



Decision impact statement

Commissioner of Taxation v PepsiCo Inc & Anor [2025] HCA 30

📌 Relying on this Decision impact statement

This publication provides our view on the implications of the court or tribunal decision discussed, including on related public advice or guidance.

Taxpayers can rely on this Decision impact statement to provide them with protection from interest and penalties in the following way. If a statement turns out to be incorrect and taxpayers underpay their tax as a result, they will not have to pay a penalty, nor will they have to pay interest on the underpayment provided they reasonably relied on this Decision impact statement in good faith. However, even if they do not have to pay a penalty or interest, taxpayers will have to pay the correct amount of tax provided the time limits under the law allow it.

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Venue: High Court of Australia

Venue reference No: M98/2024

M99/2024

M100/2024

M101/2024

M102/2024

M103/2024

Judgment date: 13 August 2025

Summary of decision

1. The High Court dismissed the Commissioner's appeal and found that PepsiCo Inc (PepsiCo) and Stokely-Van Camp Inc (the Taxpayers) were not liable to royalty withholding tax nor to diverted profits tax (DPT).
2. The Court delivered a split decision, with 4 justices (Gordon, Edelman, Steward and Gleeson JJ) delivering the majority judgment (Majority) and 3 justices comprising the minority (Gageler CJ, Jagot and Beech-Jones JJ) (Minority).
3. All legislative references in this Decision impact statement are to the *Income Tax Assessment Act 1936*.
4. All judgment references in this Decision impact statement are to the judgment of *Commissioner of Taxation v PepsiCo Inc & Anor* [2025] HCA 30 (*PepsiCo*), unless otherwise indicated.

Royalty withholding tax

5. The Majority found that payments received by an Australian company in the PepsiCo Group from an independent third-party bottler were not made 'as consideration for' use of intellectual property and therefore not a royalty for withholding tax purposes. The Minority, in dissent, viewed the payments as containing a royalty.
6. The Court was unanimous that the payments were not 'paid to' or 'derived by' the Taxpayers for withholding tax purposes. It followed that there was no royalty withholding tax payable.

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Diverted profits tax

7. The Majority rejected the Commissioner's alternative argument that the DPT applied, finding that there were no reasonable alternatives to the scheme and therefore no DPT benefit (tax benefit). The Minority, in dissent, considered that the DPT did apply.

Overview of facts

8. PepsiCo and Stokely-Van Camp Inc are United States-resident companies in the global PepsiCo Group. They own the brands, recipes and trademarks for well-known branded drinks such as Pepsi, Mountain Dew and Gatorade.

The umbrella contract

9. The Taxpayers each entered into exclusive bottling agreements (EBAs) with Schweppes Australia Pty Ltd (the Bottler), an Australian company outside of the global PepsiCo Group, to manufacture, bottle, and distribute branded drinks in Australia.

10. The EBAs granted the Bottler exclusive rights to manufacture, bottle and distribute the drinks in Australia and also provided the Bottler with an implied licence from PepsiCo to use trademarks, as well as mixing formulas, and other intellectual property (IP). The EBAs also obliged the Bottler to purchase flavour concentrate necessary to make the drinks and required the Bottler to maintain quality standards.

11. The relevant payments being made by the Bottler were expressed in the EBAs as the 'price' for flavour concentrate. In one EBA, the payments were expressly labelled as 'royalty-free'.

12. Under the EBAs, the Bottler was able to purchase flavour concentrate from a 'seller'. The 'seller' under the EBA was identified as the relevant Taxpayer, but they could, and did, nominate another entity within the PepsiCo Group to take on this 'seller' role.

Other key contracts

13. Alongside the EBAs, the Bottler also entered into other agreements with companies in the PepsiCo Group in respect of the marketing of the drinks. These included:

- (i) an agreement which the Bottler entered into with an Irish member of the PepsiCo Group, and
- (ii) co-operative annual advertising and marketing agreements which the Bottler entered into with the nominated seller.

14. Under these additional agreements, the Bottler and members of the PepsiCo Group agreed to share contributions to marketing for the relevant drink brands in Australia.

