

Debt Collection

With the economic downturn more and more families are behind on their bills. Financial educators and counselors are increasingly hearing from consumers who are facing mounting financial responsibilities and unmanageable liabilities resulting in past due bills. This triggers a range of financial and legal issues, many of which are technical. While not a substitute for legal advice, this brief provides some background on common issues. These days finding access to legal assistance—especially low or no cost assistance—is challenging. The terms and definitions discussed here can serve as a starting point for dialogue with clients.

What Triggers Debt Collection?

Missing a payment on any kind of bill usually triggers a letter asking for immediate payment, often with a penalty fee included. At least one more letter and a phone call requesting payment typically occur next if the bill remains unpaid. At some point most past due bills are managed by a collection agency. That agency may buy the debt (typically at a steep discount relative to the amount owed) or just be paid to ‘service’ the debt. For a consumer it can be confusing to determine the company the debt is now owed to. Regardless, the debt remains. Collections processes can be aggressive, but consumers do have rights.

What is the Fair Debt Collection Practices Act?

The Act prevents credit collectors from using practices that are abusive, unfair and deceptive (see 15 U.S.C. 1692). Collectors cannot use inappropriate or demeaning language. Calls are usually restricted to 8:00 a.m. to 9:00 p.m., and the frequency of calls cannot be excessive. Collection agents cannot misrepresent themselves, contact you at work or threaten imprisonment. Collectors may contact a spouse, or parents of minors, but

may not contact other parties (unless designated by the debtor).

A collector cannot disclose, or threaten to disclose, information about your personal or credit reputation to anyone, including a neighbor or a relative, without a legitimate business need to know it. A collector may contact a third party to determine if you live at the location listed on the account. Further discussion between a third party and a collector is prohibited.

The Act also establishes standards of practice. For example, the collector must give written notice to the debtor that includes all the details of the debt including the amount owed and information about the lender. The notice also must include information about how the debtor can dispute the debt and gives the debtor 30 days from the date of the letter to verify or dispute the debt. This period is called the “Verification Period.” If the 30 days pass and the debtor does not dispute the debt, the collector assumes the information about the debt is correct and proceeds with attempting to collect payment.

Why is the 30-Day Verification period important?

It is the *debtor’s* obligation to seek information about the debt during the verification period. During the verification period, the collector is obligated to give the debtor this information upon request, but after the verification period expires the collector no longer has an obligation to provide this information.

Is a collection agency allowed to contact my employer?

The collector may contact your employer only for the following reasons – to verify employment or the amount of your earnings, or to communicate with an employer who has an established debt

counseling service or procedure. Collectors may also contact an employer after a final court judgment has been made on the debt.

What can be collected and how?

The contract that created the debt determines the fees that the collector is permitted to collect. This contract may be an account agreement or loan document. Actions in the contract may include: (1) acceleration, where the entire debt is payable at once, (2) repossession, where the creditor seizes property used as collateral, and (3) garnishment, where a court order or judgment requires wages to be withheld to pay the creditor. Payroll and/or banking accounts can be garnished in most cases. A court action is required for most repossessions or garnishments. The court mandates payment or surrender of property.

After obtaining a judgment, the creditor files a request for garnishment with the circuit court. A notice is then issued to the “garnishee” (the employer, bank, or third party holding your property) directing them to turn over the property to the creditor to satisfy or partially satisfy the judgment.

A repossession begins with a “Notice of Right to Cure Default” which will list the amount that must be paid to cure the debt. This amount usually includes back payments and additional fees. If the amount owed is not paid in 15 days, the consumer is served a summons and complaint from the court. Repossession of a vehicle does not require a court judgment unless the borrower objects within 15 days of receiving Notice. Often the sale of the collateral produces less than the amount owed. As a result the debtor is still responsible for paying any remaining balance as well as any fees, costs and even cleaning or repairs before sale.

It should be noted that falling behind on property taxes can result in a lien on the property. That lien can result in a foreclosure proceeding in order to collect the amount due.

Is a debtor liable for the debts of a spouse?

Each spouse is jointly liable for debts incurred in the marriage. If a debt was incurred before the marriage, but an individual adds his spouse to the account after marriage, both are jointly liable for the debt.

What about multiple debts collected by same collection agency?

It can be confusing which debt the payment is intended for if a borrower has multiple debts and sends in one payment. The best practice is to send multiple payments, each designated for a specific account. The collector must apply the payment as instructed by the borrower. The collector cannot apply the payment to a debt the borrower has disputed.

