Full Federal Court decision in PepsiCo falls flat for the ATO

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Full Federal Court decision in PepsiCo falls flat for the ATO

The PepsiCo case is one of the more significant tax cases in recent times, and touches on a number of important considerations for multinationals. It explores what constitutes an embedded royalty for tax purposes, the concept of consideration for the use of intangible assets and the application of Australia's Diverted Profits Tax anti-avoidance provisions.

Summary of key takeaways

- The Full Federal Court found in favour of PepsiCo, meaning that PepsiCo is not subject to either Royalty Withholding Tax or Diverted Profits Tax in respect of certain cross-border intellectual property licencing arrangements involving unrelated Australian third parties. The decision will be of high relevance to Australian taxpayers and multinational groups with similar third party commercial arrangements.
- The taxation treatment of intellectual property arrangements continues to be a focus area of the Australian Taxation Office (**ATO**), and is subject to ongoing change, contrasting opinion, differing interpretation and uncertainty.
- Taxpayers should remain vigilant and proactively review relevant arrangements. In particular, they should reflect on the ATO's willingness to consider the application of the Diverted Profits Tax anti-avoidance provisions in circumstances where payments for intellectual property may be viewed as containing royalty components.
- Such review should include an objective assessment of the terms of any contracts and legal agreements that record relevant arrangements. Contemporaneous documentation and evidence that support the commercial nature of relevant arrangements should also be reviewed, including any associated economic analysis, and the basis on which that analysis has been undertaken.
- The statements made by the majority of the Full Federal Court regarding how the 2013 amendments to Part IVA operate in determining or identifying a tax benefit will also be relevant to the application of Part IVA more generally (subject to any High Court decision if special leave to appeal is sought and granted).
- The decision represents a potentially unfavourable outcome for the Commissioner that could have broader application. This is particularly relevant in the context of announcements in this year's Federal Budget regarding the application of penalties for mischaracterised or undervalued royalty payments, to which Royalty Withholding Tax would otherwise apply.

The Full Federal Court, in a decision handed down recently on 26 June 2024, has found in favour of PepsiCo, Inc (**PepsiCo**) in its Royalty Withholding Tax (**RWHT**) and Diverted Profits Tax (**DPT**) disputes with the Commissioner. This overturned the previous decision and findings of the Federal Court at first instance.[1]

The decision is important on a number of levels. Most notably, this is in respect of the Court's findings and comments regarding the analysis and interpretation of key elements of Part IVA of the *Income Tax Assessment Act 1936* (Cth) (**ITAA 1936**).[2] The PepsiCo dispute also represents the first occasion on which the operation of the DPT provisions, inserted within Part IVA in 2017, has been judicially considered.

The findings and comments of the majority judgement of the Court in respect of the characterisation of intellectual property arrangements are also insightful and timely, particularly given the current focus of the Commissioner and the government on intangibles, and the associated, fast-changing regulatory landscape.

1 *PepsiCo, Inc v Commissioner of Taxation* [2023] FCA 1490.
2 All legislative references are to the ITAA 1936 unless otherwise indicated.

