

TAX LITIGATION ISSUES

Courts Grapple With The Corporate Transparency Act

By Jeremy H. Temkin

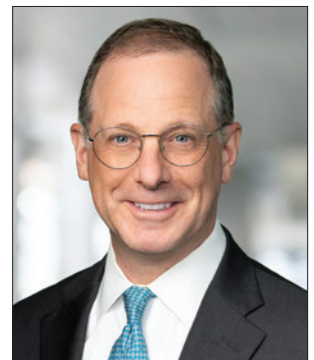
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Over the past two decades, the Internal Revenue Service and the Department of Justice have cracked down on the use of offshore accounts and vehicles to evade U.S. income taxes. However, as this column has previously discussed, for years foreign nationals have used limited liability companies and other entities formed under state law to avoid transparency and evade their own tax obligations. See, e.g., J. Temkin, *Closed for Business: Shutting Down the US as an Offshore Tax Haven*, N.Y.L.J. (May 16, 2019).

In a 2016 report, the Financial Action Task Force (FATF) found that the lack of a federal beneficial ownership information reporting requirement in the United States was problematic from an anti-money laundering and counter-terrorism financing perspective. Almost five years later, Congress passed the Corporate Transparency Act, which requires certain domestic and foreign businesses to file reports with the

Financial Crimes Enforcement Network (FinCEN) of the U.S. Department of Treasury disclosing information about their “beneficial owners.” After FinCEN issued a final rule on Sept. 30, 2022, businesses formed or registered prior to Jan. 1, 2024 had until Jan. 1, 2025 to file required reports, and businesses formed or registered after Jan. 1, 2024 had to file within 90 calendar days of their formation or registration.

Unsurprisingly, the CTA has been subject to extensive litigation, with four district courts splitting on the statute’s constitutionality. In early December, Judge Amos L. Mazzant, III of the United States District Court for the Eastern District of Texas issued a nationwide injunction against the CTA and its reporting requirements. See *Texas Top Cop Shop, Inc. v. Garland*, 2024 WL 5049220 (E.D. Tex. Dec. 5, 2024).



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In response to the government's request for a stay of the injunction, a panel of the United States Court of Appeals for the Fifth Circuit initially lifted the injunction, finding that the government made a "strong showing" that it is likely to succeed on the merits. *Texas Cop Shop*, 2024 WL 5203138 (5th Cir. Dec. 23, 2024). Three days later, however, a different panel of the Fifth Circuit reinstated the preliminary injunction "in order to preserve the constitutional status quo," pending oral argument. See *Texas Cop Shop*, 2024 WL 5224138, at *1 (5th Cir. Dec. 26, 2024).

As a result of the most recent order, the reporting obligation is currently on hold, see [Fincen.gov](https://www.fincen.gov) (last checked Jan. 10, 2025), and the landscape is in flux. Not only has the outgoing Biden Administration asked the Supreme Court to stay the injunction and allow enforcement of the CTA while the appeals process plays out, but given both the new Trump Administration's desire to reduce regulation and burdens on small businesses and some Congressional Republicans' historical hostility to the statute, it remains to be seen whether the transparency envisioned when the CTA was enacted will actually come to pass.

The Corporate Transparency Act

The CTA was first introduced in August 2017 following the FATF's determination that the U.S. government's failure to collect information regarding beneficial owners facilitated "the use of complex structures, shell or shelf corporations, other forms of legal entities, and trusts, to obfuscate the source, ownership, and control

of illegal proceeds." After several attempts, the CTA became law on Jan. 1, 2021, when it was included in the "must pass" National Defense Authorization Act for Fiscal Year 2021.

As implemented, the statute imposes reporting requirements on approximately 32 million businesses formed by filing documents with a state secretary of state, including corporations, limited liability companies, limited partnerships, and limited liability partnerships, and foreign businesses registered to do business in the United States.

The reporting requirements do not, however, apply either to entities that are not formed by filing documents with a secretary of state, such as many trusts, sole proprietorships or unincorporated associations, or to foreign entities that are not registered to do business in the U.S. Moreover, the statute expressly exempts from its reporting requirements twenty-three categories of entities, including banks and public utilities, registered brokers and dealers, investment advisers, insurance companies, and operating companies with over 20 full-time employees and more than \$5 million in revenue.

