Growers to manufacture and sell almond milk products using a name and trade marks owned by Blue Diamond Growers. The only payment to be made by Freedom Foods was for the almond base which was to be used to manufacture the products to be sold under the licensed names. There was no separate licence fee for the use of the name and trade marks.

200 Amongst other things, in order for the licence agreement to be a franchise agreement for the purposes of the regulation it had to provide for Blue Diamond Growers to grant the right to Freedom Foods to carry on the business of offering, supplying or distributing goods or services in Australia under a Blue Diamond Growers system or marketing plan.

201 In considering what was provided for by the agreement for the purposes of reaching a conclusion as to whether the above requirement was met, the following conclusion was reached as to the significance of the fact that the only price to be paid was a price for almond base supplied by Blue Diamond Growers to Freedom Foods (at [66]):

It may be inferred that the price that Blue Diamond was to charge Freedom Foods for the Almond Base was to include remuneration for the value of the brands (the value of which was to be further enhanced by the ongoing marketing expenditure to be incurred by Blue Diamond) or that there was no charge for the value of that intellectual property. The latter is such an unlikely commercial position that, in the absence of the Court being taken to evidence to the contrary, it may be inferred that the Almond Base price included remuneration not just for the supply of the Almond Base.

202 The above reasoning was undertaken in a very different context and provides no authority as to how to approach the present statutory task. Nevertheless, it does provide an example of a different factual circumstance in which the adopted method for calculation of the monetary consideration to be paid under an agreement (per unit of product sold) does not mean that the consideration is being paid solely for that product.

Does the ‘exclusive royalty-free licence’ language in the EBA with SVC lead to a different conclusion concerning the royalty?

203 For reasons I have given, the fact that the EBA with SVC provided expressly that the grant of the right to use the trade marks was of ‘an exclusive royalty-free licence to use’ cannot determine what the monetary consideration provided for by the EBA was ‘for’. The provisions of the EBA with SVC are otherwise not materially different (for present purposes) from the provisions of the EBA with PepsiCo. To label the grant of the right to use the trade marks as being given ‘royalty-free’ could do no more than say that there was no monetary consideration beyond that which was provided for elsewhere in the EBA, namely in the form of a price per

unit of concentrate. There remained the question whether any part of that amount when paid was paid ‘as consideration for’ the use of the trade marks. For reasons that have been given, that amount was, in part, consideration for the use of the trade marks and was therefore a royalty to that extent.

Whether the amounts paid constituted income derived by PepsiCo and SVC?

204 As has been explained, in order for a liability to withholding tax to be imposed, the amount derived by a non-resident that consists of a royalty must also be income of PepsiCo or SVC as the case may be.

205 The trial judge concluded that the relevant portions of the amounts paid by the Bottler to the Related Entity were income derived by PepsiCo and SVC and were amounts to which they were beneficially entitled. His Honour said that this conclusion ‘follows as a matter of contract from the fact that PepsiCo and SVC were the parties to the EBAs and [the Bottler’s] payment obligations under the EBAs were owed to them’: at TJ[255]. Respectfully, I do not accept that to be the case. As has been explained, if a Related Entity was nominated the Seller (as was the case) then the obligation to buy the concentrate from PepsiCo or SVC (as the case may be) became an obligation to buy from the Related Entity. Admittedly it was the case that the party entitled to enforce performance in that way remained PepsiCo or SVC. But the obligation became one which required the Bottler to buy from the Related Entity (and to make payment of the price per unit to that Related Entity). In effect, the nomination of the Related Entity as the Seller directed the benefit of the payment required by the EBAs to the Related Entity. Once the nomination was made, all of the amounts to be paid upon supply of the concentrate were owed to the Related Entity as the Seller. This position is reinforced by regard to the manner in which the supply of concentrate was actually effected by the Australian subsidiary as the Seller.

206 Therefore, it was not the case that the amounts that were paid by the Bottler to the Related Entity were ‘owed’ to PepsiCo or SVC (as the case may be).

207 Respectfully, I agree with Perram and Jackman JJ for the reasons they give that the payments made by the Bottler received by the Related Entity did not result in the derivation of income by PepsiCo or SVC (as the case may be).

