A *McCARTHY* WITCHHUNT – WAS THE COURT OF APPEAL CORRECT IN *McCARTHY v McCARTHY & STONE PLC*?

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Introduction

The case of *McCarthy v McCarthy & Stone plc*[2] ("*McCarthy*") has gone largely unacknowledged in the tax world. However, the reasoning of the Court of Appeal in that case would appear to have a major effect on the consequences of what is not an uncommon situation, *viz*. when employers make an error in their PAYE and NIC obligations, leading to an under-deduction from the wages of their employees.

The facts of *McCarthy*

The case concerned a dispute between the company, McCarthy & Stone plc, and its eponymous former director, John McCarthy. The former director brought an action against the company in relation to the discretion exercised by the company's Remuneration Committee concerning the company's share scheme: the committee had accepted his exercise concerning only 75% of his options. The company counterclaimed.

The subject matter of the counterclaim was the tax and National Insurance that the company had been required to pay to Her Majesty's Revenue and Customs ("HMRC") as a direct consequence of Mr McCarthy's exercise of his share options. As Mr McCarthy had no other remuneration at the time, the company was unable to recoup those sums from Mr McCarthy's pay as would ordinarily be the case.

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2 [2007] EWCA Civ 664

The Judge at first instance (Mr Justice Peter Smith) allowed the counterclaim, almost summarily[3]. The Court of Appeal dismissed Mr McCarthy's appeal against this decision.

The High Court decision

As already noted, Peter Smith J dismissed the former director's defence to the company's counterclaim. The underlying logic was that the company was required to pay sums over to HMRC which, in the ordinary course of events, it would have been able to recover from an employee. Furthermore, so far as the income tax is concerned, that income tax would be treated as a credit available to the director in his Self Assessment account with HMRC. Consequently, the decision continued, it would be appropriate for the director to reimburse the company for the amounts paid.

The Court of Appeal's decision

The Court of Appeal considered the legislative scheme in much more detail – in particular, the secondary legislation underlying the Pay As You Earn and National Insurance codes. Without looking at the statutory schemes, one can see some attractiveness in the conclusion reached by the Court of Appeal (and the High Court previously) in that an employer, obliged to pay over sums to HMRC in situations where it would have usually deducted sums from other payments made to an employee (but where a deduction could not be made, due to an absence or shortage of such payments from which to take a deduction), ought to be able to claim those sums from the employee in some other way; otherwise, the employer would inevitably be out of pocket (to the advantage of the employee).
However, underlying the Court of Appeal's reasoning was an application of the principle of restitution. This long-established principle provides that X can recover from Y a sum of money if:

- X has paid that sum of money to Z;
- X has done so under a compulsion of law;
- X did not officiously expose itself to that liability; and
- by making the payment, X discharged a liability of Y's to Z.

There was little controversy that the first three of those conditions were satisfied in the *McCarthy* case; what was disputed by the Claimant was whether or not the last condition was satisfied. By dismissing the former director's appeal, the Court of

3 [2006] EWHC 1851 (Ch)

Appeal reached the conclusion that the company had indeed discharged the former director's personal liability to the Revenue in respect of both the income tax and the National Insurance.

As previously noted, the Court's ultimate conclusion and that of the Court below both have some attractiveness. And, I would venture to suggest that, in the particular circumstances of the case, it might not be wrong. However, where I am in respectful disagreement – particularly with the reasoning of the Court of Appeal – is in respect of whether or not it is correct to say that the company actually discharged any liabilities of the former director. The difficulty that I have with the Court's conclusion is best highlighted by a less unusual situation and, indeed, one best illustrated by a case that was heard by a Special Commissioner in 2005 and which gave rise to its own notoriety, the case of *Demibourne Ltd v HMRC*[4].

It is worth noting that, in my respectful view, the errors arose in the discussion of both the income tax and the National Insurance treatments. However, reflecting the different legislative schemes, these different errors are discussed separately (income tax first).