Sales of concentrate

15. As provided for in the EBAs, an Australian company, PepsiCo Beverage Singapore Pty Ltd (the Seller) was nominated as the 'seller'. The Seller was not a party to the EBAs. The Seller provided concentrate to the Bottler and received the relevant payments from the Bottler. The Taxpayers did not receive the relevant payments.

16. The Bottler sent the Seller purchase orders requesting amounts of concentrate. The Seller shipped concentrate to the Bottler and invoiced the Bottler for that concentrate. The Bottler paid those invoices into the Seller's bank account. The purchase orders and invoices made no mention of being in relation to of anything other than concentrate.

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17. The Seller made only a negligible profit from its dealing in concentrate, making a 0.05% markup on its concentrate sales. The Seller's revenue from concentrate sales to the Bottler were matched almost entirely by the Seller's costs of concentrate it purchased from another PepsiCo Group company in Singapore.

Tax treatment adopted

18. The Australian tax treatment adopted by the PepsiCo Group was that the only income tax liability in Australia was a negligible amount paid by the Seller because its income from concentrate sales was largely offset by its costs of concentrate purchased from overseas related parties.

Issues before the Court

19. The Commissioner won at first instance, with the Federal Court finding that the Taxpayers were liable to royalty withholding tax, and in the alternative, the DPT applied. In the Full Federal Court, the Commissioner lost on both issues and appealed to the High Court.

20. Before the High Court, the Commissioner contended that royalty withholding tax applied because:

- (i) part of the payment by the Bottler to the Seller was 'consideration for' the IP being provided to the Bottler by the Taxpayers and was thus a 'royalty', and
- (ii) the part of the payments that was 'consideration for' IP was being dealt with by the Seller on behalf of the Taxpayers, and thus was to be treated as paid to the Taxpayers due to a deeming rule set out in subsection 128A(2).

21. In the alternative, the Commissioner contended that the DPT applied because:

- (i) there was a scheme involving the setting of the terms of the EBAs to exclude recognition of any part of the payments as a royalty
- (ii) a reasonable alternative to the scheme was that the Taxpayers would have entered into EBAs with terms that recognised a royalty and this illustrated that the scheme produced tax benefits, that is, savings of withholding tax, and
- (iii) there were parties to the scheme who had an objective principal purpose for the Taxpayers to obtain those tax benefits.

Decision on royalty withholding tax – was there a royalty?

22. The first question considered by the Court was whether some part of the payments by the Bottler was a royalty. Royalty is defined in section 6, relevantly:

royalty or **royalties** includes any amount paid or credited, however described or computed, and whether the payment or credit is periodical or not, to the extent to which it is paid or credited, as the case may be, as consideration for:

- (a) the use of, or the right to use, any copyright, patent, design or model, plan, secret formula or process, trade mark, or other like property or right; ...

Payment was 'consideration for' concentrate only

23. The Majority characterised the relevant payments as consideration for concentrate alone. This means there was no royalty and royalty withholding tax did not apply.

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The arrangements

24. Key to the Majority's view that the relevant payments were not royalties to any extent was its conclusion that those payments arose under individual contracts that did not include provision of any rights to IP. The rights to IP were supplied for a different consideration.

25. The Majority considered that there were 2 arrangements present, one being a broad arrangement comprising several contracts¹ which they referred to as 'the SAPL Bottler, Seller and Distributor Agreement' and the second being separate agreements under which concentrate was sold between Bottler and Seller.

26. The Majority characterised the 'SAPL Bottler, Seller and Distributor Agreement' as an 'agreement that the Bottler would manufacture, bottle, sell and distribute' soft drinks'.² They found that the relevant rights to intellectual property were being provided under this broad commercial agreement as consideration for promises and payments provided under the broader agreement.

