REVENUE ALERT

Non-compliance in the horticultural sector

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RA 26/02

Inland Revenue is concerned about a number of practices it has identified in the horticultural sector, including:

- payers of schedular payments not deducting withholding tax correctly;
- complex contracting arrangements for the supply of labour being used to obscure the true nature of arrangements; and
- workers being paid in cash.

These practices can result in tax not being correctly accounted for or paid.

The practices also give an unfair advantage over those taxpayers who are complying with the rules and meeting their tax obligations.

The Commissioner considers that non-compliance in the horticultural sector poses a significant risk to the integrity of the tax system. The Commissioner is increasing his focus on growers, contractors and subcontractors in the horticultural sector. When the Commissioner finds evidence of behaviours of concern, taxpayers who are involved will be investigated further and the Commissioner will consider a range of options available to him to respond. This could include prosecution action and/or the imposition of shortfall penalties.

About Revenue Alerts

Revenue Alerts are issued by the Commissioner and provide information about a significant and/or emerging tax issue that is of concern to Inland Revenue. At the time an alert is issued, risk assessments will already be underway to determine the level of risk and to consider appropriate responses.

A Revenue Alert will identify:

- the issue (which may be a scheme, arrangement, or particular transaction) which the Commissioner believes may be contrary to the law or is inconsistent with policy;
- the common features of the issue;
- our current view; and
- our current approach.

An alert should not be interpreted as being Inland Revenue's final position. Rather, an alert outlines the Commissioner's current view on how the law should be applied. For any alert we issue, it is likely that some investigatory work has already been carried out.

If people have entered into an arrangement similar to the one described or are thinking about it, they should talk to their tax advisor and/or to Inland Revenue for advice about tax implications.

Background

1. Inland Revenue is concerned about non-compliance in the horticultural sector.

2. The horticultural sector involves the growing of fruit crops and vegetables for export and domestic consumption. Key roles in this industry include growers who own or lease orchards and growing facilities (or management companies appointed by owners to operate the horticultural growing business), contractors that provide labour to growers relating to the cultivation of crops, and post-harvest facilities that receive and process goods for sale and export.

Schedular payments

3. Payments to contractors for "cultivation contract work" are subject to the schedular payment rules. These are payments to contractors for work or services that are for the supply of labour, or substantially for the supply of labour, on or in connection with land that is used or intended to be used for the cultivation of fruit crops, orchards, vegetable crops or vineyards.[1] A person who makes a schedular payment to a

[1] Section RD 8(1)(a) and schedule 4, part C, clause 1(b) of the Income Tax Act 2007 (the ITA) which applies to "cultivation contract work". Work or services provided by a post-harvest facility or by a management entity under a formal management agreement under which the entity is responsible for payment for the work or services provided are excluded.

contractor (a payer) is required to withhold tax from the payment (exclusive of GST). In the context of the supply of labour in the horticultural sector, this includes where the contractor is a company.[2] The obligation to withhold tax under the schedular payment rules applies to anyone who is making payments for cultivation contract work. The obligation is not limited to a particular class of person, such as owners of orchards or growing facilities.

4. Tax withheld under the schedular payment rules is not a final tax on income. Depending on a contractor's income, deductions, and the withholding tax rate used, tax withheld under the schedular payment rules may not satisfy the contractor's income tax obligations for a tax year (in addition, in certain circumstances a contractor may obtain a certificate of exemption from the schedular payment rules). Contractors also still need to separately account for GST if they are registered for GST (or are liable for GST registration) and PAYE obligations if they employ workers.

5. Inland Revenue is aware some growers and contractors are not correctly meeting their obligations under the schedular payment rules.

6. Inland Revenue is also concerned about broader non-compliance with GST, PAYE and income tax obligations in relation to the supply of labour in the horticultural sector, including through the use of uncommercial contracting practices described below.

Contracting practices of concern

7. Inland Revenue is aware of arrangements where false invoices[3] are created and used to obscure the true nature of transactions and can result in the under-reporting of GST, PAYE and/or income tax obligations.

