

Corporate Transparency Act: Is it Constitutional?

BY ETHAN FOSTER, ESQ., AND REW GOODENOW, ESQ.

Many business owners have recently learned of the Corporate Transparency Act (CTA).¹ Although this U.S. federal law has been in existence since 2020, its requirements didn't become effective until this year, 2024. The CTA requires most small companies to disclose their beneficial ownership information.

In a recent decision by a federal judge in the Northern District of Alabama, Northwestern Division, *National Small Business United v. Yellen*, No. 5:22-cv-01448 (March 1, 2024), the court held that the CTA exceeds the U.S. Constitution's limits on Congress's power and enjoined the U.S. Department of the Treasury and the Financial Crimes Enforcement Network (FinCEN) from enforcing it against the plaintiffs in that case. The U.S. Attorney General appealed the *NSBU v. Yellen* decision to the U.S. Court of Appeals for the Eleventh Circuit on March 11, 2024. The appeal has not been resolved, as of the time when this article was submitted.

FinCEN announced it will comply with the *NSBU v. Yellen* order as to the plaintiffs in that case, pending appeal. It has also said that it will not enforce the CTA against members of the National Small Business Association as of March 1, 2024. But FinCEN advises that “[o]ther than the particular individuals and entities subject to the court’s injunction, reporting companies (a defined term in the CTA) are still required to comply with the CTA and file beneficial ownership reports as provided in FinCEN’s regulations.”

There is a handy small business reference guide available on the web at <http://fincen.gov/boi/small-business-resources>. Large, public companies are exempt from the CTA. Sole proprietors who

don't use a corporation or other entities are exempt. But small business owners who own their businesses through a corporation or other entity filed with the state will probably need to comply by January 1, 2025, if they existed at the beginning of the year. Newly formed businesses have 90 days to comply.

Penalties for failure to file CTA reports are steep, \$500 per day, up to a maximum amount. Business owners unsure of this obligation should consult an expert well before the year-end deadline.

Reactions from lawyers to the *NSBU v. Yellen* decision have been mixed. The opinions about how the case will turn out on appeal abound and are worth about what you pay for them. Count One of the *NSBU v. Yellen* complaint alleges that the CTA exceeds Congress's power under Article I of the U.S. Constitution, as well as Amendments IX and X, because states have exclusive power to regulate entity formation. That power was not granted to the federal government in the U.S. Constitution. The NSBU points out that the CTA “aims to establish a clear, Federal standard for incorporation practices,” citing 31 U.S.C. § 5336 note (5)(A), and that the CTA prohibits any state from authorizing the issuance of “a certificate in bearer form evidencing either a whole or fractional interest,” citing 31 U.S.C. § 5336(f). We all learn in school that the 10th Amendment to the U.S. Constitution says that the powers not granted to the federal government are reserved to the states, unless prohibited to the states. There are also concurrent powers such as taxation. Under the Commerce Clause of Article I, Section 8, Clause 3, Congress is vested with the broad power to regulate interstate commerce and states are restricted from impairing interstate commerce. This power

is to regulate commerce among the states, and while the regulation of commerce often sweeps corporate activity into its ambit, it is not directed at the formation of corporations that engage in such commerce.



The district court in *NSBU v. Yellen* rejected the three justifications the U.S. Attorney offered for its exercise of authority in the CTA: plenary power to conduct foreign affairs, Commerce Clause authority, and the Necessary and Proper Clause under its taxing authority. The district court did not reach the plaintiffs' arguments raised under the First, Fourth, and Fifth Amendments, because it found that the CTA exceeded Congress's Article I authority.

Businesses hoping *NSBU v. Yellen* will topple the CTA should not hold their breath. Even if the district court is affirmed on appeal, such affirmance may narrowly hold that Congress cannot impose the CTA's disclosure requirements on businesses the moment they are formed but may do so when they engage in commerce. Such a holding would not exempt most affected businesses from the CTA's disclosure requirements. True, *NSBU v. Yellen* may signal the first in a long series of challenges to the CTA's constitutionality throughout the U.S., but that legal terrain is likely to develop too slowly to affect the enforceability of the CTA's disclosure requirements this year. The safest advice for those awaiting further legal developments is to be ready to file reports with FinCEN.

1. Congress enacted the CTA in the Anti-Money Laundering Act of 2020, which is part of the National Defense Authorization Act for Fiscal Year 2021 ("NDAA"). Then-President Trump vetoed the NDAA, but Congress overrode the veto on January 1, 2021. The CTA is codified at 31 U.S.C. § 5336. The regulations implementing the CTA are codified at 31 C.F.R. § 1010.380.

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