The Corporate Transparency Act: Where It Stands and What May Come Next

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By Fay L. Szakal

The question on every business owner's mind for the past two and a half months has been, what in the world is going on with the Corporate Transparency Act? For a period of time in December, the Corporate Transparency Act, or CTA, was all over the news reports, bouncing back and forth, up and down, between enforceability and unenforceability seemingly every day. From one minute to the next, the CTA was enjoined, or the injunction lifted, or enjoined again. And then suddenly the injunction was being vetted before the Supreme Court of the United States.

In that moment, we corporate lawyers breathed a sigh of relief – finally the see-saw would settle. SCOTUS would make a clear decision regarding the injunction, allowing time for the constitutionality of the CTA to make its way fully through the federal court system. But alas! We lawyers were fooled, for reasons to be explained.

By way of background, the CTA was originally passed on January 1, 2021, as part of the National Defense Authorization Act of 2021, which included the Anti-Money Laundering Act of 2020, in which the CTA appeared. While it had split support in the House of Representatives, the Senate vote was 82 in favor and 14 opposed, demonstrating the law's widespread bipartisan support. The Department of Treasury, and its Financial Crimes Enforcement Network ("FinCEN"), was tasked with developing regulations to implement the CTA, i.e., the "Reporting Rules," which would officially go into effect on January 1, 2024.

The CTA is intended to combat financial crimes committed through the use of shell companies, such as money laundering and wire fraud. To achieve this goal, the CTA imposes certain registration requirements on any domestic or foreign entity formed by the filing of a document with any jurisdiction's Secretary of State (a "reporting entity"). This includes companies, corporations, and limited partnerships, amongst other forms – totaling an estimated 40,000,000 reporting entities across the country. In the absence of qualifying for one of the twenty-three (23) exemptions under the Reporting Rules, each reporting entity is required to report its "beneficial owners" and its "company applicant" in a federal database and to update that database each time its beneficial owners change.

The CTA quietly entered the public eye in January 2024, with its most acknowledgment coming from pop-up, third-party industry determined to capitalize on this otherwise free, new federal filing. Marketing was rife with entities charging $150 to $450 for facilitating the compliance of a single reporting entity. For frightened business owners alarmed by exorbitant fines and possible imprisonment, these relatively nominal fees were a small price to pay for painless compliance. To a lesser extent, state filing offices were also including on their business formation web portals information about the CTA reporting requirement, and slowly states were notifying entities pre-existing 2024 of their CTA reporting obligations as well. For just a few months, it seemed that the only parties truly concerned about CTA were lawyers and accountants, but that quickly turned tide in March 2024.

The first lawsuit, National Small Business United, et al. v. U.S. Department of the Treasury et al. was filed in the U.S. District Court for the Northern District of Alabama, which granted summary judgment in favor of the plaintiffs on March 1, 2024, stating that the CTA was not constitutional. On March 11, 2024, the DOJ appealed to the U.S. Court of Appeals for the Eleventh Circuit, where the lawsuit remains awaiting resolution. Other suits quickly followed around the country alleging violations of plaintiff's privacy rights as well as federal infringement on states' rights over corporate formation. Although there is some variance, the common arguments made across all of the lawsuits are these:

- The CTA exceeds congressional power to regulate interstate commerce because it also regulates purely domestic corporations that do not engage in interstate commerce, which domestic corporations fall under the domain of the individual state.
- The CTA interferes with **the authority of states** to regulate corporate formation.

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- The CTA **violates personal privacy** by requiring beneficial owners and company applicants to disclose personal information, which could lead to identity theft, other privacy breaches, and legal issues for high-profile persons engaged in sensitive businesses.
- Compliance with the CTA is **unnecessarily burdensome** for small businesses.
- The CTA **infringes on First Amendment rights to free association** because some people will be less inclined to engage in business due to the reporting requirement for beneficial owners.
- The CTA is **not authorized under the Necessary and Proper Clause** because it is not related to foreign affairs nor is it reasonably related to ensuring compliance with federal tax laws.

In response, the Department of Justice argues that the CTA is, in fact, a proper exercise of congressional authority. The DOJ argues:

- The CTA **is authorized by the Commerce Clause** because Congress may regulate any activity that substantially affects interstate commerce, including activities that are purely local but related to a class of activities that may impact interstate commerce, i.e., local activity that threatens the national market.
- Congress is authorized, through means like the CTA, to **prohibit financial crimes and harmful economic activity**, like money laundering, human and drug trafficking, and securities fraud.
- The Necessary and Proper Clause authorizes the CTA because identification of corporate ownership **facilitates the taxing power**, as wrongdoers may obscure their financial gain from businesses to avoid taxation.
- The CTA **facilitates congressional authority and power to counter money laundering, human and drug trafficking, securities fraud** and financial fraud with foreign nations, amongst the state, and with Native American tribes.
- The **CTA is no different than any number of federal laws that require private information be disclosed** to a government entity, such as the requirement for taxpayers to file returns or employers to report employees' wages. Corporations are often subject to similar forced disclosures for Securities Exchange Commission purposes.

The Federal District Courts have varied on where they fall regarding the constitutionality of CTA, and there is no consistency or predictability based upon the prior political trends of the judges in these matters. Every decision has been, more or less, a roll of the dice.