8. In these arrangements, an entity issues invoices for the supply of labour where, in reality, that entity did not perform the work. The entity issuing the invoices often conducts little to no business activity and there is no commercial reality to the transactions that are invoiced for. The invoices are created to give the appearance that the work was completed by the entity that issued the invoices, rather than the entity that actually completed the work.

9. The exact nature of arrangements entered into can vary. Arrangements typically result in the contracting entity whose labourers actually completed the work not meeting its GST, PAYE and/or income tax obligations. The contracting entity may claim to have

[2] Sections RD 8(1)(b)(iii) and YA 1 (definition of "agricultural, horticultural, or viticultural company") of the ITA.

[3] In this Revenue Alert references to "invoices" are also intended to capture "taxable supply information" (taxable supply information effectively being the GST equivalent of an invoice).

subcontracted the work to the entity that issues the false invoices and may claim income tax deductions and/or GST input tax deductions based on these false invoices, as well as not deducting tax from wages paid to labourers.

10. Arrangements also often involve cash payments, including cash wages being paid to labourers. In addition to tax obligations not being met, the use of cash wages also gives rise to opportunities for money laundering. The nature of the sector also means there may be opportunities for worker exploitation.

Current view

11. Payments to contractors for the supply of labour, or substantially for the supply of labour, in the horticultural sector will generally be subject to the schedular payment rules, including where the contractor is a company. Growers and any other payers of schedular payments to contractors in the horticultural sector must therefore deduct withholding tax from these payments.[4] The obligation for the grower or other payer to withhold tax applies unless the contractor has shown the payer that they have a valid and current certificate of exemption or tailored tax rate certificate with a 0% deduction rate.[5]

12. The obligation to withhold tax remains on the grower or other payer where the contractor has not met the requirement of providing the payer with the **IR330C** – Tax rate notification for contractors.[6]

13. If the contractor does not notify a particular rate, the standard withholding rate will generally apply.[7] For cultivation contract work this is 15%.[8] If the contractor has failed to notify the payer of their name and tax file number, a non-notification rate of 45% will apply.[9]

[4] Sections RA 5(1)(a) and RD 3(1)(a)(iii) of the ITA.

[5] For certificates of exemption see s RD 8(1)(b)(iv) of the ITA and s 24H and schedule 5, part C, clause 6 of the Tax Administration Act 1994 (the TAA) and for tailored tax rates see s RD 10B(2)(b) of the ITA and s 24G and schedule 5, part C, clause 5 of the TAA.

[6] Section 24I(1) of the TAA.

[7] Section RD 10B(2)(c) of the ITA.

[8] Schedule 4, part C, clause 1 of the ITA.

[9] Section RD 10B(4)(b) of the ITA.

14. A payer who fails to deduct withholding tax from a schedular payment when required to do so may be liable for one or more criminal offences under the Tax Administration Act 1994.

15. Taxpayers who knowingly participate in contracting arrangements of a nature described in this Revenue Alert to evade the assessment or payment of tax by themselves or any other person will also be committing one or more criminal offences under the Tax Administration Act 1994. This includes the offence of tax evasion. A person convicted of tax evasion may be liable to a fine of up to $50,000, imprisonment for up to 5 years, or both.[10]

16. There are also civil penalties that may apply. This includes the shortfall penalty that applies for evasion or similar act, which is 150% of the resulting tax shortfall.[11]

Information sharing where there is evidence of other offending

17. If Inland Revenue obtains evidence of other offending or breaches of legislative requirements in the course of investigating a taxpayer in the horticultural sector, it may, in certain circumstances, share information with other government regulators and enforcement agencies. For example, Inland Revenue's information sharing powers include the ability to:

    - share information relating to serious crime (being offending punishable by imprisonment of 4 years or more) with the Police, Customs and the Serious Fraud Office in certain circumstances;[12]
    - disclose information to other government agencies and AML/CFT supervisors for the purpose of ensuring compliance with the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 or associated regulations;[13] and
    - share information with the Labour Inspectorate to assist in identifying breaches of workplace legislation.[14] Workplace legislation includes legislation setting out

[10] Section 143B(4) of the TAA.

