

Alabama Federal Court Decision Throws Corporate Transparency Act into Disarray

March 8, 2024 | Client Alert

A federal district court in Alabama issued a significant decision in [*National Small Business United v. Yellen*](#) on March 1, declaring the Corporate Transparency Act (CTA) unconstitutional as it exceeds the Constitution's limits on the power of Congress.¹

Background of the CTA

The CTA, enacted as part of the National Defense Authorization Act for Fiscal Year 2021, aims to combat money laundering and terrorist financing by requiring certain businesses to report beneficial ownership information to the Financial Crimes Enforcement Network (FinCEN). This information includes beneficial owners' full legal names, dates of birth, residential street addresses, and the identifying number and an image of a government-issued identification document. Although the CTA passed with bipartisan support, it was criticized by some business groups that argued the act imposed a heavy reporting burden on legitimate businesses.

The plaintiffs in this case included one such group: National Small Business United, a nonprofit trade group also known as the National Small Business Association (NSBA) that represents more than 65,000 member companies. Plaintiff Isaac Winkles owns an Alabama corporation that is an NSBA member. The plaintiffs filed suit in the U.S. District Court for the Northern District of Alabama challenging the constitutionality of the CTA. The named defendants were the U.S. Department of the Treasury, Treasury Secretary Janet Yellen and FinCEN Acting Director Himamauli Das in their official capacities. Ultimately, the court sided with the plaintiffs and held that the CTA was unconstitutional.

Key Points of the Alabama Court's Decision

- **Exceeding Enumerated Powers:** The court held that the CTA exceeds Congress's enumerated powers under the Constitution. U.S. District Judge Liles Burke focused on (1) the powers over foreign affairs and national security, (2) the Commerce Clause and (3) the taxing power.
 - **Foreign Affairs and National Security:** The court rejected the defendants' argument that the CTA fell within the defendants' powers over foreign affairs and national security because it aids in preventing money laundering and terrorism financing. The court reasoned that even if these are legitimate goals, the CTA's means to achieve them are

¹ [*National Small Business United v. Yellen*](#), No. 5:22-cv-01448 (N.D. Ala. March 1, 2024).

not necessary and proper. The act's broad scope and intrusion into areas traditionally regulated by states were deemed excessive.

- **Commerce Clause:** The court considered whether the CTA could be considered under one of three broad categories of Commerce Clause jurisprudence: (1) channels of interstate and foreign commerce; (2) the instrumentalities of, and things and persons in, interstate and foreign commerce; and (3) activities that have a substantial effect on interstate and foreign commerce. The court acknowledged that the CTA targets entities that may utilize interstate commerce channels. However, it found that the CTA lacks a sufficient nexus to the Commerce Clause because it does not regulate interstate commerce. Judge Burke distinguished the CTA from other cases in which Congress regulated activities with a substantial effect on interstate commerce. Here, the focus on the non-commercial, intrastate activity of incorporating entities was not sufficient to justify the federal intrusion. The court noted that the CTA does not regulate activities that, although purely intrastate, substantially affect interstate commerce. Further, the court reasoned that many entities are established for purposes that may or may not be commercial. The court also suggested that FinCEN already has the means of obtaining ownership information through its Customer Due Diligence (CDD) rule, which requires financial institutions to obtain certain beneficial ownership information from their customers. "FinCEN's CDD rule and the CTA provide FinCEN with nearly identical information, but the CDD rule does so in a constitutionally acceptable manner," the court said.²
- **Taxing Authority:** The court rejected the Treasury's argument that the CTA is justified by the taxing power. "The CTA's civil penalties are not a tax: they are not paid into the Treasury and have no income thresholds; the penalty amounts are fixed rather than variable; the penalties are not 'found in the Internal Revenue Code and enforced by the IRS'; and the penalties are imposed only on those who 'knowingly' or 'willfully' violate the law," Judge Burke noted.³
- **Plaintiffs' Claimed Violations of Multiple Constitutional Amendments:** The court declined to address the plaintiffs' arguments that the CTA's expansive reporting requirements violate several amendments to the Constitution, including the following:
 - **First Amendment:** The plaintiffs raised concerns regarding the potential chilling effect on the formation of new entities due to the disclosure of personal information.
 - **Fourth Amendment:** The plaintiffs questioned whether broad data collection authorized by the CTA constitutes an unreasonable search and seizure.
 - **Fifth Amendment:** The plaintiffs argued that the potential for self-incrimination due to the reporting requirements was a point of concern.
 - **Ninth and Tenth Amendments:** The plaintiffs noted the potential infringement on unenumerated rights and the power reserved to the states, particularly regarding corporate formation and regulation.