Background to the PepsiCo dispute

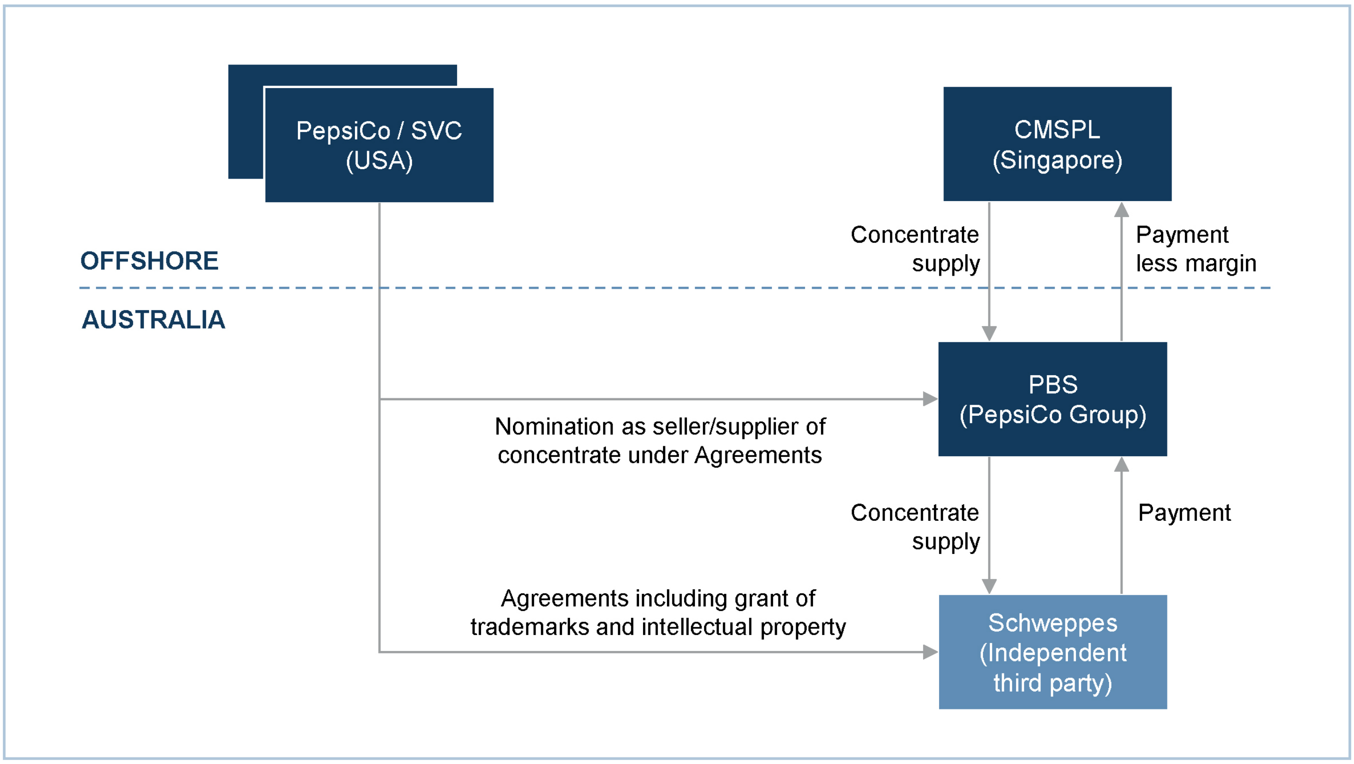
Colvin J summarised the factual background to the PepsiCo dispute:[3]

> *"These appeals concern agreements by which the holders of intellectual property in established and valuable beverage brands agreed to supply to a buyer the essential (and secret) components to make the beverages so that the buyer could make and sell the branded beverages to its own customers."*

More specifically:

- The agreements were two separate Exclusive Bottling Agreements (**Agreements**), entered into in 2009 by PepsiCo and Stokely-Van Camp, Inc (**SVC**) respectively (both companies being US companies and part of the PepsiCo Group), with Schweppes Australia Pty Ltd (**Schweppes**) (Schweppes being an Australian company owned by Asahi Breweries). Schweppes was an unrelated third party to both PepsiCo and SVC.
- Under the Agreements, Schweppes was the sole distributor and bottler in Australia of the Pepsi, Mountain Dew and Gatorade beverages in the relevant income years, which ended 30 June 2018 and 30 June 2019.
- Under the Agreements, PepsiCo and SVC nominated PepsiCo Beverage Singapore Pty Ltd (**PBS**) to sell or supply the beverage concentrate to Schweppes, which enabled the relevant beverages to be made (PBS being an Australian company and part of the PepsiCo Group). Schweppes paid PBS for the concentrate in accordance with invoices issued to it by PBS, with the sale price determined in accordance with the terms of the Agreements.
- PBS, in turn, was supplied with the concentrate by Concentrate Manufacturing (Singapore) Pte Ltd (**CMSPL**) (CMSPL being a Singaporean company and part of the PepsiCo Group).
- CMSPL produced the concentrate according to a recipe or formula provided by PepsiCo and SVC. The money received by PBS for the supply of concentrate to Schweppes was transferred by PBS to CMSPL, less a margin, for its initial purchase of the concentrate from CMSPL.
- Under the Agreements, Schweppes was granted the right to use trademarks and other intellectual property in Australia to enable it to manufacture, bottle, sell and distribute the finished beverages in branded PepsiCo Group packaging. The Agreements provided for Schweppes to pay for the concentrate, but did not expressly provide for the payment of a royalty for the right to use the intellectual property.[4]

A diagrammatic representation of the above is as follows:



3 Refer to [2024] FCAFC 86 at paragraph [136]; all paragraph references are to [2024] FCAFC 86 unless otherwise indicated.
4 Refer to [2023] FCA 1490 at paragraphs [5b] and [6].

