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Iron Bridge Resources, LLC
9 Shanandoah Drive
Paxton, MA 01612
(508) 459-9880 | ironbridgeresources.com

From the desk of...

Robert Weinerman, Director of Training

Let's Talk about the Professional Judgment Issue When an Applicant is eligible for Maximum Pell Grant but a Contributor Reported Having a Foreign Earned Income Exclusion

As you may know, I provide an email helpdesk service. The service is available to the staff of institutions that invite me to provide training, and member of state and regional financial aid associations that invite me to provide training for their members through their professional development and training programs, or have me provide sessions at their conferences. The service runs through the aid cycle for each relevant training year.

Prior to the pandemic, I offered, as a conference session, a summary of the top five questions I had been asked during the prior year's helpdesk cycle. As we all know, the pandemic changed a lot, and was quickly followed by FAFSA Simplification, and I replaced this conference session with sessions addressing the changes and uncertainties FAAs were dealing with.

But I am bringing it back as an option, and I thought I would celebrate by addressing the issue that I get asked the most about – ISIR Comment Codes 040, 076, 096, and 127, in today's newsletter. These codes will appear on ISIRs of applicants who are flagged with Maximum Pell Grant eligibility based on the primary contributor's (contributors') AGI, which has been reduced by a manually reported foreign earned income exclusion (FEIE). Financial aid administrators (FAAs) are required to consider using Professional Judgment (PJ) to remove the student's eligibility for Maximum Pell Grant in every case where one of these codes appears on an ISIR. This is a novel situation – as far as I know it is the first time FAAs have been required to consider using professional judgment for a class of students. And many FAAs are surprised to learn that professional judgment can be used to reduce a student's eligibility for financial aid – most saw it only as a tool to increase a student's aid eligibility.

Since there are many different issues here, I'm going to use a Question-and-Answer format to address them. I'll summarize the common themes in the questions I have received with sample questions and answer each question as thoroughly as I can. Because we are talking about PJ, there is not a lot of specific guidance available.

You may disagree with my take here and if you do, I hope you'll let me know what you think either by emailing me at robert@ironbridgeresources.com or if you are reading this on LinkedIn, in the comments below.

What is the issue here?

With the introduction of Maximum and Minimum Pell Grant based solely on an independent student's (and spouse's) or dependent student's parents' AGI, family size, family structure, and state of residence, AGI has become an even more important factor when determining a student's eligibility for financial aid. The FEIE reduces the AGI by removing foreign earned income from United States taxable income (and, hence, AGI). This means that there are financial aid applicants who appear to be eligible for Maximum Pell Grant because they have low AGIs, despite they or their parents having considerable amounts of earned income,

For example, if an applicant's parents both live outside the United States and each earned the equivalent of $100,000 in the other country, and the couple received $100 in interest income and $1,000 in dividend income, their AGI may be as much as low as $1,100, even though they earned $200,000. This is because the foreign earned income is removed from the AGI by the FEIE.

Why do people who earn income outside of the United States have lower AGIs than people who earn income in the United States?

Most countries tax income earned within their borders and do not tax income earned outside their borders. The United States is different. The United States taxes worldwide income. This means that a United States citizen or permanent resident who works outside the United States may be required to report their earned income on the tax returns of both their nation of residence and the United States. This would result in the income being counted on both tax returns and taxed by both countries. The FEIE is designed to reduce this double taxation by removing some, if not all, of the earned foreign income from taxation by the United States. It does this by reducing the taxpayer's AGI by the excludable foreign earned income.

Why is this an issue for financial aid administrators?

People who claim the FEIE have lower AGIs as a result, and the only income factor that matters when determining eligibility for Maximum Pell Grant is the AGI. In the example above, we have a student whose parents' AGI was only $1,100, even though the parents earned $200,000. This student may qualify for Maximum Pell Grant due to this low AGI.

What does this mean for financial aid administrators?

The FAFSA Simplification Act includes a section that requires financial aid administrators to review each ISIR that is flagged with Maximum Pell Grant eligibility, in which a primary contributor also reported an FEIE. These ISIRs will be flagged with Comment Code 040, 076, 096, or 127, based on which contributor reported the FEIE (the student, parent, parent spouse or partner, or student spouse, respectively).

If an ISIR is flagged with one of these codes, then the FAA must:

1) Confirm that the FEIE was correctly reported. This is more a best practice than guidance, but since documentation would be needed if the FAA decided to use PJ to remove the applicant's eligibility for Maximum Pell Grant, having the documentation to confirm that the FEIE was properly reported would be a good idea.
2) Add the FEIE to the AGI to get what I call the "domestic AGI" (because it would be the taxpayer's AGI if they had earned the income in the United States) and check the new value against the values in the relevant poverty guidelines tables to see if the applicant would still have been eligible for Maximum Pell Grant had their AGI been this value.
3) If the applicant would still have been eligible for Maximum Pell Grant at the domestic AGI level, there is no need to consider using PJ.
   Make sure to document that this was the case.
4) If, based on the domestic AGI, the applicant would not have been eligible for Maximum Pell Grant, the FAA must consider using PJ to remove the Maximum Pell Grant eligibility. Note the language here: the FAA is required to decide whether to use PJ. They are not required to use PJ in every case.

