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The Corporate Transparency Act Isn't Dead Yet

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Congress has enacted legislation over the decades aimed at curbing money laundering and the financing of terrorism.^[1] Increased legislation has been necessary to ensure that the federal government is able to address evolving threats.

The Corporate Transparency Act was enacted as part of the Anti-Money Laundering Act of 2020 as a tool designed to combat the use of shell companies by those seeking to evade anti-money laundering laws and economic sanctions.^[2] The legislation is intended to empower law enforcement and security agencies in fighting crime and to bring the U.S. into parity with international standards.

Literally 60 days after the effective date of the new law, a federal court **ruled** that the CTA is unconstitutional. On Friday, the U.S. District Court for the Northern District of Alabama in National Small Business United v. Janet Yellen struck down the new law while, at the same time, recognizing its "sensible and praiseworthy" objectives, opining: "The wisdom of a policy is no guarantee of its constitutionality."^[3]

The Corporate Transparency Act: Requirements, Impact and Teeth

The focus of the CTA is on greater transparency of state-registered entities. States do not generally require disclosure of personally identifying information when entities are formed.

The new law, which became effective on Jan. 1, requires millions of companies formed or registered to do business in the U.S. to report identifying information about the companies and their beneficial owners and applicants to the U.S. Department of the Treasury's Financial Crimes Enforcement Network.

The reporting rules under the CTA require covered companies and applicants to file specified beneficial ownership information that will be maintained in a secure, nonpublic database for at least five years.^[4]

The beneficial ownership information may be accessed by law enforcement and certain financial institutions for customer due diligence. The reach of the new law is extensive. Compliance with the CTA is

estimated to affect 32.6 million existing entities and 5 million additional entities formed each year.[5]

A failure to comply with the statutory scheme and report — and update — required information subjects individuals to punishment that includes fines, imprisonment, or both.[6] The ultimate result of the CTA, according to the opinion in NSBU v. Yellen, "is that tens of millions of Americans must either disclose their personal information to FinCEN through State-registered entities, or risk years of prison time and thousands of dollars in civil and criminal fines."[7]

The U.S. Constitution and the CTA: A Bridge Too Far?

Each state has the sovereign power to charter corporations, limited liability companies and other entities under such terms and conditions such state deems appropriate. The Northern District of Alabama in NSBU v. Yellen addressed the issue of whether Congress has the power to regulate state-created entities and their stakeholders the moment they obtain formal corporate status from the state.

On Friday, at 4:47 p.m., the district court issued its opinion in NSBU. The court found the CTA to be an unconstitutional exercise of Congress' enumerated powers and struck down the law.

The court found that the "CTA exceeds the Constitution's limits on the legislative branch and lacks a sufficient nexus to any enumerated power to be a necessary or proper means of achieving Congress' policy goals." [8]

Is the CTA dead? Absolutely not. Although — at least temporarily — the opinion in NSBU represents a notable development, particularly in Alabama.

The significance of the decision and the breadth of its implications will assuredly result in an immediate appeal by the government to the U.S. Circuit Court of Appeals for the Eleventh Circuit. Legislative amendments to the CTA may be ultimately required, but ongoing compliance is the best course of action for most.

Parties' Positions in Summary Disposition Contest

The plaintiffs in the case — NSBU, doing business as the National Small Business Association, and one of its small business members — challenged the constitutionality of the CTA by suing the Treasury Department, alleging that the mandatory disclosure requirements of the law exceed Congress' authority under Article I of the Constitution.

The CTA exceeds the confines of the Constitution by collecting, for law enforcement purposes, the personal information of millions of individuals without any reasonable suspicion of wrongdoing, the suit alleged. The plaintiffs also alleged that the CTA is an unprecedented and unconstitutional intrusion into privacy rights protected by the First, Fourth, Fifth, Ninth and 10th Amendments.

The government justified the constitutionality of the CTA by contending that the legislation falls within the ambit of the commerce, taxing, and necessary and proper clauses of the Constitution along with the powers of Congress to regulate foreign affairs and national security matters.

Since there were no facts in dispute, summary disposition of the issues was the path for resolution. A number of trade associations submitted *amicus curiae* briefs as part of the proceedings, some in defense of the CTA and, naturally, others in opposition.

