

LEGAL ADVISOR



A PilieroMazza Update for Federal Contractors and Commercial Businesses

SMALL BUSINESS PROGRAMS

It's a New Year. Are You Still a Small Business?

By Michelle Litteken



It is a new year, and this is the perfect time for a small business to consider whether it still qualifies as a small business. We recommend that small businesses assess their size at least once a year. Because eligibility under a revenue-based size standard is based on a company's average revenues from the most recently completed three fiscal years, and those revenues generally establish a company's size for the entire upcoming year, the beginning of a new fiscal year is a good time to reevaluate one's size.

When a contractor submits a proposal for a federal small business set-aside contract, its size is determined on the day of proposal submission. For solicitations with a size standard based on the number of employees, this is generally a straightforward exercise because a company's size is based on the number of employees for each of the preceding completed 12 calendar months. As such, a contractor can determine its size under an employee-based size standard relatively easily by looking at the last 12 months. It is more challenging to determine a company's size at the start of a new year under a revenue-based size standard because a contractor has not usually finalized its financials from the prior year. If a contractor's average revenues are close to a given size standard threshold, the contractor may be uncertain as to whether it still qualifies as a small business when a new fiscal year begins. Understanding how SBA approaches situations like this can help a contractor decide whether to submit a proposal at the start of a fiscal year.

As noted above, SBA calculates a business' size using the revenues received in the three prior fiscal years. See 13 CFR 121.104(c). Thus, for a proposal submitted in January 2017, if the company uses the calendar year for its fiscal year, SBA would look at the company's revenues from 2014, 2015, and 2016. The average of those three years would determine whether the company qualifies as small under a particular size standard. In most cases, SBA obtains annual revenue information from tax returns. See 13 CFR 121.104(a)(1). However, if a contractor is submitting a proposal in early 2017, it probably has not prepared its 2016 tax return yet. With no tax return, how will the contractor's size be calculated?

First, it must be said that if you have not yet filed your tax return for the prior year, this does not mean that year will be excluded from determining your size. If a tax return has not been filed for a fiscal year, SBA's regulations provide: "SBA will calculate the concern's annual receipts for that year using any other available information, such as the concern's regular books of account, audited financial statements, or information contained in an affidavit by a person with personal knowledge of the facts." 13 CFR 121.104(a)(2). This means that SBA will examine a company's internal records, such as financial statements, to determine the revenues from the recently-completed year. Accordingly, a contractor should use its best efforts to ensure that its financial statements are accurate and determine whether it is a small business under the applicable size standard before the tax return is filed.

It is important to recognize that a size protest and size determination can take a substantial amount of time. It is not uncommon for a company to submit a proposal

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before its tax return for the prior year and then submit its tax return while a size protest is pending. If this occurs, and a tax return is available when the SBA conducts the size determination, SBA will use that tax return. Brooks Range Contract Service, SBA No. SIZ-4652 (2004), provides a useful example for this situation. In that case, the contractor self-certified its size on February 9, 2004. Because its 2003 tax return was not complete, it used its 2001 and 2002 tax returns and an estimate for 2003 to calculate its annual receipts. Its size was protested, and when the SBA Area Office requested information, the contractor's 2003 tax returns were available. Based on this information, the Area Office determined that the contractor was other than small. The contractor's internal estimate for 2003 understated its revenues. At OHA, the contractor argued that the Area Office should not have used the 2003 return because the return was not available when it certified its size. OHA disagreed, holding that a concern's annual receipts must be determined using the most recently completed three fiscal years, even if there is little time between the end of the most recent fiscal year and the certification date. And, because the tax return was available when the Area Office made its size determination, it was appropriate for the Area Office to rely on it.

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To avoid a situation like the one presented in Brooks Range, we advise contractors to verify their size under revenue thresholds at least once a year, preferably at the beginning of a fiscal year. Because the SBA will look to the prior fiscal year, contractors should have financial records available to accurately document its revenues from the fiscal year that recently ended, even if the tax returns have not been prepared yet. And, if a contractor is close to the size standard provided in a solicitation, it should carefully review its financial records before submitting a proposal to ensure it is below the size standard. If the contractor is selected for award, a disappointed offeror could file a size protest. If the SBA determines that the awardee is not small, the awardee will lose the contract and could be precluded from bidding on other contracts

under the same size standard until it can prove to SBA that it is small. If the contractor's average revenues were clearly over the size standard, the government could take the position that the contractor intentionally or recklessly misrepresented its size and pursue fraud charges. These problems can be avoided by reassessing one's size at the start of a new year and submitting a proposal only if the applicable size standard is met.

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