GSA Assertions of Setoff against Rents for a Real Estate Tax Reconciliations

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In the current era of tight Federal budgets, the General Services Administration ("GSA") has begun utilizing real estate tax consultants to find instances of real estate tax savings in its leased portfolio. A GSA lease is targeted for review, and the tax consultant will review parameters impacting the Tax Adjustment clause in the lease including the establishment of the base year used as the yardstick for future GSA reimbursements of real estate taxes, reimbursements made in subsequent tax years by GSA to the lessor, and whether any portion of real estate taxes reimbursed by GSA may be recast as special assessments or charges for services billed by the local taxing authority. The goal of the GSA and its tax consultant is to find an opportunity to recoup any mistakenly paid reimbursement of real estate taxes paid to the lessor.

Generally, the Government possesses the inherent authority to recoup funds erroneously or mistakenly paid. *See,* Kimco Realty v. United States, 51 Fed. Cl. 257, 264 (2001) (finding the Government has a common law right to recoup erroneously paid taxes without analyzing estoppel or effect of contractor's reliance) citing Wright Runstad Properties Ltd. P'ship v. United States, 40 Fed. Cl. 820, 827 (1998). GSA's right to recoup a mistakenly made payment may be limited in specific instances, but GSA lessors need to be aware that a mistake made by GSA in payment of taxes, rent or any other lease obligation can generally be corrected by GSA.

Once an alleged overpayment of prior real estate tax reimbursement is found, GSA acts quickly to assert setoff to recapture the overpayment. Setoff is a deduction taken administratively by GSA from the rent paid under a lease. Setoff alleged by GSA as a real estate tax reconciliation is usually taken against rental by GSA through assertion of a credit (or credits) against current rent. GSA takes rent from its lessor either after offering a brief mailed summary or email message to the lessor, and in many cases, the lessor is advised by GSA of offset for reconciliation of alleged real estate tax only AFTER the rent credit has been taken via offset by GSA. Lessors can and should assert that GSA's setoff procedure is improper. GSA has failed to assert its right to setoff as a Government "claim" under the lease prior to deducting money from rent as a setoff.

GSA's error is procedural. GSA action to assert a claim of setoff against rent is permissible only when GSA properly asserts a "claim" against the lessor giving a Contracting Officer's Final Decision and appeal rights to the lessor, as stated at Federal Acquisition Regulation ("FAR") Subpart 33.211(a)(4)(v).

FAR compliant appeal rights must read substantially as follows:

> "This is the final decision of the Contracting Officer. You may appeal this decision to the agency board of contract appeals. If you decide to appeal, you must, within 90 days from the date you receive this decision, mail or otherwise furnish written notice to the agency board of contract appeals and provide a copy to the Contracting Officer from whose decision this appeal is taken. The notice shall indicate that an appeal is intended, reference this decision, and identify the contract by number.
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> With regard to appeals to the agency board of contract appeals, you may, solely at your election, proceed under the board's—
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> (1) Small claim procedure for claims of $50,000 or less or, in the case of a small business concern (as defined in the Small Business Act and regulations under that Act), $150,000 or less; or

(2) Accelerated procedure for claims of $100,000 or less.

Instead of appealing to the agency board of contract appeals, you may bring an action directly in the United States Court of Federal Claims within 12 months of the date you receive this decision."

As prescribed in 48 Code of Federal Regulations ("CFR") 570.703, and stated in the GSA standard lease, the Government has an obligation to pay rent under the lease, and that obligation is subject to setoff only upon proper Government assertion of a claim (FAR Clause 552.270-28). GSA is obligated to adhere to the procedure set out in the Mutuality of Obligation provision commonly made part of the GSA lease (set out at General Clause 9 of GSA Form 3517B dated 11/05). This provision reads as follows:

"9. 552.270-28 MUTUALITY OF OBLIGATION (SEP 1999)
The obligations and covenants of the Lessor, and the Government's obligation to pay rent and other Government obligations and covenants, arising under or related to this Lease, are interdependent. The Government may, upon issuance of and delivery to Lessor of a final decision asserting a claim against Lessor, set off such claim, in whole or in part, as against any payment or payments then or thereafter due the Lessor under this lease. No setoff pursuant to this clause shall constitute a breach by the Government of this lease." (64 FR 37229, July 9, 1999, as amended at 76 FR 30847, May 27, 2011)

The case of Teller Envtl. Sys., Inc. v. United States, 802 F.2d 1385, 1389 (Fed. Cir. 1986) before the U.S. Court of Appeals for the Federal Circuit succinctly stated that "[A]ll contract claims, whether by contractor against the government or vice versa, must be submitted to the contracting officer for [final] decision." The GSA's standard lease imposes a clear contractual duty upon GSA to take a setoff against rent only after delivering a final decision of the Contracting Officer to the lessor asserting the claim.

