

The Value of Loss Relief

How income tax relief and loss relief combine to limit the effective downside — ascension.vc

Client Scenario

Your client is interested in EIS but concerned about the downside. They need to understand that even in a total wipeout — the absolute worst case — a 45% taxpayer's maximum effective loss is 38.5p per £1 invested. Income tax relief reduces the cost to 70p, then loss relief recovers a further portion. There are four different routes to claim it, depending on the client's circumstances.

38.5p

Maximum loss
45% taxpayer

42.0p

Maximum loss
40% taxpayer

56.0p

Maximum loss
20% taxpayer

The Strategy

Why loss relief matters

EIS investments are genuinely high-risk. These are earlier-stage, illiquid companies. Some will fail. But the government built specific tax reliefs into EIS for precisely this reason. Income tax relief of 30% reduces the effective cost before anything happens. If the investment then fails, loss relief on the remaining cost can recover a further 20–45% depending on the client's tax rate. Even in a total wipeout, a 45% taxpayer's maximum effective loss is 38.5p per £1 invested. The upside, if the company succeeds, is entirely free of capital gains tax.

How It Works

Three stages of protection

- 1 **Client invests £1 into EIS**
Capital is at risk from this point. The investment is illiquid with no secondary market.
- 2 **Income tax relief: effective cost is 70p**
30% income tax relief becomes available once the EIS3 certificate is issued. The effective cost reduces to 70p per £1 — the other 30p is recovered from HMRC.
- 3 **If a loss occurs: further recovery**
The 70p effective cost qualifies for loss relief — either against income (s.131 ITA 2007) or capital gains. At 45%: 31.5p recovered, maximum loss 38.5p. At 40%: 28p recovered, maximum loss 42p. At 20%: 14p recovered, maximum loss 56p.

Four Routes to Claim

- **s.131 ITA 2007 — Against income:** Most valuable route. Marginal rate (up to 45%), uncapped, claim in year of disposal or carry back one year. No holding period requirement — available regardless of when shares are disposed of.
- **Standard CGT loss — Against capital gains:** At 18% or 24% CGT rate. Less valuable than income relief but available regardless of income.
- **Carry forward — Against future gains:** Capital losses carried forward indefinitely against future gains. Useful if no current gains.
- **Schedule 5B TCGA 1992 — Against deferred CGT:** Loss from failed EIS offsets crystallised deferred gain. Available where original EIS was a CGT deferral investment.

Key Rule: 3-Year Holding Period

If EIS shares are disposed of within 3 years, the 30% income tax relief may be clawed back. However, if the exit value is below 70p per £1 (below the effective cost after relief), income tax relief is retained because the investment has made a genuine loss. Relief is only clawed back when the exit value equals or exceeds the effective cost.

Important: s.131 income loss relief against income has **no holding period requirement** and can be claimed regardless of when shares are disposed of. The 3-year rule only applies to the 30% income tax relief clawback.

Suitability

Loss relief is most relevant when:

- Client is a UK income taxpayer at 40% or 45% marginal rate
- Client has sufficient income or capital gains to absorb the relief
- Client understands the risk of capital loss is real
- Client is investing as part of a diversified portfolio approach
- Client is not relying on this investment for income or liquidity
- Adviser has confirmed suitability and capacity for loss

Key risks:

- Capital loss is real — total loss is possible
- Illiquidity — no secondary market, 5–10 year typical holding periods
- Tax relief clawback if sold within 3 years (at or above 70p)
- EIS qualifying status must be maintained
- No FSCS protection

Important: This document is for illustrative purposes only and does not constitute financial, tax or investment advice. Figures are hypothetical and based on simplified assumptions and current tax legislation (2025/26). Tax treatment depends on individual circumstances and may change. EIS investments carry significant risk of total capital loss. They are illiquid, with no secondary market, and expected holding periods of 5–10 years or longer. EIS investments are not protected by the FSCS. Past performance is not a guide to future performance.

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