HIGH COURT OF AUSTRALIA

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Details of Filing

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IN THE HIGH COURT OF AUSTRALIA
MELBOURNE REGISTRY

M98, M100 and M101 of 2024

BETWEEN:

Commissioner of Taxation
Appellant

and

PepsiCo, Inc.
Respondent

M99, M102 and M103 of 2024

BETWEEN:

Commissioner of Taxation
Appellant

and

Stokely-Van Camp, Inc.
Respondent

RESPONDENTS' SUBMISSIONS

PART I – Certification

1. It is certified that these submissions are in a form suitable for publication on the Internet.

PART II – Issues

2. Section 128B of the *Income Tax Assessment Act 1936* (Cth) (**ITAA 1936**) relevantly provides (emphasis added):

> (2B) Subject to subsection (3), this section also applies to **income** that:
>
> (a) is **derived by a non-resident**:
>
> (i) during the 1993-94 year of income of the non-resident; or
>
> (ii) during a later year of income of the non-resident; and
>
> (b) **consists of a royalty** that:
>
> (i) **is paid to the non-resident** by a person to whom this section applies and is not an outgoing wholly incurred by that person in carrying on business in a foreign country at or through a permanent establishment of that person in that country; or
>
> (ii) …
>
> …
>
> (5A) A person **who derives income to which this section applies** that consists of a royalty is liable to pay income tax upon that income at the rate declared by the Parliament in respect of income to which this subsection applies.

3. The principal issue presented by the appeals is whether **PepsiCo**, Inc. and Stokely Van-Camp, Inc. (**SVC**) derived income consisting of a royalty paid to them when Schweppes Australia Pty Ltd (**SAPL**) paid amounts to their nominated seller in Australia, PepsiCo Beverages Singapore Pty Ltd (**PBS**) for the purchase of beverage concentrate.

4. If PepsiCo and SVC did not derive income consisting of a royalty paid to them, a further issue arises whether, by each entering into an exclusive bottling agreement (**EBA**) under which they granted SAPL a licence to use certain intellectual property on a royalty-free basis, they entered into a scheme to which s 177J of the ITAA 1936 applies with the consequence they are liable to pay diverted profits tax under s 177P.

PART III – Section 78B

5. The Respondents consider no notice under s 78B of the *Judiciary Act 1903* to be required.

PART IV – Facts

6. The Respondents agree with the facts as set out at [6]-[15] of the Commissioner's submissions dated 8 January 2025 (**AS**), but note by way of clarification: (a) the SVC

EBA expressly stated that the licence for the use of intellectual property[1] was granted royalty-free (cf. AS [7]); (b) PBS provided SAPL with its bank account details (cf. AS [8]); (c) PBS issued the invoices to SAPL for the beverage concentrate (cf. AS [8]); (d) the amounts PBS transferred to Concentrate Manufacturing (Singapore) Pte Ltd (**CMSPL**) were payments for the purchase of concentrate; and (e) Perram and Jackman JJ's conclusion regarding "principal purpose" within the meaning of s 177J(1)(b) referred to at AS [15] was based on what they described as "*the highly artificial assumption … that the price of concentrate included a royalty*" (*PepsiCo, Inc v Commissioner of Taxation* (2024) 303 FCR 1 (**FC**) at [133]).

PART V – Argument

Royalty withholding tax

A taxing statute operates on the result of the taxpayer's activities as it finds them

7. Section 128B imposes royalty withholding tax on income derived by a non-resident that consists of a royalty that is paid to the non-resident.

8. The Commissioner seeks to apply s 128B to payments made by one Australian company to another for the purchase of goods. Such a transaction does not fall within the ambit of the section.

9. The pertinent facts are these. PBS's role in the PepsiCo Group was to act as a distributor of beverage concentrate. Pursuant to an agreement with the concentrate manufacturer, CMSPL, PBS purchased concentrate and on-sold it to third parties including SAPL. SAPL placed orders for concentrate with PBS. PBS satisfied the orders by supplying the concentrate to SAPL. PBS invoiced SAPL for the goods. The invoices contained a breakdown of the prices of the constituent components of the concentrate. SAPL paid PBS for the concentrate in accordance with the invoices. PBS returned and reported the proceeds of the sales as income in its Australian tax returns and financial statements. (See: *PepsiCo, Inc v Commissioner of Taxation* [2023] FCA 1490 (**PJ**) [7(d)-(e)], [112], [119]-[121], [124]; FC [2].[2])

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1 The term "intellectual property" is used as a shorthand in these submissions to capture the items referred to in the definition of "royalty" in s 6(1) of the ITAA 1936.

2 See also: annexure LD-44 to the affidavit of Ms Lilian Dent affirmed on 15 September 2022 (**Dent affidavit**) (Concentrate Distribution Agreement between CMSPL and PBS dated 1 January 2018) (Respondent's Book of Further Materials (**RBFM**), pp 176-192); annexures LD-45 and

10. The Commissioner does not allege that any of these transactions were shams.[3] Yet he invites the Court to construe the EBAs in such a way as to produce the result that PBS did not sell the concentrate to SAPL for the invoiced prices. Rather, he contends for a legal conclusion that PBS sold the concentrate for lesser amounts; when SAPL paid the invoices, it paid PBS those lesser amounts for the concentrate and, simultaneously, paid PBS amounts which were not due to it, but were due to PepsiCo or SVC (as applicable) for a licence to use intellectual property. From the Commissioner's construction, it would follow that SAPL could successfully raise by way of a defence in an action by PBS on the invoices a plea that it did not owe PBS the full amounts described in the invoices because parts of those amounts were owed to PepsiCo or SVC.

11. In contending for this construction, the Commissioner does not allege that PBS received the monies putatively payable to PepsiCo and SVC as trustee or agent for them. Nor does he seek to explain the necessary consequence that PBS would thereby have been trading at a loss. His construction bears the heavy burden of having to overcome the express terms of the EBAs under which the parties agreed the prices at which SAPL would purchase the concentrate from PBS (addressed further below). The Commissioner's construction is also contradicted by the way the parties conducted themselves and recorded the transactions contemplated by the EBAs.

12. The Commissioner's construction of the EBAs should be rejected. As this Court recently affirmed, a tax Act must take the result of the taxpayer's activities as it finds them.[4] Here, the relevant transactions were sales of goods for a price. The Commissioner impermissibly seeks to recast those transactions to substitute an economic equivalent.[5]

LD-48 (sample purchase orders) (RBFM pp 193-199, 208-212); annexures LD-46 and LD-49 (sample invoices) (RBFM pp 200-207, 213-223).

3 Appeal Transcript, Day 2, p 118 at lines 41-46 and p 138 at lines 10-12 (Appellant's Book of Further Materials (**ABFM**), p 117); see also Trial Transcript, Day 2, p 90 at line 33 (RBFM pp 356).

4 *Automotive Invest Pty Ltd v Federal of Commissioner of Taxation* [2024] HCA 36; (2024) 98 ALJR 1245 at 1270 [135] (Edelman, Steward and Gleeson JJ); *Commissioner of Taxation v **Thomas*** [2018] HCA 31; (2018) 264 CLR 382, 415 [85] (Gageler J).

