



# USAID

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## Acquisition & Assistance Policy Directive (AAPD)

From the Director, Office of Acquisition & Assistance Issued: **September 8, 2023**

**AAPD 21-03, Revision 1**

### Exceptions to the Limitation on Subcontracting Requirements for Small Business Set-asides

Subject Category:	ACQUISITION MANAGEMENT
Type:	POLICY

AAPDs provide information of significance to all agency personnel and partners involved in the Acquisition and Assistance process. Information includes (but is not limited to): advance notification of changes in acquisition or assistance regulations; reminders; procedures; and general information. Also, AAPDs may be used to implement new requirements on short notice, pending formal amendment of acquisition or assistance regulations.

AAPDs are EFFECTIVE AS OF THE ISSUED DATE unless otherwise noted in the guidance below; the directives remain in effect until this office issues a notice of cancellation.

This AAPD:  Is New  Replaces: AAPD 21-03

Applicable to:

Existing awards;  Modification required

No later than

As noted in guidance below

RFPs for small business set-asides, issued on or after the effective date of this AAPD;

Other or N/A

Precedes change to:

AIDAR Part(s) Appendix

USAID Automated Directives System (ADS) Chapters

Code of Federal Regulations

FAR 52.219-14

No change to regulations

New or Revised Provision/Clause Provided Herein

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## **1. PURPOSE:**

AAPD 21-03 was originally issued on September 7, 2021; this Revision 1 renews the content of the original AAPD and updates the background (TAB 2), with no other changes to the guidance or deviated FAR text. This AAPD applies ONLY to awards (including task orders) that are partially or fully set-aside for small businesses such as:

- 1) small business set-asides issued directly to small businesses above the simplified acquisition threshold (see FAR part 19);
- 2) awards under the 8(a), HubZone, women-owned small business (WOSB), and service-disabled veteran owned small business (SDVOSB) programs, regardless of dollar value (see FAR 19.8, 19.13, 19.14, and 19.15).
- 3) IDIQs that allow for Task Orders to be set-aside (or reserved) for small businesses.

This AAPD notifies COs of exemptions from the limitation on subcontracting requirements available to USAID contractors under the FAR class deviation #M/OAA-DEV-FAR-21-02c and its successor, #M/OAA-DEV-FAR-23-04c). The exemptions are authorized by the Small Business Administration (SBA) in 13 C.F.R. § 125.6, and will be included in the FAR through the rulemaking process. The deviation excludes the following types of work from the percentage of work that must be performed by a similarly-situated small business concern pursuant to the revised FAR 52.219-14: (i) other direct costs, to the extent they are not the principal purpose of the acquisition and small business concerns do not provide the service; (ii) work performed outside the United States on awards made pursuant to the Foreign Assistance Act of 1961; and (iii) work performed outside the United States required to be performed by a local contractor.

This deviation also provides clarity on how small businesses should treat independent contractors for purposes of the limitations on subcontracting requirements, as provided in the SBA's final rule revising 13 C.F.R. § 125.6, published in the Federal Register on November 29, 2019 ([84 FR 65647](#))

The deviations (#M/OAA-DEV-FAR-21-02c) was effective on September 10, 2021, and the new deviation (#M/OAA-DEV-FAR-23-04c) will remain in effect until rescinded or FAR rulemaking is concluded, whichever occurs first.

### **Required Actions (to be taken on or after September 10, 2021):**

#### **Solicitations and Resulting Contracts:**

For contracts awarded under FAR Part 19, COs must include the deviated clause 52.219-14 in solicitations and resultant contracts for the following:

- 1) Contracts expected to exceed the simplified acquisition threshold, when all or any portion of the requirements is set aside for a small business;

- 2) Contracts set aside or awarded on a sole-source basis under the 8(a), HubZone, WOSB, or SDVOSB programs (see subparts 19.8, 19.13, 19.14, or 19.15), regardless of dollar value.
- 3) Contracts awarded using the HUBZone price evaluation preference. However, if the prospective contractor waived the use of the price evaluation preference, or is other than a small business, COs must NOT insert the clause in the resultant contract.
- 4) That are IDIQs that allow for orders to be set aside for small business concerns, as described in FAR 8.405-5 and 16.505(b)(2)(i)(F), and when orders may be issued directly to a small business concern as described in 19.504(c)(1)(ii). COs must indicate in paragraph (f) of the clause if compliance with the limitations on subcontracting is required at the contract or order level.

