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Federal Student Aid Need Analysis System: Background, Description, and Legislative Action

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Summary

A federal need analysis system underlies the annual allocation of billions of dollars (more than \$73 billion in FY2005) in student financial aid supported by Title IV of the Higher Education Act (HEA) (P.L. 89-329, as amended). The system has regularly been characterized by many as too complex, creating a barrier for students seeking financial assistance, especially low-income students. In the 1992 Higher Education Act (HEA) amendments (P.L. 102-325), Congress overhauled the federal need analysis system to create a “simplified” system consisting of a free, common application form and a single methodology for determining the expected family contribution (EFC) for students desiring to attend postsecondary school. The new system was intended to simplify the process for applying not only for federal student aid, but also for state and institutional aid. More than 14 years later, simplification of need analysis remains a perennial issue. Many researchers and policymakers continue to debate the complexity of the federal need analysis system. They remain concerned with ensuring that the system is able to accurately gauge an individual’s ability to contribute to the cost of a college education.

This report provides an overview of the federal need analysis system, including a discussion of recent legislative changes and proposals. This report will be updated as warranted by significant legislation.

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A federal need analysis system underlies the annual allocation of billions of dollars (more than \$73 billion in FY2005) in student financial aid supported by Title IV of the Higher Education Act (HEA) (P.L. 89-329, as amended). The system has regularly been characterized by many as too complex, creating a barrier for students seeking financial assistance, especially low-income students. In the 1992 Higher Education Act (HEA) amendments (P.L. 102-325), Congress overhauled the federal need analysis system to create a “simplified” system consisting of a free, common application form and a single methodology for determining the expected family contribution (EFC) for students desiring to attend postsecondary school. The new system was intended to simplify the process for applying not only for federal student aid, but also for state and institutional aid. More than 14 years later, simplification of need analysis remains a perennial issue. Many researchers and policymakers continue to debate the complexity of the federal need analysis system. They remain concerned with ensuring that the system is able to accurately gauge an individual’s ability to contribute to the cost of a college education.

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Federal Need Analysis

Federal need analysis (Title IV, Part F) is a complex system that is used to allocate billions of dollars of federal student aid under Title IV of the HEA. It entails gathering financial data, which are provided by the student via the free application for federal student aid (FAFSA);¹ calculating the EFC; and packaging of the applicant’s financial aid award by the postsecondary institution’s financial aid administrator (FAA). This section provides a description of the EFC and how it is calculated. In addition, the role of the FAFSA and student financial aid packaging is examined.

¹ The FAFSA can be submitted through the Internet using FAFSA at [<http://www.fafsa.ed.gov>], electronically through a higher education institution, or with a standard paper application.

Expected Family Contribution

The EFC is the amount that the federal need analysis system determines a family has available to contribute toward postsecondary education expenses. In calculating the EFC, consideration is given to available income (a combination of taxable and untaxed income and benefits), and for some families, available assets. In addition, living expenses, retirement needs, and federal and state tax liability are considered. The income contribution is calculated by determining the total income of a student and his or her family (where applicable), and determining available income by subtracting a series of allowances from total income; a percentage of that available income is considered as an income contribution toward postsecondary education costs. A contribution from assets is similarly calculated. The combination of the available income contribution and asset contribution divided by the number of individuals in the family enrolled in college constitutes the EFC. The EFC process looks back a year for its income data and federal income tax liability. That is, for award year 2006-2007², 2005 income and federal income tax data will be used.

The calculation of the EFC varies depending upon the applicant's dependency status. There are three separate dependency classifications for individual applicants: dependent student, independent student with dependents, and independent student without dependents.³ These distinctions are important because parental financial information is *not* considered if the applicant meets the statutory definition of an *independent student*. To be classified as statutorily independent [Title IV, Section 480(d)], an applicant must meet **one** of the following conditions:

- 24 years of age or older by December 31st of the award year;
- married;
- enrolled in a graduate or professional program;
- have a dependent other than a spouse;
- orphan or ward of the court (or the applicant was until age 18); or
- a military veteran.