What do I need to do if I decide to use PJ in this situation?

To implement this PJ, do the following:

1) Document that the FEIE value is correct. You can do this by collecting a signed copy of the taxpayer's tax return, or just a signed copy of Schedule 1. The FEIE is claimed on Form 1040, Schedule 1, line 8d.
2) Add the FEIE to the AGI and put that value in the relevant manual data field in the ISIR.
3) Zero out the FEIE. If you don't zero out the FEIE, the calculated SAI will be too high, as the FEIE will be counted twice – once as part of the AGI and then again as untaxed income.
4) Document why, in the specific case you reviewed, the PJ was appropriate. Congress had defined this process as PJ, which means that you must review each case individually. Each decision must be based on factors specific to the applicant. Also,

be sure to document how you determined the values you used to update the ISIR for the PJ.

What can go wrong?

If you do this PJ, you may, in rare situations, get back an ISIR that has been rejected. The most likely reason for this is that the applicant did not report assets on their application.

Here's why this may happen.

One of the three circumstances that exempt an applicant from reporting assets on the FAFSA is that they are eligible for Maximum Pell Grant. But, if a dependent student's parent(s) reported that they live outside the United States or its territories, the student will be required to report assets even if they appear to qualify for Maximum Pell Grant.

Imagine a situation where the applicant's parents lived outside of the United States in the base year but moved back to the United States before they filed the FAFSA. Maybe they moved back to the United States to establish state residency for in-state tuition purposes, or their foreign appointment ended. In this case, we might have an applicant who reported an FEIE on the FAFSA (because their parents earned income outside of the United States in the base year) but also reported living in a state or territory of the United States when they filed the FAFSA. If this applicant appears to qualify for Maximum Pell Grant based on their parents' base year AGI, they will be exempt from reporting assets on the FAFSA (because they now live in the United States).

If an FAA uses PJ to increase the AGI to remove the Maximum Pell Grant, the applicant may lose their exemption from reporting assets (because the Maximum Pell flag will be removed from the ISIR and the applicant may not have any other reason to be exempt from reporting assets). If the FAA performs the PJ and submits the data back to the FAFSA Processing System (FPS), the ISIR will be rejected because the assets are needed to calculate the Student Aid Index (SAI).

So, as a best practice, make sure you have assets in the ISIR before performing this PJ. If you do not have assets in the ISIR, consider asking the applicant to send you a signed statement indicating what their assets were worth on the day they and their contributors completed their sections of the FAFSA, and include these values in the transaction you submit to FPS when you do the PJ.

This is so complicated. Why didn't Congress just base eligibility for Maximum Pell Grant on the sum of the AGI and the FEIE?

This is a great question, and one on which I can only speculate. I have a couple of thoughts.

First, this PJ review process was implemented by the FAFSA Simplification Act, which, in part, was designed to make it easier for applicants to estimate their eligibility for Pell Grants. Changing the threshold for Maximum Pell Grant to include the FEIE would have added complexity to the process by which applicants would explore their potential aid eligibility. Since most applicants and their parents do not claim the FEIE, this complexity might have confused more people than it helped.

Second, and this is only me speculating, I believe that Congress intentionally set the PJ review up this way to allow FAAs, people whose primary job is determining a student's aid eligibility, to allow some people to have Maximum Pell Grant that might not otherwise have been eligible for it. Here's my thinking:

Anyone claiming the FEIE lived outside of the United States during the base year. The financial aid formula is based on the economic circumstances of the United States and normalized to the US economy. People living outside the United States may be experiencing different economic circumstances from those in the United States. They may live in countries with higher or lower costs of living, be incurring expenses not typically paid in the United States like tuition for English language education for their children, travel costs for medical care, security costs, local language courses or on demand translation services, etc. The PJ process we are discussing here gives FAAs the authority to allow certain applicants in higher income families to receive Maximum Pell Grant because of these non-United States economic factors. On a case-by-case basis, of course.

This is too much. Can't we just say we will always do this PJ?
This is too much. Can't we just say we will never do this PJ?

The answer to the first question is a definite "No." FAAs cannot create a class of students for whom they will always use PJ – they must consider all PJs on a case-by-case basis. By stating that you will always use PJ in this case, you have created a class.

On the other hand, I don't know whether you can have a policy to never consider this PJ. But I think the answer is "No" here as well. While we know unequivocally that we are not allowed to have an institutional policy to never do any PJs, the Department of Education (ED) had been inconsistent about whether an institution can have a policy of never considering a specific kind of PJ. In this case, though, the FAFSA Simplification Act clearly requires the FAA to consider using PJ in this specific circumstance. A policy of never doing this PJ would seem to counteract that the FAA is required to make this consideration. If you already know you won't do any of these PJs, you are not considering them in each case.

