



May 20, 2026

Indexing Capital Gains Taxes for Inflation: Marginal Effective Tax Rates and Revenue Estimates

Proposals to index capital gains taxes for inflation have recently generated public debate. For example, S. 798 and H.R. 1857 would inflation index capital gains on assets held for at least three years. Some Members of Congress have also advocated for the Administration to adopt indexing of capital gains by regulation. This In Focus compares capital gains taxation under current law with inflation indexing, examines how indexing affects marginal effective tax rates (METRs) on corporate stock returns, and presents revenue estimates of selected versions of inflation indexing options.

Current Law and Inflation Indexing

A capital gain represents the increase in value of an asset over time. It is computed by subtracting the asset’s basis from the final sales price. For a financial asset, such as corporate stock, the basis is typically its original purchase price. For a physical asset, such as a building, the basis is the acquisition cost plus any improvements, minus depreciation.

Under current law, an asset’s basis is not adjusted for inflation. Consequently, a portion of any capital gain often reflects “phantom gains”; that is, compensation for eroded purchasing power rather than a true increase in investor wealth. For example, a stock originally purchased for \$100 and sold for \$150 after 10 years would result in a taxable gain of \$50 under current law. But if inflation averaged 2% over those 10 years, inflation indexing would adjust the basis upward by \$22 (2% compounded over 10 years), leaving a taxable real gain of \$28 (\$150 minus \$122).

Capital gains receive a number of tax benefits under current law that some view as proxies for inflation indexing. Taxes on capital gains are deferred until realization. Long-term capital gains (on assets held for more than a year) are taxed at rates (0%, 15%, and 20%) that are lower than those imposed on ordinary income (up to 37%). And capital gains are excluded from taxation at death via a step-up in basis on inherited assets.

Higher-income taxpayers (incomes over \$200,000 if single and \$250,000 if married and filing jointly) are subject to an additional 3.8% net investment income tax on capital gains and other types of passive capital income.

Marginal Effective Tax Rates (METRs) on Returns to Stock Investments

Marginal effective tax rates (METRs) provide a useful measure through which to examine the effects of inflation indexing on investment. These measures account for the various factors that influence effective taxes: statutory tax rates, tax exclusion at death, inflation, holding period, and the composition of an asset’s return.

Table 1 shows estimated METRs on corporate stock under current law and with inflation indexing by holding period for taxpayers subject to the top marginal capital gains rate (20%) and net investment income tax (3.8%). Corporate stocks are analyzed because they generate the majority of capital gains and do not depreciate, which simplifies the analysis. However, the METR framework can be used to understand the impact of taxes on investments more generally. See CRS Report R48277, *CRS Model Estimates of Marginal Effective Tax Rates on Investment Under Current Law*, by Mark P. Keightley and Jane G. Gravelle.

The last column of **Table 1** displays the percentage reduction in METRs when switching from current law to inflation indexing. Somewhat counterintuitively, inflation indexing is *more* beneficial at *shorter* holding periods, as indicated by the declining percentage reduction in METR stemming from indexing. The reason is that nominal gains compound at a faster rate than phantom gains. As a result, real gains become a larger share of total nominal gains over time, while the proportion of phantom gains decreases. Because inflation indexing only eliminates tax on the phantom portion of gains, its importance falls as that portion shrinks.

Table 1. METRs Under Current Law and Indexing, Historical Dividend and Capital Gains Returns, Top Marginal Tax Rate (23.8%)

Holding Period (years)	METR Current Law	METR Inflation Indexing	Percentage Reduction in METR
1	30.5%	23.7%	22.3%
5	29.1%	23.1%	20.5%
10	27.6%	22.5%	18.3%
15	26.2%	22.0%	16.2%
20	25.0%	21.4%	14.2%
30	22.9%	20.4%	10.7%
40	21.3%	19.6%	7.9%
Until Death	12.7%	12.7%	0.0%

Source: CRS calculations.

Notes: METRs are the weighted averages of effective tax rates on capital gains and dividends. Assumes annually a 3.61% dividend, 3.17% real appreciation, and 2% inflation. See CRS Report R48277, *CRS Model Estimates of Marginal Effective Tax Rates on Investment Under Current Law*, by Mark P. Keightley and Jane G. Gravelle. Tax rate includes 20% rate on dividends and capital gains and 3.8% net investment income tax.

Deferral provides an alternative way to understand why the impact of indexing falls with the holding period. Without indexing, taxable gains are larger—because they include phantom gains—resulting in a larger tax being deferred. Thus, the deferral benefit is stronger under no indexing (current law), and as the holding period lengthens, that growing deferral benefit increasingly offsets the effective tax on phantom gains. As a result, a switch to inflation indexing adds less value as the holding period gets longer. This is indicated by narrowing the METR gap between the two regimes in **Table 1**.

