

PROFESSIONAL JUDGMENT AND FOREIGN INCOME EXCLUSION

Suzanne Evans

Rocio Perez

AGENDA

- ❖ What is Foreign Income?
- ❖ Maximum Pell Grant Indicator and Reporting Foreign Income Exclusion
- ❖ U.S. Territories and Foreign Tax Authorities
- ❖ Using PJ to Correct AGI and Income Taxes Paid
- ❖ Verification
- ❖ Next Steps and Examples
- ❖ Professional Judgment and Changes for 2024-2025
- ❖ Special Circumstances
- ❖ Procedures
- ❖ Important Notes





What Is Foreign Income Exclusion and Where Do I Find It?

- ❖ Foreign Income Exclusion is also referred to as Foreign Income Exempt from U.S. Federal Taxation. It is earned income from outside the country, by a US Citizen or Permanent Resident.
- ❖ Any amount listed on IRS, Schedule 1, line 8d is foreign earned income.
- ❖ Currently, Foreign Income is not included as untaxed income in 2023-24. Beginning with the 2024-25 FAFSA this untaxed income will need to be reported either as untaxed income OR included in AGI.
- ❖ Reporting of any Foreign Income is self disclosed by the student and/or contributors.

Why Isn't Foreign Income Brought in as FTI Along With All Other Tax Data?

The Future Act tells ED which (FTI) can be retrieved from the IRS. Foreign Earned Income is not included in the Future Act and therefore it is not included in the Future Act Direct Data Exchange (FA-DDX).

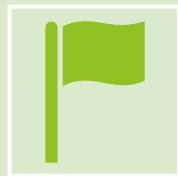
Although foreign income is included in the calculation of an applicant's SAI, it is not considered when determining the applicant's eligibility for a Maximum Pell Grant. For this reason, ED will flag the ISIR for the FAA to review.

Maximum Pell Grant Indicator And Reporting Foreign Income Excluded from Taxation

The FAA is required to review Maximum Pell Grant eligibility for applicants when the following occurs:



The student and/or contributor discloses they have foreign income as untaxed income.



The ISIR contains a Maximum Pell Indicator flag.



There will be a new C flag comment code added to the ISIR that will require institutions to review how foreign income exclusion amounts impact eligibility for a Maximum Pell Grant prior to awarding federal student aid.

Only U.S. Federal Tax Return Data is Transferred

As stated in a prior slide, the Future Act does not authorize any transfer of income data other than that of the U.S. Federal Tax Returns

This means the FA-DDX does not import tax information from tax authorities for the U.S. Territories of Puerto Rico, Guam, American Samoa, the U.S. Virgin Islands, and the Commonwealth of the Northern Mariana Islands. These U.S. Territories are not considered foreign countries to the United States; however, applicants and/or contributors will have the same FAFSA experience as individuals who filed with a foreign tax authority.

U.S. Territory and Foreign Tax Authorities

Both the applicant who filed taxes through a U.S. Territory tax authority and the applicant who filed through a Foreign Tax Authority will have to manually input their tax data.

As in years past, these applicants will need to enter financial information that is equivalent to the income and tax information found on an IRS Form 1040 (AGI, tax paid, and certain untaxed income.)

Applicants and their contributors are still required to provide their consent and approval even if such FTI does not exist with the IRS.

Dual Tax Filers

Income transferred into the FAFSA from the FA-DDX will be the default information that the SAI is calculated from. However, some applicants may file both a U.S. IRS 1040 form as well as a tax return from a U.S. Territory's tax authority.

When this happens the 2024-2025 FAFSA will not allow dual tax filers to manually report income and tax information not reported to the IRS. This means the SAI and the Pell Grant eligibility calculations will be inaccurate since both calculations will only use the federal tax information transferred from the IRS and will not reflect the additional income data information reported to a US Territory tax authority.

Dual Tax Filers (cont.)

In this situation the applicant may have a different AGI and taxes paid on the US and the US Territory forms. **These discrepancies require correction.** Since the AGI is a key factor in determining Pell Grant eligibility as well as the AGI and total income tax paid are two important components that determine the amount of available income that is considered in the SAI formula.

Schools must correct the AGI and income taxes paid based on the total amount of US Territory Income earned and add it to the AGI from the US 1040.

Likewise, schools must also add the taxes paid from the 1040 and the US Territory's tax document to come up with the total taxes paid.

