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

From the desk of…

Robert Weinerman, Director of Training

An Easy Way to Get More Pell Grant into Some of Your Student's Hands: Addressing a Department of Education Created Inequity in the 2024-2025 FAFSA Process

On April Fool's Day, 2024, the Department of Education (ED) announced a change in the definitions of two FAFSA data elements: income tax paid and education credits. The change made the Student Aid Index (SAI) formula more generous (sometimes hugely more generous) to undergraduate students who received the American Opportunity Credit (AOC) and students with FAFSA contributors who were self-employed. Left out of this generous change was anyone who was required to report tax information manually. Let me explain what happened, and how, in some cases, you can address this egregiously unfair inequity in the 2024-2025 aid processing cycle. Note that this discussion only applies to aid year 2024-2025. ED corrected the inequity for the 2025-2026 cycle.

In its General-24-29) (https://EDpartners.ed.gov/knowledge-center/library/electronic-announcements/2024-04-01/update-tax-data-received-fa-ddx-and-manually-entered-information) ED announced that the FUTURE Act Direct Data Exchange (FA-DDX) brought unexpected values into ISIRs for income tax paid and education credits. ED was expecting these values to be pulled from the same tax lines as they had been in 2023-2024 but apparently forgot to tell the IRS. It is important to note that the values the IRS provided differed from those asked of people who were required to manually enter their tax information into the FAFSA, and that ED elected neither to update the line instructions for these items in the pdf FAFSA or on-line FAFSA instructions, or communicate with contributors who manually entered data that these definitions had changed. Later, in GENERAL-24-71 (https://EDpartners.ed.gov/knowledge-center/library/electronic-announcements/2024-06-17/resolving-conflicting-information-updated-august-1-2024), ED stated that "applicants (or their contributors) who are directed to manually enter income taxes paid and education credits into the online FAFSA form or who completed a PDF FAFSA form and used the provided instructions on the 24-25 FAFSA form are not considered to have reported incorrect or conflicting information." In other words, even though people who manually entered data into the FAFSA were following instructions that were incorrect (and per this announcement, would not be fixed until 2025-2026), institutions were not required to treat the manually reported values as conflicting information and did not have to address the difference.

This was great for institutions – one less mess created by ED to clean up – but it created an inequity, based on how an applicant provided data to the FAFSA. For both income tax paid and education credits, the value provided by the IRS will always be equal to or greater than the values asked for in the pdf FAFSA and on-line FAFSA instructions. And since we subtract both income tax paid and education credits from income before determining the SAI, many dependent students whose parents manually entered tax data into the FAFSA, and some independent students (if they or their spouse manually entered data) ended up with higher SAIs (and less aid eligibility) than students whose contributor's FAFSA record matched their IRS record and had the IRS fill in their FAFSA tax data.

Let's look at the two FAFSA data elements that might have different values based on how the contributor provided tax information and see how the values might be different. Note that whenever I mention Pell Grants in this discussion, I am referring to the full-time Pell Grant amounts.

Income Tax Paid

In 2023-2024, the FAFSA asked contributors to calculate their income tax paid using the formula (Form 1040, line 11 minus Schedule 2, line 2). This approach goes back to at least 2017-2018, even as the tax forms changed, and the line items shifted. The 2024-2025 pdf FAFSA and on-line FAFSA instructions also instruct contributors to use this formula to answer the income tax paid question.

The FA-DDX used the value from Form 1040, line 24 for income tax paid.

Form 1040, line 24 is Form 1040, line 22 plus Form 1040, line 23. Line 23 is "other taxes" and includes taxes like the self-employment tax and the early withdrawal penalties from retirement accounts. Line 24 is not just "income tax paid" but all taxes accrued to the taxpayer during the tax year. Note that even though the 2025-2026 pdf FAFSA now asks for "Form 1040, line 24", it continues to define the question as "income tax paid" even though line 24 includes taxes that are not part of the income tax[i].

Let's look at an example of how this creates an inequity based on a contributor's FAFSA completion method. Let's imagine that a contributor to the FAFSA earned $20,000 of net income from self-employment on their tax return. Let's also assume that Form 1040, line 22 is $5,000 and Schedule 2, line 2 is 0. If the FA-DDX cannot match the contributor's FAFSA record to their IRS record, perhaps because they do not have a Social Security Number, then they would be required to manually enter Form 1040, line 22 minus Schedule 2, line 2, or $5,000, as the answer to the income tax paid question. However, if the FA-DDX match works and the IRS can put the contributor's tax data into the ISIR directly, the IRS will pull the answer from Form 1040, line 23. Since the contributor had $20,000 of net income from self-employment income, their self-employment tax would be $2,826. This would be added to the $5,000 on Form 1040, line 22 to get Form 1040, line 24. The FA-DDX would put $7,826 into the ISIR for income tax paid.

