

## MONEY MYTHS SERIES

# Debt Settlement, Debt Elimination, and Endless 0% Transfers: The Real Math

*Debt settlement fees, taxable canceled debt, lawsuits mid-program, and the fee trap in endless 0% balance transfers. What federal and California law require.*

By Eric Ridley, attorney, Ridley Law · Updated September 2026 · Read online with live links: [ridleylawoffices.com/debt-settlement/](https://ridleylawoffices.com/debt-settlement/)

Part of our [money myths series](#), where we look at who gets paid when you follow money advice from social media.

**The pitch:** stop paying your credit cards, put one monthly payment into our program, and we'll cut your debt in half. Or skip interest forever by moving your balance to a new 0% card every year. Some versions go further and claim a legal trick can erase the debt outright. **The verdict:** settlement companies take 15% to 25% of what you owe, creditors can sue while you wait, and the forgiven debt is usually taxable income. Endless balance transfers replace interest with fees. The legal tricks are fraud, and people have gone to prison for selling them.

**15% to 25%**

of enrolled debt, the usual settlement company fee (NFCC, 2026)

**\$600**

canceled debt that triggers a Form 1099-C to the IRS (Treas. Reg. § 1.6050P-1)

**Nearly 1 in 3**

customers sued by creditors in one FTC debt settlement case (FTC, 2010)

**4.3%**

average balance transfer fee at the largest card issuers (CFPB, 2024 data)

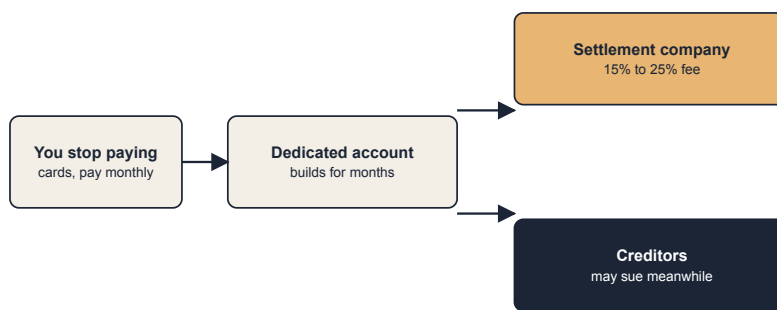
**22 years**

federal prison sentence for a debt elimination promoter (DOJ, 2024)

**Who gets paid.** The settlement company, from your monthly deposits. The CFPB alleged Freedom Debt Relief charged fees that typically ranged from 18% to 25% of enrolled debt. In its case against Strategic Financial Solutions, the CFPB and state attorneys general allege the companies collected over \$100 million from consumers before paying any creditor, and that one woman saw about 91% of her first \$2,114 go to fees. Card issuers get paid on the 0% treadmill: balance transfer fees came to \$2.1 billion in 2024, the CFPB reports. Debt elimination promoters charge a cut of the debt they claim to erase.

## How does debt settlement work?

You stop paying your unsecured creditors and instead pay the company each month into a dedicated account. Once enough builds up, the company offers creditors a lump sum to settle each account for less than you owe. The CFPB alleged Freedom Debt Relief told customers to stop paying their creditors (CFPB complaint). The CFPB, citing industry data, reported that the average successful settlement comes 14 months after enrollment (CFPB, 2020).



While you wait, the original debts keep growing with interest and fees, and the creditors don't have to wait with you. The FTC warns you could be sued while you're waiting for a settlement, and a creditor that wins might garnish your wages or put a lien on your home (FTC). In one FTC case, nearly a third of the company's 18,116 customers were sued.

## Is debt settlement a good idea?

Sometimes, for a few people, after other options fail. For most, it's expensive and uncertain. In the record for its 2010 rule, the FTC cited the industry's own survey: three years in, only 24.6% of consumers had completed a program, meaning settlements on at least 75% of their debt. One large provider's numbers meant 57.7% of its customers dropped out within three years (75 FR 48458). The FTC says many people have trouble keeping up payments long enough to settle all their debts and lose what they paid in fees.

