



## Understanding Unconditional Ownership and Transfer Restrictions

### Issue:

This brief defines unconditional ownership and discusses ownership transfers by an applicant that are not considered impermissible conditions on ownership.

(For purposes of this brief, the regulations when referring to Service-Disabled Veterans applies equally to Veterans; applicant refers to the business entity applying for verification; and participant refers to a business entity that has already been verified.)

### The Regulations:

**13 CFR § 125.11** provides:

*Veteran owned small business concern* means a small business concern:

(1) Not less than 51 percent of which is owned by one or more veterans or, in the case of any publicly owned business, not less than 51 percent of the stock of which is owned by one or more veterans; and

(2) The management and daily business operations of which are controlled by one or more veterans. All of the provisions of subpart B of this part apply for purposes of determining ownership and control.

**13 CFR 125.11** provides that “[u]nconditional ownership means ownership that is not subject to conditions precedent, conditions subsequent, executory agreements, voting trusts, restrictions on or 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.”

**13 CFR 125.12** provides that “[g]enerally, a concern must be at least 51% unconditionally and directly owned by one or more service-disabled veterans.”

**13 CFR 125.12(b)** provides that “[i]n the case of a concern which is a partnership, at least 51 % of aggregate voting interest must be unconditionally owned by one or more service-disabled veterans. The ownership must be reflected in the concern’s partnership agreement.”

**13 CFR 125.12(c)** provides that “[i]n the case of a concern which is a limited liability company, at least 51% of each class of member interest must be unconditionally owned by one or more service-disabled veterans.”

**13 CFR 125.12(d)** “[i]n the case of a concern which is a corporation, at least 51% of the aggregate of all stock outstanding and at least 51% of each class of voting stock outstanding must be unconditionally owned by one or more service-disabled veterans. In the case of a publicly owned business, not less than 51 percent of the stock (not including any stock owned by an ESOP) must be unconditionally owned by one or more veterans.”

**13 CFR 125.12(e)** provides that “[i]n determining unconditional ownership, SBA will disregard any unexercised stock options or similar agreements held by service-disabled veterans. However, any unexercised stock

options or similar agreements (including rights to convert nonvoting stock or debentures into voting stock) held by non-service-disabled veterans will be treated as exercised, except for any ownership interests which are held by investment companies licensed under the Small Business Investment Act of 1958.”

## What This Means:

- Subpart B as referred to in 13 CFR § 125.11 is saying that anywhere in the regulations where the term Service-Disabled Veteran is used, it is equally applicable to Veterans for purposes of determining eligibility.
- Unconditional ownership means that a Veteran’s stock or membership interest 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 determination as to whether an applicant meets the unconditional ownership requirement is decided by evaluating the facts and circumstances presented from the bylaws, operating agreements, and other documents relating to the formation and operation of the applicant.
- A right of first refusal is a standard provision used in normal commercial dealings and does not burden the Veteran’s ownership interest unless he/she receives a bona fide offer and chooses to sell some of his or her interest. As a result, a right of first refusal provision does not burden the Veteran’s unconditional ownership interest as it relates to 13 CFR § 125.12.
- The requirement for the approval of a company’s other shareholders or members prior to the Veteran owner transferring his/her shares and/or interest to another is also used in normal commercial dealings and does not affect the Veteran’s unconditional ownership interest. As a result, this type of approval requirement does not burden the Veteran’s unconditional ownership as it pertains to 13 CFR § 125.12, unless he or she receives a bona fide offer and chooses to sell some of his/her interest.
- Tag-along rights that allow non-Veteran owners to participate in the Veteran owner’s transfer to third parties on the same terms and conditions do not affect the Veteran owner’s unconditional ownership. As a result, this type of requirement does not burden the Veteran’s unconditional ownership as it pertains to 13 CFR § 125.12, unless there is a bona fide offer and the owner chooses to sell some of his/her interest.
- Provisions that require a forfeiture of interest in the event of bankruptcy do not affect the unconditional nature of the ownership interest.
- 100% owned, single member LLCs do not trigger unconditional ownership issues when there is only one member since there is no one else who could exert influence over that interest.
- 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 (i) follow normal commercial practices and (ii) the owner retains control **absent violations of the terms**. (Emphasis added) We have seen this when a Veteran is purchasing his interest and uses the equity value of the interest as collateral for the loan.
- Essentially, unexercised stock options and similar agreements held by Veteran Owners will not be counted against the 51 percent ownership interest held by Veteran Owners and are not a condition on ownership.

However, stock options and similar agreements held by the non-Veteran will be counted against the non-Veteran's ownership interest.

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