

Small Business Notes

In this issue:

- **New “Reasonable Person” Standard for Determining Disadvantaged Status in U.S. Department of Transportation Infrastructure Construction Program**
- **A Reminder for Businesses Undergoing SBA Review of PPP Loans and Loan Forgiveness**
- **Cost of Capital and Inflation Driven Barriers to Growth Develop the Need for Business Valuation**
- **Corporate Transparency Act Challenged in Federal Court**
- **Changes to Implement Provisions of the Trademark Modernization Act**

New “Reasonable Person” Standard for Determining Disadvantaged Status in U.S. Department of Transportation Infrastructure Construction Program

On July 21, 2022, the U.S. Department of Transportation issued a proposed rule making changes to the standards for showing disadvantaged status under the Infrastructure Investment and Jobs Act. (The proposed rule appears at 87 Federal Register 43620.) That Act appropriated \$550 billion for improvements to the nation’s physical transportation infrastructure; and stressed the importance of using contractors certified through the DOT’s Disadvantaged Business Enterprise (DBE) program.

That DBE program provides that a business can be either socially or economically disadvantaged. The definition of socially disadvantaged business remains straight-forward under the proposed rule: membership in a class of individuals identified by the U.S. Small Business Administration (to include women, Hispanic Americans, African Americans, and Asian and Pacific Islander Americans). The standard for economic disadvantaged is based, currently, on the business owner’s net worth of less than \$1.32 million and that the owner does not have the ability to accumulate substantial wealth. That test for the ability to accumulate substantial wealth involves a review of five factors:

- Average gross income over \$350,000 for the last three years;
- An amount of income unlikely to be repeated.
- Substantial losses that offset earnings.
- The degree to which income is reinvested.
- A total fair market value for all assets that exceeds \$ 6 million.

The proposed rule would eliminate that five factor test and replace it with a test of whether a reasonable person would regard the owner as disadvantaged looking at factors like the owner’s lifestyle and access to immediate wealth or assets of a type or magnitude inconsistent with being disadvantaged.

In short, the test has become more subjective on the part of the evaluators.

Small Business Notes

A Reminder for Businesses Undergoing SBA Review of PPP Loans and Loan Forgiveness

The SBA is conducting reviews of loans and loan forgiveness under the Payroll Protection Program (PPP). These reviews are for loans under both the first and second draws of the program. An adverse decision for the loan recipient triggers appeal rights that are explained in the final decision.

Recipients considering an appeal are reminded that the appeal decision is made by an administrative judge on the administrative record only. That is, it will be made only on the documents that SBA considered in making its initial decision, plus the content of the appeal petition, plus any reply by SBA, plus any filings relating to objections to the administrative record. There will be no oral hearings or additional evidence beyond the administrative record. The recipient appealing the SBA's decision has the burden of proof.

Final decisions may be taken to federal district court but only after the appellant has filed a request for consideration with SBA and thus exhausted its administrative remedies.

Possible appellants are advised to seek review and assistance of their private legal counsel.

Cost of Capital and Inflation Driven Barriers to Growth Develop the Need for Business Valuation

Having an accurate and comprehensive business valuation is necessary for the sale of a business: both to identify a sales price and to identify any steps the seller must take to achieve and support that price.

But there are additional benefits to the business owner to having a business valuation even when a sale is not presently planned:

- As a benchmark and to identify factors which might accelerate or inhibit growth which to compare future growth.
- As support to requests to banks and other lenders for loans and lines of credit, and to support efforts to raise outside equity capital.
- In planning for expansion, collaborations, or joint ventures in setting targets and identifying capabilities that are congruent with the other parties.
- In planning for business success to enable the owner to identify what needs to be done to get the sales price the owner needs to take out of the business.

Continued...

Small Business Notes

A comprehensive valuation is most often a mix of various methods of evaluation:

- The business' "book value," which is the difference between total balance sheet assets and total balance sheet liabilities;
- The business' "liquidation value", which is the net proceeds in cash that the business would receive if all its assets were sold off;
- The business' "comparable value" –what other similar businesses in the same industry are selling for;
- The business' "discounted future cash flow". This generally has two parts, a simple multiplication of the business' annual earnings by a standard, published industry multiple and an analysis of the factors which might inhibit cash flow or accelerate earnings. For example, on the accelerate side a business may have an asset not on its balance sheet, like a patent, for which research shows future value. On the inhibition side, a business may be in an industry where its market is in decline, or new technology gives competitors a market advantage.

