

An aerial photograph of an oil drilling rig in a desert landscape at dusk. The rig is a tall, complex structure with a derrick and various platforms. It is surrounded by storage tanks, pipes, and other industrial equipment. The ground is flat and sandy, with some sparse vegetation. The sky is a mix of orange and blue, indicating the time is either dawn or dusk. The overall scene is industrial and remote.

Oil & Gas Working Interests: What CPAs and Financial Advisors Need to Know

A Professional Brief on IRC 263(c), the Section 469(c)(3) Working Interest Exception, and Rev. Rul. 68-331 for Advisors Serving High-Income Clients

PROFESSIONAL ADVISORY BRIEF

SUMMIT VENTURES

Executive Takeaway & Why It Matters

The Core Technical Insight

A growing number of your high-income clients are asking about oil and gas as a tax planning category, and many advisors do not yet have a confident, defensible answer. This brief is written peer to peer, for CPAs, tax professionals, RIAs, qualified intermediaries, business brokers and M&A advisors, estate planning attorneys, and commercial real estate brokers who are evaluating whether direct working interest ownership belongs in their advisory toolkit.

How a working interest is held — directly, or through an entity that does not limit liability — is the single fact that determines both whether a client's losses can offset active income under IRC Section 469(c)(3), and whether the interest qualifies as real property for Section 1031 purposes under Revenue Ruling 68-331.

The Stakes

Get the holding structure wrong and both benefits disappear. Get it right, and you have a statutory, IRS-acknowledged mechanism for addressing:

- Year-end income spikes
- Failed or failing 1031 exchange timelines
- Post-sale capital deployment

All documented with a K-1 and, where warranted, a tax opinion letter.

- ❏ Structure is everything. The holding entity — not just the underlying asset — controls the tax outcome.

Three Client Scenarios That Surface This Category

Three recurring client situations tend to surface this category on an advisor's desk.

The High-Income Year

A business owner or W-2/1099 professional closes a strong year and faces a concentrated tax liability with limited remaining planning options.

The 1031 Deadline Crisis

A client in the middle of a 1031 exchange identifies replacement property that falls through inside the 45-day window, with the 180-day closing deadline still running.

The Post-Sale Proceeds

A business broker or M&A advisor closes a sale and the client is holding liquid proceeds with no immediate reinvestment plan and an accountant already modeling the tax bill.

In each scenario, oil and gas working interests are frequently mentioned informally — by other advisors, at industry conferences, or by the client directly — but the advisor is often unable to independently verify whether the specific structure being proposed is compliant, properly documented, or appropriately vetted. **That uncertainty is the real gap this brief addresses.**

The Issue & The Opportunity

Why the Gap Exists

The issue is not that oil and gas tax treatment is obscure. IDC expensing has existed in the Code since 1918 and the working interest passive-loss exception has existed since Section 469 was enacted in 1986. The issue is that most advisory practices do not encounter the category often enough to build internal expertise, which creates two failure modes:

Failure Mode 1

Avoiding the category entirely and losing the client's business to a competitor who can speak to it.

Failure Mode 2

Recommending a structure without verifying its compliance posture and absorbing the reputational and litigation exposure if the sponsor's reporting, reserve disclosures, or entity structure do not hold up.

The Right Approach

The opportunity is to treat working interest ownership the way you would any other technical planning tool: understand the statutory mechanics, confirm the sponsor's documentation standard, and apply it only where it genuinely fits the client's facts.



Key Statutory Findings

The following provisions form the complete technical foundation for oil and gas working interest planning. Each must be understood and verified before any client recommendation is made.

