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WHITE BLACK LEGAL is an open access, peer-reviewed and refereed journal providededicated to express views on topical legal issues, thereby generating a cross current of ideas on emerging matters. This platform shall also ignite the initiative and desire of young law students to contribute in the field of law. The erudite response of legal luminaries shall be solicited to enable readers to explore challenges that lie before law makers, lawyers and the society at large, in the event of the ever changing social, economic and technological scenario.

With this thought, we hereby present to you

W H I T E B L A C K
L E G A L

THE BATTLE FOR TRANSPARENCY: LEGAL HURDLES AND THE FUTURE OF THE CTA

AUTHORED BY - YASH BAJPAI

ABSTRACT

The Corporate Transparency Act (CTA), enacted on January 1, 2024, aims to enhance financial transparency by requiring corporations in the United States to disclose their beneficial owners. This legislation addresses issues such as hidden ownership structures used for money laundering, tax evasion, and other financial crimes. Despite its objectives, the CTA has faced significant legal challenges, including a recent ruling by the Federal District Court in Northern Alabama declaring the Act unconstitutional. This ruling raises concerns about federal overreach and state sovereignty, potentially impacting the future enforcement and efficacy of the CTA. This article examines the CTA's scope, mandatory reporting requirements, compliance deadlines, and legal hurdles, providing a comprehensive analysis of its implications for businesses and the regulatory landscape.

Keywords

Corporate Transparency Act, beneficial ownership, financial transparency, money laundering, tax evasion, compliance, financial crimes, U.S. legislation, regulatory landscape.

1. Introduction

Imagine a scenario where businesses could easily operate with hidden ownership structures, allowing them to create and utilize anonymous shell companies for potentially nefarious purposes. This reality was unveiled by the 2016 Panama Papers scandal¹, which exposed a complex and secretive financial structure used by the world's affluent to hide wealth and avoid taxes, highlighting critical vulnerabilities in international finance. Such structures often involve

¹ Fitzgibbon W and Fitzgibbon W, 'Panama Papers FAQ: All You Need to Know about the 2016 Investigation' (*ICIJ*, 23 March 2022) <<https://www.icij.org/investigations/panama-papers/panama-papers-faq-all-you-need-to-know-about-the-2016-investigation/>> accessed 19 May 2024

funneling profits through a labyrinth of offshore subsidiaries, effectively obscuring true earnings and sidestepping tax obligations. Such tactics not only strip governments of vital fiscal resources but also undermine public confidence in the global financial system. Scandals like this highlight a critical vulnerability in international finance and the lack of transparency that allows such practices to flourish unchecked.²

In response to growing concerns over the financial regulatory issues, the United States introduced the Corporate Transparency Act (“CTA”), which came into force on January 1, 2024. This legislation compels corporations operating within the United States to disclose their beneficial owners, aiming to pierce the corporate veil that has traditionally protected the identities of those controlling and benefiting from business entities.³ By mandating such disclosures, the CTA seeks to curb the potential for financial abuses like money laundering, corruption, and tax evasion, aligning with global efforts to enhance financial transparency.⁴

Its implementation, however, has raised a lot of concerns amongst small businesses. For instance, businesses under the CTA are required to file a beneficial ownership information report with the Treasury’s Financial Crimes Enforcement Network (FinCEN). Details pertaining to the people who exercise control over the company is an integral part of this report. While the objective is to ensure transparency, it has raised concerns of privacy due to ambiguity surrounding the extent of details that ought to be revealed in the report.⁵

Therefore, in light of such concerns, it is imperative to analyse the CTA to identify its limitations, to better address the objectives of the act and increase its efficacy.

² Ibid

³ Fraccio M, ‘Corporate Transparency Act - What You Need to Know’ (*CO*, 18 December 2023) <<https://www.uschamber.com/co/start/strategy/small-business-corporate-transparency-act>> accessed 19 May 2024

⁴ ‘The Basics of the Corporate Transparency Act’ (*The basics of the Corporate Transparency Act | Wolters Kluwer*) <<https://www.wolterskluwer.com/en/expert-insights/what-is-the-corporate-transparency-act-cta-basics#:~:text=Effective%20January%201%2C%202024%2C%20the,U.S.%20Department%20of%20Treasury’s%20Financial>> accessed 19 May 2024

⁵ Adam.gleason@thomsonreuters.com, ‘Navigating the Corporate Transparency Act’ (*Tax & Accounting Blog Posts by Thomson Reuters*, 19 May 2024) <<https://tax.thomsonreuters.com/blog/navigating-the-corporate-transparency-act/#evolving-attitudes-and-potential-changes-to-the-corporate-transparency-act>> accessed 19 May 2024

2. SCOPE OF THE CTA

COMPANIES BOUND TO REPORT UNDER THE CTS.