Applicants who do not meet any of the aforementioned conditions are considered to be dependent for the purposes of Title IV student aid.

Calculating the EFC. The following is a step-by-step description of the basic calculations used to determine a student's EFC. This description applies to the 2006-2007 award year.⁴ The calculation descriptions are organized as follows: parents of dependent students (dependent students are included within the calculation for parents) and independent students with dependents other than a spouse; and

² The 2006-2007 award year begins July 1, 2006, and ends on June 30, 2007.

³ The calculation of the EFC is delineated in the HEA in Sections 475, 476, and 477. Each of these sections applies to recipients based on their dependency status.

⁴ For a more detailed description of the federal need analysis system, see the *2006-2007 EFC Formula Worksheets and Tables*, located at [<http://www.ifap.ed.gov/efcinformation/attachments/0607EFCFormulaGuideDecFinal.pdf>].

independent students without dependents other than a spouse. The calculation for parents of dependent students and independent students with dependents other than a spouse are discussed together because the two are identical, except that the dependent student's contribution is added together with the parents'.

EFC Calculation for Parents of Dependent Students and Independent Students with Dependents Other than a Spouse

First Step. Calculate Total Income (TI). TI is calculated by adding the following: income earned from employment, untaxed income and benefits (e.g., welfare and child support payments), other sources of income such as federal education income tax credits (e.g. Hope and Lifetime credits), and certain student grant and scholarship aid (e.g., AmeriCorps benefits).

Second Step. Calculate Allowances. Various allowances for non-educational expenses are subtracted from TI. These allowances are for expenses such as basic living expenses (the income protection allowance), federal income tax liability, state and other taxes, Social Security and employment expenses.

Third Step. Calculate Available Income (AI). AI is calculated by subtracting the various allowances previously described from TI. AI can be a negative number.

Fourth Step. Calculate Asset Contribution (AC). AC is calculated by adding cash, savings, and checking and the net worth of investments, businesses, and farms (excluding the value of the family home or family farm), and then subtracting an asset protection allowance to determine a "discretionary net worth." The amount of the asset protection allowance increases with the age of the older parent (for dependent students) or the age of the student (for independent students with dependents). The asset protection allowance protects assets that are needed for retirement and future education costs. The AC is equal to 12% of the discretionary net worth. If the result is negative, the AC is zero.

Fifth Step. Calculate Adjusted Available Income (AAI). AC is added to AI to produce the AAI. A progressive assessment schedule is applied to the AAI to determine the proportion of income and assets to be contributed.⁵ The assessment rate ranges from 22% to 47%. Both AAI and the contribution from AAI can be a negative number.

Sixth Step. The contribution from AAI is divided by the number of family members in the household, excluding the parents in the case of dependent students who are enrolled in college. For parents of dependent students, the resulting number is the parent's contribution to the EFC; for independent students with dependents other than a spouse, this number is the EFC.

Next, the **dependent student's** portion of the EFC is calculated as follows:

⁵ Under a progressive formula, as the aggregate amount of income and assets rises, the proportion expected to be contributed toward educational expenses also rises.

Seventh Step. Similar to Step 1, TI is calculated for the dependent student based on the amount of untaxed income and benefits, other sources of income, and certain student grant and scholarship aid.

Eighth Step. Dependent students also receive various allowances for federal income tax liability, state and other taxes, and Social Security. However, dependent students do not receive an allowance for employment expenses. In addition, if the parents' AAI is negative (see Fifth Step above), then the amount is converted to a positive amount and added to the total allowances that the student receives.

Ninth Step. Calculate the Available Income (AI). AI is calculated by subtracting the allowances (previously discussed) from TI. AI is then assessed at 50% — this equals the dependent student's contribution from AI. If the result is negative, the AI is zero.

