# Tax Alert

A focus on topical tax issues

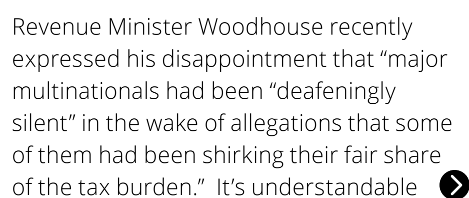
July 2016

# Taxing multinationals: What exactly is New Zealand doing about it?

By Bruce Wallace

Well, a lot actually.  Media coverage and debate in New Zealand and around the world in relation to the level of tax paid by multinationals continues, with a growing number calling on the New Zealand government "to do something".  There has been more political pressure of late from opposition politicians.   The tax issues are complex and as a result there is much misinformation, especially in the New Zealand context.

Revenue Minister Woodhouse recently expressed his disappointment that "major multinationals had been "deafeningly silent" in the wake of allegations that some of them had been shirking their fair share of the tax burden."  It's understandable



## In this issue:

**Taxing multinationals: What exactly is New Zealand doing about it?**

**New Zealand trust disclosure rules: Not fit for purpose but fixable**

**Update on GST on low value goods**

**Withholding tax now applies to bright line residential land sales by offshore vendors**

**Government sets out framework for taxing inbound investment**

**A snapshot of recent developments**

that multinationals are perhaps reluctant to get into the debate publically – not because there is anything to hide, but because they are damned if they do and damned if they don't.

What hasn't been well reported by the media is the fact that Inland Revenue tax officials have done a lot of work in recent years to ensure New Zealand's international tax regime is robust and they have been donkey deep in the OECD's BEPS (base erosion and profit shifting) project since the project was set up over three years ago.

New Zealand has already implemented rules that are consistent with a lot of the OECD's BEPS recommendations.

New Zealand has to date resisted the temptation to implement its own additional ad hoc tax rules but officials are currently preparing a report for Ministers on whether New Zealand should adopt similar measures to those adopted recently by Australia and the UK.

Government has released a cabinet paper on the BEPS work programme that explains what New Zealand is doing in this regard. When all the projects are lined up on the one page, it's pretty clear the tax landscape for multinationals is already changing and substantially so.

The report sets out some key principles and outlines a four-prong approach to managing these issues as follows:

**Key Principles:**

1. **All taxable income earned in New Zealand should have tax paid in New Zealand; and**
2. **In determining taxable income:**
   a. All gross revenue earned in New Zealand should be identified and reported; and
   b. Deductions from gross revenue should reflect the real economic costs of production, free of measures deliberately designed to reduce tax liability.

**The New Zealand Approach:**

1. **Ensure New Zealand's domestic tax rules are robust and consistent with international best practice**

Under this heading, it is noted that:

- New Zealand has recently strengthened its controlled foreign company and thin capitalisation rules;
- It has introduced bank minimum equity rules, eliminated the conduit tax regime and removed the foreign dividend exemption for deductible foreign equity;
- New rules for applying GST to online services consumed in New Zealand have recently been enacted to apply from 1 October 2016;
- Legislation has been introduced that will strengthen the non-resident withholding tax and approved issuer levy rules;
- In late August/early September 2016, the government is to release a consultation paper on hybrid mismatch arrangements. New rules will prevent companies structuring their business entities or financing arrangements to take advantage of differences in how countries' tax these arrangements;
- The government will also consult on whether to introduce interest limitation rules to prevent companies stripping excessive profits by way of deductible interest payments. This is despite the fact we already have strong thin capitalisation rules in comparison to some other countries;

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- The government has just released the report on the inquiry into foreign trust disclosure rules (see next article). We expect most, if not all of the recommendations from this report to be adopted; and
- As noted above, the government may consider whether other BEPS measures are necessary (e.g. a diverted profit tax as adopted by the United Kingdom and Australia) and has asked Officials to report to cabinet thereon.

