

TREATMENT OF CERTAIN IRA WITHDRAWALS RELATED TO THE 2005 HURRICANES

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Current IRS rules permit certain individuals who were affected by the 2005 gulf coast hurricanes (Katrina, Rita, and Wilma) to make withdrawals from IRA accounts under special rules for the treatment of the withdrawal as income. Under these special hurricane rules the taxpayer may elect to allocate as taxable income the withdrawn amount over a three-year period.

One item from Worksheet B of the FAFSA instructs the applicant to calculate the amount of untaxed portions of IRA distributions, using information from the tax return. However, under the special IRS rules, when a taxpayer elects to use the three-year reporting option the current year's non-taxable income will become taxable income in subsequent years. A financial aid administrator may use professional judgment to exclude, from the calculation of EFC, qualifying non-taxable income that was reported on the tax return. The professional judgment decision may be made without regard to whether the student will re-apply for Title IV aid in a subsequent year or had applied in a prior year.

For example, the parents of a dependent student withdrew \$30,000 from an IRA in calendar 2006. The entire withdrawal is shown on the income tax return (1040 line 15a or 1040A line 11a). However, under the IRS guidance, the taxpayer chooses to report as taxable income only \$10,000 in lines 15b or 11b, resulting in that amount being included as part of the taxpayer's adjusted gross income (AGI) that will be reported on the FAFSA. The remaining \$20,000 of the IRA distribution would be reported on Worksheet B of the FAFSA. Under the guidance provided in this letter, the financial aid administrator, using professional judgment, may exclude the \$20,000 of non-taxable income by making a change to FAFSA items #41 or #85. Similar professional judgment adjustments may be made in subsequent years.

Before making a decision to use professional judgment in these cases, the financial aid administrator must obtain a written statement from the taxpayer, which may be submitted in an electronic format, indicating that the taxpayer intends to, or has, reported the non-taxable income as taxable income in subsequent or past years.