Updates

On March 1, 2024, the U.S. District Court for the Northern District of Alabama held that the CTA was unconstitutional because it exceeds Congress' enumerated powers.

Key Takeaways

- A federal district court in Alabama ruled that the Corporate Transparency Act (CTA) is unconstitutional on the basis that it regulates beyond Congress' Article I legislative powers.
- The case is now being reviewed on an expedited basis by the U.S. Court of Appeals for the Eleventh Circuit and may go on to the Supreme Court of the United States for further review as early as fall 2024.

- In the meantime, the CTA is still in effect for all parties (except the plaintiffs in the case, the National Small Business Association (NSBA), and its members as of March 1, 2024).
- If the plaintiffs' lawsuit is successful, it might be possible for Congress or the enforcing agency to apply a regulatory/legislative "fix" by limiting the CTA to entities that engage in commerce.
- It remains to be seen when and how courts will address the several other constitutional arguments raised against the statute that were not resolved by the district court, which could result in much more significant limitations to application of the CTA.

The CTA and Legal Challenges

The CTA is a sweeping new anti-money-laundering law that, as of January 1, 2024, requires most entities formed or registered to do business in the United States to disclose detailed information regarding their owners, officers, and control persons to the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN). The CTA implements the most significant revisions in more than 20 years to the United States' compliance framework for anti-money-laundering and countering the financing of terrorism (AML/CFT). The law responds to domestic and international concerns that entities in the United States are often anonymously formed and leveraged to obscure the conduct of criminal enterprises, hide the proceeds of corruption, and evade U.S. economic sanctions.

The new regime imposes a significant burden on affected U.S. entities (and their owners) given the breadth of the reporting requirements and the many ambiguities in application to complex corporate structures. It also raises concerns regarding privacy rights and the security of the vast amounts of personal information already being collected in the CTA reporting database.

In that context, it is unsurprising that the CTA has been subject to legal challenges. And one such challenge recently found success: On March 1, 2024, the U.S. District Court for the Northern District of Alabama held that the CTA was unconstitutional because it exceeds Congress' enumerated powers. As a result, the Alabama district court enjoined enforcement of the CTA as to the plaintiffs in that matter, the National Small Business Association (NSBA), and one of its individual members. Treasury subsequently issued a statement confirming that, as a result of the injunction, "the government is not currently enforcing the Corporate Transparency Act against the plaintiffs in that action," including all members of the NSBA, as of the March 1 order. The government subsequently appealed the Alabama district court's decision to the U.S. Court of Appeals for the Eleventh Circuit.

While the injunction is presently limited and the CTA remains enforceable as to all other reporting companies, this ruling creates uncertainty about the CTA's future. In this Update, we provide a practical overview of the Alabama district court's ruling along with guidance on its wider implications and what to expect next. As explained in more detail below, it seems unlikely that the current challenge, even if it succeeds, will ultimately overturn or even significantly narrow the application of the CTA. But the plaintiffs in the Alabama case raised additional constitutional challenges to the CTA that the district court did not reach. And it remains unclear when and how those challenges will be resolved.

The Alabama Court's Ruling

The NSBA and one of its members, Mr. Isaac Winkles, filed a lawsuit in the Alabama district court against the Treasury, the Secretary of the Treasury, and the Acting Director of FinCEN challenging the constitutionality of the CTA on numerous grounds. The plaintiffs claimed that the CTA's mandatory disclosure requirements exceeded Congress' authority under Article I of the Constitution and that the CTA also violated the First, Fourth, Fifth, Ninth, and Tenth Amendments.

On March 1, 2024, the court held that the CTA is unconstitutional because it is beyond Congress' enumerated powers. The court enjoined the enforcement of the CTA, although only against the plaintiffs, the NSBA, and its members. *Id.* The district court rejected each of the three grounds of constitutional authority that the government had invoked to justify the CTA: Congress' foreign affairs power, its power to regulate commerce, and its power to tax.

Foreign affairs. First, the court rejected the argument that the CTA is constitutional as an exercise of Congress' authority over foreign affairs and national security. Op. 17–25. The court acknowledged that the CTA was aimed in large measure at curbing cross-border money laundering, and it stated that Congress deserves deference for that policy objective. But the court also found that the specific activity regulated by the CTA—incorporation—"is an internal affair" that has been regulated throughout the nation's history by states rather than the federal government. The court found the CTA problematic because it would convert "an astonishing amount of traditionally local … conduct into a matter for federal enforcement," and "[it] involve[s] a substantial extension of federal police resources."

Commerce Clause. The court next rejected the government's attempts to justify the CTA under the Supreme Court's Commerce Clause, finding that the CTA is neither a permissible regulation of the channels and instrumentalities of commerce nor a permissible regulation of transactions that have a substantial effect on interstate and foreign commerce. Op. 25–49.