Outcome and Impact on the Future of the CTA

Ultimately, the court declared the CTA to be unconstitutional and enjoined the defendants, along with any other agency or employee acting on behalf of the United States, from enforcing the

² *Id.* at 44.

³ *Id.* at 50.

statute against the plaintiffs.⁴ The decision represents a setback in the government's efforts to combat financial crime through enhanced beneficial ownership transparency and creates some confusion for those covered by the CTA.

However, it is important to note that this is a single district court ruling, and the injunction imposed by the judge applies only to the specific plaintiffs. FinCEN's [published response to the decision](#) states FinCEN would comply strictly with the court's order: "As a result, the government is not currently enforcing the Corporate Transparency Act against the plaintiffs in that action: Isaac Winkles, reporting companies for which Isaac Winkles is the beneficial owner or applicant, the National Small Business Association, and members of the National Small Business Association (as of March 1, 2024). Those individuals and entities are not required to report beneficial ownership information to FinCEN at this time."⁵ Accordingly, the decision has no binding impact on any other reporting company or beneficial owner thereof.

The government will likely appeal, potentially leading to a lengthy legal battle. In [a statement reported](#) by *The New York Times*, U.S. Sen. Sheldon Whitehouse (D-Rhode Island), an advocate of the CTA, "urge[d] the government to appeal quickly to correct the erroneous decision and ensure the law's transparency requirements can be fully and uniformly implemented." Industry groups also criticized the ruling. Zorka Milin, policy director at the Financial Accountability and Corporate Transparency (FACT) Coalition, [described the decision](#) as being "off the mark in terms of constitutional interpretation and is based on a misunderstanding of U.S. anti-money laundering law." It also remains to be seen if this decision will result in the filing of additional lawsuits challenging the constitutionality of the CTA in other jurisdictions, whether on the same or different grounds from those on which this case was decided.

What Steps Does Your Business Need to Take Now?

While the Alabama decision clouds the future of the CTA, businesses should take note of the narrow scope of the remedy applied by the court. For now, reporting requirements under the CTA **remain in effect as written for all covered entities other than the plaintiffs in this case**, and reporting companies are still subject to civil and criminal penalties should they willfully fail to report on a timely basis.

Consider taking the following actions:

- Identify entities within your organization that may be reporting companies.
- Identify whether you and any or all of your affiliate entities qualify for any exemption.
- If any entity within your organization is not exempt from the reporting requirements, identify such entity's beneficial owners.
- Collect the required information about the entity and its beneficial owners.
- Develop a system for updating and correcting beneficial ownership information regularly. This may include reviewing agreements to ensure that anyone who could be a beneficial owner is required to provide the company with updated and accurate information on a timely basis.
- Establish procedures for filing initial and updated reports with FinCEN.

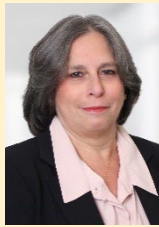
⁴ This was the remedy sought by the plaintiffs, who did not request a broader injunction.

⁵ [Notice Regarding National Small Business United v. Yellen](#), No. 5:22-cv-01448 (N.D. Ala.) (March 4, 2024).

More Information

The CTA requirements remain subject to further modification and guidance. FinCEN has published [guidance tools](#) that may be useful in interpreting the regulations as they are implemented. For current guidance and updates from FinCEN on the rules and existing regulations, see [FinCEN's BOI Small Entity Compliance Guide](#). Stradley Ronon's CTA Task Force will continue to monitor these developments, and we are available to assist clients with their obligations to navigate these complicated new requirements.

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