# An EIS guide to loss relief

For UK investors

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A brighter way

## About this guide

**For UK investors.**

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# Introduction

## The Enterprise Investment Scheme (EIS) is a government initiative designed to encourage individuals to invest in early stage companies.

EIS provides finance for smaller, higher-risk companies to help them develop and grow. The government recognises the benefits smaller businesses bring to the UK economy and offers a range of tax benefits to reward investors for investing into high risk small companies through an EIS. To retain the benefits you have to maintain your investment for at least three years.

Because EIS investments are high-risk, the returns of the individual companies may vary. Some companies may do well, while others may drop in value. However, because EIS investors can take advantage of loss relief, the impact of any losses made on individual companies can be reduced. This is the case even if an investor holds a portfolio of EIS companies that, overall, has delivered a positive return.

**For details of the risks, please see pages 4-5 of this guide.**

## What is loss relief?

Loss relief allows an investor to offset a loss made on an EIS company against either their capital gains tax bill or their income tax bill, depending on which better suits their individual needs. They can claim loss relief either in the tax year when they realise the loss or the following tax year. This is in addition to other EIS tax reliefs. This guide explains how loss relief works and how you go about making a claim, although we suggest that you get financial advice to help you fully understand your specific circumstances.

To qualify for loss relief the value of an investment when it is sold has to have fallen below what's called the effective cost. The effective cost is the amount invested minus whatever you previously claimed in income tax relief. For example, if you invested £20,000 into an EIS-qualifying investment and you then claimed upfront income tax relief of £6,000 (equal to 30% of the amount you invested), the effective cost of that investment would be £14,000.

## You can still lose money overall, even if you claim loss relief

EIS investments have to be in small, early stage and high-risk companies. That means the value of your investment, and any income from it, can fall as well as rise and you may not get back the full amount you invest.

This is still the case even if you claim loss relief. That's because while you can use loss relief to reduce the impact of a loss, it won't eliminate the impact entirely. Page 6 has details of how loss relief is calculated. Please note that there are varying levels of relief depending on your tax bracket and whether you're claiming against income tax or capital gains tax. We strongly suggest that you take specialist tax advice to ensure the best use of the relief in your circumstances.

You should consider an EIS as a long-term investment. The shares of smaller companies could fall or rise in value more than shares listed on the main market of the London Stock Exchange. EIS shares are by their nature high risk and they may also be harder to sell.

## Claiming loss relief against income tax

With an EIS an investor may be able to offset a loss against their income tax bill for the current or previous tax year. The amount of relief an individual can claim is worked out by multiplying the value of their effective loss and their marginal rate of income tax.

For example, if the effective cost of the investment was £14,000, and it is sold for £2,000, the effective loss is £12,000. Assuming a marginal rate of income tax is 45%, then the amount that could be claimed as loss relief against income tax is £5,400. (£12,000 x 45% = £5,400)

## Claiming loss relief against capital gains tax

It may be more suitable for an investor to offset their loss against their capital gains tax bill for the current or future tax years. The relief is then calculated by multiplying the effective loss by the rate at which they pay capital gains tax.

## Keep in mind that tax treatment may change

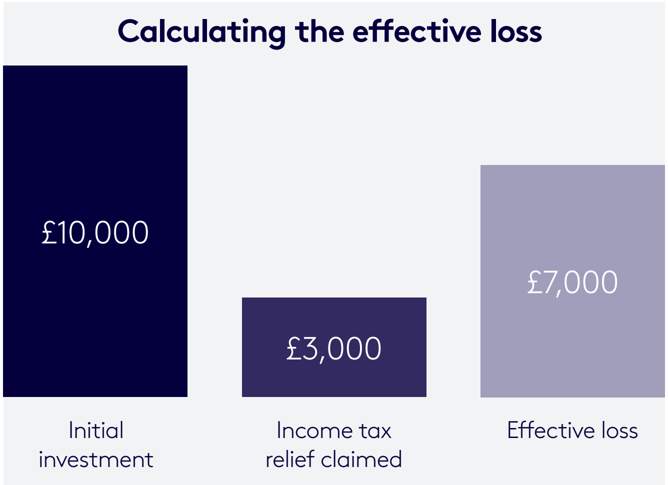
Tax treatment depends on individual circumstances and may change in the future. Tax reliefs depend on the portfolio companies maintaining their EIS-qualifying status.

## How does loss relief work with a portfolio of EIS companies?

An EIS fund manager will often construct a portfolio of EIS qualifying companies. However, for loss relief purposes each company is considered a distinct investment. This means that if any of the individual holdings within the portfolio are sold at an effective loss, it may qualify for loss relief even if the overall portfolio performance is positive.

# A worked example

## The example below shows how loss relief is calculated for an individual EIS-qualifying company.





In the above example an investor invests £10,000 into an EIS-qualifying company. He claims 30% income tax relief (£3,000) on his initial investment. The value of this investment then falls to zero. As he has claimed £3,000 tax relief on his initial investment, his effective loss is only £7,000.

He can then opt to offset loss relief against either income tax or against capital gains tax. Both situations have been illustrated above at the different rates of tax for each route.

This client tax scenario is based on selling EIS-qualifying shares within the 2017/18 tax year and using that year's tax rates. The exact amount of loss relief you can claim will depend on, among other things, your eligibility to make a claim, the tax year you make your claim and when you realised the loss. The exact amount you can claim will also be affected by fees.

*10% and 20% tax rates shown are for individuals and do not include residential property or carried interest. These will be taxed at rates of 18% and 28%.

## How to claim loss relief

### Using a self-assessment form

If you complete a self-assessment tax return, you can claim EIS losses against either income tax or capital gains tax by completing the SA108 form.

Loss relief claimed through self-assessment may reduce the amount of tax that an individual needs to pay for the relevant tax year. If that means they have already paid too much income tax, they can request that HMRC repay the excess either by cheque or directly into their bank account, by completing the relevant part of the self-assessment form.

To receive a self-assessment form, you can download one from hmrc.gov.uk or ask HMRC to send you one. HMRC also have SA108 summary notes available to help you fill out this form. Alternatively, if you wish to fill out your return online and you don't currently complete a tax return you can register at hmrc.gov.uk. There are notes throughout the process to help you fill it out.

## FAQ

### If a beneficiary inherits EIS shares can they claim loss relief if they have fallen in value?

No. Under HMRC rules, if a beneficiary inherits EIS shares (called secondary shares) as the new beneficial owner they cannot claim loss relief if the shares have lost value. HMRC treat the shares as having been acquired by the deceased's personal representatives at their market value at the time of death, even if the shares have lost most or all of their value since the original investment date. We suggest that you talk to your accountant or financial adviser for more information.

### What should an investor do if the value of their shares falls to zero?

If shares in an EIS-qualifying company fall in value to zero, in certain circumstances investors may have the option of making a negligible value claim, by informing HM Revenue & Customs that the shares are worth nothing or next to nothing, even if they haven't been sold. Usually, a claim for loss relief is based on the price at which you sell your shares. But if the shares have nil value you may be able to make a claim for the amount of the effective loss. We suggest that you talk to your accountant or financial adviser for more information.

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