

# Corporate Transparency Act – Federal District Court’s Ruling that the Act is Unconstitutional

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## What is the Corporate Transparency Act?

- Designed to assist with investigations related to illegal financial activities, including tax fraud, money laundering and terrorism financing
- Reporting company: corporation, LLC, or other similar entities that are either –
  - (i) created by the filing of a document with a secretary of state or a similar office under the law of a State or Indian Tribe, or
  - (ii) formed under the law of a foreign country and registered to do business in the United States.
- 24 Exemptions
- Beneficial ownership reporting regime
- First regulation went into effect on January 1, 2024

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## CTA Reporting Requirements: Who is obliged to report?

- The CTA required millions of entities to disclose the identity and information of any “beneficial owner.”
- Beneficial owner: an individual who –
  - (i) exercises substantial control over the entity; or
  - (ii) owns or controls not less than 25 percent of the ownership interests of the entity, with some exceptions for children, creditors, and a few others
- Substantial control
  - some clear categories like “senior officers”
  - someone who “has any other form of substantial control over the reporting company” besides those listed

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## CTA Reporting Requirements: Who is obliged to report?

- Entities incorporated from January 1, 2024 – disclose the identity and information of both Beneficial Owners and “Applicants”
- Applicants: any individual who files an application to form a corporation, LLC, or other similar entity; or registers a foreign entity to do business in the United States

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## CTA Reporting Requirements: What must be reported?

- Full legal name, date of birth, current address, and identification number from a driver's license, ID card, or passport.
- Also required to submit an image of identifying document.
- FinCEN retains Applicant and Beneficial Owner information on an ongoing basis for at least five years after the reporting company terminates.

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## *Nat'l Small Bus. United v. Yellen*

- The Parties:
  - Plaintiff National Small Business Association (NSBA) is “an Ohio non-profit corporation that represents and protects the rights of small businesses across the United States,” including “over 65,000 businesses and entrepreneurs located in all 50 states.”
  - Plaintiff Isaac Winkles is an NSBA member and owner of two small businesses, one of which “is a small family business with 3 full-time employees and annual turnover of under \$20 million.”
  - Defendant Treasury Department, Treasury Secretary, and acting director of the Department's Financial Crimes Enforcement Network (FinCEN).

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## *Nat'l Small Bus. United v. Yellen*

- The Complaint:

- Allegations - CTA's mandatory disclosure requirements exceed Congress' authority under Article I of the Constitution and violate the First, Fourth, Fifth, Ninth, and Tenth Amendments.
- The parties agreed that the case could be resolved on dispositive motions without discovery, so the parties cross-moved for summary judgment in early 2023, with the Government simultaneously moving to dismiss.

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## *Nat'l Small Bus. United v. Yellen*

- The Court's Discussion:

- After addressing Plaintiffs' standing to challenge the CTA, the Court considered whether Congress had the authority to enact the CTA.
- The Government argued three sources of constitutional authority for Congress' enactment of the CTA:
  - 1) Foreign Affairs & National Security;
  - 2) Commerce Clause; and
  - 3) Necessary and Proper Exercise of Congress' Taxing Power.
- Congress' foreign affairs powers do not extend to purely internal affairs, and Congress cannot look to international standards or agreements to extend those powers.
- CTA doesn't regulate the channels and instrumentalities of commerce or prevent their use for a specific purpose, it cannot be justified as a valid regulation of those channels and instrumentalities.
- The necessary and proper clause did not provide Congress authority to enact the CTA because even if the CTA's provisions were "necessary," "such an expansion of federal power is not a 'proper' means for making those [policy goals] effective."

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## *Nat'l Small Bus. United v. Yellen*

- The Court's Ruling:
  - CTA exceeds the Constitution's limits on the legislative branch and lacks a sufficient nexus to any enumerated power to be a necessary or proper means of achieving Congress' policy goals. As such, the Court found the Plaintiffs are entitled to judgment as a matter of law.
  - The Court did not address whether the CTA violates the First, Fourth, and Fifth Amendments because it found it was unconstitutional.
- Pending Appeal:
  - On March 11, 2024, FinCEN filed an appeal to the 11th Circuit Court of Appeals. The appeal is still pending.
  - In a notice issued March 4, 2024, updated on March 11, FinCEN announced that it intends to continue implementation and enforcement of the CTA, but that the named plaintiffs and members of the NSBA as of March 1, 2024, would not be required to report beneficial ownership under the CTA at this time.

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## Implications & Potential Consequences

- Currently, despite the Federal Court decision regarding CTA's unconstitutionality, FinCEN seems dedicated to keeping the reporting system in place, including the January 1, 2025, filing deadline for pre-existing reporting companies, and requiring newly formed reporting companies to file a timely report.
- All businesses, such as non-NSBA members and those who were not plaintiffs in the action, must continue to comply with the Corporate Transparency Act's Beneficial Ownership Information reporting requirement. According to FinCEN, this amounts to approximately 32 million companies.
- In addition, businesses that join the NSBA after the March 1 ruling date, are not within the scope of the ruling and must still comply with the CTA, unless they meet one of its 23 exemptions.

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## Non-Compliance Risks

- The willful failure to report complete or update beneficial ownership information to FinCEN, or the willful provision of or attempt to provide false or fraudulent beneficial ownership information may result in civil or criminal penalties, including civil penalties of up to \$590 for each day that the violation continues, or criminal penalties including imprisonment for up to two years and/or a fine of up to \$10,000.

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## Key Takeaways

- While the Northern District of Alabama has found the CTA unconstitutional, an appeal is still pending which could reverse this opinion.
- Attorneys should continue to monitor the status of the CTA, the pending appeal, and client filing obligations pending resolution of the court challenges or alternative action by FinCEN or Congress.
- The ruling by the Northern District of Alabama *only* applies to the Plaintiffs in that case, namely NSBA and its existing members. The CTA remains in effect for all other non-exempt businesses.

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## Closing Remarks



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## Questions?



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