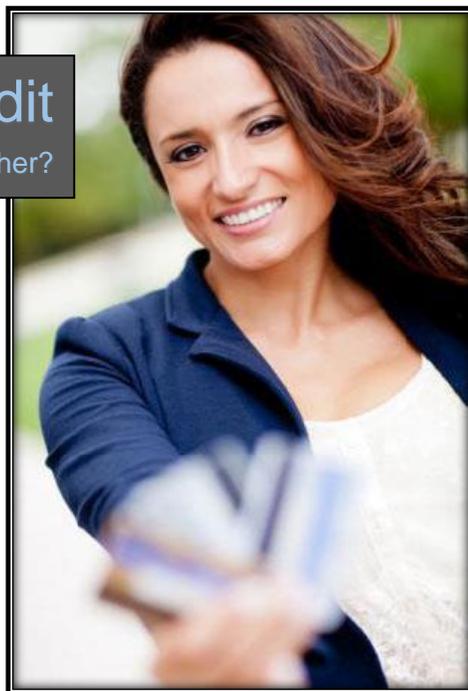




Using Debit vs. Using Credit

How preferable is one type of plastic to another?



You're about to purchase a pricy good or service and you don't have your checkbook or enough cash on hand to do it. Should you pull out a debit card, or a credit card?

Given the choice, you'd probably pick a debit card – right? After all, aren't they preferable to credit cards? Usually, yes – but not always.

How debit cards actually work. Debit cards pull money straight from your bank account. What if you have insufficient funds in your account? If that happens, the bank can decide to do one of two things, per the terms of the particular debit card – it can elect to decline the charge, or shoulder the cost of the transaction and ding you for insufficient funds. Some banks give you overdraft protection for recurring debit card charges, but not for one-time transactions.^{1,2}

Your debit card may bear a VISA or MasterCard logo. If that is the case, you have the option to use it as a credit card. If you choose that option, your transaction is then handled by the credit card firm rather than the bank, and the money may not be taken out of your account immediately as some retailers wait until the end of their business day to notify credit card companies of transactions.³

How credit cards actually work. A credit card purchase is processed in four phases. First, you authorize a purchase with your signature. Next, the purchase is compiled with other credit card charges into a “batch”, which the merchant may wait until the end of the day to send. The batch is sooner or later sent to the card issuers, thereby requesting payments. Finally, the merchant gets the payments minus discount and interchange fees along the way.³

The small businesses you frequent likely prefer debit to credit. Debit card transactions come with lower transaction fees than those of their plastic cousins. A debit card purchase is not a cash sale, but it is remarkably close to one. Due to the larger transaction fees associated with credit transactions, some stores bar the use of a credit card for very small purchases – in those cases, it isn't worth the trouble for the retailer.

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Banks charge merchants fees for the privilege of accepting debit cards, and retailers are hailing a July U.S. District Court ruling calling for lower caps on those fees. This summer, U.S. District Court Judge Richard Leon tossed out the current Federal Reserve cap of \$0.21 in interchange fees per debit card swipe as too excessive. The Fed will likely appeal the ruling well into 2014.⁴

Debit cards may offer less fraud protection, however. Here is an area where credit cards look good in comparison. While a straight-up debit card payment is instantly deducted from your bank account, you ultimately pay credit charge charges only if you agree to the legitimacy of the charge and the delivery of the product or service. Translation: a credit card offers you a kind of signatory “firewall” against fraud (at least at the point of purchase). Your liability for fraudulent credit charges is capped at a certain level; fraudulently debited charges can be another story. Disputed charges on credit cards are often handled faster as well.^{5,6}

Also, there are some situations where it is pretty hard to get by with just a debit card. If you want to rent a car or reserve a nice hotel room, a credit card is all but essential. You also build credit history through credit card use, not debit card use.⁵

Both kinds of cards are susceptible to “gray” charges. Tiny little monthly membership charges, small levies for “phantom” (additional) products or services sold to you at the point of sale, “zombie” charges for an ongoing subscription you don’t formally cancel – they are some of the “gray” charges that may come your way with both kinds of cards, and they are entirely legal. Retailers bury them in the fine print, and made an extra \$14.3 billion of cardholders this way in 2012.⁷

Debit is usually preferable to credit, but cash is still king. Sensible use of debit and credit cards can help you build your credit history and perhaps make things a little easier for you as a consumer. Runaway use of them may bring problems. Credit and debit cards are ultimately conveniences, and not replacements for cash.

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Citations.

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