



June 9, 2022

Linda Neilson
Director, Defense Acquisition Regulations System
U.S. Department of Defense
3062 Defense Pentagon
Washington, DC 20301-3062

Subject: Early Engagement Opportunity to Provide Input Regarding Pilot Program to Incentivize Contracting with Employee-Owned Businesses authorized by Section 874 of the National Defense Authorization Act for Fiscal Year 2022

Dear Ms. Neilson,

On behalf of the community of employee-owned businesses and the primary trade associations and coalitions – the **Employee-Owned Contractor Roundtable (ECR)**, the **Employee-Owned S Corporations of America (ESCA)**, the **Employee Ownership Expansion Network (EOX)**, and **Ownership for America (OA)** – this letter is submitted in support of the Pilot Program to Incentivize Contracting with Businesses Wholly-Owned through an Employee Stock Ownership Plan (ESOP) authorized by Section 874 of the National Defense Authorization Act for Fiscal Year 2022. The signatories represent over 200 employee-owned companies, many of which are federal government contractors, servicing the government at large, including the Department of Defense (DoD).

In addition to providing DoD with tangible and innovative benefits, data from top economists has consistently shown businesses wholly-owned through an ESOP create significant value in the economy, and this value extends to all workers, particularly those who represent disadvantaged communities or who are the intended beneficiaries of federal preference programs. Congress recognized the innovative potential in encouraging businesses wholly-owned through an ESOP to work with DoD and authorized the Pilot Program to Incentivize Contracting with Employee-Owned Businesses in Section 874 of the National Defense Authorization Act for Fiscal Year 2022.

The signatories offer the following recommendations for implementation and rulemaking of the Pilot Program to Incentivize Contracting with Employee-Owned Businesses authorized by Section 874 of the National Defense Authorization Act for Fiscal Year 2022.

Section 874 provides authority for DoD to establish a pilot program to incentivize contracting with businesses wholly-owned through an ESOP for an award of a sole-source follow-on contract. The authorization is dependent on DoD establishing procedures for the business 1) to verify status (using existing Federal reporting mechanisms) and 2) to certify no more than 50% of the award will be expended on subcontracts. Additionally, DoD must have procedures and mechanisms to 1) record details on the follow-on contract and 2) collect and analyze data. The data must include developing and sharing best practices as well as contract data to include size of business, performance of the follow-on contract, and any other data determined necessary.

To achieve these statutory requirements, we recommend capturing the data in a one-page form submitted by the business wholly-owned through an ESOP with each of their proposals and at completion of each contract. This form would capture elements of the data strategy required by statute as well as additional data elements such as employee retention rate, total retirement plan value, and average per employee retirement savings (see attachment 1). These additional data elements would be useful for the statutory GAO report in highlighting the innovative potential of encouraging businesses wholly-owned through an ESOP to work with DoD.

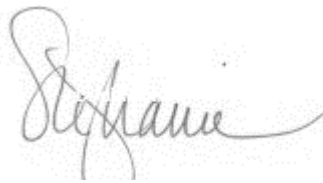
In implementing and rulemaking of the pilot program, Congress suggested DoD review Internal Revenue Service form “Schedule K-1 (Form 1120-S)” when looking to make a determination whether a business is wholly-owned through an ESOP. The signatories suggest DoD verify the status of the company as either 1) a qualified business wholly-owned through an ESOP for the purposes of this section by using the Internal Revenue Service Schedule K-1 (Form 1120-S) 2021, Part I, Lines A (Corporation’s employer identification number), and B (Corporation’s name, address, city, state, and ZIP code); and Part II, Lines E (Shareholder’s identifying number), F (Shareholder’s name, address, city, state, and ZIP code), and G (current year allocation percentage), or 2) a wholly-owned subsidiary, as demonstrated by Internal Revenue Service Form 1120-S (2021), Schedule B, Line 4a, of a qualified business wholly-owned through an ESOP based upon the Schedule K-1 documentation required by item 1). The signatories offer a draft proposed rule specifying these refinements and examples of the Internal Revenue Service Forms (attachments 2 and 3).