27. Importantly, this broad agreement was seen as being separate from the series of future sales transactions for concentrate.³ Those future sales transactions later materialised in the form of individual contracts (concentrate sales agreements) for the supply of concentrate (evidenced by purchase orders and invoices). The Majority pointed out that the Commissioner had not argued that these sales transactions between the Seller and the Bottler were a sham, or that the Seller was acting as an agent or trustee for the Taxpayers when receiving the payments for the concentrate. The Majority found that the relevant payments were being made under the concentrate sales agreements, in consideration for the concentrate alone.⁴

The stamp duty cases are good law for 'royalty' characterisation

28. The Majority, having found the provision of IP and the payments were arising under different arrangements, considered that the payments could not be 'consideration for' IP. The Majority framed the test with reference to *Archibald Howie*⁵, *Dick Smith*⁶, and *Lend Lease*⁷ as being one where it was necessary to identify what was a "moving cause" or a "material cause" for the payment'.⁸ The Majority did not see the payments being consideration for anything outside of the arrangements for concentrate sales.⁹ The Majority was assisted in resolving the characterisation question by looking to the 'purpose' of the payment, or the 'basis' or 'condition' upon which it is made.¹⁰

¹ This includes not just the EBAs but also the agreements outlined in paragraph 13 of this Decision impact statement.

² At [162].

³ At [173].

⁴ All members of the Court acknowledged that the IP licence was important to the bargain – 'a significant part of the architecture of the entire [Agreement]' per the Majority at [163] and that 'the EBAs would be pointless without the intellectual property licences and other interlocking promises', per the Minority at [50].

⁵ *Archibald Howie Pty Ltd v Commissioner of Stamp Duties (NSW)* [1948] HCA 28.

⁶ *Chief Commissioner of State Revenue v Dick Smith Electronics Holdings Pty Ltd* [2005] HCA 3.

⁷ *Commissioner of State Revenue v Lend Lease Development Pty Ltd and Others* [2014] HCA 51.

⁸ At [160].

⁹ At [172].

¹⁰ At [160–161].

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29. In concluding that the relevant payments arose under the concentrate sales agreements and were for concentrate only, the Majority observed that:

- (i) the Commissioner had not argued that the pricing of the payments for the concentrate were 'inflated' or otherwise included an amount that reflected additional consideration for intellectual property¹¹, and
- (ii) the (clearly valuable) IP was not being provided 'for nothing' because the Taxpayers received a number of valuable promises in their favour under the broader 'Bottler, Seller and Distributor Agreement'.¹²

30. The Minority, however, considered the EBAs were part of a 'single, integrated and indivisible' transaction which also included the making of the relevant payments. The Minority's view was that the provision of IP, the agreement to buy concentrate and the various other interlocking promises between the Bottler and the Taxpayers were not separable – the agreement between the parties involved and depended on all of those things together.

31. The Minority, having identified that there was only one transaction, viewed the Bottler's promise to make the relevant payments as being, in part, consideration 'for' the use of the IP rights provided under the EBA. The Minority emphasised that consideration should be assessed by reference to the entire transaction rather than the labels or computational inputs used by the parties. The Minority relied on *Archibald Howie, Davis*¹³, *Dick Smith*, and *Lend Lease* (the stamp duty cases) to support the principle that consideration encompasses the value that moves the transaction.

Decision on royalty withholding tax – if there was a royalty, was it income derived?

32. The second question the Court considered was, if any of the payments were a royalty, whether those royalties were being 'paid or derived' by the Taxpayers.

33. As the relevant amounts were not directly paid to the Taxpayers, the answer to this question was affected by the deeming in subsection 128A(2). Subsection 128A(2) is a constructive payment rule contained within the Division¹⁴ which sets out the rules for withholding tax liability which reads as follows:

For the purposes of this Division, interest or a royalty shall be deemed to have been paid by a person to another person 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.

34. The Court was unanimous in characterising the dealings in concentrate as involving the selling the concentrate by the Seller to the Bottler and the Seller receiving the payments as the proceeds of that sale.

35. The Court found the relevant payments were occurring in the course of sales of concentrate between the Seller and the Bottler and the proper construction of the sales agreements was that the proceeds of the concentrate sales were not amounts that the Taxpayers had a pre-existing (antecedent) entitlement to.