Background to the issues in dispute

The issues in dispute as between PepsiCo and the Commissioner were also summarised by Colvin J:[5]

> *… Broadly speaking, there are two aspects to the appeal proceedings. The first concerns whether the agreed price paid for concentrate as provided for by the [Agreements] included royalties which were derived by PepsiCo and SVC as income such that they were liable to pay withholding tax on the royalty amounts. The second, which arises only if there is no withholding tax liability, concerns whether entry into each of the [Agreements] was a scheme that gives rise to a diverted profits tax liability.*

Issue 1 – Royalty Withholding Tax

There were two elements that the Court needed to consider relating to the characterisation of the payments Schweppes made to PBS for royalty withholding tax purposes:[6]

- Firstly, whether upon the proper construction of the Agreements, the agreed price was payable in part for a royalty and not payable solely as consideration for the concentrate.
- Secondly, whether the amounts paid under the terms of the Agreements constituted "income derived" by PepsiCo and SVC, even though they did not receive those payments.

All three judges of the Court (Perram and Jackman JJ in the majority judgement, and Colvin J in the minority judgement) ultimately concluded that the payments made by Schweppes to PBS for the concentrate were not income derived by PepsiCo and SVC for the purposes of section 128B(2B). This meant that the Court unanimously rejected the Commissioner's primary position that PepsiCo and SVC were liable to pay RWHT in respect of these payments.

However, the Court did differ on the question of whether the price paid for the concentrate, as provided for by the Agreements, included an "embedded" royalty.

Embedded royalty

A key component of the Court's analysis related to the definition of the term "royalty" within section 6(1). It also spoke to the requirement that for a royalty payment to have been made, the payments are required to have been made "*as consideration for*" the use of relevant intangible or intellectual property.

Perram and Jackman JJ in the majority judgement favoured a somewhat literal and legalistic approach to their consideration of this issue, focussing on the express terms of the Agreements and stating that "*… to determine whether the payments made by [Schweppes] to [PBS] were in part paid as consideration for the right to use the trade marks and other intellectual property, attention is to be confined to the terms of the contractual documents which, in this case, include at least the [Agreements].*"[7]

The majority also affirmed a key principle from the decision of Bennet J in *International Business Machines Corporation v Commissioner of Taxation* [2011] FCA 335, acknowledging that "*… the question of whether payments are consideration for the right to use intellectual property rights, and therefore a 'royalty', for the purpose of s 128B of the ITAA 1936 is determined by the construction of the relevant agreement",* also noting that *"Senior Counsel for both parties in the present case agreed that that was correct".*[8]

In determining the construction of the Agreements, Perram and Jackman JJ concluded that "*… the Commissioner's submission that PepsiCo and SVC were giving away the right to use the trade marks for nothing unless some element of the concentrate price was seen as embedding some value for it, must be rejected".*[9] In reaching this conclusion, they placed significant weight on their finding that the licence rights granted by PepsiCo and SVC to Schweppes did not exist "*in isolation*".

Rather, "*… they were intertwined with [Schweppes'] obligations to distribute the beverages in Australia*".[10] A more complete view of the licence was one which acknowledged not only the benefits to Schweppes in being permitted to use the goodwill attaching to the trade marks, but the restrictions and burdens imposed on Schweppes in utilising that goodwill, together with the benefits to PepsiCo and SVC in having Schweppes promote their goodwill in Australia.[11]

Perram and Jackman JJ also affirmed a key principle from the decision of Dixon CJ in *Davis Investments Pty Ltd v Commissioner of Stamp Duties* (NSW) (1958) 100 CLR 392 (**Davis**), acknowledging that "*… where parties to a conveyance have agreed the purchase price for a transfer on sale then the consideration for the transfer is that agreed price".*[12] They went further and stated that this "*… particular issue arising in the context of section 128B of the ITAA 1936 is determined by the construction of the relevant agreement",* preferring a "*formal expression*" approach.[13]

5 Paragraph [138].
6 Ibid.
7 Paragraph [10].
8 Paragraph [12].
9 Paragraph [21].
10 Paragraph [17].
11 Paragraph [21].
12 Paragraph [26].
13 Paragraphs [27] and [28].

