Fill This Out to Prove You're Not a Russian Oligarch: Court Holds Corporate Transparency Act Unconstitutional

By David Gorvitz

A federal court has recently held that, while it may serve "sensible and praiseworthy ends," the Corporate Transparency Act (CTA)[1] was beyond Congress's constitutional powers to enact.

As we explained in our overview of the law last year, the CTA designates most private business entities formed or authorized to do business in any U.S. State as "reporting companies" and compels them to file a report with the Financial Crimes Enforcement Network ("FinCEN"), a division of the U.S. Treasury, providing the name, birth date, physical address, and a copy of a government ID for each of their "beneficial owners." The mandate for new entities to submit their reports within 90 days of formation (reduced to 30 days next year) went into effect on January 1, although entities formed prior to 2024 have until January 1, 2025 to file.[2] Compliance, long anticipated to involve an "enormous amount of labor,"[3] has, as we have learned in filing reports for clients, come with the typical rollout headaches, including a clunky, counterintuitive online submission platform which rejects filings without explanation.

Billed as a means of stopping terrorists, arms "proliferators, and corrupt oligarchs"[4] and supported across the political spectrum, including by the Trump White House,[5] the CTA became law on January 1, 2021.[6] Perhaps surprisingly given its name, the CTA exempts large corporations and instead "focuses on investment entities and small businesses," — estimated by FinCEN to number at over 32 million around the country[7] — including non-corporate entities like LLCs and limited partnerships.

Hard as it is to believe for a law sponsored by both Rep. Maxine Waters (D-CA) and Sen. Tom Cotton (R-AR), the legislation attracted challenges. The National Small Business Association (NSBA) and one of its members, a would-be beneficial owner of a reporting company under the CTA, sued in U.S. District Court for the Northern District of Alabama to block it.[8] On March 1, 2024, Judge Liles C. Burke granted the plaintiffs in the case, captioned as National Small Business United v. Yellen, summary judgment,[9] declaring the law unconstitutional and permanently enjoining its enforcement as to them.[10]

Initially, the court held the plaintiffs had standing as potentially injured parties, noting the prospect of "compelled disclosure" of "sensitive personal information"[11] under a threat of a "$500 per day civil penalty and up to $10,000 in fines and 2 years in federal prison" for noncompliance.[12] It found the CTA to be unique in compelling ordinary individuals to provide personal data to a criminal enforcement agency, "for law enforcement purposes."[13]

On the merits, the District Court held that the CTA was not, as the government argued, authorized by Congress's foreign affairs, commerce, or tax powers and that it "lack[ed] a sufficient nexus to any [such] enumerated power" to rely on Congress's implied powers under the Necessary and Proper Clause.[14]

Reviewing the government's foreign affairs power justification, the District Court posited that the CTA effectively imposes a federal regulatory requirement incidental to incorporation,[15] intruding upon what had been "firmly established" as an area of regulation for the states.[16] The court analogized with U.S. v. Bond, where the Supreme Court overturned a federal conviction for an "unremarkable" and "purely local" offense under the law implementing the Chemical Weapons Convention.[17] The need to comply with international anti-money laundering standards, much like observance of foreign treaties, does not, the court held, confer powers on Congress with respect to "internal affair[s]" which are not otherwise authorized by the Constitution, nor does it eliminate restrictions on Congress's reach.[18] Otherwise "almost any exercise of Congressional power" could be justified some international standard.[19] Nor can "the States' historically exclusive" powers over local incorporation be invaded simply by making a broad "finding" that foreign malign actors may be incorporating U.S. entities.[20]

Turning to the federal commerce power,[21] the District Court found that the CTA regulates an activity —incorporation — that the government concedes is non-commercial, without limiting its reach to entities that use the "channels" or "instrumentalities" of commerce.[22] It noted that the CTA fails to include any "jurisdictional hook [that] is standard … for Commerce Clause legislation" (i.e. phrasing that the law intends to regulate persons "engaged in commerce" or activity "affecting commerce," etc.) or, indeed, mention commerce at all.[23] The court found no constitutional authority for Congress to regulate a whole class of entities simply because "some sub-class engages in commerce."[24] For similar reasons, it also held that the CTA cannot regulate incorporation because, in the aggregate, it "substantially affects interstate commerce."[25] Relying on National Federation of Independent Business v. Sebelius ("NFIB"), where the Supreme Court barred regulation of individuals based only on their potential ***future*** participation in relevant commercial activity,[26] the court concluded that Congress also lacked the power to "regulate non-commercial, intrastate activity" of tens of millions of entities simply because "certain" of those entities may substantially affect commerce.[27]