The advertised savings are often overstated. The FTC's own example: a \$10,000 debt settled for \$5,000, with a \$1,000 fee, saves \$4,000, or 40%, and calling it 50% would be deceptive (FTC business guide). Its rulemaking added a second wrinkle: if interest and creditor fees add \$2,000 during the program, a promised 40% reduction on \$10,000 means paying \$7,200, a real savings of 28%.

## Is it legal to charge upfront fees for debt relief?

No, not for debt relief sold by phone. The FTC's Telemarketing Sales Rule bars requesting or receiving any fee until the company has settled at least one debt, you've agreed to the settlement, and you've made at least one payment under it (16 C.F.R. § 310.4(a)(5)). The fee must be proportional to the debt settled or a percentage of what you saved. Money you set aside has to sit in an account at an insured bank, the money stays yours, and you

can quit at any time and get it back within seven business days. Before you sign, the company must tell you that stopping payments will likely hurt your credit and may lead to collection or lawsuits (§ 310.3). The FTC's consumer advice is blunter: only scammers try to collect fees before they settle any of your debts.

Regulators keep finding companies that ignore those rules. Freedom Debt Relief agreed in 2019 to pay \$20 million in restitution and a \$5 million penalty to settle CFPB charges (CFPB). In the StratFS case, the Second Circuit in 2025 upheld a preliminary injunction, asset freeze, and receivership while the case goes on (Second Circuit). In 2025 a federal court, at the FTC's request, temporarily halted Accelerated Debt Settlement. The FTC's complaint says the operation took in an estimated \$100 million, mostly from older consumers, and its filings describe an Army veteran who ended up \$13,000 deeper in debt with his score down from the high 700s to the 500s (FTC, 2025).

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## What does California's Fair Debt Settlement Practices Act require?

More than federal law. California's Act, Civil Code § 1788.300 and following, took effect January 1, 2022, and covers debt settlement however it's sold. A provider can't collect any fee until it has settled at least one debt under an agreement you approved and you've made at least one payment (§ 1788.302(c)). It must give you the disclosures and the unsigned contract at least three calendar days before you sign, including warnings that creditors may sue and that canceled debt may be taxable income. You can cancel at any time without a fee or penalty, and a court can award \$1,000 to \$5,000 per violation (§ 1788.305).

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## Is forgiven credit card debt taxable?

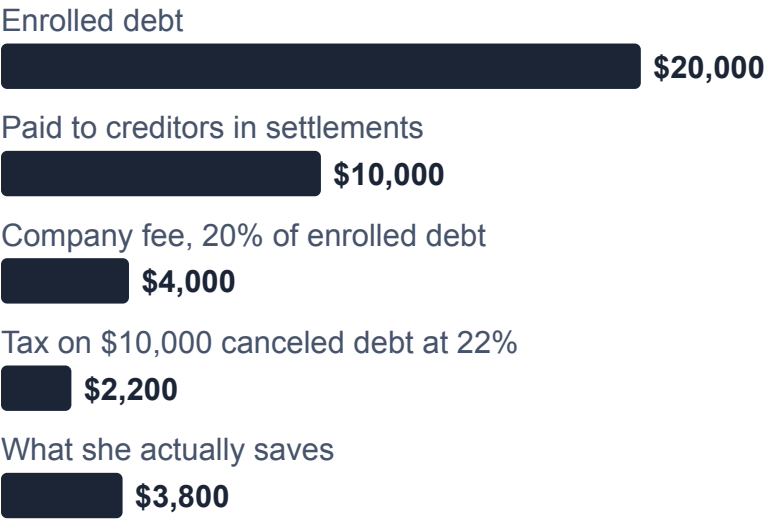
Usually, yes. Income from discharge of indebtedness is gross income under 26 U.S.C. § 61(a)(11), and the IRS says the amount of canceled debt is generally taxable. A creditor that cancels \$600 or more must file a Form 1099-C. California follows along: the Franchise Tax Board says this income may be included in your federal adjusted gross income, which you report to California.

