CollegeBoard CSS Profile

PROFESSIONAL JUDGMENT TIP SHEET

Topic: Bankruptcy

What?
Bankruptcy is a legal process through which individuals or businesses seek relief from all or some of their debts, as they typically do not have the income or assets to satisfy these debts. For more information about the most common types of bankruptcy, refer to the Addendum and the Internal Revenue Service website.

Why?
Depending on the bankruptcy type, assets may have been lost or reduced, or the debt may be under a repayment plan. Families in a repayment plan typically have no other choice than to keep current with payments, Also, the bankruptcy may negatively impact the family's ability to borrow to pay for educational expenses.

How do I…

Collect information?
The CSS Profile includes a "Special Circumstances" section where information regarding a bankruptcy may be reported. In addition, the financial aid administrator may collect the following supporting documentation:

- A statement from the family regarding the circumstances surrounding the bankruptcy
- An updated family assets statement
- An income/expense statement showing family cash flow
- Explanation or summary from the bankruptcy trustee
- Documentation of any mandatory court-ordered bankruptcy payments, including total amount due and monthly payment
- Earnings statements verifying garnishments taken directly out of paycheck

Analyze the information?
Bankruptcy may be the result of various circumstances, such as job loss, extraordinary medical expenses, natural disaster, business failure, or living beyond one's means due to lifestyle choices. Careful analysis of the documentation can provide insight into the circumstances surrounding the bankruptcy.

The financial aid administrator should evaluate the family statement, documentation from the bankruptcy trustee, and official bankruptcy documentation to determine an approximate timeline of relevant events, as well as the future of the family's financial situation (i.e., is their situation declining, stabilizing, improving?). The documentation may provide details about the specific debts, the terms and conditions of the repayment plan (if applicable), and how the debts will be repaid (e.g., wage garnishment).

A review of the documentation may help the financial aid administrator determine how much of the family's income is being used for repayment as well as other discretionary expenses.

Treatment in IM and FM

There is no single approach in Institutional Methodology (IM) to account for bankruptcy. Instead, financial aid administrators can use an approach based upon the unique circumstances to reflect these changes within IM. Aid administrators may consider adjusting income and/or asset components based on the situation. It may be helpful to review other Professional Judgment Tip Sheets for examples of how to address related circumstances, such as exceptional expenses, alternate year parent income, etc.

Federal Methodology (FM) allows an approach similar to IM. There is no single component to adjust in every situation. Financial aid administrators may change income and asset values, but should not change the need analysis calculation rules within FM.

Additional Considerations

For additional information on the various bankruptcy types, please refer to IRS Publication 908, Bankruptcy Tax Guide.

PROFESSIONAL JUDGMENT CASE STUDY

TOPIC: Bankruptcy

Case Study 1
The Carson family appealed the financial aid award for their son Simon. Mr. and Mrs. Carson submitted a letter explaining that although their income during the last three years seems sufficient, they have significant financial challenges. Over a ten-year timeframe, Mr. Carson, the primary wage earner, was unemployed periodically due to lay-offs in his industry. Mr. Carson struggled to find comparable employment that would support the family's expenses due to the specialized nature of his work. They attempted to sell their home and downsize, but home values in their area were on the decline and they were unable to find a buyer. During that time, the family utilized credit for basic living expenses and their children's private school education. They fell behind on their mortgage and automobile payments, and one of their vehicles was repossessed.

Mr. and Mrs. Carson recently filed for Chapter 13 bankruptcy to rehabilitate their debt and have a fresh start, without losing their home. They have entered into a three-year repayment plan for the debt owed to numerous creditors. This monthly $4,500 payment includes $2,100 for the original mortgage amount. A stipulation of the repayment plan is that payments are made through payroll deductions, so only a portion of Mr. Carson's wages are available for daily living expenses.

Decision
The financial aid administrator confirmed that Mr. Carson's wages are being garnished at $4,500 a month. The decision was made to provide an additional income allowance based upon the wage garnishments, less the $2,100 being paid towards their mortgage.

In addition, the financial aid administrator recognized the family's inability to borrow against home equity and therefore eliminated it from consideration.

Treatments in Methodologies

IM Treatment
The financial aid administrator entered an additional parent income allowance of $28,800 ($2,400 monthly payment x 12 months), and the home equity was capped at zero times income.

FM Treatment

The financial aid administrator incorporated this allowance by increasing federal taxes paid by $28,800. Since home equity is not included in FM, no adjustment was made to asset values.

PROFESSIONAL JUDGMENT CASE STUDY

TOPIC: Bankruptcy

Case Study 2
Carly Anderson's family owns a small manufacturing business, which is their sole source of income. Over the past several months, the business has experienced a significant decline in income, as it has been closed due to the loss of a contract with their sole purchaser. The family has struggled to make payroll and is unable to make payments toward debt on new equipment purchased prior to the business closing. With the uncertainty surrounding the business' future and the length of their closure, the family has begun the process of filing bankruptcy to rehabilitate the business debt and have a fresh start when they are able to resume business.

Carly's family submitted an appeal of her financial aid due to their cash flow limitations. When the family filed the aid applications 6 months ago, their business equity had been $250,000, with assets worth $600,000 and debts of $350,000. In an effort to pay their employees and maintain their business, the Anderson family's business accumulated additional debt. At the current time, the business equity stands at $100,000.

In addition to a detailed statement explaining their circumstances, Carly's family provided an updated Business/Farm Supplement to document the business' current financial position as well as documentation from their lawyer regarding the bankruptcy filing. Per the bankruptcy documentation, the business debt will be restructured into a five-year repayment plan.

Decision
Upon reviewing the appeal and supporting documentation, the financial aid administrator adjusted the business equity to reflect the current $100,000 position. The financial aid administrator offered the family the option to later submit finalized documentation related to the repayment plan. At that time, an additional income allowance could be considered.

Treatments in Methodologies

IM Treatment
The financial aid administrator changed the business debt to $500,000 to reflect the decreased equity.

FM Treatment

Since the business did not meet the federal requirements to be considered as an asset in need analysis, no changes were made to business equity.