Can we simplify the process by determining how much larger than the cutoff in the poverty tables the domestic AGI is, and always do the PJ for people whose domestic AGI exceeds our own threshold? We are thinking of establishing a cutoff of 150% of the basic threshold for Maximum Pell Grant eligibility.

Again, this takes away the FAA's judgment and creates a class of people for whom a PJ would be done without a case-by-case justification. So, like above, the answer is "No."

What are some of the things we can consider establishing a "case-by-case" basis for distinguishing among our applicants flagged with these comment codes?

There are several factors that could lead you to decide, or not decide, to use PJ in these cases, including (this list is not comprehensive):

- Does the family live in a country with a higher cost of living than the United States, which means their income will not go as far as it would in the United States? This might be a factor that leads you to conclude that you should not perform the PJ, allowing the higher income family to have the Maximum Pell Grant.
- Does the family live in a country with a lower cost of living than the United States? This might suggest that using PJ to remove the Maximum Pell Grant eligibility is appropriate, as their income would go further in their country of residence than the United States.
- Does the family live in a high tax country, so that they are paying more income tax than comparable families living in the United States? This might suggest that the threshold for Maximum Pell Grant should be higher for the family than the US threshold.
- Do United States citizens and permanent residents living in the country incur expenses that are not usually incurred in the United States, such as tuition for English education for children, travel costs related to medical care, personal security, costs etc.? Having these costs may encumber the family income in a way that suggests they should qualify for Maximum Pell Grant at higher incomes than United States residents.
- Does the family have significant resources (income or assets) that suggest that they would be able to cover the student's educational costs without too much hardship?
- Does the family appear to have limited assets, suggesting that paying for college without the Maximum Pell Grant would be especially challenging?
- Would the student still receive a significant amount of calculated Pell Grant based on their AGI?
- Has the family moved back to the United States, so that they should be held to the same formulaic standards as other residents of the United States?

Remember, ultimately, the decision to use PJ must include a judgment. These factors can be used to distinguish between applicants but cannot be used to remove the FAAs judgment in the decision-making process.

Should we document the situations in which we choose not to use PJ to remove the Maximum Pell Grant eligibility?

You absolutely should document all the work you do related to this issue, even if you decide not to use PJ. You are required to review all these cases.
In a few years, when a program reviewer or auditor looks at these files, you'll want to be able to show that a FAA reviewed each case, even if the review did not result in any changes. Otherwise, there is no evidence that an FAA reviewed every case they were required to review.

Does this requirement to consider using PJ to remove Maximum Pell Grant eligibility apply to Minimum Pell Grant eligibility?

No, it does not. However, there is no prohibition against an FAA using this kind or PJ to eliminate eligibility for Minimum Pell Grant, which is also dependent on the AGI. If the student is eligible for Minimum Pell Grant due to an AGI reduced by an FEIE, you can use PJ on a case-by-case basis to increase the AGI above the cutoff for Minimum Pell.

If the student is eligible for calculated Pell Grant based on their SAI, any FEIE is already being counted as untaxed income and is included in the income that went into the SAI formula. There is no missing income in SAI formula.

Remember, if you increase the AGI to remove Maximum Pell Grant, one of the results will be a calculated SAI. The student may become eligible for Pell Grant based on the calculated SA, or, if there is no calculated Pell Grant, they may still be eligible for Minimum Pell Grant if the domestic AGI is not too large. The PJ eliminating Maximum Pell Grant may not eliminate all Pell Grant, and if you have adjusted the AGI to include the FEIE, then there is no further PJ you can use to eliminate calculated or Minimum Pell Grant eligibility.

Is there anything else you'd like to share about this issue?

Yes! Although I do think that Congress structured this process this way to empower FAAs to use their knowledge and skills to allow some higher income people to receive Pell Grants, the process puts the FAA in a tough place. The applicants will know from their initial FAFSA Submission Summary (FSS) that they have been assigned an SAI of –1,500 and may be eligible for $7,395 in Pell Grant. If an FAA uses PJ to remove their Maximum Pell Grant, the applicant will receive a new FSS showing a calculated SAI and a reduced or no Pell Grant availability. Applicants may reach out and ask what happened, and there really is no uncomplicated way to explain why their Pell Grant was taken away.

While I think that giving FAA's the authority to allow higher income taxpayers to have Maximum Pell Grant was a good idea, I don't like this implementation. I would rather have had a process that worked the other way. Applicants with FEIEs would never be shown eligibility for Maximum Pell Grants, and FAAs would be required to review each file to determine whether to award Maximum Pell Grant in certain circumstances.

As always, please feel free to reach out to me with any thoughts, comments, or disagreements. You can reach me at robert@ironbridgeresources.com or through my LinkedIn page.