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Federal court holds Corporate Transparency Act unconstitutional

By Martha Waggoner

Today

A federal district court in Alabama held that the Corporate Transparency Act (CTA), P.L. 116-283, which requires the reporting of beneficial ownership information (BOI) by businesses, is unconstitutional.

The district court granted the plaintiffs' motion for summary judgment Friday in the case of *National Small Business United v. Yellen* (<https://law.justia.com/cases/federal/district-courts/alabama/alndce/5:2022cv01448/183445/51/>), No. 5:22-cv-1448-LCB (N.D. Ala. 3/1/24). One plaintiff, the National Small Business Association, has over 65,000 members.

While the legislation may have "sensible and praiseworthy ends," the court stated in its opinion, the government's arguments that Congress has "the power to regulate millions of entities and their stakeholders the moment they obtain a formal corporate status" from a state "are not supported by precedent."

The act "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," the opinion said.

BOI reporting provisions

Under the act, which Congress passed as an anti-money-laundering initiative in 2021, reporting companies, defined as corporations, limited liability companies (LLCs), and similar entities, must disclose the identity and information about beneficial owners of the entities. For new entities incorporated after Jan. 1, 2024, reporting companies must also disclose the identity of "applicants" — defined as any individual who files an application to form a corporation, LLC, or other similar entity.

Reporting companies are required to provide information about both the companies and their beneficial owners and applicants, including full legal name, address, state or tribal jurisdiction of formation, IRS taxpayer identification number, birth date, and other details. Willful violations are punishable by a fine of \$591 a day, up to \$10,000, and two years in prison with similarly serious penalties for unauthorized disclosure.

Treasury's Financial Crimes Enforcement Network (FinCEN), which administers the act, estimates that BOI reporting regulations apply to 32.6 million entities with 5 million added each year through 2034.

Constitutional arguments

The government argued that Congress has the power to enact the CTA under its plenary power to conduct foreign affairs; via its Commerce Clause authority; and as a necessary and proper exercise of its taxing power.

The court rejected all three arguments. On the foreign affairs argument, the court found that *Bond*, 564 U.S. 211 (2011), "yields an unavoidable conclusion: 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."

The court also found that the law does not fall within the scope of Congress's powers under the Commerce Clause: "The plain text of the CTA does not regulate the channels and instrumentalities of commerce, let alone commercial or economic activity." The court also held that Congress does not have authority to "regulate non-commercial, intrastate activity when 'certain entities, which have availed themselves of States' incorporation laws, use the channels of commerce, and their anonymous operations substantially affect interstate and foreign commerce.'"

Regarding the government's Commerce Clause arguments, the court found that Congress could have written a law that would have survived a constitutional challenge. The court pointed to two cases cited by the government — *American Power & Light Co. v. Securities & Exchange Commission*, 329 U.S. 90 (1946), and *California Bankers Ass'n v. Shultz*, 416 U.S. 21 (1974) — that show "how easily Congress could have written the CTA to pass constitutional muster."

Nothing in either case "would bar Congress from imposing the CTA's disclosure requirements on State entities as soon as they are engaged in commerce, or from prohibiting the use of interstate commerce to launder money, 'evade taxes, hide ... illicit wealth, and defraud employees and customers,'" as the BOI reporting requirements state.

FinCEN's customer due diligence (CDD) rule from 2016 provides "nearly identical information," the court stated, "but the CDD rule does so in a constitutionally accepted manner."

On the question of Congress's taxing power, the court said the act's civil penalties are not a tax for several reasons, including that they have no income thresholds and that the amounts are fixed, not variable.

Because it found that the act is unconstitutional on the grounds that Congress lacked authority to enact it, the court declined to consider whether it violates the First, Fourth, and Fifth amendments, as the plaintiffs had argued.

An attorney for the plaintiffs, John Neiman, agreed with the court that the goals of the legislation to counter money laundering and terrorism financing are laudable. "But as the court also noted, the Constitution sets limits on what Congress can do to achieve even the most laudable of goals, and Congress violated those limits here," he said. "Congress can find a way to achieve these goals without exceeding the limits on its powers under the Constitution."

An official from Treasury, which oversees FinCEN, said the agency would comply with the injunction and referred further questions to the Justice Department, which declined comment.

AICPA response

In a statement, the AICPA said that small businesses should continue to file BOI reports. The statement also said that the AICPA continues to push for suspension of the BOI reporting rule.

— *To comment on this article or to suggest an idea for another article, contact Martha Waggoner at Martha.Waggoner@aicpa-cima.com (<mailto:Martha.Waggoner@aicpa-cima.com>).*

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