In summary, the signatories are encouraged by the recent recognition by Congress of the innovative potential of encouraging businesses wholly-owned through ESOPs to work with DoD and look forward to supporting DoD in their efforts to implement and conduct rulemaking of the Pilot Program to Incentivize Contracting with Employee-Owned Businesses authorized by Section 874 of the National Defense Authorization Act for Fiscal Year 2022.

Please consider us a resource on this issue and don’t hesitate to contact Matt Pearce at matt.pearce@ecrcoalition.com, 202-449-8366 (office), or 701-471-8391 (cell).



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Attachment 1: Recommended Draft Data Collection Strategy

Attachment 2: Recommended Draft Proposed Rule

Attachment 3: Sample IRS Forms to Verify Status

Attachment 4: Section 874 of the National Defense Authorization Act for Fiscal Year 2022 (P.L. 117-81)

Attachment 5: Joint Explanatory Statement to Accompany the National Defense Authorization Act for Fiscal Year 2022 (Conference Report Language)

Attachment 1:
Recommended Draft Data Collection Strategy

The signatories recommend DoD create a one-page form to require the business wholly-owned through an Employee Stock Ownership Plan (ESOP) to submit with each of their proposals and at contract completion the following data:

- Verify status of the company as either;
 - a qualified business wholly-owned through an Employee Stock Ownership Plan for the purposes of this section by using the Internal Revenue Service form Schedule K-1 (Form 1120-S) 2021, Part I, Lines A (Corporation's employer identification number), and B (Corporation's name, address, city, state, and ZIP code); and Part II, Lines E (Shareholder's identifying number), F (Shareholder's name, address, city, state, and ZIP code), and G (current year allocation percentage), or
 - a wholly-owned subsidiary, as demonstrated by Internal Revenue Service Form 1120-S (2021), Schedule B, Line 4a, of a qualified business wholly-owned through an Employee Stock Ownership Plan based upon the Schedule K-1 documentation required above;
- Verify performance of the qualified business wholly-owned through an Employee Stock Ownership Plan on the prior contract was rated as satisfactory (or the equivalent) or better in the applicable past performance database or through a signed letter from the contracting officer;
- Require certification from the company that not more than 50 percent of the amount paid under the contract will be expended on subcontracts, subject to any waivers prescribed by the Secretary;
- Collect data to include
 - date business became wholly-owned through an ESOP;
 - size of the business (for the follow-on contract);
 - performance of the current contract;
 - performance of the follow-on contract;
 - employee retention rate;
 - total ESOP retirement plan value (does not include individual 401(K) value);
 - average per employee ESOP retirement savings (does not include individual 401(K) value); and
 - best practices relating to the pilot program.

The signatories recommend OSD identify an office in OSD (A&S) to collect the forms and provide to GAO to support the statutory report.

206.302-8. Pilot Program to Incentivize Contracting with Employee-Owned Business

206.302-80 Scope.

This implements the Pilot Program to Incentivize Contracting with Employee-Owned Business (hereafter referred to as the “Program”) established under section 874 of the National Defense Authorization Act for Fiscal Year 2022 (Pub. L. 117-81). The purpose of the Program is to provide incentives for DoD to leverage the innovative potential of businesses wholly-owned through an Employee Stock Ownership Plan (ESOP) to work with the Department of Defense and bolster the defense industrial base. The pilot program established under this section shall expire on December 27, 2026.

206.302-81 Policy.

Notwithstanding the requirements of section 2304 of title 10, United States Code, and with respect to a follow-on contract for the continued development, production, or provision of products or services that are the same as or substantially similar to the products or services procured by the Department of Defense under a prior contract held by a qualified business wholly-owned through an Employee Stock Ownership Plan, the products or services to be procured under the follow-on contract may be procured by the Department of Defense through procedures other than competitive procedures if the performance of the qualified business wholly-owned through an Employee Stock Ownership Plan on the prior contract was rated as satisfactory (or the equivalent) or better in the applicable past performance database.