Using PJ to Correct AGI and Income Taxes Paid

Once the AGI and the Income Taxes Paid has been corrected to include both US Territory and 1040 amounts, the FAA must use the professional judgment flag to override the default use of FTI.

While FAAs are directed to use the PJ flag for this purpose, the FAA should not consider themselves as making a professional judgment when correcting AGI and income tax paid for a dual tax filer from one of the US Territories.

Unlike professional judgments based on special circumstances, these corrections DO NOT need to be reviewed and granted on a case-by-case basis and may apply to a population or category of students.

Foreign Income Not From a U.S. Territory

If an applicant and/or contributor reports Foreign Earned Income on their 1040, the steps in determining how to process it are:

1. If the application is selected for verification, the FAA must complete verification first. The FAA only verifies the foreign earned income exclusion since the data retrieved using the FA-DDX is considered accurate.
2. Since the Foreign Income is not transferred from the IRS the September 19, 2023 Federal Register states that the following documentation is sufficient for verification of this data element:

Acceptable Verification Documentation

1

A Transcript

obtained from the IRS or U.S. Territory, or a foreign government, that lists 2022 tax account information of the tax filer; or

2

A copy of the income

tax return and the applicable schedules that were filed with the IRS or other relevant tax authority of a U.S. territory, or a foreign government that lists 2022 tax account information of the tax filer.

3

The FAA may have to determine the exchange rate as of the filing date of the tax return to calculate the US Dollar amount equivalency at the time of filing and/or have the tax document translated if not in English

4

Note that IRS Form 2555 (Foreign Earned Income) is not listed as acceptable documentation

Acceptable Verification Documentation (cont.)

5

If you are using a copy of the federal tax return to complete verification, you will need the 1040 as well as the Schedule 1, even though the foreign income only appears on the Schedule 1. This is true even if the items in line a through h do not need to be verified because they were transferred and unchanged.

6

This may result in the school having to review the 1040 for potential conflicting information even though the other tax data were retrieved via the FA-DDX.

Example

Dependent Student with one sibling and parents who are married and have a family size of 4. The 1040 reports an AGI of \$15,000 and 0 taxes paid. Parents have a foreign income exclusion of \$675,000. Student qualifies for automatic maximum Pell Grant because their parents AGI falls below the 175% of federal poverty guidelines.

If the income exclusion were removed from untaxed income and reported in AGI, the total amount would exceed the 175% of the federal poverty guideline and the student would no longer qualify for the automatic maximum Pell Grant award.

Note too that the students SAI would change based on the new income information.

Example

Students' application was not selected for verification. Would you...
Ask for more documentation?

Ask what type of income it is, is it reoccurring or is it a one-time
income amount?

Is it income they still have to use going forward into the 2024-25
academic year or has it been completely depleted?

These and other questions will help an FAA determine whether it is
appropriate to add it to AGI or leave in untaxed income.

Next Steps

The FAA must then make a determination and submit the judgment as appropriate. The FAA may ask for additional documentation to support their PJ decision, but ultimately, the FAA must determine based on all factors whether to add the foreign income to the AGI and if so, does this action make the student ineligible for Maximum Pell Grant.

Statutory Requirement

Keep in mind this process is a statutory requirement under: *Section 401(b)(1)(D) of the Higher Education Act of 1965 (HEA) as amended [20 USC 1070A9(b)(1)(D) Amendment of Section].*

The process explained is only for maximum Pell recipients with a Foreign Earned Income Exclusion- not ALL Pell Recipients.

What is Professional Judgment?

Professional judgment is the discretion granted to financial aid administrators to override dependency status and/or make adjustments to need analysis, including data elements used to calculate the Student Aid Index (SAI) and costs within the Cost of Attendance (COA) components.

The financial aid administrator decides if adjustments are warranted due to special circumstances or unusual circumstances.



Changes for 2024-2025

The FAFSA Simplification Act introduced changes related to professional judgment (PJ), dependency overrides, and homeless youth determinations effective for the 2023-24 aid year and beyond. Institutions are now required to:

- Inform students about their ability to request PJ adjustments for special and unusual circumstances, such as publicly posting this information on their websites.
- Notify students of the school's process, requirements, and timeline for reviewing PJ requests.
- Abandon any policy of denying all PJ requests of a specific type and remove deadlines by which students must submit PJ requests.

Changes for 2024-2025 (cont.)