What legal process does a debtor go through?

Creditors can threaten legal action but only the creditor, not a third-party collection agency, has the authority to decide whether legal action should be taken. A collection agency cannot initiate legal action on its own but can recommend legal action to the creditor.

When the creditor files a lawsuit, the debtor receives a summons as notice that the lawsuit has been filed and the court will schedule a hearing. At the hearing the debtor can challenge the lawsuit. If the debtor does not appear at the hearing, the Court automatically rules in favor of the collector.

What about past due utility bills?

Services such as electric, gas, or your cell phone may be turned off if bills are unpaid, however primary heating cannot be disconnected during the heating “moratorium.” This is a period during which utility company may not disconnect current service, though the utility continues to accumulate charges. The moratorium is different from state-to-state, but is November 1st to April 15th in Wisconsin.

However, if some one is behind on utility bills *before* the moratorium begins, the utility company does not have to reconnect service by November

1st unless remaining balance is paid off. A reconnect charge may also be assessed with interest and fees may be charged on overdue amounts.

A utility must send a notice before service is disconnected. However, utilities that are cooperatives are not under the jurisdiction of the Public Service Commission and may not observe the November 1st and April 15th restriction on shut offs.

What about Child Support Orders?

Child support is court-required and cannot be evaded. This is the only form of debt where nonpayment can result in imprisonment. Only courts can change the amount owed.

What is garnishment?

Wage garnishment, the most common type of garnishment, is the process of deducting some portion of a person's earnings for the payment of a debt. Other forms of garnishment include the seizure of assets in bank accounts or other financial accounts.

When is a garnishment used?

Garnishments are issued after a judgment has been made and the court has ruled in favor of the creditor/collector. The mechanism to repay the debt is a garnishment of accounts or wages. Examples of this include spousal support, back taxes, child support or other debts.

Any amount in bank accounts, above an initial \$1,000 maximum across all accounts, is subject to garnishment. Only funds in the account at the time of the garnishment can be taken. Because government benefits are exempt from garnishment if these funds are in an account these funds cannot be garnished. In practice, determining the source of funds can be challenging to document. The Court will **not** presume that any of the debtor's funds are exempt from garnishment. At the court hearing the debtor may argue that certain funds are exempt from garnishment, as only the Court can approve the exemption.

What happens after a debtor deposits funds that are exempt from garnishment in a checking account ?

If a garnishment order instructs a financial institution to garnish a debtor's bank account, the bank does not distinguish exempt funds from non-exempt funds. Therefore, any money deposited in the garnished bank account will most likely be subject to garnishment.

What amount of income is garnished?

Up to 20% of an individual's disposable income earnings (earnings after deducting Social Security, state and federal income taxes) may be garnished (Wis. Stat. 812.34). Court-ordered child or spousal support payments, take priority over the earnings garnishment for other debts. Debtors first receive a notice of the garnishment. Then they are allowed to file an "Earnings Garnishment Debtor's Answer" to prove what earnings are exempt from garnishment.

Garnishment is generally not permitted if earned income is below the federal poverty level, if the debtor receives supplemental security income (SSI), food stamps or a veteran's benefit that is based on need. Generally debtors who have received public benefits within the last 6 months or are eligible for public benefits will not have wages garnished.

Can a tax refund be garnished?

State or federal agencies can garnish a tax refund. An example of a state or federal agency doing this would be for back taxes or child support.

If a debtor receives child support, can that be garnished?

If at least 25% of disposable income is assigned by court order for support, it cannot be garnished. A debtor must present a defense that a certain amount of her income is child support and should be exempt from garnishment.

What benefits cannot be garnished?

Many federal benefits are generally exempt from garnishment.

- Social Security Benefits
- Supplemental Security Income (SSI) Benefits
- Veterans' Benefits
- Civil Service and Federal Retirement and Disability Benefits
- Service Members' Pay
- Military Annuities and Survivors' Benefits
- Student Assistance
- Railroad Retirement Benefits
- Merchant Seamen Wages
- Longshoremen's and Harbor Workers' Death and Disability Benefits
- Foreign Service Retirement and Disability Benefits
- Compensation for Injury, Death, or Detention of Employees of U.S. Contractors Outside the U.S.
- Federal Emergency Management Agency Federal Disaster Assistance

However, delinquent taxes, child support or student loans permit garnishment even of federal benefits.

How are garnishments treated in bankruptcy?

If a debt existed before bankruptcy is filed, then the garnishments associated with that debt will stop. However, bankruptcy does not stop child/spousal support garnishments that have been ordered by a court.

