

Tax Alert

ATO releases Decision Impact Statement on High Court PepsiCo decision

March 2026

EY

Shape the future
with confidence

At a glance

- The ATO has released a Decision Impact Statement (DIS) following the High Court's decision in *Commissioner of Taxation v PepsiCo Inc*.
- The DIS states that the outcome in *PepsiCo* was determined by the particular facts and circumstances of the appeals.
- The ATO makes clear that in their view the decision does not limit the Commissioner's ability to challenge arrangements involving IP, including where rights are said to be embedded in payments for goods or services.
- The ATO also indicates that it will continue to examine pricing, economic substance and the evidence in cases involving IP.
- The ATO also indicated that the Diverted Profits Tax (DPT) decision was based on the unique facts of the case.

On 19 March 2026, the Australian Taxation Office (ATO) released its Decision Impact Statement (DIS) following the High Court's decision in *Commissioner of Taxation v PepsiCo Inc & Anor* [2025] HCA 30. The crux of the DIS is the reliance of the Commissioner on the uniqueness of PepsiCo's particular facts and circumstances to support the Commissioner continuing to challenge arrangements involving intangibles and intellectual property (IP), including characterisation, embedded royalties, and the application of the anti-avoidance provisions.

Key Highlights

- The DIS emphasises that the outcome in *PepsiCo* was determined by the particular facts and circumstances of the appeals and should not be read as limiting the Commissioner's ability to challenge arrangements involving IP and intangibles.
- The DIS maintains that royalty characterisation remains a question to be determined by the proper construction of the relevant arrangements and what the parties have, in substance, agreed. Contractual labels are not determinative.
- The DIS also states that the ATO will continue to examine characterisation of payments (whether involving arm's length parties or related parties) and will particularly examine related party arrangements closely.
- The DIS further states that in the determination of key concepts of 'consideration' and the 'agreement', it is appropriate to take a broad view. As such, a relevant agreement may comprise a composite of contracts and dealings, rather than a single written instrument. The ATO also highlight that the High Court did not endorse any "central bargain" or "central transaction" test for royalty characterisation.
- It is clear the ATO maintains that *PepsiCo* does not disturb its position that royalties may, on the facts of a particular case, be embedded in payments described as being for goods or services.
- In relation to the Diverted Profits Tax (DPT), the ATO states that the finding that the DPT did not apply was based on critical facts which were unique to PepsiCo and would have limited application in other cases. However, the ATO state that the DPT decision does raise some broader technical issues for DPT and Part IVA ("PIVA") which may require judicial clarification.

■ ■ ■
The better the question.
The better the answer.
The better the world works.

Background

- The ATO has released its DIS following the High Court's decision in *Commissioner of Taxation v PepsiCo, Inc* [2025] HCA 30.
- In that decision, the High Court, in a majority 4:3 decision, dismissed the Commissioner's appeals in relation to royalty withholding tax and DPT. The majority found that:
 - Payments were not made as consideration for the use of IP and therefore were not a royalty.
 - The DPT did not apply as there was no reasonable alternative to the scheme.
- A DIS outlines the ATO's view on the implications of a court decision. The ATO publishes DIS for key court decisions to provide guidance as to how it will administer the law following a key decision.

Key Themes

- The DIS indicates that, notwithstanding the outcome in *PepsiCo*, the ATO will continue to examine arrangements involving IP by reference to their specific legal and commercial circumstances. This includes examining arrangements:
 - To determine the characterisation of payments and whether any part of payments is for IP and is a royalty.
 - To determine whether the anti-avoidance provisions, including DPT, could apply to any arrangements involving mischaracterisation of payments.

Identification of Royalties

- While accepting the High Court's conclusion on whether the payments were royalties, the ATO emphasises the uniqueness of the particular circumstances present in the *PepsiCo* arrangement.
- The DIS reflects a view on the part of the ATO that the High Court has endorsed that a broad approach can be taken in the determination of the meaning of "consideration for" IP and that "consideration" is not to be given a narrow, technical meaning of contract.
- Similarly, in terms of the identification of the correct 'agreement' that needs to be analysed, the ATO also highlighted support for a broad analysis i.e. one that may be a composite of multiple contracts or arrangements. That is, the ATO can focus on the "totality of the relevant bargain".
- The DIS further states that the High Court did not endorse the Full Federal Court's "central bargain" test i.e. where one examines an agreement for whether IP rights are a central item of the agreement for the purposes of characterisation. However, the DIS is silent on the point that the High Court did not reject it either.