The decision in *Demibourne*

Demibourne was in many ways a typical case about a worker's status: it concerned, the status of a casual worker (a Mr Bone) at a hotel. The appellant was the alleged employer who was appealing against a determination under regulation 80 of the PAYE Regulations and a decision under section 8 of the Social Security Contributions (Transfer of Functions, etc.) Act 1999. Having heard the evidence and the legal arguments, the Special Commissioner (John Clark) concluded that Mr Bone was indeed an employee and consequently dismissed the company's appeals. In other words, Mr Clark upheld the regulation 80 determination and the section 8 decision, meaning that the company was found liable to pay the income tax and National Insurance which it should have deducted from Mr Bone's wages and paid over to the Revenue on a monthly or quarterly basis.

Mr Clark nevertheless expressed reservations about the consequences of his decision. He noted (apparently because of a change of Revenue practice) that this would lead to a manifest unfairness, particularly in view of the income tax position. After all, Mr Bone had previously assumed that he was self-employed. Therefore, the income tax that should have been deducted from his wages had in any event been paid by him through the Self Assessment system – so, notwithstanding the appellant's apparent failure to comply with the PAYE regulations, Mr Bone and the Revenue had both ended up in the correct financial position. Similarly, with the employer, Demibourne Limited: it had paid Mr Bone gross, instead of deducting tax

4 (2005) SpC 486

and paying that tax over to the Revenue. However, in view of the outcome of the appeal against the regulation 80 determination, Demibourne Limited would now be obliged to pay the tax element over to the Revenue – so that the Revenue would end up with the tax a second time, at the expense of the employer.

The consequence of *Demibourne*

Mr Clark suggested that the parties ought to reach some arrangement to reflect the fact that Mr Bone had effectively paid the tax that the Revenue were now seeking from Demibourne Ltd. Whether that ever happened is not known; however, the suggestion (after much discussion) did lead to an amendment of the PAYE Regulations which eventually came into effect from 6 April 2008. Those regulations extended the situations in which a PAYE compliance failure by an employer would lead to a correction by the employee, rather than the employer.

Regulation 185

Before looking in detail at the effect of the '*Demibourne* regulations', it is vital to understand the mechanics of regulation 185 of the PAYE Regulations[5]. In particular, it is important to note that it operates in a wholly counter-intuitive fashion.

The starting point, however, is regulation 59B of the Taxes Management Act 1970. That is the provision that provides that taxpayers are required to make a 'balancing payment' (usually on 31 January following the end of a tax year) representing the final payment of tax due for the year. That payment is equal to the total tax liability for the year (as per the Self Assessment)[6] less the sum of the tax paid on account (generally, but not restricted to, the payments made on the previous 31 January and 31 July) and any other tax deducted at source.[7]

For these purposes, regulation 185 starts off with the unsurprising rule that the amount of deducted tax includes the tax deducted from an employee's pay in accordance with the PAYE rules[8]. However, paragraphs (3) to (5) then provide adjustments to this figure. In particular, paragraph (5) (when read with the definitions in paragraph (6)) then provides that an employee is given a credit for the tax that *ought* to have been deducted by an employer. Thus, to provide a numerical example, if an employer paid an employee £1,000 and, had the PAYE rules been

5 Income Tax (PAYE) Regulations 2003, SI 2003/2682

6 section 59B(1)(a)

7 section 59B(1)(b)

8 regulation 185(1), (2)

operated properly by the employer, the employer would have deducted £300 from that payment, the employee is treated as entitled to the benefit of the tax credit of £300.[9]

As I noted earlier, the operation of regulation 185 is counter-intuitive: it gives employees credit for tax that has not been deducted. Furthermore, that credit will generally relate to sums that an employee would have received direct from the employer so that the employee in fact receives a windfall (initially, at the expense of the Revenue). Reverting to the numerical example in the previous paragraph, the employee will receive cash of £1,000 (instead of £700); however, the employee will still be entitled to account for tax as if the £300 that should have been deducted had been paid over to HMRC by the employer. (In other words, HMRC are obliged to give the employee credit for cash that they should have received, but did not in fact receive.)