In citing Davis with approval, Perram and Jackman JJ endeavoured to reconcile certain decisions of the High Court regarding the imposition of duty on the transfer of property, in response to the Commissioner's submissions "*… that the consideration for a transfer of property could be something different to that which the parties had agreed it to be*".[14]

In distinguishing the High Court decisions in Dick Smith and Lend Lease, in the context of citing Davis with approval, Perram and Jackman JJ concluded that Dick Smith and Lend Lease apply when:[15]

(a) The parties to an agreement have agreed that an item of property or the conferral of a right is in return for a nominated price.

(b) The agreement provides for the transfer of other items of property or the performance of other obligations for value.

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

The majority further stated:[16]

> "*In this case, we do not think that the concentrate prices in the [Agreements] are of this kind. … The right to use the trade marks and other intellectual property was not the central property disposition or transaction which [the Agreements] contemplated. Rather, the central bargain under the [Agreements] was the establishment of an exclusive arrangement to distribute PepsiCo / SVCs beverages in Australia.*
>
> *… It follows that the consideration for the purchase of the concentrate was the price the parties stipulated for it in the [Agreements]. As such, the payments made by [Schweppes] to [PBS] did not include an element which was a royalty for the use of the trade marks (since the payments were not in consideration for the right to use the trade marks).*"

Colvin J in the minority also endeavoured to reconcile the decisions of the High Court in Davis, Dick Smith and Lend Lease, but instead concluded that "*… Davis does not assist in resolving a case like the present where the agreement has other dimensions, save that … it places an emphasis upon understanding the precise character of the commercial dealing effected by the terms in which the agreement is expressed*".[17]

In considering the nature of the dealing provided for by the Agreements, and dissenting from the majority judgement as to whether there was a royalty, Colvin J stated:[18]

> "*… regard to the whole of the terms of the [Agreements] makes plain that it is not an agreement to supply concentrate. The nature of the transaction or dealing recorded in the agreement is one in which PepsiCo appoints [Schweppes] to bottle, distribute and sell branded beverages.*
>
> *… If the amount that is required to be paid under the [Agreements] is for the concentrate alone then the right to distribute the branded products is being afforded without any part of the monetary consideration being attributable to the licence to use the valuable brands of PepsiCo. That is a commercially unreasonable view of the terms of the [Agreements] considered as a whole.*"

Derivation

Notwithstanding the conclusions reached by the majority as to the royalty-free nature of the payments under the Agreements, Perram and Jackman JJ also considered whether the amounts received by PBS from Schweppes could constitute income derived by PepsiCo and SVC for royalty withholding tax purposes.

The majority noted that the Commissioner's submission in this regard was based on the contention that the consideration for the concentrate had been paid by direction to PepsiCo and SVC.[19] The majority rejected this submission, noting that "*… there can be no payment by direction unless there is an antecedent monetary obligation owed by [Schweppes] to PepsiCo / SVC …*".[20]

The majority concluded that there was no such antecedent obligation as, under the Agreements, it was clear that a related entity nominee of PepsiCo / SVC under the Agreements would be the entity selling the concentrate.[21] Further, while there were certain contractual obligations that remained the responsibility of PepsiCo / SVC, as PepsiCo / SVC "*… had neither possession of nor title to the concentrate … they did not deliver the concentrate either actually or constructively.*"[22]

14 Paragraph [26]. Refer to the decisions of the High Court in *Chief Commissioner of State Revenue (NSW) v Dick Smith Electronics Holdings Pty Ltd* [2005] HCA 3; 221 CLR 496 (Dick Smith) and *Commissioner of State Revenue (Vic) v Lend Lease Development Pty Ltd* [2014] HCA 51; 254 CLR 142 (Lend Lease), and the Commissioner's submission (also at paragraph [26]) that the principle in Davis was qualified by the subsequent decisions in *Dick Smith and Lend Lease*.

