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Thomas M. Rutter

Natala Wickstrom

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THE USE OF INCOME TAX RETURNS IN THE NEEDS ANALYSIS PROCEDURE

Thomas M. Rutter

Natala Wickstrom

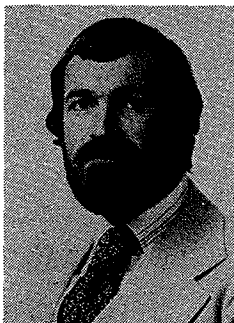
A basic assumption in the financial aid community prior to 1973-74 was that parents and students reported income and asset figures accurately when submitting financial statements to the scholarship services. This assumption has been seriously challenged and proven inaccurate by many institutions verifying income through follow-up procedures and analysis of the parents' Federal Income Tax returns.

In the current economic setting of diminishing funds and increasing budgets, collection of income tax forms has been proven by many institutions to be an extremely useful method of directing funds toward those with true "need". However, due to the timing and lack of selectivity, it is a difficult process accompanied by massive work loads and personal confrontations with parents and students.

SHIFTING PATTERNS

As institutions begin to collect tax returns, revise student awards and evaluate the overall effect of the procedures, a consistent pattern of policy evolution has become evident.

Usually, as in the case of the University of California system, the initial review was not a 100 per cent request for returns, but a random sample. The results of this sample were evaluated and projected for 100 per cent of the aid population, and the findings quickly prompted campus policies



Tom Rutter is Director of Student Financial Services at the University of California, San Diego. Prior to his current position, he served as Associate Director of Financial Aids at the University of California, Davis.

Natala Wickstrom has been a financial aids counselor at U.C., San Diego since 1974. She was recently appointed Associate Director of Student Financial Services at the San Diego campus.

which required 100 percent tax form verification. The University of California at San Diego (enrollment 8,500) realized over a quarter of a million dollars in award revisions as a result of revised parent contributions following the processing of Internal Revenue Service Form 1040's (see attached table).

The third step has usually involved the additional requirement for certification of the accuracy of the tax return itself with requests for Internal Revenue Service-produced copies. This level of sophistication will often be accompanied by a realization that the student's tax form for both independent and dependent students is required to identify accurate income data.

Consistent with this pattern, institutions and agencies such as the California State Scholarship and Loan Commission are examining the use of techniques such as interface and matching of reported tax and needs analysis information through the direct interchange of computer data.

As the financial aid community has followed the tax form validation continuum, it has become apparent that the process should be reviewed for a simpler, less comprehensive methodology which would still provide identification of those incomes reported inaccurately.

The San Diego campus of the University of California, (UCSD) began collecting tax returns on a selective basis from the parents of students applying for aid in early 1971. The policy then was to request tax returns for those cases where the Federal Tax reported exceeded standard tax by ten percent or more and in others where it was deemed necessary. In 1973-74 a ten percent random computer-selected sample was added to this request. For the academic years 1974-75 and 1975-76, UCSD has requested 100 per cent of all returns from parents of dependent students and 100 percent of all independent student 1040's.

Establishment of policy to collect 100 per cent of the returns followed reports of extensive understatement of parents' and students' income throughout the University of California system. During the process of collection, review and adjustment, UCSD tabulated the identifiable characteristics associated with the need for revision.

The seven selective criteria identified as potential indicators of highly inaccurate parental income were:

- 1) Income tax reported exceeds standard tax by ten per cent or more
- 2) Same income reported for three years
- 3) High business expense
- 4) High standard of living
- 5) Income source unexplained
- 6) Conflict with former needs analysis document
- 7) 1040 requested due to counselor discretion

The attached Table shows the discrepancies found between the data collected by a need analysis service and the corresponding 1040's. These discrepancies are categorized into the seven selective criteria and those discrepancies found through the general request for all remaining 1040's (non-selective criteria.) It should be noted that all parents providing business sup-

plements were required to provide 1040's within one of the seven selective criteria, and were not awarded until confirmation of income by a 1040.

The results of the collection effort indicate that the seven characteristics accounted for 78.9 per cent of the downward dollar adjustments in awards. However, this group represented 53.8 per cent of the total 1973 1040's reviewed at University of California, San Diego. Due to the four year history of selective collection of tax returns, it is assumed that the adjustments were lower than might be anticipated during an initial year of collection.