The court also disagreed that the CTA was "necessary and proper" for the exercise of the federal commerce power. In the court's view, this case was a far cry from those sanctioning regulation of intrastate activity to fill a "gaping hole" in some comprehensive federal scheme of economic regulation.[28] Here, the court saw neither an underlying economic regulation scheme nor a

"hole," since existing regulations already require banks to "provide FinCEN with nearly identical information."[29]

Lastly, the District Court rejected the government's tax power justification. It found that the CTA's civil penalties are far more like punitive measures than taxes, as they are not found in the tax code, are not collected by the IRS or paid into the Treasury, have no income thresholds, and are imposed only on willful violators of the law.[30] Nor does the "usefulness" of the collected information to federal tax authorities justify a significant expansion of federal power into a sphere of traditional local control.[31]

While focused on constitutional issues, the opinion also tracks some of the CTA's policy criticisms. The remark that the law's "ultimate result … is that tens of millions of Americans must either disclose their personal information to FinCEN … or risk years of prison time and thousands of dollars in … fines" suggests that the CTA's intrusion on state powers may have been sharpened in the court's eyes by its intrusive requirements.[32] The court also seemed sensitive to the provision of the personal data directly to law enforcement agencies. As we have noted, the reported information would be put in a database accessible to various federal (and, in some circumstances, certain state and foreign) law enforcement and taxing units. Even one inclined to give the government the benefit of the doubt can have reasonable concerns about handing over one's personal details to an unknown number of investigative agencies looking for "corrupt oligarchs." Just ask the architecture professor forced to litigate for eight years to get off a TSA no-fly list because an FBI agent had "checked the wrong boxes" on a form.[33]

The court also clearly recognized that because U.S. business entities service "far more than for-profit enterprise," the CTA would target "millions of entities that can and do serve 'any lawful purpose,' including" non-economic purposes.[34] One familiar example is the single-family home, which many families, for liability, estate planning, or other reasons, put in entity ownership. This does not mean the home is used for commercial ends — it is just as often used by the family to live in, or to vacation. Yet, the family members holding interest in the entity would almost certainly have to submit their personal information to the Financial Crimes Enforcement Network, so that investigative agencies around the world could make sure they are definitely not Russian oligarchs.

The court's comments that the "definition of 'substantial control'" in the statute "is as vague as it sounds" and that FinCEN's regulations do little to "clarify" it hint at the law's other common criticism: the uncertainty about who is covered.[35] NSBA, for example, asks hypothetically if an accountant who helps her son start his business could be deemed to have "substantial" enough "control" in it to make her a beneficial owner under the CTA despite having no equity (let alone the 25% normally needed under the law for beneficial ownership).[36] A family vacation home could create even more uncertainty. Say the grandparents of the family, who had put their beach house in Manasquan into an LLC years ago, are now elderly and (while retaining financial responsibility) ask their two adult daughters who live nearby to take over the maintenance and upkeep of the house, including dealing with the HVAC and lawn service, making any improvements and repairs, ensuring the property taxes are paid, and the like. Say at one point one of the daughters asks her husband to take the lead on dealing with the HOA, tax

reassessment issues, insurance problems, and repair permits. Say at a later point they decide to let one of the granddaughters live in the house rent-free while she attends Monmouth University nearby, on condition that she take over managing the maintenance and upkeep. Do any or all of them — the daughters, son-in-law, and granddaughter — become beneficial owners, with a duty to submit and update their personal information for oligarchy checks? Or say instead the grandparents maintain the house until they pass away but, in the later years, let the LLC fall into inactive status. They leave all right and title to the house to equally their five children, one of whom is the executor, but the will does not specifically mention the LLC, and the children do not get to the bottom of the issue until a year later, long after the 90-day safe harbor period to correct inaccurate or missing CTA filings. In the meantime, the granddaughter lives in and takes care of the house but consults her parents on any repair decisions. Given the 25% equity threshold, who are the beneficial owners? Is there even a reporting company?

The ruling leaves the fate of the law uncertain. Other challenges have now been filed elsewhere, with one court recently declining to put enforcement on hold for the duration of the case, despite sharing some of the challengers' "concerns."[37] In the meantime, the federal government has appealed the Northern District of Alabama ruling to the Eleventh Circuit,[38] which will hear the case on an expedited basis, with briefing scheduled to be concluded by June 3.

The outcome of the appeal is anyone's guess. The court's reasoning on the Commerce Clause, on which the government placed the most reliance in its briefing, seems fairly robust. The Eleventh Circuit has recently shown willingness to at least limit federal statutes which purport to regulate the world based on the commerce power without any self-limiting "jurisdictional hook."[39] And the Supreme Court, which may adjudicate the CTA's constitutionality before too long, may be receptive to the analogy with NFIB.

