

## Anti-Money Laundering

December 4, 2024

### **Texas Federal District Court Rules Corporate Transparency Act Likely Unconstitutional, Issues Nationwide Preliminary Injunction**

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#### Overview

On December 3, 2024, a federal district court in Texas issued a nationwide preliminary injunction enjoining enforcement of the Corporate Transparency Act (CTA).<sup>1</sup> The court indicated that the CTA is “likely unconstitutional,” although it did not make a definitive ruling on the issue.<sup>2</sup> A preliminary injunction prevents a defendant from continuing allegedly harmful conduct before a final judgment is issued. The ruling comes just weeks shy of the January 1, 2025 reporting deadline for entities formed prior to 2024.

The CTA seeks to prevent money laundering, tax evasion, terrorist financing, and other illegal financial activity by creating a federal database in which entities formed or conducting business in the U.S. must report beneficial ownership information unless the entity qualifies for one of the statutory exemptions to the reporting requirements.<sup>3</sup> Since becoming effective on January 1, 2024, the CTA has faced constitutional challenges in several U.S. federal district courts, with different courts arriving at different conclusions as to the CTA’s constitutionality.<sup>4</sup> The plaintiffs in these cases have alleged that the CTA violates multiple clauses of the Constitution, including the First, Fourth, Fifth, Eighth, Ninth and Tenth Amendments.<sup>5</sup>

#### Other Recent Federal District Court Rulings

Prior to the issuance of the December 3 preliminary injunction, two federal district courts issued rulings that held the complete opposite of the Texas court, declining to issue a preliminary injunction due to the CTA’s likely constitutionality.

In the first instance, on September 20, 2024, the U.S. District Court for the District of Oregon denied a request for a preliminary injunction, concluding that the plaintiffs did not establish either that: (1) the CTA would likely be deemed unconstitutional upon final judgment, or (2) the plaintiffs would sustain irreparable injury in the absence of a preliminary injunction.<sup>6</sup> The ruling has been appealed to the U.S. Court of Appeals for the Ninth Circuit and is awaiting review.

Soon after, on October 24, 2024, the U.S. District Court for the Eastern District of Virginia, issued a similar ruling, similarly finding that the plaintiffs in that case failed to meet either of the two requirements discussed above.<sup>7</sup> That ruling has been appealed to the U.S. Court of Appeals for the Fourth Circuit and is also awaiting review.

#### Constitutional Rulings on the Merits

In March of this year, the U.S. District Court for the Northern District of Alabama issued the first – and currently only – ruling on the merits regarding the constitutionality of the CTA, holding that the law is unconstitutional.<sup>8</sup> Following the ruling, the CTA was enjoined only as to the named plaintiffs in that case at the time of the district court’s decision.

That case is currently on appeal to the U.S. Court of Appeals for the Eleventh Circuit, which heard oral arguments on September 27, 2024. No ruling has been issued yet by the Eleventh Circuit.

### **Current Case: *Texas Top Cop Shop, Inc. v. Garland***

On December 3, 2024, the U.S. District Court for the Eastern District of Texas issued a preliminary injunction, preventing enforcement of the CTA while the court determines its constitutionality.<sup>9</sup> Unlike the federal courts in Oregon and Virginia, the Texas court held that the CTA has a substantial likelihood of being deemed unconstitutional, and that enforcement of the CTA before a final judgment was reached would cause irreparable harm due to the nonrecoverable costs of complying with the law. In its reasoning, the court also noted that the injury to plaintiffs would outweigh any potential harm to the government caused by the injunctive relief.

Notably, the Texas district court ruled that the preliminary injunction should apply nationwide, not just to the plaintiffs in the case or to those within its jurisdiction.<sup>10</sup>

In its holding, the court noted that the CTA is likely unconstitutional because, among other things, regulation of corporation formation and activity is a power granted to the states under the Tenth Amendment to the Constitution, and compelling the production of entity ownership information to the federal government likely violates the First and Fourth Amendments to the Constitution.

### **Implications of the Injunction**

While the December 3 injunction seeks to suspend all reporting obligations under the CTA until further notice, the court's decision is at odds with two other federal district courts whose decisions are currently on appeal in two different Circuit Courts of Appeal. Further, the injunction is preliminary in nature, and is potentially subject to suspension in the likely event that the court's ruling is appealed to the Fifth Circuit. As a result, companies should consult with their legal advisors to assess their reporting obligations under the CTA and whether they should seek to comply with the law's January 1, 2025 filing deadline for companies formed before 2024.

Lowenstein Sandler continues to monitor the legal landscape surrounding the CTA. For more information on the CTA, please contact the authors of this article or [LSAMLCTA@lowenstein.com](mailto:LSAMLCTA@lowenstein.com).

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<sup>1</sup> See *Texas Top Cop Shop, Inc. v. Garland*, 4:24-cv-00478 (ALM), Dkt. No. 30 (E.D. Tex. Dec. 3, 2024).

<sup>2</sup> See *id.* at 77.

<sup>3</sup> See 31 C.F.R. §1010.380.

<sup>4</sup> See *Nat'l Small Business United d/b/a Nat'l Small Business Assoc. v. Janet Yellen*, 5:22-cv-01448 (LCB), Dkt. No. 51 (N.D. Ala. Mar. 1, 2024) (holding that the CTA is unconstitutional and enjoining the U.S. government from CTA enforcement against the plaintiffs); *but see Michael Firestone v. Janet Yellen*, 3:24-cv-1034 (SI), Dkt. No. 18 (D. Or. Sept. 20, 2024) (holding that plaintiffs failed to show that the CTA will likely be deemed unconstitutional).

<sup>5</sup> See *e.g., Firestone*, 3:24-cv-1034 (SI), Dkt. No. 18.

<sup>6</sup> See *id.*

<sup>7</sup> See *Community Assoc. Inst. v. Janet Yellen*, 1:24-cv-1597 (MSN/LRV), Dkt. No. 40 (E.D. Va. October 24, 2024).

<sup>8</sup> See *Nat'l Small Business United d/b/a Nat'l Small Business Assoc. v. Janet Yellen*, 5:22-cv-01448 (LCB), Dkt. No. 51 (N.D. Ala. Mar. 1, 2024).

<sup>9</sup> See *Texas Top Cop Shop, Inc. v. Garland*, 4:24-cv-00478 (ALM), Dkt. No. 30 (E.D. Tex. Dec. 3, 2024).

<sup>10</sup> See *id.* at 74-77.

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