How and When to Cancel a Credit Card Without Damaging Your Credit

There are many reasons why you may choose to cancel a credit card. For example, you may have just paid one off or transferred the balance to another that offers a lower interest rate, and you may think that it's best to close the account immediately. While canceling a credit card is a perfectly legitimate financial decision, you should be aware of how to cancel it properly, so that it doesn't negatively affect your credit score.

Credit scoring models use various pieces of information from your credit history to calculate your credit score. A portion of this model measures how much credit you're using in relation to the amount you have available. This is a ratio known as "credit utilization." If you close an unused or paid off credit card, you'll reduce your total available credit. This will increase your credit utilization ratio, and your credit score may decrease.

In addition, closing a credit card at the wrong time can lower the average age of the accounts on your credit report. This may also have a negative impact because credit scores are affected by the length of payment history and properly managed accounts. Closing an older account that was paid on-time could negatively impact your credit score even more than opening a new credit card account would.

So, exactly how and when should you cancel a credit card to avoid damaging your credit score? Check out our tips below:

When Canceling a Credit Card Makes Sense. First and foremost, if your credit card has a high interest rate, it's a good idea to consider canceling it. Paying excess finance charges with high interest isn't good for your wallet, and it will cost you more in the long run. Your credit score may dip temporarily, but will recover within a few months if you consistently make on-time payments and don't incur additional debt. Similarly, credit cards with high annual fees should be avoided, especially if you're not taking advantage of the rewards and benefits they offer.

If you have the tendency to overspend due to a readily available credit card, you may benefit by closing it. This will help you save money and ultimately preserve your credit score. Until you've established new or better spending habits, it's a financially responsible move to make.

Finally, keeping finances separate after a divorce is a smart monetary decision. Closing a joint credit card with your ex-spouse can protect your credit and help you avoid unexpected purchases from them.

When to Avoid Canceling a Credit Card. When you've had a credit card for many years, made consistent on-time payments, and it's one of the oldest accounts in your credit history, it's not a good idea to cancel it. Remember, longevity is a factor, and hanging onto a credit card in this situation will have a positive impact on your credit score.

If you don't have many open accounts in your credit history, canceling a credit card could hurt your credit score. It may even make it more difficult to qualify for new credit in the future. Many lenders look at the big picture when evaluating your credit history in regards to a loan request. The number of accounts and the length of time they have been established (along with other factors) help lenders determine the likelihood that you will repay them.

Finally, not using a credit card very often doesn't necessarily mean that it needs to be closed. As mentioned above, having available credit has a positive impact on your credit score by reducing your credit utilization ratio. Plus, it’s good to have a credit card and the available credit in the case of an emergency. You never know when you might need it, and it’s better to be prepared.