A qualified business wholly-owned through an Employee Stock Ownership Plan may have a single opportunity for award of a sole-source follow-on contract, unless a senior contracting official (as defined in section 1737 of title 10, United States Code) approves a waiver of the requirements of this section.

The term “qualified businesses wholly-owned through an Employee Stock Ownership Plan” means an S corporation (as defined in section 1361(a)(1) of the Internal Revenue Code of 1986) for which 100 percent of the outstanding stock is held through an employee stock ownership plan (as defined in section 4975(e)(7) of such Code).

206.302-82 Procedures.

Contracting officers must –

- (a) Verify status of the company as either:
 - (1) a qualified business wholly-owned through an Employee Stock Ownership Plan for the purposes of this section by using the Internal Revenue Service form Schedule K-1 (Form 1120-S), Part I, Lines A (Corporation’s employer identification number), and B (Corporation’s name, address, city, state, and ZIP code); and Part II, Lines E (Shareholder’s identifying number), F (Shareholder’s name, address, city, state, and ZIP code), and G (current year allocation percentage), or
 - (2) a wholly-owned subsidiary, as demonstrated by Internal Revenue Service Form 1120-S, Schedule B, Line 4a, of a qualified business wholly-owned through an Employee Stock Ownership Plan based upon the documentation required by subsection (a)(1);
- (b) Verify performance of the qualified business wholly-owned through an Employee Stock Ownership Plan on the prior contract was rated as satisfactory (or the equivalent) or better in the applicable past performance database or through a signed letter from the contracting officer;

- (c) Require certification from the company that not more than 50 percent of the amount paid under the contract will be expended on subcontracts, subject to any waivers prescribed by the Secretary;
- (d) Collect data to include
 - (1) date business became wholly-owned through an ESOP;
 - (2) size of the business;
 - (3) performance of the current contract;
 - (4) performance of the follow-on contract;
 - (5) employee retention rate;
 - (6) total retirement plan value;
 - (7) average per employee retirement savings; and
 - (8) best practices relating to the pilot program;
- (e) Not require disclosure of any Internal Revenue Service forms or information on such forms other than those sections of those forms specified above.

Schedule K-1 (Form 1120-S) 2021 for DoD Implementation of Sec. 874, FY22 NDAA

671121

Final K-1

Amended K-1

OMB No. 1545-0123

Schedule K-1 (Form 1120-S)

2021

Department of the Treasury
Internal Revenue Service

For calendar year 2021, or tax year

beginning / / 2021

ending / /

Shareholder's Share of Income, Deductions, Credits, etc.
▶ See separate instructions.

Part I Information About the Corporation

A Corporation's employer identification number

B Corporation's name, address, city, state, and ZIP code
Name of company doing business with the government.

C IRS Center where corporation filed return

D Corporation's total number of shares
Beginning of tax year _____
End of tax year _____

Part II Information About the Shareholder

E Shareholder's identifying number

F Shareholder's name, address, city, state, and ZIP code
Name of employee stock ownership plan (ESOP).

G Current year allocation percentage **100%**

H Shareholder's number of shares
Beginning of tax year _____
End of tax year _____

I Loans from shareholder
Beginning of tax year \$ _____
End of tax year \$ _____

For IRS Use Only

Part III Shareholder's Share of Current Year Income, Deductions, Credits, and Other Items

1	Ordinary business income (loss)	13	Credits
2	Net rental real estate income (loss)		
3	Other net rental income (loss)		
4	Interest income		
5a	Ordinary dividends		
5b	Qualified dividends	14	Schedule K-3 is attached if checked <input type="checkbox"/>
6	Royalties	15	Alternative minimum tax (AMT) items
7	Net short-term capital gain (loss)		
8a	Net long-term capital gain (loss)		
8b	Collectibles (28%) gain (loss)		
8c	Unrecaptured section 1250 gain		
9	Net section 1231 gain (loss)	16	Items affecting shareholder basis
10	Other income (loss)		
		17	Other information
11	Section 179 deduction		
12	Other deductions		
18	<input type="checkbox"/> More than one activity for at-risk purposes*		
19	<input type="checkbox"/> More than one activity for passive activity purposes*		

* See attached statement for additional information.