Conclusion as to withholding tax appeal

208 It follows from the conclusion as to derivation of income that PepsiCo and SVC have demonstrated that the trial judge was in error in concluding that the terms of s 128B(2B) were met in the circumstances of the present case. Their appeals must be upheld.

The diverted profits tax appeal

209 The relevant statutory provisions are carefully considered in the joint reasons of Perram and Jackman JJ. For the reasons there given, if I am wrong in my view that the amounts paid by the Bottler consisted of a royalty because they were paid as consideration for the use of the trade marks then, with respect, I agree that for the reasons expressed in the joint reasons, that the diverted profits appeal must fail.

210 However, there remains the issue whether the diverted profits tax appeal can and should be upheld on the basis of the conclusions I have reached to the effect that the EBAs provided for the payment of amounts that were, in part, as consideration for the use of the trade marks. On the conclusion I have reached, it is the mechanism by which the Related Entity 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 liability on the part of PepsiCo or SVC (as the case may be). Therefore, on the conclusions I have reached in the context of the withholding tax appeal, different questions arise to those considered in the joint reasons.

211 The possibility that the scheme case may arise for consideration in the circumstances I have found was raised in the course of oral argument. Counsel for PepsiCo and SVC accepted that the scheme case would still need to be considered in such circumstances.

212 The schemes as alleged by the Commissioner are set out in the joint reasons. They allege, in effect, that by entering into the EBAs, PepsiCo and SVC appointed the Bottler to bottle, sell and distribute branded beverages on terms that required the purchase of concentrate and conferred the right to use the trade marks, but that they did so in circumstances where ‘no royalty was paid’ for the licence to use the trade marks.

213 As to the relevant tax benefit that is required for the scheme provisions to apply and the operation of those provisions, I agree with the analysis in the joint reasons.

214 Much of the case advanced for PepsiCo (or SVC) as to why the trial judge was in error in finding (on the assumption that there was no withholding tax liability) that the diverted profits tax provisions applied involved submissions as to why the payment of monetary consideration by way of royalty for the licence to use the trade marks was not essential to the commercial character of the dealings with the Bottler. However, those submissions presumed a finding to the effect that in the EBAs there was no amount included in the price per unit of concentrate that was for the licence to use the trade marks. For reasons that have been given, I do not

accept that premise. Therefore, in my respectful view, the application of the scheme provisions fall to be considered in respect of a transaction which includes an amount which is consideration for the use of the trade marks.

215 On the conclusion that I have reached concerning the royalty question, 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.

216 The second of the reasonable alternatives advanced by the Commissioner as the basis for the contention that tax effects would have occurred if the scheme had not been entered into, was that the EBAs would have, or might reasonably be expected to have, expressly provided for the payments to be made by the Bottler to include a royalty for the use of the trade marks. Given that the claim made was that there was a diverted profits tax liability that would support the assessments that had been issued to PepsiCo and SVC, the postulate advanced by the Commissioner must refer to an express provision for a royalty to be paid to PepsiCo or SVC (as the case may be).

217 It follows that the reasonable postulate that I have described is consistent with the second of the alternatives advanced by the Commissioner. In any event, as the joint reasons explain, it is the burden of PepsiCo and SVC to prove that there was no reasonable alternative to entering into the scheme and for the reasons I have given they have not done so.

218 Therefore, it is necessary to consider the principal purpose of PepsiCo and SVC (as the case may be) in entering into and carrying out the scheme in order to determine whether the requirements of s 177J(1)(b) are met. As to the requirements to be met, I agree with the analysis in the joint reasons. Their Honours have undertaken their analysis of purpose on the basis of an assumption which equates to my findings. On that basis their Honours would have concluded that the requisite purpose would have been established. Respectfully, I agree with their analysis.

Conclusion as to diverted profits tax appeals

219 For those reasons, I would uphold the Commissioner's appeals.

Conclusion

220 For those reasons, I would join in the orders allowing the appeals by PepsiCo and SVC. However, I would allow the Commissioner's appeals. I would have heard from the parties on

the question of costs, but as I am in a minority the appropriate order as to costs is properly determined by Perram and Jackman JJ.

I certify that the preceding eighty-five (85) numbered paragraphs are a true copy of the Reasons for Judgment of the Honourable Justice Colvin.

Associate:

Dated: 26 June 2024