

PUBLICATION

Alabama Federal Court Finds Corporate Transparency Act Unconstitutional

Authors: Perry F. Sofferman

March 05, 2024

The United States District Court for the Northern District of Alabama (Northeastern Division) held the Corporate Transparency Act (herein the CTA) to be unconstitutional. This decision, which came out on March 1, 2024, is limited to the plaintiffs in the matter as the Court's order states, "The Defendants, along with any other agency or employee acting on behalf of the United States, are **PERMANENTLY ENJOINED** from enforcing the Corporate Transparency Act *against the Plaintiffs.*" (Italics added for emphasis.) For that reason, it appears all other parties subject to the CTA should continue taking all necessary steps to comply with its terms without interruption. As the Court noted in its 53-page opinion, "The ultimate result of this statutory scheme is that tens of millions of Americans must either disclose their personal information to FinCEN through state registered entities, or risk years of prison time and thousands of dollars in civil and criminal fines." Until advised otherwise by your legal advisor or the ruling's scope is clarified, parties subject to the CTA should continue to comply.

Following is a brief summary of the Court's opinion, which was written by United States District Judge, Liles C. Burke. Highlighted below are several key sections of the decision, but the decision should be read in its entirety for a thorough understanding of the arguments posed by the parties and the Court's analysis.

Judge Burke writes, "This case presents a deceptively simple question: Does the Constitution give Congress the power to regulate those millions of entities and their stakeholders the moment they obtain a formal corporate status from a state?" Noting the Government's position that the "CTA is within Congress's broad powers to regulate commerce, oversee foreign affairs and national security, and impose taxes and related regulations," the Court was unpersuaded writing, "The Government's arguments are not supported by precedent. Because the 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's policy goals, the Plaintiffs are entitled to judgment as a matter of law."

The case, *National Small Business United, d/b/a the National Small Business Association, et al. v. Janet Yellen, in her official capacity as Secretary of the Treasury, et al*, was brought by the National Small Business Association (NSBA) and one of its members, Isaac Winkles (Winkles). The Plaintiffs argued that the CTA's mandatory disclosure requirements exceeded Congress's authority under Article I of the Constitution and violated the First, Fourth, Fifth, Ninth, and Tenth Amendments. The parties cross-moved for summary judgment in early 2023. Oral arguments were held in November of 2023.

Standing

The Court found that:

- Winkles had standing to challenge the CTA's beneficial owner provisions because "the compelled disclosure of Winkles' sensitive personal information to FinCEN is a concrete, imminent injury that is traceable to the government, and redressable by a favorable decision."
- Winkles had standing in his capacity as a company applicant as Winkles submitted sworn testimony that he "formed [other Alabama entities] in the past," and "anticipate[s] forming other Alabama entities

over the next few years." "Winkles has standing to challenge the CTA's applicant provisions because they present Winkles with a choice between compliance and felony prosecution."

- The court goes on to state that Winkles' "standing to challenge the CTA's applicant and beneficial owner provisions on First, Fourth, and Fifth Amendment Grounds gives him standing to challenge the CTA as congressional overreach.
- The court found the NSBA to have "associational standing." Citing *Georgia Republican Party v. Sec. & Exch. Comm'n*, 888 F. 3d 1198, 1203 (11th Cir. 2018), the court writes, "An association has standing to bring suit on behalf of its members when its members would otherwise have standing to sue in their own right."

CTA's Constitutionality

The Government argued that Congress has authority to enact the CTA under: (i) its foreign affairs powers, (ii) its Commerce Clause authority, and (iii) its necessary and proper exercise of taxing power, since one purpose of the FinCEN database created by the CTA is to assist in efficient tax administration. The Court rejected all these arguments.

i. Foreign Affairs and National Security

The Court asks whether "Congress's Foreign Affairs powers justify the CTA's regulation of 'creatures of state law,' which are ordinarily within the sovereign purview of the States." Succinctly, the Court answers this with "no." The Court relied heavily on *Bond v. United States*, 572 U.S. 844 (2014) in which the U.S. Supreme Court ruled that the Chemical Weapons Act did not reach "purely local crimes." The Court uses this as its basis to assert that "... like local criminal law, corporate formation has always been the province of the States. So although the CTA does not directly interfere with or commandeer State incorporation practices, the CTA still convert[s] an astonishing amount of traditionally local...conduct into a matter for federal enforcement, and involve[s] a substantial extension of federal police resources," citing to *Bond*. The Court also rejects the view that the CTA is in keeping with Congress's ability to legislate that which is "necessary and proper" to exercise other powers, such as bringing "the United States into compliance with international anti-money laundering and countering the financing of terrorism standards." The Court posits that the "necessary and proper" clause gives Congress the ability to legislate those powers incidental to others that are specifically enumerated. "It would sanction almost any exercise of Congressional power given the existence of a relevant international standard. Read that way, the Necessary and Proper clause would give Congress carte blanche to do as it pleases...."

ii. Commerce Clause

The Court recognizes that the U.S. Supreme Court has identified "three broad categories of activity that Congress may regulate under its commerce power," and that in the "Government's view, the CTA's regulations fit squarely within all three categories: (1) the 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."