U.S. Income Tax Return for an S Corporation

Form 1120-S

Department of the Treasury Internal Revenue Service

Do not file this form unless the corporation has filed or is attaching Form 2553 to elect to be an S corporation.

Go to www.irs.gov/Form1120S for instructions and the latest information.

2021

For calendar year 2021 or tax year beginning , 2021, ending , 20

Form header section with fields: A S election effective date, B Business activity code number, C Check if Sch. M-3 attached, Name, Number, street, and room or suite no., City or town, state or province, country, and ZIP or foreign postal code, D Employer identification number, E Date incorporated, F Total assets (see instructions)

Form section G through J: G Is the corporation electing to be an S corporation... H Check if: (1) Final return (2) Name change... I Enter the number of shareholders... J Check if corporation: (1) Aggregated activities... (2) Grouped activities...

Caution: Include only trade or business income and expenses on lines 1a through 21. See the instructions for more information.

Income section (lines 1a-6): 1a Gross receipts or sales, 1b Returns and allowances, 1c Balance, 2 Cost of goods sold, 3 Gross profit, 4 Net gain (loss), 5 Other income (loss), 6 Total income (loss)

Deductions section (lines 7-21): 7 Compensation of officers, 8 Salaries and wages, 9 Repairs and maintenance, 10 Bad debts, 11 Rents, 12 Taxes and licenses, 13 Interest, 14 Depreciation, 15 Depletion, 16 Advertising, 17 Pension, 18 Employee benefit programs, 19 Other deductions, 20 Total deductions, 21 Ordinary business income (loss)

Tax and Payments section (lines 22a-27): 22a Excess net passive income, 22b Tax from Schedule D, 22c Add lines 22a and 22b, 23a-23c 2021 estimated tax payments, 24 Estimated tax penalty, 25 Amount owed, 26 Overpayment, 27 Enter amount from line 26

Sign Here: Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete.

Signature fields: Signature of officer, Date, Title, and a box for 'May the IRS discuss this return with the preparer shown below?' with Yes/No options.

Paid Preparer Use Only section: Print/Type preparer's name, Preparer's signature, Date, Check if self-employed, PTIN, Firm's name, Firm's EIN, Firm's address, Phone no.

Schedule B Other Information (see instructions)

1	Check accounting method: a <input type="checkbox"/> Cash b <input type="checkbox"/> Accrual c <input type="checkbox"/> Other (specify) ▶ _____	Yes	No
2	See the instructions and enter the: a Business activity ▶ _____ b Product or service ▶ _____		
3	At any time during the tax year, was any shareholder of the corporation a disregarded entity, a trust, an estate, or a nominee or similar person? If "Yes," attach Schedule B-1, Information on Certain Shareholders of an S Corporation . . .		
4	At the end of the tax year, did the corporation:		
a	Own directly 20% or more, or own, directly or indirectly, 50% or more of the total stock issued and outstanding of any foreign or domestic corporation? For rules of constructive ownership, see instructions. If "Yes," complete (i) through (v) below	X	

