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7 Facts That The Average Debt Settlement Company Won't Tell You

In a recent article, I debunked a blog entry by J. Carlton Ford, owner of a website called Debt Warriors. Mr. Ford is a sales associate for Pre-Paid Legal, Inc. and sells "coaching videos" that purport to teach debtors how to reduce their debts. The cottage industry of "quick fixes" to debt problems is a sign of growing desperation by debtors who are confused about their options. Whether purchasing a video from someone like Mr. Ford or considering the use of a "debt settlement company", consumers should be wary of quick fixes and empty promises of easy solutions.

Debt settlement companies offer to negotiate directly with your creditors, often for fees from ranging from 9%-16% of the consumer's total unsecured debt. But debt settlement plans can harm debtors in ways they never imagined.

1. **Debt Cancellation/Forgiveness is Presumed to be Taxable Income.** Generally, if you owe a debt to someone else and they cancel or forgive that debt, you are treated for income tax purposes as having income and may have to pay tax on this income. If you owe a credit card company $10,000 and settle the account for $5000, the credit card company will send you and the IRS a 1009 form showing $5000 of income for the forgiven debt. You may be trading a debt that is completely dischargeable in bankruptcy for a nondischargeable tax debt. Debt forgiveness achieved in bankruptcy is not taxable.

2. **Debt Settlement Plans Are Not Binding On All Creditors.** Creditors do not have to deal with the debt settlement companies. Some creditors like American Express usually refuse to do so. If a creditor does not agree to the proposal, the creditor can sue you to obtain a judgment and garnish your wages and take your assets. A chapter 13 repayment plan is binding on all of your creditors and the automatic stay created by the filing of a bankruptcy prohibits any of your creditors from suing you.

3. **A Debt Settlement Company Cannot Represent You In Court.** Unless the debt settlement company is also a law firm, it cannot legally represent you in court. If you do not hire any attorney or do not have sufficient legal skills to represent yourself, then you risk have a judgment entered against you.

4. **Debt Settlement Plans Are Often More Harmful to Your Credit Than Bankruptcy.** Unless your debt settlement company skillfully crafts a settlement agreement the correct way, your creditors can still continue to report you as delinquent. While filing for bankruptcy will impact your credit, the automatic stay prevents creditors from reporting further negative information. In the case of a Chapter 7 discharge, creditors must start

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reporting zero balances within 30 days of your discharge and you can quickly distance yourself from any bad payment history. You can actually have bad credit longer under a debt settlement program than when filing for bankruptcy.

5. Debt Settlement Plans Are Often More Expensive Than Attorney Fees For Bankruptcy. In the Southern District of California where I practice, most consumer Chapter 13 cases cost approximately $3300 in legal fees plus expenses such as the $274 filing fee. Chapter 7 fees are often less than half of what an attorney might charge for a Chapter 13 bankruptcy. A person with $30,000 in debt will often pay a debt settlement company more than they would pay an attorney to file for bankruptcy.

6. Bankruptcy Can Accomplish More Than Debt Settlement Plans. Debt settlement plans typically only deal with unsecured debts such as credit cards and medical bills. Debt settlement plans usually do not deal with taxes or secured debts such as a home or car loan. Using bankruptcy, debtors can discharge certain income taxes, modify certain types of loans and many debtors are even using Chapter 13 bankruptcy to remove second mortgages from their homes. Debt settlement plans cannot accomplish any of those things.

7. Most Debt Settlement Companies Use the Carrot On a Stick Approach. Debtors rarely have the money to offer lump sum settlements to creditors. Debt settlement companies will often take installment payments and collect their fees first. Once they have a sufficient pot of money, they will offer a token settlement to one or two creditors. While this is happening, creditors may sue the debtor and the debtor's credit rating will continue to drop.

While debt management plans may have their place, I have yet to see a satisfied customer come through my doors. If you are in financial difficulty, a consultation with a qualified bankruptcy attorney is always a good choice and often free.

About the Author: *Carl H. Starrett II has been a licensed attorney since 1993 and is a member in good standing with the California State Bar and the San Diego County Bar Association. Mr. Starrett practices in the areas of bankruptcy, business litigation, construction, corporate planning and debt collection.*