

Debt Settlement Considerations

“Settle Your Debt and Save!”
“Reduce Monthly Payments by Half!”
“Lower Your Debt Up to 60%!”

The advertising claims of debt settlement companies sound very promising, and, while debt settlement may potentially be an option to consider, there are other options that could be better for your particular situation. Doing your homework to find out whether or not debt settlement is right for you could end up paying off.

A settlement is when a creditor agrees to eliminate a debt after receiving a portion of the balance as a lump sum. For example, the creditor shows a balance of \$5,000, but would be willing to accept \$3,000 as payment in full if you can pay by next Tuesday. When considering this type of agreement, consumers should think carefully about their situational specifics and the impact the settlement could have on credit ratings, annual income taxes and their future ability to use credit as part of their lifestyle.

Does it Make Sense?

Settlements may make your budget more workable in the short term, but, because there are long term consequences, it is only the best solution in some situations. Here are three examples when it might make sense to settle:

1. Some or all of your debt is charged off
2. You have received or are expecting to receive a lump sum of money
3. You may be able to liquidate an asset

If your situation seems like a fit, there is still a lot to consider.

Impact to Your Income Taxes

Before going forward with a debt settlement, you should know that forgiven debts are considered income and the canceled portion of the debt will be reported to the IRS on Form 1099-C. This could have a significant impact on your taxes. For example, if you settle a \$5,000 debt for \$3,500, then the difference is considered \$1,500 of income and must be figured into your annual earnings to determine your tax liability. Any amount of debt forgiven above \$600 can be subject to this rule. Keep this in mind when considering or agreeing to debt settlement.

There also may be other tax consequences so you should check with your tax preparer.

Impact to Your Credit Report

When you are negotiating a settlement, you may be able to request that the creditor show the debt as “paid in full” rather than “settled” on your credit report. This may help to minimize the adverse impact on your credit. You should always get this in writing prior to executing the settlement.

If you don’t get the creditor or collection agency to agree to report the balance as “paid in full,” even though it may seem like a bargain to settle the balance for less than you owe, there will likely be negative information reflected on your credit report. Most lenders look at past debts that are reported as “settled for less than the full balance” as a negative indication of your future repayment plans.

Consider all the pros and cons before moving forward.

Settlements	
Pros	Cons
<ul style="list-style-type: none">• Your overall monthly creditor payments will be reduced,• The account balance will show as zero• Liquidating the debt will improve your credit faster,• You can possibly avoid bankruptcy if you have a large amount of debt• You will avoid other types of collection activity by the creditor such as garnishment	<ul style="list-style-type: none">• You typically need a large sum of money for a settlement payment• Your credit report may show the debt as settled, not paid in full. This is still better than showing as charged off and unpaid, but not as good as if it had been paid in full.• If the settlement results in a forgiven amount of more than \$600, you will most likely have to pay taxes on the forgiven portion,• If you hire a debt consolidation company to negotiate on your behalf, you will still receive collection calls and letters until the negotiator finalizes the settlement for you.• Creditors are not obligated to accept settlements so you may still have to go through other types of collection activity if no agreement is reached.

Negotiating a Settlement

If you’ve carefully considered the impact of a settlement and determined that it is, indeed, the best choice for you, be prepared to negotiate. Collectors will typically look for 50-75 percent of the debt balance in a lump sum settlement. But, begin your negotiation at a smaller amount than you are prepared to pay. And never agree to pay more than you are

able. Your first step is to contact the creditor or collection agency and make a settlement offer. The creditor can then accept, reject, or make a counteroffer. If the settlement is accepted, you would pay the agreed amount, typically by a due date agreed upon by both parties, and the creditor would then waive the remaining balance on the debt.

There is no guarantee that a collector will agree to settle, but if they do, get everything in writing prior to executing the settlement. Don't wait for the collection agency to draft the agreement. Instead write them a letter and send it via certified mail, return receipt requested.

In Summary

Debt settlement can be the right choice in some situations and it is always recommended that you settle debts on your own or with the help of a nonprofit organization with a helping mission. If you are thinking of debt settlement as a potential solution, be sure to consider all the facts and move forward carefully. Seeking credit counseling can also help. With a knowledgeable, certified and compassionate counselor, you'll learn how to repair your credit and enjoy a brighter financial future.