**2. Work with OECD and treaty partners to ensure international agreements are fit for purpose**

It is noted that New Zealand:

- Has signed the Convention on Mutual Administrative Assistance in Tax Matters in 2012. This became operative for New Zealand on 1 January 2015 and is also an essential element of New Zealand's overall transparency framework;
- Will sign up to the OECD's multilateral instrument which will be open for signatures by 31 December 2016. This instrument will amend countries' network of tax treaties to insert a new anti-treaty abuse article, a new permanent establishment definition, anti-hybrid entity rules and dispute resolution articles; and
- Will apply revised OECD Transfer Pricing Guidelines to address misallocation of profits to low tax jurisdictions. Legislation could be introduced to facilitate this (if needed) in March 2017.

**3. Improve the transparency of tax information so people cannot hide their wealth and avoid tax obligations**

In this regard, New Zealand:

- Has introduced an International Questionnaire to monitor profit shifting activities of major foreign-owned groups of companies;
- Implemented measures to comply with the United States (US) foreign account tax compliance act which requires the collection and exchange of information from financial institutions about investments by US citizens (from 1 April 2015);
- Will introduce legislation in mid-2016 to enable automatic exchange of information with a wide range of countries' tax administrations about the financial affairs of their residents (from September 2018);
- Is already starting to exchange Inland Revenue's taxpayer binding ruling information with foreign tax administrators; and
- Is introducing legislation to require our multinational companies to prepare country-by-country reports (these reports basically provide a breakdown of business activities of the multinational group across the world and financial information for each country in which they operate) in line with the OECD proposal.

**4. Ensuring that current compliance measures adequately address BEPS**

In addition to the above, it is also noted that:

- Inland Revenue has an extensive international compliance programme addressing profit shifting, in particular transfer pricing of goods and services and international financing arrangements;
- The top 50 taxpayer groups receive comprehensive coverage, being account managed on a one-to-one basis; and
- Advance pricing agreements have proven extremely useful as a robust up-front means of dealing with profit shifting risk, especially the more complex issues that arise.

The OECD action plan to address BEPS includes 15 separate actions on the various tax issues. The final reports released in September 2015 amounted to more than 2,000 pages (see our previous article on this). The tax issues are incredibly complex and can't happen as quickly as some would like because consensus among countries is required on a number of issues. But as the above list demonstrates, things have been and continue to be happening and New Zealand is very much in the thick of it.

The reality is that the government's response to addressing the issues for multinationals is not likely to grab as much headline attention as the calls for action to do something. It's also unfortunate that this BEPS update report was released on the same day as the report on the inquiry into foreign trusts, which hijacked the media's attention.

Finally, let's also not forget that New Zealand has its own home grown multinationals which will also likely face increased taxation costs in other countries due to operations carried out therein as a result of these measures and we need to ensure that there is a balanced global response.

# New Zealand trust disclosure rules: Not fit for purpose but fixable

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John Shewan's Report regarding the Government Inquiry into Foreign Trust Disclosure Rules (Inquiry) was released on 27 June 2016, delivering a very clear and targeted summary of the deficiencies of the current regime and recommendations for improvement. The Report does not pull any punches in describing the existing foreign trust disclosure rules as inadequate, not fit for purpose, and light-handed. Nevertheless, the Report correctly (in our view) identifies the appropriate solution to be enhanced information disclosure requirements and regulation, as well as education around the perceptions of the rules, rather than the repeal of the foreign trust tax exemption altogether. Initial indications are that the Report recommendations will receive cross-party political support and that the Government will provide a formal response to the Report in the coming weeks.

### Re-setting the conversation

It is important, as noted in the Report, to re-set the conversation by identifying what is actually wrong with our foreign trust regime, so that the real risks are recognised and addressed, and misleading perceptions are corrected.

