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The Corporate Transparency Act Declared Unconstitutional

Client Alert

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On March 1, 2024, the Corporate Transparency Act (the "CTA") was declared unconstitutional by the United States District Court for the Northern District of Alabama in the case of *National Small Business United d/b/a The National Small Business Association v. Janet Yellen*.^[1] This decision comes two months after the CTA became effective on January 1, 2024 and just weeks prior to the 90 day reporting deadline for reporting companies formed in early January 2024. The decision raises numerous questions about the future of the CTA.

CTA Background

The CTA requires businesses to disclose sensitive personal information of their beneficial owners to the Financial Crimes Enforcement Network ("FinCEN"). Six weeks after FinCEN issued its final rule implementing the CTA in September 2021, the National Small Business Association (the "NSBA"), which represents U.S. small businesses and entrepreneurs, and Isaac Winkles, a small business owner and NSBA member, sued the Treasury department and FinCEN, alleging the CTA exceeded Congressional authority and violated the First, Fourth, Fifth, Ninth and Tenth Amendments.

The CTA has a potentially wide-ranging effect on U.S. businesses. The Court's opinion noted FinCEN's estimate that some 32.6 million currently existing entities and 5 million newly formed entities each year would be required to make CTA disclosures to FinCEN. Knowing or willful violations of the CTA carry significant individual civil and criminal penalties, which could amount to thousands in fines and years in prison.

The Decision

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Laura E. Johnson
Shareholder

Justin G. Klimko
Shareholder

Shanika A. Owens
Shareholder

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In his 53-page opinion, District Judge Liles C. Burke granted summary judgment to the NSBA and Winkles, holding 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.”^[2] Because he found the CTA unconstitutional on these grounds, he did not reach the question of whether the CTA violates the First, Fourth, or Fifth Amendments.

The Government cited three sources of Congressional authority under the Constitution for enactment of the CTA: (i) the foreign affairs and national security powers of Congress; (ii) its authority under the Commerce Clause; and (iii) that the CTA is a necessary and proper exercise of Congressional taxing power. The Court found none of these justifications authorized the CTA.

While recognizing Congress’ authority with respect to foreign affairs and national security, the Court noted that matters of incorporation are internal affairs governed by state law, as recognized by previous Supreme Court precedent. Although the CTA does not attempt to regulate incorporation directly, the Court found the Act to be too intrusive on “purely internal affairs” reserved to the states.^[3]

The Court also disagreed with the Government’s argument that the CTA was justified under the Commerce Clause, finding that Congress does not have the authority “to regulate an entire class just because *some* members of the class use the channels and instrumentalities of commerce.”^[4] The Court found that “the CTA does not regulate economic or commercial activity on its face”^[5] and cited the Supreme Court case of *United States v. Lopez*^[6] for the proposition that mere incorporation is “in no sense an economic activity that might, through repetition elsewhere, substantially affect any sort of interstate commerce.”^[7]

Further, the Court determined that the regulations and civil penalties under the CTA do not constitute an exercise of Congress’ taxing power. It found that the CTA’s penalties do not bear the hallmarks of a tax, and that making the CTA database accessible for tax administration purposes is not a close enough relationship to establish that the CTA is justified by Congress’ power to tax.

The Court also rejected the Government’s attempt to invoke the Constitution’s Necessary and Proper Clause. It stated that the clause applies only to the exercise of powers granted to Congress by the Constitution. The Court’s finding that the CTA exceeds any authority granted to Congress rendered the Necessary and Proper Clause inapplicable.

What Now?

What is the future of the CTA? With this decision, the reporting obligations of newly formed and previously existing (prior to 2024) entities are unclear. The jurisdiction of the deciding court is limited to its district in Alabama. Unlike other cases from prior years, the Court did not accompany its opinion with any sort of nationwide or extraterritorial injunction prohibiting enforcement elsewhere. It seems highly likely that the decision will be appealed. We will continue to monitor subsequent developments and provide further updates.

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Please reach out to any of the authors of this Client Alert with questions or concerns regarding your entity's reporting obligations under the CTA.

Justin G. Klimko

313.225.7037

klimkojg@butzel.com

Laura E. Johnson

248.593.3014

johnson@butzel.com

Shanika A. Owens

313.983.6908

owens@butzel.com

Joseph Kuzmiak

313.983.7497

kuzmiak@butzel.com

[1] Case No. 5:22-cv-1448-LCB.

[2] Op. at 3.

[3] Op. at 25.

[4] Op. at 32.

[5] Op. at 43.

[6] 514 U.S. 549, 558 (1995).

[7] Op. at 40, citing *Lopez*, 514 U. S. at 567.