A BLACKFINCH GUIDE TO

Loss Relief

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For today's investors, the Enterprise Investment Scheme (EIS) offers two outstanding features. First, it is one of the most tax-efficient ways to invest, offering clients a number of advantageous tax reliefs that cover a variety of different circumstances. Second, it's an excellent way to invest in a portfolio of the type of innovative, growth-oriented UK start-ups that are helping to grow the UK economy. It's therefore no wonder that an increasing number of clients are interested in talking to their advisers about EIS.

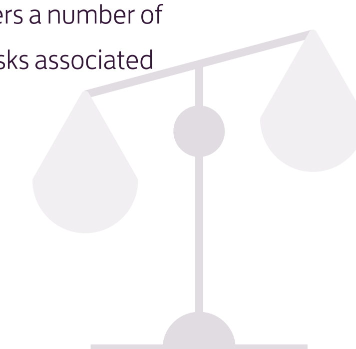
At Blackfinch, we're passionate about supporting innovative firms as they grow, and building outstanding portfolios of EIS-qualifying companies for our investors. We invest in smaller companies with great ideas, strong teams and environmental, social and governance (ESG) concerns at their core. Of course, not every company will succeed, which is why Loss Relief, which we explain in this guide, is such an important tax relief.

Loss Relief allows investors to claim tax relief when substantial losses have been made with their EIS investments. This guide gives you a full overview of how Loss Relief works and offers some helpful case studies for advisers to talk through with their clients.

In this guide

Introduction to EIS

Introduced back in 1994, the Enterprise Investment Scheme (EIS) was created to make it easier for smaller companies to gain the funding they needed to grow. Investing in EIS-qualifying companies offers a number of valuable tax incentives designed to counter-balance the risks associated with investing in higher risk early-stage businesses.



What types of companies qualify?

To be eligible to raise money under the EIS, a company must meet several qualifying criteria. For example:

- The company should have a maximum of 250 employees (or a max of 500 employees for companies deemed 'knowledge-intensive')
- The company's gross assets should not exceed £15m immediately before the EIS investment, and £16m immediately afterwards
- The company's shares are not listed on a recognised stock exchange (such as the FTSE All Share), but listing on the Alternative Investment Market (AIM) is allowed
- Subject to exceptions, the company's first commercial sale must have taken place less than seven years ago, although this increases to ten years for 'knowledge-intensive' companies

In other words, an EIS-qualifying company would tend to be small, early-stage, unlisted, and therefore higher risk for investors.

What does 'knowledge-intensive' mean?

To meet the definition of 'knowledge-intensive', the company must be carrying out research, development or innovation at the time it is issuing shares. It must also meet certain conditions in relation to Research & Development (R&D) expenditure as a proportion of its historical or future operating costs. Knowledge-intensive firms have historically struggled because of the high cost of their research and a lack of working capital.

However, the more generous qualifying criteria for knowledge-intensive companies were introduced in 2015 (with an increase in individual's annual EIS limit for investment into knowledge-intensive companies following in 2018) to help these firms secure the EIS funding they need.

As a Knowledge Intensive Company
you can raise up to:

£10m
in EIS investment
per 12-month period
(instead of £5m)

and

£20m
in EIS investment in
your company's lifetime
(instead of £12m)

EIS Tax Reliefs

Up to 30% Income Tax Relief
On a maximum investment of £1m per investor per tax year (raised to £2m for investment in knowledge-intensive companies).

Carry back
to previous tax year before the investment (subject to the investor paying enough Income Tax in the current and/or previous tax years to utilise this).

Up to 100% Inheritance Tax (IHT)
exemption on qualifying investments held for at least two years (and if held at time of death).

Capital Gains Tax (CGT) deferral relief
(up to three years prior to investment and up to one year after).

Growth on the investment is free of CGT
(if Income Tax relief has been claimed and is retained at the time of disposal).

Loss Relief
up to 45% of capital losses can be offset against taxable income, dependant on the client's marginal rate of income tax.

For EIS investments to qualify for Income Tax relief, Loss Relief and Tax free capital growth investors must hold them for a minimum of three years (the qualifying period).

What is Loss Relief?

