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# NAICS Codes Don't Flow Down to Subcontracts

Many prime contractors are missing a little something in their subcontracts, particularly subcontracts with small businesses: the designation of the appropriate NAICS code and associated small business size standard. Contrary to a common misunderstanding, the prime contract's NAICS code and size standard do not automatically flow down to subcontracts—and this means that just because a business qualifies as small under the prime contract's NAICS code does not necessarily mean that the prime can count the business as small for subcontracting purposes.

The SBA's regulations, at [13 C.F.R. 125.3\(c\)\(1\)\(v\)](#), provides that when an "other than small" prime contractor is awarded a contract or modification exceeding \$750,000, or \$1.5 million for construction:

The [prime] contractor must assign to each subcontract, and to each solicitation, if a solicitation is utilized, the NAICS code and corresponding size standard that best describes the principal purpose of the subcontract (see [[13 C.F.R. 121.410](#)]). A formal solicitation is not required for each subcontract, but the contractor must provide some form of written notice of the NAICS code and size standard assigned to potential offerors prior to acceptance and award of the subcontract."

[FAR 52.219-9](#), which governs small business subcontracting plans, includes a similar requirement.

The SBA's regulation at 13 C.F.R. 121.410, in turn, says that a subcontractor ordinarily qualifies as small when "it does not exceed the size standard for the NAICS code that the prime contractor believes best describes the product or service being acquired by the subcontract." In other words, the prime contractor must assign the appropriate NAICS code based on the subcontractor's scope of work.

While neither the FAR nor 13 C.F.R. 121.410 provide additional guidance to prime contractors when it comes to selecting NAICS codes, the prime's task is little different than that of the Contracting Officer when it comes to picking the best NAICS code for the prime contract. With that in mind, prime contractors would be wise to consider the factors set forth in [13 C.F.R. 121.402\(b\)](#), which requires consideration of the descriptions set forth in the [NAICS Manual](#) and, among other guidance, states that "[a] procurement is generally classified according to the component which accounts for the greatest percentage of contract value."

The phrase "believes best" provides the prime contractor with some degree of subjectivity in close cases, in which two or more NAICS codes might be appropriate. In many cases, though, there is only one reasonable answer to the question of which NAICS code is "best." If the "best" NAICS code for the subcontractor's scope of work isn't the same as the one assigned to the prime contract, the prime contractor could land in hot water if it simply flows down the prime contract's NAICS code and associated size standard. In fact, 13 C.F.R. 125.3(f)(2) says that an SBA compliance review of a prime contractor's subcontracting practices will include:

An evaluation of whether the prime contractor assigned the proper NAICS code and corresponding size standard to a subcontract, and a review of whether small business subcontractors qualify for the size or socioeconomic status claimed.

A disconnect between the prime contract's NAICS code and the "best" NAICS codes for subcontracts can arise under almost any type of prime contract, but prime contracts for general construction are an obvious example. Prime contracts for general construction ordinarily are assigned NAICS code 236210 or NAICS code 236220, both of which currently carry associated \$45.0 million small business size standards. (Other general construction codes under NAICS Subsector 237 also have \$45.0 million size standards).

When it comes to subcontracting, though, the typical subcontractor is not performing general construction, as described in the *NAICS Manual*, but rather specialty trade work: masonry, roofing, siding, electrical, plumbing, and so on. In other words, the "best" NAICS code for many construction subcontracts is a specialty trade NAICS code under NAICS Subsector 238—and these codes all have \$19.0 million size standards, except NAICS code 238290, whose size standard is only slightly higher at \$22.0 million.

If an other-than-small prime contractor simply assumes that the \$45.0 million size standard flows down to all its subcontracts, the prime runs the risk of improperly counting as “small” businesses that don’t qualify under the \$19.0 million size standard that the prime should have assigned to many, if not all, of the subcontracts. This, in turn, could lead to trouble with the SBA or Contracting Officer—or, potentially, even expose the prime contractor to risks under the False Claims Act.

Of course, the prime-picks-the-best-NAICS rule doesn’t always work to the detriment of prime contractors. In fact, sometimes it can *enlarge* the field of small business subcontractors. For example, consider a prime contract designated with NAICS code 541310 (Architectural Services), which carries an associated \$12.5 million size standard. If the prime contractor wants to award a subcontract for engineering services, the prime shouldn’t flow down NAICS code 541310. Instead, the prime should assign the “best” NAICS code, 541330 (Engineering Services), with an associated \$25.5 million size standard. Just like that, the prime’s pool of potential small business subcontractors expands dramatically.

In my years working as a government contracts lawyer, I reviewed more than my share of draft subcontracts sent by large prime contractors to my small business clients. Many of these subcontracts—almost certainly the majority—did not include a NAICS code or size standard, or simply repeated the prime contract's NAICS code, even if the code clearly didn't apply to the subcontractor's work. When I asked, the prime usually said the same thing: “oh, don’t worry about that: the prime contract’s NAICS code flows down.”

It doesn’t.

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