- Make determinations of independence for unaccompanied homeless youth, foster care youth, orphans, wards of the court, and students with unusual circumstances within 60 days of the student's enrollment.
- Presume any student who received a dependency override in a preceding award year to be independent for each subsequent award year at the same institution unless the student informs the institution that their circumstances have changed, or the institution has conflicting information about the student's independence.
- The FAFSA Simplification Act also Creates a new distinction between special and unusual circumstances.

Special vs. Unusual Circumstances

Special circumstances relate to PJ adjustments to FAFSA data elements or to the cost of attendance (COA).

Unusual circumstances relate to making an adjustment to a student's dependency status based on a unique situation, commonly known as dependency overrides.

Special Circumstances

Special Circumstances refer to the financial situations that justify an aid administrator to adjust the components of a student's cost of attendance or the data used to calculate their SAI on a case-by-case basis. This adjustment is valid only at the school making the change.

The purpose of addressing special circumstances is to make reasonable adjustments to accurately reflect a student's unique situation.

If the student is selected for verification by either the FAFSA Processing System (FPS) or by the school, verification must be completed before the financial aid administrator may exercise professional judgment (PJ).

A school is not permitted to make a professional judgement for a student after that student has ceased to be eligible, including when a student is no longer enrolled.

Adjusting components of a student's Cost of Attendance

COA components may be adjusted to address special circumstances, but adjustments must be made within the accepted categories as defined in the Higher Education Act (HEA). An adjustment to a component of the COA may address a student's situation more adequately than adjustments to SAI data elements.

It is important to note, that adjustments to SAI data elements or COA components may result in the same outcome. Which approach to take may be a matter of personal preference, based on experience and on the school's established policies and procedures.

Financial situations that justify adjusting data elements in the COA (or the SAI calculation)

Change in housing status (e.g., homelessness)

Tuition expenses at an elementary or secondary school

Medical, dental, or nursing home expenses not covered by insurance

Child or dependent care expenses

Other changes or adjustments impacting the student's costs or ability to pay for college

Severe disability of the student or other member of the student's household

COA Example 1

Note: Abbott College does not include a student health insurance fee in the COA.

Melissa works full-time while she attends school. Unfortunately, she was recently laid off. To maintain her health insurance, Melissa has opted to pay the COBRA insurance premiums until she is able to find employment. The cost of the monthly premium is high, so Melissa is hoping the Financial Aid Office can help.

Making a COA adjustment for Melissa requires PJ.

COA Example 2

Gregory has been an outstanding student but has recently struggled after the loss of a sibling. His studies have been affected and he decided to seek the help of a professional therapist. He was able to find a therapist who he finds helpful. The process is ongoing, but Gregory feels that he is making progress. Gregory's insurance only covers part of the expense. He has made an appointment to speak with an administrator in the Financial Aid Office.

Making a COA adjustment for Gregory requires PJ.

Do we set a PJ flag for COA adjustments?

When adjusting the Cost of Attendance, the FAA does not need to set the Professional Judgment (PJ) Flag in the Institutional Student Information Record (ISIR) or reprocess the ISIR solely for such adjustment. However, the FAA should document the results of a PJ decision regarding the COA (or other non-SAI data element adjustments) in the student's file.

Adjusting the Data used to calculate Student's SAI

The law gives some examples of special circumstances that may be considered (HEA Sec. 479A):

Change in employment status, income, or assets;

Change in housing status (e.g., homelessness);

Tuition expenses at an elementary or secondary school;

Additional family members enrolled in college;

Medical, dental, or nursing home expenses not covered by insurance;

Child or dependent care expenses;

Severe disability of the student or other member of the student's household; and

Other changes or adjustments that impact the student's costs or ability to pay for college.

Special Circumstances Example

A student's parent had income earned from work of \$50,000 in 2022 but is no longer employed. After receiving documentation confirming this, the FAA at the student's college decides to adjust the AGI reported for the student's parents to account for their reduced income. The FAA also reduces the income earned from work for the student's parent to zero.

Procedures

- ❖ The reason for the FAA decision to approve or deny a request for professional judgment and any subsequent adjustments must be documented.
- ❖ The documentation must substantiate the special circumstances that differentiate the student—not conditions that exist for a whole class of students.
- ❖ Documentation can include a documented interview between the student and the FAA and supplementary information, as necessary.
- ❖ The data elements that are adjusted must relate to the student's special circumstances. For example, if a family member is ill, the FAA might modify the AGI to allow for lower earnings in the coming year or might adjust assets to indicate that family savings will be spent on medical expenses.