(i) Name of Corporation	(ii) Employer Identification Number (if any)	(iii) Country of Incorporation	(iv) Percentage of Stock Owned	(v) If Percentage in (iv) Is 100%, Enter the Date (if applicable) a Qualified Subchapter S Subsidiary Election Was Made
			100%	

b	Own directly an interest of 20% or more, or own, directly or indirectly, an interest of 50% or more in the profit, loss, or capital in any foreign or domestic partnership (including an entity treated as a partnership) or in the beneficial interest of a trust? For rules of constructive ownership, see instructions. If "Yes," complete (i) through (v) below		
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(i) Name of Entity	(ii) Employer Identification Number (if any)	(iii) Type of Entity	(iv) Country of Organization	(v) Maximum Percentage Owned in Profit, Loss, or Capital

5a	At the end of the tax year, did the corporation have any outstanding shares of restricted stock? If "Yes," complete lines (i) and (ii) below.		
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(i)	Total shares of restricted stock ▶ _____
(ii)	Total shares of non-restricted stock ▶ _____

b	At the end of the tax year, did the corporation have any outstanding stock options, warrants, or similar instruments? If "Yes," complete lines (i) and (ii) below.		
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(i)	Total shares of stock outstanding at the end of the tax year ▶ _____
(ii)	Total shares of stock outstanding if all instruments were executed ▶ _____

6	Has this corporation filed, or is it required to file, Form 8918 , Material Advisor Disclosure Statement, to provide information on any reportable transaction? <input type="checkbox"/>		
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7	Check this box if the corporation issued publicly offered debt instruments with original issue discount <input type="checkbox"/> If checked, the corporation may have to file Form 8281 , Information Return for Publicly Offered Original Issue Discount Instruments.		
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8	If the corporation (a) was a C corporation before it elected to be an S corporation or the corporation acquired an asset with a basis determined by reference to the basis of the asset (or the basis of any other property) in the hands of a C corporation, and (b) has net unrealized built-in gain in excess of the net recognized built-in gain from prior years, enter the net unrealized built-in gain reduced by net recognized built-in gain from prior years. See instructions ▶ \$ _____		
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9	Did the corporation have an election under section 163(j) for any real property trade or business or any farming business in effect during the tax year? See instructions		
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10	Does the corporation satisfy one or more of the following? See instructions		
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- a** The corporation owns a pass-through entity with current, or prior year carryover, excess business interest expense.
- b** The corporation's aggregate average annual gross receipts (determined under section 448(c)) for the 3 tax years preceding the current tax year are more than \$26 million and the corporation has business interest expense.
- c** The corporation is a tax shelter and the corporation has business interest expense.
If "Yes," complete and attach Form 8990.

11	Does the corporation satisfy both of the following conditions?		
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- a** The corporation's total receipts (see instructions) for the tax year were less than \$250,000.
- b** The corporation's total assets at the end of the tax year were less than \$250,000.
If "Yes," the corporation is not required to complete Schedules L and M-1.

Schedule B Other Information (see instructions) <i>(continued)</i>		Yes	No
12	During the tax year, did the corporation have any non-shareholder debt that was canceled, was forgiven, or had the terms modified so as to reduce the principal amount of the debt?		
	If "Yes," enter the amount of principal reduction ▶ \$		
13	During the tax year, was a qualified subchapter S subsidiary election terminated or revoked? If "Yes," see instructions		
14a	Did the corporation make any payments in 2021 that would require it to file Form(s) 1099?		
b	If "Yes," did the corporation file or will it file required Form(s) 1099?		
15	Is the corporation attaching Form 8996 to certify as a Qualified Opportunity Fund?		
	If "Yes," enter the amount from Form 8996, line 15 ▶ \$		