1	<p>IRC § 263(c) — IDC Expensing</p> <p>Administered through Treasury Regulation 1.612-4, allows a working interest holder to elect to expense intangible drilling costs — labor, fuel, drilling mud, site preparation — in the year incurred rather than capitalizing them. Tangible drilling costs, including casing and wellhead equipment, are capitalized and depreciated.</p>
2	<p>IRC § 469(c)(3)(A) — Active Loss Exception</p> <p>Excludes a working interest in an oil or gas property from the definition of a passive activity, provided the taxpayer holds the interest directly or through an entity that does not limit liability. Unlike real estate professional status, there is no material participation hours test — which matters for a client working a demanding full-time schedule.</p>
3	<p>The LLC / LP Trap</p> <p>The moment that same working interest sits inside an LLC or limited partnership interest that limits the holder's liability, the 469(c)(3) exception is lost and the position reverts to passive treatment. The entity structure — not just the underlying asset — controls the outcome.</p>
4	<p>Rev. Rul. 68-331 & 78-135 — 1031 Like-Kind</p> <p>Revenue Ruling 68-331 holds that an operating working interest in an oil and gas lease is a real property interest, like-kind to other real property, for Section 1031 purposes. Revenue Ruling 78-135 clarifies that a general partnership interest itself does not carry this treatment — only a direct or undivided working interest qualifies.</p>
5	<p>IRC § 461(h) — Economic Performance Timing</p> <p>Economic performance rules, including the 90-day drilling exception, govern the timing of a December IDC prepayment for a well that will not spud until the following quarter — a detail that matters for last-minute year-end planning.</p>
6	<p>IRC § 613A & § 57(a)(2) — Depletion & AMT</p> <p>Percentage depletion, generally 15 percent of gross income for independent producers within statutory limits, continues to apply even after a client's basis reaches zero. Excess IDC can be an AMT preference item, with partial relief available where the excess does not exceed 40 percent of a taxpayer's alternative minimum taxable income — a calculation worth running before year-end placement.</p>

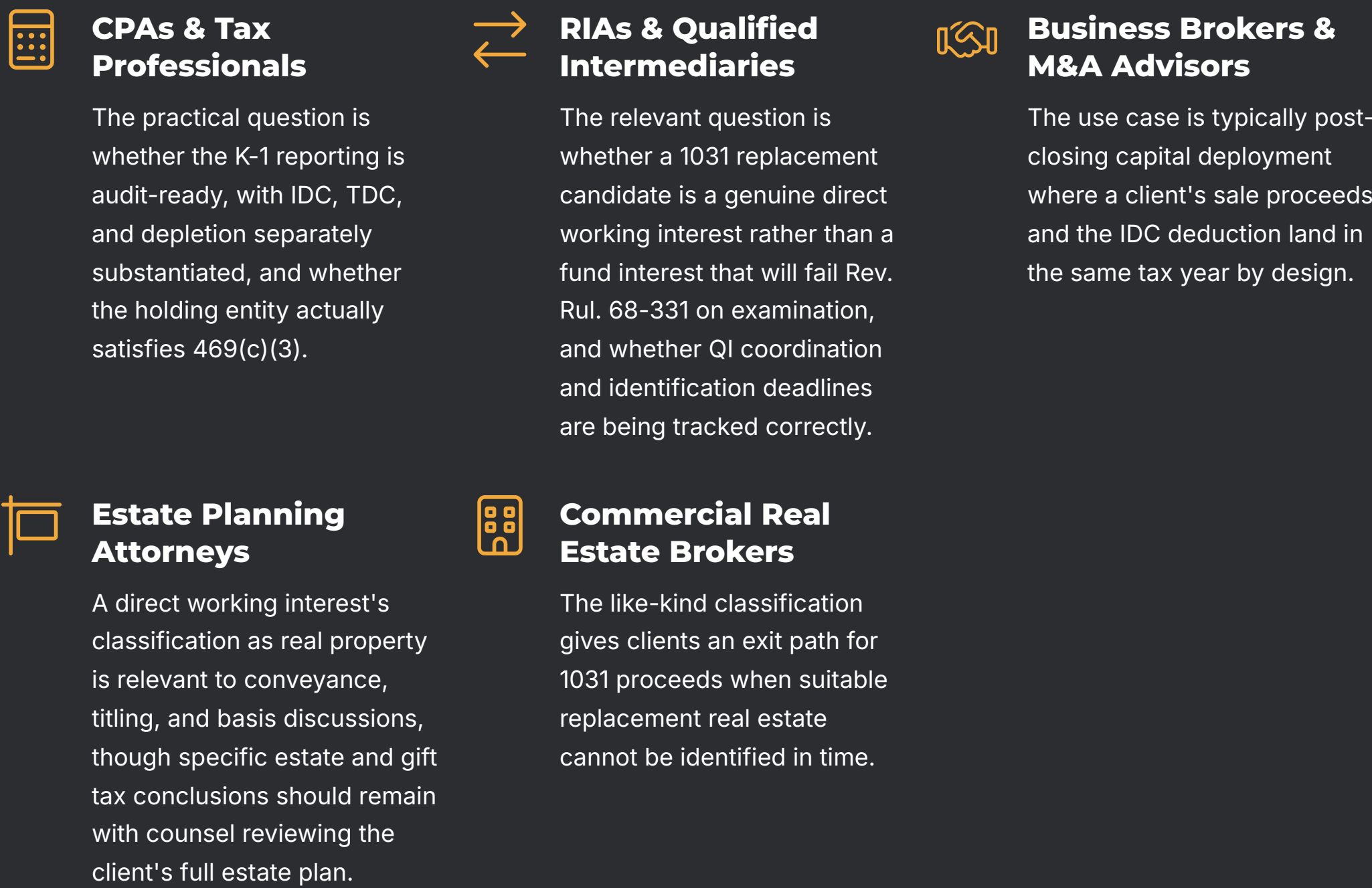
Analysis: Structure, Documentation & Advisor-Type Considerations