36. Accordingly, the nomination of the Seller under the EBA did not amount to a 'direction to pay' the relevant amounts to the Seller for the purposes of subsection

¹¹ At [168]. See also at [174].

¹² At [163]. See also at [123] and [216].

¹³ *Davis Investments Pty Ltd v Commissioner of Stamp Duties (NSW)* [1958] HCA 22.

¹⁴ Division 11A of Part III.

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128A(2). The Majority characterised the effect of the nomination of the Seller as the Taxpayers giving the Bottler a 'direction to buy' concentrate from the Seller.

37. Having found that there was no antecedent monetary obligation for the Bottler to pay the Taxpayers, the Court was unanimous in concluding that subsection 128A(2) did not deem the Taxpayers to have been paid the relevant amounts and thus the Court was unanimous that there was no withholding tax liability.

Decision on diverted profits tax – tax benefit?

38. This case is the first time that the High Court has considered the application of the DPT and also the rules in section 177CB for identifying a 'tax benefit', which were introduced in 2013 and which have general application for Part IVA. Exceptions specific to the DPT (income test, sufficient foreign tax test and sufficient economic substance test) were not in contention, meaning the DPT dispute focused on whether the scheme produced a tax benefit and whether someone had a principal purpose¹⁵ of producing that tax benefit.

39. When considering whether a scheme produces a tax benefit, section 177C frames the test as having 2 limbs – first, what would have happened, and secondly, what might reasonably be expected to have happened. Section 177CB contains statutory directions about the satisfaction of these limbs.

40. Our case was based on the second limb which involves a reconstruction. Subsection 177CB(3) requires that for this limb to be satisfied, there must be a postulate that is a reasonable alternative to the scheme.

41. Subsection 177CB(4) provides that:

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).

The parties' arguments

42. The Commissioner argued that the Taxpayers obtained a tax benefit in connection with the scheme by reference to 2 postulates, each of which were reasonable alternatives to the scheme and produced a liability for royalty withholding tax. As an alternative to the scheme, the Commissioner postulated that the Taxpayers might reasonably be expected to have entered into an EBA including terms that:

- (i) recognised that the relevant payments were being made for all things under the EBA, including the IP, or
- (ii) expressly recognised a royalty.

¹⁵ Noting that for the application of the DPT, the relevant purpose is a 'principal' purpose per paragraph 177J(1)(b).

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43. The Taxpayers argued that there was no tax benefit because:
- (i) our postulates were not reasonable because they did not align with the substance, results and consequences of the scheme, and
 - (ii) there was no alternative to the scheme which was reasonable for the purposes of subsection 177CB(4).

The decision

44. The Court confirmed that taxpayers bear the onus of proving that they have not obtained a tax benefit in connection with a scheme.

45. The Majority set out that the test of reasonable expectation is a question to be determined objectively on all of the evidence 'including inferences open on the evidence, as well as the apparent logic of events'.¹⁶

46. In the Majority's view, the EBAs reflected a commercially standard contracting model, which did not involve the payment of royalties for concentrate-based drinks. In their view, the absence of a royalty was not contrived but consistent with global commercial practice. On this basis, they found that the postulates the Commissioner put forward were not reasonable.

47. The Majority found that, on 'critical facts, unique to these appeals'¹⁷, the Taxpayers fell within the 'unusual' scenario of being able to show that there were no reasonable alternatives to the scheme. These unique facts included that:

- (i) the commercial and economic substance of the DPT scheme was that the relevant payments were for concentrate alone¹⁸
- (ii) the DPT scheme had come about through dealings between unrelated parties dealing at arm's length, and the pricing for the concentrate was not 'disproportionally high', and
- (iii) the DPT scheme was the implementation of an established 'market standard' business model that, as part of its substance, had no royalty component to the relevant payments.

48. Key to the Majority's decision – that the Commissioner's alternative postulates were not reasonable and that there was no alternative that was reasonable – was the finding that the substance of the scheme was that there was no royalty.

49. Having found this to be the substance of the scheme, and noting the requirement in subsection 177CB(4) to have 'particular regard' to the scheme's substance, the Majority concluded that there were no alternative postulates that 'correspond' to this substance of the scheme. It followed from this that it was not reasonable to expect that the Taxpayers would have done anything different.

