PROFESSIONAL JUDGMENT TIP SHEET

Topic: One-Time Taxable Income

What?

Standard Institutional Methodology (IM) and Federal Methodology (FM) use a family's base year income, which is the total income for the tax period two years prior to the academic year for which aid eligibility is being determined.[1] For some families, a portion of their income is one-time, and therefore not representative of the family's typical income. In these cases, it may be reasonable to examine the family's financial situation by excluding the one-time income or treating it as an asset.

Why?

Parental income is the most important factor in determining the family's ability to pay. Therefore, the receipt of one-time income can make it difficult to adequately determine the family's financial strength and sustained ability to contribute to educational expenses. Examples include, but are not limited to:

- Early distribution of an IRA or retirement plan
- Vacation/sick days paid due to termination
- Severance payments
- Bonus income
- Conversion of traditional IRA to Roth IRA
- Capital gains
- Unemployment compensation
- Gambling or prize earnings
- Employer reimbursement for moving expenses
- Insurance settlements

How do I…

Collect information?

There is no single way to collect documentation of the one-time income from a family. Many aid administrators ask families to explain the source of the one-time income and if applicable, explain expenses related to the acquisition or use of the one-time income. This could include documentation from the source to confirm the income is not

[1] For the CSS Profile™, three years of income are reported: base year, recent year and anticipated year. The FAFSA collects only base year income.

recurring, a copy of the recent year tax return, a copy of the 1099-R indicating an IRA/pension distribution, or receipts/statements detailing the medical expenses related to an insurance settlement.

Analyze the information?

It is common practice to review the information provided for accuracy, confirm the income was one-time, and ensure the documentation supports the explanation(s) provided by the family. Options for treatment of one-time income may include:

- Removing the income from the base year and adjusting the related data elements (e.g., adjusted gross income [AGI], wages, taxes paid).
- Removing the income from the base year and adjusting the related data elements, per above, but also moving the funds to an asset (e.g, cash, savings, checking, investments). If the income will be treated as an asset, take into account any expenses that may need to be paid from the income (e.g., lawyer fees or property taxes) and deduct this amount from the value entered as an asset.

When determining treatment of one-time income, the financial aid administrator may want to consider how the funds were utilized by the family:

- Were the funds used to cover expenses during the base year? This may be a reason to disregard all or a portion of the income.
- Were the funds saved for future use and reported as savings or an investment? This may support treating them as an asset.

Treatment in IM and FM

Similar approaches can be used in both IM and FM. Since the base year income is reported on both applications, this amount may be adjusted based on the one-time taxable income. However, the aid administrator should ensure the adjusted data elements are appropriate for each methodology. For example, foreign income is included in IM but excluded in FM.

Additional Considerations

It may be beneficial to verify the event was not repeated in subsequent years by requesting supporting documentation. It may also be more accurate to use recent 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.

Consider your institutional policies and procedures when determining how to evaluate one-time income.

PROFESSIONAL JUDGMENT CASE STUDY

TOPIC: One Time Taxable Income

The Cooper family appealed their financial aid award for their daughter, Bertha. They sent a letter stating that in the base year they received a one-time taxable payment for the sale of Bertha's grandfather's farm. The family indicated that the funds have not been spent. They also provided a copy of the check they received from the sale, along with a copy of their base and recent year's federal tax returns. Since the farm was sold and the payment was cashed, there is no potential for this income to be repeated.

Decision

The financial aid administrator verified the income was one-time by reviewing the parents' base and recent year tax returns. The decision was made to remove the one-time taxable income from the family's base year AGI and recalculate the income taxes. The administrator confirmed that the proceeds had been invested and reported as an investment asset on the financial aid application. Further, documentation was received from the family that the funds were invested. This adjustment most accurately reflects the family's current financial situation and ability to contribute to educational expenses.

Treatments in Methodologies

IM Treatment

The financial aid administrator can remove the one-time event from the AGI and other related data elements (such as other taxable income) and allow the system to recalculate the income tax. Alternatively, a financial aid administrator could manually recalculate taxes paid using the base year tax tables.

FM Treatment

In FM, the financial aid administrator could utilize professional judgment and revise the AGI and taxes paid according to their institutional policy.