Tenth Step. The calculation for the dependent student asset contribution is the same as the calculation for parents and independent students with dependents (see Third Step above). However, dependent students' assets are assessed at 35%.

Eleventh Step. The final step, the total EFC for the dependent student, is calculated by adding the parents' contribution (see Sixth Step above) to the student's asset and income contribution.

EFC Calculation for Independent Students Without Dependents Other Than a Spouse

The EFC calculation for **independent students without dependents other than a spouse** is a hybrid of the calculation for parents and the one for dependent students. The calculation for this group is as follows:

First Step. Calculate Total Income (TI). TI is calculated by adding the following: income earned from employment; untaxed income and benefits; and other sources of income, such as federal education income tax credits and certain student grant and scholarship aid.

Second Step. Subtract Allowances. Various allowances for non-educational expenses are subtracted from TI. These allowances are for expenses such as basic living expenses (the income protection allowances), federal income tax liability, state and other taxes, Social Security, and in some instances, employment expenses.⁶

Third Step. The total allowances are subtracted from TI to produce the available income (AI). Similar to the assessment imposed upon dependent students, the AI of independent students without dependents is also assessed at 50%. The resulting amount is the contribution from AI.

⁶ Independent students without dependents other than a spouse receive an employment expense allowance only if they are married and both the student and the spouse are employed.

Fourth Step. The asset contribution is calculated by adding together cash, savings, checking, and the net worth of investments, businesses, and farms (excluding the value of the family home or family farm). Similar to the protection afforded to parents and independent students with dependents, independent students without dependents also receive an allowance to protect assets that are needed for retirement and future education costs, and the amount of the protection also increases with the student's age. However, the asset assessment rate for independent students without dependents is 35%.

Fifth Step. The EFC is calculated by adding the contribution from AI to the contribution from AC, and then dividing by the number of family members in college.

Special EFC Conditions. In addition to creating a common application form and a single methodology for determining need, Congress has also sought to further reduce the application burden for those applicants with family incomes at or below a specified threshold. Under the *simplified needs test* (SNT),⁷ the EFC calculation does not consider assets for the student (or spouse if married) or parent (if the student is a dependent) if their adjusted gross income (AGI) is less than \$50,000, and certain conditions regarding federal tax returns are met.⁸ The *automatic zero EFC* (hereinafter auto-zero EFC)⁹ sets the expected family contribution to zero for a dependent student's parents and the dependent student, or for an independent student who has dependents and has an AGI not greater than \$16,000.¹⁰ The auto-zero EFC is not provided to independent students without dependents other than a spouse.

FAFSA

The FAFSA is used to collect most of the information that is utilized to calculate the EFC. Applicants are required to report identifying information such as their name and Social Security number, information about the institutions where their information should be forwarded, and financial information pertaining to income and assets. As mentioned above, there are three ways to complete the FAFSA — via the web, electronically through a higher education institution, or by filling out a paper form.

The paper, web, and on-site electronic versions of the FAFSA differ in the ways that submitted data are treated. As a result, the two electronic versions of the FAFSA

⁷ HEA, Section 479(b).

⁸ To be eligible for the simplified needs test, the student and his or her parents must not have to file an income tax return, or must file or be eligible to file a federal tax form 1040A or 1040EZ. This requirement is also met if a form 1040 is filed by the parents or student if that form is filed only to claim the federal Hope or Lifetime Learning tax credit. The same requirement applies to independent students and their spouse, if any.

⁹ The tax form/filing requirements specified for the simplified needs test must also be met.

