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TAX MATTERS

Tips and traps for students borrowing money to pay for an education

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A few years ago, I shared a scary moment when our youngest son, Michael, was contemplating which university to attend. He had been looking at a school in Switzerland known for its undergraduate degree in … yodelling.

I'm glad to report that he has since graduated in business and finished level two of his chartered financial analyst designation; he is going to pursue a master's in finance this fall. Thank goodness for all that. My fears of having to support my son as he tried to make a living in yodelling were unfounded.

Of course, for many students, pursuing a postsecondary education will mean borrowing to pay for all or part of it. Here are some tips and traps to think about.

The facts

According to Statistics Canada, 47 per cent of all students graduate from their postsecondary education with debt related to their studies.

The rate is a bit less for college students (46 per cent) than for those graduating with a bachelor's degree from university (51 per cent). Meanwhile, a whopping 80 per cent of those who pursue a professional program (defined as a degree in law, medicine, dentistry, veterinary medicine, optometry and pharmacy), graduate owing money.

The average debt owed postgraduation is $25,200, or $86,200 for the professional degrees mentioned above.

The loans

Here is my ranking of where to find loans to cover education-related expenses, in order of preference.

Government student loans: Both federal and provincial student loans are typically available to students with low and middle incomes, students with dependants and students with disabilities. Most provinces offer federal-provincial integrated loans, so one application is good for both.

Since April 1, 2023, the federal government offers student loans at 0 per cent interest. The provincial rate varies by jurisdiction – some at 0 per cent, others at prime rate, and some at prime plus 1 per cent (Ontario, for example).

Bank student lines of credit: If there's a gap between the loans you can get from government and how much you need for tuition, living costs and other school-related expenses, consider a bank line of credit. They are common for those studying medicine, law or pursuing a master's degree, and the interest rate can be better than many loans.

Private lenders: If you're considering borrowing from a private lender (that isn't a friend or family member) you could face double-digit interest rates. If this is your only option, you should think long and hard about whether saving for a period of time before starting studies is a better idea. Seeking assistance from this type of lender should be a last resort.

The tips

Borrowing for your education is often considered an acceptable type of debt, because you're using it to build an asset (your earning capacity). Still, there are some things to keep in mind.

Apply for grants first: The federal government, and some provinces, offer grants in addition to loans. Since grants don't have to be repaid, apply for those if you qualify. Generally, your family's income must be below certain thresholds ($141,180 for a family of five, $129,769 for a family of four or $117,317 for a family of three, for federal grants).

Cap the amount you borrow: Follow the rule of 10s: For every $10,000 of student debt, you should be able to earn $10,000 above a base of $10,000 annually, in order to pay off that debt in 10 years. For example, if you graduate with $50,000 of debt, you should be able to earn $50,000 over a base of $10,000, for a total of $60,000. This rule will generally keep your debt payments to between 10 and 15 per cent of your take-home pay, which is manageable, and allow you to pay things off in a decade.

Pay off certain debts first: If you've borrowed under the federal or provincial student loan programs, you'll be able to claim a tax credit for any interest you pay. This makes these loans generally a lower cost type of debt, meaning you should generally pay off other, more expensive, debt first. If your province charges interest on its student loans, you should pay off the provincial loans before the federal ones, which carry no interest.

Request assistance if needed: If you're having trouble making your government student loan payments, you can apply for the Repayment Assistance Plan (RAP), which can result in reduced payments or no payments at all, depending on your income.

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