

You lend \$4,000 at 10% in 2012 and the loan is paid back in 2014

Tax on Interest Income is 30%

Tax you owe

$$\$400 \times 0.30 = 120$$

$$\text{Interest Income} = 4,000 * 0.1 = \$400$$

CPI = 200

2012

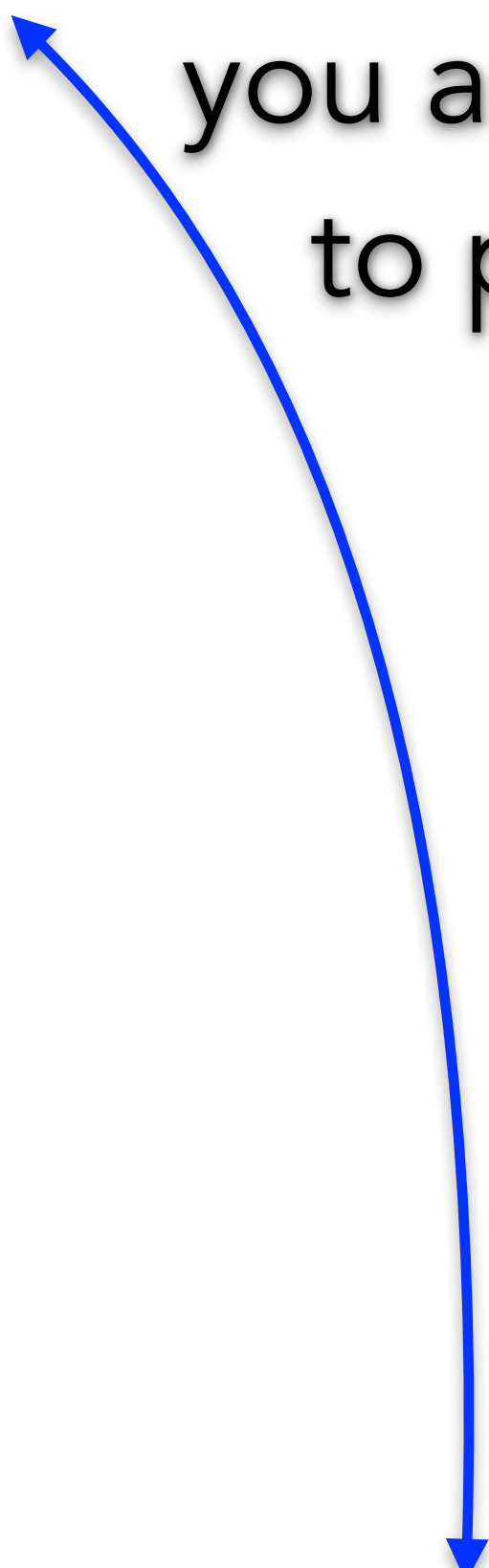


CPI = 210

2014

$$\text{Real Value} = \frac{4400}{210} \times 100 = 2,095.2$$

You pay 126%
instead of the 30%
you are supposed
to pay by law



$$\frac{120}{95.2} \times 100 = 126\% \text{ effective tax!}$$

Even though your **Real** Interest Income was only
\$95.2 the government still makes you pay \$120

$$\text{Real Value} = \frac{4000}{200} \times 100 = 2,000$$

Your **Real Interest Income** = $2,095.2 - 2,000 = 95.2$

In real terms, the borrower got \$2,000 and returned 2,095.2

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In real terms, the borrower got \$2,000 and returned 2,095.2

$$\text{Your Real Interest Income} = 2,095.2 - 2,000 = 95.2$$

Even though your Real Interest Income was only \$95.2 the government still makes you pay \$120 $\frac{120}{95.2} \times 100 = 126\%$ effective tax!

You pay 126% instead of the 30% you are supposed to pay by law

