WHEN TRANSPARENCY BECOMES OPAQUE: DISTRICT COURT FINDS CORPORATE TRANSPARENCY ACT UNCONSTITUTIONAL

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US Corporate Alert

By: Gary J. Kocher, Eric N. Feldman

EXECUTIVE SUMMARY

On 1 March 2024, the US District Court for the Northern District of Alabama issued an opinion holding the Corporate Transparency Act (CTA) unconstitutional.[1] Specifically, the court found that the CTA exceeds the Constitution's limits on the legislative branch and lacks a sufficient nexus to any enumerated Congressional power to be a necessary and proper means of achieving the worthy policy goals behind the CTA.

The CTA is part of the Anti-Money Laundering Act of 2020 and was adopted with the stated purpose to combat money laundering and the engagement of other illicit activities through anonymously owned entities in the United States. The CTA became effective 1 January 2024, and it applies both to newly formed and already existing US entities and to foreign entities doing business in the United States. It has significant implications for most domestic and foreign businesses that fall within the definition of a Reporting Company under the CTA. Please find additional information that we have published on the requirements of the CTA here.

The CTA requires all Reporting Companies to begin providing to the Financial Crimes Enforcement Network (FinCEN), a bureau of the US Department of the Treasury information about their Beneficial Owners and, for Reporting Companies formed on or after 1 January 2024, information about their Company Applicants (as such terms are defined in the CTA).

SUMMARY OF RULING

The court recognized that Congress had a legitimate aim to prevent financial crimes like money laundering and tax evasion, which are sometimes committed through shell companies. However, the court recognized that the breadth of the CTA would apply to millions of entities that can and do serve any lawful purpose. The government argued, unpersuasively, that the CTA is within Congress' broad powers to regulate commerce, oversee foreign affairs and national security, and impose taxes and related regulations.

In granting summary judgment to the plaintiffs, the court decided that 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' legitimate policy goals. It therefore found that the CTA was unconstitutional and could not be enforced against the plaintiffs in the case, Isaac Winkles and the National Small Business Association.

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WHAT LIES AHEAD

It is anticipated that the government will appeal this decision There are also pending cases in other states questioning the validity of the CTA. It seems possible, if not likely, that it will take some time for the courts to sort through the issues and, in the event of disagreements among the Federal Circuit Courts, the issue may ultimately be decided by the US Supreme Court.

It is also possible that Congress could enact changes to the CTA that would provide clearer nexus to the enumerated authority of Congress. In its decision in the Alabama case, the court seemed to offer some thoughts on how the CTA could be made to align with Congress' authority to regulate interstate commerce and other enumerated authorities, but it noted that any such nexus was lacking in the CTA as presently constituted.

What does this mean for the myriad of Reporting Companies, including numerous small businesses and their owners and controllers who believed that they must report the required information to FinCEN? That is a good question. The Alabama decision itself is fairly narrow in its application and, for its part, FinCEN has issued a release stating that for as long as the Alabama Court's order remains in effect, the government will not be enforcing the CTA against Isaac Winkles, Reporting Companies for which Isaac Winkles is the Beneficial Owner or Company Applicant, the National Small Business Association or members of the National Small Business Association (as of March 1, 2024). Accordingly, if you fall into one of those categories you may have at least a temporary reprieve of your obligations under the CTA.

For all other Reporting Companies, however, the answer is not as simple or straight-forward. The easy answer as it applies to Reporting Companies that were formed prior to 2024 (and that are therefore not required to report their information to FinCEN until the end of 2024) is that you may want to wait for a period of time to allow the courts to wrestle with the constitutionality of the CTA. For Reporting Companies formed in 2024 (which must comply with the CTA within 90 days from the date of formation), we would recommend continued compliance with the CTA until there is a definitive resolution.

We will continue to monitor the developments in this case and others as they work their way through the court system.

FOOTNOTES

[1] *Nat'l Small Bus. United v. Janet Yellen*, Case No. 5:22-cv-1448-LCB

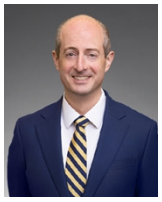
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KEY CONTACTS



GARY J. KOCHER
PARTNER

SEATTLE
+1.206.370.7809
GARY.KOCHER@KLGATES.COM



JOHN M. HAGAN
PARTNER

PITTSBURGH
+1.412.355.6770
JOHN.HAGAN@KLGATES.COM



DEVAN R. PATRICK
PARTNER

CHARLOTTE, DALLAS
+1.704.331.7448
DEVAN.PATRICK@KLGATES.COM



ERIC N. FELDMAN
PARTNER

WILMINGTON
+1.302.416.7077
ERIC.FELDMAN@KLGATES.COM



W. H. SNYDER
PARTNER

PITTSBURGH
+1.412.355.6720
HENRY.SNYDER@KLGATES.COM

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