## **2. GUIDANCE:**

FAR 19 changes made under the FAC 2021-07 dated August 11, 2021 requires that a set-aside small business concern must not pay more than 50% of the funds received under a contract to its subcontractors. See Tab 2 for additional information on how contractors must apply the 50 percent limitation, including amounts paid to similarly situated entities.

Recognizing the challenges small business contractors may face implementing the new FAR requirements, on November 29, 2019, SBA added several exceptions to the limitation on subcontracting requirements in its regulations at 13 CFR § 125.6, which will be adopted in the FAR when rulemaking for FAR case 2021-020, Limitations on Subcontracting Revisions, is concluded. To allow USAID contractors to use these exceptions ahead of the planned FAR changes, FAR class deviation #M/OAA-DEV-FAR-21-02c adds SBA's exceptions into the revised clause, FAR 52.219-14 Limitation on Subcontracting (Tab 1). In addition, the class deviation clarifies the revised FAR language in 52.219-14 related to independent contractors.

As instructed in the "Required Actions" section above, for awards made using FAR Part 19, COs must include the revised clause 52.219-14 in solicitations and resultant contracts that are partially or fully set-aside for small businesses. COs may include the revised clause in existing contracts if requested by the small business contractors.

Tab 2 provides background information on the revised FAR limitation on subcontracting requirements and additional details on exceptions provided by SBA in its final rule at [84 FR 65647](#) dated 11/29/19.

## **ATTACHMENTS:**

Tab 1 - **TAB 1: FEDERAL ACQUISITION REGULATION (FAR) DEVIATION TEXT 52.219-14** (Deviation #: M/OAA-DEV-FAR-21-02c)

Tab 2 - **Addendum: BACKGROUND**

**3. POINTS OF CONTACT:**

Please direct any questions on this AAPD to [“Ask M/OAA Policy”](#)

**TAB 1: FEDERAL ACQUISITION REGULATION (FAR) DEVIATION TEXT**

**52.219-14 Limitations on Subcontracting.**

(Deviation #: **M/OAA-DEV-FAR-23-04c**)

As prescribed in 19.507(e) and 19.811-3, insert the following clause:

**Limitations on Subcontracting (Sept 2021)**

**(Deviation September 2021)**

- (a) This clause does not apply to the unrestricted portion of a partial set-aside.
- (b) Definition. Similarly situated entity, as used in this clause, means a first-tier subcontractor, including an independent contractor, that—
  - (1) Has the same small business program status as that which qualified the prime contractor for the award (e.g., for a small business set-aside contract, any small business concern, without regard to its socioeconomic status); and
  - (2) Is considered small for the size standard under the North American Industry Classification System (NAICS) code the prime contractor assigned to the subcontract.
- (c) Applicability. This clause applies only to—
  - (1) Contracts that have been set aside for any of the small business concerns identified in 19.000(a)(3);
  - (2) Part or parts of a multiple-award contract that have been set aside for any of the small business concerns identified in 19.000(a)(3);
  - (3) Contracts that have been awarded on a sole-source basis in accordance with subparts 19.8, 19.13, 19.14, and 19.15;
  - (4) Orders expected to exceed the simplified acquisition threshold and that are—
    - (i) Set aside for small business concerns under multiple-award contracts, as described in 8.405-5 and 16.505(b)(2)(i)(F); or
    - (ii) Issued directly to small business concerns under multiple-award contracts as described in 19.504(c)(1)(ii);
  - (5) Orders, regardless of dollar value, that are—
    - (i) Set aside in accordance with subparts 19.8, 19.13, 19.14, or 19.15 under multiple-award contracts, as described in 8.405-5 and 16.505(b)(2)(i)(F); or
    - (ii) Issued directly to concerns that qualify for the programs described in subparts 19.8, 19.13, 19.14, or 19.15 under multiple-award contracts, as described in 19.504(c)(1)(ii); and

(6) Contracts using the HUBZone price evaluation preference to award to a HUBZone small business concern unless the concern waived the evaluation preference.