Other aspects of the opinion, however, seem less strong, particularly with respect to implied powers. For example, the notion that the CTA duplicates mandatory information-gathering by banks ignores the possibility that some malign actors may bypass banks by using cryptocurrency. And if the government can demonstrate a rational basis for believing that the CTA is "useful" for tax collection, that may be enough to hold the law "necessary and proper" for that purpose under current Supreme Court precedent.[40] The Supreme Court may have become less deferential to the other branches since the NFIB decision, which preserved most of the Affordable Care Act. However, if NFIB taught us anything, it is that one cannot necessarily anticipate which arguments will gain traction on appeal.

While the injunction will remain in place pending appeal, it will protect only the individual plaintiff and his businesses, the NSBA, and approximately 65,000 of its members.[41] Everyone else (which FinCEN interprets to include anyone joining NSBA after March 1)[42] will still have to submit beneficial ownership information to FinCEN by the applicable due dates. FinCEN may yet change tack, especially if the National Small Business ruling is affirmed or other adverse decisions are handed down, and delay enforcement of its reporting rule, as the leading CPA trade group and others are urging it to do.[43] Until then, millions of U.S. business entities and those with interests in them will potentially continue to face uncertainty about their

obligations under the law as well as challenges with compliance. For anyone with a potential CTA reporting obligation, consulting with knowledgeable counsel is highly advisable.

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[1] Pub. L. 116-283, Div. F, Titles LXIV (§6403(a)) and LXV (§6509(b)), 31 U.S.C. §5336.

[2] 31 C.F.R. §1010.380; see also FinCEN, Beneficial Ownership Information FAQs, www.fincen.gov/boi-faqs#B_2

[3] Amber Gray-Fenner, "FinCEN Reporting Requirements May Prove Problematic For Small Businesses," Forbes, July 28, 2023, available at www.forbes.com/sites/ambergray-fenner/2023/07/28/new-fincen-reporting-requirements-may-prove-problematic-for-small-businesses/ (last seen Apr. 29, 2024).

[4] Id.

[5] FACT Coalition, FACT Sheet: "A Brief Summary of The Corporate Transparency Act (Title LXIV of the NDAA, H.R. 6395)," available at https://thefactcoalition.org/fact-sheet-a-brief-summary-of-the-corporate-transparency-act-of-2019-title-lxiv-of-the-ndaa-h-r-6395/ (last seen Apr. 29, 2024).

6 H.R.6395 - National Defense Authorization Act for Fiscal Year 2021 ("NDAA"), available at www.congress.gov/bill/116th-congress/house-bill/6395/all-actions (last seen Apr. 29, 2024). While President Trump vetoed the NDAA, to which the CTA was attached, for reasons unrelated to the CTA, the law had enough support in Congress to secure an overwhelming veto override.

[7] Dylan Tokar, et al., "Corporate Transparency Ruling Complicates Campaign to Register Business Owners," Wall Street Journal, Mar. 15, 2024, available at https://www.wsj.com/articles/corporate-transparency-ruling-complicates-campaign-to-register-business-owners-87ade241 (last seen Apr. 29, 2024).

[8] 5:22-Cv.-1448 (LCB)(N.D. Ala.).

[9] --- F.Supp.3d ---, 2024 WL 899372 (N.D. Ala. Mar. 1 2024).

[10] "CTA's Prospects, Post-NSBA v. Yellen," ("CTA's Prospects") S-Corp Washington Wire Blog, Mar. 7, 2024, available at https://s-corp.org/2024/03/ctas-prospects-post-nsba-v-yellen/ (last seen Apr. 30, 2024).

[11] Nat'l Small Bus., 2024 WL 899372, at *4.

[12]Id. at *3.

[13]Id. at *5. While other agencies may collect similar data, with the IRS likely the closest comparison, the latter does not demand a picture ID with tax returns or require information to be continually updated between returns.

[14]Id. at *1.

[15] The law reaches entities created or authorized to do business "by the filing of a document with a [state] secretary of state or a similar office." Id. at *2 (quoting 31 U.S.C. §5336(a)(11)(A)). 31 C.F.R. §1010.380(b)(1)(i)-(ii). The duty to report is triggered by notification of the effectiveness of the state filing creating or authorizing the entity. 31 C.F.R. §1010.380(a)(1). As we have previously reported, in addition to information on its beneficial owners, and, in certain cases, other individuals, the report to be filed by each entity subject to the law must also include information about the entity (i.e. reporting company) itself, specifically, its full legal name, any trade name(s), principal business address, jurisdiction of formation, and Taxpayer Identification Number. 31 C.F.R. §1010.380(b)(1)(i)-(ii).

