

# DST vs. Working Interest: Which 1031 Replacement Property Is Right for Your Exchange?

A Comparative Guide to Ownership Structure, Governance, Tax Treatment, and Timeline Fit for Commercial, Multifamily, and Land Sellers Facing the 45-Day Clock

1031 EXCHANGE GUIDE

SUMMIT VENTURES

# Introduction

If you have sold, or are under contract to sell, a commercial property, a multifamily asset, or a parcel of land, you are already living on a calendar most buyers never think about. The 45-day identification window and the 180-day closing deadline under IRC Section 1031 do not pause for due diligence delays, financing contingencies, or a disappointing replacement property search. Many sellers reach day 30 or day 35 still unsure of what qualifies, and that uncertainty is exactly where two very different categories of replacement property deserve a side-by-side look: the Delaware Statutory Trust (DST) and the direct oil and gas working interest.

Both are legitimate, IRS-recognized paths to completing a like-kind exchange. Both can absorb proceeds quickly enough to meet a tight timeline. But they are built on different legal foundations, they allocate control differently, and they treat the tax code differently once the exchange closes. This guide compares them directly, criterion by criterion, so you and your advisors can evaluate which structure, or which combination of the two, fits your specific liquidity event.

## 45-Day Rule

Identification window that does not pause for delays or contingencies

## 180-Day Rule

Closing deadline under IRC Section 1031 — absolute and non-negotiable

## Two Paths

DST and direct working interest — both IRS-recognized, structurally different

# What Is Being Compared

## Delaware Statutory Trust (DST)

A Delaware Statutory Trust is a legal entity formed under Delaware law that holds title to income-producing real estate. The real estate is acquired by the trust, while the DST sponsor owns all the trust's interests, which are then sold to investors as replacement property to complete their Section 1031 exchanges. Under IRS Revenue Ruling 2004-86, a properly structured DST interest is generally treated as an interest in like-kind real property, allowing it to serve as replacement property for investors trading direct control for passive, professionally managed ownership.

## Direct Working Interest

A direct working interest is the operating interest in a producing oil or gas lease — the right (and the corresponding cost obligation) to participate in drilling and production from a specific well or group of wells. The exchange of a leasehold interest in a producing oil lease, extending until exhaustion of the deposit and held for productive use in trade or business or for investment, for a fee interest in improved real estate is an exchange of property for property of like kind under Section 1031(a). That holding, Revenue Ruling 68-331, is the statutory foundation Summit Ventures relies on when structuring working interest positions as qualified replacement property.

The distinction that matters most for exchange purposes: a DST interest is a securities offering that enables fractionalized ownership of actual real estate. A direct working interest is not a security transaction at all. The exchanger takes recorded title to an actual operating interest in a specific lease, which is why the structure must be held directly, or through an entity that does not convert it into a partnership interest, since an interest in a partnership is generally excluded from like-kind treatment unless the partnership has a valid election under Section 761(a) to be excluded from Subchapter K, in which case it is treated as an interest in each underlying asset rather than as a partnership interest.

# Evaluation Criteria

Before comparing the two side by side, it helps to define what "better" actually means for a 1031 exchanger. The questions that matter are not about which asset class performs better in the abstract. They are about fit: how much of the closing timeline does the structure consume, how much control does the seller retain or surrender, how is the position taxed going forward, and what happens if the exchange fails or leaves boot behind.

1

## Ownership Structure

How title is held and who controls the asset

2

## Participation Level

Active vs. passive role in operations

3

## Governance

Decision-making rights and restrictions

4

## Liquidity

Exit options and timeline flexibility

5

## Tax Treatment

Deferral, deductions, and income classification

6

## Exposure & Complexity

Risk profile and administrative requirements

# Option A: The Delaware Statutory Trust (DST)

A DST is designed to be the opposite of active ownership. A DST investor has no ability to influence operations, no vote on capital decisions, no mechanism to replace the property manager, and no exit other than waiting for the sponsor to sell the asset. That passivity is not incidental, it is the legal price of the 1031 treatment. Revenue Ruling 2004-86 imposes seven restrictions on the trustee, commonly called the "seven deadly sins": no new capital contributions once the offering closes, no new debt or refinancing, no reinvestment of sale proceeds, no renegotiation of leases beyond substantially similar renewal terms, no capital improvements beyond normal maintenance, no commingling of trust assets, and no active management by the trustee. Violating any one of them risks recharacterizing every investor's interest as a partnership interest, which would disqualify the exchange entirely.

