

**DECISION**

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**THE COMPTROLLER GENERAL  
OF THE UNITED STATES  
WASHINGTON, D. C. 20548**

**FILE:** B-221717**DATE:** May 5, 1986**MATTER OF:** Priority to Contract Proceeds**DIGEST:**

Assignee bank has priority over the Internal Revenue Service for payment of contract proceeds even though tax debt matured before assignee satisfied requirements of Assignment of Claims Act, 31 U.S.C. § 3727, since contract included a no setoff clause, the assignment was made to finance the contract, and the assignor still owes the assignee bank more than the amount of the contract proceeds.

An Army Corps of Engineers disbursing officer asks about priority between the Internal Revenue Service (IRS) and the assignee, Security State Bank of Aitkin, Minnesota, (Bank) for distribution of \$7,068.55 proceeds due under a purchase order contract between the Corps of Engineers and Ray Kullhem, and the proper amount to be paid to each. For the reasons given below, assuming the Bank's factual assertions are correct, the proceeds should all be paid to the Bank.

On January 24, 1984, an assignment under the Uniform Commercial Code of all the accounts receivable of Ray Kullhem in favor of the Security State Bank of Aitkin was recorded in the Office of the County Recorder for Aitkin County, Minnesota. On August 6, 1985 an IRS tax lien was issued against Ray Kullhem in the assessed amount of \$5,529.64. The dates of the assessments were March 5, 1984 and March 18, 1985.

In September 1985, Mr. Kullhem entered into a purchase order contract with the Corps of Engineers for construction of a swimming pool for \$9,983. Subsequently, the contract amount was increased to \$13,123. The contract permitted assignments under the Assignment of Claims Act, 31 U.S.C. § 3727, and contained a no setoff clause. The clause stated: "[P]ayments to an assignee of any amounts due or to become due under this contract shall not to the extent specified in the Act, be subject to reduction or setoff."

On November 7, 1985, Mr. Kullhem executed an assignment of the described purchase order contract to the Security State Bank of Aitkin. The assignment provided that all sums

035327

payable on the contract would be payable to the Bank. The assignee informs us that the assignment was given in exchange for the Bank providing financing for the work on the purchase order contract. The assignment was not immediately served on the Corps of Engineers disbursing or contracting officers.

Subsequently, on December 12, 1985 an IRS Notice of Levy was issued and served on the Army Corps of Engineers disbursing officer for the St. Paul District. The levy was in the amount of \$7,068.55, consisting of an assessed amount of \$5,601.08 and statutory penalties and additions of \$1,467.47. The IRS informs us that the \$71.44 difference between the assessed amount described in the lien and that in the levy was due to a \$20 filing fee and a \$51.44 bad check written by Mr. Kullhem. On December 19, 1985, the Bank sent two copies of the November 7 assignment to the Corps of Engineers' Office of Counsel, requesting that they be forwarded to the disbursing officer and contracting officer. (The Bank also forwarded a copy of the January 24, 1984 UCC assignment.) The Corps received the Bank's letter on December 23, 1985, and its acting disbursing officer acknowledged receipt of the assignment on December 24, 1985.

The IRS maintains that its lien and levy have priority over any existing assignment. The assignee, Security State Bank of Aitkin, contends that its UCC filing and the November 7, 1985 assignment take priority over any interest of the IRS. The assignee also maintains that the amount Mr. Kullhem still owes on the loan for financing the contract exceeds the \$7,068.55 to be distributed.

The Assignment of Claims Act, 31 U.S.C. § 3727, permits an assignment to a bank of money due or to become due from the United States under a contract providing for payments aggregating \$1,000 or more. The Act requires that the assignment cover all amounts payable under the contract not already paid. Moreover, we have held that the assignee must have a financial interest in the contractor's operations under the contract. B-195629, Sept. 7, 1979. Generally, this means that an assignment is valid only if it secures a loan which the assignee has made to the assignor to finance the assignor's performance of the contract. See 62 Comp. Gen. 683, 684 (1983), modifying 60 Comp. Gen. 510 (1981). Thus, blanket assignments usually do not meet the Act's requirements.