With respect to the "channels" and "instrumentalities" argument, the Court writes, "The plain text of the CTA does not regulate the channels and instrumentalities of commerce, let alone commercial or economic activity. The CTA applies to "reporting companies," defined (with a list of exceptions) as entities "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 formed under the law of a foreign country and registered to do business in the United States by the filing of a document with a secretary of state or a similar office under the laws of a State or Indian Tribe." 31 U.S.C. § 5336(a)(11). The CTA then mandates that those entities report information about their beneficial owners and

applicants to FinCEN. *Id.* § 5336(b)(1)-(2)(A). The word "commerce," or references to any channel or instrumentality of commerce, are nowhere to be found in the CTA. See 31 U.S.C. § 5336." The Court goes on to redirect the relevance of cases put forth in the Government's argument, namely *California Bankers Ass'n v. Schultz* and *American Power & Light Co. v. Sec. & Exch. Comm'n*, with the Court saying that the Government had read those cases "too broadly." Using those cases to turn the table, the Court states, "These cases also illustrate how easily Congress could have written the CTA to pass constitutional muster. For instance, nothing in *Schultz* or *American Power & Light Co.* would bar Congress from imposing the CTA's disclosure requirements on State entities as soon as they engaged in commerce...".

The Court describes the "substantial effect" category as allowing "Congress to regulate purely intrastate, non-economic activity that: (1) has a substantial effect on interstate commerce in the aggregate, when (2) the regulation is in the service of a comprehensive statute that regulates commercial activity on its face, and (3) regulation of the non-economic, non-commercial activity is necessary to make the broader regulation effective." The Court continues, "Yet this argument can't be reconciled with the plain text of the CTA." "First, the *future* activities of state entities are not enough to invoke Congress's 'substantial effects' commerce powers. Even a near certainty of future conduct is insufficient –[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." *NFIB*, 567 U.S. at 557. Congress may "anticipate the effects on commerce of an economic activity," but it has never been "permitted . . . to anticipate that activity itself in order to regulate individuals not currently engaged in commerce." *NFIB*, 567 U.S. at 549. The Supreme Court's Commerce Clause jurisprudence has always "involved preexisting economic activity."

Rejecting the idea of entity formation as being a "commercial activity that substantially affects interstate commerce," the Court asks, "Does Congress have authority under the Commerce Clause 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?" The Court again answers in the negative. The Court later goes on to write, "...the connection between incorporation and criminal activity is far too attenuated to justify the CTA.

iii. Taxing Power & Necessary and Proper

The Court proceeds to consider the government's argument that the CTA is justified by Congress's taxing power and the Necessary and Proper Clause. The Court concludes that "The chain here is weak indeed." It would be a "substantial expansion of federal authority to permit Congress to bring its taxing power to bear just by collecting 'useful' data and allowing tax-enforcement officials access to that data. Read that way, the Necessary and Proper Clause would sanction any law that provided for the collection of information useful for tax administration and provided tax officials with access. All Congress would have to do to craft a constitutional law is simply impose a disclosure requirement and give tax officials access to the information." Consequently, the Court rejected the Government's Necessary and Proper argument.

Jurisdictional Hook

The Court then concludes its analysis by writing that the CTA "is missing a crucial component of valid substantial effects legislation: it has no express jurisdictional element which might limit its reach to a discrete set of [activities] that additionally have an explicit connection with or effect on interstate commerce" citing to *United States v. Lopez*, 514 U.S. 549, 558 (1995). The Court continues, "The conclusion of a jurisdictional hook is standard operating procedure for Commerce Clause legislation for good reason – it 'precludes any serious challenge to the constitutionality of [a] statute as beyond the Commerce power, because it guarantees a legitimate nexus with interstate commerce' citing to Goodwin, 141 F. 3d at 400 quoting Lopez. The Court gives examples of "jurisdictional hooks" such as "affecting commerce" and "engaged in commerce." The Court

finds the lack of these expressed references to "commerce" to be indicative of the CTA's substantive shortcomings.

At this point, an appeal to the Eleventh Circuit appears likely while practitioners and their clients continue to work their way through the CTA's requirements.

See FinCEN's recent statement on the decision [here](#). For more information contact [Perry F. Sofferman](#), or your Baker Donelson [Business and Corporate](#) attorney. You may also visit Baker Donelson's [Corporate Transparency Act page](#) for more guidance on the CTA.