Schedule K Shareholders' Pro Rata Share Items		Total amount	
Income (Loss)	1 Ordinary business income (loss) (page 1, line 21)	1	
	2 Net rental real estate income (loss) (attach Form 8825)	2	
	3a Other gross rental income (loss) 3a		
	b Expenses from other rental activities (attach statement) 3b		
	c Other net rental income (loss). Subtract line 3b from line 3a	3c	
	4 Interest income	4	
	5 Dividends: a Ordinary dividends 5a		
	b Qualified dividends 5b		
	6 Royalties	6	
	7 Net short-term capital gain (loss) (attach Schedule D (Form 1120-S))	7	
8a Net long-term capital gain (loss) (attach Schedule D (Form 1120-S))	8a		
	b Collectibles (28%) gain (loss) 8b		
	c Unrecaptured section 1250 gain (attach statement) 8c		
9 Net section 1231 gain (loss) (attach Form 4797)	9		
10 Other income (loss) (see instructions) Type ▶	10		
Deductions	11 Section 179 deduction (attach Form 4562)	11	
	12a Charitable contributions	12a	
	b Investment interest expense	12b	
	c Section 59(e)(2) expenditures Type ▶	12c	
d Other deductions (see instructions) Type ▶	12d		
Credits	13a Low-income housing credit (section 42(j)(5))	13a	
	b Low-income housing credit (other)	13b	
	c Qualified rehabilitation expenditures (rental real estate) (attach Form 3468, if applicable)	13c	
	d Other rental real estate credits (see instructions) Type ▶	13d	
	e Other rental credits (see instructions) Type ▶	13e	
	f Biofuel producer credit (attach Form 6478)	13f	
	g Other credits (see instructions) Type ▶	13g	
International Transactions	14 Attach Schedule K-2 (Form 1120-S), Shareholders' Pro Rata Share Items—International, and check this box to indicate you are reporting items of international tax relevance ▶ <input type="checkbox"/>		
Alternative Minimum Tax (AMT) Items	15a Post-1986 depreciation adjustment	15a	
	b Adjusted gain or loss	15b	
	c Depletion (other than oil and gas)	15c	
	d Oil, gas, and geothermal properties—gross income	15d	
	e Oil, gas, and geothermal properties—deductions	15e	
	f Other AMT items (attach statement)	15f	
Items Affecting Shareholder Basis	16a Tax-exempt interest income	16a	
	b Other tax-exempt income	16b	
	c Nondeductible expenses	16c	
	d Distributions (attach statement if required) (see instructions)	16d	
	e Repayment of loans from shareholders	16e	
	f Foreign taxes paid or accrued	16f	

Schedule K		Shareholders' Pro Rata Share Items <i>(continued)</i>	Total amount	
Other Information	17a	Investment income	17a	
	b	Investment expenses	17b	
	c	Dividend distributions paid from accumulated earnings and profits	17c	
	d	Other items and amounts (attach statement)		
Reconciliation	18	Income (loss) reconciliation. Combine the amounts on lines 1 through 10 in the far right column. From the result, subtract the sum of the amounts on lines 11 through 12d and 16f .	18	

Schedule L		Balance Sheets per Books		Beginning of tax year		End of tax year	
		(a)	(b)	(c)	(d)		
Assets							
1	Cash						
2a	Trade notes and accounts receivable						
b	Less allowance for bad debts	()		()			
3	Inventories						
4	U.S. government obligations						
5	Tax-exempt securities (see instructions)						
6	Other current assets (attach statement)						
7	Loans to shareholders						
8	Mortgage and real estate loans						
9	Other investments (attach statement)						
10a	Buildings and other depreciable assets						
b	Less accumulated depreciation	()		()			
11a	Depletable assets						
b	Less accumulated depletion	()		()			
12	Land (net of any amortization)						
13a	Intangible assets (amortizable only)						
b	Less accumulated amortization	()		()			
14	Other assets (attach statement)						
15	Total assets						
Liabilities and Shareholders' Equity							
16	Accounts payable						
17	Mortgages, notes, bonds payable in less than 1 year						
18	Other current liabilities (attach statement)						
19	Loans from shareholders						
20	Mortgages, notes, bonds payable in 1 year or more						
21	Other liabilities (attach statement)						
22	Capital stock						
23	Additional paid-in capital						
24	Retained earnings						
25	Adjustments to shareholders' equity (attach statement)						
26	Less cost of treasury stock		()		()		
27	Total liabilities and shareholders' equity						

Schedule M-1 Reconciliation of Income (Loss) per Books With Income (Loss) per Return

Note: The corporation may be required to file Schedule M-3. See instructions.