50. By contrast, the Minority found that the Taxpayers did obtain a tax benefit. The Minority accepted the postulates that the EBAs would have incorporated a basis for recognition of a royalty as reasonable. In the Minority's view, these postulates aligned with the commercial and economic substance of the arrangements, which involved the Bottler obtaining valuable IP rights essential to its operations and the evidence supported the Taxpayers having flexibility when setting terms of the EBAs.

¹⁶ At [211].

¹⁷ At [219].

¹⁸ See further at paragraph 29 of this Decision impact statement.

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Decision on diverted profits tax – purpose?

51. Having found that there was no tax benefit, the Majority noted that discussion of purpose was ‘unnecessary’.¹⁹ The Majority, however, did make observations in respect of the purpose element.

52. The Majority observed that even if a tax benefit existed, the evidence did not support the inference that the Taxpayers entered the EBAs for a principal purpose of obtaining that benefit. They stressed that the arrangements were negotiated at arm’s length and produced a fair price for concentrate. They also noted that the Commissioner’s reliance on a reduction in United States tax, while a factor favouring the position put forward, was insufficient to establish the requisite purpose under paragraph 177J(1)(b).²⁰

53. In dissent, the Minority did consider that the obtaining of a tax benefit was a principal purpose of the Taxpayers. The Minority emphasised the statutory test was focused on substance rather than form. In their view, the EBAs were structured so that payments were described as for concentrate but in substance facilitated the Bottler’s use of IP.

54. The Minority found that this disconnect between form and substance, combined with the resulting reductions in US tax and the absence of detailed evidence explaining why the pricing structure was adopted, supported a conclusion that a principal purpose of the scheme was to obtain a tax benefit.

ATO view of the decision

55. Our views on the implications of this decision are set out in paragraphs 56 to 78 of this Decision impact statement.

Identification of royalties

Consideration is not to be given a narrow technical meaning of contract

56. One issue before the Court was the question of whether the term ‘consideration for’ in the royalty definition takes on its narrow technical meaning under contract law, or a broader meaning of that which moves the transfer of property developed in the stamp duty cases. The Court²¹ endorsed the broader approach and we will continue to apply that principle in determining whether or not there is a royalty in arrangements we are examining.

57. Notably, the ‘central bargain’ or ‘central transaction’ test – where one examines an agreement for whether IP rights are a central item of the agreement for the purposes of characterising what the payment is for²² – was not endorsed in either of the judgments of the High Court.

It is important to identify the totality of the relevant bargain

58. This decision also reflects the importance of correctly identifying the ‘agreement’ that is to be analysed for whether there is a royalty. That the relevant ‘agreement’ to be analysed can be framed more broadly than a single contract and may be a composite of multiple contracts is a conventional approach, and ultimately a factual question.

¹⁹ At [266].

²⁰ At [236].

²¹ At [34] and [160].

²² *PepsiCo, Inc v Commissioner of Taxation* [2024] FCAFC 86 at [36], per Perram and Jackman JJ.

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59. Noting the Court's endorsement that the relevant arrangement can extend beyond a single contract, we will continue to seek to obtain documents and information necessary to understand the nature of the arrangements between the parties and their associates where there is a dealing in IP. This could include seeking copies of contracts, details of dealings between relevant parties and details of the negotiations which informed those contracts and dealings.

Embedded royalties

60. The decision does not disturb our view that, depending on the relevant facts and circumstances, a royalty may be found notwithstanding rights to use IP have been 'embedded' into amounts labelled as consideration for something that is not IP, such as a good or a service. The characterisation of a payment is not determined by the label attached to it by the parties (for example, stating it as being for goods or services, or being 'royalty-free'), or how it is computed.

61. The decision in *PepsiCo* does not establish any broad proposition that the characterisation of a payment under a contract – whether involving arm's length parties or related parties – can never be challenged. We continue to examine the arrangements of related parties closely.

