

# FAQ: Can my small business subcontract all our work to a large, experienced government contractor?

This issue generates a lot of confusion among government contractors who wonder if they can leverage their designation as a small or disadvantaged business to win a set-aside award and then simply pass most or all of the work through to a subcontractor who is larger and more experienced. The answer is generally *no*.

Because one of the purposes of the set-aside system is to ensure that the small and/or disadvantaged business will actually perform a significant portion of the work, allowing it to gain meaningful experience and continue to grow and succeed, pass-through arrangements are strictly prohibited, with certain rare exceptions. Regulations contain a Limitation on Subcontracting for set-aside contracts to small businesses and 8(a) firms. *At least half of the overall award amount* for most small business set-aside contracts for services or supplies must remain with the prime contractor itself rather than being given to its subcontractors (the percentages are smaller for construction contracts). However, the percentage of the award amount that the prime contractor spends on “similarly situated entity subcontractors,” *i.e.*, other qualified small businesses eligible for the same set-aside, is excluded from the limitation. This means that subcontracts to such similarly certified small businesses will not count toward the limitation on subcontracting otherwise imposed on prime contractors on a set-aside.

Additionally, a firm can undermine its qualification as a small business if it is found to be “affiliated” with another firm that does not meet the applicable definition of a small business or the factors for the applicable disadvantaged status(es). If another firm exerts control, even indirectly, over the small or disadvantaged prime contractor, then it may be deemed an affiliate. If so, then the affiliate’s size will be included in the calculation of the prime contractor’s size for purposes of determining its eligibility for a small-business set-aside award. Thus, to maintain its small size and avoid problems arising from affiliation, a small business should take care to ensure that its larger subcontractors or teaming partners or certain minority shareholders do not have control or other significant leverage that could lead to a finding of affiliation. Otherwise it risks losing small business set-aside opportunities.

A presumption of affiliation exists for firms that conduct business with each other and are owned and controlled by persons who are married couples, parties to a civil union, parents and children, and siblings. Additionally, if a business derives 70% or more of its average annual revenue over the previous three years from another firm, then SBA will presume that the one firm is economically dependent on the other and, therefore, that the two firms are affiliated.

Limited exceptions include the 8(a) Business Development program’s Mentor/Protégé program, which pairs a larger contractor with a small disadvantaged one to help the latter grow and become successful. A major benefit of this program, which is subject to an extremely thorough application process and other rigorous requirements, is that the larger firm’s revenues will not be considered when the small disadvantaged firm applies for a set-aside contract, even though the firms would otherwise be affiliated for purposes of calculating size. Similarly, special designations for Alaska Native and Native American tribe-owned firms also offer exemptions from the affiliation rule.

Some contractors also mistakenly believe that Joint Ventures can be used to circumvent the affiliation issue for size determination, but federal regulations still require that the small business exercise majority ownership and genuine control over a Joint Venture in order to be eligible for set-asides. However, a Joint Venture of two or more small businesses may submit an offer as a small business on any set-aside, so long as each member of the Joint Venture is small under the size standard corresponding to the NAICS code assigned to the contract.

For more information on changes to the SBA rules that took effect in May 2016, read our blog: [SBA Finalizes Important Rule Changes for Limitations on Subcontracting, Affiliation & Joint Ventures](#).