

## Transfer Restrictions

**Issue:** Can there be any restrictions on the veteran owner's ability to transfer ownership of the firm?

### The Regulations

#### **38 CFR § 74.3 – As relating to the ownership requirements:**

- (b) *Ownership must be unconditional.* Ownership by one or more veterans or service-disabled veterans must be unconditional ownership. Ownership must not be subject to conditions precedent, conditions subsequent, executory agreements, voting trusts, restrictions on assignments of voting rights, or other arrangements causing or potentially causing ownership benefits to go to another (other than after death or incapacity). The pledge or encumbrance of stock or other ownership interest as collateral, including seller-financed transactions, does not affect the unconditional nature of ownership if the terms follow normal commercial practices and the owner retains control absent violations of the terms. In particular, CVE will evaluate ownership according to the following criteria for specific types of business concerns.
  - (b)(1) *Ownership of a partnership.* In the case of a concern that is a partnership, at least 51 percent of every class of partnership interest must be unconditionally owned by one or more veterans or service-disabled veterans.
  - (b)(2) *Ownership of a limited liability company.* In the case of a concern that is a limited liability company, at least 51 percent of each class of member interest must be unconditionally owned by one or more veterans or service-disabled veterans.
  - (b)(3) *Ownership of a corporation.* In the case of a concern that is a corporation, at least 51 percent of each class of voting stock outstanding and 51 percent of the aggregate of all stock outstanding must be unconditionally owned by one or more veterans or service-disabled veterans.
- (c) *Stock options' effect on ownership.* In determining unconditional ownership, CVE will disregard any unexercised stock options or similar agreements held by veterans or service-disabled veterans. However, any unexercised stock options or similar agreements (including rights to convert non-voting stock or debentures into voting stock) held by non-veterans will be treated as exercised, except for any ownership interests that are held by investment companies licensed under part 107 of title 13, Code of Federal Regulations.
- (e) *Change of ownership.* (1) A participant may remain eligible after a change in its ownership or business structure, so long as one or more veterans or service-disabled veterans own and control it after the change and the participant files a new application identifying the new veteran owners or their new business interest.
- (3) Where the transfer results from the death or incapacity due to a serious, long-term illness or injury of an eligible principal, prior approval is not required, but the concern must file a new application with contracting officer and CVE within 60 days of the change. Existing contracts may be performed to the end of the instant term. However, no options may be exercised.

#### **38 CFR § 74.4 – As relating to the control requirements:**

- (h) Non-veterans who transfer majority stock ownership or control of the firm to an immediate family member within 2 years prior to the application and remain involved in the firm as a stockholder, officer, director, or key employee of the firm are presumed to control the firm. The presumption may be rebutted by showing that the transferee has independent management experience necessary to control the operation of the firm, and indeed is participating in the management of the firm.

## What This Means

- The Veteran owner must be able to transfer any or all of his ownership interest, to anyone, at any time, he/she pleases.
- Ownership must be unconditional. Ownership must not be subject to conditions that allow transfer of ownership benefits to another. Restrictions may not be placed upon the ownership interests of the Veteran owner. Owners should avoid the creation of any business structure which includes conditions or limitations on the Veteran owner's present or immediate right to exercise the full range of ownership rights. The existence of such provisions will prevent the applicant from receiving verified status.
- One common restriction on ownership which will prevent an applicant from receiving verified status (due to ownership not meeting the "unconditional" requirement) is requiring approval of other shareholders/members or a right of first refusal to purchase the Veteran's shares/interest for the Veteran owner to transfer his shares/interest.
- A business may remain eligible for Verification if after the ownership is transferred, another Veteran or service-disabled Veteran owns and controls the applicant and files a new VA Form 0877 application identifying the new Veteran owners or their new business interest and this change is reported to CVE within 60 days...
- If a transfer occurs based on incapacity or death, the concern must file a new VA Form 0877 application with the contracting officer and CVE within 60 days of the change.
- If a transfer in ownership from a non-Veteran to a Veteran has occurred within the past two years, and the non-Veteran remains a stockholder, officer, director, or key employee, the non-Veteran will be presumed to remain in control of the concern. Supporting documentation reflecting management experience of the Veteran and evidence of the Veteran's current participation in the management of the applicant must be provided to refute this presumption.

## Excerpts from Current Denial Letters

- "You supplied a Shareholders' Agreement for your company. This Agreement states that, "[t]o accomplish the purposes of this Agreement, any transfer, sale, assignment, hypothecation, encumbrance, or alienation of any of the shares of the Corporation, other than according to the terms of this Agreement is void and transfers no right, title, or interest in or to those shares to the purported transferee, buyer, assignee, pledgee, or encumbrance holder. Each Shareholder shall have the right to vote shares held of record and to receive dividends paid on them until the shares are sold or transferred in accordance with this Agreement." A subsequent section goes on to state that, "A Shareholder may transfer all or any part of his or her shares to: [a spouse, ancestors or lineal descendants or the spouses of any of such persons, or to any trust solely for the benefit of the Shareholder or any of the foregoing persons,] provided that each such permitted transferee shall first agree in writing to be bound by the terms and provisions of this Agreement." The agreement does not indicate any other instances where transfer of shares would be permitted. 38 CFR § 74.3(b) requires that the Veteran's ownership interest must be unconditional. These types of restrictions, placed on the ownership rights of the shareholders, violate the requirements. For these reasons CVE is unable to conclude that you meet the ownership requirements of 38 CFR § 74.3."
- "You supplied an Operating Agreement for your company. The pertinent Articles state that a Member shall not transfer his membership interest unless all of the Members approve of the transfer. The Operating Agreement identifies you, Jane Doe, and John Jones as Members of the company. Mr. Jones is not a Veteran. 38 CFR § 74.3(b) requires that the service-disabled Veterans own their shares of the business unconditionally. Because Mr. Jones, a non-Veteran,

must approve of any transfers, a restriction is placed upon the ownership interests of you and Ms. Doe. For these reasons CVE is unable to conclude that your company meet the ownership requirements set forth in 38 CFR § 74.3.”

**Center for Veterans Enterprise Verification Facts Sheet - *Restrictions on Transfers***