The emphasis of the supporters was on the compelling government interest in transparent, global financial systems.^[9] Entities operating within U.S. borders should not be anonymous, and requiring minimal disclosure of information about the real owners of a legal entity is not an undue burden, the supporters argued.^[10]

The CTA is a permissible exercise of Congressional authority as the *de minimis* disclosure at the time of a company's formation or registration in the U.S. is outweighed by a law that "marginalizes bad actors, shores up national security interests, and creates a fairer marketplace for legitimate competition," an *amicus curiae* brief from Transparency International U.S. and Main Street Alliance said.^[11]

Others expressed concerns, contending the CTA is an unwarranted government intrusion into the privacy of individuals with any marginal benefit of the law being far outweighed by the costs borne by small businesses.

Constitutional Limits of Congressional Power

The district court in NSBU recognized the laudable purposes of the CTA — the prevention of crimes like money laundering and tax evasion often perpetrated through shell corporations.

Nevertheless, no matter how well intentioned, the court observed that the powers of the federal government are expressly limited to those specifically enumerated in the Constitution or those that are necessary and proper to carry them out. The court found that text of the CTA and its wide-ranging scope exceeds the limits of enumerated legislative authority.

The government offered several sources of constitutional authority for Congress to enact the CTA.

First, the government asserted that Congress' motivating interest in enacting the CTA was to curb foreign money laundering — falling within its foreign affairs power.

Second, the government said Congress has the power to enact the CTA due to the authority conferred under the commerce clause of the Constitution: State entities engage in activities that affect commerce and, as such, the act of corporate formation itself is sufficient to invoke

Congress' commerce powers.

Finally, the government argued that the CTA is a necessary and proper exercise of Congress' tax power since one of the purposes of the FinCEN database is to facilitate efficient tax administration.

The district court rejected each of the government's justifications for the CTA's constitutionality and concluded that the CTA is not authorized by the Constitution. The court was troubled by what it perceived to be an inappropriate federal intrusion to the regulation of state-created and regulated enterprises.[12]

The founders long ago recognized that matters of business regulation were to be left to the individual states and, while this may cause friction with federal interests, it appropriately balances state and federal power, the court observed.[13]

The court recognized that the CTA does not represent a direct regulation of corporate formation, an important point.

Nevertheless, the intrusion by Congress into an area squarely within the sovereign purview of the states and their responsibility for regulating creatures of state law was not viewed by the court to be justified. The court found that the CTA converts an "astonishing amount" of traditionally local matters into fertile ground for federal enforcement.

The CTA, in the court's view, could have easily been written to pass muster under the Constitution. Congress does have the authority to regulate interstate commerce and prohibit the use of that commerce to launder money and evade taxes. The new legislation does not do that — it does not regulate the channels and instrumentalities of commerce or prevent their use for a specific purpose.[14]

The government conceded that submitting documents to a secretary of state does not implicate the commerce clause; it is the activities of the entities that justifies the regulation.

Entity formation cannot be properly viewed, as the CTA does, as a commercial activity that substantially affects interstate commerce sufficient to warrant federal regulation. The fact that many state-registered entities do ultimately engage in interstate commercial activity is not enough to extend commerce clause power to regulation that encompasses such entities from "cradle to grave," as the court put it.[15]

The Northern District of Alabama in this case found the connection between incorporation and criminal activity to be too attenuated to justify the CTA, and that the nexus of the legislation to any enumerated power reserved for Congress is not sufficient to pass muster under the Constitution.

Accordingly, the court granted summary judgment in the plaintiffs' favor and issued an injunction permanently enjoining the government from

enforcing the CTA against the plaintiffs in this case.[16]

Takeaways

The legal challenges at issue in NSBU underscore the friction between the power of the states to regulate businesses, the privacy rights of individuals and the government's efforts to address criminal activities. Certainty and clarity with respect to the CTA and the requirements it imposes on millions of state-registered entities is critical.

The federal court's decision in NSBU creates doubt about a significant piece of legislation and whether further changes to the law are necessary to curtail the CTA's reach. The constitutional considerations addressed by the district court will obtain further review on appeal. A focal point by any appellate court should begin with the recognition that the CTA does not regulate the mere act of incorporation.

The district court pointed out steps that Congress could take to render the CTA constitutional.[17] Whether legislative action will be undertaken by Congress in response to NSBU or other decisions that may emerge remains to be seen.