However, the logic of the operation of regulation 185 can be simply explained. The entire tax system in the UK is designed to keep most employees out of Self Assessment – for those employees, all tax obligations should be complied with by their employer. Indeed, if insufficient tax has been deducted at source[10], it will be almost invariably (if not always) because of a failure by the employer. Therefore, it does make sense – at least as a starting point – for the employee not to be involved in the correction process and for the error to be rectified by the employer.

Thus, regulation 185 ensures that HMRC will not usually turn to employees when employers fail to deduct the correct amount of tax. On the other hand, the cause of the underpayment – i.e. the employer – will be the person to whom HMRC turn for the tax which should have been deducted and with which the employee has been (perhaps unjustly) credited. This is the essence of a determination under regulation 80 and it appears to be of no concern to the legislation that this will cause the employer to have to pay out the tax element for a second time.

Regulation 72

However, the regulations have long recognised that this situation is not usually fair, notwithstanding the employer's failure to comply with the obligations statute imposes on employers. Historically, the recognition has come in the form of regulation 72 which, when it applies, has the effect of transferring the burden of the underpayment from the employer (who caused the underpayment but who has not

9 Regulation 185(5) does provide a cap to this credit equal to the employee's overall tax liability. In other words, the credit on its own cannot trigger any entitlement to a repayment. However, for the purposes of this article, that further complexity is not considered any further.

10 i.e. the tax deducted is less than the amount of tax that should have been deducted by reference to the gross pay and the tax code in force at the relevant time

actually benefited from the failure) to the employee (who otherwise gets the advantage of the regulation 185 adjustment).

The operation of regulation 72 is deceptively subtle. It simply provides that the adjustment to the regulation 185 amount (i.e. the inclusion of tax that should have been deducted but was not) is disapplied. There is no immediate requirement for the Revenue to knock on the employee's door demanding payment – it is simply that the employee cannot claim credit for tax that the employee has not actually suffered. Furthermore, (evidencing the sheer beauty of the regulations) in the vast majority of cases, the employee will not even be particularly aware of this transfer of liability, because the disapplication of the regulation 185 adjustment will usually put the employee back in the position that the employee had assumed the situation to be in the first place. So, for example, if one considers the position of Mr Bone in the *Demibourne* case, he had paid the tax on the income on the (mistaken) assumption that the income represented the profits of a trade. In other words, Mr Bone had not claimed the credit under regulation 185 (even though it was due to him) because he did not even realise that the income was employment income and ought to have been subject to PAYE.

On the facts of that case, regulation 72 could not have been applied to Mr Bone's income because that income had by then been subject to a regulation 80 determination.[11] However, the outcome is likely to be the same even if the worker correctly realises that the income is from an employment. This is because the guidance notes telling workers how to complete their tax returns requires employees to include (for the purposes of the tax credit) the amount of tax actually deducted (as per the P45 or P60) rather than the tax that should have been deducted. Thus, even when a taxpayer is undoubtedly in receipt of employment income and, therefore, indisputably subject to PAYE, it is unlikely that the taxpayer will know to claim the credit available under regulation 185. Therefore, in either case, the application of regulation 72 is unlikely to cause much concern to employees.

The difficulty with regulation 72, however, is that it is subject to restrictions on when it can be used (over and above the rule that a determination under regulation 80 precludes the subsequent operation of regulation 72). Regulation 72 is designed to forgive employers for failing to comply with their PAYE obligations; it is not intended to protect them from the ensuing unfairness of a regulation 80 determination (i.e. the obligation on them to account for the income tax a second time to the benefit of the employee (if a credit under regulation 185 has been claimed) or the Revenue (if not)). Consequently, regulation 72 applies only if either:

(a) the employer can show that the employer took reasonable care to comply with the PAYE Regulations, and the failure to deduct the correct amount was due to an error made in good faith; or

11 regulation 80(3)

(b) HMRC are of the opinion that the employee received employment income knowing that the employer wilfully failed to deduct the amount of tax which should have been deducted from those payments.