[11] Section 141E(4) of the TAA.

[12] Privacy (Information Sharing Agreement Between Inland Revenue, New Zealand Police, New Zealand Customs Service, and Serious Fraud Office) Order 2020.

[13] Section 140 of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009.

[14] Section 18H and schedule 7, part C, clause 26 of the TAA and Memorandum of Understanding between Inland Revenue and Ministry of Business, Innovation and Employment for supplying information to enable performance of functions under workplace legislation.

minimum employment standards and standards in relation to health and safety in the workplace.[15]

Current status

18. The Commissioner considers that non-compliance in the horticultural sector poses a significant risk to the integrity of the tax system.

19. The Commissioner is increasing his focus on growers, contractors and subcontractors in the horticultural sector. When the Commissioner finds evidence of behaviours of concern, the taxpayers involved will be investigated further and the Commissioner will consider a range of options that are available to him to respond. The matters discussed in this Revenue Alert are not intended to be an exhaustive list.

20. If the Commissioner identifies instances of taxpayers participating in contracting arrangements described in this Revenue Alert to evade tax, the Commissioner will seek to make or amend assessments to correctly reflect taxpayers' liabilities. The Commissioner will also consider the imposition of civil penalties and the possibility of prosecution.

21. The Commissioner is increasing scrutiny of new applications for GST registration by entities in the horticultural sector. This includes entities that may have been incorporated for the purpose of issuing false invoices. If an entity cannot satisfy the Commissioner that it is carrying on a taxable activity (or intending to carry on a taxable activity), its application for GST registration will be declined.

22. The Commissioner will continue to investigate other non-compliance in the horticultural sector, including withholding obligations under the schedular payment rules not being met by growers or other payers. The Commissioner is also increasing his focus on the use of certificates of exemption and tailored tax rates by taxpayers in the sector.

23. The Commissioner is increasing action taken to pursue outstanding debt in the horticultural sector and will use the range of powers available to him to collect this debt.

24. Finally, if evidence of other offending by a taxpayer in the sector is identified, Inland Revenue will consider whether information may be shared with other government regulators or enforcement agencies.

[15] See definition of "workplace legislation" in s 3(1) of the TAA.

Going forward

25. If you consider that the concerns outlined in this Revenue Alert may apply to your situation, we recommend you discuss this matter with your tax advisor or Inland Revenue and consider making a voluntary disclosure. If you are aware of a taxpayer that may be engaging in behaviours outlined in this Revenue Alert, you can anonymously report this to Inland Revenue: **Report tax evasion or fraud anonymously - IR873**.

26. In respect of payers and their obligations under the schedular payment rules, payers need to be aware that:

    - They have an obligation to withhold tax from schedular payments made to contractors for cultivation contract work.
    - They must keep records relating to the tax treatment of schedular payments for at least 7 years. This includes completed tax rate notification forms provided to them by contractors (the IR330C), copies of certificates of exemption and tailored tax rate certificates (where applicable) and any other evidence they rely on in determining whether payments are (or are not) liable for withholding.
    - Certificates of exemption and tailored tax rates are only issued for a year (ending 31 March) and need to be renewed by contractors each year. Payers need to ensure contractors have a valid and current certificate of exemption or tailored tax rate certificate and collect a copy of the certificate from the contractor for each tax year.

Authorised by

Daniel Hicks,

Domain Lead, Legal Services

Legislative References

Sections RA 5, RD 3, RD 8, RD 10B, YA 1 and schedule 4 of the Income Tax Act 2007.

Sections 3, 18H, 24G, 24H, 24I, 141E, 143B, schedule 5 and schedule 7 of the Tax Administration Act 1994.

Section 140 of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009.

Privacy (Information Sharing Agreement Between Inland Revenue, New Zealand Police, New Zealand Customs Service, and Serious Fraud Office) Order 2020.

Contact by email

revenue-alerts@ird.govt.nz

Media queries

mediaqueries@ird.govt.nz