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Managing Tough Times – Debt Settlement or Elimination

Debt settlement or debt elimination requires the assistance of a professional. They basically get the credit card companies to agree to accept a fraction of the original debt and then consider the debt paid in full. “The credit companies do this because if you file bankruptcy, they may receive little or nothing that you owe them,” says Brenda Schmitt, ISU Extension Family Resource Management Field Specialist. “But, there are a few catches.”

Those in need of debt elimination and debt reduction programs are targeted by predators. These types of scams are so prevalent, the Board of Governors of the Federal Reserve System has sent out warnings. One popular debt elimination scam uses fake financial instruments to claim the debt is invalid. If you think about it, you would question the validity of this. For example, you cannot legally pay for a vacation with your credit card and then think you will not have to pay it back because some organization claims the charges to be invalid.

Questionable organizations claiming to provide debt settlement services charge large upfront fees, claiming to be able to get the debts eliminated by showing they are, in fact, invalid. Their presentation will seem logical and will be back by official sounding documentation. In the end, you’ll be left deeper in debt than before.

The other catch to debt elimination and debt reduction programs is that they can hurt your credit score. Lowering your credit score can make it more difficult to secure new credit, especially now, when lenders look closely at credit scores when providing financing for loans.

The last catch is rarely talked about, especially by the debt settlement companies. Forgiven debt will be reported on a form 1099 as non-employee compensation. Credit companies do this so they can deduct from their income, the debt that is forgiven. The problem for you is that nothing was withheld for federal and state taxes. When you file your taxes, the income listed on the 1099 will be added to the income listed on your W2. Unless you have increased the amount of taxes withheld from your paycheck you will most likely owe taxes at the time of filing.

Be sure to contact the Attorney General and Better Business Bureau before enlisting the services of a Debt Settlement business.