Loss Relief allows investors to claim tax relief when substantial losses have been made with their EIS investments. It is important to note that EIS investors can still lose money overall, but Loss Relief may be available where company shares have been sold at a loss to the purchase price.

Loss relief may be available where a net loss has been made, including any income tax relief already claimed. For example:

An investor invests £100,000 into an EIS-qualifying company

£30k
30% of the amount invested

Claiming Income Tax
They claim the full amount of Income Tax relief available on that investment

<£70k
(£100,000 - £30,000)

Claiming Loss Relief
The investor would only be able to claim Loss Relief if the investment returned less than £70,000

For more information on Loss Relief see: HS286
For more information on what qualifies for Loss Relief see: Calculating the allowable loss

Calculating Loss Relief

Loss Relief is calculated on an individual company basis. This means that even if the overall investment in a portfolio of companies makes a gain, Loss Relief may still be available for individual companies within an investor's EIS portfolio which have returned less than the amount invested.

At Blackfinch, we run a portfolio structure, meaning our clients may be able to claim Loss Relief on any of the individual companies within their portfolio, should they be sold at a substantial loss.

EXAMPLE 1 shows how Loss Relief can work, based on a theoretical portfolio of ten EIS-qualifying companies, where three portfolio companies are sold (exited) at a loss. Even though an overall gain has been made on the portfolio, the investor could still claim Loss Relief on those three companies.

EXAMPLE 1

EIS Portfolio of 10 Companies

Figures are based on an investment of £10,000 into 10 companies

Returns	**Fail**	**x3 return**	**x7 return**	**x24 return**
Number of companies	3	4	2	1
Cost of initial investment	£30,000	£40,000	£20,000	£10,000
Sale/exit proceeds	£0	£60,000	£50,000	£70,000
Income Tax relief at 30%	£9,000	£12,000	£6,000	£3,000
Loss relief at 40% of investment, net of Income Tax Relief	£8,400	£0	£0	£0
Total return including reliefs	£17,400	£72,000	£56,000	£73,000
Grand Total	**£218,400**			

Note: the investment amounts shown are after deduction of the portfolio establishment fee.

** Loss Relief calculated assuming that the investor is an additional rate taxpayer with a marginal rate of 40%.*

***The figures for sale proceeds including tax reliefs assume growth without including the annual management charge (AMC) applied to the EIS portfolio companies.*

Claiming Loss Relief

When EIS shares are sold at a loss, HMRC allows investors to offset the loss either by deducting the value of the loss against their taxable income (paid through Income Tax) or against any capital gains which would be subject to Capital Gains Tax (CGT).

How the relief is given

The relief is given by deducting the allowable loss from your total income from all sources, before any deduction for your personal Income Tax allowances. This means you cannot restrict the claim to leave your income equal to your personal Income Tax allowances.

You may claim that the loss be set against your income of the year in which the loss arose or against your income of the preceding year. If the loss is sufficiently large, you may claim that it be set against the income of both years. If you claim for both years, your claim should show which year is to take priority. (see example 2).

If there is still a balance of unused capital loss, it can be deducted from chargeable gains in the usual way.

Option 1: Offsetting the loss against Income Tax

The loss can be offset against Income Tax paid in the tax year the loss was made, and/or the previous tax year. If the Income Tax paid in the year of the loss and the previous year was less than the full loss on the EIS investment, any excess loss can also be offset against any CGT paid/due in the current tax year, or carried forward against any future gains (for CGT purposes only).

EXAMPLE 2

Using Loss Relief to reduce an Income Tax bill

An investor wants to claim Loss Relief for a £50,000 EIS loss in the 2020/21 tax year. Their financial adviser informs them that they can choose to offset this loss against their Income Tax bill from the current and previous tax year. As they are claiming for both years, they must choose which year takes priority when offsetting the loss, so in this case choose to prioritise the 2020/21 tax year.