## No New Capital

No new capital contributions once the offering closes

## No New Debt

No new debt or refinancing of existing obligations

## No Reinvestment

No reinvestment of sale proceeds into new assets

## No Lease Changes

No renegotiation of leases beyond substantially similar renewal terms

## No Capital Improvements

No capital improvements beyond normal maintenance

## No Commingling

No commingling of trust assets with other funds

## No Active Management

No active management by the trustee under any circumstance

On the practical side, a DST can close quickly. Because the sponsor has already purchased the property, buying a beneficial interest typically takes three to five days, which can be decisive for an exchanger facing a tight 45-day identification period. That speed, along with minimum investments typically in the \$100,000 to \$250,000 range, is why DSTs are frequently used to absorb an odd, leftover slice of exchange equity that no whole property purchase would cleanly accept.

The trade-off shows up on the back end. Hold periods typically run five to ten years with no easy exit, most offerings are limited to accredited investors, and returns depend heavily on the sponsor's competence and fee structure. Total fee drag across the holding period commonly runs in the range of 25 to 35 percent of invested capital, layering an upfront load, ongoing asset and property management fees, and a disposition fee plus promote above a preferred return hurdle. If circumstances change and an early exit is needed, DST interests have no active secondary market, and a sale to another accredited investor, when one can be found, typically requires accepting a discount in the range of 20 to 50 percent off book value.

⚠ DST interests have no active secondary market. Early exits typically require accepting a discount of 20–50% off book value.

# Option B: The Direct Oil and Gas Working Interest

A working interest moves in the opposite direction. The holder is not a passive beneficiary of a trust, but a business participant in the lease itself, with a proportional share of both the production revenue and the drilling and operating cost obligations. Because the interest is deeded and recorded the same way a real estate parcel is, it carries the real-property classification Revenue Ruling 68-331 established, which is why it can stand alongside a commercial building, a multifamily asset, or raw land on a 1031 identification letter.

Two additional tax provisions attach specifically to this structure, and only when it is held correctly. Intangible drilling costs — the non-salvageable expenses of drilling and preparing a well such as labor, fuel, chemicals, drilling fluids, site preparation, and rig rental — may be elected for current deduction under IRC Section 263(c) rather than capitalized over time. Separately, IRC Section 469(c)(3) excludes a working interest in an oil or gas property from the passive activity loss rules entirely, provided the taxpayer's form of ownership does not limit liability, meaning losses can offset wages, business income, and other active income without any material participation test.



## IRC Section 263(c)

Intangible drilling costs elected for current deduction rather than capitalized over time



## IRC Section 469(c)(3)

Working interest excluded from passive activity loss rules — losses offset active income



## Rev. Ruling 68-331

Real-property classification enabling use as qualified 1031 replacement property

That second provision is the one most generic 1031 content skips, and it is also the one most frequently lost through poor structuring. The Section 469(c)(3) exception only applies when the investor holds the interest through an entity that does not limit personal liability — in practice a general partnership or direct individual ownership. Most oil and gas placements are structured as limited partnerships, where investors hold limited liability, and as limited partners their deductions are classified as passive losses that can only offset passive income, not W-2 wages or active business income. This is precisely why Summit Ventures structures participation as a direct working interest position rather than a fund or limited partnership unit: the governance rights and liability exposure that come with a true working interest are what preserve both the 1031 real-property classification and the active-income tax treatment.

This combination also gives the working interest structure a second job beyond identification: a parallel path for tax boot mitigation. If a seller cannot complete a qualifying exchange within the 180-day window, or receives cash or debt-relief boot that will be taxed regardless of the exchange's success, a direct capital contribution into a working interest — made outside the exchange mechanism entirely — can generate an IDC deduction under Section 263(c) that works against that taxable gain. A DST cannot perform this second function. Its tax benefit begins and ends with gain deferral; it does not generate a current-year deduction of its own.

-  A direct working interest can serve a second function: boot mitigation through a current-year IDC deduction under Section 263(c), even if the exchange itself falls through. A DST cannot offer this.

# Side-by-Side Comparison

The seven criteria below capture the structural differences that matter most for a 1031 exchanger evaluating these two replacement property categories.

| Category               | Delaware Statutory Trust (DST)                                                                                                                                                                         | Direct Working Interest                                                                                                                             |
|------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------|
| Ownership              | Beneficial interest in a trust; the trust, not the investor, holds title to the property                                                                                                               | Direct leasehold or working interest, held in the exchanger's own name, in the specific producing lease                                             |
| Participation          | Entirely passive; a single signatory trustee controls the asset and investors have no management role                                                                                                  | Active JV member with governance rights tied to the operating agreement governing the lease                                                         |
| Governance / Control   | None; the trustee itself is restricted by the seven IRS-mandated prohibitions                                                                                                                          | Participation in operational decisions through the joint venture's governance structure                                                             |
| Liquidity              | Illiquid for five to ten years, with no standing secondary market                                                                                                                                      | Illiquid real asset position; cash flow is tied to production rather than a scheduled sponsor sale event                                            |
| Tax Treatment          | Gain deferral only, carried-over basis, no current-year deduction of its own                                                                                                                           | Gain deferral, plus a potential current-year IDC deduction under Section 263(c) and active-income offset under Section 469(c)(3) when held directly |
| Exposure / Limitations | Sponsor cannot call new capital, refinance, or reinvest proceeds; the trust must be sold and wound down on the sponsor's timeline, not the investor's                                                  | Direct exposure to the producing asset, governed through the operating agreement rather than insulated behind a third-party sponsor                 |
| Complexity             | Structured as a security under federal law even though it is real estate under tax law; offering involves a private placement memorandum, accredited-investor verification, and subscription documents | Direct title transaction coordinated with a Qualified Intermediary and supported by a tax opinion addressing the 68-331 identification language     |