Procedures (cont.)

- ❖ When considering using PJ, an FAA should keep in mind that an income protection allowance (IPA) is included in the SAI calculation to account for modest living expenses. Before adjusting for an unusual expense, consider whether it is already covered by the IPA. It is reasonable to assume that approximately 30% of the IPA is for food, 22% for housing, 9% for transportation expenses, 16% for clothing and personal care, 11% for medical care, and 12% for other family consumption.

Acceptable Tax Documents For Professional Judgment

For the purposes of processing a professional judgment (PJ) or special circumstances request, it is up to the school to determine what it considers to be acceptable documentation, which could include a **signed copy of an applicant's tax return**. A school could choose to require tax return transcripts.

The benefit of using tax return transcripts for PJ documentation is consistency in documentation requests among various aid processes, which would be easier for the student and his or her family to understand, especially if the student has been selected for verification.

PJ Flag Required For 2024-25

For the 2024-25 award year, the financial aid administrator (FAA) will need to set the Professional Judgment Flag (PJ Flag) on the Institutional Student Information Record (ISIR) only in the following situations:

1. There are changes (corrections, updates, or PJ adjustments) to federal tax information (FTI) that is retrieved from the Internal Revenue Service (IRS) via the FUTURE Act Direct Data Exchange (FA-DDX), and the FAA determines a need to override the FTI and trigger a recalculation of the student aid index (SAI).
2. There are required corrections to FTI retrieved from the IRS via the FA-DDX when an amended tax return was filed with the IRS after the FAFSA was completed, and the FAA determines there is a need to override the FTI and trigger a recalculation of the SAI.
3. There are individuals who file both an IRS tax return and a tax return with Puerto Rico or another U.S. territory and the FTI from the IRS must be corrected to reflect the territory tax return and override the FTI from the FA-DDX, as instructed in the December 19, 2023, Electronic Announcement (GENERAL-23-118).
4. The FAA uses their PJ discretion to make PJ adjustments to non-FTI data (such as the Foreign Earned Income Exclusion, child support received, assets, etc., but not the cost of attendance).

These are the only times setting the PJ Flag is required. Except for non-FTI PJ adjustments in #4, **the FAA only sets the PJ Flag when there is a need to override FTI from the FA-DDX.**

Important Notes

An FAA's decision regarding adjustments is final and cannot be appealed to the Department.

The law doesn't allow you to modify either the formula or the tables used in the SAI calculation; the FAA can only change the cost of attendance, or the values of specific data elements used in the SAI calculation.

The FAA cannot adjust data elements or the cost of attendance solely because they believe the tables and formula are not adequate or appropriate.

The FAA cannot use PJ to waive general student eligibility requirements or to circumvent the intent of the law or regulations. For instance, the FAA cannot use PJ to change FSEOG selection criteria.

An FAA cannot reduce SAI based on recurring costs such as vacation expenses, tithing expenses, and standard living expenses (e.g. utilities, credit card expenses, children's allowances, etc.).

Difference Between a Correction, an Update, and a PJ Adjustment

Corrections

changes to data elements that are incorrect and need to be corrected, including data that were incorrect at the time the FAFSA was filed. In many situations when corrections are made to application data, the institution or the student must submit these corrections to the FAFSA Processing System (FPS) for reprocessing before the student can be paid.

Updates

changes to data elements that were correct at the time of application, but changed since the FAFSA was filed. As a general rule, information that was correct as of the date the FAFSA was filed cannot be updated. But they are allowable only under very specific circumstances related to dependency status, number in household (household size), number in college, and marital status.