Embedded Royalties

- As set out in the DIS, the ATO does not consider the decision establishes a 'broad proposition' that characterisation of a payment under a contract 'can never be challenged'. Of particular emphasis, the ATO states that arrangements between related parties will be examined closely.
- The ATO maintains that the absence of an express royalty clause, or the contractual description of an arrangement as royalty-free, does not conclude the characterisation enquiry. Specifically, the ATO states that the decision does not disturb the ATO view that a royalty may be found notwithstanding rights are embedded into amounts which are labelled as consideration for something else.
- The ATO referred to the High Court's observation relating to the 'criticality' of the ATO not contending that the payments for concentrate were inflated. The ATO state this is consistent with the potential for pricing evidence to be relevant for a characterisation analysis. The ATO expand on this and state that in future cases they will seek to understand and test the economic fundamentals of arrangements that involve provision of IP with no royalty.

Diverted Profits Tax

- The finding that DPT did not apply because the taxpayer was able to demonstrate there was no reasonable alternative that produced a tax benefit is considered by the ATO to be attributable to the particular facts of the case.
- The DIS focuses on the majority's comments that their DPT judgement is based on "critical facts, unique to these appeals" and the "unusual scenario" that the Taxpayers were able to show that there were no reasonable alternatives to the scheme.
- The DIS outlines those three unique facts as follows, the inference being that other taxpayers will not likely be able to demonstrate the same 'unique facts':
 - The commercial and economic substance was that the relevant payments were for concentrate alone.
 - The dealings were between unrelated parties and the pricing for the concentrate was not 'disproportionally high'.
 - The arrangement was an established 'market standard' business model with no royalty.
- The ATO also state that various aspects of the DPT decision require further judicial clarification. These are quite technical issues which would have broad application and which apply to both PIVA and DPT and may be settled in future anti-avoidance cases. The two issues raised are :
 - Whether there can be more than one reasonable alternative postulate.
 - Whether a taxpayer discharges their onus if they can demonstrate one reasonable alternative postulate that has no tax benefit.

Implications

- The ATO focus in the DIS on features of the specific fact pattern present in *PepsiCo* confirm that the ATO considers there is narrow scope for any broader implications to be inferred from the decision. As such the ATO does not see the case as in any way limiting their ability to examine embedded royalty cases.
- The DIS also suggests there will be no significant changes to the ATO's compliance approach in relation to embedded royalties and character of the payment questions. This aligns with our experiences to date and the manner in which the ATO is continuing to dedicate compliance resources and examine arrangements.
- Unsurprisingly, but still disappointingly for taxpayers, we expect the ATO will continue to examine arrangements involving IP across all industries with a focus on technology, consumer and life sciences and we also expect the ATO's focus to expand (rather than contract) given the references in the DIS to understanding the entirety of arrangements and testing the economic fundamentals.
- We also expect the ATO will prioritise related party arrangements and will continue to examine both royalty characterisation and the application of the anti-avoidance provisions. We also expect the ATO will continue to seek judicial clarification on the anti-avoidance rules.
- The ATO also specifically warn against changing current arrangements to align with the specific facts of the *PepsiCo* arrangement.

ATO Activity

- Royalty characterisation has been, and will continue to be, an area of focus for the ATO notwithstanding the decision in *PepsiCo*.
- Given the particular facts in *PepsiCo*, including arm's-length dealing with an unrelated party, a 'business as usual' approach is to be expected with the ATO continuing to examine arrangements that are outside that unique factual setting.
- The DIS states that the ATO is still reviewing the impact of the case before finalising draft *Taxation Ruling TR 2024/D1 Income tax: royalties – character of payments in respect of software and intellectual property rights*. There is no further guidance on when that guidance will be updated and finalised with the ATO's website continuing to state that the finalisation date is "to be advised". This is unfortunate for taxpayers seeking certainty given the draft was issued over two years ago.
- The DIS also states that the ATO is also reviewing the impact of the case on *Law Administration Practice Statement PS LA 2005/24 Application of General Anti-Avoidance Rules*. This practice statement contains the ATO's administrative practice on the anti-avoidance rules.