5 *City Link Melbourne Ltd v Commissioner of Taxation* [2004] FCAFC 272; (2004) 141 FCR 69 at 83 [42]; *Federal Commissioner of Taxation v Myer Emporium Ltd* [1987] HCA 18; (1987) 163 CLR 199 at 217; *Federal Commissioner of Taxation v Orica Ltd* [1998] HCA 33; (1998) 194 CLR 500 at [70]; *St George Bank Ltd v Federal Commissioner of Taxation* [2008] FCA 453; (2008) 69 ATR 634 at 653 [63]; *Federal Commissioner of Taxation v Citylink Melbourne Limited* [2006] HCA 36; (2006) 228 CLR 1 at 31 [95]; *Ausnet Transmission Group Pty Ltd v Commissioner of Taxation* [2015] HCA 25; (2015) 255 CLR 439 at 510-1 [190]-[191] per Nettle

Any process of characterisation of a payment must commence with a correct identification of the legal rights and obligations attending the transaction giving rise to the payment.[6] The Commissioner's case amounts to a redefinition of those legal rights and obligations to make good an assumption which underpins his case; that is, that because valuable items of intellectual property were licensed to SAPL under the EBAs, SAPL must have paid PepsiCo and SVC something for that licence.

Relevant tests

13. The ultimate question is whether the Respondents derived income consisting of a royalty paid to them.

14. The question whether the Respondents derived income is to be determined by the application of ordinary business and commercial principles.[7] Income derived represents gains that have come home to the taxpayer in a realised or immediately realisable form.[8] This requires beneficial receipt[9] and the reaching of a situation in which monies received might properly be counted as gains completely made, so that there is neither legal nor business unsoundness in regarding them, without qualification, as income derived.[10]

15. For an amount of income to consist of a royalty, it must relevantly be an amount "*paid or credited, however described or computed ... as consideration for ... the use of, or the right to use, any ... secret formula or process, trade mark, or other like property or right*".[11] The question whether amounts were paid as consideration for the use of or the

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J in dissent in the result; *Federal Commissioner of Taxation v Visy Industries USA Pty Ltd* [2012] FCAFC 106; (2012) 205 FCR 317 at 335 [68].

6 *International Business Machines Corporation v Commissioner of Taxation* [2011] FCA 335; (2011) 83 ATR 32 (***IBM***) at 36 [16], 42 [41], 43-4 [51] and 44 [54]; cf. AS [27].

7 ***Brent*** *v Commissioner of Taxation of the Commonwealth of Australia* [1971] HCA 48; (1971) 125 CLR 418 at 427.9-428.2 (Gibbs J).

8 *Commissioner of Taxes (SA) v Executor Trustee and Agency Co of South Australia Ltd* [1938] HCA 69; (1938) 63 CLR 108 at 155.2 (Dixon J).

9 Article 12(1) of the *Convention between the Government of the United States of America and the Government of Australia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income*, signed at Sydney on 6 August 1982 (as amended) (**US DTA**) also requires that the resident of the other Contract State to whom the royalty is paid be "beneficially entitled" to it.

10 *Arthur Murray (NSW) Pty Ltd v Federal Commissioner of Taxation* [1965] HCA 58; (1965) 114 CLR 314 at 318.2 (Barwick CJ, Kitto and Taylor JJ).

11 Definition of 'royalty' in s 6(1) of the ITAA36. FC [154] per Colvin J.

right to use such items is to be answered by reference to the terms of the agreements between the parties.[12]

16. In order for payment to occur, there must be a monetary obligation, the offer of an act by the debtor in discharge of it, and an acceptance of that offer by the creditor.[13] A creditor may direct the debtor to pay an amount owing to the creditor to a third party and payment to the third party will be a payment to the creditor.[14] But there must first be a monetary obligation owed to the creditor.

17. Subsection 128A(2) also deems a royalty to have been paid by one person to another "*although it is not actually paid over to the other person but is reinvested, accumulated, capitalized, carried to any reserve, sinking fund or insurance fund however designated, or otherwise dealt with on behalf of the other person or as the other person directs*". The provision presupposes an amount owing by the putative payor to the putative payee, such that the subsequent dealing can be said to be done on the payee's behalf or at its direction. That is, the section is concerned with a form of payment whereby funds are not actually received by the putative payee but a monetary obligation to that person nonetheless exists which is discharged by other means.[15]

Relevant legal rights and obligations

18. A correct identification of the legal rights and obligations as between the Respondents, SAPL and PBS is necessary to answer each aspect of the question whether the Respondents derived income consisting of a royalty paid to them.

19. Contractual rights and obligations are to be determined objectively, by reference to the language used, circumstances addressed and commercial purpose or objects to be secured

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12 Cf., *IBM* at 36 [16], 42 [41], 43-4 [51] and 44 [54]. *IBM* concerned the definition of "royalties" in art 12(4) of the US DTA which is given primacy by s 4(2) of the *International Tax Agreements Act 1953* (Cth). The current proceedings have been conducted on the basis that there is no presently relevant difference between the royalty definitions in s 6(1) of the ITAA 1936 and art 12(4) of the US DTA (PJ [237]; FC [157]).

13 *ABB Australia Pty Ltd v Federal Commissioner of Taxation* [2007] FCA 1063; (2007) 162 FCR 189 (***ABB Australia***) at 226 [166].

14 *ABB Australia* at 226 [164].

15 *Liquidator of the North Sydney Investment and Tramway Co. Ltd v Commissioners of Taxation* (1898) 19 LR (NSW) 225 at 229.5; *Perrott v Commissioner of Taxation* (NSW) (1922) 23 SR (NSW) 118 at 124.1; *Permanent Trustee Co of New South Wales Ltd v Federal Commissioner of Taxation* [1940] ALR 291 at 293.2; *Brent* at 430.5-431.2.

by the contract. In construing a commercial contract, it is necessary to ask what a reasonable businessperson would have understood its terms to mean.[16]

20. PepsiCo appointed SAPL "*to bottle, sell and distribute*" certain beverages: cl 3(a) of the PepsiCo EBA. Relevantly, SAPL agreed to "buy", either from PepsiCo or its nominated "Seller", all units of concentrate required for the manufacture of the beverages at specified "prices" which were subject to adjustment based on the official Australia Consumer Price Index. Similar terms appear in the SVC EBA: cll 3, 7.1 and 7.2(a).

21. The ordinary meaning of the word "price" is "*the sum or amount of money or its equivalent for which anything is bought, sold or offered for sale*": *Macquarie Dictionary* (4th Ed.). There is no reason to suppose the parties intended that word to bear a different meaning where it appears in the EBAs.

22. Originally, the nominated Seller of concentrate under the PepsiCo and SVC EBAs was Pepsi-Cola International, Cork: PJ [70]. On 8 December 2015, coinciding with the construction of a concentrate manufacturing facility in Singapore, each of PepsiCo and SVC sent a notification to SAPL that, from 1 January 2016, the Seller of units of concentrate under the respective EBAs would change to PBS and that all purchase orders should be sent to PBS.[17] Thus, from 1 January 2016, SAPL came under an obligation to each of PepsiCo and SVC to purchase its required concentrate from PBS.

23. When SAPL placed orders for concentrate with PBS and was issued invoices by PBS for its supply, SAPL came under an obligation to pay PBS the purchase price for the concentrate. Contrary to what is submitted by the Commissioner at AS [36], it did not come under an obligation to pay the purchase price to PepsiCo or SVC.

