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## Corporate Transparency Act Found Unconstitutional for Certain Businesses

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In March 2024, the Northern District of Alabama held that Congress exceeded its Constitutional authority by enacting the Corporate Transparency Act (“CTA”). The CTA requires variety corporate entities—everything from LLCs to trusts—to disclose beneficial ownership information to the U.S. Treasury Department. The CTA extended the nation’s anti-money laundering (“AML”) regime, known as the Bank Secrecy Act (the “BSA”), which combats illicit financial activity like tax fraud, money laundering, and financing terrorism. To the Alabama District Court presiding over *National Small Business United v. Yellen*, however, even in the pursuit of these “sensible and praiseworthy ends, Congress sometimes enacts smart laws that violate the Constitution.”

The court’s ruling does not, however, strike down or even stay the CTA. Nor does the ruling impact all entities covered by the CTA’s beneficial ownership reporting obligations. The ruling is limited to the plaintiffs in the suit: businesses that belong to National Small Business United. But indirectly this ruling may generate additional scrutiny of the CTA, leading to more legal challenges around the country, and perhaps a review of the BSA more broadly. That said, the North District of Alabama’s ruling may not last long—the Treasury Department has appealed.

For now, here is the essential analysis and impact:

### ***The CTA: What is it?***

Congress passed the CTA to prevent financial crimes like money laundering and tax evasion. These crimes are often facilitated with shell companies, which help bad actors hide their identity in a proverbial haystack of layered corporate, partnership, and legal entities (e.g., trusts). It is time-consuming and resource-draining for regulators and law enforcement to weed through ownership documents of each shell, only to find that that shell is owned by others, sometime offshore, all within a vast and complex hierarchy and international structure.

The goal of the CTA is to cut through these layers. With increased transparency of true beneficial ownership, the CTA intended to make it more difficult both to engage in financial crime and conceal the source, ownership, nature, and location of financial crime proceeds. Legal entities must accordingly disclose their “beneficial owner”—those who exercise substantial control over the entity or own more than 25% of the entity—to the Treasury Department’s Financial Crimes Enforcement Network (“FinCEN”). Under the CTA, each legal entity would link to a particular person, rather than a series of fictional, legal entities.

Violations of the CTA's reporting requirements come with stiff civil and criminal penalties, including imprisonment. In that way, the CTA's penalties mirror other reporting obligations under the U.S.'s AML legal regime, the BSA (at Title 31, United States Code and Title 31, Code of Federal Regulations). This includes penalties for not filing "FBARs" (on foreign bank accounts with more than \$10,000) and "CMIRs" (on cash imports or exports exceeding \$10,000 in cash).

***The legal challenge to the CTA and the Northern District of Alabama's reasoning***

National Small Business United, which challenged the CTA, is a small business advocacy group. Their suit claimed that the CTA's disclosure requirements exceeded Congress's authority under the Constitution and violated the group's Constitutional rights. The defendant, the Treasury Department, countered with three arguments, each one rejected in turn.

First, the Treasury Department asserted that the CTA was within Congress's broad powers to regulate foreign affairs and national security. To that end, collecting beneficial ownership information will "'protect vital US national security interests'; 'better enable critical national security, intelligence, and law enforcement efforts to counter money laundering, the financing of terrorism, and other illicit activity'; and 'bring the United States into compliance with international anti-money laundering and countering the financing of terrorism standards.'" The Northern District of Alabama disagreed. It reasoned that a corporation's formation, resulting powers, and state recognition has historically been an internal affair for individual states. Without "a clear indication from Congress," which was not the case here, Congress could not extend its foreign affairs powers to local matters such as regulating corporate obligations.

Second, the Treasury Department argued that the CTA was merely an exercise of Congress's authority to regulate the channels and instrumentalities of interstate commerce. This argument failed because, according to the Northern District of Alabama, the CTA applied to corporations the moment they were formed, regardless of whether they ever engaged in interstate commerce. And while many of the newly formed entities might eventually engage in interstate commerce, the court reasoned that this possibility did not justify congressional regulation of all corporate entities. Notably, the court remarked that Congress could have "easily" written a constitutionally-compliant version of the CTA by imposing the "disclosure requirements on State entities as soon as they engaged in commerce" or by "prohibiting the use of interstate commerce to launder money" and other illegal activities. To that end, this is as much a criticism of legal drafting as its constitutionality.

Lastly, the Treasury Department argued that "the collection of beneficial ownership information is necessary and proper to ensure taxable income is appropriately reported"—generally an area Congress has regulated. This too was unpersuasive to the Northern District of Alabama. Although Congress does have the power to levy taxes, and while the CTA's civil penalties yield revenue for the government, the government did not claim that its civil penalties were a tax. Instead, the government cast the need to collect beneficial ownership information as necessary to ensure taxable income was appropriately reported. This renders it merely "incidental" to Congress's taxing power without a "sufficiently close relationship" between Congress's taxing power and collecting beneficial ownership information to ensure proper income reporting.

***What does this mean?***

The 11th Circuit will be the first federal appellate court to opine on the CTA's constitutionality. Regardless of the outcome of that appeal, companies operating in the U.S. that are not exempt under the CTA must continue to comply with all AML, BSA, and CTA reporting requirements. Even if the 11th Circuit or other federal courts find that Congress lacked the authority to impose beneficial ownership disclosure obligations under the CTA, we fully expect that the current trend of heightened scrutiny of financial transactions and corporate ownership will continue.



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