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The exclusion ratio is the portion of the payments made to a gift annuitant that will not be reportable as ordinary income on the annuitant's income tax return.

If the gift annuity was funded with cash, the excluded portion of the annuity will all be tax-free income. If the gift annuity was funded with appreciated property, typically part of the excluded portion will be reportable as tax-free income and part of it as capital gain income.

Using the jargon of the gift annuity calculation, the exclusion ratio equals the annuitant's investment in contract divided by the annuitant's expected return.

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