Again, since we subtract the income tax paid from the total income as part of the SAI formula, this means that the student with a contributor whose tax data was provided by the IRS will be assessed on $2,826 less income than the student with the contributor manually entering their tax data. For students who are getting Pell Grants (but not Maximum Pell Grant), this could mean a reduction in their Pell Grant of up to $820[ii] (remember, full time Pell Grants are rounded to the nearest $5.00) – just because their contributor's FAFSA record could not be matched to their IRS record.

Education Credits

In 2023-2024, the FAFSA asked contributors to calculate their Education Credits Form Schedule 3, line 3. The 2024-2025 pdf FAFSA also instructs contributors to use Schedule 3, line 3 for the education credits.

In 2024-2025, the FA-DDX imported the values from Form 8863, line 8 and Form 8863, line 19. These values are identical to Form 1040, line 29 and Schedule 3, line 3. I will use the latter formula in this discussion.

One of the education credits, the American Opportunity Credit (AOC), can be as large as $2,500 per undergraduate student for up to four tax years. The AOC is claimed in two parts. Schedule 3, line 3 is the “non-refundable credit” and is only available to a taxpayer with accrued tax that can be offset by the credit. If a taxpayer does not have an income tax liability for the tax year, they cannot receive the non-refundable portion of the AOC. The non-refundable portion of the AOC can be as large as $1,500 per student.

The other piece of the AOC, the refundable portion, is claimed on Form 1040, line 29. It can be as large as $1,000 per student and is available even if the tax filer did not have any income tax accrued in the tax year.

You should be able to see where this is going. If a contributor manually enters the education credits into the FAFSA, the instructions tell them to report Schedule 3, line 3, which might be $1,500. If the FA-DDX works, then the IRS will put Schedule 3, line 3 plus Form 1040, which might be $2,500, into the FAFSA for education credits.

At the assessment rates mentioned in the endnote in the previous section, this could result in an SAI difference of as much as $290 in the calculated Pell Grant range, and thus as much as $290 less Pell Grant for manual contributors compared to FA-DDX match contributors.

Addressing the Inequity – If You Want to

There is some good news here. It is not difficult to identify many of the students impacted by this inequity, and it is not difficult to fix it. It requires searching through your students’ ISIRs and looking for those who most likely lost out on some Pell Grant because they or their contributor(s) manually entered their tax data into the ISIR. In the 2024-2025 tax transcript matrix provided by ED (https://EDpartners.ed.gov/sites/default/files/attachments/2024-08/FAFSAVerification2425IRSTaxReturnTranscriptMatrix.xlsx), ED tells us in the final footnote that

> *Applicants and contributors who were required to manually enter their income and tax information may have been instructed to provide different line items for income tax paid (IRS Form 1040: Line 22 - Schedule 2: Line 2) and education credits (IRS Form 1040: Schedule 3, Line 3). Schools may use their discretion to use manually-entered tax data provided based on these instructions if the information results in more aid eligibility for the student.*

You have the authority to address this issue but are not required to do so.

First, let's consider a few things:

1) We only need to look for applicants with contributors who provided tax information manually. If the contributors used the FA-DDX, they already have the most advantageous values for income tax paid and education credits possible. For dependent students, this is most likely their parent(s). For independent students, it can be the independent student or their spouse.

2) You do not need to worry about your students who received the Maximum Pell Grant, whether they received it based on the poverty guidelines or based on having a low SAI. Updating their income tax paid or education credits cannot result in additional Pell Grant if the student already has the maximum allowable amount.

3) Generally, when I discuss adjusting student's FAFSA data, I am thinking about increasing grant fund eligibility. Many of your students with manual contributors are not eligible for grants. You could go through the process below and adjust their FAFSA data, but may end up with more work-study eligibility, or subsidized loan eligibility where only unsubsidized loans were available, or even no change at all. Collecting a tax return from a student or their parent/spouse and updating their FAFSA data may not be worthwhile if it does not change their eligibility for grant aid. Luckily, it is not difficult to predict which student might benefit from this process and receive more Pell Grants[iii].

Identifying students whose manually reported INCOME TAX PAID is smaller than the allowable amount.

As I mentioned earlier, one of the most likely "other taxes" that may be included in Form 1040, line 24 but is not included in Form 1040, line 22, is the self-employment tax. The most common kind of self-employment income is Schedule C income – and we have a question on the FAFSA that asks about Schedule C. The question is "[n]et profit or loss from IRS Form 1040 Schedule C". If this value is positive and greater than $433.14[iv], then the contributor almost certainly paid self-employment tax, and Form 1040, line 24 is greater than Form 1040, line 22.

