

Practical Tips on Dealing with Scholarship Displacement



What Is Scholarship Displacement?

- Award displacement occurs when receipt of one form of financial aid, such as a private scholarship, results in a reduction in other forms of financial aid.
- This reduction may include student loans and work-study, not just scholarships and grants from the college or government.
- Scholarship displacement is a type of award displacement where a reduction in college grants occurs after a student wins a private scholarship.

Reasons Why Scholarship Displacement Occurs

- Receipt of a scholarship reduces the student's financial need and thereby reduces eligibility for need-based financial aid.
- The Higher Education Act of 1965 requires colleges to subtract estimated financial assistance that is "known to the institution at the time the determination of the student's need is made" from the definition of financial need.¹
- Restrictions on the type of eligible expenses, such as just tuition and fees or just textbooks, can lead to scholarship displacement even when the student has unmet need.
- Last-dollar financial aid programs, such as some state grant and free tuition programs, require all other financial aid to be applied to tuition costs first.
- Total financial aid, including scholarships and student loans, cannot exceed the college's total cost of attendance.
- Some colleges have a minimum student contribution or summer work expectation for all students, regardless of low income and inability to pay for college. These colleges do not allow scholarships to replace the minimum student contribution and summer work expectation.
- Certain tax breaks, such as the American Opportunity Tax Credit and tax-free distributions from 529 plans, are reduced by the amount of qualified scholarships used by the student. Taxes can displace part of the scholarship or increase debt.

Problems Caused by Scholarship Displacement

- Scholarship displacement prevents students from getting the full benefit of the scholarships they win.
- When a college reduces its grants by the amount of the scholarship, there is no net financial benefit to the student, despite their hard work in winning the scholarship. The college's net price and the student's debt and work burden do not decrease. There is no improvement in graduation rates.
- In addition, colleges do not allow families to use private scholarships to pay their share of college costs.
- Some colleges that practice scholarship displacement do not meet the student's full demonstrated financial need. These colleges use scholarship displacement to preserve the gap instead of allowing the scholarship to fill the unmet need.
- Scholarship displacement does not lead to an increase in the college's need-based aid. The college's non-need-based aid increases while need-based aid does not change.
- Scholarship displacement mainly affects students with financial need. Wealthy students don't experience scholarship displacement because they do not receive need-based aid.

Reporting Requirements

- Most colleges require students who win scholarships to report them to the financial aid office, leading to displacement.
- Reporting requirements are mostly due to college policies, not federal law or regulations.
- Federal overaward regulations require reductions in campus-based aid (FSEOG and Federal Work-Study) and student loans when total financial aid, including scholarships, grants, student employment and student loans, exceeds the cost of attendance. This is rare because most scholarships are less than the unmet need. The Federal Pell Grant is never reduced.
- The IRS requires taxpayers to report only the *taxable* portion of a scholarship, such as amounts used for room and board, transportation and other living expenses.
- The Free Application for Federal Student Aid (FAFSA) has an optional question about the taxable portion of scholarships reported to the IRS as income, so that they can be subtracted from income on the FAFSA.

How Colleges Learn about Scholarships

- Taxable scholarships may be reported on the FAFSA and federal income tax returns.
- Some colleges review the list of scholarship winners reported on the websites of major scholarship providers and in newspaper announcements.
- Scholarships may also be reported on high school transcripts.

How to Reduce Scholarship Displacement

- Review the college's outside scholarship policy before accepting the offer of admission. Choose a college that doesn't practice scholarship displacement.
- Some colleges have more favorable outside scholarship policies. The best policies let scholarships replace unmet need and student loans instead of reducing grants. This will reduce the net price, which is the cost of attendance minus grants and scholarships. Compare colleges based on the net price.
- Ask the college financial aid administrator to use the scholarship to reduce unmet need first, then loans.
- Appeal to the college financial aid administrator to increase the student's cost of attendance (COA), if there are costs that can justify an increase (e.g., above-average textbook and transportation costs, cost of a computer and Internet access, child care costs and the cost of basic necessities). The increase in COA will increase financial need, potentially reducing how much of the scholarship will be displaced.
- Ask the scholarship provider for help. Scholarship providers may be in a stronger position to negotiate with the college about their outside scholarship policies.
- Defer the scholarship, if allowed, to a subsequent year, the summer or to graduate school, when it won't be displaced.
- Ask the scholarship provider for flexibility in the type of eligible expenses, if restrictions are causing displacement.
- Scholarship providers can bypass scholarship displacement (and more taxes) by awarding scholarships by contributing to 529 plans or by repaying student loans after graduation.

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