62. The Court's observation in this case as to the 'criticality' of our not contending that the pricing of concentrate was inflated²³ is consistent with the potential for pricing evidence to be relevant for a characterisation analysis. In future cases involving royalty characterisation, we will seek to understand and, if necessary, test, the economic fundamentals of arrangements that involve provision of IP but where no royalty is recognised. This may include, but is not limited to, seeking evidence for the values of IP rights being supplied under an arrangement, as well as the values of other property or things being exchanged.

Payment of royalties

63. All justices of the High Court found that, on the particular contracts before them, there was no antecedent obligation of the Bottler to make the relevant payments to the Taxpayers. This meant that even if there had been a royalty component to the payment, it could not be said that there had been a constructive payment (and receipt) of a royalty to the Taxpayers and therefore the payments made to the Seller was not a case of the Bottler making a payment on behalf of or at the direction of the Taxpayers.

64. This conclusion was based on a factual finding of what the parties in this case had agreed under the terms of their bargain.²⁴ We do not expect a scenario where a royalty is present but that royalty is not being paid to or at the direction of the provider of the relevant IP to be common. If such a scenario were to present in the future, we would seek to understand the commercial context and rationale for the arrangement.

65. We will examine closely any existing arrangements under which a non-resident IP holder receives compensation for making IP available but the arrangements are changed resulting in there no longer being a payment (actual or constructive) of a royalty to a non-resident. Such altered arrangements are considered high-risk for the purposes of Part IVA and the DPT.

²³ At [167].

²⁴ Royalty characterisation being driven by factual findings is consistent with the Full Federal Court's comments in *Oracle Corporation Australia Pty Ltd v Commissioner of Taxation* [2025] FCAFC 145 at [83].

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Diverted profits tax generally

66. The finding that that the DPT did not apply because there was no tax benefit present was based on ‘critical facts, unique to these appeals’.²⁵ These unique facts included that:

- (i) the substance of the scheme was that there was no royalty component to the relevant payments,
- (ii) the scheme had come about through dealings between unrelated parties dealing at arm’s length, and
- (iii) the scheme was the implementation of a long-standing ‘market standard’ business model.

67. We do not expect that this set of ‘unique’ and ‘critical’ facts will be common to other cases. Because of this, we consider that the Majority’s analysis as to tax benefit in this case has limited implications for the application of the DPT or Part IVA in other cases.

Identification of tax benefits and the taxpayer’s onus

Onus

68. The Court unanimously found that the onus rests on taxpayers in respect of the application of Part IVA. This decision is consistent with a long line of authorities that for taxpayers seeking to discharge their onus it is not enough to find error in the Commissioner’s case – for example, showing that our postulates are not reasonable – they need to positively discharge their onus.²⁶

69. The decision clarifies that a taxpayer discharges its onus in respect of tax benefit under subsection 177CB(3) if it establishes that there is no reasonable alternative to the scheme, in the sense required by subsection 177CB(3). We expect that discharging the onus in this way will be, as the Majority said, ‘unusual’.²⁷

More than one alternative postulate that is reasonable

70. It is our view that *PepsiCo* at [207] raises the possibility that there can be more than one alternative postulate that is reasonable, contrary to the position for Part IVA prior to the 2013 amendments. In our view, the analysis required by section 177CB as to the identification of ‘reasonable postulates’ can result in the identification of more than one such ‘reasonable postulate’.²⁸ The observation by the High Court in this case, as to it being possible that there could be multiple reasonable postulates, is in tension with the Full Federal Court’s decision in *Hicks*²⁹. The decision in *Hicks* is currently the subject of a special leave application.

71. A question arises about whether the onus is discharged where there are 2 or more reasonable alternative postulates, where one or more results in the identification of a tax benefit and at least one does not. It is our view that, in such a scenario, a taxpayer does not discharge its onus merely by demonstrating that there is one reasonable alternative that does not result in the obtaining of a tax benefit. This too is a matter raised in the *Hicks*’ special leave application.

²⁵ At [219].

²⁶ At [205].

²⁷ At [212].

