Need Analysis and Professional Judgment

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Overview

- Review of Need Analysis Methodology
- Relationship of Need Analysis to Professional Judgment
- Counterintuitive Consequences of Adjustments
Principles of Need Analysis

- Family has primary responsibility to pay
- Estimate ability to pay without regard lifestyle choices or willingness to pay
- Snapshot Philosophy
- Prior tax year as proxy for award year
- Focus on discretionary income and discretionary net worth (free cash flow)
- No double-dipping
Income

- Parent discretionary income based on income after subtracting allowances
  - Basic living expenses (IPA) based on HHS & NIC
  - State and Federal taxes
- Student income assumed to be primarily for education
  - Excludes student aid counted in taxable income (Worksheet C)
  - Excludes dependent student IPA of $2,420
Total Income

- Based on prior tax year income
  - Starts with AGI, because it is verifiable
- Adds back in discretionary deductions
  - Worksheet A (untaxed income for lower income families)
  - Worksheet B (other untaxed income and benefits: tax deferred income, child support received, and cash support)
- Subtracts exclusions from taxable income
  - Worksheet C (student aid included in taxable income, child support paid)

\[
\text{Total Income} = AGI + \text{Worksheet A} + \text{Worksheet B} - \text{Worksheet C}
\]
Available Income

• Measure of discretionary income
• Subtracts allowances from total income
  – Income Protection Allowance (IPA)
  – Employment Expense Allowance (EPA)
  – State and Other Tax Allowance
  – Federal Tax Liability
  – FICA Tax Liability
Income Protection Allowance (IPA)

• Modest allowance for basic living expenses
  – 30% food
  – 22% housing (including utilities, appliances & furnishings)
  – 9% transportation
  – 16% clothing and personal care
  – 11% medical care
  – 12% other family consumption (includes life and disability insurance, entertainment, periodicals)

• Approximately $9,470 + $3,280 HHS - $2,330 NIC
• Allowance adjusted annually for inflation
Employment Expense Allowance

- Expense allowance for double income households
- Intended to address increased costs for childcare, housekeeping, transportation, meals away from home
- $3,000 or 35% of lower income, whichever is less
Assets

- Parent discretionary net worth based on percentage of net worth after excluding certain assets
  - Excludes net worth of family’s primary residence
  - Excludes qualified retirement funds
  - Excludes allowance to supplement Social Security (APA)

- Student assets assumed to be primarily for education (no APA)
Income & Asset Assessment Percentages

- **Student**
  - 50% of income above IPA
  - 35% of assets (no APA)

- **Parent**
  - Bracketed system
  - 22% to 47% of income above allowances
  - Maximum of 5.64% (12% of 47%) of assets above allowances and after exclusions
Changes to Data Elements

• Three types of changes
• Corrections
  – Data not correct as of application date
  – May make corrections at any time
• Updates
  – Data was correct, but has since changed
  – Only HHS & NIC during verification if not due to change in applicant’s marital status
• Adjustments and Overrides
  – Professional judgment justified by special circumstances
Methods of Implementing Adjustments

- Amount of adjustment dictated by financial impact of special circumstance
- Data element often indicated by special circumstance
- If adjustment to income, can reduce AGI or Worksheets A and B or increase Worksheet C
- Use worksheets when no AGI, or to make it easier to match FAFSA AGI with IRS AGI
No Double Dipping

- Adjustments limited by degree to which already considered by the formula
- IPA and EEA allowances
Medical Expense Example

- Subtract amounts already considered from adjustment
  - 11% of IPA
  - Insurance reimbursements
  - Above-the-line deductions (self-employed health insurance deduction for 70% of health insurance premiums)
  - Below-the-line credits (Health Coverage Tax Credit)

- Family of 4 with 1 in college and $4,000 in medical expenses
  - IPA of $21,070 → 11% is $2,317.70
  - Adjustment of $4,000 - $2,318 = $1,682
Schedule A Example

- Itemized deductions on Schedule A affect taxes paid but not AGI
- Therefore acceptable to adjust income to reflect items listed on Schedule A, such as unreimbursed employee expenses (tools of trade, union dues)
- Need to consider EEA as offset to adjustment
Double Counting One-Time Events

- One-time events double-counted as income and assets
  - Not reflective of award year income
- Adjustment to eliminate non-recurring event as income, leaving it as asset
  - Inheritance, insurance settlement, worker’s comp
- Replace recurring event income with average of past three years
  - Unusual capital gains
Counterintuitive Results

- Sometimes an adjustment results in an increase instead of a decrease
- Most often due to error
  - Adjustment made to wrong worksheet
  - Using tax tables instead of actual tax liability (e.g., foreign income exclusion)
- Sometimes due to quirks in formula
Number in College (NIC)

• NIC decreases and increases EFC
  – Decreases EFC
    • Parent contribution divided by NIC
  – Increases EFC
    • Reduces IPA by $2,330 per additional NIC
• EFC increases when increase NIC when
  PC/NIC < 47% * $2,330 = $1,095
• Only occurs for Pell eligible students (low PC)
Married Students, Different EFCs

- Caused by differences in student APA
  - APA based on age of student, not age of older student
- Prerequisites
  - Couple born in different years
  - One student at least 26 years old
  - Assets exceed APA for younger student
- Amount of difference depends on difference in ages and amount of assets
  - Maximum difference of $4,000 in EFCs
  - Penalty $80 to $140 per year difference in ages
Worksheet C Matches AGI

- Edit check assumes error when
  - Worksheet C matches student total income
  - Worksheet C >= 90% parent total income
- Often triggered when student’s only income source is Federal Work Study and Americorp
- Sometimes triggered by professional judgment, yielding increase in EFC
  - Fix by using assumption override code 5 for parents, 6 for students
Bigger than Expected Change in EFC

- Threshold effect for Automatic Zero EFC at $15,000 in income
- Threshold effect for Simplified Needs Test at $50,000 in income
- Dependent other than spouse (e.g., first child) switches independent student to more favorable formula
Dependency Override Increases EFC

- Dependency override usually decreases EFC
  - IPA $3,000 higher for independent students

- If cash support from parents included on Worksheet B, and parent income was sheltered by allowances, may lead to an increase in EFC

- Wiggle room between independent student IPA and parent IPA
More Information

• FinAid’s Guide to Professional Judgment
  – 100 pages of best practices
  – More than 50 special circumstances

• http://www.finaid.org/educators/pj/