24. In relation to the SVC EBA, the Commissioner relies on cl 7.4(f) which provides that payment shall be made to an account "*as may be specified by Company or a Company Affiliate*". That wording corresponds with the introductory words of the clause which contemplate that the concentrate may be supplied by the Company, a Related Corporation or Company Affiliate. Indeed the entire contract is set on that footing by cl 7.1(b) which provides that if the concentrate is supplied by a Related Corporation or Company

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16 *Mount Bruce Mining Pty Limited v Wright Prospecting Pty Limited* [2015] HCA 37; (2015) 256 CLR 104 at 116 [46]-[47] (French CJ, Nettle and Gordon JJ).

17 Dent affidavit at [45]-[46], [49]-[51] (RBFM pp 61-62)

Affiliate, the terms of the EBA, to the extent that they are relevant, apply to transactions between SAPL and that company as if they were direct parties to the agreement. That clause tells against the Commissioner's refusal to acknowledge a separate contract of sale between PBS and SAPL (cf. AS [35] and paragraph 27 below). Here, the account details were provided by PBS and not SVC.[18] However, even if the account details had been provided by SVC pursuant to cl 7.4(f), it would not transform the debt owed by SAPL to PBS for the supply of concentrate into a debt owed to SVC. PBS was the vendor of the concentrate and payments were made in satisfaction of debts owed to it, as each member of the Full Court agreed (FC[41] and [205]).

25. In relation to the PepsiCo EBA, the Commissioner relies on cl 4(c) which obliges SAPL to pay "*for each order of Units*" within 7 days of delivery. Contrary to AS [36(b)], cl 4(c) did not oblige SAPL to pay PepsiCo for the concentrate. The orders were placed with PBS as requested by PepsiCo in accordance with PBS's nomination as Seller and PBS made the sales of concentrate to SAPL. If PepsiCo sought to enforce cl 4(c), its remedy would be an order for specific performance requiring SAPL to pay PBS for the concentrate invoiced.

26. Both the PepsiCo and SVC EBA contained certain machinery clauses concerning the sale of concentrate, which must be read in a context where sales could either be made by them or their nominated subsidiary as "Seller".[19] It is not necessary for this Court to decide whether, in circumstances where PBS made the sales as nominated Seller, PepsiCo or SVC might have held the benefit of those clauses on trust for PBS such that PBS might have been able to enforce them as against SAPL.[20] Nor is it necessary for this Court to decide whether relevant terms of the EBAs (being those relating to the sale of concentrate) might have been implied or incorporated into the sale by PBS to SAPL such that they could have been enforced by either of those parties as between them: cf. cl 7.1(b) of the SVC EBA referred to above.[21] It is sufficient, for the purposes of answering

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[18] Annexures LD-42 and LD-43 to the Dent affidavit (ABFM p 94-97).

[19] E.g. cl 4(c) of the PepsiCo EBA; cl 7.4 of the SVC EBA (ABFM pp 9, 50-51).

[20] C.f. *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd* [1988] HCA 44; (1988) 165 CLR 107 at 115.2 (Mason CJ and Wilson J).

[21] Clause 7.1(b) of the SVC EBA suggests this is at least what SVC and SAPL intended. It is open to conclude that, by the letters dated 11 January 2016 (annexures LD-42 and LD-43 to the Dent affidavit) and, in particular, by PBS's reference to the relevant "Exclusive Bottling Appointment" and the letters of 8 December 2015 (which expressly referred to the EBAs), PBS communicated

the statutory question, that SAPL did not owe the amounts payable to PBS for the concentrate to either of PepsiCo or SVC.

The Commissioner's pleading point

27. The Respondents do not go beyond their pleaded case by pointing to the legal aspects of the sale transactions between PBS and SAPL as the Commissioner suggests at AS [35].[22] The Respondents pleaded and the Commissioner admitted that PBS sold the concentrate to SAPL and that SAPL purchased it from PBS.[23] It has never been disputed that PBS (and not PepsiCo or SVC) had title to the concentrate.

28. A "sale" is "a *nomen juris*; it is the name of a particular consensual contract",[24] the essential idea of which imports an agreement to transfer property for valuable consideration.[25] The word "purchase" conveys the reflex meaning, encompassing the existence of parties with a mutual intention in respect of the acquisition of property and the giving of consideration.[26] The Respondents adduced evidence recording the sales by PBS to SAPL including purchase orders, invoices, bank statements, tax returns and

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its intention to SAPL to assume the responsibilities of "Seller" of concentrate under, and on the terms of, the EBAs upon acceptance by SAPL, which acceptance was expressed by SAPL issuing a purchase order to acquire a quantity of beverage concentrate on the terms so stipulated. (ABFM pp 94-97).

[22] These matters acquired greater significance after the Commissioner filed his written outline of opening submissions in which he first articulated his contention that the amounts paid by SAPL to PBS were paid at the direction of the Respondents: Commissioner's outline of submissions dated 3 March 2023 at [42]-[44] (RBFM pp 308-309). The Commissioner did not articulate his "payment by direction" case in his response to a request for particulars of the allegation in his defences that SAPL "paid" the Respondents: see request for particulars dated 28 March 2022 and response dated 14 April 2022 (RBFM pp 8-18). The Respondents engaged with that case in its reply: Respondents' submissions in reply in VID 74 of 2022 and VID 82 of 2022 dated 10 March 2023 [26]-[27] (RBFM p 339).

[23] See paragraph 10(a) of the Amended Statements of Claim filed in VID 74 of 2022 (PepsiCo) (ABFM p 126) and VID 82 of 2022 (SVC) (RBFM p 270) and paragraph 10(b)(i) of the Commissioner's Amended Defences in VID 74 of 2022 (PepsiCo) (ABFM p 132) and VID 82 of 2022 (SVC) respectively (RBFM p 277).

[24] *Kirkness v John Hudson & Co. Ltd.* [1955] 1 AC 696 at 727.5 (Lord Reid).

[25] *Smith v Commissioner of Taxation (Cth)* [1932] HCA 44; (1932) 48 CLR 178 at 186.7 (Rich J) and 189.8 (Starke, Dixon and McTiernan JJ). See also *Chan v Dainford Ltd* [1985] HCA 15; (1985) 155 CLR 533 at 537.7 (Gibbs CJ, Mason, Wilson, Brennan and Dawson JJ); *Taxation, Commissioner of (Cth) v Salenger* [1988] FCA 176; (1988) 19 FCR 378 at 382.2 (French J); *Sun World International Inc v Registrar, Plant Breeders' Rights* [1988] FCA 1260; (1998) 87 FCR 405 at 406.2 (Burchett J) and 412.7 (Carr J).

[26] *Colby Corporation Pty Ltd v Federal Commissioner of Taxation* [2008] FCAFC 10; (2008) 165 FCR 133 at 139-140 [25] (Stone and Branson JJ).

financial statements. The Commissioner accepted before the Full Court that SAPL "*bought the concentrate from PBS*"[27] and that "*one might infer that there is a contract between SAPL and PBS*".[28]

29. The sales by PBS to SAPL, constituting an exchange of goods for money, were subject to State sale of goods legislation as a "*contract of sale of goods*"[29] including provisions relating to conditions and warranties as to PBS's title in the concentrate and its quality[30] and to the conferral of a right on PBS to maintain an action against SAPL for the price of unpaid goods.[31]

The payments were not a 'royalty' to any extent

30. The EBAs contain a licence for the use of intellectual property by SAPL[32] to which significant restrictions and controls were yoked. The restrictions included confining SAPL's use of the intellectual property to distribution of the relevant beverages, and requiring SAPL to prepare the beverages precisely as directed by each Respondent; while the controls included reserving to the Respondents rights of inspection, reporting and testing, and of prescription of the manner in which the intellectual property was used (FC [20]). SAPL might, for instance, lose its right to bottle, sell and distribute beverages (and to use the intellectual property necessary to perform those functions) if it failed to comply with strict quality measures imposed by the PepsiCo Group in terms of, say, water quality, ingredient procurement and dilution ratios;[33] or for failure to maintain sufficient bottling plant capacity;[34] or if it failed actively to advertise the beverages and vigorously

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27 Appeal Transcript, Day 2, p 120 at lines 29-32 (RBFM p 366).

