

## OFAC guidance on “sham transactions” erodes the Fifty Percent Rule for ownership

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OFAC’s recent “Guidance on Sham Transactions and Sanctions Evasion” suggests heightened due diligence obligations and erodes the “bright line” distinction between ownership and control previously provided by the Fifty Percent Rule.

The Treasury Department’s Office of Foreign Assets Control (OFAC) recently published a Sanctions Advisory titled “Guidance on Sham Transactions and Sanctions Evasion” (the Sham Transactions Guidance), which provides examples of red flags that OFAC suggests are indicative of “sham transactions” designed to evade sanctions by persons subject to OFAC’s blocking sanctions (a Blocked Person). In the Guidance, OFAC states that it has “encountered numerous instances” of property that has been transferred by Blocked Persons using “opaque legal structures” (including legal entities such as an investment vehicles, trusts, or corporations) that seek to obscure a Blocked Person’s continued interest in the property.<sup>1</sup> For this reason, OFAC outlines a non-exhaustive list of “red flags” that should be considered by regulated entities when determining whether to process or otherwise deal with transactions involving potentially sanctioned property. Relatedly, the Sham Transactions Guidance also provides additional context on the legal theories apparently underlying several enforcement actions taken by OFAC between 2022 and 2025 involving a U.S.-based trust that OFAC determined to be blocked as a result of a Blocked Person’s ability to direct the trust, even though the Blocked Person did not have a 50 percent or greater ownership interest in the trust.<sup>2</sup>

The Sham Transactions Guidance and the enforcement actions that preceded it are in tension with longstanding OFAC guidance concerning entities that are owned by Blocked Persons, commonly known as the “50 Percent Rule,” which provides that entities that are 50 percent or more owned, directly or indirectly, individually or in the aggregate, by one or more Blocked Persons are considered blocked by operation of law—and conversely, that entities in which Blocked Persons hold less than a 50 percent ownership interest are not considered to be blocked, even if otherwise controlled by the Blocked Person(s).<sup>3</sup> OFAC’s guidance on the 50 Percent Rule cautions that entities controlled by Blocked Persons may themselves be the subject of future sanctions designations, and that such entities may be acting as intermediaries for transactions with the controlling Blocked Person, in which case the transaction would be a prohibited indirect dealing if subject to OFAC’s jurisdiction. However, under the 50 Percent Rule, the ability of a Blocked Person to direct an entity, standing alone, was not a basis to consider the entity blocked by operation of law such that transactions with the entity would be generally prohibited.

While OFAC has not expressly repudiated the 50 Percent Rule (and had previously suggested that “sham transactions” did constitute a limited exception to the rule), the Sham Transactions Guidance appears to indicate that, at least in cases where the types of red flags described in the Guidance exist, that rule no longer can be viewed by regulated parties as a bright line test for determining whether an entity is blocked. Instead, the Guidance suggests that in such cases a broad facts and circumstances test should be applied, taking into account control by and potential benefit to the Blocked Person and not solely beneficial ownership. The Sham Transactions Guidance does not address, or even acknowledge, this tension, leaving it to regulated parties to attempt to discern whether there is any limiting principle that would prevent this exception from swallowing the 50 Percent Rule in its entirety.

### Overview of the Sham Transactions Guidance

The stated purpose of the Sham Transactions Guidance is to highlight sanctions risks associated with so-called “sham transactions,” which OFAC defines as occurring “when Blocked Persons, often operating through proxies or other intermediaries, effectuate transfers or establish arrangements that conceal—rather than genuinely extinguish—a continuing interest in property.” In such cases, OFAC states that it will disregard the form of the purported transfer in favor of the “underlying practical and economic realities” and consider the property to be blocked. OFAC notes the following “red flags” as potential indicia of a sham transaction:

- Commercially unreasonable transactions. OFAC notes that a purported transfer of a Blocked Person’s interest in property on terms that are not commercially reasonable or consistent with an arm’s-length transaction may suggest that the Blocked Person retains an interest in the property.
- Transfer to family members or close associates. OFAC considers such transfers to be more likely to be mere paper transactions, with the Blocked Person continuing to act with respect to the property through the new nominal owner.
- Unclear purpose of transfer. OFAC notes that transfers of property with no apparent business purpose, or to a person without relevant experience or qualifications, may reflect sham transactions intended to obscure a Blocked Person’s continuing interest.
- Unduly complex corporate structures involving higher-risk jurisdictions. OFAC states that “unnecessarily complex legal structures without a discernible legitimate purpose” may reflect attempts to conceal ownership or other interests in property of a Blocked Person, particularly where such legal structures involve higher risk jurisdictions.
- Continued involvement of a Blocked Person. Where a Blocked Person remains involved in the use, management, or disposition of property—including through proxies or intermediaries—OFAC views this as indicative of a possibility that the blocked person continues to retain an interest in property.
- Transfer near the time of designation. OFAC appears to consider such transfers to inherently raise suspicions that the transfer is for the purpose of evading sanctions.
- Evasive responses regarding a Blocked Person’s involvement. Similarly, OFAC notes that failure to be transparent in responding to questions about such involvement should be viewed as raising suspicions that a Blocked Person’s interest is being concealed in order to evade sanctions.