The district court reasoned that the CTA is too broad to be a permissible regulation of the channels and instrumentalities of commerce because it applies to ***all*** entities formed by state filings, and the Commerce Clause does not allow Congress to "regulate an entire class just because *some* members of the class use the channels and instrumentalities of commerce." Op. 32 (emphasis in original); *see* Op. 25–33. The government had argued that reporting entities frequently use the channels of commerce, and therefore, Congress could impose conditions on that use. But the district court observed that "the word 'commerce' or references to any channel or instrumentality of commerce are nowhere to be found in the CTA" so that the CTA regulates entities irrespective of their commercial or economic activity (or lack thereof). The Alabama district court suggested that "Congress could have written the CTA to pass constitutional muster" if it had simply "impos[ed] the CTA's disclosure requirements on State entities as soon as they engaged in commerce …."

The district court then addressed the substantial effects doctrine: Congress' broad power to regulate noneconomic activities that have a substantial effect on interstate commerce, including activities that do so only when aggregated with similar activities of others. Op. 33–43. But the court again found it problematic that the CTA does not "regulate economic or commercial activity on its face," observing that the Supreme Court's Commerce Clause cases have all involved at least some form of pre-existing economic activity and reasoning that incorporation itself is "in no sense an economic activity." The district court was also troubled by the lack of historical precedent for the CTA, finding it unlike any other existing state or federal law. And the court reasoned that, although the CTA was motivated by genuine concerns about criminal activity, the connection between incorporation and criminal activity "is too attenuated." In reaching that last holding, the district court invoked *United States v. Morrison*, 529 U.S. 598, 613 (2000), in which the Supreme Court addressed the constitutionality of a law addressing gender-based violence and held that "[g]ender-motivated crimes of violence are not, in any sense of the phrase, economic activity." The Alabama district court concluded that "[h]ere, as in *Morrison*, 'the but-for causal chain from' incorporation to … 'interstate commerce' is too attenuated to be justified under the Commerce Clause."

The district court also rejected the government's attempt to rely on the Necessary and Proper Clause, finding that the CTA's requirements are "far from essential" and that, in any event, the CTA has an improper reach by not limiting its regulations to companies engaged in commerce.

Taxing power and Necessary and Proper Clause. Last, the court rejected the government's argument that the CTA's regulations were constitutionally incidental to Congress's taxing power given that the requirement to provide beneficial ownership information to the government could help ensure that taxable income is appropriately reported. Op. at 50–51. The court essentially found an insufficient fit between the disclosures required to be made to FinCEN and tax enforcement, reasoning that the Necessary and Proper Clause does not "sanction any that law that provided for the collection of information useful for tax administration and [merely] provided tax officials with access."

As the Alabama district court acknowledged in its decision, Congress' powers under the Commerce Clause are generally read quite broadly, as is Congress' authority over foreign affairs and taxation. The district court's opinion took a relatively limited view of Congress' powers, especially given the congressional findings about the need for the CTA to prevent federal crimes and the fact that virtually all entities that incorporate do engage in some form of commerce. If the Supreme Court adopted the Alabama district court's analysis, it could have significant implications for other federal regulatory laws. That said, the CTA is undoubtedly an aggressive federal regulatory scheme with vast implications for U.S. entities and individuals who own and administer those entities. Time will tell whether the appellate courts agree that the extremely broad reach of the CTA creates a constitutional problem.

Current State of Play

On March 4, 2024, the government issued a statement confirming its view that the injunction against the application of the CTA applies only to the plaintiffs in the Alabama district court case. As such, the government will not currently enforce the CTA against "Isaac Winkles, reporting companies for which Isaac Winkles is the beneficial owner or applicant, the [NSBA], and members of the [NSBA] (*as of March 1, 2024*)."

Notably, the government's position is that the injunction applies to NSBA members ***and reporting companies for which they are the beneficial owners or company applicants***. It remains unclear whether the government would take the position that a reporting company of which an NSBA member was one of several beneficial owners or company applicants would be required to report. It seems likely that such a reporting company would be required to report, but it is also clear that the CTA could not be enforced individually against the NSBA-member beneficial owner or company applicant if they refused to provide the beneficial ownership information required for such reporting.

Moreover, this logic would seem to extend to other individuals who may be in the crosshairs of enforcement for failures to file CTA reports, such as senior officers, corporate service providers, and lawyers. To the extent that any such individual or entity was an NSBA member as of March 1, 2024, it appears that they would not currently be subject to potential liability for failure to provide information or file a CTA report on behalf of an entity under their administration.

What To Expect Next

Appeal. On March 11, 2024, the government noticed its appeal to the Eleventh Circuit. The average time from filing the notice of appeal to decision in the Eleventh Circuit is about one year. But on March 21, 2024, the government and plaintiffs filed a joint motion for the Eleventh Circuit to expedite consideration of the appeal, and the Eleventh Circuit set a briefing schedule that could lead to oral arguments as early as June. The government's opening appeal brief is due on April 22.

