

# Transfer Pricing Case: PepsiCo Australia

BDO Tax Advisory (Transfer Pricing)

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# PepsiCo - Australia transfer pricing case

## Overview of key issues and court proceedings

### Case reference

Commissioner of Taxation v PepsiCo Inc.  
[2025] HCA 30

### Key Issue

Whether payments under Exclusive Bottling Agreements (EBAs) between PepsiCo group entities and Schweppes Australia Pty Ltd (Schweppes Australia) contained:

- ▶ Embedded royalties for use of PepsiCo's intellectual property (IP)
- ▶ Leading to royalty withholding tax liability
- ▶ Or alternatively, diverted profits tax (DPT) liability

### Key Parties

#### Taxpayer Group

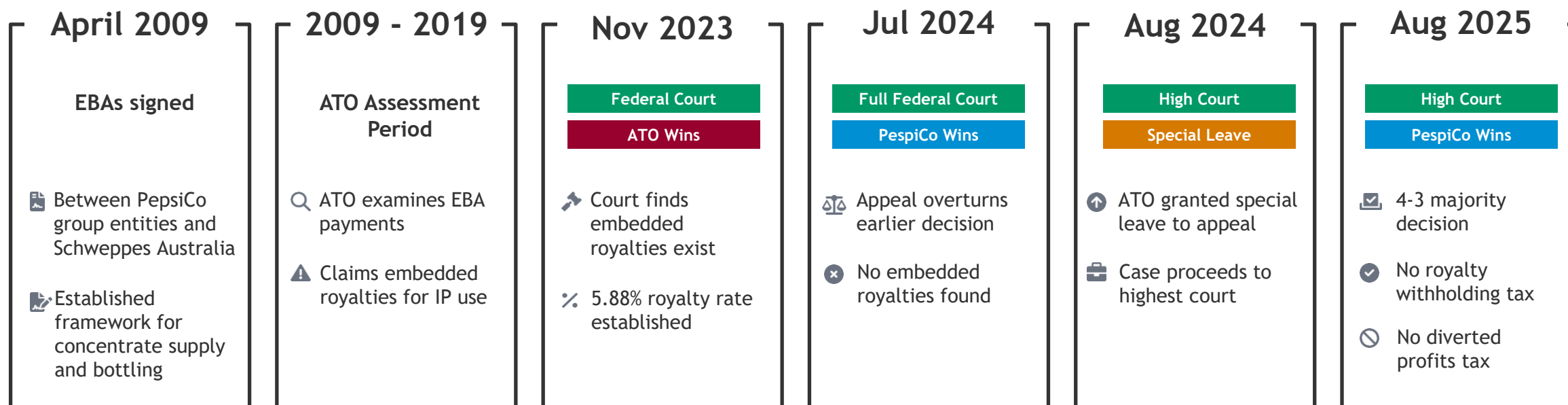
- ▶ Schweppes Australia
- ▶ PepsiCo Inc. (PepsiCo)
- ▶ Stokely-Van Camp Inc. (SVP)
- ▶ PepsiCo Beverage Singapore Pty Ltd (PBS)

#### Tax Authority

- ▶ Australian Taxation Office (ATO)

# Chronological timeline of events

Case progression (2009-2025)



## Key Case Progression

The case progressed through **multiple court levels** with **contrasting decisions**, ultimately resulting in a **4-3 majority** ruling in favour of the taxpayer at Australia's highest court.