The CTA defines a “reporting company” as any entity, including corporations, LLCs, and limited partnerships, that is created by filing a document with any U.S. state, territory, or Indian tribe, or any foreign entity that registers to do business in the U.S.⁶ These companies must report specific details including their name, any names, address, employer identification number, and identify all beneficial owners.⁷ Financial Crimes Enforcement Network estimates that approximately 32.6 million companies will fall under the reporting requirements in the first year of implementation.⁸

EXCLUSIONS FROM REPORTING

To mitigate unnecessary regulatory burdens, the CTA specifies twenty-three exemptions for entities unlikely to pose a money laundering risk. These exempted entities, which include banks, credit unions, registered investment companies, state-regulated insurance companies, and certain inactive entities, are detailed in the legislation.⁹ The exemption also extends to subsidiaries of exempt entities, provided they are wholly owned, preventing partially owned subsidiaries from using this exemption to shield their beneficial owners. Additionally, entities like public utilities, financial market utilities, public accounting firms, and large operating companies with substantial U.S. presence and revenues also qualify for exemption.¹⁰

MANDATORY REPORTING INFORMATION

The CTA mandates that reporting companies and individuals associated with such companies

⁶ 31 U.S.C. § 5336(a)(11)(A)(i)

⁷ Bell D, Barnett N and Segrera SO, ‘Understanding the Corporate Transparency Act’s Company Reporting Obligations’ (*The Harvard Law School Forum on Corporate Governance*, 3 November 2023) <<https://corpgov.law.harvard.edu/2023/11/03/understanding-the-corporate-transparency-acts-company-reporting-obligations/>> accessed 19 May 2024

⁸ ‘The Federal Register’ (*Federal Register :: Request Access*) <<https://www.federalregister.gov/documents/2022/09/30/2022-21020/beneficial-ownership-information-reporting-requirements>> accessed 19 May 2024

⁹ Feldman S, ‘The 23 Exemptions from the Corporate Transparency Act’s Beneficial Ownership Information Reporting Requirement’ (*Understanding the 23 CTA exemptions | Wolters Kluwer*, 2024) <<https://www.wolterskluwer.com/en/expert-insights/the-23-exemptions-from-the-corporate-transparency-act>> accessed 19 May 2024

¹⁰ Leon AJ, ‘The Corporate Transparency Act Is Here-Are You Ready?’ (*Global law firm | Norton Rose Fulbright*) <<https://www.nortonrosefulbright.com/en/knowledge/publications/55b72cd0/the-corporate-transparency-act-is-here>> accessed 19 May 2024

provide detailed identification information to FinCEN.¹¹ For reporting companies, this includes the full legal name, any trade or “doing business as” names, the principal business address in the U.S., the jurisdiction of formation or first U.S. registration, and the taxpayer or employer identification number (TIN or EIN)¹². For beneficial owners and company applicants, required details encompass full legal name, date of birth, current residential or business address, a unique identifying number from a valid government-issued ID (e.g., U.S. passport, driver's license), and an image of the identification document. This information is submitted to FinCEN and maintained in the Beneficial Ownership Secure System (BOSS), accessible only to certain law enforcement and taxing authorities, and other designated users for specific purposes. The reporting company must keep this information current, and FinCEN will retain the Beneficial Ownership Information (BOI) for no less than five years after the reporting company ceases operations.¹³

DEFINING BENEFICIAL OWNERS AND COMPANY APPLICANT

The CTA significantly alters the legal framework for businesses operating in the United States by mandating that reporting companies provide FinCEN with specific identifying information for both “beneficial owners” and “company applicants.”¹⁴ According to FinCEN, a beneficial owner is defined as an individual who, directly or indirectly, either exercises substantial control over the reporting company or owns or controls at least 25% of the company’s ownership interests.¹⁵ This includes positions such as CEOs, CFOs, or any senior officer equivalent, regardless of their formal title.¹⁶ The definition of “ownership interest” is comprehensive, covering not just equity but also capital or profit interests, convertible instruments like warrants and options, and even indirect

¹¹ Feldman S, ‘The 23 Exemptions from the Corporate Transparency Act’s Beneficial Ownership Information Reporting Requirement’ (*Understanding the 23 CTA exemptions* / Wolters Kluwer, 2024) <<https://www.wolterskluwer.com/en/expert-insights/the-23-exemptions-from-the-corporate-transparency-act>> accessed 19 May 2024

¹² 31 C.F.R. § 1010.380(b)(1)(i)

¹³ ‘U.S. Beneficial Ownership Information Registry Now Accepting Reports’ (*U.S. Department of the Treasury*, 1 January 2024) <<https://home.treasury.gov/news/press-releases/jy2015>> accessed 19 May 2024