The big exception is insolvency. If your debts exceeded the value of everything you owned right before the debt was canceled, you can exclude canceled debt up to the amount you were insolvent (26 U.S.C. § 108(a)(1)(B), (a)(3), (d)(3)). You claim it on Form 982, and IRS Publication 4681 has a worksheet for the math. Many people in settlement programs qualify for at least part of the exclusion, so run the worksheet before you assume you owe.

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## What does debt settlement cost? A worked example

Take a hypothetical borrower who enrolls \$20,000 of card debt, settles every account at 50%, and pays a fee of 20% of the enrolled debt, the middle of the range the CFPB alleged in the Freedom case. She pays creditors \$10,000 and the company \$4,000. The creditors report \$10,000 of canceled debt. If she isn't insolvent and her rate is 22%, she owes about \$2,200 in income tax on it.



| Hypothetical debt settlement              |          |                                                                 |
|-------------------------------------------|----------|-----------------------------------------------------------------|
| Item                                      | Amount   | Basis                                                           |
| Debt enrolled                             | \$20,000 | Hypothetical                                                    |
| Settlements at 50%                        | \$10,000 | Hypothetical                                                    |
| Company fee at 20% of enrolled debt       | \$4,000  | Middle of the 18% to 25% the CFPB alleged in the Freedom case   |
| Canceled debt reported on Form 1099-C     | \$10,000 | Creditors report discharges of \$600 or more                    |
| Income tax at a 22% rate if not insolvent | \$2,200  | Hypothetical rate; IRC § 61(a)(11)                              |
| Net savings                               | \$3,800  | Before interest and creditor fees that build during the program |

She saves about \$3,800, less any interest and creditor fees that built up while she was saving, and her report shows settled and charged-off accounts for up to seven years from the start of the delinquency (15 U.S.C. § 1681c). That assumes she finishes, which most people in the FTC’s 2010 data did not.

### Can you avoid interest forever with 0% balance transfers?

No. You trade interest for fees. The CFPB says a card company may charge a balance transfer fee even on a zero percent offer, and the average fee at the 25 largest issuers was 4.3% in 2024, when consumers moved \$59.5 billion this way. Promotional rates last a limited time, and if you fall more than 60 days behind, the issuer can raise the rate on the existing balance (12 C.F.R. § 1026.55). The deals go mostly to people with strong credit: borrowers with prime or better scores accounted for more than 98% of balance transfer volume, the CFPB found (CFPB, 2023).



Hypothetical: 4.3% average transfer fee (CFPB, 2024 data), fee added to the balance, nothing paid toward principal

| Year   | Total fees paid so far | Balance owed |
|--------|------------------------|--------------|
| Year 1 | \$430                  | \$10,430     |
| Year 2 | \$878                  | \$10,878     |
| Year 3 | \$1,346                | \$11,346     |
| Year 4 | \$1,834                | \$11,834     |
| Year 5 | \$2,343                | \$12,343     |

Rolling \$10,000 to a new card every year at a 4.3% fee, without paying down principal, costs \$2,343 in fees over five years, and you owe more than you started with. If one promotion ends before the next approval comes through, you’re back at the regular rate, which averaged 22.15% on accounts charged interest in mid-2026, according to the Federal Reserve. A single transfer used to pay a balance off fast is a good tool. A permanent rotation isn’t.

## Can a legal loophole erase your debt?

No. The “debt elimination” pitches that claim a special instrument, a trust, or a hidden government account will discharge your debts are fraud. A South Carolina couple wrote checks on closed accounts marked “EFT only for discharge of debt,” trying to eliminate over half a million dollars of debt. The U.S. Attorney’s release says sovereign citizen groups falsely teach that a creditor’s acceptance of such an instrument discharges the debt even though no money changes hands. The couple got 30 and 27 months in federal prison ([DOJ, 2015](#)).