	2020/2021	**2021/2022**
Income	£40,000	£44,000
Income Tax paid/due (as a basic rate taxpayer with a marginal rate of 20%)	£5,500	£6,286
Portion of the loss being offset	£40,000	£10,000
Taxable income	£0	£34,000
Personal Allowance	£0	£12,570
Taxable income less Personal Allowance	£0	£21,430
Income Tax due	£0	£4,286
Income Tax saving	**£5,500**	**£2,000**

The value of the relief will be between 20% and 45% of the loss, depending on the marginal rate at which the investor pays Income Tax. If offsetting the full value of the loss would reduce the investor's total income into a lower tax bracket, the rate of Loss Relief available will vary.

EXAMPLE 3

Using Loss Relief to reduce an Income Tax bill across multiple Income Tax brackets

In this example, the investor is a higher rate taxpayer with an annual income of £70,000. The amount of Income Tax they pay is as follows:

	2022-2023
Income	£70,000
Amount taxable at 0% (personal allowance)	£12,570
Amount taxable at 20% (basic rate)	£37,700
Amount taxable at 40% (higher rate)	£19,730
Income Tax due	**£15,432**

After a £30,000 net loss on the value of their EIS investments the investor chooses to offset this against their Income Tax for the current year. Their Income Tax computation is now as follows:

	2022-2023
Income	£70,000
Net loss on EIS Investment	£30,000
Taxable income (after EIS loss)	£40,000
Amount taxable at 0% (personal allowance)	£12,570
Amount taxable at 20% (basic rate)	£27,430
Amount taxable at 40% (higher rate)	£0
Income Tax due	£5,486
Income Tax saving	**£9,946**

Option 2:

Offsetting the loss against Capital Gains Tax

The second option available to investors looking to use Loss Relief is to offset the loss against a capital gain – either in the current tax year or 'carrying the loss forward' against any future capital gain. This effectively means Loss Relief will be available as per the applicable rate of CGT due on any gains made.

EXAMPLE 4:

Using Loss Relief to reduce a CGT bill

An investor suffers a net loss of £20,000 on an EIS investment, while also making a capital gain of £50,000 (after utilising their annual CGT allowance) on a separate non-EIS investment within the same tax year. The investor has an annual income of £60,000, making them a higher rate taxpayer. They decide to offset the loss on their EIS investment against the gain on their separate non-EIS investment.

	2022-2023
Gain on non-EIS investment	£50,000
CGT due*	£10,000
Net loss on EIS Investment	£20,000
Net gain	£30,000
CGT due*	£6,000
CGT saving	**£4,000**

**In the 2022-2023 tax year, CGT is charged at 10% for basic rate taxpayers and 20% for higher or additional rate taxpayers. However, if the gain was made on a residential property, CGT will be due at 18% or 28%, respectively.*

For more information see: How the relief is given

When can Loss Relief be claimed?

There is a timeframe to consider for investors in which to claim Loss Relief once the sale (at a loss) of the EIS-qualifying company has been made. The claim must be made within one year of 31st January following the end of the tax year in which the loss occurred. For example, for a loss that occurred in the 2021/22 tax year, the claim would need to be made by 31st January 2024.

It may also be possible for investors to make a 'negligible value claim' while they are still in possession of any EIS-qualifying shares that have fallen to a negligible value. However, it may be better to wait until the company in question has been formally wound-up and the loss is realised. This would still allow Loss Relief to be backdated to the tax year within which the loss occurred, and would avoid potential administrative complications if unanticipated shareholder value is subsequently identified and the negligible value claim is reversed.

What if the EIS investment was used to defer capital gains?

Investors often use their EIS investment to defer an existing capital gain. A capital gain occurs when an asset has been sold and the profits or gains made on that asset have been realised (also known as 'crystallisation').

However, if the capital gain has been deferred by investment in an EIS-qualifying company that subsequently failed with a total loss, the deferred capital gain becomes chargeable again, and is treated as a new capital gain (subject to capital gains allowances available). In other words, the capital gain has been 'recrystallised'. To continue to defer the gain, it would need to be reinvested into another EIS-qualifying company.

EXAMPLE 5

Deferred Capital Gains

An investor makes an EIS investment of £50,000 spread equally across a portfolio of ten companies, deferring a crystallised capital gain of £50,000 made on a separate non-EIS investment. After one year, one company in the EIS portfolio fails completely, meaning that the portion of the gain made on the non-EIS investment will recrystalise.