Participation Model

Summit Ventures operates as an entrepreneurial joint venture platform rather than a fund or security. Clients who participate become working interest owners and active JV members in specific producing or development assets, with governance rights and operational transparency built into the joint operating agreement rather than disclosed after the fact in a prospectus. This is a structural distinction worth confirming with any sponsor, because it is the holding structure — not a sales narrative — that determines the tax outcome described above.

Structural Elements

Capital contribution amounts, cost allocation between intangible and tangible categories, and depletion calculations flow through to a K-1 that is prepared on a schedule built around the advisory tax season rather than delivered as an afterthought. Where a client's position is large enough or technical enough to warrant it, a written tax opinion letter addressing the entity structure and the statutory basis for the IDC election is available for the advisor's file.



Four Checkpoints Before Any Recommendation

Before recommending or approving any working interest program on behalf of a client, confirm the following. These four checkpoints address the majority of the compliance and reputational exposure advisors describe when this category goes wrong.



Checkpoint 1: Holding Structure

The client will hold a **direct or undivided working interest** rather than a membership or limited partnership interest that limits liability.



Checkpoint 2: Written Election & Opinion

The sponsor can produce a **written 263(c) election methodology** and, where applicable, a tax opinion letter addressing the entity structure and statutory basis.



Checkpoint 3: K-1 Delivery History

The sponsor has a **documented, consistent K-1 delivery history** relative to the April filing deadline — not delivered as an afterthought.



Checkpoint 4: Reserve & Production Disclosures

The sponsor's **reserve and production disclosures** are presented with appropriate qualification rather than as guaranteed outcomes.

Implications for Your Practice

Compliance

Verifying structure before recommending it reduces the risk of an improper passive-loss position or a failed 1031 exchange surfacing on audit years later.

Client Retention

Being able to speak knowledgeably about a statutory, IRS-acknowledged category — rather than deferring the conversation to a competitor — keeps the advisory relationship at the center of the client's decision.

Practice Development

This category has natural recurring relevance across year-end planning, 1031 identification deadlines, and business sale closings — which means it is not a one-time conversation but an ongoing part of the advisory calendar.

Six Due Diligence Questions to Ask

- 1

Direct or Undivided Interest?

Is the client's proposed working interest a direct or undivided interest, or does it sit inside an entity that limits liability?
- 2

Written Tax Opinion Available?

Can the sponsor produce a written tax opinion addressing the 263(c) election and the entity's 469(c)(3) status?
- 3

K-1 Delivery Track Record?

What has the sponsor's K-1 delivery timeline looked like in prior tax seasons, measured against the April filing deadline?
- 4

1031 Replacement Confirmed?

In a 1031 scenario, has the qualified intermediary confirmed the replacement property is a genuine working interest under Rev. Rul. 68-331, not a fund or trust share?
- 5

IDC, TDC & Depletion Substantiated?

How are intangible drilling costs, tangible drilling costs, and depletion separately identified and substantiated on the K-1 the client will receive?
- 6

IRC 461(h) Timing Aligned?