For real estate tax reconciliations, or for any reason underpinning a GSA initiated deduction in rent taken as a setoff, GSA must assert a claim and issue a Contracting Officer's Final Decision reciting appeal rights. A Final Decision with appeal rights allows a lessor to challenge the setoff, and the Final Decision should pre-date GSA taking a setoff against rent. Without a Contracting Officer's Final Decision containing appeal rights, a lessor cannot challenge or obtain judicial review of the GSA setoff against its rent.

In a representational case of recent GSA rent setoff, GSA gave no notice whatsoever before shorting the rent paid to lessor in an amount over $13,000 per month. Only when lessor inquired upon noting the shortfall in GSA's rental payment did GSA give the lessor any explanation for GSA's alleged real estate tax reconciliation claim that served as GSA's basis to reduce this lessor's rent using setoff. GSA then also made clear its intent to assert an on-going claim of setoff against rent in an amount over $13,000 per month for eight (8) months until a real estate tax reconciliation alleged by GSA in a total amount of almost $110,000 could be fully recouped. In another recent instance, GSA gave its lessor a written demand for repayment of almost a million dollars within thirty (30) days of a mailing containing an unsigned government "claim" with no appeal rights, and enclosures setting out the basis for correction of a multiple year allegedly mistaken tax overpayment. Lessor was advised that if it did not remit the demanded payment to GSA within 30 days, it would suffer a lump sum offset against future rentals until the GSA claim was satisfied.

Nothing provided by GSA to the lessors impacted by such recent tax reconciliation setoffs has served to "inform the contractor of his rights", as required by the Contract Disputes Act (41 U.S.C. § 605(a), referred to herein as the "CDA"). Yet this necessary element of a Contracting Officer's Final Decision allows and confers jurisdiction of an appeal if the claim made by GSA is objected to by the lessor. *See*, National Electrical Coil v. United States, 227 Ct.Cl. 595 (1981). The GSA's assertion of setoff against rent owed to the lessors under GSA standard leases is inherently a Government claim which is required by the CDA to be the subject of a Contracting Officer's written Final Decision. A Final Decision both explains and justifies the Government claim asserted to support a real estate tax reconciliation. The GSA standard lease, the CDA and controlling case law require that the Government assert a "claim" before taking such draconian action of setoff against rent, and failure of GSA to do so is a violation and breach of its standard Mutuality of Obligation clause and applicable law. Furthermore, GSA's assertion of setoff is a Government claim, and carries with it the obligation to give the lessor appeal rights allowing the lessor to seek immediate review of the Government's alleged right to take rental due under a lease.

From the lessor's perspective, it is critical that GSA comply with its Mutuality of Obligation clause prior to setoff of any claim because interruption of the lessor's rental stream can have dire and far-reaching impacts. Consider that lessors, as well as lenders or mortgage holders secured by the rental stream due under a GSA lease, assume rental under the lease to be secure and safe unless the lessor is in default. GSA's disregard of its lease obligation to assert an appealable claim against a lessor before asserting rights of setoff may force a lessor into default in the repayments of its mortgage obligations or prevent service the lessor's debts. GSA's standard lease does not permit GSA to interrupt, deduct from, or setoff its rent obligations while simultaneously denying the lessor any avenue to object and seek immediate review and redress.

If faced with a GSA setoff of an allegedly mistaken tax payment, a lessor can and should demand a Contracting Officer's Final Decision from GSA before GSA inposes setoff against any rent. In addition, contacting GSA in writing to object to setoff also opens the door for a lessor to negotiate how a deduction from rent will be administered by GSA. Lessor should (1) seek to have the Contracting Officer utilize an as long as possible duration for recoupment of any prior mistaken tax payment so as to lessen the bite of lost rental in any one month, and (2) attempt to retain enough rental to service all debt obligations. It serves neither GSA nor its lessor community to force lessors into default scenarios with their lenders. Frequently, the period of recoupment from rent by GSA can be negotiated and tailored to the needs of the lessor. Any lessor subject to recoupment of a prior real estate tax reconciliation should examine the Government's calculations, and scrutinize the basis of the setoff.

Often GSA seeks to recast a portion of real estate taxes as a "special assessment" or a cost for services in order to exclude the charge from the definition of a real estate tax. Lessor appeals are currently being planned and brought to challenge GSA's recent recasting of past charges imposed by local taxing authorities. GSA lessors should consider contacting an experienced attorney to analyze any GSA alleged mistake concerning the definition of a real estate tax, as this analysis turns on a case-by-case basis. Lastly, GSA's vigorous use of offset is certain to result in additional case law concerning what is and is not properly defined as a real estate tax adjustment under GSA leases.

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