This restriction has been reinforced by the provisions that were introduced with effect from April 2004 which formally allow employers to request that the Revenue take the regulation 72 route (instead of issuing a regulation 80 determination). The only basis for such a request is where the employer can demonstrate that the first of those conditions is satisfied.[12]

In contrast, the post-*Demibourne* regulations[13] are far more liberal in their application and allow for a transfer of liability in a wider range of circumstances. (The one restriction is that – short of an application for judicial review – the employer cannot formally request that liabilities be transferred in this way. The probable reason for this is that HMRC need to ensure that liabilities are not transferred to employees who are no longer traceable etc.)

If this reasoning is correct, it is a further clue that the rules put the onus of compliance on employers, and employers should expect to be out of pocket if they fail to deduct sufficient tax first time around.

Whose liability?

However, what is important for the purposes of this article is that, absent a formal transfer of liability – which is effected by a reversal of the regulation 185 adjustment – any liability to account for the income tax on the employment income lies firmly at the doorstep of the employer; furthermore, even though the employee is generally liable for income tax on employment income, that liability is fully satisfied (to the extent that the employer's proper compliance with the regulations would have led to the deduction of tax) by the operation of regulation 185.

Therefore, reverting to the law on restitution, what would be the position between Demibourne Limited and Mr Bone? Having been liable to pay HMRC the regulation 80 tax, could the employer now seek recovery from Mr Bone. Arguably, the first three conditions for restitution are satisfied. However, it is clear that the final condition is not – the employer is not in any sense discharging a liability of the employee by paying the tax over to the Revenue. This leads to the question as to why the Court of Appeal in *McCarthy* reached the opposite conclusion. That cannot be answered with any certainty. In my view, it would seem that, despite some close analysis of the operation of the PAYE régime, the Court was not fully apprised of the workings (and purpose) of regulation 185. Of course, the Court would have had

12 regulation 72A

13 regulations 72E—72G

sympathy in the circumstances of the case with the employer and I would not seek to criticise their Lordships from seeking to attribute the liability from the blameless employer to the employee (who might be just as blameless, but so as to prevent a windfall in the employee's hands). However, it is arguable that that conclusion could have been reached on the narrow facts of the case without suggesting that any settlement of PAYE obligations always permits employers to turn to their employees (past or present) for a recoupment of the income tax paid over to the Revenue.

The wrongness of the Court's conclusion is evidenced by reconsidering the facts of the *Demibourne* case. As already noted, that was a simple case of an employer getting the worker's status wrong and failing to deduct PAYE at all. However, it could just as easily have been a case of an employer deducting insufficient PAYE due to an error in operating the employee's code. It is uncontroversial that the Revenue has the right to seek correction from the employer in such circumstances by way of regulation 80 determination. However, if the Court of Appeal was right, any recovery of such liabilities by HMRC would prove to be of little consequence to employers since (in many cases, at least) they could simply recoup them from their employees.

Whilst this would seem to undermine all protection given to employees (and expose them more directly to the vagaries of the tax system), this conclusion has an even more adverse effect on employees. Under the PAYE Regulations, the Revenue has the right to remove the regulation 185 adjustment from an employee in three circumstances.[14] However, in all three circumstances, the employee has the right to appeal against the reversal. Although the grounds of appeal are generally prescribed, they do allow the worker to challenge the basis of the liability transferred (in particular, the question of the worker's true status). This is particularly relevant in the *Demibourne* situation. The employer in that case chose to contest the Revenue's view of Mr Bone's status: however, had the resulting tax liability been easily recoverable from Mr Bone (as per the Court of Appeal's reasoning in *McCarthy v McCarthy & Stone plc*) then the employer company might simply not have bothered with the challenge and reimbursed itself by pursuing the employee (or, perhaps, unilaterally deducting the tax from the worker's pay on a subsequent occasion). Under the regulations, whilst the employer can (often) unilaterally transfer the liability to the employee, the employee will always have the right to challenge the transfer at a Tribunal – thus, if the facts of *Demibourne* had been repeated, the company could have avoided the Tribunal challenge but it would have still been available to Mr Bone to defend his assumed status as a self-employed worker. The expressed reasoning of the Court of Appeal would suggest that the employer's failed appeal before a Tribunal (at which the employee would not have been a party) can indirectly permit the employer to recover the tax from the employee.