The Inquiry was commissioned in light of the extensive publicity around the so-called Panama Papers, a cache of documents that has never been publicly released and was not available to the Inquiry. The papers are alleged to detail extensive use of New Zealand's foreign trust regime by high-wealth individuals to evade tax, hide assets and launder money.

The perception that there is a problem with the foreign trusts regime was based largely on media coverage that created the unfortunate misconception that either large amounts of offshore money was being hidden in New Zealand, or that New Zealanders were themselves exploiting foreign trusts to evade tax. However, the foreign trusts tax exemption is not available in either of those scenarios. The taxation of trusts in New Zealand is based on the principle that foreign sourced income derived by non-residents is not taxable in New Zealand. This is consistent with the fundamental principles of our taxing legislation and international norms, and does not make New Zealand a tax haven.

### The current status – a "light-handed" regime

The real problem is that our minimal disclosure requirements and almost non-existent sanctions for failure to comply with the rules provide little assistance to other countries in determining whether their own tax base is being diminished by non-residents using the New Zealand regime to evade tax in their own country.

If another country taxes trusts in a different way from New Zealand, this provides opportunities for residents of that other country to take advantage of the mismatch in rules and not pay tax anywhere. Similarly, tax evaders may benefit from our limited disclosure requirements in concealing income that would be taxable in their own country. In either scenario, non-residents could correctly conclude that there is a very low risk of New Zealand authorities either having or passing on information that would identify them to their home jurisdiction's authorities.

### Is there any reputational harm?

This lack of information is a major concern identified by the report. A key reason for initiating the Inquiry was ensuring New Zealand's reputation as a nation that co-operates with other countries to deter tax avoidance, is maintained. The Report concludes that as there is a "reasonable likelihood" that the regime is facilitating the concealment of funds or evasion of tax in other countries, our tax treaty partners could reasonably expect that New Zealand would do something to remedy that situation.

### What should the Government do to fix this?

The Report outlines four options for reforming the foreign trust rules, ranging from moderately enhanced disclosure requirements to removing the tax exemption on foreign sourced trust income entirely. The option preferred by the Report is a significant increase in initial and ongoing disclosure requirements and improvements to the supporting legal framework. This many-pronged response to the current deficiencies includes:

- Enhanced registration requirements, including a register of trusts searchable by regulators;
- Detailed disclosure upon registration, including detailed information about settlors, protectors, trustees, other natural persons who have control of the trust, and beneficiaries, as well as a copy of the trust deed;
- Ongoing annual returns disclosing changes to any information provided on registration, and details of all distributions made during the year, including the recipients;
- Registration and annual filing fees;
- Expansion of scope of the Anti-Money Laundering and Countering of Foreign Terrorism Act 2009 to apply to lawyers and accountants who advise foreign trusts; and
- Suspicious transaction reporting.

A key objective of the recommendations is to introduce a deterrent for failure to comply. Foreign trusts that do not comply with the registration and ongoing filing obligations will not be exempt from New Zealand tax.

The Report envisages that the recommended changes will discourage non-residents who are currently relying on the secrecy inherent within our rules to hide taxable income from their own jurisdiction, and will remedy the perception that New Zealand has weak foreign trust disclosure and reporting rules.

### What happens next?

Although the Government has not formally responded to the Report, Prime Minister John Key has indicated the Government is broadly supportive of the proposals, with support also indicated from the Labour Party. It is understood a formal response will be provided next month. The Report recommends a transitional period with new trusts required to comply with the new disclosure rules once the new legislation is enacted, existing trusts required to comply by 30 June 2017, and an annual foreign trust return required for income years starting from 1 April 2017.

A lack of information is a major concern identified by the report

# Update on GST on low value goods

On 30 June 2016, Minister of Customs, Nicky Wagner issued a press release stating that Customs is continuing to look into different ways of collecting tax effectively for low-value imports by private consumers before proposing to lower the threshold at which it is collected, and that more time is needed before changes are made. At the same time a cabinet paper was released explaining the work and thinking done to date.