So – if you look for applicants who 1) have a contributor that provided tax information manually, 2) has Pell Grant, but not Maximum Pell Grant, and 3) has a value for "net profit or loss from Form 1040, Schedule C" that is $434 or greater, and get a signed copy of their tax return so you can update their income tax paid answer, you are almost certain to increase their Pell Grant to what it would have been had they been able to use the FA-DDX.

Note that if the student has $740 Pell Grant because they qualified for Minimum Pell based on the poverty guidelines, their Pell Grant is not based on their SAI. Unless their SAI is close to $6,655 and the post-adjustment SAI is likely to be smaller than that, you should exclude Minimum Pell recipients from this selection.

Identifying students whose manually reported EDUCATION CREDIT is smaller than the allowable amount.

The American Opportunity Credit can be as large as $2,500 for low to moderate income undergraduate students. It is usually claimed on the student's parents' tax return. Up to $1,500 of this credit is claimed on Schedule 3, line 3, and the other $1,000 on Form 1040, line 29. The pdf FAFSA and on-line FAFSA instruction ask only for Schedule 3, line 3, so many contributors who manually entered data into the FAFSA reported $1,500 (or a multiple of $1,500). However, almost all contributors who reported $1,500 for the education credit will have $1,000 on Form 1040, line 29.

If we look for independent students, spouses, or dependent student's parents who manually entered a $1,500 education credit into the FAFSA and ask for their tax return, we might be able to increase the education credit by $1,000. You could also look for multiples of $1,500 – as the American Opportunity Credit is a per-student credit and a $3,000 credit, for example, might mean there were two eligible students in college in 2023.

If you wanted to try to identify more students who might benefit from an education credit update and are willing to accept the possibility that more of them might not benefit from a tax return review, you could include people who manually reported and education credit that was less then $1,500. If these people are claiming the AOC (and not the other education credit, the Lifetime Learning Credit), then they would still have the $1,000 refundable credit on Form 1040, line 29.

Summary

If you search for ISIRs that have the following characteristics:

- The independent student, spouse, or dependent student's parent(s) manually reported their income tax data
- The student is not eligible for Maximum Pell Grant based on the poverty guidelines
- If the student is eligible for Minimum Pell Grant based on the poverty guidelines, their SAI is close to $6,655 and would likely fall below it if the income tax or education credits increased
- The student is eligible for calculated Pell Grant (SAI less than $6,658) or, if you want to try to capture more students, a value higher than $6,658 but low enough that small changes to the SAI may create eligibility for Pell Grant
- And either
    - The education credit is a multiple of $1,500, or smaller than $1,500 or
    - The manually reported value for the "net profit of loss from Schedule C" is greater then $433

and you collect the relevant tax returns, you almost certainly will increase the student's eligibility for Pell Grant.

Final Thoughts and Observations

This is not something you are required to do. ED has been clear that you do not need to treat the manually reported values for income tax paid and education credits as conflicting information and do not need to address the difference. However, it is inequitable and unfair, and addressing this would directly benefit low-income students.

This only applies to 2024-2025. The FAFSA and online help information has been updated in 2025-2026 so that FA-DDX and manually entered data should be coming from the same lines on the tax returns.

If you do ask students to send you this information, make sure you let them know it is optional, not required. You are not resolving conflicting information so do not want to hold up disbursements while you wait for information (or worse, undisbursed funds already disbursed). The data in the ISIR is valid, and the ISIR is payable, even if the student chooses not to provide their or their parent's tax returns to you.

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[i] This may be responsible for an increase in rejected FAFSA based on the ratio of the FAFSA tax value and the AGI being greater than 40%.

[ii] I am focused here on students who are Pell Grant eligible based on their SAI, not based on Maximum or Minimum Pell Grants based on the poverty guidelines. If a dependent student is eligible for Pell Grant based on their SAI, then their SAI must be $6,658 or less. The conversion rate from adjusted available income (AAI) to Parent Contribution (PC) to get an SAI this low or lower is either 22%, 25%, or 29% (See Table A5 in the 2024-25 *Federal Pell Eligibility and SAI Guide,* found here: 20242025FAFSAPellEligibilityandSAIGuide.pdf)). In this example, students eligible for Pell Grants between $740 and $7,390 in Pell Grant based on their SAI would receive more Pell Grant based on Form 1040, line 24 than they would based on Form 1040, line 22 minus Schedule 2, line 2. Most students would get between $620 and $820 additional Pell Grant. However, students whose calculated Pell Grant is close to maximum Pell ($7,395) would receive a smaller additional amount, due to the cap on total Pell Grant a student can receive.

[iii] You may be able to adapt this search to take SEOG, state grants, or institutional need-based grants into account based on your institution's, and state's eligibility guidelines.

[iv] An individual is required to pay self-employment taxes if their net-earnings from self-employment are at least $400.00. A person would need to have net-income from self-employment of $433.14 or more to have net-earnings from self-employment of at least $400.00.