CollegeBoard CSS Profile™

PROFESSIONAL JUDGMENT

TOPIC: Distribution of Retirement Funds

What?

Standard Institutional Methodology (IM) and Federal Methodology (FM) collect a family's income from the base income tax year. If the family takes a distribution from a retirement account, that income is reported on both the CSS Profile and FAFSA. A distribution may be included as taxed or untaxed income, depending on the type of retirement account and the age of the parent.

Financial aid administrators can review the family's financial situation and choose to use professional judgment to exclude part or all of the retirement distribution from income, or treat as an asset.

Why?

Parental income is the most important factor in determining the family's ability to pay. A distribution of retirement funds may inflate income and inadequately reflect the family's ability to contribute to educational expenses. However, some families rely on these funds as an annual source of income. In these circumstances, it may be fair to include the distribution as income. Therefore, it is critical that the aid administrator consider the circumstances associated with the distribution.

How do I…

Determine the approach to take?
The aid administrator should examine the type of distribution and the reason the income was withdrawn from the retirement account. The current disposition of the funds, as well as institutional policy, may determine if it should be counted as income and/or an asset or excluded entirely.

For example, a school may:

- Include as income if used as annual payout or liquidation of an asset;
- Include as an asset when reinvested (not a rollover);
- Exclude income used for "qualified expenses" (i.e., college tuition, private school tuitions, medical expenses, or consumer debt); or
- Exclude all of the income (i.e., distributions during period of unemployment).

If making the income adjustments changes the AGI, the aid administrator should recalculate taxes paid.

Collect information?

The aid administrator may collect this information through the base year federal tax return, a recent year federal tax return, and a 1099-R. A federal tax return from the base year will show if the distribution was taken as income or was a rollover. A federal tax return from the recent year will indicate if the distribution is an annual occurrence. It is possible for a distribution to be both taxed and untaxed. The 1099-R is a specific tax form that will document any distribution from a pension, annuity or retirement plan. Similar to the W-2, there are many boxes on the 1099-R, but only a few impact financial aid. Information about the 1099-R form and codes can be found on the IRS website.

An explanatory letter from the family can also provide greater understanding of the circumstances surrounding the distribution. In addition, the aid administrator may want to request supporting documentation related to use for qualified expenses. Please refer to institutional policies and procedures for qualified expenses.

Analyze the information?

It is common practice to review the documentation for accuracy and to ensure it supports the explanation(s) provided by the family. When determining treatment of a retirement distribution, the financial aid administrator may want to consider how the funds were utilized by the family:

- Is the retirement distribution an annual event? If the family will receive a similar distribution in future years, the aid administrator may decline to make adjustments. This is an annual source of income and a resource that contributes to the family's overall financial strength and ability to pay for college.
- Is the retirement distribution a one-time occurrence? If one-time, consider the following:
  - Were the funds moved to a different retirement account? The aid administrator may want to remove these funds from income and recalculate income taxes paid (if necessary).
  - Were the funds moved to a non-retirement account or saved for future use? The aid administrator may want to remove these funds from income, recalculate income taxes paid (if necessary), and confirm these funds are included in the value of cash, savings, checking or investments.
  - Were the funds received as income and spent? The aid administrator may want to remove from income any funds used for qualified expenses and recalculate income taxes paid (if necessary).

The decision to remove income and increase assets can vary based on institutional policies.

Treatment in IM and FM

Similar approaches can be used in both IM and FM. Since the base year income is reported on both financial aid applications, this amount may be adjusted based on the distribution of retirement funds. However, the aid administrator should ensure the adjusted data elements are appropriate for each methodology.

Additional Considerations

It may be beneficial to verify the distribution was not repeated in other years by requesting copies of the recent or anticipated year federal tax returns or 1099-R (where applicable). It may also be more accurate to use actual recent year or anticipated year income if either will be a better indicator of the family's ability to contribute to educational expenses. Refer to the Alternate Year Parent Income Tip Sheet for additional guidance.

PROFESSIONAL JUDGMENT CASE STUDY

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Case Study 1

The Green family appealed the financial aid award for their daughter, Jackie. They sent a letter stating that in the base year they received a distribution of the father's retirement account. They provided a copy of their base year federal tax return that showed the distribution as taxable income and a 1099-R demonstrating it was an early distribution. The retirement fund had $300,000 and they received a distribution for $50,000 to cover college tuition for Jackie and an older sibling. The family has submitted a recent year tax return that did not show any further distributions.

Decision

According to institutional policy, the decision was made to remove the one-time distribution from the income and recalculate the income taxes paid, as the funds were used for qualified expenses and did not recur in the recent year.

Case Study 2

The Johnson family appealed the financial aid award for their daughter, Annie. They sent a letter explaining that in the base year they received a distribution from the father's retirement account. They provided a copy of their federal tax return that showed a taxable retirement distribution of $80,000 and a 1099-R demonstrating an early distribution. The retirement fund has $320,000 remaining after this distribution. The Johnsons explained that $20,000 was used to pay Annie's college tuition, $15,000 was used for a family vacation, and $45,000 was saved for a future real estate purchase. A copy of the parents' recent tax return was submitted, which confirmed a repeated distribution for Annie's college tuition.

Decision

After reviewing the appeal, the financial aid administrator excluded $65,000 from the base year income. This $65,000 adjustment included two components. The institution recognized the $20,000 for tuition as a qualified expense and removed it fully from income. The institution also removed $45,000 from income for the future real estate purchase, but ensured it was included in the family's cash/savings as an asset. The aid administrator did not remove the $15,000 used for family vacation as it was considered a discretionary expense. The financial aid administrator recalculated taxes paid after removing $65,000 from income.

Treatments in Methodologies

IM Treatment

Standard IM includes all taxed and untaxed distributions in total income, with the exception of rollovers, which are excluded.

Depending on institutional policy and on the use of the funds, the financial aid administrator can remove the retirement distribution amount from income and recalculate taxes paid. The retirement distribution can also be moved from income to an asset.

FM Treatment

A similar approach can be taken in FM depending on institutional policy.