Policy Considerations

- The DIS reflects a clear concern on the part of the ATO that *PepsiCo* not be treated as a broader constraint on future challenges involving intellectual property. Although the ATO accepts the outcome, it repeatedly emphasises the factual specificity of the decision and preserves scope for continued challenge in other cases.
- The practical question is whether the ATO will seek to test the limits of *PepsiCo* through further strategic litigation, particularly in related-party cases, or whether it will instead seek to address any perceived gaps through guidance, administrative or legislative change. There is at least one known case which may be heard in the Federal Court in the next 12 months and there are likely more in the pipeline.
- As regards to possible legislative change, in the 2024–25 Federal Budget the Government announced a new penalty, to apply from 1 July 2026, for significant global entities (SGEs) that mischaracterise or undervalue royalty payments to which royalty withholding tax would otherwise apply. This measure, details of which may be developed in the 12 May 2026 Budget, would constitute a legislative response, at least for SGEs, in relation to royalties and may, in practice, significantly constrain the scope of the *PepsiCo* decision in SGE cases, even if it does not formally disturb the Court's reasoning.

How EY can help

Our EY tax advisors can help you to:

- Determine whether a royalty exists as a matter of substance.
- Review your arrangements and ensure the evidence and legal structure meets the bar set in the *PepsiCo* decision and is defensible.
- Assess whether the price of goods, services or underlying arrangements are arm's length and help test the economic fundamentals of arrangements.
- Prepare for and defend an ATO review or audit on intangibles and mischaracterisation and the application of the anti-avoidance provisions.

For more information please
contact your usual EY advisor or:

Sydney:

Sandra Farhat
sandra.farhat@au.ey.com

Sean Monahan
Sean.Monahan@au.ey.com

Yvette Adams
yvette.adams@au.ey.com

Jason Vella
Jason.vella@au.ey.com

Jarrold Thomas
Jarrod.Thomas@au.ey.com

Leonid Shaflender
Leonid.Shaflender@au.ey.com

Russ Williams
Russ.Williams@au.ey.com

Sophie Lewis
Sophie.lewis@au.ey.com

Sam Lavender
Sam.lavender@au.ey.com

Perth:

Joe.lawson
Joe.lawson@au.ey.com

Fiona Beckett-Cooper
Fiona.beckett-cooper@au.ey.com

Melbourne:

Michael Jenkins
michael.jenkins@au.ey.com

Tony Merlo
tony.merlo@au.ey.com

Liz Cullinan
Liz.Cullinan@au.ey.com

EY | Building a better working world

EY is building a better working world by creating new value for clients, people, society and the planet, while building trust in capital markets.

Enabled by data, AI and advanced technology, EY teams help clients shape the future with confidence and develop answers for the most pressing issues of today and tomorrow.

EY teams work across a full spectrum of services in assurance, consulting, tax, strategy and transactions. Fuelled by sector insights, a globally connected, multi-disciplinary network and diverse ecosystem partners, EY teams can provide services in more than 150 countries and territories.

All in to shape the future with confidence.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via ey.com/privacy. EY member firms do not practice law where prohibited by local laws. For more information about our organization, please visit ey.com.

© 2026 Ernst & Young, Australia
All Rights Reserved.

EYSCORE 111301-26-AUNZ

ED None



In line with EY's commitment to minimize its impact on the environment, this document has been printed on paper with a high recycled content.

Ernst & Young is a registered trademark.

This communication provides general information which is current at the time of production. The information contained in this communication does not constitute advice and should not be relied on as such. Professional advice should be sought prior to any action being taken in reliance on any of the information. Ernst & Young disclaims all responsibility and liability (including, without limitation, for any direct or indirect or consequential costs, loss or damage or loss of profits) arising from anything done or omitted to be done by any party in reliance, whether wholly or partially, on any of the information. Any party that relies on the information does so at its own risk. Liability limited by a scheme approved under Professional Standards Legislation.

ey.com