Briefing

BURGES SALMON

Corporate Turnaround and Insolvency

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The Budget 2015 – impact for the insolvency community

The 18 March saw George Osborne's budget speech, heralded by Mr Osborne announcing that "Britain is walking tall again" and promising to "use whatever additional resources we have to get the deficit and the debt falling". We examine what the drivers behind the hyperbole might mean for the insolvency community.

Further austerity as the key theme

Few can mistake the intent behind statements such as *"no short term giveaway can ever begin to help people as much as the long term benefits of a recovering national economy ... I said we would turn Britain around - and in this last Budget of the Parliament we will not waiver from that task."*.

Osborne's message is clear: he expects to continue to make cuts to public finances in order to balance the books and will not be making *"unfunded spending"* or *"irresponsible extra borrowing"*. His announcements make clear that Britain needs to make an extra £30 billion of savings by 2017/18. Of that, he expects £13 billion to come from government departments, £12 billion from welfare savings and £5 billion from measures designed to prevent tax avoidance, tax evasion and aggressive tax planning. Although he has not – understandably, due to the impending election – stated where the axe will fall, fall it will. At the same time these Keynesian ideals are being pursued, it is also likely that interest rates will not rise significantly, not least because a financial recovery (and any inflation it brings) will help the government to reduce the deficit more quickly. Let's take a look at expected trends from these themes of the Budget, should Osborne and his cohorts be re-elected.

Benign deflation - a new challenge?

With one of the key themes from the Budget speech being cuts and deficit reduction, market commentators have started to question whether the spectre of "benign deflation" is becoming an issue.

"Benign" deflation occurs where the *relative* unit price of goods or services reduces due to improvements in technology or better management practices. "Malign" deflation, on the other hand, occurs where average prices decrease due to lack of demand.

Where does one begin and the other end, however? The protracted and unprecedented nature of this downturn – even now with inflation forecast at 0.2% and a GDP increase of 2.3% for 2015/16 – raises some questions which should set alarm bells ringing. Have producers and suppliers of goods and services, in seeking to increase demand, taken efficiency and cost reduction measures to a stage where consumers of those goods and services now expect prices to stay at that level? Does the relatively stagnant level of wage inflation mean that – should the cost of production rise – consumers will not have the flexibility within their budgets to keep consuming at the same level? Equally, does the plethora of cost-saving measures employed by producers to reduce their pricing mean that, should things come to the crunch, the cupboard is bare when looking at the traditional methods of restructuring businesses through cost savings and efficiency drives?

Added to these micro-level factors, a further question remains as to what tools for economic policy remain within the Chancellor's arsenal should the present benign growth in GDP and employment not continue? With historically low interest rates and a consumer inclination to save extra increments of income, the impact of monetary (reduction in interest rates) and fiscal (tax reductions) stimulus may not be enough to counter a downturn in economic confidence and could even – in the medium term – prove damaging to the ability of the government to tackle the budget deficit.

The public sector

The detail of what the Budget means for the public sector in the short to medium term is unclear. What is clear is that the public sector is under scrutiny. With £13 billion of savings budgeted to come from "government departments", what this means is increased uncertainty for publicly funded projects, giving rise to the very real possibility that some of these projects may simply have to be abandoned. There would appear to be opportunity for those of us working alongside both public and non-governmental organisations to advise on the best way forward should further expected funding be unforthcoming.

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A focus on employment and welfare savings

Rather than focus on cuts, the Chancellor highlighted that the Government would focus upon employment as a means to economic success. The figures are impressive – unemployment, he says, is due to fall to 5.3%.

Whilst certain measures the Chancellor announced (such as decreasing the pensions lifetime allowance from £1.25 million to £1 million and index-linking that cap from 2018) may seem swinging in their nature, other measures, such as the increase in the national minimum wage to £6.70 per hour from October, and the increase in both taxpayers' personal allowances and the rise (to £42,700) of the higher rate tax band, seem to more positively promote it. With £12 billion in deficit reduction measures to come from welfare savings, the promotion of employment must certainly be a more effective way of tackling the issue than piecemeal welfare reform.

However, taking into account the potential for benign deflation to convert to malign deflation, one has to question what impact a general reduction in the *average* (rather than the *relative*) price of goods and services would have, and whether this might not have a negative effect on employment as producers of goods and services look to cut costs further. This raises questions both for those working in the insolvency sector, and on the wider macroeconomic field.

Tax avoidance and evasion countermeasures

Some of the more interesting potential developments arise from the Chancellors proposed measures to combat tax avoidance, tax evasion and aggressive tax planning (from which he is looking to recover £5 billion). Harder times appear to be ahead for the users and promoters of aggressive tax avoidance schemes, with announced measures including restriction of access to tax reliefs for those who persistently abuse them, and the increase in sanctions against promoters of tax avoidance schemes who fail to avoid these measures.

Nor is your ordinary man on the street immune from the government's roving eye. Some of the more eye-watering measures to be introduced include the widening of the DOTAS scheme to require employers to notify employees of their use of such schemes (and an obligation on employers to provide details of affected employees to HMRC), and the abolition of the paper tax return system (and its mandatory £100 fine for missing the 31 January deadline) with an online system and a motoring-style "points" system for those who continuously fail to file on time (with maximum fines anticipated to be at a level of £2,000 or more).

On the advisory side, when coupled with previously announced proposals to directly access tax avoiders' bank accounts and to require participants in avoidance schemes to pay tax up-front, even in cases where analogous - but not identical – schemes have been impugned (and where the prospect of judicial review remains a very real one), these measures in particular constitute a platform for a very busy time for insolvency professionals where persons engaging in such schemes potentially face immediate cash shortages, particularly with the up-front DOTAS payments having retrospective effect. Add to the mix the thrift factor of individuals and companies trying to shield more of their income from the taxman during harder times, this battleground looks set to be a bloody one.

Conclusion

Whilst this budget has been phrased in triumphant terms and no doubt carefully judged for public consumption just prior to the General Election, there remains little doubt that there are lean times to come, and that businesses and individuals will have tough decisions to make. With an eye to areas for potential opportunity, there is the potential for lots to be done by the insolvency community.

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