[16]Id. at *8 (quoting CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 89 (1987)).

[17]Id. at *9 (quoting U.S. v. Bond, 572 U.S. 844, 860 (2014)).

[18]Id. at *9-10.

[19]Id. at *10.

[20]Id. at *9. Under Supreme Court precedent, such findings must yield to constitutional "limiting principles" on the powers of Congress, lest it "completely obliterate the Constitution's distinction between national and local authority." Id. at *19 (citing U.S. v. Morrison, 529 U.S. 598, 615 (2000)).

[21] The court assumed that the federal foreign and interstate commerce powers have the same reach. Id. at *10.

[22]Id. at *11, 14.

[23]Id. at *11.

[24]Id. at *12.

[25]Id. at *13-17.

[26] 567 U.S. 519, 549-557 (2012).

[27]Nat'l Small Bus., 2024 WL 899372, at *15-16.

[28]Id. at *18 (citing Gonzales v. Raich, 545 U.S. 1, 22 (2005)).

[29]Id. at *17-18.

[30]Id. at *20. By contrast, the statutory impositions found to be taxes for constitutional purposes were collected by the IRS, varied based on income, and were not criminally enforceable. NFIB, 567 U.S. at 566.

[31]Id. at *21.

[32]Id. at *3.

[33]Ibrahim v. U.S. Dep't of Homeland Sec., 912 F.3d 1147, 1157 (9th Cir.), cert. denied, 140 S.Ct. 424 (2019); see also Carolyn Muyskens, "Mich. Biz Groups Can't Block Corporate Transparency Act," Law360, Mar. 28, 2024, available at www.law360.com/tax-authority/articles/1829989 (last seen May 1, 2024) (noting court in different challenge to CTA "expressing discomfort with the idea of the federal government collecting large amounts of personal data to 'put on a shelf' for law enforcement to use when needed").

[34]Nat'l Small Bus., 2024 WL 899372, at *1.

[35]Id. at *2. The FinCEN definition of "substantial control" includes (A) serving as a senior officer of the company; (B) having appointment and removal authority over such officers or control of the company's board; (C) controlling or having "substantial influence" as to "important decisions" of the company; and (in the court's view, self-referentially) (D) having "any other form of substantial control" over the company. "Substantial influence" in Part (C) is not defined, but a non-exclusive list of "decisions" FinCEN considers "important" is provided. Decisions about the "nature, scope, and attributes of the business," "[m]ajor expenditures," and "significant contracts," including whether or not to perform them, all make the list.

[36] Noah Logan, "Small businesses brace as Corporate Transparency Act showdown comes to a head in downtown Huntsville courts," Huntsville Business Journal, Dec. 1, 2023, available at https://huntsvillebusinessjournal.com/news/2023/12/01/small-businesses-brace-as-corporate-transparency-act-showdown-comes-to-a-head-in-downtown-huntsville-courts/ (last seen Apr. 30, 2024).

[37]See Small Business Association of Michigan et al. v. Yellen et al., No. 1:24-Cv.-314 (RJJ) (W.D. Mich.); Boyle v. Yellen, No. 2:24-Cv-00081 (LEW) (D.Me.); see Muyskens, supra n.33.

[38] Jack McLoone, "US Appeals Corporate Transparency Act Ruling To 11th Circ.," Law360, Mar. 11, 2024, available at www.law360.com/articles/1812486 (last seen Apr. 30, 2024).

[39]United States v. Davila-Mendoza, 972 F.3d 1264, 1275-76 (11th Cir. 2020).

[40]See United States v. Comstock, 560 U.S. 126, 133–34 (2010) (Congress has "power to enact laws that are convenient, or useful or conducive to the … exercise" of enumerated powers) (cleaned up).

[41] J.D. Tuccile, "Feds Enforcing Unconstitutional Reporting Law Against Most Businesses," Reason, Mar. 11, 2024, available at https://reason.com/2024/03/11/feds-enforcing-unconstitutional-reporting-law-against-most-businesses/ (last seen Apr. 30, 2024).

[42]See CTA's Prospects, supra n.10.

[43]See Tuccile, supra n.41; NFIB, "New Beneficial Ownership Regulations Burden Small Businesses," Aug. 16, 2023, available at www.nfib.com/content/analysis/national/the-upcoming-regulation-change-every-small-business-owner-should-know/ (last seen Apr. 30, 2024).