28 Appeal Transcript, Day 2, p 119 at lines 29-36 (RBFM p 365), referring to the effect of the State sale of goods legislation.

29 See, for example, s 6 of the *Sale of Goods Act 1923* (NSW).

30 See, for example, ss 17 and 19 of the *Sale of Goods Act 1923* (NSW).

31 See, for example, s 51 of the *Sale of Goods Act 1923* (NSW). As the majority of the Full Court noted at FC [39] and [43], the Commissioner expressly eschewed any case that PBS sold the concentrate as agent for PepsiCo or SVC.

32 The PepsiCo EBA contained an implied licence (PJ[57]), whereas the SVC EBA contained an express royalty-free licence (cl 4.1) (ABFM p 38).

33 Affidavit of Randall Lovorn affirmed on 5 September 2022, [43]-[46] (RBFM p 28); PepsiCo EBA, cl 6; SVC EBA, e.g., cll 5 and 12 (ABFM pp 40-44, 56-58).

34 PepsiCo EBA, cl 8; SVC EBA cl 5.4 (ABFM pp 11, 44).

to engage in sales promotion activities for the beverages in Australia;[35] or for failure to meet performance targets.[36]

31. In addition to the PepsiCo EBA, SAPL entered into a Performance Agreement with a subsidiary of PepsiCo[37] setting out the obligations of the parties to perform advertising and marketing within the local market,[38] including allocating responsibility for sponsorship and trade promotion;[39] and "Co-op A&M" agreements prescribing significant annual investments in local advertising and marketing.[40] Similar obligations were prescribed in relation to non-carbonated beverages.[41]

32. The majority of the Full Court was, with respect, correct to identify that, just because valuable items of intellectual property were licensed to SAPL under the EBAs, it should not be assumed that SAPL must have paid PepsiCo and SVC for it. But it does not follow that the licences were granted for nothing as the Commissioner contended (FC [19]). By taking a "complete view" of the EBAs, their Honours, with respect, correctly identified that the grant of the licences was of significant benefit to the Respondents (FC [21]). That view acknowledged the significant restrictions and controls, described above, to which the grant of the licences was subject, and the mutual rather than unilateral benefits enjoyed by SAPL and each Respondent (FC [21]).

33. The Respondents respectfully submit that, on a proper analysis, the consideration which passed from SAPL to the Respondents under the EBAs, insofar as it related to the transactions giving rise to the payments, was a promise to purchase concentrate at unit prices. That consideration was non-monetary. It was a promise to enter into further transactions – being purchases of goods for a price. It was, as set out above, one among many promises given by SAPL as part of its appointment as the Bottler. To accept, as

35 Clause 11(e) of the PepsiCo EBA; cl 9.2(a) of the SVC EBA (ABFM pp 11-12, 52).

36 See, e.g., annexure LD-24 to the Dent affidavit (RBFM pp 148 - 170) and PepsiCo EBA, cl 19 (ABFM p 14).

37 Dent affidavit [40]-[41] (RBFM pp 60); annexure LD-24 to the Dent affidavit (RBFM pp 148-170).

38 Affidavit of Andrew Williams affirmed on 7 September 2022 (**Williams affidavit**) [54] (RBFM p 41); annexure LD-24 to the Dent affidavit (RBFM pp 148-170).

39 Williams affidavit [53]-[57] (RBFM pp 41-42).

40 Dent affidavit [44] (RBFM p 61); Williams affidavit [64] (RBFM p 43); see, e.g., annexure LD-27 to the Dent affidavit (RBFM pp 148-170).

41 Schedule 6 to the SVC EBA (ABFM pp 79-84).

Colvin J noticed (FC [144]), that "*the buying of the 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*" does not transform the payment of the purchase price for the concentrate into consideration for the Respondents' grants of the licences to SAPL. As Barwick CJ observed in a different context in *Cliffs International, Inc. v Federal Commissioner of Taxation* (1979) 142 CLR 140 at 150 [25], "... *the fact that the promise to make the payments formed part of the consideration for the transfer of the shares does not mean that, when made, they were paid for the shares*".[42]

34. At FC [191], Colvin J, with respect, incorrectly states that the parties did not dispute 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 Respondents have never identified the consideration supporting the EBA as monetary; rather, their case has been that the relevant consideration moving from SAPL, insofar as it relates to the payments, was a promise to purchase concentrate.[43]

35. The present question of whether the payments made by SAPL to PBS were to any extent a royalty for the purposes of the definition in s 6(1) – being only one of the elements of the criteria for liability – turns on what the payments were "consideration for". The stamp duty cases referred to by the Commissioner[44] concern a different tax established by substantially different provisions under which liability in each case turned on what was received by the vendor so as to move a conveyance of property to a purchaser. The outcomes of those cases turned on the application of that quite different test to their

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[42] In that case, the payments, which resembled a royalty, secured nothing further for the payor. The notion is even more apt in the present case where the payments were for the purchase of goods.

[43] See, e.g., PepsiCo and SVC's Outlines of Opening Submissions (VID 74 and 82 of 2022) dated 17 February 2023 at [23], which stated that the EBAs established "*a mutually beneficial co-operative arrangement between the parties, with non-monetary consideration passing both ways*" (RBFM pp 288-289); and PepsiCo and SVC's Amended Notices of Appeal before the Full Court (VID 27 and 28 of 2024) dated 13 June 2024 at [10(b)-(c)) which stated that "*the consideration passing from SAPL to the Appellant under the EBA consisted of a series of promises and undertakings*" and "*the payments were made by SAPL to PBS for the purchase of concentrate and were not, to any extent, consideration received by the Appellant*" (RBFM pp 346, 353).

[44] *Archibald Howie Pty Ltd v Commissioner of Stamp Duties (NSW)* [1948] HCA 28; (1948) 77 CLR 143; *Davis Investments Pty Ltd v Commissioner of Stamp Duties (NSW)* [1958] HCA 22; (1958) 100 CLR 392; *Dick Smith Electronics Holdings Pty Ltd* [2005] HCA 3; (2005) 221 CLR 496; and *Commissioner of State Revenue (Vic) v Lend Lease Development Pty Ltd* [2014] HCA 51; (2014) 254 CLR 142.

particular facts and the majority decisions were, in three of the four cases, accompanied by strong dissents. The Respondents agree that the present case does not call for a reconciliation of those decisions (cf. AS [25]). However, two matters of principle may be borrowed from them in determining the present question. The ***first*** is that, in working out what the payments were consideration for, one should look to what was stipulated in the agreement. That was the approach of Bennett J in *IBM* to identifying what payments were for in the context of the royalty withholding tax provisions of the ITAA 1936.[45] The majority was, with respect, correct in concluding that, on an ordinary reading of the pricing clauses in the EBAs, the price specified for the concentrate was the consideration for the purchase of the concentrate (FC [24]). The same conclusion follows when one looks at the sales by PBS to SAPL as distinct transactions contemplated by the EBAs. The ***second*** is that, if one looks at what was received by PBS as the vendor of the concentrate (applying the test borrowed from the stamp duty cases) the answer is the payments, and the whole of the payments.

