



Grafton Firm  
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# FAQS AND TIPS ON DEBT SETTLEMENT A BANKRUPTCY ALTERNATIVE

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**A**re you behind on credit card payments? Do you want to stop harassing phone calls? Collection agencies often use threatening tactics, invoke fear and even threaten garnishment. What creditors don't tell you is that they might be willing to settle the debt for less than the amount owed. Debt settlement is an effective way to handle debt without filing for bankruptcy. There is no magic formula for how to handle a creditor, but there are some things you can do to try and reach a satisfactory resolution through settlement.

# DEBT SETTLEMENT FAQs

## WHAT IS DEBT SETTLEMENT?

Debt settlement is a process by which you or your attorney directly negotiates with creditors to reduce the amount you pay on principal in exchange for having the rest of the debt “forgiven.” It is up to each creditor to decide whether to agree to a partial payment and also to determine how much to accept to settle the debt. Every situation is different and there is no set way to handle each creditor.

## WHAT TYPE OF DEBT CAN I SETTLE?

The most common type of debt that is settled is credit card (consumer) and medical debt. You can also try to settle personal loans, utility bills, apartment leases, auto repossession balances, and real estate “short sale” balances. Debt settlement for federal student loans is rarely an option. Private student loans sometimes can be settled for less than the amount owed, but it not common. Likewise, settling debts on loans secured by collateral (*e.g.*, house or car) is also unlikely.

## CAN THE CREDITOR SUE ME?

If you are overdue on your debt, a creditor can take legal action against you. If the creditor wins and receives a judgment, the creditor can then have your wages and/or bank accounts garnished. Often creditors sue as a last resort only after they have made multiple attempts to collect the debt. The time that a creditor has to sue you (called the statute of limitations) varies from state to state, but in Maryland it is typically three years from the date you last made a payment (or promise to pay). So, making a small payment can be a bad idea, even if you are doing it just to get the creditor to stop harassing you, because it restarts the statute of limitations.

## **PAYMENT PLANS VS. DEBT SETTLEMENT**

Agencies and debt relief programs, some of them very reputable and others not so much, will devise a repayment plan and negotiate and deal with creditors on your behalf. However, there are no guarantees these agencies can settle all of your debt or how they will report any settlements to the credit bureaus. Furthermore, in payment plans, you typically turn over all your debts to the agency and give them power of attorney. The agency might work out a settlement agreement that will reduce an outstanding balance, but it usually means your account will be closed and a payment plan will be completed over an extended period of time. In debt settlement you negotiate (or your attorney negotiates) directly with your creditor for a reduced balance payoff. You will know almost immediately whether your offer has been accepted. Debt settlement allows you to pick and choose what debts you settle first and negotiate for a reduced rate directly. The direct communication with the creditor also allows you to dictate other terms of the settlement. These might include asking that notations appear on your credit report that the balance has been settled, agreeing to release you from garnishments, etc.

## **WILL I OWE TAXES IF I SETTLE A DEBT?**

Legally, if a creditor “forgives” more than \$600 of the debt principal, the full forgiven amount must be reported to the IRS as income. The creditor will then send you a 1099 tax form for this amount. For example, if you owed \$1000 on a credit card and settled the debt for \$300; your 1099 will be for \$700. You will be required to include the written off amount as income on your taxes and you may owe taxes on the amount. In some cases, if you can prove you are insolvent, you may not owe taxes on the forgiven amount. Consult with your tax professional to discuss your options.

# TIPS FOR NEGOTIATING A FAVORABLE DEBT SETTLEMENT

- ❑ Determine how much extra cash you have for negotiating a settlement. Examine your income and expenses and see if you can save some money. In order to settle the debt, you are going to have to have some available cash. Creditors are far more likely to settle if you can offer a lump sum rather than a payment plan.
- ❑ Be proactive. If you receive an acceptable debt settlement offer, be prepared to act. The offer can be rescinded (go away) at any time.
- ❑ Be prepared to show creditors your financial situation. Often creditors will ask for documentation of your income, assets, and existing obligations and debts.
- ❑ Verify that the statute of limitations has not run on your debt. Remember, in Maryland, the statute of limitations is usually 3 years from the date of your last payment or promise to pay (for debts like credit cards and medical bills)
- ❑ Take notes: Keep a log of dates, times, physical address of the agency and who you talked with at the credit/collection company. Keep notes about what was said in the conversation.
- ❑ Follow up all phone conversations with a letter or fax (registered mail is ideal).
- ❑ Don't agree to make partial payments until you have considered all your options and talked to an attorney.

- ❑ Negotiate additional favorable terms (*e.g.*, like notifying your each of the Credit Bureaus that the debt has been settled).
- ❑ If you are negotiating yourself, don't start the offer too high. As a general rule start low (less than 25% of the balance owed) and work your way up. Typically, the older the debt, the smaller the settlement the creditor is likely to agree to.
- ❑ Never appear too eager. Don't tell them up front that you have "cash" to settle. Don't share too many personal facts-like you are buying a car or a home. Keep pushing for better terms. It is okay to say no to an offer and try again a few weeks later.
- ❑ Get all settlement terms in writing before you even consider making a payment! This is a must! Creditors play games. Don't expect a creditor to honor any agreements it makes verbally.