15 Paragraph [33].

16 Paragraphs [36] and [37].

17 Paragraph [186].

18 Paragraphs [194] and [195].

19 Paragraph [39].

20 Paragraph [40].

21 Paragraph [41].

22 Paragraph [42].

As such, as there "*… was no sale of concentrate by PepsiCo / SVC it cannot be the case that [Schweppes] was ever obliged to pay them for something they were not selling*".[23] Accordingly, the payments made by Schweppes to PBS were not income derived by PepsiCo and SVC for the purposes of the royalty withholding tax provisions as the payments did not "*come home*" to PepsiCo and SVC.[24]

Colvin J agreed with the reasoning of the majority judgement in relation to the non-derivation of income by PepsiCo and SVC.[25]

Issue 2 – Diverted Profits Tax

The DPT provisions were introduced into Part IVA in 2017. In broad terms, this gave rise to the need for the Court to consider the application of the "customary" machinery provisions of Part IVA regarding "scheme", "tax benefit" and "purpose" to the arrangements between PepsiCo and SVC with Schweppes.

Importantly, amendments were also made in 2013 to Part IVA which saw the introduction of section 177CB. These amendments are relevant to identifying a tax benefit in connection with a scheme, and in particular, in determining whether a postulate is a reasonable alternative for the purposes of considering what might reasonably be expected to have happened, but for the scheme.

Of significance in the majority judgement, Perram and Jackman JJ observed as follows in connection with the formulation of reasonable alternative postulates to the scheme / arrangements entered into, for the purposes of Part IVA:[26]

- In review proceedings of the present kind, it is the taxpayer which bears the burden of proving that assessments are excessive.
- Proving that the Commissioner's postulates are unreasonable does not in itself discharge that burden. It remains the burden of the taxpayer to show on all of the evidence that the tax benefit would not reasonably be expected to have been obtained if the schemes had not been entered into.
- What this means in practice in a proceeding such as the present is that PepsiCo must show that there is no reasonable postulate for the purposes of section 177CB(3). Naturally, this will include demonstrating that the Commissioner's postulates are not reasonable but PepsiCo must also demonstrate on the evidence that there is no other reasonable postulate.

Perram and Jackman JJ found that, in framing the scheme the subject of the dispute, the Commissioner did so in a manner that did "*… not, in any way, depend on the prices at which the concentrate was to be sold.*" Accordingly, this gave rise to the consequence that "*… the scheme relied upon by the Commissioner operates regardless of the concentrate price and, in particular, even where that price does not reflect the value … placed upon the intellectual property licence*."[27]

In the words of Perram and Jackman JJ, "*… the Commissioner's scheme case begs the question of why the concentrate price should be understood as including a royalty*",[28] and "*… it is not possible to conduct the kind of inquiry implicit in the Commissioner's scheme case without detailed analysis of the pricing under the EBA*."[29]

Rather, the Commissioner's scheme case assumed that a royalty component was included in the concentrate price. This was the same assumption that the experts for both the Commissioner and PepsiCo had been asked to make in determining a value for the intellectual property licence. As such, the difficulty that arose for Perram and Jackman JJ was "*… there was no evidence before the Court that this assumption was correct*", nor was there any "*… corresponding evidence which showed that [the value of the licence granted under the Agreements] was being recovered through the concentrate price.*"[30]

Accordingly, while the Commissioner identified two postulates that were contended to be reasonable alternatives to the entry into or the carrying out by PepsiCo and SVC of the scheme / arrangements entered into, these were ultimately rejected by Perram and Jackman JJ. This was primarily on the basis that the commercial and economic substance of these postulates (which incorporated the use of / payments for the use of trade marks and other intellectual property, in addition to payments for the concentrate) were different to the scheme / arrangements entered into.

23 Paragraph [43].
24 Paragraphs [45] and [46].
25 Paragraph [207].
26 Paragraphs [67] and [68].
27 Paragraph [53].
28 Paragraph [51].
29 Paragraph [53].
30 Paragraph [50].

More specifically, the majority found that, having regard to the Explanatory Memorandum that accompanied the introduction of section 177CB,[31] "*… for a postulate to constitute a reasonable alternative it 'should correspond to the substance of the scheme'.*"[32] Perram and Jackman JJ stated:[33]

> "*In this case, the Court must therefore assess the commercial and economic substance of the scheme and the commercial and economic substance of each postulate and reach a conclusion as to whether they correspond. It is necessary therefore to assess the commercial and economic substance of the scheme, on the one hand, and that of the [Commissioner's alternative] postulates, on the other.*"

In considering the commercial and economic substance of the scheme / arrangements entered into, the majority also found that "*[t]he commercial and economic substance of the scheme was that the price agreed for concentrate was for concentrate*",[34] and that "*… neither the scheme advanced by the Commissioner nor any of the evidence provides material from which it may be inferred that the commercial and economic substance of the scheme was that the concentrate price included a royalty for the licence of the intellectual property.*"[35]

Further, Perram and Jackman JJ also found that PepsiCo had also discharged the higher burden of showing that there were no reasonable alternative postulates to the scheme / arrangements entered into, in addition to showing that the Commissioner's postulates were not reasonable.