If the Eleventh Circuit affirms the Alabama district court's ruling that the statute is unconstitutional, then this case is very likely headed to the Supreme Court. The Solicitor General's practice is to defend an act of Congress

so long as there is any reasonable argument to be made for it, and the Supreme Court will almost always grant a petition for a writ of certiorari to review a federal court decision holding a federal statute unconstitutional. But even with expedited consideration by the Eleventh Circuit, the Supreme Court would not take up the case until its October 2024 Term at the earliest—and it is even possible the case could slip into the October 2025 Term, depending on how long it takes the Eleventh Circuit to rule.

As noted above, the Alabama district court's opinion reflects a relatively aggressive view of the limitations on congressional power. But multiple justices on the current Supreme Court have at times indicated their openness to revisiting the current doctrine on the scope of federal power. It is thus exceedingly difficult to predict how either the Eleventh Circuit or the Supreme Court would react to the Alabama district court's constitutional analysis.

If the Alabama district court's analysis does not persuade the court of appeals, it might consider the other constitutional challenges raised by the plaintiffs, which the Alabama district court declined to address, as alternative grounds for affirmance. But the most likely course would be for the court of appeals to simply consider the various constitutional arguments the district court ruled on and, if the appellate court disagrees, to remand to the district court for further proceedings. The district court could then take up the plaintiffs' other constitutional objections to the CTA at that point.

Tag-on challenges. Because the Alabama district court enjoined enforcement of the CTA only as to the plaintiffs in this case, we anticipate that other plaintiffs may file similar suits in an attempt to more readily benefit from the Alabama district court's decision. In fact, at least three other challenges have already been filed—in the U.S. District Court for the Northern District of Ohio, the U.S. District Court for the Western District of Michigan, and the U.S. District Court for the District of Maine. While the Alabama decision will not have a precedential effect in those matters, it could be persuasive to other courts where challenges are raised and result in swift decisions by courts amenable to the Alabama district court's constitutional analysis.

Interim stay of injunction. The government may seek to stay the district court's injunction pending appeal, though it has not yet done so. Given the limited application of the injunction, the government might not seek such a stay. But even if the government declines to request a stay at this stage, it might pursue one later if other courts follow the Alabama court's lead and issue broader injunctions that would have a more material impact on the administration of the CTA.

Even if the plaintiffs win, the CTA may largely survive. The Alabama district court suggested that the CTA's Commerce Clause problem could be cured if a filing requirement were triggered by "engaging in commerce" rather than the mere formation of an entity under state law. That observation provides a clear path for the government, either if it were to lose on appeal or perhaps even during a pending appeal, to amend the CTA's implementing regulations to apply more narrowly only to covered entities engaged in some form of commerce. And, of course, Congress could also amend the CTA if necessary to add that limitation.

The Treasury Department has the authority under the CTA to exempt "any entity or class of entities" that by regulation it determines should be exempted from the requirements of the CTA "because requiring beneficial ownership information from the entity or class of entities would not serve the public interest; and would not be highly useful in national security, intelligence, and law enforcement agency efforts to detect, prevent, or prosecute money laundering, the financing of terrorism, proliferation finance, serious tax fraud, or other crimes." 31 U.S.C. § 5336(a)(11)(B)(xxiv). That provision suggests that Treasury may already possess the power—even without legislative action—to amend the CTA's regulatory reach to exclude entities "not engaging in commerce." A revision to the regulations along those lines could arguably moot the Alabama district court challenge or lessen the impact of the court's constitutional holding.

Under current Supreme Court jurisprudence, the concept of "engaging in commerce" is typically construed very broadly. Courts would likely hold that simple corporate activity as basic as opening a bank account or purchasing an asset would be "commerce" that could trigger a filing requirement consistent with the Constitution. Thus, were the CTA regulations amended to "fix" the Commerce Clause deficiency, the CTA would likely remain broadly applicable with relief afforded only to those entities not engaged in any transactions, such as dormant or shelf entities. This "fix" would also almost certainly result in yet another broad ambiguity in applying the CTA—and further litigation.

***

The upshot is that we should expect a long slog through the appellate court system with no fulsome resolution of the constitutional challenges raised—and likely no broad relief from the CTA's requirements—for quite some time. And no matter the outcome of this particular challenge to Congress's authority to enact the CTA, it remains to be seen how courts will address the several other unresolved constitutional arguments raised against the statute.

Authors

Michael R. Huston

Partner
MHuston@perkinscoie.com 202.434.1630

Jamie A. Schafer

Partner
JSchafer@perkinscoie.com 202.661.5863

Adrianna Simonelli

Associate
ASimonelli@perkinscoie.com

Explore more in

International Law Corporate Governance White Collar & Investigations Emerging Companies & Venture Capital Law Appeals, Issues & Strategy International Trade Real Estate & Land Use Private Client Services Public Companies Ethics & Compliance

Related insights

Update

October Tip of the Month: U.S. Department of Labor Issues Guidance on AI in the Workplace

Update

Novel Decision Striking Down False Claims Act's Qui Tam Statute Tees Up Further Litigation Over Whistleblower Lawsuits