36. Although couched in terms of "characterisation" (cf. AS [27]), the Commissioner's submissions in relation to the definition of "royalty" necessarily invite a legal conclusion, based on a construction of the EBAs, namely that PBS sold the concentrate for a price less than the payments. Such a construction of the EBAs is, the Respondents respectfully submit, not open. In the absence of ambiguity, recourse to "context" or subjective assessments of "commercial reasonableness" (cf. FC [195] per Colvin J) are not required, and do not assist the Commissioner in any event.[46]

37. It is trite that the mandate to discover the parties' intentions expressed in the instrument of their agreement is no licence to alter that agreement even if it may be considered inconvenient or unjust *inter partes*.[47] This Court's insistence that binding contractual promises must be regarded as reliable indicators in an exercise of characterisation is

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45 (2011) 83 ATR 32 at 36 [16], 42 [41], 43-4 [51] and 44 [54].

46 Here, any consideration of 'context' ought to include the transactions entered into between PBS and SAPL recorded in invoices and other documents and the absence of any trust or agency relationship as between PBS and the Respondents. The provision of the licences to SAPL royalty free to enable it to perform its functions under the EBAs is not commercially unreasonable in light of the parties' collaborative relationship for the reasons given by the majority at FC [17]-[21].

47 *Australian Broadcasting Commission v Australasian Performing Right Association Ltd* [1973] HCA 36; (1973) 129 CLR 99 at 109.4 (Gibbs J). See also, e.g., *Cushman & Wakefield (NSW) Pty Ltd v Farrell* [2017] NSWCA 24 at [71].

founded upon the view that the function of the courts is to enforce legal obligations, and that it is no part of the judicial function to recast a contractual relationship to reflect a quasi-legislative judgment.[48] The same aim is undermined where the Revenue seeks to remake another's bargain based on an idiosyncratic view of its commercial attributes or to achieve a particular tax outcome.[49]

The payments were not to any extent paid to the Respondents and income derived by them

38. The Commissioner's payment by direction case relies on the letters sent by the Respondents to notify SAPL of their nomination of PBS as Seller.[50] However, the language of those letters gainsays his case. They are properly characterised as directions to *buy*, not directions to *pay*; i.e., directions to purchase concentrate from PBS (FC [44]).

39. Justice Colvin, with respect, correctly described the effect of the nominations in absolute terms. SAPL assumed an obligation to buy concentrate from PBS and to make payment of the price per unit to PBS such that all of the amounts to be paid on supply of the concentrate were owed to PBS (FC [205]). In his Honour's observation, that position was reinforced by the manner in which the supply of concentrate occurred, the evidence of which included purchase orders, invoices with itemised prices, bank statements and financial statements in which the Seller recorded the concentrate sale proceeds as wholly derived by it, none of which evidence was challenged by the Commissioner.

40. The efficacy of the Respondents' nomination of PBS as the seller of the concentrate is unchallenged. The discrete sale and purchase of concentrate by PBS and SAPL, upon the former's nomination as Seller, not acting (or said to be acting) as agent or trustee of the Respondents, provide a complete answer to the question of derivation, as all members of

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48 *WorkPac Pty Limited v Rossato* [2021] HCA 23; (2021) 271 CLR 456 (***WorkPac***) at 478-9 [62] (Kiefel CJ, Keane, Gordon, Edelman, Steward and Gleeson JJ); *Charter Reinsurance Co Ltd v Fagan* [1997] AC 313 at 388 (quoted in *WorkPac* at 479 [63]).

49 See *Anglo American Investments Pty Ltd (Trustee) v Commissioner of Taxation* [2022] FCA 971 at [309] where Logan J observed that, outside of anti-avoidance provisions, it is likewise no part of the judicial function to reshape or recast a contractual relationship in order to reflect a quasi-legislative judgment as to the just taxation of a particular corporate or natural person or a trust; citing: *Slutzkin v Federal Commissioner of Taxation* [1977] HCA 9; (1977) 140 CLR 314 at 319; *Inland Revenue Commissioners v Europa Oil (NZ) Ltd* [1971] AC 760 at 771; and *Federal Coke Co Pty Ltd v Federal Commissioner of Taxation* [1977] FCA 3; (1977) 34 FLR 375 at 387.

50 Annexures LD-40 and LD-41 to the Dent affidavit (ABFM pp 90-93).

the Full Court correctly agreed (FC [44]-[45] and [207]). That answer evinces no legal or business unsoundness.

41. Every member of the Full Court was, with respect, therefore correct in concluding that the amounts in question were paid by SAPL to PBS for the purchase of concentrate (FC [40]-[41], [44], [148], [205]-[207]); that SAPL owed no monetary obligation to the Respondents (FC [40]-[41] and [205]-[206]); and that the Respondents derived no income from the sale of concentrate by PBS to SAPL (FC [44]-[45] and [207]).

Conclusions on royalty withholding tax

42. The Court should find that the payments SAPL made to PBS were consideration for the sale of concentrate to it by PBS. No part of the amounts were paid to the Respondents and the Respondents did not derive any income consisting of a royalty. Section 128B of the ITAA 1936 does not apply to them.

Diverted profits tax

Introduction

43. The assessments for diverted profits tax are predicated on a finding that the amounts SAPL paid to PBS were, as provided for by the EBAs, for the purchase of concentrate and were not, to any extent, a royalty paid to either of the Respondents for the use of intellectual property. The schemes identified by the Commissioner consist of entry into the EBAs on these terms.[51] The Commissioner posits that, had the schemes not been entered into and carried out, the EBAs might reasonably be expected to have:

(a) expressed the payments to be for all of the property provided by (and promises made by) the PepsiCo Group entities (rather than for concentrate only); or

(b) expressly provided for the payments to include a royalty for the provision to SAPL of certain rights, knowledge and assistance (whether or not the amount of the royalty was specified).

44. The Commissioner's alternative postulates would represent a departure from the pricing model the PepsiCo Group[52] adopted in the early 1900s when it first began entering into

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[51] Commissioner's Amended Appeal Statements in VID 53 and 55, [67] (ABFM p 170).

[52] Including PepsiCo's predecessor, the Pepsi-Cola Company: Williams affidavit [12] (RBFM p 34).

exclusive bottling appointments with third parties. That model is currently deployed by the PepsiCo Group in at least 115 jurisdictions globally. It exemplifies the industry standard in the bottling industry and is well-understood.[53] The EBAs were themselves each a restatement of an existing EBA between the parties which had been in place in Australia since the early 2000s and which contained similar terms.[54] Agreements in the form postulated by the Commissioner would have been anomalous from an historical and industry perspective.

Tax benefit

45. The Respondents submit that any alternative postulate involving the payment by the bottler of a royalty for the use of intellectual property, as opposed to payments wholly for the purchase of concentrate, is unreasonable. Because the Commissioner defined the schemes as, in effect, entry into the EBAs on terms where no royalty was payable, that brings about the condition that there is no reasonable alternative postulate to the schemes. In those circumstances, there cannot be a tax benefit.

46. The Commissioner's alternative postulates involve events and circumstances that did not actually happen (PJ [432]). As such, their reasonableness must be determined pursuant to s 177CB(3), which requires that "*[a] decision that a tax effect might reasonably be expected to have occurred if the scheme had not been entered into or carried out must be based on a postulate that is a reasonable alternative to entering into or carrying out the scheme*".