In Maryland, a promoter who ran “debt elimination classes” told people that a number on the back of their Social Security cards and birth certificates opened a special bank account of government money owed to them. He charged a percentage of the debt and got 22 years, with \$3,281,109.38 in restitution ([DOJ, 2024](#)). That’s the same story we take apart in [the birth certificate bond myth](#) and [sovereign citizen trusts](#).

## What are the better options?

Start with the ones that don't charge a cut of your debt. A nonprofit credit counselor can set up a debt management plan: you make one payment, creditors often cut interest, possibly to 10% or less, and the plan runs 36 to 60 months ([NFCC](#)). Bankruptcy is a court process with fixed filing fees: Chapter 7 costs \$335 in court fees and individual debtors get a discharge in more than 99% of cases, while Chapter 13 costs \$310 and pays debts over three to five years ([U.S. Courts](#)).

Debt settlement compared with the alternatives

| Question               | Debt settlement company                            | Nonprofit debt management plan                         | Bankruptcy                                         |
|------------------------|----------------------------------------------------|--------------------------------------------------------|----------------------------------------------------|
| Who gets paid          | The company, 15% to 25% of enrolled debt           | Small monthly fee, if any                              | Court fees of \$310 to \$335, plus a lawyer        |
| Lawsuits while it runs | Creditors can sue                                  | Creditors usually stop collection on enrolled accounts | Automatic stay stops most collection               |
| Tax on forgiven debt   | Often taxable unless insolvent                     | No forgiveness, so no tax                              | Debt discharged in bankruptcy isn't taxable income |
| Credit report          | Settled and charged-off accounts for up to 7 years | Accounts paid as agreed                                | Chapter 7 shows for 10 years                       |
| Chance of finishing    | Most 2010-era enrollees didn't                     | Depends on steady payments                             | Chapter 7 discharge in over 99% of cases           |

## What should you do instead?

- ✓ Call your card issuers first and ask about hardship programs. It costs nothing.
- ✓ Talk to a nonprofit credit counseling agency before any for-profit settlement company.
- ✓ Refuse any company that wants money before it settles a debt. That's illegal under federal and California law.
- ✓ If you settle, run the insolvency worksheet in IRS Publication 4681 before you file your taxes.
- ✓ Get a bankruptcy attorney's opinion if your debts are large compared with your income. Many offer free consultations.
- ✓ Ignore anyone selling a legal document, trust, or bond that makes debt disappear.

Debts don't disappear at death either. See [how to handle debt in estate planning](#) and [whether you're responsible for a parent's debts](#).

## Frequently asked questions

### Is debt settlement a scam?

Not always, but it's risky. Legitimate companies can't charge until they settle a debt, and even then fees run 15% to 25% of what you owe. Any company asking for money up front is breaking the law.

## Will I owe taxes on settled credit card debt?

Usually, unless you were insolvent when the debt was canceled. A creditor that cancels \$600 or more sends you and the IRS a Form 1099-C, and California taxes the same income through your federal AGI.

## Can I be sued while I'm in a debt settlement program?

Yes. The FTC warns creditors can sue while you wait for a settlement, and a judgment can lead to wage garnishment or a lien.

## Can I cancel a debt settlement contract in California?

Yes, at any time and without a fee or penalty, under Civil Code § 1788.302.

## Is it smart to keep moving my balance to 0% cards?

Only as a short-term step while you pay the balance down. Each transfer costs about 3% to 5%, and if you miss a promotion or fall 60 days behind, you're paying around 22%.

## Do debt elimination programs that use trusts or bonds work?

No. Federal prosecutors have convicted promoters who sold them, with sentences up to 22 years.

Related reading: [0% business funding and credit card stacking](#) and [infinite banking](#). [Talk to Ridley Law](#) about planning around debt.

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## Questions about your own plan?

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