Each covered business entity is required to file a Beneficial Ownership Information Report with FinCEN that includes the entity's legal name and principal place of business; the full legal name, birth date, and current residential street address of each "beneficial owner" – defined as one who directly or indirectly exercises "substantial control" over the reporting company, or who directly or indirectly owns or controls 25% or more of the "ownership interests" of the reporting company; and a copy of an acceptable identification

document with a unique identifying number for each beneficial owner.

Entities formed or registering to do business after Jan. 1, 2024 were also required to provide substantially the same information regarding the individuals, including lawyers and accountants, responsible for their formation or registration.

Prior to litigation over the statute, reporting companies created or registered before Jan. 1, 2024 had until Jan. 1, 2025 to file their initial reports with FinCEN. For a reporting company formed during 2024, the reports were due 90 calendar days after “the earlier of the date on which the reporting company receives actual notice that its creation (or registration) [had] become effective; or a secretary of state or similar office first provide[d] public notice ... that the domestic reporting company [had] been created or the foreign reporting company [had] been registered.”

And companies formed after Jan. 1, 2025 would have 30 calendar days following notice of their formation or registration to file their BOIRs. As of November 8, 2024, FinCEN had received 6.5 million BOIRs, the vast majority of which appear to have been filed by newly formed entities.

The CTA includes civil and criminal penalties for both the willful failure to comply with the reporting requirements and the unauthorized disclosure of information obtained through filed reports. The maximum civil fine is currently \$591 per day, while the failure to file timely and accurate reports is punishable by up to two years in prison and up to \$10,000 in criminal fines, and the unauthorized disclosure

or use of reports is punishable by up to five years in prison and a \$250,000 fine.

Litigation Over the CTA

On Nov. 15, 2022, the first of four lawsuits challenging the CTA was filed in the Northern District of Alabama. The plaintiffs in that case – the National Small Business Association, a non-profit corporation that purports to represent small businesses across the U.S., and an individual owner of two small businesses – alleged that the CTA’s reporting requirements exceeded Congress’s authority under Article I of the Constitution and violated the First, Fourth, Fifth, Ninth, and Tenth Amendments.

The case was assigned to District Judge Liles C. Burke, and on March 1, 2024, he agreed with plaintiffs that the CTA exceeds Congress’s Article I authority. *Nat’l Small Bus. United v. Yellen*, 721 F. Supp. 3d 1260, 1289 (N.D. Ala. 2024). Specifically, Judge Burke concluded that Congress lacked the authority to enact the CTA under its foreign affairs powers (because those powers do not extend to the purely domestic affairs covered by the CTA), the Commerce Clause (because the CTA “doesn’t regulate the channels and instrumentalities of commerce or prevent their use for a specific purpose”), or the taxing power and the Necessary and Proper Clause (because “providing access to the CTA’s database for tax administration purposes is not enough” to establish a sufficient exercise of Congress’ taxing power). Judge Burke found it unnecessary to decide plaintiffs’ remaining arguments, and permanently enjoined enforcement of the CTA against the plaintiffs.

On May 28, 2024, six plaintiffs – including Texas Top Cop Shop, Inc., a family-run Texas corporation that sells merchandise only in Texas, and the National Federation of Independent Business (NFIB), a tax-exempt organization – filed *Texas Top Cop Shop, Inc. v. Garland*, Case No. 4:24-cv-478, in the Eastern District of Texas. The plaintiffs in *Texas Top Cop Shop* argued that the CTA and its corresponding reporting rule are unconstitutional and moved for a preliminary injunction barring its enforcement.

After agreeing with Judge Burke’s conclusion that the CTA “is in no way connected to whatever authority over foreign affairs Congress might have” and “does not regulate, by its text, a channel or instrumentality of commerce,” Judge Mazzant issued a nationwide injunction suspending the CTA’s reporting requirements. *Texas Top Cop Shop*, 2024 WL 5049220, at *18, *28, *36. After noting that plaintiffs had only sought an injunction on behalf of themselves, Judge Mazzant reasoned that nationwide relief was necessary because NFIB has members across the country.