In short, a valuation is a tool to obtain not just a potential sales price but also to look at factors that will enhance or limit growth in the business' particular market.

Corporate Transparency Act Challenged in Federal Court

As noted earlier in this publication ([Small Business Notes, December 2021](#)) the federal Corporate Transparency Act (CTA)—which requires a business to disclose the identities and other information on the beneficial owners of a business—has an exemption for certain classes of business, mostly those in the financial services industry which already collect this kind of information, but the Act does not have an exemption based on business size: small businesses are held to the same standard as larger businesses.

The absence of such a small business exemption was a major part of objections to the legislation and its implementing rules by interested and affected parties who argued that the Act and its rules would impose a substantial financial burden on small firms.

On November 15, 2022, National Small Business United, doing business as the National Small Business Association filed suit in the U.S. District Court for the Northern District of Alabama against the U.S. Department of the Treasury, Secretary of the Treasury Janet Yellen, and Himamauli Das the Acting Director of Treasury's Financial Crimes Enforcement Network (FINCEN).

Continued...

Small Business Notes

The plaintiff's complaint reprises the small business burden argument noting that "Among other burdens imposed by the CTA, business owners may have to consult lawyers to parse through nearly 100 pages of the Final Rule to determine whether the vague and confusing reporting requirements of the CTA apply or, alternatively, risk interpreting such terms on their own."

But the complaint makes an (unexpectedly) broader constitutional challenge to the CTA arguing that the Act violates six constitutional principles:

1. The CTA infringes on the States' sovereign powers over the formation and governance of entities under State law;
2. While the U.S. Constitution gives Congress the power to regulate commerce, the formation of a business entity at the moment of its formation is not a commercial activity subject to such regulation.
3. CTA's broad application to all entities formed under state law is an indiscriminate regulation of entity formation to include entities not involved in interstate commerce and possibly not involved in any commercial activity in violation of the Constitution's limit of Congressional regulation to interstate, foreign, and Indian commerce.
4. By requiring individuals forming an entity under to state law to identify themselves to the federal government, the CTA violates these individuals' rights to free speech and free association.
5. The CTA in requiring individuals to disclose personal information without any suspicion of wrongdoing violates the individuals' rights under the Fourth Amendment to "be secure in their persons, houses, papers, and effects," and violates their privilege against self-incrimination under the Fifth Amendment.
6. The CTA is unconstitutionally vague as to definitions of "applicant" and "beneficial owner" giving too much interpretive power to the federal government.

On all the constitutional claims the suit seeks the court to declare the CTA unconstitutional and to enjoin the federal government from enforcing the Act against the plaintiffs.

Small Business Notes

Changes to Implement Provisions of the Trademark Modernization Act

As part of the Trademark Modernization Act of 2020, the United States Patent and Trademark Office (USPTO) has made and is implementing two changes to the issuance of trademark registration certificates and the available period in which to respond to office actions provisionally refusing pending applications.

The USPTO's first change was, as of May 24, 2022, to issue only electronic trademark registration certificates. After that date, electronically issued registration certificates authenticated with the electronic signature of the USPTO Director and agency digital seal will serve as official registration certificates. The electronic trademark registrations according to the USPTO, will be issued 1 – 2 weeks more quickly than the current printed registration certificates.

The USPTO's second change is, effective December 3, 2022, to reduce the response period for office actions from 6 months to 3 months. According to the USPTO data, most responses to office actions issued during the examination of a trademark application are already filed within 3 months. This formal change is intended to promote efficiency in examination by shortening the time period applicants have to respond to official letters from the USPTO.

If additional time is needed, applicants may request a single extension of 3 months (for a total of 6 months) for \$125 USPTO fee. The extension must be requested within the initial time period of 3 months.

This change does not alter the response period for applications filed under the Madrid system.

Small Business Notes

Past issues of Small Business Notes are available on the Department of Employment and Economic Development website at [Small Business Notes](#)

Small Business Notes is published to offer timely, accurate, and useful information on topics of concern to small businesses in Minnesota. It is for general information purposes only. It is not legal advice and should not be relied on for resolution or evaluation of legal issues or questions. Readers are advised to consult with their private legal advisors for specific legal advice on any legal issues they may have.

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