The rates in **Table 1** can be contrasted with the rates that apply to ordinary income. Internal Revenue Service data suggest that the average holding period for realized gains is about five years, and CRS estimates that about 40% of gains are never realized (see CRS Report R48562, *Boundaries on the Long-Run Realization Response to Changes in Capital Gains Taxes*, by Mark P. Keightley and Jane G. Gravelle). These shares indicate an aggregate weighted average METR of 22.5% under current law and 19.0% with inflation indexing, compared to the top ordinary income tax rate of 37%.

The effective tax rate on corporate stock depends on composition of returns. At one extreme, when no dividend is paid, inflation indexing again reduces the METR across holding periods (see **Table 2**). In this scenario, METRs are lower than those assuming a historical composition of returns (**Table 1**) due to the maximum benefit of deferral, as there is no current taxation of dividends.

Table 2. METRs Under Current Law and Indexing, No Dividend Payments, Top Marginal Tax Rate (23.8%)

Holding Period (years)	METR Current Law	METR Inflation Indexing	Percentage Reduction in METR
1	29.8%	23.2%	22.2%
5	26.0%	20.9%	19.8%
10	22.0%	18.4%	16.7%
15	18.8%	16.2%	13.9%
20	16.2%	14.3%	11.3%
30	12.2%	11.4%	7.1%
40	9.7%	9.3%	4.3%
Until Death	0.0%	0.0%	0.0%

Source: CRS calculations.

Notes: METRs are the weighted averages of effective tax rates on capital gains and dividends. Assumes annually a 3.61% dividend, 3.17% real appreciation, and 2% inflation rate. Tax rate includes 20% rate on dividends and capital gains and 3.8% net investment income tax.

At the other extreme, where the entire return is paid as a dividend (not shown here), METRs do not vary much with the holding period under current law. For example, the rate is 30.8% for a 1-year holding period compared to 30.0% for a 40-year holding period. The METR for inflation indexing across all holding periods is simply the statutory tax rate (23.8%).

Potential Revenue Effects

Implementation of inflation indexing would involve a number of policy choices. These include what assets would be eligible, which taxpayers would be eligible, whether the policy would apply retrospectively to previously acquired assets or prospectively to newly acquired assets, whether there would be a minimum holding period, whether indexation could result in losses, and what inflation measure to use for indexing.

Table 3 provides estimates of the potential individual income tax revenue effects from FY2026 to FY2035 of indexing the cost basis of all assets. The estimates were made by CRS using the Budget Lab at Yale’s open-source Tax-Simulator. Estimates for both prospective and retrospective indexing are presented assuming three different minimum holding periods. Gains were inflation indexed using the Consumer Price Index for All Urban Consumers (CPI-U) through 2017, then adjusted using the Chained-CPI-U thereafter, consistent with the treatment of most individual provisions following reforms enacted in 2017 and the Tax-Simulator’s default indexing approach.

Table 3. Estimated Revenue Effects of Prospective and Retrospective Inflation Indexing Cost Basis Capital Gains by Minimum Holding Period

Proposal	Total Revenue Change, Billions of Dollars (FY2026-FY2035)
Prospective:	
1-year minimum	-\$165
3-year minimum	-\$91
5-year minimum	-39
Retrospective:	
1-year minimum	-\$955
3-year minimum	-\$855
5-year minimum	-\$762

Source: CRS estimates and calculations using the Budget Lab at Yale’s Tax-Simulator (Commit 18a25c8f0).

The estimates contained in **Table 3** are not considered official for revenue “scoring” purposes or compliance with budgetary rules, nor are they intended to represent the estimated cost of any specific legislative proposal that has been introduced. The Joint Committee on Taxation (JCT) provides Congress with official tax revenue estimates. CRS could not determine how closely the estimates in **Table 3** would be to those produced by the JCT, and they may differ significantly. The estimates in **Table 3** are intended to inform congressional deliberation.

Jane G. Gravelle, Senior Specialist in Economic Policy
Mark P. Keightley, Specialist in Economics

Disclaimer

This document was prepared by the Congressional Research Service (CRS). CRS serves as nonpartisan shared staff to congressional committees and Members of Congress. It operates solely at the behest of and under the direction of Congress. Information in a CRS Report should not be relied upon for purposes other than public understanding of information that has been provided by CRS to Members of Congress in connection with CRS's institutional role. CRS Reports, as a work of the United States Government, are not subject to copyright protection in the United States. Any CRS Report may be reproduced and distributed in its entirety without permission from CRS. However, as a CRS Report may include copyrighted images or material from a third party, you may need to obtain the permission of the copyright holder if you wish to copy or otherwise use copyrighted material.