THE IMPACT

The University of California, San Diego administered \$3.8 million of need-based aid to undergraduates during 1974-75; the UCSD aid represented approximately one-tenth of the total need-based aid administered throughout the University of California system. The net change due to the selective criteria requests (aid adjusted downward less aid adjusted upward) was a \$178,450 increase in available aid at UCSD alone. Projected over the entire University of California system, the increase would be a minimum of \$1.8 million. The change in available aid due to non-selective criteria requests for 1040's was \$53,200. Projecting this over the University of California system, an additional \$532,000 would result.

SOME PROBLEMS

Contrary to the hoped-for results prior to this survey, the findings do not conclusively show that use of these seven characteristics identify and isolate an acceptable majority of those parents who need not be required to provide income tax verification. It had been hoped that use of this selection process would be the first step in making the use of income verification a more workable and reasonable part of the needs analysis procedure. However, application of the seven criteria does not prove to be an effective solution because the percentage of 1040's collected is too great (53.8 per cent) and results in a yield of the needs analysis documents in error is too low to be acceptable (78.9 per cent). Within this study, the remaining 46.2 per cent of the documents when compared with corresponding 1040's yielded award reductions totaling \$53,200. It is estimated that a system which would identify 85-95 per cent of the errors through collection of less than 40 per cent of the parents' 1040's would be a valid method of selection for UCSD.

Use of any pre-selection system contains the disadvantage of staff time required to identify and review the needs analysis document prior to the request of the 1040. It is therefore necessary that the percentage collected have a high level of yield (as estimated above) to warrant use of a selective system. In any case, a campus-based 1040 collection procedure required the filing and review of the 1040 request and a revision of the information; thus the calculation is duplicated in a hand-computed, cumbersome and expensive process on each campus for entering students.

Institutions currently have few viable choices. They may ignore the fact that parents and/or students often report information inaccurately on the financial statements and not collect 1040's. They may review these statements obtained through the scholarship services and require 1040's from all or an identifiable portion of the parents and students, or, the institutions may decide, as has occurred in some major institutions, that the inaccuracy of the externally produced documents renders them useless and excessively expensive for students. If this conclusion is reached, an institutional application and needs analysis procedure based on use of the 1040 will be developed and used.

The most effective and recommended step would therefore be 100 percent collection of tax returns by the national scholarship services, prior to production of the output document. Initiating this procedure would prevent multi-campus requests for, and reviews of the same 1040 for entering students; it would allow 1040's to be collected and analyzed in one place by experts rather than in several with obvious benefits in confidentiality derived. Further, the procedure of 1040 collection by the scholarship services would alleviate current strain on financial aid staffs.

Through this procedure the accuracy of needs analysis and the use of scholarship services can be justified. Only when collection of tax forms is accomplished by these external systems at the evaluation stage can the economies of scale which accompany centralized processing and multi-institutional disbursement be realized.

SUMMARY OF AWARD CHANGES DUE TO REVIEW OF PARENTS' 1973 1040'S

Reason for Request	Total 1040's	Percent of Total 1040's	No. Change	Decrease in Award	Total Award Decrease	Average Award Change	Increase in Award	Total Award Increase	Average Award Change
Reported tax exceeds standard	254	25.5	57	171	\$ 95,200	\$557	26	\$ 9,200	\$354
10% or more Same income Reported for three years	169	16.9	26	127	\$ 56,200	\$443	16	\$ 5,200	\$325
Income source unexplained	11	1.1	1	10	\$ 5,800	\$580	0	\$ 0	0
Conflict with prior needs analysis document	15	1.5	3	10	\$ 5,650	\$565	2	\$ 400	\$200
High business expense reported	27	2.7	3	20	\$ 12,600	\$630	4	\$ 2,400	\$600
High standard of living indicated	7	.7	0	7	\$ 6,000	\$857	0	\$ 0	\$ 0
1040 requested due to counselor discretion	54	5.4	19	27	\$ 17,600	\$651	8	\$ 3,400	\$425
SUB-TOTAL	537	53.8	109	372	\$199,050	\$535	56	\$20,600	\$367
Never awarded due to non-submission of 1040	50	5.0							
Non-selective Criteria Requests	412	41.2	246	133	\$ 53,200	\$400	33	\$ 9,600	\$290
TOTAL	999	100.0	355	505	\$252,250	\$500	89	\$30,200	\$339