# Commercial arrangement

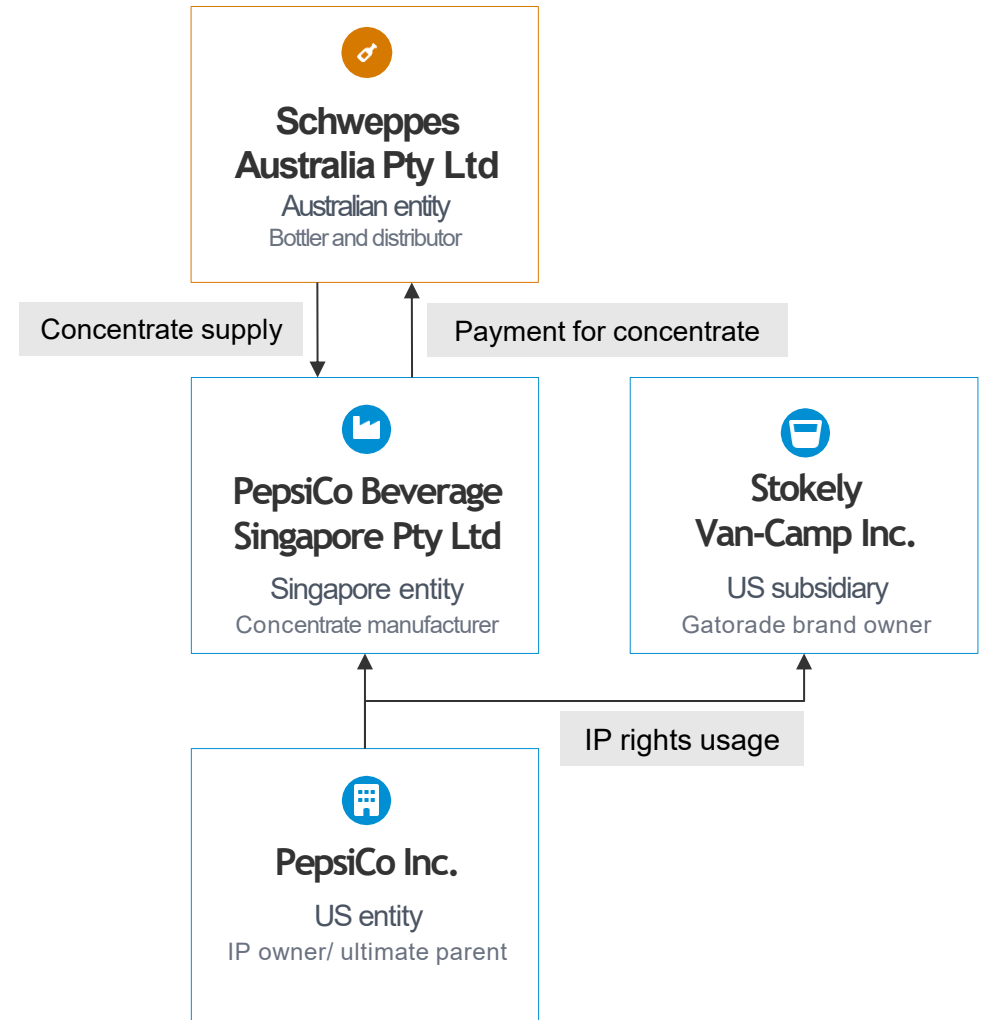
Flow of goods, payments and IP rights

## Key Transactions

- ▶ **Concentrate supply:** PBS supplies beverage concentrate to Schweppes Australia for bottling
- ▶ **Payment flows:** Schweppes Australia pays PBS for concentrate under the EBAs
- ▶ **IP usage:** Schweppes Australia uses PepsiCo trademarks (Pepsi, Mountain Dew, Gatorade) for bottling and distribution













## Key Issue

The central dispute was whether payments from Schweppes Australia to PBS for concentrate included embedded royalties for the use of PepsiCo's IP or were solely for the physical product.



# Transfer pricing positions

## Contrasting perspectives: ATO vs PepsiCo













|  ATO's position   | vs |  PepsiCo's position   |
|--|----|--|
|  <b>Embedded royalties</b><br>Payments from Schweppes Australia to PBS included hidden royalties for use of PepsiCo's IP (trademarks, know-how)     |    |  <b>Concentrate supply only</b><br>Payments were solely for the purchase of beverage concentrate, with no separate payment for IP use   |
|  <b>Transfer pricing method</b><br>Applied Comparable Uncontrolled Price (CUP) method using comparable licensing agreements for trademark use       |    |  <b>No licensing arrangement</b><br>No separate IP licensing agreement existed; any IP rights were incidental to the concentrate supply |
|  <b>Royalty rate determination</b><br>Determined 5.88% of net revenue as appropriate royalty rate based on expert analysis of comparable agreements |    |  <b>Arm's length pricing</b><br>Pricing was commercially reasonable and consistent with arm's length principle                          |
|  <b>Alternative claim</b><br>If not royalty withholding tax, then DPT applies due to arrangement designed to avoid Australian tax                   |    |  <b>Business purpose</b><br>Structure had legitimate commercial rationale and was not designed primarily to avoid tax                   |
|  <b>Tax Consequences</b><br>Royalty withholding tax payable at treaty rate of 5% on embedded royalties, or 40% DPT on diverted profits             |    |  <b>Legal position</b><br>No royalty withholding tax or DPT liability as structure reflects genuine business arrangements               |

## Core Dispute

The fundamental disagreement centered on whether the concentrate payments had an embedded royalty component for IP use. The ATO argued that payments for the physical product implicitly included payment for related IP rights, while PepsiCo maintained these were purely product payments at arm's length prices with no separate royalty element.

