



**The Comptroller General
of the United States**

Washington, D.C. 20548

Decision

Matter of: Corps of Engineers -- Priority of Payment

File: B-230902

Date: July 1, 1988

DIGEST

An assignee bank receives priority of payment over an IRS tax levy against the contractor under an Army Corps of Engineers Contract. A valid assignment under a government contract gives the assignee priority over government claims against the assignor arising after perfection of the assignment.

DECISION

A disbursing officer in the U.S. Army Corps of Engineers requests our decision on whether the Internal Revenue Service (IRS) or an assignee has priority to receive payments under a government contract. For the reasons indicated below, we conclude that the order of payment should be first to the assignee and then to the IRS.

BACKGROUND

On August 20, 1985 the Corps entered into a contract with the Small Business Administration (SBA) for a flood control and river maintenance project in Minnesota. The SBA in turn awarded the contract to Walter Ervin and his business, Minnesota Drillers. The Corps administered both contracts and made direct payments to the contractor. The contract work was commenced on August 26, 1985.

On August 27, 1985 the contractor executed an assignment to the Tri-County State Bank under the Assignment of Claims Act, 31 U.S.C. § 3727 (1982). The assignment was acknowledged by the Corps on September 3, 1985 and is considered by the Corps to be a proper assignment under the Act. The bank stated that the assignment was made for the purposes of financing the contract. We have held that assignments are valid if made to secure a loan which the assignee has made to the assignor to finance the assignor's performance of the contract, provided all the other provisions of the Act have been met. B-221717, May 5, 1986; B-201164, Sept. 29, 1983. The assignment thus appears to be a valid assignment.

042607/130231

On February 3, 1987 the IRS issued the Corps a tax levy in the amount of \$17,391.27 against the payments owed to the contractor for unpaid employment taxes for periods ending December 31, 1985, September 30, 1986, and December 31, 1986. The Corps has retained payments totaling \$13,618.33 under the contract.

DISCUSSION

The question arises over who has priority to receive payment because the contract did not contain a no set-off provision as defined in 31 U.S.C. § 3727 and 41 U.S.C. § 15 (1951).^{1/}

This Office has held that, in the absence of a no set-off clause, "the Government's common law right to set-off a tax debt of the assignor that was in existence, even if not yet due (mature), prior to the date on which the contracting agency was notified of the assignment will not be extinguished by the assignment" 60 Comp. Gen. 510, 516-517 (1981). In that decision we considered the priority of a federal tax lien against a government contractor and the claim of a bank to which the contractor had assigned his rights under the contract. We held that when a contract did not contain a no set-off provision, a claim by the IRS that arose before the assignment became effective could be set off against the payments to be made to the assignee. Thus if the assignor's obligation to pay the taxes in question had already come into existence before the assignment was made, the tax claim would have priority over the assignment.

Specifically, in regard to employment taxes, we have held:

"An employer's obligation to pay the Government amounts withheld from his employee's salaries for tax . . . purposes comes into existence . . . at the time the employee has completed earning the salary to which the obligation applies, i.e., in general, on pay day, even though the actual payment to the Government need not be made until later. During the interim between the withholding and the satisfaction of the liability to the Government, an employer holds the amounts involved as a constructive trustee for the Government."

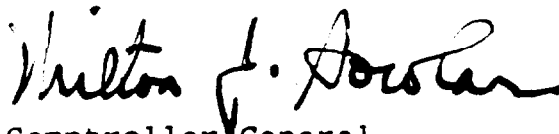
^{1/} Contracts such as the one in this case are required by Army regulations to have a no set-off clause or at least a determination that such a provision is unnecessary. DOD FAR Supplement 32.806(a)(2) and Army FAR Supplement 32.803(d). There is no explanation in the record for the absence of either the clause or a justification for its omission in this case.

Thus a notice of assignment received by the Government does not render the assignee immune from set-off of newly arising withholding liabilities of the assignor until the beginning of the pay period . . . following the pay period . . . during which notice of assignment is received."

B-152008, Sept. 10, 1963, quoted in 60 Comp. Gen. at 516.

The important question in the present case, therefore, is whether the contractor's tax debt arose before the assignment of the contract to the bank. If, on the one hand, the contractor owed the IRS taxes before he assigned his right to the government proceeds, the debt and the government's right to set it off are not extinguished. 60 Comp. Gen. at 515. On the other hand, if the tax debts owed by the contractor to the government arose after perfection of the assignment, these debts may not be set off against payments due the assignee. 60 Comp. Gen. at 516. B-152008, Sept. 10, 1963. Once an assignment has been properly made, the assignor "does not retain any property interest in the assigned contract which would be subject to attachment by any lien creditor, including the Federal Government." 60 Comp. Gen. at 514; see also 37 Comp. Gen. 318, 320 (1957).

The assignment in the present case appears to have been perfected prior to any pay period in the last quarter of 1985, the earliest quarter for which the assignor's tax liability is claimed by the IRS. Since these unpaid employment taxes arose as a liability after the assignment was perfected, the levy by the IRS cannot be set off against payment due the assignee.

for 
Comptroller General
of the United States