47. It is true, as the Commissioner says (AS [72]), that the question posed by s 177C(1)(bc) cannot be answered simply by rejecting the premise of that question (what might have happened but for the scheme). However, s 177CB(3) confirms that if the thought experiment in s 177CB(1)(bc) does not yield a valid answer – because there is no reasonable alternative to the scheme – one cannot conclude that the taxpayer obtained a tax benefit (FC [64]). Subsection 177CB(3) makes this certain through the use of the word "must". It is unambiguous.

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53 See, e.g., Williams affidavit [24]-[29] (RBFM pp 36-37) and "*Cola Wars Continue: Coke and Pepsi in 2010*," David Yoffie and Renee Kim, *Harvard Business School,* 26 May 2011 (RBFM pp 367-388).

54 See, e.g., annexure LD-20 to the Dent affidavit (RBFM pp 67-147).

48. It follows that the Commissioner's speculative observation that, "*where, on a proper analysis, the commercial substance of a scheme cannot be achieved other than through the specific transaction in fact entered into,* ***so that there is no reasonable alternative to the scheme****, it is likely that the taxpayer would have a very strong case on purpose*"[55] is an irrelevant one. If there is no reasonable alternative to the scheme, s 177CB(3) dictates that there is no tax benefit and no need to consider purpose. This is consistent with s 177C's role as the "gateway" to Part IVA and secures the sensible result that a taxpayer will not be taxed on a hypothetical state of affairs which is unreasonable.[56]

49. Subsection 177CB(3) formalises the conclusion reached by this Court in *Commissioner of Taxation v* ***Peabody*** (1994) 181 CLR 359 in which it was stated (at 385) that a finding as to the existence of a "tax benefit" requires satisfaction as to "*a prediction as to the 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***" (emphasis added).[57] In that case, the Court did not make any finding as to what precisely would have occurred if the scheme had not been entered into or carried out. It was sufficient that no reasonable alternative postulate could be identified under which amounts would have been included in the taxpayer's assessable income.

50. In determining whether an alternative postulate is reasonable, s 177CB(4) further mandates that "particular regard" be had to the substance of the scheme[58] and the non-tax results or consequences it achieves. That mandate supplements s 177C(3). According to their ordinary and natural meaning, the words of s 177CB(4) direct that the scheme's substance and non-tax consequences be noticed, and preclude an alternative postulate which disregards those matters. Such guidance as can be found in the Explanatory Memorandum at [1.106] is to the effect that a reasonable alternative postulate should correspond to the commercial and economic substance of the scheme. That guidance is consistent with the principle expressed in *Peabody*, namely that, in the assessment of a

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55 AS [73], emphasis added.

56 *Commissioner of Taxation v Lenzo* [2008] FCAFC 50; (2008) 167 FCR 255 at 262 [38] (Heerey J).

57 *Peabody* at 385.3.

58 See FC [73], which cites the **Explanatory Memorandum** to the Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013 (Cth) at [1.103].

postulate, reliability is the touchstone of reasonableness, such that the identification of a possibility is insufficient.[59]

51. The Commissioner included as an element of the scheme that "*no royalty was paid*" for the intellectual property. The negative element of the scheme – the absence of a royalty – corresponds to a substantive element of the PepsiCo Group's model which, being substantive, will not change under any alternative postulate that the Respondents might posit; rather, every postulate which the Respondents might posit as a reliable prediction of what might reasonably be expected to have occurred but for the scheme would replicate a "taxable fact"[60] present in the scheme precluding liability for royalty withholding tax. On the other hand, postulates which omit that substantive element will not be reliable in the sense identified in *Peabody* and picked up in s 177CB(3) because they will not amount to a prediction of what might reasonably be expected to have occurred but for the scheme (cf. FC [100]).

52. Such cases are rare in Part IVA litigation,[61] and this is one of those rare cases. It comes about here because of the way in which the Commissioner defined the schemes.

Why the Commissioner's alternative postulates are unreasonable

53. In this case, for the purposes of ss 177CB(4)(a)(i) and (4)(a)(ii), the effect of the evidence is that the change to the EBAs contemplated by the Commissioner's alternative postulates is not merely a "*small textual change*" (cf. AS [47]). The reliability of the Commissioner's prediction should not be measured by the number of words altered, but by its commercial and practical effects. The change would fundamentally alter the pricing structure under the EBAs which has been in place within the PepsiCo Group since inception and is ingrained in the industry, and for no commercial benefit. It is not a sufficiently reliable prediction to be regarded as reasonable. It is no more than a possibility.

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59 *Peabody* at 385.

60 *Bailey v Federal Commissioner of Taxation* [1977] HCA 11; (1977) 136 CLR 214 at 217.7; and see *Thomas* at 415 [84] (Gageler J).

61 Another example can be found in *Commissioner of Taxation v Mochkin* [2023] FCAFC 15; (2003) 127 FCR 185 where Sackville J (Merkel and Kenny JJ agreeing) observed in *obiter* (at 209 [102]) that the taxpayer would not have conducted his business other than through a limited liability entity.

54. It was put to Mr Williams that the payment being made under the EBAs, which remained calculated in exactly the same way as it was before, could be expressed to be a payment for concentrate and for everything else under the agreement including the relevant items. Putting to one side the question begged by the proposition that the payment would be calculated exactly as before, Mr Williams explained why that would bring about a change to the commercial results obtaining under the EBAs:[62]

> I think it's too broad. People want to understand exactly what it is they're paying for. I mean, when a bottler typically gets an EBA they're investing so much money, hundreds of millions in infrastructure so they're looking at every line item in a very detailed way. If we suddenly start changing the structure of our concentrate pricing, that will open up a huge debate.

55. When it was put to him again that the scenario (i.e., the alternative postulate) was one in which the amount of the payment remained exactly the same, Mr Williams said, "*Yes, but ... you're painting a very simple picture of a scenario. What I'm saying is that simple scenario will open up much broader discussions*". He then explained his answer, stating: "*Because you're changing the structure of the payment. You're changing, in effect, the concentrate price payment*"[63] Mr Williams had earlier observed:

> [Y]ou would be in that model – if I understand it correctly, you would be taking the concentrate pricing down, and then you would be charging them for access to the brand. That brand gets built and developed in the marketplace through the co-op fund which is jointly funded fifty-fifty. So, in effect, you would be asking them to pay twice.
>
> So are you saying that a bottler would think that paying a royalty is the same thing as paying for trade promotion?---I think so, yes.

56. In response to further questions, Mr Williams later asked rhetorically: "*But where is the benefit for either PepsiCo or the bottler in this scenario?*".[64]

57. Apart from representing a fundamental change to the PepsiCo model, the Commissioner's alternative postulates would have significant financial, accounting and practical consequences for the Respondents, SAPL and PBS. If the Respondents decided to charge amounts for the use of intellectual property, it would require a splitting up of

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62 Trial Transcript, Day 3, p 203 at lines 43-47 and p 204 at lines 1-3 (RBFM pp 359-360).

63 Trial Transcript, Day 3, p 204 at line 5-11 ((RBFM p 360). As to the requirement to agree the royalty, see Trial Transcript, Day 3, p 202 at lines 27-46; p 203 at lines 1-2, 19-22 (RBFM pp 358-359).