The Act also requires the assignee to file written notice of the assignment together with a copy of the instrument of assignment with the contracting officer or head of the contracting officer's agency, and the disbursing officer, if any, for the contract. 31 U.S.C § 3727(c)(3). An assignment does not become effective until this requirement is satisfied.


Under the Act the Government is precluded from asserting certain setoffs against funds payable under a Government contract containing a "no setoff" provision when the rights to those funds have been properly assigned to a bank.<sup>1/</sup> Id. § 3227(d). Where applicable the no setoff provision defeats operation of IRS tax liens and levies and reduces the Government's common law right of setoff to the extent the assignor is indebted to the assignee. 31 U.S.C. § 3727(d); 37 Comp. Gen. 318, 320, 322 (1957). A no setoff clause will protect an assignee only from an assignor's indebtedness resulting from loans for contract performance. 49 Comp. Gen. 44, 46 (1969).

In this instance, the purchase order contract between the Corps of Engineers and Mr. Kullhem did contain a no setoff clause. Moreover, the assignment complied with the requirements of the Assignment of Claims Act: as we understand it the assignment was to underwrite Mr. Kullhem's performance of the purchase order contract, and the Corps received notice of the assignment on December 23, 1985. Although the assignment did not become valid for purposes of the Assignment of Claims Act until December 23, 1985, and the tax liability and tax lien representing that liability arose prior to that date, we have consistently held that when a no setoff clause is included in an assigned contract neither the IRS nor any other Government agency can set off

<sup>1/</sup> Although the provision in the Act authorizing limitations on setoff states that it applies only "in war or national emergency", the provision has been extended by subsequent legislation. Pub. L. No. 94-412, 90 Stat. 1255, 1258 (1976), codified at 50 U.S.C. § 1651(a)(4). The legislative history of the provision shows the no setoff authorization was continued because of its importance in financing government contracts. H.R. Rep. No. 238, 94th Cong., 1st Sess. 12, 16 (1975). See also S. Rep. No. 1086, 95th Cong., 2d Sess. 1-2 (1978).

amounts due from the assignor against the contract proceeds owed to the assignee, even if the IRS claim matures prior to the date on which the assignment becomes effective--the date notice of the assignment is received by the contracting agency. 62 Comp. Gen. 683, 690 (1983) modifying 60 Comp. Gen. 510 (1981); 37 Comp. Gen. 318, 320 (1957). Accordingly, if as the assignee contends the assignor still owes the assignee bank more than the \$7,068.55 contract proceeds being held by the Corps of Engineers, and the assignor's debt to the Bank resulted from a loan to finance the purchase order contract, that money should be distributed to the Bank.

Should the amount still owed the assignee by the assignor be less than the remaining \$7,068.55 proceeds, the no setoff clause would only protect the assignee for the lesser amount. Any amounts above that should be paid to the IRS. Furthermore, if the loan underlying the assignment was not made to finance the purchase order contract, the no setoff clause would not protect the assignee against the IRS's claim to the proceeds.<sup>2/</sup> That claim arose before the November 7, 1985 assignment became valid under the Assignment of Claims Act, supra, and thus would prevail but for the effect of the no setoff clause. For similar reasons the IRS tax claim would prevail over the January 24, 1984 UCC assignment: that assignment was received by the Corps after the tax claim arose, and was not made to finance the purchase order contract.

*for*   
Comptroller General  
of the United States

<sup>2/</sup> The Bank has told us that the assignment was made in exchange for monies to finance the contract, and that the assignor still owes the Bank more than \$7,068.55 on that loan. To date, however, the Bank has not submitted documentation confirming this. Since the IRS has expressed a need for a decision quickly, we will assume these facts are correct. Nevertheless, before distributing the proceeds to the Bank, the Corps should verify these assertions.