14 under regulations 72 and 72F above; also under regulation 81 in circumstances where an employer fails to pay the tax charged under a regulation 80 determination

However, the Court of Appeal's error in *McCarthy* is further evidenced when one considers the Court's underlying rationale. The Court held that the employer company had discharged a personal liability of Mr McCarthy. However, in the absence of any direction that displaces the effect of regulation 185, it can be seen that the employee's personal liability for the income tax arising on the employment is discharged by the operation of statute. It makes no difference to the employee's personal standing with HMRC whether or not the employer pays the tax; therefore, it is wrong to suggest that the employer paying over the tax discharges the employee's liability.

National Insurance

It is easy for the National Insurance position to be assumed to follow the income tax; after all, on a day-to-day basis, they are both liabilities that an employer usually deducts from an employee's pay before paying sums over to the Revenue. However, the statutory codes are sufficiently distinct so as to justify a separate analysis.

In *McCarthy*, the Court of Appeal justified its finding in favour of the company on the basis that, by paying over the primary (employee's Class 1) contributions to HMRC, the company had discharged a liability of the employee. The Court of Appeal reached this conclusion by looking at the primary legislation concerning National Insurance contributions, as well as some of the regulations issued under the vires of the primary provisions. In my respectful opinion, it reached the wrong conclusion (partly based upon an incorrect reading of one provision and also partly based upon a failure to consider another).

The fact that there is confusion is not surprising. The introduction to the separate concept of primary and secondary Class 1 Contributions is found in section 6(4) of the Social Security (Contributions and Benefits) Act 1992 ("SSCBA"). That provides as follows:

The primary and secondary Class 1 contributions referred to in subsection (1) above are payable as follows–

(a) the primary contribution shall be the liability of the earner; and

(b) the secondary contribution shall be the liability of the secondary contributor.

Thus, it would seem that statute is making it clear that workers are liable for primary contributions.

However, section 6(4) continues thus:

> … but nothing in this subsection shall prejudice the provisions of paragraphs 3 to 3B of Schedule 1 to this Act.

So, there is a hint that section 6(4) does not tell the whole story. Ordinarily, I would accept that the formulation "nothing in this subsection shall prejudice …" would suggest that the other provisions in Schedule 1 might temporarily displace the effect of section 6(4), but subject to a default "truth" in the original section. Furthermore, as will be seen below, those provisions in Schedule 1 do not jump out with the news that the liability is shifted permanently from an employee to an employer. Therefore, it is understandable why section 6(4) looks as if, ultimately, primary contributions are indeed an employee's liability. However, as I shall try to demonstrate, it is my view that this is not actually the case.

Before turning to the provisions of Schedule 1, it is worth making a brief reference to some words that were previously appended to the end of section 6(4). They were originally introduced in 1989 as part of the pre-consolidation amendments to the legislation and were later consolidated as section 6(3) of SSCBA. In 1999, the Welfare Reform and Pensions Act 1999 substituted what is effectively the current version of section 6 and what was subsection (3) became subsection (4). Under all those versions of the legislation, the proviso read as follows:

> … but nothing in this subsection shall prejudice the provisions of paragraph 3 of Schedule 1 to this Act ***relating to the manner in which the earner's liability falls to be discharged***.
> [emphasis added]

These point to a greater significance of the Schedule 1 provisions so far as determining where liability for contributions falls. However, in 2000, those words were then removed as part of the changes that allowed liability for secondary contributions to be transferred to employees. However, (not that that would be determinative of the issue) there is no indication in the Explanatory Notes that suggest that their omission was of any significance, and I would suggest that those words merely confirmed that all matters relating to a person's liability were dealt with by Schedule 1 to SSCBA; consequently, their omission is of no great concern.