¹⁴ Buchanan B, ‘New Rules Require Beneficial Ownership Reporting to Fincen’ (*Grant Thornton*) <<https://www.granthornton.com/insights/alerts/tax/2024/insights-new-rules-require-beneficial-ownership-reporting-fincen#:~:text=The%20CTA%20is%20intended%20to,owners%20and%20company%20applicants%20to>> accessed 19 May 2024

¹⁵ 31 U.S.C. § 5336(a)(3)

¹⁶ ‘Who Is a Beneficial Owner under the Corporate Transparency Act?’ (*Who is a Beneficial Owner under the Corporate Transparency Act* / Wolters Kluwer, 2024) <<https://www.wolterskluwer.com/en/expert-insights/who-is-a-beneficial-owner-under-the-corporate-transparency-act>> accessed 19 May 2024

ownerships managed through intermediaries or agents.¹⁷

Exclusions from being classified as a beneficial owner are clearly outlined to include minor children (though the information of a parent or guardian is required), nominees, mere employees not in senior roles, future inheritors, creditors, and individuals who provide professional services in a standard arms-length transaction.¹⁸

Furthermore, the CTA defines a “company applicant” as the person responsible for filing the document that either creates or registers the company, or who controls the filing process, restricted to a maximum of two individuals the one who directly files and another who oversees the filing.¹⁹ The requirements to report company applicants only apply to entities formed or registered from January 1, 2024, onward, with no need for ongoing updates post-initial report unless there are corrections needed to rectify previously reported inaccuracies.²⁰

This shift to federal oversight by the CTA from what was traditionally under state or tribal law is a significant move towards enhancing transparency and accountability, particularly in preventing money laundering and other financial crimes facilitated through opaque corporate structures.

3. REPORTING TIMELINE AND COMPLIANCE

Newly formed or registered entities after January 1, 2024, must file their reports within 90 days. Existing entities have until January 1, 2025, to comply.²¹ Ongoing compliance includes reporting changes in beneficial ownership or company details within 30 days of the change.²²

4. PENALTIES FOR NON-COMPLIANCE

Failure to comply with the CTA can result in severe penalties, including daily fines and possible imprisonment, underscoring the seriousness with which the U.S. government is approaching

¹⁷ ‘Schulte Roth & Zabel LLP’ (*Schulte Roth & Zabel LLP - The Corporate Transparency Act: Key Considerations for Compliance With the Beneficial Ownership Reporting Rule*)

<https://www.srz.com/en/news_and_insights/alerts/the-corporate-transparency-act-key-considerations-for-compliance-with-the-beneficial-ownership-reporting-rule> accessed 19 May 2024

¹⁸ Ibid

¹⁹ 31 U.S.C. § 5336(a)(2)

²⁰ Paul M, ‘Who Is a “Company Applicant” under the Federal Corporate Transparency Act?’ (*Saul Ewing LLP*, 2024) <<https://www.saul.com/insights/alert/who-company-applicant-under-federal-corporate-transparency-act>> accessed 19 May 2024

²¹ 31 C.F.R. § 1010.380(a)(1)

²² 31 C.F.R. § 1010.380(a)(2)

corporate transparency. Civil penalties for failing to file required reports start at \$500 per day, accumulating up to \$10,000 for continued non-compliance. Willful failure to provide accurate and complete information can also lead to criminal charges, with possible fines up to \$10,000 and imprisonment for up to two years.²³ Unauthorized disclosure or misuse of beneficial ownership information incurs civil fines up to \$250,000 and criminal penalties of up to five years in prison.²⁴ Moreover, in cases involving a broader pattern of illegal activity exceeding \$100,000 in a 12-month period, fines may reach \$500,000 with potential imprisonment of up to ten years, reflecting the law's stringent measures to combat financial crimes effectively.²⁵

5. LIMITATIONS OF THE CTA

The CTA, initially heralded as a pivotal step in U.S. efforts to combat financial crimes, has encountered significant legal roadblocks that raise questions about its implementation and future. Specifically, a ruling by the Federal District Court in Northern Alabama has declared the Act unconstitutional, citing overreach of Congressional authority under the Commerce Clause and infringing upon states' rights as delineated by the Tenth Amendment.²⁶ This decision strikes at the core of the Act's mandate, which requires companies to report their beneficial owners to the FinCEN.²⁷

This legal challenge is particularly noteworthy because it disrupts the planned enforcement of the CTA, which was set to impose new reporting obligations aimed at enhancing transparency and preventing the misuse of corporate structures for illicit activities such as money laundering, fraud, and terrorism financing. The ruling suggests that the mandatory reporting requirements could be seen as an overextension of federal power over commerce and an unwarranted imposition on state governance.²⁸

²³ 31 U.S.C. §§ 5336(b)(3)(A)(ii)

²⁴ 31 U.S.C. §§ 5336(b)(3)(B)(ii)

²⁵ 31 U.S.C. §§ 5336(h)(2) and (3)(B)(ii)(II)

²⁶ *Nat'l Small Bus. United v. Yellen*, No. 5:22-cv-01448-LCB, 2024 WL 899372 (N.D. Ala. Mar. 1, 2024).