They found that the only postulates that could bring the payments made by Schweppes within the DPT provisions of Part IVA were those in which the payments made by Schweppes for the concentrate could be seen as being made in part for the grant of intellectual property rights by PepsiCo and SVC. Given the terms of the scheme as framed by the Commissioner, and the state of the evidence before the Court, there could be no such reasonable alternative postulate.[36]

As such, the majority concluded that in the absence of a postulate that could be a reasonable alternative to the scheme / arrangements entered into, there could be no operation of section 177CB(3), and correspondingly, PepsiCo and SVC could not be taken to have obtained, and did not obtain, a tax benefit in connection with a scheme for the purposes of Part IVA and the DPT provisions therein.

In contrast, Colvin J found that the scheme provisions within Part IVA, and the existence or otherwise of a reasonable alternative postulate, were required "*… to be considered in respect of a transaction which includes an amount which is consideration for the use of the trade marks.*"[37]

As such, having regard to the differing conclusion reached regarding the embedded royalty question, Colvin J found that "*… the {Agreements] resulted in a tax benefit because, if the [Agreements] had not been entered into, then a reasonable alternative postulate was that the [Agreements] would have provided for the royalty to be paid to PepsiCo or SVC*" as the holder of intellectual property rights.[38]

While all three judges also ultimately concluded that the "principal purpose" test under section 177J(1)(b), which relates to the entering into or carrying out of a scheme to obtain a tax benefit, would have been satisfied, Perram and Jackman JJ in the majority judgement noted that this conclusion was reached only on the basis of a "*highly artificial assumption*" in contrast to their previous conclusions that, as a matter of commercial and economic substance there was evidence that the payments made by Schweppes included a royalty for the use of the trade marks and other intellectual property, together with an accompanying necessary assumption that the Commissioner's scheme incorporated that aspect in its terms.[39]

31 Refer to *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013* (Cth).
32 Paragraph [74].
33 Paragraph [75].
34 Paragraph [82].
35 Paragraph [81].
36 Paragraph [100].
37 Paragraph [214].
38 Paragraph [215].
39 Paragraphs [110] and [133].

Detailed observations on the PepsiCo dispute

The Commissioner has until 24 July 2024 to seek special leave to appeal the Full Federal Court's decision to the High Court. While currently a matter of speculation as to whether the Commissioner may proceed down this path, or whether any special leave application may be granted by the High Court, there are a number of factors that may tend towards both of these outcomes.

Given the Commissioner's and the government's current focus on intangible arrangements, the decision in PepsiCo represents a potentially unfavourable outcome for the Commissioner that could have broader application beyond the specific facts, circumstances and industry involved in the present case.

Factors include:

- announcements in this year's Federal Budget regarding the application of penalties for mischaracterised or undervalued royalty payments to which RWHT would otherwise apply; and
- the Commissioner's detailed Draft Taxation Ruling TR 2024/D1 regarding the characterisation of payments as royalties in respect of software arrangements. It endeavours to promote an expansive view of the concept of "consideration" and the relevance of all surrounding circumstances of an arrangement beyond the terms of an agreement, which also removes the concept of "simple use".

The Commissioner could align any appeal with how separate Federal Court proceedings involving similar issues and disputes with another large global participant within the beverage industry progress. Therefore, it is a matter of high public and professional interest to both the Commissioner and taxpayers alike.

Federal Budget's intangibles integrity measure

Somewhat lost in the above is also the announcement by the government in this year's Federal Budget that the previously announced intangibles integrity measure would no longer be implemented. This was to be targeted at entities making payments relating to intangible assets connected with low corporate tax jurisdictions, and had proceeded to Exposure Draft legislation stage.

While this will now be addressed by other means (i.e. the implementation of BEPS principles), it is perhaps indicative of the changing regulatory landscape associated with the taxation of intangibles, which, in broad terms, may benefit from definitive judicial consideration and conclusions.

