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Highlights

Highlights of GAO-05-105, a report to congressional requesters

January 2005

STUDENT FINANCIAL AID

Need Determination Could Be Enhanced through Improvements in Education's Estimate of Applicants' State Tax Payments

Why GAO Did This Study

In 2003, the Department of Education (Education) proposed an update to the state and other tax allowance, a part of the federal need analysis for student financial aid. Most federal aid as well as some state and institutional aid is awarded based on the student's cost of attendance less the student's and/or family's ability to pay these costs—known as the expected family contribution (EFC). The allowance, which accounts for the amount of state and other taxes paid by students and families, effectively reduces the EFC. Given the potential impact of the allowance on the awarding of aid, we determined what factors have affected the updating of the tax data on which it is based, the effects the proposed 2003 update would have had on financial assistance for aid applicants, any limitations in the method for deriving the allowance, and strategies available to address them.

What GAO Recommends

GAO recommends that the Secretary of Education, in the short run, (1) formalize procedures to ensure that Education annually requests and obtains the most current tax data from the Internal Revenue Service (IRS) and (2) revise the methodology for calculating the allowance to better reflect the varying tax rates paid by students and families in different income groups. In the longer run, GAO recommends that Education (3) determine whether more effective data sources or methodologies exist for deriving the allowance.

www.gao.gov/cgi-bin/getrpt?GAO-05-105.

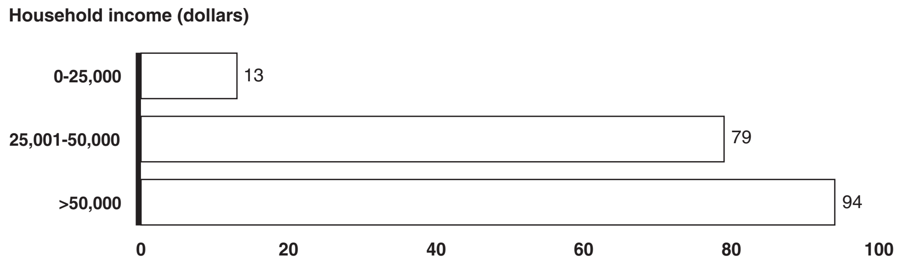
To view the full product, including the scope and methodology, click on the link above. For more information, contact Cornelia Ashby at (202) 512-8403 or AshbyC@gao.gov.

What GAO Found

While Education has been required to revise the allowance annually since 1993, prior to 2004 it attempted to update the allowance only twice—in 1993 and again in 2003—but the latter update was suspended. As a result, the 1988 IRS tax data used for the 1993 update remained in effect. The lack of updates is primarily because Education did not annually seek data needed to update the allowance or establish effective internal control to guide the updating process. Also, Education did not consider alternatives when data were not readily available.

Had the update been implemented in 2004–2005, the allowance would have decreased for most states; as a result, the EFC would have increased by about $500, on average, for a majority of aid applicants. Of those with an EFC increase, 38 percent would either have received less in Pell Grants ($144 less on average) or would have become ineligible for them; the percentage of recipients affected would have varied by income. Overall Pell Grant expenditures would have decreased by $290 million. Increases in EFCs could also have affected other forms of aid, including state aid; these effects in turn could have affected Stafford loans and Parent Loans for Undergraduate Students. The impact of the proposed update on Campus-Based, state, and institutional need-based aid would likely have varied based on state and institutional aid awarding policies and changes in state allowances.

Percentage of Recipients Who Would Have Seen a Pell Grant Reduction with the Proposed Update, by Household Income



Source: GAO analysis of the Free Application for Federal Student Aid (FAFSA) applicant file.

Due to certain limitations of the IRS dataset with respect to calculating the allowance, and problems with how Education uses this dataset, the current allowance may not reflect the amount of taxes paid by students and families. The dataset is limited because the taxpayers included in it are generally not representative of aid applicants, it does not include all state and other taxes paid by students and families, and the tax data are several years older than the income information reported by applicants on aid applications. In addition to these limitations, Education does not make full use of the dataset to better reflect the varying tax rates paid by taxpayers in different income groups.

Strategies we identified for addressing the limitations of the tax allowance include (1) using IRS data with revisions to the method for calculating the allowance, (2) substituting IRS data with one of several alternative data sources, (3) using a standard allowance for all aid applicants irrespective of state of residence, or (4) collecting tax information directly from aid applicants. These could require modest to substantial changes, would differ in their impact on applicants and federal costs, and could require legislative changes.