As the company failure occurs within the next tax year, the investor can use part of their annual CGT allowance (£12,300 for the tax years ended 2022 and 2023) for that year, absorbing the full impact of the recrystallised gain. The investor still has a further £7,300 of their annual CGT allowance to be used against any other capital gains within that tax year. If the recrystallised gain were greater than their annual CGT allowance, any excess would become payable, or would need to be deferred again.

	2022-2023
Amount invested	£50,000 (£5,000 per company)
Deferred gain on non-EIS investment	£50,000
Amount deferred against each investment within the portfolio	£5,000
Annual CGT allowance	£12,300
Recrystallised gain	£5,000
Remaining CGT allowance	£7,300
CGT due	**£0**

For more information on qualifying disposals see: Claim to set loss from share disposal against income
For more information on when Loss Relief can be claimed see: How and when to claim the relief
For more information on making a negligible value claim see: Negligible value claims

What are the tax implications on inherited EIS shares?

Shares are often passed on as part of a person's estate, with inherited EIS shares being deemed as ordinary shares by HMRC. As a result, any growth in the value of the EIS shares, from the date of death, may be subject to CGT for the beneficiary (subject to capital gains allowances). Loss Relief cannot be claimed and offset against Income Tax, however any capital losses can be offset against any gains within the current or future tax years.

What if a partial loss occurs?

If a company within an investor's EIS portfolio is sold at a loss, but is still able to return some capital to the investor, consideration will be made to any Income Tax relief that was claimed upon investment. If the company was sold after passing the minimum three-year EIS qualifying period, the investor can retain the full amount of Income Tax relief claimed. However, if the company is sold within the three-year qualifying period, any Income Tax relief claimed on the amount returned to investors will need to be repaid to HMRC, which will need be taken into account to calculate the amount available for Loss Relief (shown as 'Net loss' in Examples 6 and 7).

EXAMPLE 6

Income Tax to be repaid

An investor invests £10,000 into a company they expect to be EIS-qualifying, and claims full available Income Tax relief of £3,000. Two years later the company is sold at a loss, with the investor receiving £3,000 back. In this example the investor must repay the Income Tax relief claimed on the amount received, which in this example would equal 30% of the £3,000 received (as the EIS shares were not held for the period of three years). Loss Relief will then be available on the net loss of the investment, which can either be offset against Income Tax or CGT as mentioned previously.

Amount invested	£10,000
Income Tax relief claimed	£3,000
Amount received	£3,000
Income Tax repaid on amount received	£900
Net loss	**£4,900**

For more information see: When is Disposal Relief not due

What if the company fails within the first three years?

If the EIS-qualifying company fails in its entirety, whether within three years or after, Loss Relief will be available on the full net loss (the amount invested minus any Income Tax relief claimed). Therefore, any Income Tax relief that has been claimed would not need to be repaid here.

EXAMPLE 7

A full loss

An investor invests £10,000 into an EIS-qualifying company, claiming full available Income Tax relief of £3,000. After one year the company fails, with the investor suffering a full loss. The investor can claim Loss Relief on the net loss.

Amount invested	£10,000
Income Tax relief claimed	£3,000
Amount received	£0
Net loss	**£7,000**

How do Investors claim Loss Relief?

Investors can claim Loss Relief through their annual SA108 Self-Assessment form (which may be completed online or in paper form). In the tax year ended 2023, whether choosing to claim the relief against Income Tax or CGT, the loss is claimed for within the Capital Gains Tax Summary section of the self assessment tax return.

When you make the claim, you must ensure that you include sufficient information about the claim within the tax return. As a minimum this must include:

- the name of the company that issued the shares
- the company registration number (or overseas equivalent) of the company that issued the shares
- the country of incorporation of the company that issued the shares
- the country of tax residency of the company that issued the shares (if different to the country of incorporation)
- the date when the allowable loss arose
- if the relief is being claimed for multiple tax years, a statement of the tax year for which the deduction is to be made first

Investors can also use the Self-Assessment form to repay any Income Tax relief as required. Claiming Loss Relief through self-assessment could effectively reduce the investors' tax liability for that tax year. In cases where the investor has already paid too much Income Tax, they can use their self-assessment to request that HMRC refunds the difference directly into their bank account.

