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SBA'S SIZE AND AFFILIATION RULES

KEEPING THE "SMALL" IN "SMALL BUSINESS"

April 5, 2022









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This presentation is not intended to be legal advice. If you have specific questions, please contact a government contracts attorney.



- Why small business size is a big deal
- How does SBA determine size?
- Protecting against affiliation



Why Business Size Matters

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- Small businesses play a vital role in federal contracting
 - Federal contract spending tops \$500B each year
- Small Business Act
 - Sets goals for small business participation
 - ≥23% of all prime contract awards to small businesses

Importance of a Business's Size

Prime Contracting Achievement: 59.99%									
	2019 Achievement	2020 Goal	2020 Achievement ¹ , ²						
Small Business	26.50%	23.00%	26.02% (\$145.7 B)						
Women Owned Small Business	5.19%	5.00%	4.85% (\$27.1 B) 10.54%						
Small Disadvantaged Business	10.29%	5.00%	(\$59.0 B)						
Service Disabled Veteran Owned Small Business	4.39%	3.00%	4.28% (\$23.9 B) 2.44%						
HUBZone	2.28%	3.00%	`2.44% ´ (\$13.6 B)						

Importance of a Business's Size

Subcontracting Achievement:			19.78%
	2019 Achievement	2020 Goal	2020 Achievement¹
Small Business	33.27%	29.43%	32.46% (\$82.8 B)
Women Owned Small Business	5.25%	5.00%	5.62% (\$14.3 B)
Small Disadvantaged Business	4.17%	5.00%	4.40% (\$11.2 B)
Service Disabled Veteran Owned Small Business	1.95%	3.00%	2.14%
HUBZone	1.37%	3.00%	(\$5.5 B) 1.65% (\$4.2 B)

Small Business Benefits

- Admission into SBA Programs
 - Firm must be small its primary NAICS code to qualify for 8(a) Program, SDVOSB, WOSB, and HUBZone
 - Continuing size requirements for continued participation
- Set-aside/sole-source contracts

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Determining Business Size



Start with the NAICS Code

- Codes developed by U.S. Census Bureau to describe economy's sectors and economy
- SBA assigns size standard to each NAICS code
 - Revenue-based (services)
 - Employee-based (manufacturing /supplies)
- SBA socioeconomic programs: firm's primary NAICS code
- Contract eligibility: solicitation's NAICS code



- Total Income + Cost of Goods Sold
 - Not revenue, income, or profit
 - Look to tax returns, if filed
- Average of the preceding 5 completed fiscal years

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Form 1120-S

Department of the Treasury Internal Revenue Service

U.S. Income Tax Return for an S Corporation

Do not file this form unless the corporation has filed or is attaching Form 2553 to elect to be an S corporation.

▶ Go to www.irs.gov/Form1120S for instructions and the latest information.

OMB No. 1545-0123

2020

B Bu	election	effective date																				
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B Principal product or service			Type or	··										E	Date business started	
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	7	Other inc	ome (lo	ss) (attach state	ment)										7	
	8			oss). Combine li											8	

Fiscal Year	Total Income	CGS	Total
2016	\$1,000,000	\$500,000	\$1.5 million
2017	\$2,500,000	\$500,000	\$3.0 million
2018	\$4,000,000	\$2,000,000	\$6.0 million
2019	\$1,000,000	\$11,000,000	\$12.0 million
2020	\$13,000,001	\$11,999,999	\$24.0 million
Total			\$46.5 million
5-year avg. (20	\$9.3 million		
3-year avg. (20	\$14.0 million		

Receipts Calculation Example 1

Growing Small Business

Fiscal Year	Total Income	CGS	Total
2016	\$30,000,000	\$5,000,000	\$35.0 million
2017	\$10,500,000	\$4,500,000	\$15.0 million
2018	\$4,000,000	\$3,500,000	\$7.5 million
2019	\$4,000,000	\$0	\$4.0 million
2020	\$1,050,050	\$949,950	\$2.0 million
Total			\$63.5 million
5-year avg. (20	\$12.7 million		
3-year avg. (20	\$4.5 million		

This company will be hurt by the 5-year calculation period.

Receipts Calculation Example 2

Struggling Small Business

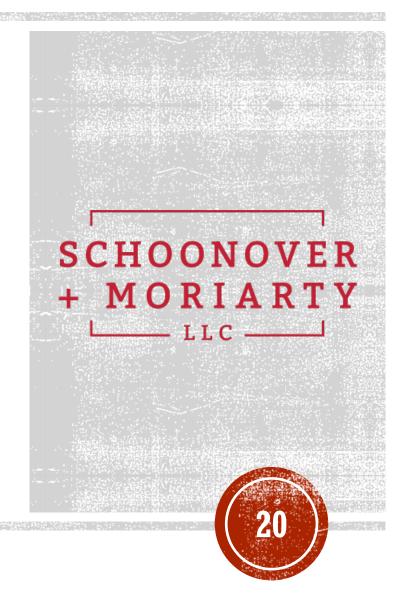


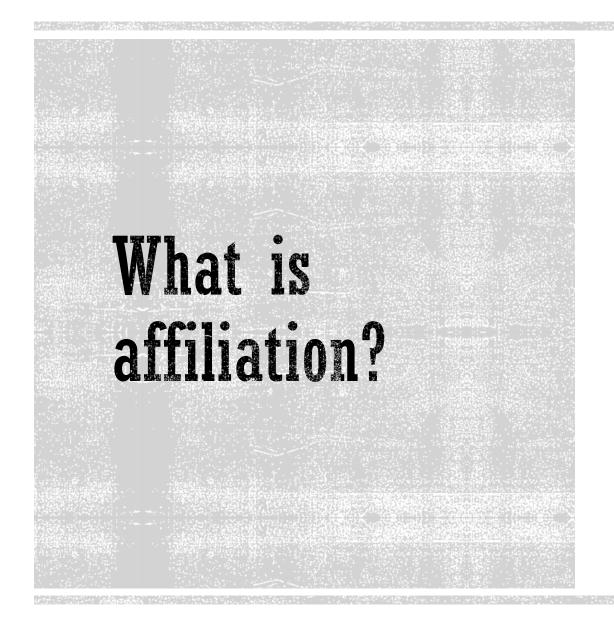
- Average number of employees for each pay period over the preceding 12 months (soon, 24 months)
 - Employee: full-time, part-time, or "other" basis (includes from temp/leasing agencies)
 - Not volunteers!
 - Independent contractors?
 - Must consider state law and tax issues

When is size determined?