# Advantages, Limitations & Best-Fit Scenarios

## DST: Advantages

The DST's advantages center on speed and simplicity: a pre-packaged closing that can be completed in days, a lower minimum entry point than buying an entire property outright, and complete removal from day-to-day management.

## DST: Limitations

Its limitations are the direct result of the same ruling that makes it eligible: no voting rights, no ability to replace the manager, and no exit mechanism other than the sponsor's eventual decision to sell.

## DST Best-Fit Scenarios

- Sellers who want zero operational involvement under any circumstance
- Sellers trying to place a small, leftover slice of exchange equity that no whole property would absorb cleanly
- Sellers already comfortable with the accredited-investor private placement process and a five-to-ten-year hold with no secondary market

## Working Interest: Advantages

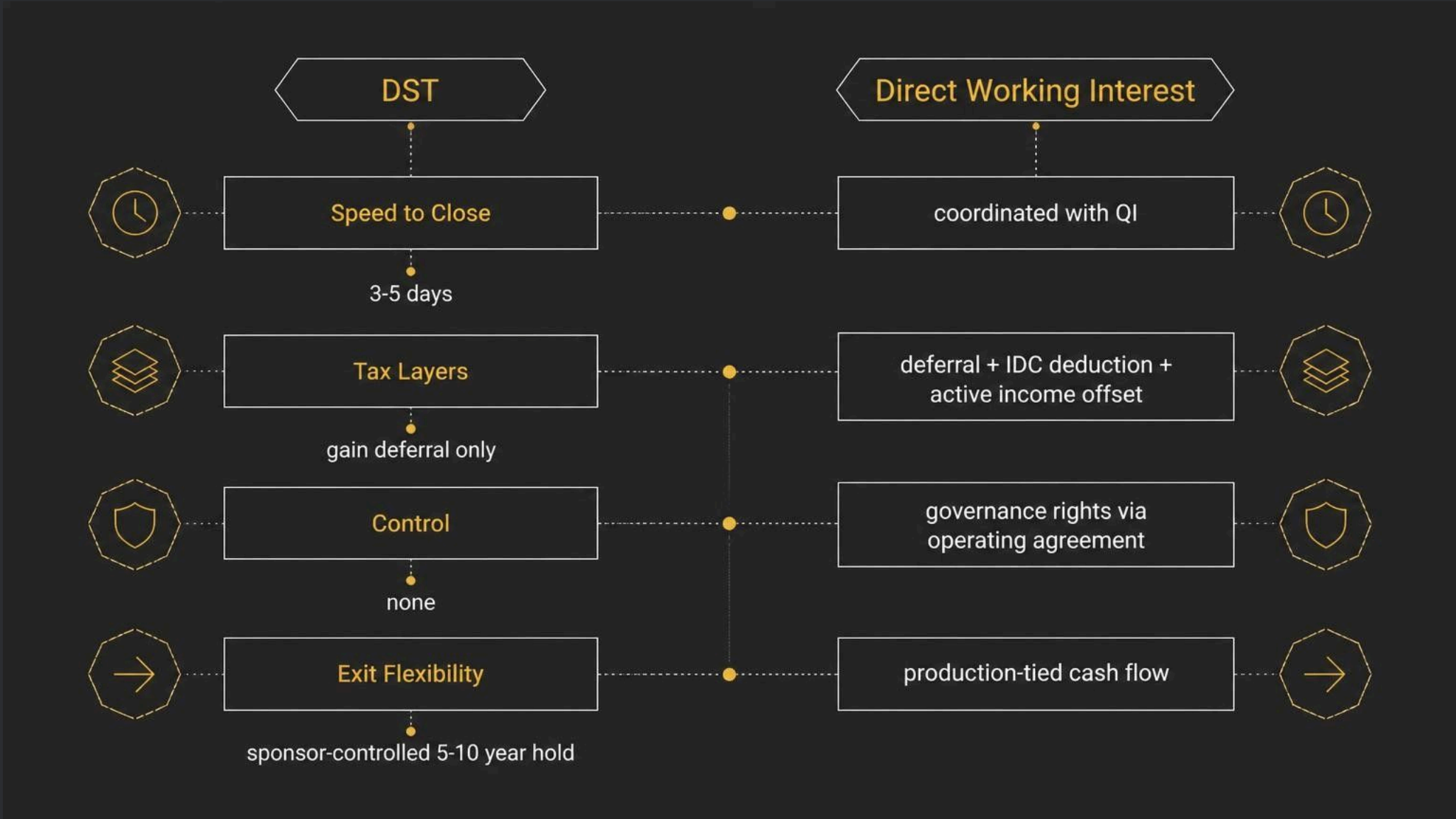
The working interest's advantages are governance participation, a real-property classification that stands on its own case law and ruling history rather than a securities exemption, and the two additional tax layers — current IDC deductibility and active-income offset treatment — that a DST structurally cannot offer.