# Court decisions summary

## Case progression through Australian courts

|  <b>Federal Court</b>   |  <b>Full Federal Court</b>  |  <b>High Court</b>  |
|--|--|--|
| <div> November 2023 <div>ATO Wins</div> </div> <div>  <b>Embedded royalties found</b><br/> Court determined that payments made by Schweppes Australia to PBS included embedded royalties for the use of PepsiCo's IP </div> <div>  <b>Royalty rate established</b><br/> Court accepted ATO's proposed 5.88% royalty rate based on CUP method analysis </div> <div>  <b>Withholding tax applicable</b><br/> Royalty withholding tax of 5% deemed applicable on the embedded royalties portion </div> | <div> July 2024 <div>PepsiCo Wins</div> </div> <div>  <b>No embedded royalties</b><br/> Overturned first instance decision, finding no embedded royalties in the payments from SAPL to PBS </div> <div>  <b>Payment characterisation</b><br/> Determined that payments were solely for the concentrate supply with no separate IP component </div> <div>  <b>No withholding tax</b><br/> Royalty withholding tax not applicable as payments did not constitute royalties </div> | <div> August 2025 <div>PepsiCo Wins</div> </div> <div>  <b>4-3 majority decision</b><br/> Court determined that payments made by Schweppes Australia to PBS included embedded royalties for the use of PepsiCo's IP </div> <div>  <b>Full Federal Court affirmed</b><br/> Affirmed that no embedded royalties existed in the payments under the EBAs </div> <div>  <b>No DPT liability</b><br/> DPT not applicable as there was no tax avoidance purpose </div> |
| <b>Key finding:</b><br>The EBAs implicitly granted Schweppes Australia the right to use PepsiCo's IP, which was an essential component of the business model.  | <b>Key finding:</b><br>The contractual arrangements did not constitute a "payment by direction" in favor of PepsiCo or SVC for the use of IP.  | <b>Key finding:</b><br>The price paid for the beverage concentrate did not include embedded royalties for IP use, and the structure had legitimate business purpose.   |

## Final Outcome and Significance

The High Court's final decision affirmed that payments for goods at arm's length prices should not be recharacterised as royalties merely because the goods embody IP. This provides important guidance on the distinction between payments for goods and payments for IP in transfer pricing arrangements.

# Is this a transfer pricing case?

A look on how ATO approached the economic substance of a transaction, and why it's a unique transfer pricing case

## How the case relates to transfer pricing?

- > **Arm's length principle at its core:** The central argument from the ATO was that a portion of the payment for beverage concentrate should be reclassified as a royalty for using PepsiCo's valuable, such as trademarks and formulas. An arm's length transaction would have typically involved a separate royalty payment for the use of this IP.
- > **Use of transfer pricing methods:** The Federal Court originally sided with the ATO, applying the CUP method to determine the appropriate royalty rate. This is a standard transfer pricing methodology used to compare a transaction's price to comparable transactions between unrelated parties.
- > **Focus on substance over form:** The ATO's position was a classic transfer pricing strategy of looking past the explicit contractual terms (which stated payments were for concentrate only) to examine the economic substance of the arrangement. They argued that the payments effectively included an "embedded royalty".

## Why the case is also distinct from a typical transfer pricing case?

Despite the transfer pricing elements, the case had several distinct features that ultimately led the High Court to rule in favour of PepsiCo:

- > **Unrelated parties:** A typical transfer pricing case involves transactions between legally related parties. The High Court, in contrast, emphasized that the PepsiCo-Schweppes arrangement was an arm's-length negotiation between large, unrelated commercial enterprises. The arm's-length nature of the deal significantly influenced the majority's reasoning.
- > **Commercial and economic substance:** The High Court majority found that the commercial and economic substance of the deal was exactly as the contracts stated: the price was for concentrate and nothing else. The ATO's alternative view—that a portion of the payment was an implicit royalty—was considered unreasonable.
- > **Reliance on general anti-avoidance rules:** When its royalty withholding tax argument failed, the ATO's alternative position was based on Australia's general anti-avoidance rules, specifically the DPT. This move highlights that the ATO was not solely relying on traditional transfer pricing provisions but was using broader anti-avoidance measures.



# Key takeaways for Clients

## Actionable insights



### Contractual Clarity

- ✓ **Clearly separate payments for goods versus IP in contracts**  
Explicitly document what each payment is for to avoid recharacterisation as embedded royalties
- ✓ **Review existing supply agreements with IP components**  
Assess whether current contracts clearly distinguish between payment for goods and IP rights



### Transfer Pricing Documentation

- ✓ **Apply appropriate transfer pricing methods**  
Support pricing with robust CUP or other OECD-approved methodologies with comparable data
- ✓ **Prepare contemporaneous documentation**  
Maintain evidence that can withstand ATO scrutiny and potential court challenges



### Commercial Substance

- ✓ **Document commercial rationale for business structures**  
Maintain robust evidence of non-tax business reasons for international arrangements
- ✓ **Substance over form in transaction planning**  
Ensure actual business operations align with contractual agreements and transfer pricing policies



### Risk Management

- ✓ **Proactively review cross-border IP arrangements**  
Identify and address potential embedded royalty and DPT risks before ATO scrutiny
- ✓ **Consider advance rulings for complex structures**  
For arrangements with significant IP components, consider seeking advance pricing agreements





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