How do I repay Income Tax relief that has been claimed when an investment hasn't been held for the full 3 years and exits at a partial loss?

To repay Income Tax relief, you need to inform HMRC within 60 days of the disposal of the EIS shares. Alternatively, you can get in touch with HMRC or speak with your accountant/tax adviser.

Self-assessment tax return form available at: SA108
For more information see: How and when to claim the relief

If my personal allowance has been reduced due to my annual income being above £100,000, will offsetting a loss against this reinstate any personal allowance that would usually be available on the remaining taxable income, where the remaining taxable income is equivalent to annual income less the loss?

If an investors income for the applicable tax year is £130,000, their personal allowance is reduced to nil. A £30,000 loss will reduce their income to £100,000 and as such they would revive their personal allowance for the current tax year.

	2021-2022
Income	£130,000
Amount taxable at 0% (personal allowance)	£0
Amount taxable at 20% (basic rate)	£37,700
Amount taxable at 40% (higher rate)	£92,300
Income Tax due	£44,460

Income	£130,000
Net loss on EIS investment	£30,000
Taxable Income (after loss relief)	£100,000
Amount taxable at 0% (personal allowance)	£12,570
Amount taxable at 20% (basic rate)	£37,700
Amount taxable at 40% (higher rate)	£49,730
Income Tax due	£27,432
Income Tax saving	**£17,028**

References

HS286: https://bit.ly/3Lv7FRF View here

Calculating the allowable loss: https://bit.ly/3wxdpoA View here

How the relief is given: https://bit.ly/3wDZz3Q View here

Claim to set loss from share disposal against income: https://bit.ly/3PA3OWT View here

How and when to claim the relief: https://bit.ly/3NpSjzd View here

Negligible value claims: https://bit.ly/38yYGSg View here

When is Disposal Relief not due: https://bit.ly/3Nr6ZOF View here

SA108: https://bit.ly/3wuotE2 View here

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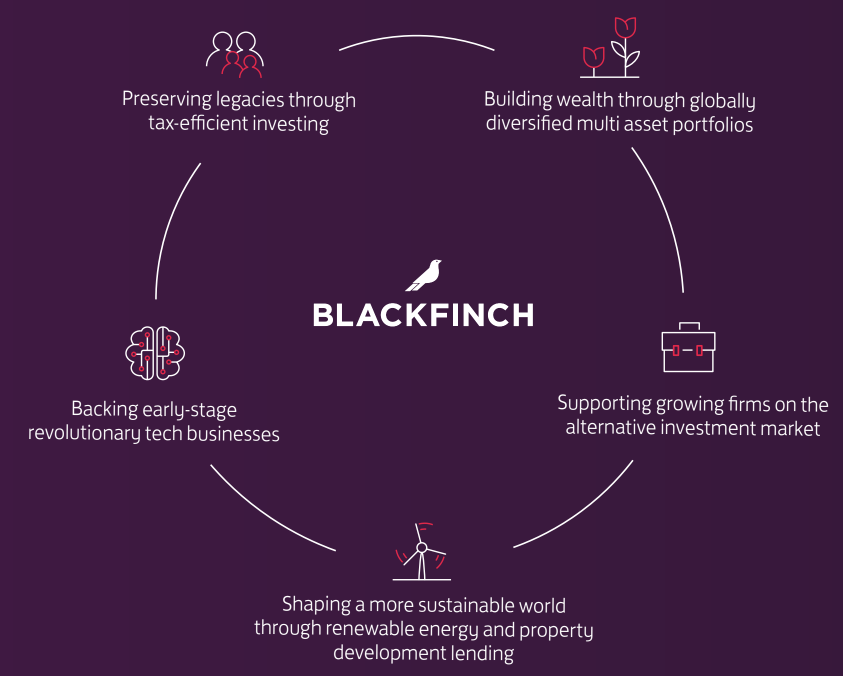
No matter where they are in their investment journey, from starting out in building their wealth, through to managing their estate to ensure they pass on as much as possible to the next generation, we are here to help you achieve their goals.



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