- General Rule: date on which a firm submits its initial offer with price
 - For IDIQ contracts where no price is submitted, size is determined on date of initial offer
 - Final proposal revision: date applicable to compliance with nonmanufacturer rule and ostensible subcontractor rule
- A firm is small for the duration of the contract, unless the CO asks for a recertification in connection with a specific order
 - Small business awards under unrestricted IDIQ: recertify with order
- For contracts extending beyond five years, firms must recertify within 120 days of the end of 5 years
- Recertification required after novation and merger, sale, or acquisition of a firm

Affiliation





- Affiliation is the power to control
 - Positive control or negative control
 - Doesn't matter whether control is exercised
- SBA will look to the totality of the circumstances
 - Regulations identify common ways to find affiliation

Common Ownership

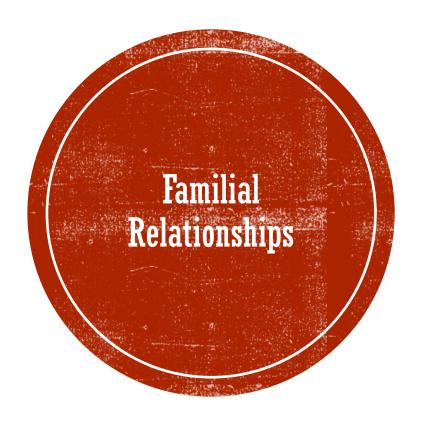
- If a single individual or entity owns 50 percent or more of a firm, the two firms are affiliated
- Minority shareholder rule: if two or more persons own less than 50 percent of the firm, and the minority holdings are equal or approximately equal in size, and the aggregate of those holdings are large when compared with others, then each minority holder is deemed to control the firm
 - Example: Three owners own 30% each, and 20 owners own .5%, then the 3 owners will each be deemed to control the firm
 - Rule can be rebutted by showing that the power to control doesn't actually exist
- Present effect rule: SBA consider stock options, convertible securities, and agreement to merge as if they had already been exercised—even if they haven't been

Common Management

• The officers, directors, managing members, or partners who control the board of directors and/or management of one firm also the control the board of directors or management of another concern.

Identity of Interest

- Targets firms or individuals that have identical or substantially identical business or economic interests.
- Three main types:
 - Family relationships
 - Economic dependence
 - Common investments



- Firms are (a) owned or controlled by close family members and (b) conduct business with each other or provide loans, resources, equipment, locations or employees with on another
 - Married/civil union
 - Parents/children
 - Siblings
- Presumption can be rebutted by showing a clear line of fracture between the firms.



- One firm depends on another for a majority of its revenues, through subcontracts or other arrangements
 - 70% or more of its receipts from another firm over the previous three fiscal years
 - Presumption can be rebutted by showing that the firm in question is not solely dependent—e.g., the firm is new and has only been able to secure a few contracts



- Individuals share investments that provide economic control
 - There must be at least two common investments
 - The investments must be substantial in terms of size or proportion of the individual's investment portfolio

Newly Organized Concerns

- Spin-off company
- Former or current officers, directors, principal stockholders, managing members, or key employees (has critical influence in or substantive control over the operations or management of the firm) of one firm organize a new one
 - New firm operates in the same or related industry
 - They serve as the new firm's officers, directors, principal stockholder, managing members, or key employees
 - The old firm furnishes the new firm with contracts, financial or technical assistance, indemnification on bid or performance bonds, and/or other facilities (even if there's a fee involved)
- Affiliation can be rebutted by showing a clear line of fracture

Affiliation Based on Joint Ventures

- Joint Venturers receive an exemption from affiliation, if they play by SBA's rules
 - All venturers must be small (unless part of an approved MPA)
 - Must have a compliant joint venture agreement
 - SBA's regulations change frequently—always review the agreement for each bid!
- A "longstanding" JV can lead to general affiliation
 - A JV cannot bid on any new opportunities more than two years after it wins its first award
 - Must form a new JV

Ostensible Subcontractor Affiliation

- Only applies to prime/sub teams!
 - Does not apply to a similarly situated subcontractor
- Subcontractor performs the contract's "primary and vital requirements"
 - Consider CLIN value, hours, workshare percentages, etc.
- Prime is "unusually reliant" on the subcontractor
 - Subcontractor is the now-ineligible incumbent
 - Prime hires subcontractor personnel en masse (esp. key employees)
 - Prime relies on subcontractor for experience needed to win the effort
 - Subcontractor performs a significant amount of work
 - Subcontractor provides needed equipment, facilities, or resources

Protecting Against Affiliation

- Understand the risk of affiliation before it becomes an issue
 - Audit size/affiliation before submitting bids or applying for socioeconomic status
 - Review solicitations and structure teaming relationships in a manner that complies with requirements
- "Fracture" affiliation
 - Change ownership/corporate structure/business relationships
 - o Consider a mentor/protégé relationship

Questions?

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