

Expanding the Definition of Income Would Penalize Work, Reduce College Completion, and Increase Complexity

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Currently, only certain forms of untaxed income are considered in determining eligibility for Pell Grants and other student financial aid. The House majority's FY2012 Labor-HHS appropriations bill proposed expanding the definition of untaxed income to include means-tested benefits, refundable tax credits, and untaxed Social Security benefits. This would have rolled back changes from the College Cost Reduction and Access Act of 2007 (CCRAA), which passed with bipartisan support as well as support from numerous higher education and student groups.¹ ***This expanded definition of income would have cut Pell Grants for needy students by an estimated \$13 billion over the next 10 years, harming college access, completion, and economic growth.***

Counting means-tested benefits, refundable tax credits, and untaxed Social Security benefits as income in determining eligibility for financial aid would hurt students widely considered to be needy. Including these forms of untaxed income in the needs analysis formula would overestimate how much students and their families can afford to pay for college. Receipt of these types of benefits is an indicator of financial need and should not disqualify students for assistance.

Counting the earned income tax credit (EITC) against Pell Grant eligibility serves to penalize work, harming students and families trying to work and educate themselves out of poverty. Consider an incoming freshman whose family of four has an earned income of \$34,575 (150% of poverty) and receives an EITC of about \$2,650. Counting the EITC and other refundable credits as income would more than triple the student's expected family contribution to nearly \$900 and cause her Pell Grant to drop by \$640 that year alone, significantly increasing the cost of college for her and her family.² The EITC has successfully encouraged work among poor adults—especially single mothers, who face high rates of poverty.³ This change would undermine that success by penalizing work.

The expanded definition of income in the House FY12 Appropriations Committee bill would have cut students' Pell Grants by \$13 billion over 10 years.⁴ By cutting Pell Grants for these needy students, this type of proposal would:

- **Reduce rather than increase college access and affordability**, as the neediest students facing steep cuts in grant aid may no longer be able to afford college at all or be forced to drop out before they complete a degree or certificate.
- **Complicate rather than simplify the student aid application process.** Including more types of untaxed income in the needs analysis formula would greatly increase the complexity of applying for financial aid, making it harder for students to access the funds they need to cover college costs.
- **Lower rather than increase college completion**, as students may be forced to take fewer classes to reduce costs or to work longer hours in order to stay in school. Research shows that students working 15 or more hours a week are more likely to drop out of college than those working fewer hours.⁵
- **Force students to borrow more, rather than less, to stay in school.** Most Pell Grant recipients already have to borrow to pay for college.⁶ In fact, Pell Grant recipients are already more than twice as likely as their peers to take out student loans.⁷ Cutting their grant awards would require them to take out more loans, leaving them even further in debt.
- **Harm rather than strengthen the economy** by decreasing the number of college-educated workers and preventing low-income students from working and educating their way into the middle class.

Expanding the definition of income increases the complexity of the student aid application process and pits one form of aid against another. Including means-tested benefits, refundable tax credits, and untaxed Social Security benefits as income in the Pell eligibility formula could lead to other programs considering Pell Grants as income in their eligibility formulas, creating a "stacking" problem where the benefits from one program affect eligibility for another and vice-versa. To avoid losing critical assistance, needy students and their families would be forced to navigate multiple, complicated programs to determine the proper order to apply for benefits. **Notably, policymakers have recently moved in the opposite direction – all tax refunds, including refundable tax credits like the EITC, are currently disregarded as income for every federal means-tested aid program.**⁸

¹ U.S. Senator Jack Reed. March 20, 2007. "Floor Statement Introducing ACCESS Act and FAFSA Act." Elements from Senator Reed's Financial Aid Form Simplification and Access Act (FAFSA) were eventually folded into the College Cost Reduction and Access Act, passed by Congress in September 2007.

² Calculations by CBPP based on the 2013-2014 Department of Education guidelines on the Pell Grant formula and the EFC formula and the CBPP tax model for tax year 2012 (last updated April 2012). This hypothetical family is eligible for a small refundable Child Tax Credit (CTC) in addition to the EITC.

³ Elissa, Nada and Hilary W. Hoynes. 2005. "Behavioral Responses to Taxes: Lessons from the EITC and Labor Supply." U.C. Davis Department of Economics Working Paper Series. http://www.econ.ucdavis.edu/working_papers/05-29.pdf.

⁴ U.S. Congressional Budget Office (CBO) staff preliminary estimates of the changes in the House bill to the discretionary and mandatory portions of the Pell Grant program, December 2011. Estimates reflect program costs and budget authority.

⁵ American Council on Education, Center for Policy Analysis. 2002. *Crucial Choices: How Students' Financial Decisions Affect Their Academic Success*. CALPIRG. 2009. *Working Too Hard to Make the Grade: How Fewer Work Hours and More Financial Aid Can Help California Community College Students Succeed*. Jonathan M. Orszag, Peter R. Orszag, and Diane M. Whitmore, "Learning and Earning: Working in College," UPromise Inc., August 2001, <http://www.brockport.edu/career01/upromise.htm>.

⁶ Calculations by TICAS on data from the U.S. Department of Education, National Postsecondary Student Aid Study, 2007-08.

⁷ Ibid.

⁸ The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 disregards all federal tax refunds as income or assets for all federal means-tested aid programs through 2012. This provision extended the refundable credits disregard from most to all federal means-tested programs, and removed the administrative burden of distinguishing between different sources of tax refunds.