"Consideration" is of fundamental importance

Both the Full Federal Court's majority and minority judgements in PepsiCo devote considerable time and comment in endeavouring to reconcile the apparent contrast in historical decisions of the High Court regarding the determination of the concept of "consideration" in a number of well-known duty cases. While at first instance, this may be seen to be disconnected with issues regarding RWHT and DPT, the definition of "royalty" in the income tax legislation promotes the concept of "consideration" to one of fundamental importance in considering issues regarding the existence or otherwise of embedded royalties.

If an appeal proceeds, further consideration and clarification by the High Court of this line of authority will also be of high interest to both the Commissioner and taxpayers.

Concept of the "counterfactual"

The PepsiCo dispute represents the first occasion where the operation of the DPT provisions have been judicially considered. In addition, the previous decision and findings of the Federal Court at first instance, together with the majority judgement of Perram and Jackman JJ in the Full Federal Court, also represents the first time that the amendments made in 2013 to Part IVA in respect of the concept of the "counterfactual" and the determination of a reasonable alternative postulate, have been considered in detail.

In particular, the majority judgement of Perram and Jackman JJ was able to deal with the Part IVA requirements surrounding how the existence or absence of reasonable alternative postulates are demonstrated, in large part because of the evidentiary constraints faced by the Commissioner. These constraints included the view of the majority that, in order to frame a reasonable alternative postulate in the circumstances, evidence in the form of a detailed analysis of the economics of the Agreements was required. Such analysis, in turn, would have to include other benefits and burdens flowing to PepsiCo under the Agreements, and the cost to PepsiCo of manufacturing the concentrate, in order to show that the concentrate price under the Agreements included a value for the licences provided to Schweppes.

Given the burden of proof faced by taxpayers under section 177CB(3), as articulated by Perram and Jackman JJ, it remains to be seen whether similar DPT or Part IVA outcomes may arise, or indeed may even be capable of arising, in different factual circumstances and where such evidentiary constraints are not present.

These points may be factors, in and of themselves, that may support the High Court's consideration and granting of any special leave application.

Other IP matters of fundamental importance to taxpayers

In addition to the above, the decision of the Full Federal Court in PepsiCo also highlights other matters that are of fundamental importance to taxpayers in general, and taxpayers with intellectual property arrangements.

It is apparent from all aspects of the Full Federal Court's reasoning – both the majority and minority judgements – that the manner of drafting commercial agreements is critical. Whether the literal and "express" approach of the majority judgement, or the broader "commercial" approach of the minority judgement is preferred, what seems clear is that the more specific and comprehensive the language of a contract, and the less ambiguous that language and the subject matter of that contract, the better.

Looking at the PepsiCo dispute, this is particularly the case in respect of transactions that involve or potentially involve the use of or payments for intellectual property, which in turn will likely involve other specialist areas of law (such as copyright / trade mark law).

The use of expert evidence

The use of expert evidence and the manner in which such experts are briefed is also of critical importance in resolving any dispute between the Commissioner and taxpayers.

This reflects Perram's and Jackman JJ's comments in the majority judgement in particular. They indicated that the assumptions made by the Commissioner's expert in conducting his valuation, together with the absence of a detailed economic analysis of the Agreements, gave rise to significant evidentiary implications from the perspective of the Commissioner. This is together with associated technical consequences in respect of the interpretation and application of the DPT provisions. It therefore becomes imperative that taxpayers seriously consider the basis, including the context, on which an expert is instructed. For example, given the evidentiary restrictions ultimately focussed on by the majority, it may be necessary to instruct different experts for different purposes (e.g. for the purposes of settlement discussions with the Commissioner, compared to the purposes of litigation).

Operating at arm's length

Finally, the majority judgement in the Full Federal Court acknowledged that PepsiCo / SVC and Schweppes were operating at arm's length (see paragraph [51]). The minority judgement acknowledged that PBS paid an arm's length price to CMSPL for the supply of the concentrate (see paragraph [148]).

Accordingly, the transfer pricing provisions in Division 815 of the *Income Tax Assessment Act 1997* (Cth) were not relevant to the dispute between PepsiCo and the Commissioner. Given the significance of the decision of the Full Federal Court in PepsiCo, together with the ongoing focus of the Commissioner and the government on intangible arrangements, it remains to be seen whether the Commissioner may seek to test the operation of the DPT provisions within the context of intellectual property arrangements involving cross-border related parties and the application of the transfer pricing provisions.

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