²⁸ See Majority at [207] where their Honours refer to ‘postulate or postulates’ as a basis for identifying a tax effect for the purposes of paragraph 177C(1)(bc).

²⁹ *Commissioner of Taxation v Hicks* [2025] FCAFC 171.

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Substance

72. The Majority's conclusion that there was no tax benefit was reached after having already found on the unique facts of this case that no part of the payment was a royalty and that the absence of a royalty was part of the 'substance of the scheme'. This meant that, in the eyes of the Majority, there was a significant misalignment in economic substance between the scheme and our postulates which did recognise a royalty. This misalignment led to the Majority finding our postulates to be not reasonable having regard to the substance of the scheme as required by subparagraph 177CB(4)(a)(i).

73. Noting the Majority's view that there was a significant misalignment between the economic substance of the scheme and our postulates, it is our view that this decision does not mean that paragraph 177CB(4)(a) requires postulates to reproduce entirely or replicate the 'substance' or 'consequences' of the scheme to be reasonable alternatives. The idea that paragraph 177CB(4)(a) requires replication is clearly incorrect, requiring replication would neuter Part IVA as postulates replicating a scheme's 'substance' and 'consequences' would also replicate that scheme's tax effects, precluding any ability to identify tax benefits and apply Part IVA.

74. The decision does not address scenarios where the substance of the scheme is that there is a royalty but the scheme avoids royalty withholding tax or results in other tax benefits. In these scenarios, postulates that include recognition of a royalty will not experience the misalignment to substance which they faced in this case.

Relevance of Peabody test

75. The Court was unanimous that *Commissioner of Taxation v Peabody*³⁰ is still relevant for the consideration under section 177CB on whether a postulate is reasonable, in particular with regard to the propositions that reasonableness requires 'sufficient reliability' and that '*reasonable expectation requires more than a possibility*'.³¹ Guidance from the courts on what this means in practice in the context of the 2013 amendments will unfold in future cases.

Tax avoidance purpose

76. Regarding purpose, the Majority had already disposed of the application of the DPT in making their finding as to there being no tax benefit and they described their observations regarding purpose as 'unnecessary'. The Majority also mentioned that submissions placed lesser importance on argument for the fourth, fifth, sixth, seventh and eighth purpose factors.³² Any consideration of the Majority's observations in respect of the purpose of the scheme should be made with these limitations in mind.

77. The Majority's observations were also made through the lens of having already found there was no tax benefit for the scheme. This is an inherently unusual scenario in which to be considering whether a scheme had an anti-avoidance purpose.

78. The Majority's (limited) observations on scheme purpose have reduced relevance where parties are not arm's-length parties acting at arm's length or where the scheme gives rise to a tax benefit.

³⁰ [1994] HCA 43.

³¹ At [77] and [224].

³² At [233].

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Implications for affected advice or guidance

79. We are reviewing the impact of this decision on Law Administration Practice Statement PS LA 2005/24 *Application of General Anti-Avoidance Rules*, and draft Taxation Ruling TR 2024/D1 *Income tax: royalties – character of payments in respect of software and intellectual property rights*.

Comments

80. We invite you to advise us if you feel this decision has consequences we have not identified. Forward your comments to the contact officer.

Due date: 1 May 2026
Contact officer: Liam Cox
Email: Liam.Cox@ato.gov.au
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Commissioner of Taxation

19 March 2026

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References

Legislative references:

- ITAA 1936 Pt III DIV 11A
- ITAA 1936 128A(2)
- ITAA 1936 Pt IVA
- ITAA 1936 177C
- ITAA 1936 177C(1)(bc)
- ITAA 1936 177CB
- ITAA 1936 177CB(3)
- ITAA 1936 177CB(4)
- ITAA 1936 177CB(4)(a)
- ITAA 1936 177J(1)(b)

Cases relied on:

Commissioner of Taxation v PepsiCo Inc [2025] HCA 30; 2025 ATC 20-969
PepsiCo, Inc v Commissioner of Taxation [2024] FCAFC 86; 303 FCR 1; 2024 ATC 20-918; 120 ATR 282

Cases distinguished:

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