

**ALERT**

# New FAR Clause Resolves Long-Standing Conflict Over How to Comply with the Limitations on Subcontracting

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August 16, 2021

**WHAT:** The Federal Acquisition Regulatory (FAR) Council has issued its final rule on prime contractors' limitations on subcontracting under small business set-aside contracts. The rule finally harmonizes the FAR with the Small Business Administration's (SBA) regulations regarding the calculation of the limitations on subcontracting, also known as the "50% Rule." Now both SBA's regulations and the FAR provide that the prime contractor cannot pay subcontractors that are not "similarly situated entities" more than 50% of the amount they receive from the government (lower percentages apply to construction and specialty trade contracts).

**WHEN:** The final rule was issued August 10, 2021, and is effective September 10, 2021. Thus, new solicitations issued after September 10 should include the new version of FAR 52.219-14.

**WHAT DOES IT MEAN FOR INDUSTRY:** Contractors have long been frustrated and confused by the conflicting methodologies used in SBA's regulations and the FAR for determining compliance with the limitations on subcontracting. The FAR Council acknowledged the delay and announced that, in the future, it will no longer wait for final SBA rules before starting the process for promulgating proposed FAR rules that address SBA issues.

As with the 2016 SBA rule, the FAR final rule changes the methodology for calculating whether a small business prime contractor performed the required amount of the work on a set-aside contract. Instead of basing the calculation on the cost of contract performance, the new version of FAR 52.219-14 focuses on the

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amount paid by the government to the prime contractor and the amount the prime contractor pays to subcontractors. For both services and supplies contracts, the prime contractor cannot pay subcontractors that do not qualify as “similarly situated entities” more than 50% of the amount it receives from the government. For mixed contracts, the 50% limitation applies only to the portion of the contract that corresponds with the designated North American Industry Classification System (NAICS) code (i.e., under a mixed contract with a services NAICS code, the 50% limitation applies only to the services portion of the contract).

The new FAR clause also adopts the SBA’s exception for “similarly situated entities,” which exempts first-tier subcontractors with the same small business program status (small, women-owned, veteran-owned, HUBZone, 8(a)) from the 50% limitation. Under the clause, compliance with the limitations on subcontracting is determined either (i) by the end of the base term and then for each option period, or (ii) by the end of the performance period for each order, depending on which box is checked in the clause.