LEGAL UPDATES

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Eleventh Circuit to Review Constitutionality of Corporate Transparency Act

Services

Corporate

Corporate Transparency Act (CTA)

Professional

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The Corporate Transparency Act (CTA), a pivotal piece of legislation aimed at preventing financial crimes, is under constitutional scrutiny. We previously reported that on March 1, 2024, the U.S. District Court for the Northern District of Alabama in *NSBA v. Yellen* ruled that the CTA is unconstitutional because it cannot be justified as an exercise of Congress' enumerated powers. The U.S. Department of the Treasury (Treasury) appealed the court's ruling to the United States Court of Appeals for the Eleventh Circuit. Both Treasury and the National Small Business Associate (NSBA), the plaintiff challenging the CTA in *NSBA v. Yellen*, have now filed their appellate briefs. We summarize the central arguments from both parties below.

For more information on the CTA, please see our Guide to the Corporate Transparency Act.

Treasury's stance on the CTA

Treasury argues that the CTA falls within the broad purview of Congress's economic regulation authority under the Commerce Clause and the Necessary and Proper Clause of Article I of the Constitution. The CTA's primary objective is to combat financial crimes such as money laundering, terrorism financing, and tax fraud, which Congress has historically legislated against. These criminal activities are enabled and concealed by the use of anonymous shell entities, a challenge that states cannot effectively address due to their limited oversight capability. Treasury emphasizes that such entities have a substantial effect on interstate and international commerce, and the lack of federal beneficial ownership information collection hampers law enforcement efforts. Consequently, Treasury asserts that the CTA's reporting requirements for

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corporations and similar entities are not just permissible, but necessary to facilitate law enforcement efforts to counter these crimes.

Treasury disputes the District Court's view that the CTA regulates the mere act of incorporation or formation. To the contrary, Treasury argues it regulates a class of entities which can conduct commercial transactions in their own name, not their owners. The CTA's reporting requirements are triggered by an entity "created by the filing of a documents with a secretary of state" because such entities can enter into contracts, borrow money, incur liabilities, and transfer real or personal property, all of which can be the means by which their owners launder money or conduct other illicit transactions. This trigger itself is not a regulation of the mere act of incorporation or formation.

Treasury further argues that the CTA's focus on commercial entities is apparent given that it addresses for-profit businesses. Other types of entities, such as certain trusts, political organizations, and non-profit organizations, can incorporate but are not subject to the reporting requirements of the CTA. In other words, the CTA governs entities with both the power to conduct, and the purpose of conducting, the types of commercial transactions that concerned Congress. In particular, the reporting requirements of the CTA make it easier to follow the movement of illicit funds through entities, and therefore improve the detection and prosecution of financial crimes.

The CTA, therefore, is within Congress's authority under both the Commerce and Necessary and Proper Clauses because it is rationally related to legitimate congressional prohibitions against financial crimes.

NSBA's counterargument

At the heart of the NSBA's argument is that not only does the CTA not target commercial activity, but Treasury also cannot rely on the fact that many of the entities it regulates will reliably engage in commercial activity **in the future**.

The NSBA cites the Supreme Court's decision in *National Federation of Independent Business v. Sebelius (NFIB)*, noting the court held it has "never permitted Congress to anticipate" economic activity "in order to regulate individuals not currently engaged in commerce." Further, "[t]he commerce clause is not a general license to regulate an individual from cradle to grave, simply because he will predictably engage in particular transactions."

Further, the NSBA argues that, under state law, corporate formation is a governmental and ministerial act, not a private commercial or economic activity. Many people create shell companies for lawful noncommercial reasons, such as individuals who form LLCs to hold family homes for personal security reasons or to create non-profit associations without tax-exempt status. The CTA does not target, nor has it been tailored to target, commercial entities. On the contrary, it targets entities at

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their formation, and no further activity, not even commercial activity, is required to bring such entities under the purview of the CTA. The CTA therefore regulates non-economic, non-commercial activities that do not substantially affect interstate commerce, as the mere act of forming an entity under state law should not subject individuals to federal reporting requirements, especially without any basis for suspecting illegal activity. This, they argue, infringes on the constitutional limits of federal authority and individual privacy rights protected by the Fourth Amendment and constitutes an unauthorized search under the Fourth Amendment.

Contact us

Husch Blackwell is ready to help with all of your CTA needs, including assessing whether you are subject to the CTA or qualify for an exemption, as well as identifying your beneficial owners and preparing a report. We will continue to provide updates as the law progresses. Contact our CTA team for more information.

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