Verification Assistance Brief

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, Veteran applies equally to Service-Disabled Veterans; applicant refers to the business entity applying for verification; and participant refers to a business entity that has already been verified.)

The Regulations:

38 CFR § 74.1 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. In particular, ...[the Center for Verification and Evaluation (CVE)]... will evaluate ownership according to the following criteria for specific types of business concerns.

(1) ...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.

(2) ...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.

(3) ...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.”

38 CFR § 74.3(b) provides that “[o]wnership 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.”

38 CFR § 74.3(c) provides that “...[i]n 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.”
What This Means:

- 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 particular 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 38 CFR § 74.3(b).

- 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 38 CFR § 74.3(b), 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 38 CFR § 74.3(b), unless there is a bona fide offer and the owner chooses to sell some of his/her interest.

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