Last year Inland Revenue determined that the New Zealand Government was missing out on GST of $140 million per year on goods that are purchased over the internet. It is questionable that a lower "de minimis" limit will increase the GST collected sufficiently enough to cover the related administrative, logistic and workforce costs with the suggested approaches for collecting GST at the border.

In all likelihood, customers will probably keep on shopping online so long as the GST and duties are collected in a straightforward way and it does not interfere with the delivery process. There is a concern about the most appropriate method of collecting the GST and preparatory time will be needed for setting-up collection mechanisms. For this reason the potential reduction of the "de minimis" limit has been postponed till 2018/19 at the earliest so the NZ budget would miss out on some revenue for a few more years.

While the actual "de minimis" limit is set at $60 duty owing (including GST), the paper discusses capping the value of the goods imported GST-free. Considerations have been given to lowering the limit to $200. This can mean that for certain dutiable goods there will not be much difference. For example, a pair of shoes is currently free of duty and GST if the total value is $226 or less.

We strongly suggest that New Zealand look more closely at the Australian approach and require any non-resident supplier that sells more than $60,000 of goods to New Zealand consumers to register for New Zealand GST and collect 15% GST when the order is placed. Without a change, we will have the situation from 1 October 2016 in New Zealand, where the on-line purchase of a physical book will not be subject to GST, but the purchase of an e-book will be subject to GST (even if the same non-resident supplier makes both sales) due to the "Netflix tax" that applies from 1 October on remote services supplied by non-residents to New Zealand resident consumers.

Overall the playing field for local retailers will not be levelled as much or as quickly as they would like it to be. We think the paper does not give enough consideration to the innovative Australian approach of collecting GST on low value imported goods at source, rather than at the border. The Australian approach will require the large non-resident sellers to collect Australian GST from goods sold online to Australian customers, regardless of the value of the goods (from 1 July 2017). Instead NZ cabinet has supported reducing the "de minimis" limit for the low value imported goods.

## We think the paper does not give enough consideration to the innovative Australian approach

# Withholding tax now applies to bright line residential land sales by offshore vendors

1 July 2016 marked the commencement of the collection of a new withholding tax – the residential land withholding tax ("RLWT"). This tax was introduced as part of a suite of measures to improve compliance on residential property investment.

Broadly, the RLWT applies to residential land located in New Zealand, which was acquired post 1 October 2015 and sold by an offshore person (defined in the legislation as an "offshore RLWT person") within two years of being acquired (i.e. it is subject to the "bright line" test).

Three calculations are required in order to determine the amount of RLWT to be withheld. The amount of RLWT is the lowest of:

- 33% (or 28% if the vendor is a company) x (the current purchase price less the vendor's acquisition cost);
- 10% of the current purchase price; or
- The current purchase price less outstanding local authority rates less security discharge amount. The security discharge amount applies if the person paying the RLWT is the vendor or the vendor's conveyancer and is the total of amounts required by licensed security holders to discharge their mortgages or other securities over the residential land.

The vendor is liable to pay the amount of RLWT to the Commissioner of Inland Revenue. However the vendor's conveyancer or solicitor, or if the vendor does not have one, the purchaser's conveyancer or solicitor, is treated as the agent of the vendor in relation to the payment of RLWT. If neither the vendor nor purchaser has a conveyancer, the purchaser will be required to withhold the RLWT and pay it to the Commissioner of Inland Revenue.

An RLWT exemption certificate is available to persons who are disposing of their "main home" as defined, or for those in the business of developing land, erecting buildings or dividing land into lots, subject to meeting certain criteria.

The vendor has a tax credit for the amount of RLWT withheld by the agent in relation to land disposed of.