<p>1 Net income (loss) per books</p> <p>2 Income included on Schedule K, lines 1, 2, 3c, 4, 5a, 6, 7, 8a, 9, and 10, not recorded on books this year (itemize) _____</p> <p>_____</p> <p>3 Expenses recorded on books this year not included on Schedule K, lines 1 through 12 and 16f (itemize):</p> <p>a Depreciation \$ _____</p> <p>_____</p> <p>b Travel and entertainment \$ _____</p> <p>_____</p> <p>4 Add lines 1 through 3</p>	<p>5 Income recorded on books this year not included on Schedule K, lines 1 through 10 (itemize):</p> <p>a Tax-exempt interest \$ _____</p> <p>_____</p> <p>6 Deductions included on Schedule K, lines 1 through 12 and 16f, not charged against book income this year (itemize):</p> <p>a Depreciation \$ _____</p> <p>_____</p> <p>7 Add lines 5 and 6</p> <p>8 Income (loss) (Schedule K, line 18). Subtract line 7 from line 4</p>
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Schedule M-2 Analysis of Accumulated Adjustments Account, Shareholders' Undistributed Taxable Income Previously Taxed, Accumulated Earnings and Profits, and Other Adjustments Account
(see instructions)

	(a) Accumulated adjustments account	(b) Shareholders' undistributed taxable income previously taxed	(c) Accumulated earnings and profits	(d) Other adjustments account
1 Balance at beginning of tax year				
2 Ordinary income from page 1, line 21				
3 Other additions				
4 Loss from page 1, line 21	()			
5 Other reductions	()			()
6 Combine lines 1 through 5				
7 Distributions				
8 Balance at end of tax year. Subtract line 7 from line 6				

Attachment 4:
Section 874 of the National Defense Authorization Act for Fiscal Year 2022
(P.L. 117-81)

SEC. 874. PILOT PROGRAM TO INCENTIVIZE CONTRACTING WITH EMPLOYEE-OWNED BUSINESSES.

(a) Qualified Business Wholly-owned Through an Employee Stock Ownership Plan Defined.--The term "qualified businesses wholly-owned through an Employee Stock Ownership Plan" means an S corporation (as defined in section 1361(a)(1) of the Internal Revenue Code of 1986) for which 100 percent of the outstanding stock is held through an employee stock ownership plan (as defined in section 4975(e)(7) of such Code).

(b) Pilot Program to Use Noncompetitive Procedures for Certain Follow-on Contracts to Qualified Businesses Wholly-Owned Through an Employee Stock Ownership Plan.--

(1) Establishment.--The Secretary of Defense may establish a pilot program to carry out the requirements of this section.

(2) Follow-on contracts.--Notwithstanding the requirements of section 2304 of title 10, United States Code, and with respect to a follow-on contract for the continued development, production, or provision of products or services that are the same as or substantially similar to the products or services procured by the Department of Defense under a prior contract held by a qualified business wholly-owned through an Employee Stock Ownership Plan, the products or services to be procured under the follow-on contract may be procured by the Department of Defense through procedures other than competitive procedures if the performance of the qualified business wholly-owned through an Employee Stock Ownership Plan on the prior contract was rated as satisfactory (or the equivalent) or better in the applicable past performance database.

(3) Limitation.--A qualified business wholly-owned through an Employee Stock Ownership Plan may have a single opportunity for award of a sole-source follow-on contract under this section, unless a senior contracting official (as defined in section 1737 of title 10, United States Code) approves a waiver of the requirements of this section.