¹⁰ HEA, Section 479(c). This amount is the current maximum amount of income rounded to the nearest \$1,000 that one can earn and still be able to claim the maximum federal earned income tax credit.

provide advantages that the paper form does not. For example, the paper version lacks internal and end-of-entry data edits that require the applicant to resolve conflicts and complete all necessary fields prior to submission. In addition, the two electronic versions contain “skip logic,” which enables applicants, if they choose, to skip over the sections of the FAFSA that do not pertain to them. As a result, eligible applicants who apply via the electronic formats are able to take advantage of either the SNT or auto-zero EFC because the technology allows sections to be skipped where applicable. At present, there is no comparable approach available for paper form filers.

Despite significant growth in electronic filing of the FAFSA, a large portion and number of filers continue to use the paper application. According to the most recent data available from the Department of Education¹¹, as of September 25, 2005, approximately 9.5 million new and renewal FAFSAs have been filed for the 2005-2006 award year. Of the more than 4.2 million new applications (web and paper), approximately 25% (slightly more than 1 million) were submitted via the standard paper application.

EFC and Packaging

FAFSA data are submitted to a Central Processor (an entity working under contract for the U.S. Department of Education) that calculates the aid applicant’s EFC based on statutorily defined rules. From the Central Processor, the EFC and other summary data are reported to FAAs and to the FAFSA filer. The FAA determines the student’s need for federal student aid and other sources of aid, based primarily upon the EFC and cost of attendance (COA).¹² This is true for all federal student aid programs (e.g., loans, campus-based programs) except for the Pell Grant program.¹³ For nearly all Pell recipients, the award is calculated by subtracting the EFC from the maximum appropriated Pell Grant for the year (i.e., without regard to the COA). The FAA determines need in conjunction with each program’s award rules and puts together the financial aid award or package, which consists of the specific sources and amounts of student aid each applicant will receive to help pay for his or her education-related expenses.

The financial aid package starts with the Pell Grant, the federal foundation for student aid. Other aid, such as campus-based student aid program funds, state and institutional aid, and federal loans, are added to create the student’s aid package. The aid applicant is then notified concerning the composition of the financial aid package.

¹¹ The data are available at [<http://www.ifap.ed.gov/eannouncements/attachments/TRN0605063.pdf>].

¹² The cost of attendance (COA) is a measure of student’s educational expenses. It is statutorily defined in Title IV, Section 472 of the HEA. In general, it is the sum of tuition and fees; an allowance for books, supplies, transportation, and miscellaneous personal expenses; and a room and board allowance.

¹³ For additional information regarding the Pell grant program, see CRS Report RL31668, *Federal Pell Grant Program of the Higher Education Act: Background and Reauthorization*, by Charmaine Mercer.

Some of these calculations vary from FAA to FAA. Not only does the aid administrator have some discretion in the awarding of campus-based student aid, but Section 479A of the HEA explicitly gives FAAs discretion to adjust, on a case by case basis, the COA or the values of the items used to calculate the EFC to “allow for treatment of an individual eligible applicant with special circumstances.” The statute offers examples of these special circumstances (such as the recent unemployment of a family member) when the FAA might exercise this professional judgement if he or she chooses to do so.

Legislative Proposals Addressing Federal Need Analysis

As discussed, simplification of need analysis is a perennial issue. Several proposals have been introduced that attempt to further simplify the process. This section reviews major legislation of the 108th and 109th Congress that addresses need analysis. Bills discussed include those that have received legislative action and those introduced by committee and subcommittee Chairmen and ranking minority members.

P.L. 108-199. H.R. 2673, introduced on July 9, 2003, by Representative Henry Bonilla (TX), became public law (P.L. 108-199). The federal Advisory Committee on Student Financial Assistance (Advisory Committee)¹⁴ was charged with undertaking a study of need analysis and simplification.¹⁵ The Advisory Committee’s primary objectives in this effort are simplifying aid application forms and the aid application process, and substantially reducing the number of data items requested. The Committee is to pay particular attention to the needs of low-income and moderate-income families in the aid process.¹⁶ Congress also required the Secretary of Education to redesign the existing FAFSA. It was specified that the redesign should include testing of simplified versions of the FAFSA.