There is plenty of detail within these rules including:

- Who is an "offshore RLWT person";
- When the obligation to pay RLWT arises, because it depends on there being a "residential land purchase amount as defined";
- The options for payment by the agent who can choose to pay transaction by transaction or opt to "batch" various amounts. Batching might be preferred say by a solicitor who has a number of transactions in a month;
- The calculations required to determine the amount of RLWT. It will be important to ensure that any GST obligation is considered, as the prices used to calculate RLWT should be net of GST, if any; and
- The obligations of agents to determine whether vendors are subject to the rules and the information required to be provided to the Commissioner of Inland Revenue. Agents can be subject to penalties and use of money interest for not complying with the rules.

If you would like further information about these rules, please contact your usual Deloitte tax advisor.

# Government sets out framework for taxing inbound investment

On 27 June 2016, the Government released a draft paper setting out New Zealand's framework for taxing income earned on inbound investment. The paper notes that over the past 15 years there have been various reviews that have examined the issues from a variety of points of view, however this paper sets out the accumulated thinking and the present framework.

The paper has been developed for use as the basis for targeted consultation with private sector representatives and to facilitate a wide understanding of the trade-offs the Government faces in responding to base erosion and profit shifting ("BEPS").

A report describing the work already undertaken to implement BEPS measures and the planned work programme for the next 12 months was also released with this paper (see related article in this issue).

The report notes that there are many factors, some of which are inherently unquantifiable, that are relevant in choosing the best tax system. Overall New Zealand has a coherent and stable tax system which adds to business certainty.

The paper addresses a range of topics, including: company taxation; non-resident withholding tax (NRWT) on interest on related-party debt; thin capitalisation and the provision of debt/equity by foreign parent companies; BEPS; and NRWT and the approved issuer levy in relation to unrelated-party debt. The principal conclusions reached are:

- It is in New Zealand's interest to levy company income tax and NRWT on income from activities carried on within New Zealand's borders. These taxes are broadly consistent with international norms and provide significant funding for Government priorities and programmes that would otherwise be needed to be raised elsewhere;
- Base-protection measures, such as thin capitalisation and transfer pricing rules, are sensible to protect the tax base and ensure that New Zealand gets its fair share of revenues;
- There is a continuing case for NRWT on interest from related-party debt to supplement the company tax and to play a role in determining New Zealand's share of taxes on activities within its borders;
- Deviations from normal tax rules, intended or otherwise, can lead to substitution of low-taxed investors for tax-paying investors, reducing national income without necessarily lowering the overall pre-tax cost of capital to New Zealand or increasing investment. Accordingly, base-maintenance provisions that ensure the intended level of tax is collected will often be in New Zealand's best interest; and
- NRWT on portfolio debt has been modified by the approved issuer levy (AIL) to provide relief from taxation in circumstances where it is in New Zealand's interest to do so. On balance, continuing with New Zealand's AIL/NRWT system for third-party debt is likely to be in New Zealand's best interest.

# A snapshot of recent developments

Below is a summary of key developments since our last Tax Alert.

## Legislative developments

On 15 June 2016, the Taxation (Annual Rates for 2016-17, Closely Held Companies, and Remedial Matters) Bill was read for a first time and referred to the Finance and Expenditure Committee. Parliament has set the submission date as Friday 29 July 2016. Refer to our May Tax Alert which outlines the contents of this bill.

## Tax Cases

Over the past month, the following tax cases have recently been released:

- Taxpayer's inconsistency cause of action struck out – *Commissioner of Inland Revenue v Michael Hill Finance (NZ) Ltd;*
- Deduction for management fee disallowed – *Honk Land Trustees Limited v Commissioner of Inland Revenue;* and
- No deduction for depreciation loss for cost of embankment – *Queenstown Airport Corp Ltd v Commissioner of Inland Revenue.*

## Inland Revenue items

Inland Revenue has certainly been busy over the past month!

### Notification of pending audit or investigation

On 28 June 2016, Inland Revenue released a Standard Practice Statement (SPS 16/03) which concerns the notification of a pending audit or investigation. Replacing SPS 07/02, SPS 16/03 sets out the Commissioner's practice for notifying taxpayers of a pending audit or investigation or advising them that one has begun. The key changes in practice relate to the introduction of a new communications framework in section 14 to 14G of the Tax Administration Act 1994.