64 Trial Transcript, Day 3, p 204 at lines 30-31 (RBFM p 360).

the payments made by SAPL to PBS into a payment to PBS and a payment to either Respondent. This immediately gives rise to unnecessary administrative complexity in comparison to the scheme. Even if the amounts payable to the Respondents were paid to PBS at their direction, it would be necessary both commercially and for accounting and tax compliance purposes for all parties to the EBAs and for PBS to ascertain what that amount should be. Valuations would need to be undertaken on a periodic basis and would need to account for increases or decreases in the value of each of the PepsiCo and SVC brands.

58. These consequences of the Commissioner's alternative postulates evince both a departure from the substance of the scheme within the meaning of s 177CB(4)(a)(i) and different commercial outcomes from the schemes for the purposes of s 177CB(4)(a)(ii).

59. The evidence exposes the Commissioner's alternative postulates as unreliable and not reasonable alternatives within the meaning of s 177CB(3) of the ITAA 1936. They reflect a possibility (a variation of the standard industry pricing model) which achieves the imposition of royalty withholding tax but is bereft of commercial rationale, as was revealed by Mr Williams' evidence under cross-examination. They would add complexity which is otherwise avoided by reason of the concentrate pricing strategy, being the very element of the EBAs that the Commissioner would re-draft, such that negotiations with bottlers would expand to a broader range of issues.[65]

PART VI – Argument in support of Notices of Contention

60. A conclusion that the Respondents did not obtain a tax benefit in connection with the scheme is sufficient to dispose of the diverted profits tax appeals. However, by their notices of contention, the Respondents contend that the Full Court's decision should be affirmed on the additional or alternative ground that, even if they obtained a "DPT tax benefit" in connection with the scheme within the meaning of s 177J(1)(a), the "principal purpose" condition in s 177J(1)(b) was not satisfied in relation to the scheme.

61. The purpose enquiry has been described in this Court as the fulcrum upon which Part IVA cases will turn.[66] Here, there is a notable feature of the Commissioner's case which

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[65] Trial Transcript, Day 3, p 203 at lines 43-47; p 204 at lines 1-3 ,5-8, 10-11 and 20-22 (RBFM pp 359-360). Cf. PJ [216]-[217].

[66] *Commissioner of Taxation (Cth) v **Hart*** [2004] HCA 26; (2004) 217 CLR 216 at 261 [92] (Callinan J).

the Respondents respectfully submit precludes a conclusion of the requisite purpose. As the Commissioner has avowed,[67] and as adverted to above in the context of tax benefit, there is no commercial or other benefit to commend his alternative postulates to the Respondents. The Commissioner's postulates are, as he described them, "neutral"[68] in terms of their commercial outcomes compared with the scheme.

62. The Respondents contend that there would be significant commercial *disadvantages* in pursuing the Commissioner's alternative postulates as set out above. However, putting his case at its highest and accepting that the alternative postulates are neutral invokes a long line of authority commencing with *Hart* at 227 [15] (Gleeson CJ and McHugh J) and followed by intermediate appellate courts since then to the effect that the requisite conclusion of purpose cannot be drawn merely because another means of achieving the same or a similar outcome which results in more tax payable can be identified.[69] That is the essence of the Commissioner's case, based as it is on a "small textual change" to the EBAs which is otherwise said by him not to alter the substantive arrangements.

63. If nothing commends a new form of transaction, why would choosing not to adopt it but instead to pursue the original form of the transaction bespeak the requisite principal purpose? The Commissioner's concession reveals the only rationale for his alternative structure to be a tax outcome: liability to royalty withholding tax.

64. Ordinarily, Part IVA applies where contrivance drives a scheme. By contrast, the Commissioner's alternative postulates, which amount to changing an enduring business model for no commercial benefit, are themselves contrived. The Commissioner's alternative postulates reveal his complaint to be one of *not* doing something: i.e., not changing the Respondents' longstanding business model. In that regard, while noting

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[67] Trial Transcript, Day 3, p 203 at lines 30-32; p 204 at line 33; and Day 8, p 619 at lines 10-15 (RBFM pp 359-360, 362).

[68] Trial Transcript, Day 8, p 619 at lines 9-16 (RBFM p 362); see also Day 3, p 204 at lines 30-33 (RBFM p 360).

[69] *Minerva Financial Group Pty Ltd v Federal Commissioner of Taxation* [2024] FCAFC 28; (2024) 302 FCR 52 at 66 [60(4)-(6)]; *Federal Commissioner of Taxation v Ashwick (Qld) No 127 Pty Ltd* [2011] FCAFC 49; (2011) 192 FCR 325 at 380 [189] (Edmonds J, Bennett and Middleton JJ agreeing); *British American Tobacco Australia Services Ltd v Federal Commissioner of Taxation* [2010] FCAFC 130; (2010) 189 FCR 151 at 162 [46]; *Commissioner of Taxation v News Australia Holdings Pty Ltd* [2010] FCAFC 78; (2010) 79 ATR 461 at 468 [15(a)] (the Court there describing the Administrative Appeals Tribunal as having identified "the applicable principles in orthodox terms"); *Calder v Commissioner of Taxation (Cth)* [2005] FCAFC 254; (2005) 61 ATR 267 at 291 [93].

variations among different EBAs, the primary judge accepted that the model "remains essentially unchanged since it was created in the early 20th century" (PJ [169]).

65. The Commissioner's case requires a conclusion that the Respondents' principal purpose in *not* changing their business model on these two particular occasions where it negotiated an EBA was to avoid a tax that did not exist when the model was developed. The neutrality of the Commissioner's alternative postulates – i.e., the conceded absence of anything commercially to commend them – is, the Respondents submit, a complete answer to the diverted profits tax appeals.

The matters under s 177D(2) and 177J(2)

66. The primary judge and the Full Court found that the matters set out in ss 177D(2)(c), (d), (f)-(h) and 177J(2)(b) were neutral. In respect of the remaining matters, the Respondents submit as follows.

<u>The manner in which the scheme was entered into or carried out: s 177J(2)(a) / s 177D(2)(a)</u>

67. The EBAs reflect the implementation in Australia of a model which has, since the early 1900s, been based on:

(a) the sale by the PepsiCo Group of proprietary concentrate, which is made into a consumable product by a bottler using a standardised and well-known cold fill process whereby the concentrate is mixed with water and carbon dioxide (and sometimes a sweetener) and packaged (PJ [135], [138]);[70]

(b) the sale and distribution of the consumable product by the bottler in local markets; and

(c) joint investment by the Bottler and the PepsiCo Group in local marketing.[71]

68. The model is not based on the PepsiCo Group deriving royalty income from licensing its intellectual property or providing knowledge or assistance to bottlers. Rather, the

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70 The primary judge accepted the following description of the process given by the General Manager of the PepsiCo Global Concentrate Solutions division (PJ [135]-[136]):

> So the general manufacturing operation in a cold fill plant is a batch system, a bowl where they mix the ingredients, a filling system where they pour it into a bottle and then they cap it, or put it in a can, and seal it.