The law is still new and represents a fundamental change to business as usual. It is comprehensive and viewed by the government as an important step to combat global illicit activities.

Even though the edges and counters of the CTA need further messaging through additional rulemaking, judicial interpretation and, potentially, legislative amendment, the law will continue to have broad applications for the business community.

Millions of businesses need to monitor developments in order to ensure ongoing compliance with the applicable requirements of the CTA.

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[1] See, e.g., Bank Secrecy Act, Pub. L. 91-508 § 121, 84 Stat. 1114 (Oct. 26, 1970), codified at 12 U.S.C. § 1951et seq.

[2] See 31 U.S.C. § 5336. The ability to use of corporations, limited liability companies and other state-created entities that are not regulated to disguise the identities of owners and those in control and the movement of money for illicit purposes has contributed to the development of the CTA. Bad actors, ranging from corrupt officials, foreign terrorists and drug traffickers are able to easily exploit the business formation process to launder money and evade detection.

[3] National Small Business United v. Janet Yellen, Case No. 5:22-cv-1448-LCB *1 (N.D. Ala. March 1, 2024) [Dkt. No. 51]. "Indeed, even in the pursuit of sensible and praiseworthy ends, Congress sometimes enacts smart laws that violate the Constitution. This case, which concerns the constitutionality of the Corporate Transparency Act, illustrates that principle." Id.

[4] Reporting companies must provide FinCEN with the beneficial owner's and applicant's full legal name, date of birth, current address, and identification number from a driver's license, ID card or passport. Id. § 5336(a)(1), (b)(2)(A). Accord 31 C.F.R. § 1010.380(b)(1)(ii)(E) (requiring the submission of an image identifying document).

[5] See Beneficial Ownership Information Reporting Requirements, 87 Fed. Reg. 59498, 59549 (Sept. 30, 2022) (to be codified at 31 C.F.R. pt. 1010).

[6] See 31 U.S.C. § 5336(h)(1), (2) & (3).

[7] National Small Business United v. Janet Yellen, Case No. 5:22-cv-1448-LCB *8 (N.D. Ala. March 1, 2024) [Dkt. No. 51].

[8] Id. at *3.

[9] Brief of Amici Curia Fact Coalition, Transparency International U.S., and Main Street Alliance, Case No. 5:22-cv-01448-LCB *23 [Dkt. No. 34].

[10] Id.

[11] Id.

[12] Corporations, limited liability companies and other business associations are creatures of state law, not federal law. See *Cort v. Ash*, 422 U.S. 66, 84 (1975); *CTS Corp. v. Dynamics Corp.*, 481 U.S. 69, 89 (1987). The district court observed that "[n]o principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations." *National Small Business United v. Janet Yellen*, Case No. 5:22-cv-1448-LCB *19 (N.D. Ala. March 1, 2024) (Memorandum Opinion) [Dkt. No. 51].

[13] Id. at *19-20.

[14] Id. at *32-33.

[15] "Does Congress have authority under the Commerce Clause to regulate non-commercial, intrastate activity when "certain entities, which have availed themselves of States' incorporation laws, use the channels of commerce, and their anonymous operations substantially affect interstate and foreign commerce? The Supreme Court's Commerce Clause decisions all point to the same conclusion: No." Id. at 35 (citation to record omitted).

[16] National Small Business United v. Janet Yellen, Case No. 5:22-cv-1448-LCB ¶ 2 (N.D. Ala. March 1, 2024) (Final Judgment) [Dkt. No. 52]. Notably, the district court did not address the other constitutional challenges put squarely at issue by the plaintiffs in the case—all which would be presumably addressed on remand in the event of a reversal on appeal.

[17] "All Congress would have to do to craft a constitutional law is simply impose a disclosure requirement and give tax officials access to the information." National Small Business United v. Janet Yellen, Case No. 5:22-cv-1448-LCB *52 (N.D. Ala. March 1, 2024) (Memorandum Opinion) [Dkt. No. 51] (Taxing Power/Necessary and Proper Clause). The inclusion of a jurisdictional hook, which is mystifyingly absent in the CTA, is standard operating procedure for Commerce Clause legislation as its presence in the statutory text precludes any serious challenge to constitutionality of a statute. *Id.* *45-46.

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