### Donee organisations and gifts

On 29 June 2016, Inland Revenue released a Question We've Been Asked - QB 16/05. This question concerns when donee organisations such as charities, schools, religious, sporting and cultural organisations may issue a donation receipt for payments made to them by individual supporters. The release replaces:

- Charitable donations: fund raising functions and sponsorship" – Public Information Bulletin No 125, March 1984; and
- "Cost of function ticket: when charitable portion can qualify for rebate" – Tax Information Bulletin Vol 6, No 2, August 1994.

### Donee organisations and when funds are applied wholly or mainly to specified purposes within New Zealand

Inland Revenue has re-released an issues paper for consultation which is relevant for donee organisations that apply some of their funds to purposes outside of New Zealand. While Inland Revenue currently accept that the "wholly or mainly" requirement is met where 51% or more of the funds are applied within New Zealand, the issues paper suggests increasing this threshold. It is proposed however, that any changes made as a result of the process following the issues paper will apply prospectively. The conclusions reached are the Commissioner's initial views and therefore interested parties are invited to make submissions by 29 July 2016.

### How to claim a foreign tax credit where the foreign tax paid is covered by a double tax agreement

On 16 June 2016, Inland Revenue released a comprehensive draft Interpretation Statement on how to claim a foreign tax credit where the foreign tax paid is covered by a double tax agreement. Submissions are due 29 July 2016.

### Goods and Services Tax – single supply or multiple supplies

On 16 June 2016, Inland Revenue released a draft interpretation statement for consultation which outlines the difference between multiple supplies and a composite supply. As supplies can be zero-rated or made at the standard rate, Inland Revenue suggests a three part test for determining whether the supply is composite or multiple supplies. Submissions close on 29 July 2016.

### Updated draft guidance issued on "permanent place of abode"

On 29 June 2016, Inland Revenue released PUB00276, a draft revision to paragraphs [28] – [156] of Interpretation statement IS 14/01 – updating the guidance on the meaning of "permanent place of abode". The revision has occurred as a result of the *Diamond* case where the Court of Appeal disagreed with the Commissioner's position on the application of section YD 1(2) of the Income Tax Act 2007. The draft now incorporates the Court of Appeal's guidance on this matter. Submissions on the draft can be made until 10 August 2016.

### Dispute resolution draft standard practice statements released for consultation

On 30 June 2016, Inland Revenue released two draft standard practice statements, ED0187 and ED0188. These drafts will replace SPS 11/05 (Disputes resolution process commenced by the Commissioner of Inland Revenue) and SPS 11/06 (Disputes resolution process commenced by a taxpayer) respectively. The changes reflect:

- Developments to the term 'response period' as defined in the Tax Administration Act 1994; and
- The new communications framework contained in sections 14 to 14G of the Tax Administration Act 1994.

Submissions are due 12 August 2016. As the review has been limited to the above two matters, Inland Revenue will not accept submission points outside of this scope.

### Draft QWBA on the date of acquisition of land for income tax purposes

On 28 June 2016, Inland Revenue released a draft Question We've Been Asked - PUB00220, concerning the issue of when land is acquired under section CB 15B of the Income Tax Act 2007. This is the section that determines the date of acquisition of land for most of the land provisions. This draft concludes that the relevant date is when the first interest in the land, to be disposed of, was acquired. This date will be when a binding sale and purchase agreement is made or when an option is exercised. For companies who acquire land prior to formation, they are treated as acquiring land at the time of agreement. Note also that the date of acquisition may differ based on the particular facts of a transaction. The draft also examines the start-date for the application of the bright-line rules, noting that this date is distinct from the date land is acquired under section CB 15B.

Submissions are due by 19 August 2016.

For information on any of these items, please contact your usual Deloitte tax advisor.

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