OFAC notes that the list of red flags is not intended to be exclusive and that no single red flag or combination thereof is intended to be determinative. Rather, OFAC expects regulated parties to apply a “functional approach” and states that “consider[ing] the totality of circumstances is critical when evaluating whether a transaction was a sham.”

## Compliance considerations – whither the 50 Percent Rule?

This apparent “totality of the circumstances” test is hard to square with the 50 Percent Rule, which OFAC has previously characterized as, and regulated parties and practitioners have long understood to be, a bright-line rule based solely on ownership, reflecting a considered decision by OFAC to prioritize administrability and clarity for the regulated public over maximizing the theoretically available reach of the sanctions. The Sham Transactions Guidance, and the underlying enforcement cases, do not refer to evidence of a retained beneficial ownership interest by the Blocked Person (relying instead on the role of the Blocked Person as the original source of funds and the ability to influence decisions of the entity in question through intermediaries). Nor do they acknowledge, let alone attempt to reconcile, this apparent inconsistency with the guidance provided on the 50 Percent Rule. While the Sham Transaction Guidance does refer to a prior FAQ on the 50 Percent Rule which notes the need to guard against “sham transactions” in cases where a Blocked Person purports to take steps to reduce their ownership interest in an entity below 50 percent, that language previously seemed to refer to transactions in which an ownership interest was secretly retained (which is consistent with historical oral guidance from OFAC staff).

The new Sham Transactions Guidance seems to bootstrap that limited exception into a broader principle that an entity can be deemed to be blocked if a Blocked Person retains any ability to direct the use of or benefit from the entity’s assets following a purported change to the Blocked Person’s ownership stake (and could perhaps be read as suggesting that this may be the case where the Blocked Person has such ability even if the Blocked Person never had a 50 percent or greater ownership interest in the first place). Thus, the reference in FAQ 402 to “ownership interests” becomes a generic reference to “interests” of any nature in the Sham Transactions Guidance, with any such interest apparently sufficing to cause the relevant property to be blocked, even if the property in question is a legal entity whose status should be governed by the 50 Percent Rule. The Sham Transactions Guidance is thus a meaningful change in practice and guidance, particularly in comparison to how the agency considered and addressed divestment transactions in the wake of pre-2022 designations of so-called Russian oligarchs.

The end result of this new guidance is that persons required to comply with sanctions administered by OFAC will need to conduct heightened due diligence when dealing with entities that are or have been linked to a Blocked Person in order to identify and address any indicia that the Blocked Person has a continuing interest in the entity short of ownership. However, OFAC does not provide any guidance or examples illustrating how one might be able to resolve any of these red flags in favor of a conclusion that property is not blocked; nor does the Guidance address the fact that many of the purported “red flags” it identifies may be motivated by benign as well as nefarious reasons (for example, complex transaction or legal entity structures may be based on any number of legitimate commercial or legal considerations, legitimate divestments of Blocked Persons’ ownership interests are also likely to occur close in time to a designation, and high net worth individuals often place assets in trust for relatives or dependents for reasons other than sanctions evasion), leaving the regulated community with uncertainty regarding the facts and circumstances under which OFAC may find that a Blocked Person’s control over an entity may result in the entity’s being considered blocked. Particularly given the very aggressive enforcement approach reflected in the trust cases referenced above, where the public record indicates that OFAC imposed monetary penalties or settlements even though the respondents in those cases relied on legal advice grounded in then-existing public guidance on the 50 Percent Rule, there will likely be significant uncertainty and compliance costs brought about by the erosion of a clear, actionable rule.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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- <sup>1</sup> OFAC, "Sanctions Advisory: Guidance on Sham Transactions and Sanctions Evasion" (March 31, 2026), available at <https://ofac.treasury.gov/media/935441/download?inline>.
- <sup>2</sup> See U.S. Dept. of the Treasury, Blocking Notice (June 30, 2022) available at <https://home.treasury.gov/news/press-releases/jy0841>; OFAC, Enforcement Release, available at <https://ofac.treasury.gov/media/934366/download?inline>; OFAC, Enforcement Release (December 2, 2025), available at <https://ofac.treasury.gov/media/934786/download?inline>; OFAC, Enforcement Release (December 9, 2025), available at <https://ofac.treasury.gov/media/934806/download?inline>.
- <sup>3</sup> See "Revised Guidance on Entities Owned by Persons Whose Property and Interests in Property are Blocked" (Aug. 13, 2014), available at <https://ofac.treasury.gov/media/6186/download?inline>; 31 C.F.R. §§ 589.411(a), 587.406; OFAC Responses to Frequently Asked Questions (FAQ), FAQ # 398, available at <https://ofac.treasury.gov/faqs/topic/1521>. The 50 Percent Rule was first published as a statement of interpretive guidance on OFAC's website in August 2014 and has subsequently been incorporated as an interpretive provision in OFAC's regulations pertaining to each of the sanctions programs where it applies. OFAC has stated that this public guidance reflects an interpretation that it has applied since at least 2008.