

Tax Treatment of Suspended Russian Securities

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Recent geopolitical events have led U.S. stock exchanges to suspend or delist the American Depositary Receipts (ADRs) or American Depositary Shares (ADSs) of numerous foreign companies. In other cases, foreign companies have recently decided to delist their ADRs from U.S. exchanges. Both situations raise questions about the tax treatment of unrealized gains for losses on these securities, given the sudden inability to easily sell them.

ADR and ADS Primer

ADRs/ADSs enable U.S. investors to buy and sell the stock of foreign companies on U.S. stock exchanges more conveniently. An ADR is a certificate issued by a U.S. bank that represents shares in a foreign corporation. These certificates are typically traded on the NYSE or NASDAQ. ADRs are listed and can be bought and sold on these exchanges in U.S. dollars, rather than the home currency of the company.

Investing in ADRs is usually less expensive than investing directly in foreign shares since investors can avoid costs associated with currency conversion (such as foreign transaction fees). ADRs also allow investors to obtain an investment exposure to companies in foreign countries whose economies may be growing faster than the U.S. (i.e., China).

For foreign companies, ADRs make it easier to raise capital from U.S. investors. By listing ADRs, foreign companies may also be able to attract higher valuations than in their less-developed home market.

In light of geopolitical events, U.S. stock exchanges last year suspended or delisted the ADRs/ADSs/common stock of all Russian companies, among them Gazprom (ADR), OZON (ADS) and YANDEX (Class A shares).

What it Means to Shareholders

Since Russian shares currently may only be traded on the Moscow Stock Exchange, investors require a depositary account in Russia. Generally, Russian ADRs can be transferred or converted into local shares with the help of brokerage accounts in Russia. Due to the development of geopolitical conditions in certain countries, the U.S. Department of Treasury's Office of Foreign Assets Control (OFAC) instituted sanctions across Russian financial institutions on February 22, 2022, meaning U.S. citizens are not able to open depositary accounts with Russian financial institutions.

[On April 16, 2022](#), Russia enacted Russian Federal Law No. 114-FZ which effectively terminated a range of ADR programs and required the conversion of the ADRs into the underlying Russian shares as prescribed by the individual ADR programs; this was referred to as "standard conversion." Later, Russia adopted Federal Law No. 319-FZ on July 14, 2022. It amended the law and added an additional mechanism ("mandatory conversion") to convert ADRs to underlying Russian shares directly in Russia without the use of agents or foreign clearing systems. Many ADR brokers, however, were unwilling to provide the required forms and documents to prove eligibility to convert the ADRs into the underlying shares using mandatory conversion. The deadline for mandatory conversion expired on November 10, 2022.

However, following the expiration of the mandatory conversion deadline, some ADR holders are still able to convert their ADRs using standard conversion depending on the underlying ADR. For instance, the deadline for standard conversion of Gazprom ADRs to Gazprom's shares is August 3, 2023, but to facilitate the conversion, it would require the cooperation of foreign brokers and clearing systems where

the ADRs are recorded, which is currently not available to U.S. holders due to the OFAC sanctions on Russian financial institutions.

Recommendation

Many U.S. investors in these delisted securities have effectively lost the ability to access their investment – unable to sell because of the delisting, but also unable to convert the ADSs or ADRs to another form. Due to the suspended state of Russian ADRs, U.S. taxpayers may want to claim losses for their Russian ADR investments. Section 165(g) of the Internal Revenue Code permits a loss deduction for a security that becomes worthless during the tax year. The loss amount is determined by treating it as having resulted from a hypothetical sale or exchange of the security on the last day of the tax year in which the security becomes worthless. Worthlessness is presumed to result from an identifiable event, such as bankruptcy, liquidation, or termination of business activities.

Cautionary Action: it is not fully clear that the delisting of a security would allow the security to be defined as “worthless” for tax purposes. While there is some historical precedent regarding the seizure of assets by a foreign government, the recent delistings are a different scenario than those courts have ruled on in the past. Even if the delisting does create a worthless security, the loss can only be taken in the year in which the security becomes worthless. For some ADRs – such as Gazprom, where the period for standard conversion has not expired – the IRS may deem the ADRs not to be worthless yet. In these cases, Regs. Sec. 1.165-5(i) allows taxpayers to solidify their loss claim on worthless securities by formally abandoning the securities. To abandon a security, the taxpayer must permanently surrender and relinquish all rights in the security and receive no consideration in exchange for it.

Given the uncertainty around these Russian securities, U.S. taxpayers may want to consider formally abandoning these securities in 2023 if they do not believe they are likely to once again access these securities. The abandonment would allow a capital loss deduction in 2023. In addition, because a worthless security deduction can only be taken in the year the security becomes worthless, the abandonment would protect against the IRS arguing the security became worthless in 2023 (perhaps when the conversion period expired) if the deduction is taken in a future year.

Contact Us

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