(d) Independent contractors. An independent contractor shall be considered a subcontractor.

(e) Limitations on subcontracting. By submission of an offer and execution of a contract, the Contractor agrees to the following requirements in the performance of a contract assigned a North American Industry Classification System (NAICS) code applicable to this contract:

(1) Services (except construction). It will not pay more than 50 percent of the amount paid by the Government for contract performance, excluding certain other direct costs and certain work performed outside the United States (see paragraph (e)(1)(i)), to subcontractors that are not similarly situated entities. Any work that a similarly situated entity further subcontracts will count towards the prime contractor's 50 percent subcontract amount that cannot be exceeded. When a contract includes both services and supplies, the 50 percent limitation shall apply only to the service portion of the contract.

**(i) The following services may be excluded from the 50 percent limitation:**

**(A) Other direct costs, to the extent they are not the principal purpose of the acquisition and small business concerns, do not provide the service. Examples include airline travel, work performed by a transportation or disposal entity under a contract assigned the environmental remediation NAICS code (562910), cloud computing services, or mass media purchases.**

**(B) Work performed outside the United States on awards made pursuant to the Foreign Assistance Act of 1961, or work performed outside the United States required to be performed by a local contractor.**

(2) Supplies (other than procurement from a nonmanufacturer of such supplies). It will not pay more than 50 percent of the amount paid by the Government for contract performance, excluding the cost of materials, to subcontractors that are not similarly situated entities. Any work that a similarly situated entity further subcontracts will count towards the prime contractor's 50 percent subcontract amount that cannot be exceeded. When a contract includes both supplies and services, the 50 percent limitation shall apply only to the supply portion of the contract.

(3) General construction. It will not pay more than 85 percent of the amount paid by the Government for contract performance, excluding the cost of materials, to subcontractors that are not similarly situated entities. Any work that a similarly situated entity further subcontracts will count towards the prime contractor's 85 percent subcontract amount that cannot be exceeded.

(4) Construction by special trade contractors. It will not pay more than 75 percent of the amount paid by the Government for contract performance, excluding the cost of materials, to subcontractors that are not similarly situated entities. Any work that a similarly situated entity

further subcontracts will count towards the prime contractor's 75 percent subcontract amount that cannot be exceeded.

(f) The Contractor shall comply with the limitations on subcontracting as follows:

(1) For contracts, in accordance with paragraphs (c)(1), (2), (3) and (6) of this clause –

[Contracting Officer check as appropriate.]

By the end of the base term of the contract and then by the end of each subsequent option period; or

By the end of the performance period for each order issued under the contract.

(2) For orders, in accordance with paragraphs (c)(4) and (5) of this clause, by the end of the performance period for the order.

(g) A joint venture agrees that, in the performance of the contract, the applicable percentage specified in paragraph (e) of this clause will be performed by the aggregate of the joint venture participants.

(End of clause)

**TAB 2 - Addendum:  
BACKGROUND:**

FAC 2021-07 announced publication of FAR case 2016-011, which revised and standardized the requirements on limitations on subcontracting, including the nonmanufacturer rule, that applies to small business concerns under FAR part 19 procurements. This rule implemented regulatory changes based on Section 1651 of the FY 2013 NDAA, issued by the Small Business Administration (SBA) in its final rule published in the Federal Register at 81 FR 34243, on May 31, 2016.

More specifically, the FAR revision shifts the limitations on subcontracting from the concept of a required percentage of work to be performed by a prime contractor to the concept of the percentage of the overall award amount to be spent by the prime on subcontractors. As a result, a prime contractor no longer has to track the percentage of costs it incurs performing work itself; it only has to track the amounts (i.e., contract price) that it spends on subcontractors.