(c) Verification and Reporting of Qualified Businesses Wholly-owned Through an Employee Stock Ownership Plan. <> --Under a pilot program established under this section, the Secretary of Defense shall establish procedures--

(1) for businesses to verify status as a qualified businesses wholly-owned through an Employee Stock Ownership Plan for the purposes of this section by using existing Federal reporting mechanisms;

(2) for a qualified businesses wholly-owned through an Employee Stock Ownership Plan to certify that not more than 50 percent of the amount paid under the contract will be expended on subcontracts, subject to such necessary and reasonable waivers as the Secretary may prescribe; and

(3) to record information on each follow-on contract awarded under subsection (b), including details relevant to the nature of such contract and the qualified business wholly-owned through an Employee Stock Ownership Plan that received such contract, and to provide such information to the Comptroller General of the United States.

(d) Data.--

(1) In general.--If the Secretary of Defense establishes a pilot program under this section, the Secretary shall establish mechanisms to collect and analyze data on the pilot program for the purposes of--

(A) developing and sharing best practices relating to the pilot program;

(B) providing information to leadership and the congressional defense committees on the pilot program, including with respect to each qualified business wholly-owned through an Employee Stock Ownership Plan that received a follow-on contract under this section--

(i) the size of such business;

(ii) performance of the follow-on contract;

and

(iii) other information as determined

necessary; and

(C) providing information to leadership and the congressional defense committees on policy issues related to the pilot program.

(2) Limitation.--The Secretary of Defense may not carry out the pilot program under this section before--

(A) completing a data collection and reporting strategy and plan to meet the requirements of this subsection; and

(B) submitting the strategy and plan to the congressional defense committees.

(e) Sunset.--Any pilot program established under this section shall expire on the date that is five years after the date of the enactment of this Act.

(f) Comptroller General Report.--

(1) In general.--Not later than three years after the date of the enactment of this Act, the Comptroller General of the United States shall submit to Congress a report on any individual and aggregate uses of the authority under a pilot program established under this section.

(2) Elements.--The report under paragraph (1) shall include the following elements:

(A) An assessment of the frequency and nature of the use of the authority under the pilot program.

(B) An assessment of the impact of the pilot program in supporting the national defense strategy required under section 113(g) of title 10, United States Code.

(C) The number of businesses that became qualified businesses wholly-owned through an Employee Stock Ownership Plan in order to benefit from the pilot program and the factors that influenced that decision.

(D) Acquisition authorities that could incentivize businesses to become qualified businesses wholly-owned through an Employee Stock Ownership Plan, including an extension of the pilot program.

(E) Any related matters the Comptroller General considers appropriate.

Attachment 5:
Joint Explanatory Statement to Accompany the National Defense Authorization Act for Fiscal Year
2022
(Conference Report Language)

Pilot program to incentivize contracting with employee-owned businesses (sec. 874)

The Senate amendment contained a provision (sec. 843) that would permit the Secretary of Defense to carry out a 5-year pilot program that allows for the use of noncompetitive procedures for follow-on contracts to qualified businesses wholly owned by an employee stock ownership plan (ESOP). The provision would also require the Comptroller General of the United States to submit a report to the Committees on Armed Services of the Senate and the House of Representatives on the Department of Defense's use of the pilot not later than 3 years after the date of the enactment of this Act.

The House bill contained no similar provision.

The agreement includes the Senate provision with an amendment that would limit the follow-on opportunity. We recognize the innovative potential in encouraging non-traditional companies, like businesses wholly owned by an ESOP, to work with the Department of Defense. While there are many companies that have a level of employee ownership, a business wholly owned by an ESOP is different. We are aware of concerns regarding correctly identifying businesses wholly owned through an ESOP, and suggest the Department review Internal Revenue Service form "Schedule K-1 (Form 1120-S)" when looking to make that determination. Additionally, while we aim to bolster the defense industrial base with the provision, we do not intend to make it possible for a business other than a small business to receive the award of a contract that would have otherwise been set aside for small businesses under the requirements of Federal Acquisition Regulation Subpart 19.502.