## Working Interest: Limitations

Its limitations are the same ones that come with any direct operating position: the seller is taking on a business participant's exposure to the asset's operating and geological performance rather than handing that exposure entirely to a third-party sponsor, and the identification paperwork requires a QI and tax counsel who are comfortable describing a lease interest, rather than a building address, on the identification letter.

## Working Interest Best-Fit Scenarios

- Sellers who are done with "toilets, tenants, and trash" but still want governance rights and a say in how the underlying asset is operated
- Sellers who want diversification into a real property category entirely outside traditional real estate cycles
- Sellers not fully confident their exchange will close inside the 180-day window and want a structure that still delivers a tax benefit even if the exchange itself falls through



# Decision Guidance & Questions to Work Through With Your Advisors

Start with the calendar, not the asset class. How many days remain in the identification window, and has a Qualified Intermediary with direct experience in both DST subscriptions and working interest title transfers been engaged. Next, assess control tolerance honestly: a DST removes every operational decision from the seller's hands, while a working interest preserves governance participation but requires comfort with an operating business rather than a fully passive holding. Finally, work through the boot question with a CPA before, not after, the identification deadline: if the exchange is at risk of failing partially or fully, only the working interest structure converts that exposure into a current-year deduction opportunity through Section 263(c).

Many sellers do not have to choose exclusively. A three-property identification list can include a DST interest to absorb a defined, smaller equity amount quickly, alongside a direct working interest position that carries the governance and tax-layering benefits described above.

## 1 Check the Calendar First

How many days remain before the 45-day identification deadline closes, and is the replacement property described specifically enough to satisfy the written identification requirement?

## 2 Verify QI Experience

Does the Qualified Intermediary have documented experience identifying a working interest by lease name, well name, and county — not just a DST subscription?

## 3 Confirm Ownership Structure

Is the ownership structure being used a direct interest or a general partnership, or does it limit liability in a way that would forfeit the Section 469(c)(3) active-income exception?

## 4 Model the Failure Scenario

What happens to the tax position if the exchange fails to close inside 180 days, and does the replacement property chosen still offer a benefit in that scenario?

## 5 Assess Operational Appetite

How much operational involvement, if any, is actually desired — versus assumed to be unavailable?

## 6 Match Exit Timeline to Liquidity Needs

What is the realistic exit timeline for the capital being deployed, and does that match the seller's broader liquidity needs over the next five to ten years?

# Closing Perspective

The 45-day clock does not leave much room for discovering, mid-identification, that a chosen replacement property does not fit the goals behind the sale in the first place. DSTs and direct working interests solve the same statutory requirement — qualifying real property to complete a Section 1031 exchange — but they solve it in structurally different ways. One trades every operational decision for a packaged, sponsor-managed security that happens to carry real-property tax treatment. The other preserves governance rights and layers two additional, source-code-level tax provisions — Section 263(c) and Section 469(c)(3) — on top of the exchange itself, provided the position is held directly rather than through a fund or limited partnership unit.

Summit Ventures works alongside Qualified Intermediaries, CPAs, and exchange counsel to structure direct working interest positions as entrepreneurial joint venture participation — with recorded title, governance rights, and full operational transparency — built to satisfy Revenue Ruling 68-331 identification requirements inside the statutory timeline. Sellers evaluating either path should bring both structures, and their own timeline, to their tax and legal advisors before the identification window narrows their options further.

"One trades every operational decision for a packaged, sponsor-managed security. The other preserves governance rights and layers two additional tax provisions — Section 263(c) and Section 469(c)(3) — on top of the exchange itself."

## Sources & References

Realized1031 · First American Exchange Company · EisnerAmper · Apers · 1031X · Bonaventure · Phoenix Strategy Group · Tax Notes (Rev. Rul. 68-331) · Asset Preservation Inc. · Holland & Knight · AE Tax Advisors · Anchor1031

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