It is at this point when the provisions of Schedule 1 need to be considered. The key paragraph is paragraph 3, which is the one paragraph referred to by section 6 prior to 2000. The other paragraphs deal with share schemes and are of no significance here. Paragraph 3, so far as it is relevant, provides as follows:

> Method of Paying Class 1 Contributions
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> 3(1) Where earnings are paid to an employed earner and in respect of that payment liability arises for primary and secondary Class 1 contributions, the secondary contributor shall (except in prescribed circumstances), as well as being liable for any secondary contribution of his own, be liable in the first instance to pay also the earner's primary contribution or a prescribed part of the earner's primary contribution, on behalf of and to the exclusion of the

> earner; and for the purposes of this Act and the Administration Act contributions paid by the secondary contributor on behalf of the earner shall be taken to be contributions paid by the earner.
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> …
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> (3) A secondary contributor shall be entitled, subject to and in accordance with regulations, to recover from an earner the amount of any primary Class 1 contribution paid or to be paid by him on behalf of the earner; and, subject to sub-paragraphs (3A) to (5) below but notwithstanding any other provision in any enactment, regulations under this sub-paragraph shall provide for recovery to be made by deduction from the earner's earnings, and for it not to be made in any other way.

It is well known that, in practice, employers end up paying primary contributions on behalf of their employees, such payments being paid for by deductions that the employers make from their employees' pay. The basis for this is paragraph 3(1) which provides that, "in the first instance", employers are in fact liable for the primary contributions and paragraph 3(3) which permits the recovery by way of deduction. The phraseology of paragraph 3(1), however, begs the question: in what situation does the liability revert to that of the employee?

In *McCarthy*, the Court of Appeal reached the view that there is always an underlying responsibility on employees to ensure that primary contributions are paid to HMRC, as provided for in the main provision of section 6(4). They reached this conclusion having dismissed Counsel's arguments in relation to paragraph 3(3). They acknowledged that paragraph 3(3) provided the vires for regulations dealing with the recovery by employers of contributions from employees. However, they dismissed arguments that suggested that the regulations provide employers with their only opportunity of recovery of contributions from their employees. As the Court held:

> *Counsel for the Claimant relies on the words "not to be made in any other way". He suggests that that provision excludes the remedy on which the Company relies. I do not agree. Those words restrict and limit what the regulations may provide for, they do not exclude the primary liability declared by s.6(4)(a) or any restitutionary remedy outside the Act or the regulations.*

With the utmost respect to their Lordships, I am of the view that the Court misdirected itself as to the correct meaning of paragraph 3(3). The first part of that sub-paragraph provides that employers have the right to recover from their employees the amount of primary contributions payable by them (under paragraph 3(1)). However, that right of recovery is "subject to and in accordance with regulations".

Once again, the statutory formula can afford two very different meanings: on the one hand, the opening part of paragraph 3(3) can be read so as to confirm that employers have an underlying common law right of recovery, except were regulations provide for the contrary. Alternatively, the paragraph creates (anew) a right of recovery, such rights to be defined by regulations. It is my strong view (contrary to that expressed in the Court of Appeal) that the latter is the correct approach. In particular, it should be noted that National Insurance is a creature of statute and it would be wrong to assume an underlying right of recovery where none is expressly spelt out in the statute. More importantly, the former approach is effectively saying that employers have the right to recover primary contributions from their employees in any way that they like except that, should they want to effect that right by the simple expedient of deduction from an employee's pay, they will be entitled to do so only if they act in accordance with the regulations. Given that the only realistic alternative is suing the employees, this would seem hopelessly convoluted.

Another clue that the Court of Appeal took a wrong turn in respect of this sub-paragraph concerns the second part of the sub-paragraph. As noted above, the Court of Appeal regarded the words "not to be made in any other way" as imposing a restriction on the scope of the regulations that may be made under paragraph 3. However, this is, with respect, to misconstrue paragraph 3(3). That sub-paragraph (and the second part of that sub-paragraph in particular) provides that regulations must (the statutory word used is the mandatory "shall") be made that provide for the recovery of primary contributions by way of deduction; secondly, those regulations "shall provide for recovery … not to be made in any other way". Thus, rather than imposing a restriction on what the regulations may provide for, paragraph 3(3) is in fact ensuring that the regulations exclude any other method of recovery. The Court of Appeal's analysis is sustainable only if one starts from the viewpoint that methods of recovery are limited to what is provided for by the regulations.