²⁷ 'The Corporate Transparency Act - NSBU V. Yellen: Insights: Vinson & Elkins LLP' (*Vinson & Elkins*, 16 May 2024) <<https://www.velaw.com/insights/the-corporate-transparency-act-nsbu-v-yellen/>> accessed 19 May 2024

²⁸ Goldstein H, 'National Small Business United v. Yellen and Its Implications for the Corporate Transparency Act' (*Business Law Today from ABA*, 16 May 2024) <<https://businesslawtoday.org/2024/05/national-small-business-united-v-yellen-implications-for-corporate-transparency-act/>> accessed 19 May 2024

KEY POINTS OF CONTENTION AND IMPLICATIONS:

- i. **Commerce Clause and Federal Overreach:** The court's decision in *National Small Business United v. Ellen* emphasizes a perceived overextension of the federal government's regulatory powers into areas traditionally governed by state law. The main argument was centered around the CTA's reach into regulating non-commercial, intrastate activities through federal legislation, which traditionally falls within the states' regulatory purview. The plaintiffs successfully argued that the Act created an intrusive database that unfairly targeted U.S. citizens, and they contended that the law's requirements for disclosing beneficial ownership information imposed undue burdens on lawful activities by U.S. citizens, infringing on their privacy and economic liberty without a sufficient nexus to federal interests.²⁹
- ii. **Tenth Amendment Concerns:** The decision also highlights tensions between federal mandates and state sovereignty. The Tenth Amendment reserves to the states all powers not explicitly granted to the federal government. By requiring states to enforce these federal regulations, the CTA is argued to coercively commandeer state resources and mechanisms, a practice that has been contested in other contexts. The government argued that the CTA was justified under Congress's foreign affairs and national security powers, asserting that tracking beneficial ownership information is crucial for combating international money laundering and terrorist financing. However, the court rejected this justification, stating that the regulation of corporate entities a matter handled at the state level cannot be appropriated as a tool for foreign affairs without overstepping constitutional boundaries.³⁰
- iii. **Impact on Corporate Compliance:** For businesses, the uncertainty generated by this ruling means a potential reprieve from new compliance obligations, but also creates a landscape of legal uncertainty. Companies must now navigate a potentially fragmented

²⁹ R. Robinson W, 'The CTA at Two Months: Key Updates and Action Items: Alerts and Articles: Insights' (*Ballard Spahr*, 2024) <<https://www.ballardspahr.com/insights/alerts-and-articles/2024/03/the-cta-at-2-months-key-takeaways-and-what-to-expect-going-forward>> accessed 19 May 2024

³⁰ 'Government Opposes Constitutional Challenge to CTA: Tax Notes' (Government Opposes Constitutional Challenge to CTA | Tax Notes) <<https://www.taxnotes.com/research/federal/court-documents/court-petitions-and-briefs/government-opposes-constitutional-challenge-to-cta/7g8x3>> accessed 19 May 2024

regulatory environment where federal requirements might be inconsistently applied or temporarily halted pending further legal review.³¹

- iv. **Future Legal Battles and Legislative Responses:** The ruling is almost certainly the beginning rather than the end of the legal saga surrounding the CTA. As the case progresses through the appellate courts, potentially reaching the Supreme Court, the ultimate constitutionality of the CTA will remain in limbo. This process may prompt legislative adjustments to the CTA or alternative approaches to achieving its transparency goals.³²

6. CONCLUSION

In conclusion, the CTA represents a pivotal advancement in U.S. and global efforts to enhance corporate transparency and combat financial crimes. However, recent legal challenges have cast uncertainty on its implementation, particularly highlighting issues of federal overreach and impacts on state sovereignty. These developments suggest a need for careful monitoring and potential legislative adjustments to ensure that the CTA effectively balances the goals of transparency with respect for state governance. As the situation evolves, it will be crucial for stakeholders to stay informed and prepared to adapt to new regulatory landscapes.

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³¹ R. Robinson W, 'The CTA at Two Months: Key Updates and Action Items: Alerts and Articles: Insights' (*Ballard Spahr*, 2024) <<https://www.ballardspahr.com/insights/alerts-and-articles/2024/03/the-cta-at-2-months-key-takeaways-and-what-to-expect-going-forward>> accessed 19 May 2024

³² Ibid