Hitting 'Pause' on the Corporate Transparency Act: Part I

By **Anthony Michael Sabino**

The Corporate Transparency Act (the CTA) requires business entities newly created pursuant to state law to fully and publicly identify their beneficial owners. This recent federal enactment (and the even more recent Department of Treasury regulations promulgated thereunder) is intended to thwart criminals, terrorists, and other evildoers who might cloak their nefarious schemes behind the mundane facades of seemingly legitimate corporations, limited partnerships, and LLCs.

Notwithstanding its lofty objective, the statutory regime has been severely questioned by those who claim that it ranges far beyond Congress's authority to legislate. *See U.S. Const., art. I, § 8.*

Recently, a federal district court agreed with that allegation, and accordingly declared the CTA unconstitutional on a number of distinct grounds. In that case, *National Small Business United v. Yellen*, ___ F.Supp.3d ____ (No. 22-cv-01448) (N.D. Ala. March 1, 2024) (*NSBU*).

District Judge Liles C. Burke of the Northern District of Alabama set forth a highly detailed analysis, and subsequent rejection, of no less than three arguments propounded by the government in support of the CTA's constitutionality.

To be certain, *NSBU* represents the legal findings of but one federal jurist out of over four hundred. Nonetheless, the trial court's comprehensive holding could very well mean the demise of the CTA, at least in its present form. Given that the statute has been a lightning rod for debate over its scope and applicability, this fresh opinion invalidating the law on fundamental constitutional grounds is worthy of our attention.

For these reasons, this first installment of our two-part article shall summarize the essentials of this complex regulatory scheme, and thereafter analyze the district court's holdings that, one, Congress's power to conduct foreign policy is incapable of sustaining the CTA, and, two, the law does not represent a legitimate exercise of Congress's power to levy taxes.

In Part II of this writing, we shall posit what we respectfully contend is the trial judge's more potent ruling, to wit, that the lawmakers irredeemably exceeded their authority to regulate interstate commerce when they enacted this statutory regime. For our conclusion, we shall offer some prognostications as to CTA's future, if indeed it has one.

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The CTA's Broad Sweep

The Corporate Transparency Act embodies a renewed congressional resolve to deter and detect financial crimes, such as money laundering and tax evasion. The enactment recognizes that sophisticated wrongdoers will ofttimes attempt to conceal their odious manipulations behind a barrier of "shell corporations," *i.e.*, facially legitimate enterprises that, in reality, lack significant assets, employees or operations.

The statute seeks to bolster law enforcement's efforts to unravel these corporate matryoshka dolls by mandating that "reporting companies," in sum, a broad swath of organizations created pursuant to state law, make fulsome disclosure of their beneficial owners. *See 31 U.S.C. § 5336.*

As Judge Burke archly observed, the CTA comprised but a tiny fraction of the gargantuan 2021 National Defense Authorization Act, yet it "packs a significant regulatory punch, requiring most entities incorporated under State law to disclose personal stakeholder information to the Treasury Department's criminal enforcement arm," including innumerable entities that serve a wide variety of lawful purposes, such as not-for-profits, holding companies, political organizations, "and everything in between." This was the law and the regulations promulgated thereunder now being challenged in the federal trial court as violative of the limits on Congress's legislative authority.

The CTA and Congress's Foreign Policy Power

If nothing else, *NSBU* posits an unforgettable opening statement. Commencing with a reference to the late Justice Scalia's wry observation that "federal judges should have a rubber stamp that says STUPID BUT CONSTITUTIONAL," the district bench then sets in exquisite counterpoise the complementary maxims that while the Constitution "does not allow judges to strike down a law merely because it is burdensome, foolish, or offensive....the inverse is also true—the wisdom of a policy is no guarantee of its constitutionality" (citation omitted).

Judge Burke then sets forth the reality underlying the matter at hand: even when pursuing the most "sensible and praiseworthy" of ends, it cannot be denied that "Congress sometimes enacts smart laws that violate the Constitution." Forewarning its ultimate holding, *NSBU* immediately announces that the case at bar is an apt illustration of the last mentioned.

In defense of the CTA, the government's first averment was that the new law was a necessary and proper exercise of Congress's plenary power to conduct » Page 6

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foreign policy. By making public the true beneficial ownership of a variety of newly formed commercial enterprises, the statute aims to deter and expose money laundering and "malign foreign influences."