What happens to past due debts on credit reports?

The Fair Credit Reporting Act regulates the credit-reporting industry and is implemented by the Federal Trade Commission. Most negative factors are reported for up to 7 years, including foreclosures, late payments, charge-offs, unpaid debts or medical bills, paid judgments and liens. Chapter 7 bankruptcies may be reported for 10 years. These timelines start when the account first goes into collection. Some collection agencies may try and extend the time the account appears on a credit report by using more recent dates.

What is the statute of limitations on debt collections?

Each state sets a statute of limitations on how long a creditor can still sue you to reclaim certain debts. When the statute of limitations expires, collectors can no longer sue, but they can keep trying to collect. Some debts have no statute of limitations, such as federal student loans, government fines, child support, and taxes.

When a debt is so old creditors cannot sue to recover funds the debts are called "time-barred." In Wisconsin credit card and other open account debts are time-barred after 6 years. Unpaid judgments may have as long as 20 years under the statute of limitations. The statute of limitations does not eliminate the debt, but rather stops the collector from being able to file a lawsuit to collect the debt.

How should collector calls be handled?

- answer the phone – don't ignore the call
- remain calm and do not argue
- write down the name, address, and phone number of collector
- write down the name of the creditor and the exact amount owed.
- If a collection agency is involved, ask the collector to "verify" the debt. This requires the bill collector to get confirmation from the original creditor that you owe the debt and how much is owed. The collection agency must then stop collection activity until a copy of the "verification" is sent to you. If the debt cannot be verified, the collection agency must stop collections.

How can someone stop collections abuses?

Keep a record with the time and date of any harassment and then file a complaint at www.ftc.gov or call 877-FTC-HELP (382-4357). Also file a complaint with the Wisconsin Department of Financial Institutions at www.wdfi.org or (800) 452-3328.

What is bankruptcy?

Bankruptcy is a federal court action that allows debtors to develop a plan to deal with outstanding debts. For most consumers there are two options: Chapter 7 and Chapter 13.

Chapter 7 allows the court to sell the debtor's nonexempt property to pay back creditors. After property and assets are liquidated, debtors are paid off and any remaining balance is forgiven. However, home mortgages, taxes, student loans and child/spousal support cannot be extinguished and not all consumers qualify for Chapter 7. Only people with qualified incomes (less than state median) and no prior use of bankruptcy qualify.

Chapter 13 is more like a repayment plan or a consolidation loan. No debt is typically forgiven nor are assets liquidated. The payment plan typically lasts 3 to 5 years and allows a debtor time to catch up on mounting debt. During bankruptcy creditors cannot pursue collections outside of the court agreement.

What is a Wisconsin Chapter 128 plan?

Wis. Stat. 128.21 provides for a state debt consolidation plan that amortizes debts (but does not just get rid of debts like a Chapter 7 bankruptcy) and may be a way to stop garnishments and interest from accruing. A trustee (usually a lawyer) lists all creditors and amounts owed and then develops a 3-year payment plan and requests the state court to approve the proposed payment plan.

If debt is cancelled, is it taxed like income?

Yes. The IRS treats cancelled debt like income. In most cases, debtor will receive a 1099-C form from the creditor who cancelled the debt. When a debt

is cancelled, the debtor should ask the creditor if he/she needs a 1099-C form. Situations where cancelled debt may not be treated like income include bankruptcy and, for a limited time, foreclosures. The Mortgage Forgiveness Debt Relief Act of 2007 generally allows taxpayers to exclude income from the discharge of debt on their principal residence. This provision applies to debt forgiven in calendar years 2007 through 2012. Cancelled debt may also not be taxable if a debtor's total debts are more than the fair market value of total assets (insolvency).

For more information

Bankruptcy Court for the Western District of Wisconsin <http://www.wiwb.uscourts.gov/>

Garnishment - Wisconsin State Law Library <http://wilawlibrary.gov/topics/laborlaw/garnish.php>

National Consumer Law Center <http://www.nclc.org/>

Federal Trade Commission <http://www.ftc.gov/bcp/consumer.shtm>

Non-profit credit counseling service: 1-800-388-2227 or <http://www.debtadvice.org/>

Legal Action of Wisconsin (southern counties) 1-800-873-0927 or <http://www.badgerlaw.net/>

Judicare (northern counties) 1-800-472-1638 or www.judicare.org.

Public Service Commission of Wisconsin 800-225-7729 or <http://psc.wi.gov>



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