

# Court Reigns in Unconstitutional Federal Power – Impacts BOI Reporting

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## Overview

The Corporate Transparency Act (CTA), P.L. 116-283, enacted in 2021 as part of the National Defense Authorization Act, contains new “beneficial ownership information” (BOI) reporting rules for many businesses. The CTA was passed with the purported purpose of enhancing transparency in entity structures and ownership to combat money laundering, tax fraud and other illicit activities. In short, it’s an anti-money laundering initiative designed to catch those that are using shell corporations to avoid tax. The BOI reporting requirement is designed to capture more information about the ownership of specific entities operating in or accessing the U.S. market. The effective date of the CTA is January 1, 2024.

However, in early March, a federal trial court in Alabama, in a case involving a constitutional challenge to the CTA granted the challengers’ motion for summary judgment. *National Small Business United v. Yellen*, No. 5:22-cv-1448-LCB, 2024 U.S. Dist. LEXIS 36205 (N.D. Ala. Mar. 1, 2024). The court’s ruling puts BOI reporting on hold for the plaintiffs’ 65,000 members.

## Background

**Who needs to report?** The CTA breaks down the reporting requirement of “beneficial ownership information” between “domestic reporting companies” and “foreign reporting companies.” A domestic reporting company is a corporation, limited liability company (LLC), limited liability partnership (LLP) or any other entity that is created by filing of a document with a Secretary of State or any similar office under the law of a state or Indian Tribe. A foreign reporting company is a corporation, LLC or other foreign entity that is formed under the law of a foreign country that is registered to do business in any state or tribal jurisdiction by the filing of a document with a Secretary of State or any similar office.

**Note:** Sole proprietorships that don’t use a single-member LLC are not considered to be a reporting company.

Reporting companies typically include LLPs, LLLPs, business trusts, and most limited partnerships and other entities are generally created by a filing with a Secretary of State or similar office.

For entities created after 2023, businesses that are required to report ownership information (corporation, LLC, or similar entity as noted above) must also report the identity of “applicants.”

**Exemptions.** Exemptions from the reporting requirement apply for securities issuers, domestic governmental authorities, insurance companies, credit unions, accounting firms, tax-exempt entities,



public utility companies, banks, and other entities that don't fall into specified categories. In total there are 23 exemptions including an exemption for businesses with 20 or more full-time U.S. employees, report at least \$5 million on the latest filed tax return and have a physical presence in the U.S. But, for example, otherwise exempt businesses (including farms and ranches) that have other businesses such as an equipment or land LLC or any other related entity will have to file a report detailing the required beneficial ownership information. Having one large entity won't exempt the other entities.

**What is a "Beneficial Owner"?** A beneficial owner can fall into one of two categories defined as any individual who, directly or indirectly, either:

- Exercises substantial control over a reporting company, or
- Owns or controls at least 25 percent of the ownership interests of a reporting company.

**Note:** Beneficial ownership is categorized as those with ownership interests reflected through capital and profit interests in the company.

**What must a beneficial owner do?** Beneficial owners must report to the Financial Crimes Enforcement Network (FinCEN). FinCEN is a bureau of the U.S. Department of the Treasury that collects and analyzes information about financial transactions to combat domestic and international money laundering, terrorist financing and other international crimes. Beneficial owners must report their name, date of birth, current residential or business street address, and unique identifier number from a recognized issuing jurisdiction and a photo of that document. Company applicants can only be the individual who directly files the document that creates the entity, or the document that first registers the entity to do business in the U.S. A company applicant may also be the individual who is primarily responsible for directing or controlling the filing of the relevant document by someone else. This last point makes it critical for professional advisors to carefully define the scope of engagement for advisory services with clients.

**Note:** If an individual files their information directly with FinCEN, they may be issued a "FinCEN Identifier" directly, which can be provided on a BOI report instead of the required information.

**Filing deadlines.** Reporting companies created or registered in 2024 have 90 days from being registered with the state to file initial reports disclosing the persons that own or control the business. *NPRM (RIN 1506-AB62) (Sept 28, 2023)*. If a business was created or registered to do business before 2024, the business has until January 1 of 2025 to file the initial report. Businesses formed after 2024 must file within 30 days of formation. Reports must be updated within 30 days of a change to the beneficial ownership of the business, or 30 days from when the beneficial owner becomes aware of or has reason to know of inaccurate information that was previously filed.

**Note:** FinCEN estimates about 32.6 million BOI reports will be filed in 2024, and about 14.5 million such reports will be filed annually in 2025 and beyond. The total five-year average of expected BOI update reports is almost 12.9 million.

**Penalties.** The penalty for not filing is steep and can carry the possibility of imprisonment. Specifically, noncompliance can result in escalating fines ranging from \$591 per day up



to \$10,000 total and prison time of up to two years. Penalties may also apply for unauthorized disclosures.

**State issues.** A state is required to notify filers upon initial formation/registration of the requirement to provide beneficial ownership information to the FinCEN. In addition, states must provide filers with the appropriate reporting company Form.

### **Constitutional Challenge**

The National Small Business United, an organization with over 65,000 members, filed a constitutional challenge against the CTA claiming that the CTA exceeded the Constitution's limits on the power of the Congress to legislate and was not sufficiently connected to any specifically enumerated power that would make it either a necessary or proper means of achieving a policy goal of the Congress. The court rejected the government's defense of the CTA that it was constitutional under the plenary power of the Congress to conduct foreign affairs as well as under the Commerce Clause and the Congress' taxing power.

The court disagreed on all claims noting that the Supreme Court had ruled in 2011 that the foreign affairs power did not extend to the CTA because the CTA regulated only internal transactions. Indeed, the court noted that informational reporting such as the BOI reporting, has historically been a matter reserved for the States.

More importantly, the court rejected the government's Commerce Clause defense. With few exceptions, since the mid-1930s, the Commerce Clause has been interpreted to give almost absolute power to the Congress to regulate commerce among the states. However, here the court noted that, "[t]he plain text of the CTA does not regulate the channels and instrumentalities of commerce, let alone commercial or economic activity." It was not sufficient to trigger federal regulatory authority via the Commerce Clause that a business that is registered with a State then uses the channels of commerce for its business activity, even if the business activity substantially affects interstate and foreign commerce. The Congress has the power to regulate the business activity but cannot require additional reporting information of a business that is already registered to do business with a State. The court noted that the Congress could have created a reporting rule that was constitutional by simply triggering the reporting requirement once a business engages in commercial business activity, and pointed out that FinCEN's customer due diligence rule from 2016 provides "nearly identical information" in a constitutional manner.

The government's taxing power argument also failed, the court determined, because the civil penalties for noncompliance with the rules were not a tax – they were fixed amounts with no income thresholds and did not vary.

### **What Now?**

FinCEN is currently not enforcing the reporting rule against the plaintiff's members. It is anticipated that the government will appeal. Once the appellate opinion is issued, the losing side will almost certainly seek review by the U.S. Supreme Court. It is also anticipated that a request will be made for a court to stay the enforcement of the BOI reporting rules entirely while the judicial process plays



out. Of course, the Congress could amend the BOI reporting rules in accordance with the directions of the trial court.

This all means that covered businesses should prepare the necessary information to be filed, but not file it at the present time. There is no need to provide the government with ownership data that it may, ultimately, not be entitled to.

### **Conclusion**

The U.S. Supreme Court will have the final say (judicially) on the matter. Congress will likely not act until it has too. So, the process could take some time which means the reporting rules will remain in “limbo” for the balance of 2024. The trial court’s judgment may not ultimately be sustained, but it is refreshing to see a federal court reign in an exercise of federal power.

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