That being said, two of the cases thus far have had a much greater impact because of perhaps some judicial activism on the part of the deciding judges. On December 3, 2024, Texas Top Shop, Inc., et al. v. Merrick Garland, Attorney General of the United States, et al., was filed in the United States District Court of the Eastern District of Texas. The six (6) plaintiffs, who ranged from a private individual to Texan domestic and foreign corporations, made the same common arguments as the other cases had alleged and requested a temporary injunction of the CTA while its constitutionality was decided by the courts. Judge Amos L. Mazzant, III, granted the temporary injunction, but took it a step further than the relief requested by the plaintiffs. Citing the Administrative Procedure Act, on December 3, 2024, Judge Mazzant issued a nationwide temporary injunction of the CTA, prohibiting enforcement by FinCEN against any reporting entity that had failed to report as of the decision date. Almost immediately thereafter, on December 5, 2024, the DOJ appealed Judge Mazzant's decision to the U.S. Court of Appeals for the Fifth Circuit, and on December 13, 2024, the DOJ filed an emergency motion with the Fifth Circuit to stay, or put aside, the injunction while its appeal was to be considered.

In response to the emergency motion, the Fifth Circuit accelerated the briefing schedule on the motion to stay the injunction, and by December 23, 2024, the Fifth Circuit granted the DOJ's motion. For almost three (3) days, the CTA was back! But that rather quickly ended on December 26, 2024, when another Fifth Circuit panel overruled the first Fifth Circuit panel and vacated its own stay of the injunction. After this intense judicial ping pong, the DOJ filed an emergency appeal to SCOTUS to stay Judge Mazzant's nationwide injunction on December 31, 2024.

Meanwhile, as Texas Top Shop was flying up the proverbial judicial flagpole and making national news, another Eastern District of Texas case was sneaking under the radar. In a matter entitled Smith v. U.S. Dept. of Treasury, Judge Jeremy D. Kernodle also issued a nationwide temporary injunction to stay enforcement of the CTA and its attendant Reporting Rules for largely the same reasons as were cited in Texas Top Shop. However, Judge Kernodle's injunction, dated January 7, 2025, went unaddressed by the DOJ – and virtually unnoticed by everyone else - for several weeks.

In fact, SCOTUS returned its decision on the DOJ's request to stay the nationwide temporary injunction in Texas Top Shop before the DOJ responded to the Smith

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decision. Such that, when SCOTUS stayed the injunction on January 23, 2025 – thereby invalidating it and restoring CTA to its enforceability (at least theoretically) – the Smith nationwide temporary injunction continued to render the CTA unenforceable despite SCOTUS' decision. The highest court in the land could not overrule the decision in a case that was not brought before it, nor had the highest court made any legal determination regarding the propriety of nationwide injunctions generally.

Thus, despite a SCOTUS decision declaring that the injunction of the CTA in Texas Top Shop is vacated, the CTA remained enjoined on a national level pursuant to Smith. Almost a month after the fact, the DOJ finally filed its appeal of the Smith decision to the Fifth Circuit in the early days of February and officially moved before Judge Kernodle to stay his nationwide temporary injunction on February 2, 2025. After a very short deliberation, Judge Kernodle reversed his own nationwide injunction, specifically citing the precedence of SCOTUS.

As of now, on the judicial spectrum, there are two things every business owner of a reporting entity should know: (1) All filing entities must now report to FinCEN by March 21, 2025, only days before argument in the Fifth Circuit. (2) The constitutionality of the CTA is awaiting judicial determination in both the U.S. Court of Appeals for the Eleventh Circuit and the Fifth Circuit, with the Fifth Circuit hearing oral arguments on March 25, 2025. It is anticipated that whichever side loses their argument will further appeal the issue to SCOTUS. In the meantime, compliance is no longer voluntary. If you have questions regarding reporting, contact your attorney.

Of course, ultimately the CTA is a federal law, and so politically speaking, our representatives can address the looming issues presented by the CTA. And politicians have responded to the unrest, but in a surprising manner. On February 10, 2025, by a unanimous vote (407 in favor, none opposed) the House of Representatives passed the Protect Small Business from Excessive Paperwork Act of 2025, also known as the Nunn Bill, addressing one provision of the Reporting Rules. The Nunn Bill only extends the CTA reporting deadline for entities that pre-existed January 1, 2024, making their new deadline to report January 1, 2026. Note that the Nunn Bill has no companion bill in the Senate, although it is anticipated that one will be filed. If passed by both the House and Senate, and signed by the President, at least entities pre-existing 2024 will have some reprieve while the ultimate decision on CTA constitutionality is deliberated. Nonetheless, any entity that was formed in or after 2024, is still subject to the reporting deadlines contained in the Reporting Rules (if the injunction is stayed), i.e., ninety (90) days post-formation for 2024 entities, and thirty (30) days post-formation for 2025 entities and beyond. As noted, all reporting entities that are not subject to the 30-day post-formation reporting, must report by March 21, 2025 (unless some other exception or extension applies). Oddly, FinCEN has announced it will not levy any monetary penalties for failure to reportor update BOI until it issues a new "interim final rule" later in March. FinCEN also vows to invite public comment for entire revisions to the CTA reporting rules, which may expand exemptions or reduce penalties. This waiver of fines and penalties is certainly a sign that CTA gusto is waning.

Arguably, the CTA is one of the most fascinating pieces of legislation in the past fifty years, certainly in this author's lifetime. This divisive exercise of congressional power begs the questions, *how much discretion do we allow our government when it comes to protecting us? Is our privacy the line in the sand that cannot be erased or crossed, no matter the potential cost?* In these coming months, we will certainly find out what exactly "necessary and proper" means, how far the constitutional authority extends under current jurisprudence, where – in this virtual economy – the line between interstate commerce and intrastate commerce is drawn, and whether corporate privacy outweighs the crime-fighting advantages of transparency.

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Moreover, documentation of the process undertaken with respect to the above review should also be maintained, particularly in the event of an IRS or state employment tax audit examination. Assistance from your external tax adviser is also recommended.

Please contact a member of Withum's Healthcare Services Group with any questions.

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