

U.S. Court Declares Corporate Transparency Act Unconstitutional

Posted on Mar. 5, 2024

By Amanda Athanasiou and Andrew Velarde

A federal court in Alabama has delivered a stunning blow to the Corporate Transparency Act (CTA), declaring the law designed to combat tax fraud through beneficial ownership disclosure unconstitutional and blocking the government from enforcing it.

The CTA exceeds the power of Congress, the U.S. District Court for the Northern District of Alabama said in a March 1 [opinion](#) in *National Small Business United v. Yellen*, granting summary judgment to a small business advocacy group. The decision rejects the government's arguments that the CTA is a sanctioned exercise of congressional taxing power and commerce clause authority.

In an order accompanying its opinion, the district court permanently enjoined the government from imposing the CTA on the plaintiffs, the National Small Business Association (NSBA) and small business owner Isaac Winkles, though the opinion states that earlier cases "illustrate how easily Congress could have written the CTA to pass constitutional muster."

Several commentators have said that they expect the decision to be appealed and potentially overturned. Severiano E. Ortiz of MNF Legal LLC underscored that the decision is limited in its application to the plaintiffs, cautioning in an email to *Tax Notes* that the CTA remains in effect and should be complied with in the meantime.

The [CTA was enacted](#) in January 2021 in an effort to update the United States' anti-money-laundering regime and prevent the abuse of anonymous shell companies for nefarious purposes, including tax fraud. It requires corporations, limited liability companies, and similar entities to disclose information about beneficial owners to the Financial Crimes Enforcement Network, which can then release the information to government authorities and financial institutions. By FinCEN's estimates, there will be 32.6 million reporting entities in 2024 and another 5 million created per year over the following decade.

NSBA and Winkles mounted their challenge to the regime in November 2022, just weeks after FinCEN issued [final implementing rules](#) under the CTA. They referred to the act as "a law enforcement dragnet of sweeping proportions," objecting to mandatory disclosure requirements and alleging violations of the First, Fourth, Fifth, Ninth, and 10th amendments.

The [government has argued](#) that the CTA is supported by Congress's foreign affairs powers, commerce clause authority, and taxing power. It filed a [motion to dismiss](#), cross-motion for summary judgment, and opposition to the plaintiffs' [motion](#) for summary judgment in March 2023.

Judge Liles C. Burke said that the case raises the “deceptively simple” question of whether Congress is empowered to regulate the millions of entities granted formal corporate status each year as soon as they obtain that status.

“The wisdom of a policy is no guarantee of its constitutionality. Indeed, even in the pursuit of sensible and praiseworthy ends, Congress sometimes enacts smart laws that violate the Constitution,” Burke said, adding that “this case . . . illustrates that principle.”

Specifically, Burke found that the “CTA is not authorized by Congress’ foreign affairs powers, because those powers do not extend to purely internal affairs, especially in an arena traditionally left to the States.” It also doesn’t “regulate commerce on its face, contain a jurisdictional hook, or serve as an essential part of a comprehensive regulatory scheme,” and thus is outside of Congress’s authority over noncommercial, intrastate activity, he said.

On the issue of whether the CTA is justified under congressional taxing power, Burke said that “it would be a ‘substantial expansion of federal authority’ to permit Congress to bring its taxing power to bear just by collecting ‘useful’ data and allowing tax-enforcement officials access to that data,” citing *National Federation of Independent Business v. Sebelius*, 567 U.S. 519 (2012). He did not opine on whether the CTA contravenes the First, Fourth, and Fifth amendments.

Ortiz said that he expects the decision to be appealed to the Eleventh Circuit. “At the end of the day . . . I think the government will prevail and the CTA is here to stay, so companies should ensure they are on track to comply with these new beneficial ownership rules,” he said.

Zorka Milin, Policy Director for the Financial Accountability and Corporate Transparency (FACT) Coalition, said in an email that the organization found the opinion to be misguided as to constitutional and anti-money-laundering aspects and expects that it will be overturned. In April 2023 the FACT Coalition [filed an amicus brief](#) in support of the CTA in the case, along with Transparency International U.S. and Main Street Alliance.

“This is a pro-crime, pro-drug cartel, pro-fentanyl ruling which undermines the rule of law and allows criminals to use anonymous shell companies to hide their dirty money from law enforcement,” FACT Coalition Executive Director Ian Gary said in a March 4 [release](#). “Stopping the abuse of anonymous U.S. companies as a means to launder criminal and corrupt funds is the single most important reform to address the U.S. role as the top destination for the world’s illicit funds,” the release says.

Burke’s opinion “imagines a world in which international money laundering simply doesn’t exist,” said Scott Greytak, director of advocacy for Transparency International U.S., in a March 3 [statement](#). “We expect this ruling to be promptly appealed to, and overturned by, the 11th Circuit Court of Appeals, and in the meantime urge FinCEN to continue implementing the CTA as much as it can” in accordance with the opinion.

Bruce Zagaris of Berliner Corcoran & Rowe LLP agreed that there is a strong chance the ruling could be overturned, particularly as to Burke’s consideration of *California Bankers Association v. Shultz*, 416

U.S. 21 (1974), in which banks and customers unsuccessfully tried to block Bank Secrecy Act record retention and reporting requirements. Burke found the case not to be on point.

"The CTA seems to fit within *Shultz*," Zagaris told *Tax Notes*. There is also a significant chance that the decision will be overturned "insofar as it finds that 'incorporation is an internal affair' which only the states can regulate," he said. "An appellate court is likely to find that, like the Bank Secrecy Act, anti-money-laundering laws, FBARs, FATCA, the CTA is within the enumerated authority of the U.S. Congress."

In *National Small Business United v. Yellen*, No. 22-cv-01448, the plaintiffs are represented by Maynard Nexsen PC and Hughes Hubbard & Reed LLP. The government is represented by Stuart J. Robinson and Taylor Pitz of the Justice Department, Tax Division.