FAFSA Basics: Student Income

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Student income seems pretty straightforward on the surface. Students get an income protection allowance of $6,840 plus the same tax allowances as parents. Income in excess of the allowance is assessed at 50%. Given the prevailing minimum wage, it would appear that student income is not much of a factor. However, there are a few big items that get added into student income:

"**Untaxed Income**" is the big one for many students. At first glance, this section looks a lot like the parent untaxed income section—until you get to the last line: "Money received, or paid on your behalf (e.g., bills), not reported elsewhere on this form. This includes money that you received from a parent or other person whose financial information is not reported on this form and that is not part of a legal child support agreement." What does that mean? That means that if your parents are divorced and the noncustodial parent pays for college *in the income year to which this FAFSA pertains*, you report those dollars as student income in this section. Same goes for payments made by grandparents or others who aren't part of your FAFSA. If possible, those payments are best held until January of sophomore year to avoid reporting. Or, parents can strategize to ensure that the total amount spent by a noncustodial adult when combined with other income items does not exceed the income protection allowance. Note that this is only for the individual student's FAFSA since it's student income. Money paid on behalf of a sibling does not need to be added.

The instructions further specify "Money received, or paid on your behalf, also includes distributions to you (the student beneficiary) from a 529 plan that is owned by someone other than you or your parents (such as your grandparents, aunts, uncles, and non-custodial parents). You must include these distribution amounts." As above, if possible students receiving need-based financial aid should wait until January of sophomore year to start tapping grandparent- or non-custodial parent 529 accounts to preserve financial aid, or limit those distributions to stay under the student income protection allowance.

Outside scholarships are the second big factor in student income. Wherever those come from, the Department of Education requires schools to count them in financial aid offers. However, schools can determine how to package outside scholarships within their overall financial aid framework so students may see very different outcomes with different schools.

What does this mean in practice? Typically an outside scholarship is disbursed directly to the school and credited to the student's account. Whether or not that's the case, students are required to report outside scholarships to the school. Likewise, the school is required to consider the scholarship: the Department of Education's instructions for packaging aid state, "Except for Pell Grants, FSA award amounts are also constrained by the other aid that a student receives." Students should expect that aid other than Pell Grants will be reduced by up to 50% of an outside scholarship. That aid might include work study, a subsidized loan, an institutional grant, or all three.

For example, one student I worked with, who attends a 100% need met/no loans school, received a $30,000 institutional grant and a $5,000 outside scholarship. Her institutional grant was reduced by $2,500 as a result of the outside scholarship. She still came out ahead by $2,500, but over the summer she chose not to apply to several smaller scholarships thinking that she could spend the same amount of time working and not impact her financial aid.

Another student received a $15,000 outside scholarship. Her financial aid package included work study and a subsidized loan in addition to a grant. That school's policy was to reduce the work study and subsidized loan first. That accounted for $6,500 of the outside scholarship; her institutional grant was reduced by 50% of the remaining scholarship balance or $4,250. The lost loan subsidy would cost around $720 over four years, so she still came out ahead by about $10,000.

Some scholarship programs give students the option of receiving the scholarship directly rather than having it disbursed to the school. In that case, it's reported as income and may be subject to the kiddie tax. Students who are given that option should both do the math on the tax burden and consult with their school's financial aid office to determine the best course. Similarly, many students would benefit from having larger scholarships disbursed over several years of college if the scholarship grantor is willing.

On the plus side: One item that gets subtracted from student income is Work Study earnings. Those are considered financial aid and therefore not included in the aid calculation itself.