S. 1932. S. 1932 was introduced on October 27, 2005, by Senator Judd Gregg (NH). On December 19, 2005, the House passed the Conference Report (H. Report 109-362) on S. 1932, and on December 22, 2005, the Senate passed the

¹⁴ Under the provisions of the Higher Education Act [Section 491(a)], the Advisory Committee is established as an independent entity in the U.S. Department of Education to “provide advice and counsel to the Congress and to the Secretary on student financial matters.”

¹⁵ The final report, entitled “The Student Aid Gauntlet: Making Access to College Simple and Certain,” was released in January of 2004. The full report is available at [<http://www.ed.gov/about/bdscomm/list/acsfa/edlite-simplification.html>]. The Advisory Committee also released interim recommendations in July 2004. These recommendations are available at [http://www.ed.gov/about/bdscomm/list/acsfa/jgregg_SimplificationStudyRecs.pdf].

¹⁶ For additional information regarding the Advisory Committee and need analysis simplification, see CRS Report RL32687, *Federal Student Aid Need Analysis Simplification: Legislative Action*, by Charmaine Mercer.

conference report with minor amendments. On February 1, 2006, the House passed the conference report as amended. The Deficit Reduction Omnibus Reconciliation Act of 2005 provides reconciliation instructions pursuant to H.Con.Res 95, the Budget Resolution for Fiscal Year 2006. The bill contains numerous provisions that pertain to reconciliation and reauthorization of the HEA. Specifically, with respect to need analysis, S. 1932 would increase the income protection allowance for dependent students and independent students without dependents other than a spouse and would lower the asset assessment rate for dependent students, and both groups of independent students (with and without dependents). In addition, it would provide a room and board allowance for students who attend less than half time for no more than three semesters.

H.R. 1277. H.R. 1277 would require the Secretary to create a simplified paper financial aid form, known as the “EZ FAFSA,” for applicants who are eligible for SNT and auto-zero EFC. Among other things, H.R. 1277 would provide that applicants who are eligible for SNT and auto-zero EFC only be required to complete the data elements necessary to determine their eligibility for SNT or auto-zero EFC. H.R. 1277 also proposes that all of the existing dollar figures in the income protection allowance tables, for all dependency groups, be increased.

H.R. 609 and H.R. 151.¹⁷ Both H.R. 609 and H.R. 151 propose changes in the way that college savings plans are treated in federal need analysis.¹⁸ H.R. 151 states that qualified education benefits shall be treated as assets, as defined in section 480(f) of the HEA, but that they should not be considered an asset of the student. Similarly, H.R. 609 also proposes to treat college savings plans as an asset of the parent of a dependent student. Finally, H.R. 609 also proposes to increase the income protection allowance for dependent students from \$2,200 to \$3,000, and to designate active duty members of the armed services as having independent status for the purposes of federal financial aid.

In addition, H.R. 609 and H.R. 1277 propose changes to the eligibility requirements for SNT and auto-zero EFC eligibility. Both bills would require that applicants who receive benefits under a federal means-tested benefit program (e.g., Social Security, food stamps, free and reduced lunch or other programs determined by the Secretary) be automatically eligible for the simplified needs test and automatic zero EFC.

¹⁷ H.R. 609 was introduced on Feb. 8, 2005, by Rep. Boehner and referred on the same day to the House Committee on Education and the Workforce. H.R. 151 was introduced by Rep. Menendez, on Jan. 4, 2005, and referred to the House Subcommittee on 21st Century Competitiveness on Feb. 9, 2005.

¹⁸ For additional information regarding college savings plans, see CRS Report RL31214, *Saving for College Through Qualified Tuition (Section 529) Plans*, by Linda Levine; and CRS Report RL32155, *Tax-Favored Higher Education Savings Benefits and Their Relationship to Traditional Federal Student Aid*, by Linda Levine and James B. Stedman.