Unlike Judge Burke in Alabama and Judge Mazzant in Texas, Judges Michael H. Simon of the District of Oregon and Michael S. Nachmanoff of the Eastern District of Virginia both upheld the CTA. In doing so, they concluded that the statute is likely constitutional under both the Commerce Clause and Necessary and Proper Clause and rejected plaintiffs’ arguments that the statute violated the First and Fourth Amendments. See *Firestone v. Yellen*, 2024 WL 4250192, at *10 (D. Ore. Sept. 20,

2024); *Cnty. Ass’ns Inst. v. Yellen*, 2024 WL 4571412, at *14 (E.D. Va. Oct. 24, 2024).

Fifth Circuit Decisions

Each of the four district court decisions was appealed but to date the Fifth Circuit is the only appellate court to address the validity of the CTA. In response to Judge Mazzant’s decision granting injunctive relief, the government filed an emergency motion for a stay of Judge Mazzant’s order pending appeal. Twenty-five state attorneys general filed an amicus brief in opposition to the stay on the basis that the CTA violates principles of federalism by allowing the federal government to override state-corporate law.

A panel of the Fifth Circuit assigned to address preliminary issues and procedural motions granted the stay on Dec. 23, 2024, finding that the government had made a strong showing that it is likely to succeed in establishing that the CTA is constitutional and that the harm to plaintiffs in requiring compliance is minimal, citing FinCEN’s estimate that a simple company would typically devote about \$85 worth of time to completing and filing the required report. The court expedited the appeal to the next available merits panel, and FinCEN extended reporting companies’ deadline until Jan. 13, 2025.

The next day, plaintiffs sought an emergency rehearing en banc and, on Dec. 26, 2024, while that application was pending, a separate panel of the Fifth Circuit assigned to address the merits of the case issued a brief, three-paragraph order vacating the motions panel’s stay “in order to preserve the constitutional status quo while the merits panel considers the parties’

weighty substantive arguments.” *Texas Top Cop Shop*, 2024 WL 5224138, at *1. The merits panel’s order mostly recounts the case’s procedural history and does not offer insight into the judges’ views regarding the statute’s constitutionality. All briefs are due by Feb. 28, 2025, and oral argument is set for March 25, 2025.

Recent Developments

Five days after the stay was lifted, the government asked the Supreme Court to restore the stay of Judge Mazzant’s injunction thereby allowing the CTA’s reporting scheme to go forward. In the meantime, in a statement issued on Dec. 27, 2024, FinCEN confirmed that “reporting companies are not currently required to file beneficial ownership information with FinCEN and are not subject to liability if they fail to do so while the [injunction] remains in force.” Fin-cen.gov (last checked Jan. 10, 2025).

The nationwide injunction issued in *Top Cop* has not obviated additional litigation over the statute’s reporting requirements. On January 7, 2025, Judge Jeremy D. Kernodle of the Eastern District of Texas preliminarily enjoined the government from enforcing the CTA against plaintiffs, each of whom owns an LLC, finding that he needed to address the merits of the plaintiffs’ claims both because of uncertainty regarding the future of the *Top Cop* injunction and because the parties before him had raised different arguments from those raised in *Top Cop*. See *Smith v. U.S. Dep’t of Treasury*, 2025

WL 41924 (E.D. Tex. Jan. 7, 2025). Thus, these plaintiffs need not comply with the CTA reporting requirements during the pendency of their lawsuit, or until a binding higher court decision.

Conclusion

Beyond the appeals currently pending in four different Circuit Courts of Appeals, the fate of the CTA will likely be addressed in the political forum. President Trump campaigned promising to promote deregulation and loosen government burdens on the business community, so opponents of the CTA will likely have a sympathetic ear in the new administration.

Moreover, on the legislative front, Congressional Republicans demonstrated their antipathy to the CTA when they attempted to include a one-year extension of the filing deadline for companies formed before 2024 in the continuing resolution to fund the government at the end of last year. While that attempt failed, the change in control of the Senate may clear the way for future legislation invalidating or narrowing the CTA. As a result, while the United States government continues to demand transparency from foreign governments and financial institutions, it’s commitment to the principle at home remains an open question.

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