33

You lend $100,000 at 9% Nominal interest in 2024 to be repaid in 2025

The borrower pays back = 100,000(1.09)=109,000

CPI = 210

2024

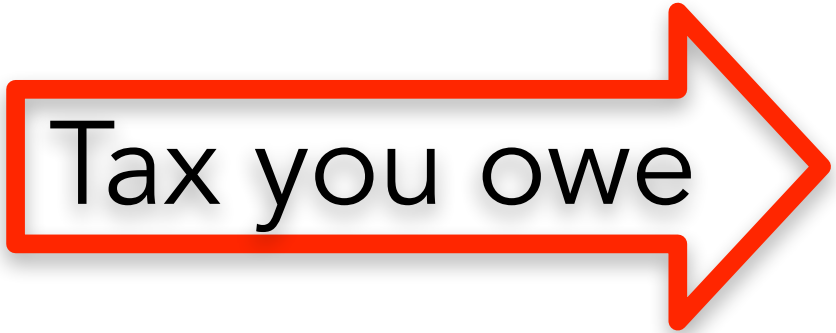
CPI = ?

2025

Real interest rate = 9% - 5% = 4%

Interest Income = 100,000 x 0.09 = $9,000

If the tax on interest income is 25%



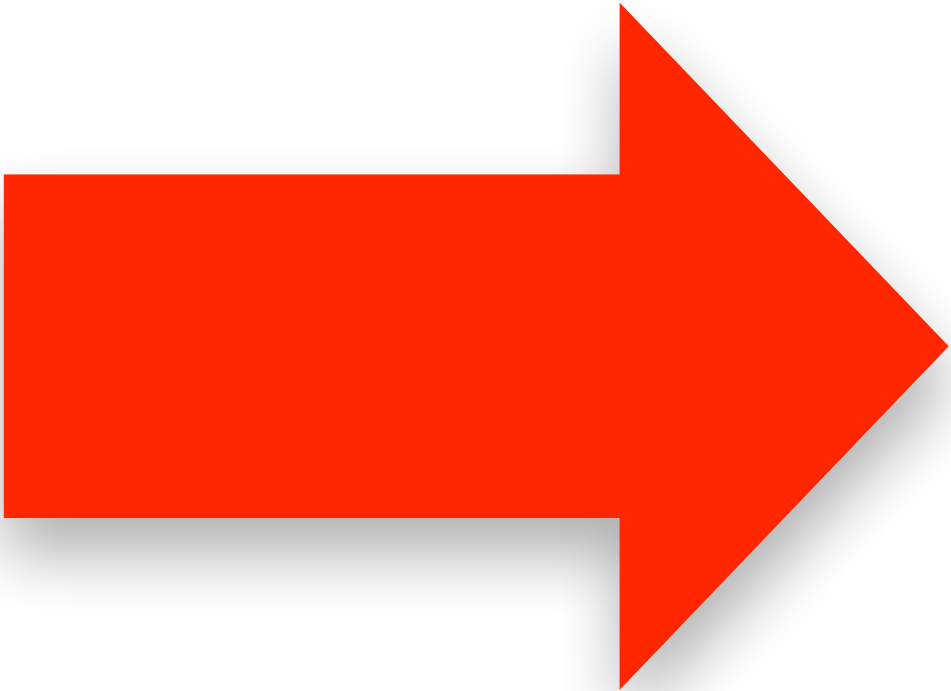
$9,000 x 0.25 = 2,250

If the tax on interest income was charged on the Real interest instead

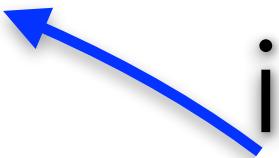

Tax you really owe
$4,000 x 0.25 = 1,000

Real Interest Income = 100,000 x 0.04 = $4,000

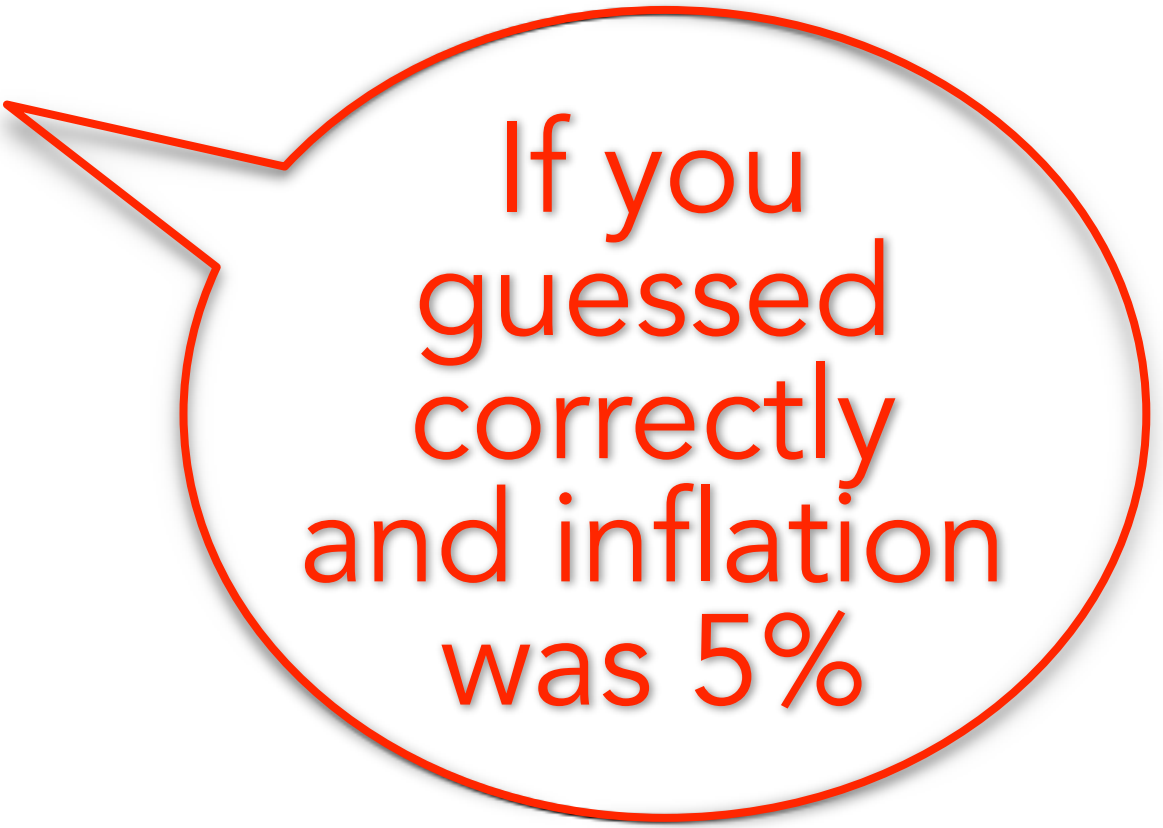
Even though your Real Income was only $4,000 the government still makes you pay $2,250



You pay 56%
instead of the 25%
you are supposed
to pay by law



$$\frac{2{,}250}{4{,}000} \times 100 = 56\%$$ effective tax!


If you guessed correctly and inflation was 5%

CPI = 210

2024

CPI = ?

2025

If you guessed correctly and inflation was 5%

Even though your Real Income was only $4,000 the government still makes you pay $2,250

The borrower pays back = 100,000(1.09)=109,000

You earn → Interest Income = 100,000 x 0.09 = $9,000

If the tax on interest income is 25%

Tax you owe → $9,000 x 0.25 = 2,250

You pay 56% instead of the 25% you are supposed to pay by law

You earn → Real Interest Income = 100,000 x 0.04 = $4,000

Tax you really owe → $4,000 x 0.25 = 1,000

$$\frac{2,250}{4,000} \times 100 = 56\%$$ effective tax!