



# SBA'S SIZE AND AFFILIATION RULES

## KEEPING THE "SMALL" IN "SMALL BUSINESS"

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

# Discussion Summary

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



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# Why Business Size Matters

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## Size Matters

- **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
  - $\geq 23\%$  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 <sup>1, 2</sup>
Small Business	26.50%	23.00%	26.02% (\$145.7 B)
Women Owned Small Business	5.19%	5.00%	4.85% (\$27.1 B)
Small Disadvantaged Business	10.29%	5.00%	10.54% (\$59.0 B)
Service Disabled Veteran Owned Small Business	4.39%	3.00%	4.28% (\$23.9 B)
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 Achievement'
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% (\$5.5 B)
HUBZone	1.37%	3.00%	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



# 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



## Receipts

- **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**

**U.S. Corporation Income Tax Return**  
 For calendar year 2020 or tax year beginning \_\_\_\_\_, 2020, ending \_\_\_\_\_, 20\_\_\_\_  
 ▶ Go to [www.irs.gov/Form1120](http://www.irs.gov/Form1120) for instructions and the latest information.

OMB No. 1545-0123

**2020**

- A Check if:**  
**1a** Consolidated return (attach Form 851)   
**b** Life/nonlife consolidated return   
**2** Personal holding co. (attach Sch. PH)   
**3** Personal service corp. (see instructions)   
**4** Schedule M-3 attached

<b>TYPE OR PRINT</b>	Name
	Number, street, and room or suite no. If a P.O. box, see instructions.
	City or town, state or province, country, and ZIP or foreign postal code

**B** Employer identification number

---

**C** Date incorporated

---

**D** Total assets (see instructions)  
 \$

- E** Check if: **(1)**  Initial return    **(2)**  Final return    **(3)**  Name change    **(4)**  Address change

<b>Income</b>	<b>1a</b> Gross receipts or sales	<b>1a</b>	
	<b>b</b> Returns and allowances	<b>1b</b>	
	<b>c</b> Balance. Subtract line 1b from line 1a	<b>1c</b>	
	<b>2</b> Cost of goods sold (attach Form 1125-A)	<b>2</b>	
	<b>3</b> Gross profit. Subtract line 2 from line 1c	<b>3</b>	
	<b>4</b> Dividends and inclusions (Schedule C, line 23)	<b>4</b>	
	<b>5</b> Interest	<b>5</b>	
	<b>6</b> Gross rents	<b>6</b>	
	<b>7</b> Gross royalties	<b>7</b>	
	<b>8</b> Capital gain net income (attach Schedule D (Form 1120))	<b>8</b>	
	<b>9</b> Net gain or (loss) from Form 4797, Part II, line 17 (attach Form 4797)	<b>9</b>	
<b>10</b> Other income (see instructions—attach statement)	<b>10</b>		
<b>11</b> <b>Total income.</b> Add lines 3 through 10	<b>11</b>		

Form **1120-S**

# U.S. Income Tax Return for an S Corporation

OMB No. 1545-0123

Department of the Treasury  
Internal Revenue Service

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

# 2020

▶ **Go to [www.irs.gov/Form1120S](http://www.irs.gov/Form1120S) for instructions and the latest information.**

For calendar year 2020 or tax year beginning \_\_\_\_\_, 2020, ending \_\_\_\_\_, 20

<b>A</b> S election effective date	<b>TYPE OR PRINT</b>	Name	<b>D</b> Employer identification number
<b>B</b> Business activity code number (see instructions)		Number, street, and room or suite no. If a P.O. box, see instructions.	<b>E</b> Date incorporated
<b>C</b> Check if Sch. M-3 attached <input type="checkbox"/>		City or town, state or province, country, and ZIP or foreign postal code	<b>F</b> Total assets (see instructions) \$

**G** Is the corporation electing to be an S corporation beginning with this tax year?  Yes  No If "Yes," attach Form 2553 if not already filed

**H** Check if: (1)  Final return (2)  Name change (3)  Address change (4)  Amended return (5)  S election termination or revocation

**I** Enter the number of shareholders who were shareholders during any part of the tax year . . . . . ▶ \_\_\_\_\_

**J** Check if corporation: (1)  Aggregated activities for section 465 at-risk purposes (2)  Grouped activities for section 469 passive activity purposes

**Caution:** Include **only** trade or business income and expenses on lines 1a through 21. See the instructions for more information.