71 PJ [156]; Williams affidavit [17], [40]-[41] (RBFM pp 35, 39).

PepsiCo Group seeks to maximise sales of beverage concentrate, which equate to sales of PepsiCo Group products in the relevant market.[72]

69. The primary judge, with respect, underestimated the significance of the fact that the model encapsulated in the EBAs, whereby the PepsiCo Group sells concentrate for a price and does not charge a fee for the grant of any intellectual property rights, was instituted at a time when royalty withholding tax could not have been a consideration. The majority of the Full Court erred, with respect, in placing significance on the date when royalty withholding tax was first introduced and the year when the model was expanded internationally (FC [132]). The important point is that the earliest example of an EBA was a domestic transaction and, for the next 50 years, PepsiCo was operating only within the United States. The model should therefore be assumed to have represented the ideal, or at least preferred, commercial arrangement to achieve the unrelated parties' business ends – absent any withholding tax considerations. The evidence shows that, as years passed, the model became entrenched such that it is what the market participants are familiar with and expect.[73]

70. A consideration of "the way in which and method or procedure by which the [EBAs] were entered into" or "how the [EBAs] came to take the form [they] did" does not reveal a principal purpose of avoiding royalty withholding tax.[74] As stated above, consideration of the EBAs in their wider context raises the question why PepsiCo and SVC would in 2009 change a form of transaction which had been in place for a century in the United States and internationally since the 1950s, and which was an integral part of the PepsiCo Group's business model. This matter necessarily leads to the objective conclusion that the form was not adopted for a purpose, let alone a principal purpose, of avoiding royalty withholding tax. As Callinan J observed in *Hart* at 261 [92], there can be cases where

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[72] Williams affidavit [17], [20], [40]-[41] (RBFM pp 35, 39). SEC Form 10-K for the year ended 29 December 2018 at 4 and 49 (RBFM pp 248-249).

[73] Williams affidavit [16], [24]-[29], [45] (RBFM pp 35-37, 39-40); and "*Cola Wars Continue: Coke and Pepsi in 2010*," David Yoffie and Renee Kim, *Harvard Business School,* 26 May 2011 (RBFM pp 367-388).

[74] *Commissioner of Taxation (Cth) v Spotless Services Ltd* [1996] HCA 34; (1996) 186 CLR 404 at 420.7; *Federal Commissioner of Taxation v Guardian AIT Pty Ltd* [2023] FCAFC 3; (2023) 115 ATR 316 at 356 [187].

one factor can be of such overwhelming weight relative to the others that it answers the inquiry.[75] This is such a case.

The form and substance of the scheme: s 177J(2)(a) / s 177D(2)(b)

71. The form and substance of the scheme are the same. The Bottler undertook to purchase concentrate from the Respondents or their nominated seller for specified prices. Those purchases were contemplated to occur within the commercial framework established by the EBAs under which the Bottler was required to convert the concentrate into finished beverages in accordance with the Respondents' strict instructions and supervision, and to then act as the exclusive distributor of the finished beverages in the Australian market. That framework involved mutual promises and obligations and operated to the advantage of both parties, as the majority of the Full Court observed at FC [19]. The framework enabled the Respondents to leverage the Bottler's investment in plant and equipment and its established distribution channels. It enabled the Bottler to sell the finished beverages for a profit.

72. The Commissioner's case below on this factor reflects his value judgment that SAPL *should* have paid something for the use of the licence granted to it because the intellectual property was valuable and that, therefore, as a matter of economic substance, it did pay for it. That view was correctly rejected by the majority, who described it as a "highly artificial assumption" (FC [133]). There is no mismatch between form and substance in providing a distributor of products with a royalty-free licence to use the intellectual property it requires to perform its function of maximising sales in a territory. That is so even if the distributor is also required to carry out what amounts to a routine function whereby the product is "finished off" (PJ [162]), like a packet cake mix (PJ [135]-[139]).

Any change of the financial position of the relevant taxpayer, or any person who has, or has had, any connection with the relevant taxpayer that has resulted, will result, or may reasonably be expected to result, from the scheme: s 177J(2)(a) / s 177D(2)(e); s 177J(2)(a) / s 177D(2)(f)

73. The entry into the scheme did not result in any immediate change to the financial position of the Respondents or persons having a connection with them because the EBAs restated pre-existing agreements on similar terms. The continuation of the existing commercial

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75 See also *Mills v Federal Commissioner of Taxation* [2012] HCA 51; (2012) 250 CLR 171 at 205-6 [73] (Gageler J, French CJ, Hayne, Kiefe and Bell JJ agreeing).

relationship between the Respondents and the Bottler meant that the PepsiCo Group reasonably expected to, and did, derive income from sales of concentrate. Further, the financial position of the Respondents may reasonably be expected to have continued to improve as a result of the marketing and sale of PepsiCo Group products in Australia by the Bottler insofar as those activities may reasonably be expected to augment the value of the goodwill in the brands that the Respondents owned.

74. On the basis the Commissioner's alternative postulates are commercially "neutral", there would be no changes to the financial position of the parties when comparing the schemes with the alternative postulates other than by reason of the putative tax benefit. For the same reason that factor 177D(2)(d) is generally regarded as neutral where all it reveals is the tax benefit, this factor should also be, at worst, neutral for the Respondents.

<u>The result, in relation to the operation of any foreign law relating to taxation, that (but for Part IVA) would be achieved by the scheme: s 177J(2)(c)</u>

75. Because no royalty was paid by the Bottler to the Respondents under the EBAs, no such amounts were included in their income in the United States. However, the gravamen of the Commissioner's scheme is not changing a pricing mechanism which was instituted at a time when the PepsiCo Group was trading within the United States and international tax implications could not have been a consideration. Again, for the same reason that factor 177D(2)(d) is generally regarded as neutral where all it reveals is the tax benefit, this factor should also be, at worst, neutral for the Respondents in that all it reveals is that a foreign tax liability would have been incurred under the Commissioner's alternative postulates. However, his alternative postulates are specially formulated to generate a royalty payment and have nothing else to commend them. Accordingly, this matter ought to be given limited, if any, weight.

<u>The amount of the tax benefit mentioned in s 177J(1)(b): s 177J(2)(d)</u>

76. The amount of royalty withholding tax in issue was correctly identified by the primary judge as being approximately $2.4 million for the two-year period, subject to adjustment downwards (PJ [464]), with the final amount being $2.25m. This amount is approximately 1% of the total payments made by SAPL to PBS to purchase concentrate

(circa. $240m[76]) and is accordingly negligible. Its relative size weighs against the conclusion that PepsiCo and SVC entered into each scheme with the requisite purpose.

77. The primary judge was, with respect, correct to conclude that it is more relevant to have regard to the amount of the putative tax not paid as opposed to the amount of the royalty. Whilst the majority of the Full Court was correct to observe that the tax benefit is, strictly, the amount of the royalty, s 177J(2)(d) is not prescriptive as to what is to be made of that number. Having regard to the purpose and objects of the section, it is appropriate in a royalty withholding tax case to have regard to the tax which would have been payable on the royalty.

Conclusion and disposition

78. The appeals should be dismissed with costs.

PART VII – ESTIMATE

79. The Respondents estimate that they will require three and a half hours to present their oral argument.

Dated: 30 January 2025

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[76] Replacement royalty withholding tax notice issued to SVC for the period between 1 July 2017 and 30 June 2019; Replacement royalty withholding tax notice issued to PepsiCo for the period between 1 July 2017 and 30 June 2019 (RBFM pp 250-251, 252-254).

ANNEXURE TO RESPONDENTS' SUBMISSIONS

No	Description	Version	Provision(s)	Reason for providing this version	Applicable date or dates (to what event(s), if any, does this version apply)
1.	*Income Tax Assessment Act 1936* (Cth)	As at 1 January 2023 (Compilation No. 181)	ss 6, 128A, 128B, and Pt IVA	Version agreed with the Commissioner of Taxation before the Full Court of the Federal Court of Australia as the relevant provisions are materially identical for the relevant income years	Not applicable