Furthermore, sub-paragraph (3) provides that the regulations apply "notwithstanding any other provision in any enactment". In my view, this trumps the effect of section 6(4) which states that primary contributions are the liability of an employee.

In my view, the correct approach is therefore that employers have a one-off opportunity to recover what statute has determined to be their liability for primary contributions – that is that they must deduct the contributions from their employees' pay at the time of payment. Failure to do so is the employer's responsibility and they cannot turn to their employees for compensation at a later time.

However, it is worth considering the implications of the Court of Appeal's decision if it is indeed correct. If, by paying to HMRC, an employer discharges an employee's personal liability, then it must be the case that the liability ultimately falls on employees. However, if that is the case, then it must mean that HMRC will always have the right to pursue employees (as opposed to employers) for unpaid contributions. In my view, analysis of section 6(4) and paragraph 3 does not support that approach – as I have argued, the liability becomes that of the employer and ceases to be that of the employees. But there is a further statutory clue that HMRC cannot generally pursue employees and this is a provision that appears not to have been brought to the Court of Appeal's attention. In regulation 86, there are specific rules[15] that do have the effect of transferring liability back to employees – that transfer is effected by the disapplication of paragraph 3(1). Therefore, the regulations proceed on the basis that paragraph 3 is sufficient to displace the employee's liability for primary contributions and to shift it to the employer. Furthermore, if there were an underlying obligation on employees to pay primary contributions then regulation 86 would be otiose.

A further clue can be obtained by noting that the National Insurance rules make no distinction between cases where contributions are deducted from an employee's pay, but simply not handed over to HMRC, and those where the employee receives his or her pay without any such deduction. If Parliament had intended employees to be liable for the primary contributions, it would be expected that some concession would be made in cases where an employee had already effectively paid the contributions to the employer. There is no such provision and, in my view, this further supports the argument that Parliament always intended the burden of compliance to fall on employers. Employers are entitled to recover these contributions from their employees but they have only one opportunity to do so. If they miss that opportunity, they alone are liable for the contributions to HMRC.

Finally, the absence of a rule equivalent to the PAYE regulation 185 is also telling. Regulation 185 ensures that employees are given the credit for income tax that should have been deducted under PAYE even though it was not: this is because employees are ultimately liable for income tax and regulation 185 ensures that this liability does not generally extend to any income tax that ought to have been accounted for by their employers under PAYE. There is no equivalent rule for National Insurance for the simple reason that there is no ultimate liability on employees for contributions: there is no need therefore for employees to be given any such credit.

Conclusion

It is unsurprising that employees might be thought to be ultimately liable for primary National Insurance contributions in the same way as they are for income tax. However, a close examination of the statutory code reveals that, whilst the liability

15 They apply in three situations. First, where the employer is an international organisation (e.g. an embassy of an overseas government which has employed local staff) where HMRC cannot enforce any of the employer's obligations. Secondly, where any failure to pay contributions is the employee's fault and the employer has not been negligent. Thirdly, where the employee knows that the employer has wilfully failed to pay the primary contribution which the employer was liable to pay on behalf of the employee and has not recovered that primary contribution from the employee.

for such contributions is generally borne by employees, the responsibility for paying them falls solely on employers. Except in the limited circumstances prescribed by regulation 86, employees have no need to account for such contributions once they receive their pay.

Similarly, with regard to income tax payable under PAYE. The liability for payment falls solely on employers and the operation of regulation 185 ensures that, even when employers fail to account for the tax, the burden of the tax does not generally fall on the employees.

In both cases, Parliament has determined that employers alone are responsible for complying with the legislation and the cost of failure falls on them, and not on the employees.

Consequently, by complying with the PAYE and NIC procedures (either on a timely basis or following a determination or decision after an earlier compliance failure), employers are discharging their own liabilities and not those of their employees. Because any payment of tax and NIC by employers does not represent the discharging of any employee's liability, the last condition for restitution is plainly not satisfied. Therefore, employers do not have a right of recovery from employees. To the extent that the Court of Appeal in *McCarthy v McCarthy & Stone plc* held otherwise, it is my view that the decision was wrong.