<b>Income</b>	<b>1a</b> Gross receipts or sales . . . . .	<b>1a</b>	
	<b>b</b> Returns and allowances . . . . .	<b>1b</b>	
	<b>c</b> Balance. Subtract line 1b from line 1a . . . . .		<b>1c</b>
	<b>2</b> Cost of goods sold (attach Form 1125-A) . . . . .		<b>2</b>
	<b>3</b> Gross profit. Subtract line 2 from line 1c . . . . .		<b>3</b>
	<b>4</b> Net gain (loss) from Form 4797, line 17 (attach Form 4797) . . . . .		<b>4</b>
<b>5</b> Other income (loss) (see instructions—attach statement) . . . . .		<b>5</b>	
<b>6</b> <b>Total income (loss).</b> Add lines 3 through 5 . . . . . ▶		<b>6</b>	

Form **1065**

Department of the Treasury  
Internal Revenue Service

# U.S. Return of Partnership Income

OMB No. 1545-0123

For calendar year 2020, or tax year beginning \_\_\_\_\_, 2020, ending \_\_\_\_\_, 20\_\_\_\_\_.

**2020**

► Go to [www.irs.gov/Form1065](http://www.irs.gov/Form1065) for instructions and the latest information.

<b>A</b> Principal business activity	<b>Type or Print</b>	Name of partnership	<b>D</b> Employer identification number
<b>B</b> Principal product or service		Number, street, and room or suite no. If a P.O. box, see instructions.	<b>E</b> Date business started
<b>C</b> Business code number		City or town, state or province, country, and ZIP or foreign postal code	<b>F</b> Total assets (see instructions) \$

- G** Check applicable boxes: (1)  Initial return (2)  Final return (3)  Name change (4)  Address change (5)  Amended return
- H** Check accounting method: (1)  Cash (2)  Accrual (3)  Other (specify) ► \_\_\_\_\_
- I** Number of Schedules K-1. Attach one for each person who was a partner at any time during the tax year ► \_\_\_\_\_
- J** Check if Schedules C and M-3 are attached . . . . .
- K** Check if partnership: (1)  Aggregated activities for section 465 at-risk purposes (2)  Grouped activities for section 469 passive activity purposes

**Caution:** Include **only** trade or business income and expenses on lines 1a through 22 below. See instructions for more information.

<b>Income</b>	<b>1a</b> Gross receipts or sales . . . . .	<b>1a</b>	
	<b>b</b> Returns and allowances . . . . .	<b>1b</b>	
	<b>c</b> Balance. Subtract line 1b from line 1a . . . . .		<b>1c</b>
	<b>2</b> Cost of goods sold (attach Form 1125-A) . . . . .		<b>2</b>
	<b>3</b> Gross profit. Subtract line 2 from line 1c . . . . .		<b>3</b>
	<b>4</b> Ordinary income (loss) from other partnerships, estates, and trusts (attach statement) . . . . .		<b>4</b>
	<b>5</b> Net farm profit (loss) (attach Schedule F (Form 1040)) . . . . .		<b>5</b>
	<b>6</b> Net gain (loss) from Form 4797, Part II, line 17 (attach Form 4797) . . . . .		<b>6</b>
<b>7</b> Other income (loss) (attach statement) . . . . .		<b>7</b>	
<b>8 Total income (loss). Combine lines 3 through 7 . . . . .</b>		<b>8</b>	

<b>Fiscal Year</b>	<b>Total Income</b>	<b>CGS</b>	<b>Total</b>
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
<b>5-year avg. (2016-2020)</b>			<b>\$9.3 million</b>
<b>3-year avg. (2018-2020)</b>			<b>\$14.0 million</b>

# Receipts Calculation Example 1

Growing Small Business



<b>Fiscal Year</b>	<b>Total Income</b>	<b>CGS</b>	<b>Total</b>
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
<b>5-year avg. (2016-2020)</b>			<b>\$12.7 million</b>
<b>3-year avg. (2018-2020)</b>			<b>\$4.5 million</b>

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

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# What is 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





## Familial Relationships

- 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.



## Economic Dependence

- 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



## Common Investments

- **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
  - Consider a mentor/protégé relationship

# Questions?

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