NSBU readily agreed that such a worthy objective falls within the purview of the Executive and Legislative Branches, as the political departments directly responsible to the People. In sharp contradistinction, the Judicial Branch lacks both the aptitude and the responsibility for foreign affairs, and therefore the district court conceded that deference to the People's elected representatives in such matters is the more prudent course.

"All the same," the federal judiciary must never abdicate its responsibility to uphold the Constitution's carefully crafted restraints upon the lawmaking authority. Notwithstanding proper respect for a coordinate branch of government, the bench is obligated to strike down any legislation which transgresses those limits. Accordingly, the district court pronounced that its northern star would be the first principle that the enumeration of certain legislative powers concomitantly denies others to Congress. *See National Federation of Independent Business v. Sebelius*, 567 U.S. 519 (2012).

Accompanying a pungent reminder that virtually all business entities are creatures of state law, *see Cort v. Ash*, 422 U.S. 66 (1975), and that their formation is a matter generally reserved to the several States, *see CTS Corp. v. Dynamics Corp. of America*, 481 U.S. 69 (1987), Judge Burke duly noted that proposals to grant powers of incorporation to the federal authorities "were rejected outright" at the time of the Founding, given trepidation that bestowing such authority upon the national government would overconcentrate economic power therein.

Certainly, the trial court was not dismissive of the CTA. *NSBU* was circumspect enough to point out that enacting safeguards to prevent the abuse of the corporate form "may be good policy." Yet "no matter how praiseworthy the policy goal," the implementing statute, just like any law, must still pass constitutional muster.

State Sovereignty Over Corporations

Solemnly intoning that "the Founders' deliberate choice to leave general incorporation to the States has gone unchanged," Judge Burke found "little support in history or precedent" for the CTA. Notwithstanding that the statutory regime "is not a direct regulation of corporate formation," nor does it directly interfere with nor commandeer state laws for business organization, the enactment is nonetheless premised upon a belief that congressional prerogatives regarding foreign relations justify intervention into matters "ordinarily within the sovereign purview of the States."

Such intrusions by federal authorities into purely local matters, the trial bench remonstrated, are intolerable under our dual system of national and state governments, especially in the domain of business organizations, where "corporate formation has always been the province of the States." *See Bond v. United States*, 572 U.S. 844 (2014). Condoning the CTA today would signal Congress that it now possessed "*carte blanche* to do as it pleases."

By converting an extraordinary amount of business conduct historically regulated by the States into mandated reporting to federal agencies, the statutory regime ranged too "far afield" from the legislative authority granted in Article I. Accordingly, *NSBU* reached its "unavoidable conclusion" that the CTA was unconstitutional, on the grounds that Congress's powers to conduct foreign policy "do not extend to purely internal affairs, especially in an arena traditionally left to the States."

The CTA and Congress's Taxing Power

And what of the government's alternative argument, that the statute was salvageable as a lawful exercise of Congress's power to tax? *See U.S. Const., art. I, § 8, cl. 1.* The trial court disposed of that allegation in a virtual aside, first pointing out that the law's proponents had already made the key concession that the civil penalties for noncompliance embedded within the enactment bore no similarity to actual taxing measures (the latter are paid into the United States Treasury, calculated upon income, codified within the revenue law, and enforced by the IRS). *See Sebelius, ante* (a "functional approach" is required to determine if an imposition is a true tax).

The government instead pivoted to a somewhat novel contention; by accumulating beneficial ownership information, the CTA fulfilled a constitutional function by assuring the accurate reporting and collection of taxable income.

NSBU rejected that assertion out of hand, opining that "to permit Congress to bring its taxing power to bear just by collecting useful data and allowing tax enforcement officials access to that data" would far surpass the Constitution's prescribed limits (quotation and citation omitted). Here Judge Burke expressed significant consternation, observing that, if accepted, such rationalizations could end in "unfettered legislative power," unmoored from Article I's explicit enumeration of the lawmakers' authority.

Conclusion

The foreign policy and taxing power arguments made in defense of the CTA thus disabused, next was the government's contention that the statute was nonetheless constitutional when viewed as an exercise of Congress's power to regulate interstate commerce. Accordingly, that shall be the subject of Part II of this article.