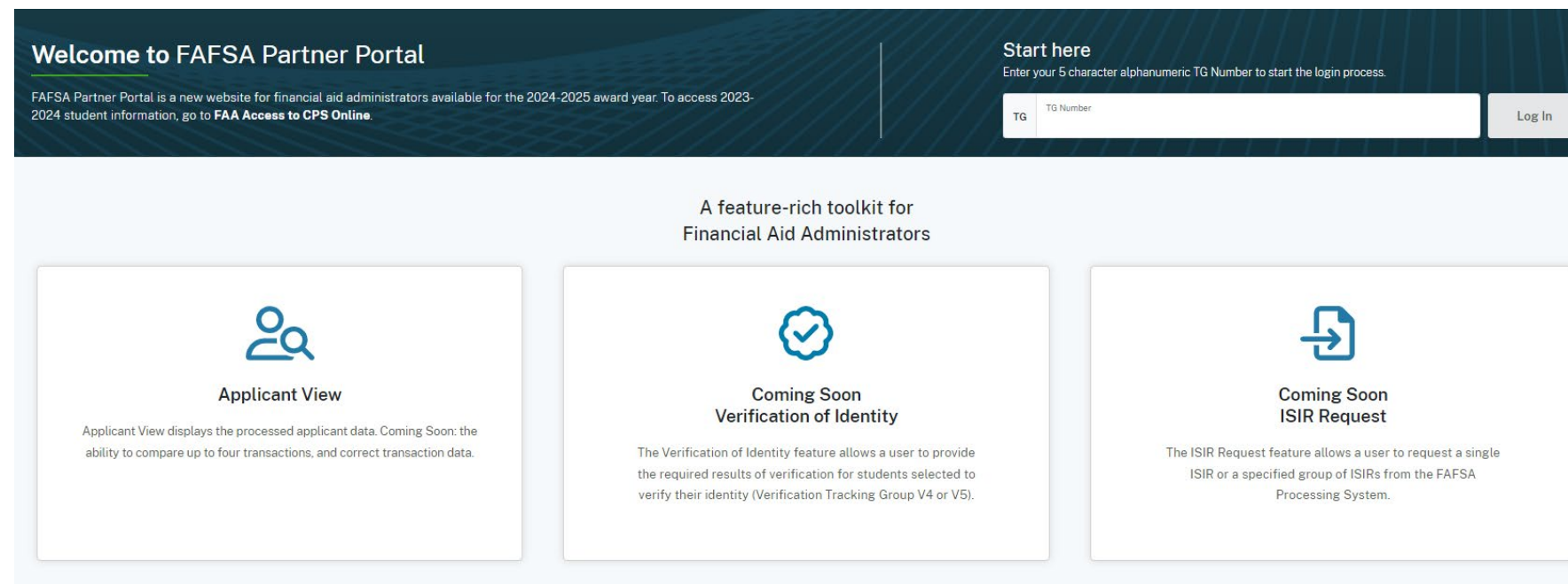
PJ Adjustments

Changes made to FAFSA data elements by a financial aid administrator (FAA) exercising their PJ authority are called adjustments. FAAs may exercise discretion in a number of areas when a student has special or unusual circumstances.

Processing corrections, updates, or PJ adjustments

The FAA may submit a change electronically, via the FAFSA Partner Portal (FPP) or third-party software and may do so without a signature from the student or parent. When changes to FTI are necessary, the FAA should set the PJ Flag to override the FTI and send the ISIR corrections with the updated fields either via the FAFSA Partner Portal (FPP) or the Electronic Data Exchange (EDE).

These changes will generate a new FAFSA transaction, and a new ISIR will be sent to the school indicating any changes to the student's Title IV aid eligibility.



Questions



RESOURCES

- ❖ September 19, 2023, *Federal Register*:
<https://www.federalregister.gov/documents/2023/09/19>
- ❖ FAFSA Simplification Act Questions and Answers:
<https://www2.ed.gov/policy/highered/reg/hearulemaking/2009/fafsa-q-and-a.html>
- ❖ Section 401(b)(1)(D) of the Higher Education Act of 1965 (HEA), as amended [20 USC 1070A(b)(1)(D) Amendment of Section
- ❖ GEN 23-118: <https://fsapartners.ed.gov/knowledge-center/library/electronic-announcements/2023-12-19/puerto-rico-and-other-us-territories-dual-tax-filers-reporting-income-and-tax-information-2024-25-fafsa>
- ❖ NASFAA Ask Regs: <https://www.nasfaa.org/AskRegs>
- ❖ 2024-2025 Federal Student Aid Handbook – Special Cases:
<https://fsapartners.ed.gov/knowledge-center/fsa-handbook/2024-2025/application-and-verification-guide/ch5-special-cases>
- ❖ Knowledge Center Library: <https://fsapartners.ed.gov/knowledge-center/library>
- ❖ GEN 22-15: <https://fsapartners.ed.gov/knowledge-center/library/dear-colleague-letters/2022-11-04/fafsar-simplification-act-changes-implementation-2023-24>