Under the revised limitations on subcontracting requirements, a small business concern performing a set aside contract must agree that it will not pay more than 50% of the amount paid from the Government to firms that are not “similarly situated” (see FAR 19.001 and 13 CFR 125.6(a)(1)). For a contract that includes both services and supplies, the 50 percent limitation applies only to the services portion of the contract. Work performed by similarly situated entities is counted as if it were performed by the prime contractor for purposes of compliance with the clause. “Similarly situated entity” is further defined as

*“A first-tier subcontractor, including an independent contractor, that—*

- (1) Has the same small business program status as that which qualified the prime contractor for the award (e.g., for a small business set-aside contract, any small business concern, without regard to socioeconomic status); and*
- (2) Is considered small for the size standard under the NAICS code the prime contractor assigned to the subcontract.”*

Exclusions from the limitations on subcontracting for other direct costs and overseas contracts:

One down side of this change is that small businesses are not able to exclude from their calculations the amounts paid for services that are not provided by US small businesses, such as airline fares. This FAR change also does not recognize the unique challenges federal contractors face in an overseas environment; for example, reliance on foreign subcontractors, including individuals (“independent contractors”) to perform part of the contract’s scope of work and the fact that foreign contractors will rarely be treated as “similarly-situated entities.”

In recognition of these challenges, SBA, in its final rule at [84 FR 65647](#) dated 11/29/19, added the following exceptions to the limitation on subcontracting requirements in 13 FR 125.6(a)(1):

*“Other direct costs may be excluded to the extent they are not the principal purpose of the acquisition and small business concerns do not provide the service, such as airline travel, work performed by a transportation or disposal entity under a contract assigned the environmental remediation NAICS code (562910), cloud computing services, or mass media purchases. In*



***addition, work performed overseas on awards made pursuant to the Foreign Assistance Act of 1961, or work required to be performed by a local contractor, is excluded.***”

As noted in the SBA’s final rule, “*The regulatory text is not meant to be inclusive. It allows a small business in another industry in a similar situation] ...[to also demonstrate that certain direct costs should be excluded because they are not the principal purpose of the acquisition and small business concerns do not provide the service.*”

Independent Contractors—Employee vs. subcontractor:

The FAR change adds the following language to the limitation on subcontracting clause at 52.219-14, related to independent contractors: “An independent contractor shall be considered a subcontractor.” This statement, which was previously included in the SBA’s regulation at 13 CFR 125.6(e)(3), caused some confusion as to how to properly treat independent contractors for purposes of the limitations on subcontracting provisions. SBA, in its final rule at [84 FR 65647](#), revised 13 CFR 125.6(e) by providing the following clarification related to independent contractors:

*“(3) For contracts where an independent contractor is not otherwise treated as an employee of the concern for which he/she is performing work for size purposes under § 121.106(a) of this chapter, work performed by the independent contractor shall be considered a subcontract. Such work will count toward meeting the applicable limitation on subcontracting where the independent contractor qualifies as a similarly situated entity.”*

The preamble of this rule provides additional guidance on *circumstances* under which an independent contractor may be considered an employee, as opposed to a subcontractor. This is largely a matter of state employment law, and the CO does not need to make this determination. Instead, the CO may rely on the determination made by the contractor as to whether an individual is considered an employee or an independent contractor/subcontractor.

Status

The FAR Council agreed to open FAR case [2021-20, Limitations on Subcontracting Revisions](#), to add SBA-approved exceptions to the limitation on subcontracting requirements into the FAR. Meanwhile, the Senior Procurement Executive has signed a class deviation from the FAR #M/OAA-DEV-FAR-21-02c and its successor [#M/OAA-DEV-FAR-23-04c](#) to allow USAID contractors to use these exceptions ahead of the FAR rulemaking process. The exceptions are incorporated into the revised limitation on subcontracting clause at 52.219-14.