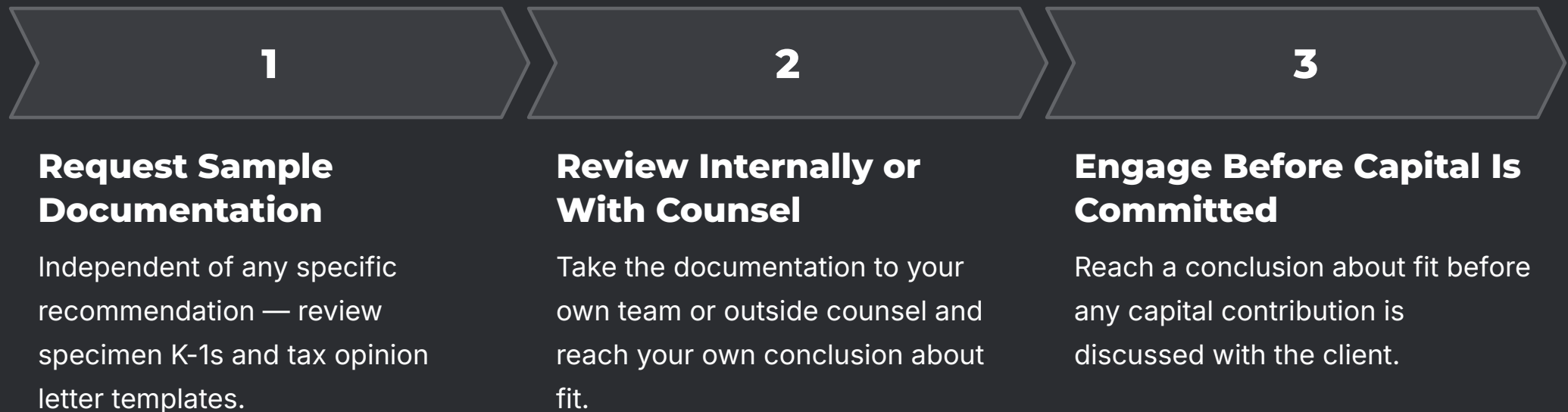
Does the timing of a proposed capital contribution align with IRC 461(h) economic performance requirements if it is being placed late in the calendar year?

Next Steps: Summit Ventures as Your Back-Office Resource

Summit Ventures is structured to function as a back-office educational resource for advisory practices working through these questions — not as a product pitch.

That support includes specimen K-1 documentation, tax opinion letter templates, and a direct technical point of contact for CPAs during filing season who need to confirm how a specific client's allocation was calculated.

Advisors evaluating whether this category fits a given client's facts are welcome to:



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Summary & Statutory References

The Bottom Line

The tax mechanics behind oil and gas working interests — IDC expensing under IRC 263(c), the active-loss exception under 469(c)(3), and the like-kind treatment confirmed in Rev. Rul. 68-331 — are long-standing, statutory, and well documented.

What separates a defensible recommendation from a reputational liability is not the existence of these provisions but the discipline applied to verifying holding structure, documentation, and sponsor reporting before a client's capital is committed. Advisors who build this verification into their process gain a legitimate, durable addition to their planning toolkit rather than a one-time transaction they later have to explain.

❏ Structure verification is not optional — it is the entire difference between a defensible recommendation and a reputational liability.

Sources & Statutory References

26 U.S.C. § 469(c)(3)(A) — Statutory text excluding certain working interests from passive activity treatment.

Treas. Reg. 1.612-4 — Implementing IRC § 263(c): election to expense intangible drilling and development costs.

Rev. Rul. 68-331 — Holding that an operating oil and gas working interest is real property for § 1031 purposes.

Rev. Rul. 78-135 — Clarifying that a general partnership interest does not independently qualify for 1031 nonrecognition.

IRC § 461(h) — Economic performance rules, including the 90-day drilling exception relevant to year-end IDC timing.

IRC § 613A — Percentage depletion for independent producers and royalty owners.

IRC § 57(a)(2) — Alternative minimum tax treatment of excess intangible drilling costs.

IRC § 168(k) — Bonus depreciation provisions relevant to tangible drilling cost recovery, as amended by the One Big Beautiful Bill Act of 2025.

This brief is prepared for informational purposes for licensed professionals. It does not constitute legal or tax advice. Advisors should confirm all structural and compliance details with qualified counsel before making client recommendations.

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