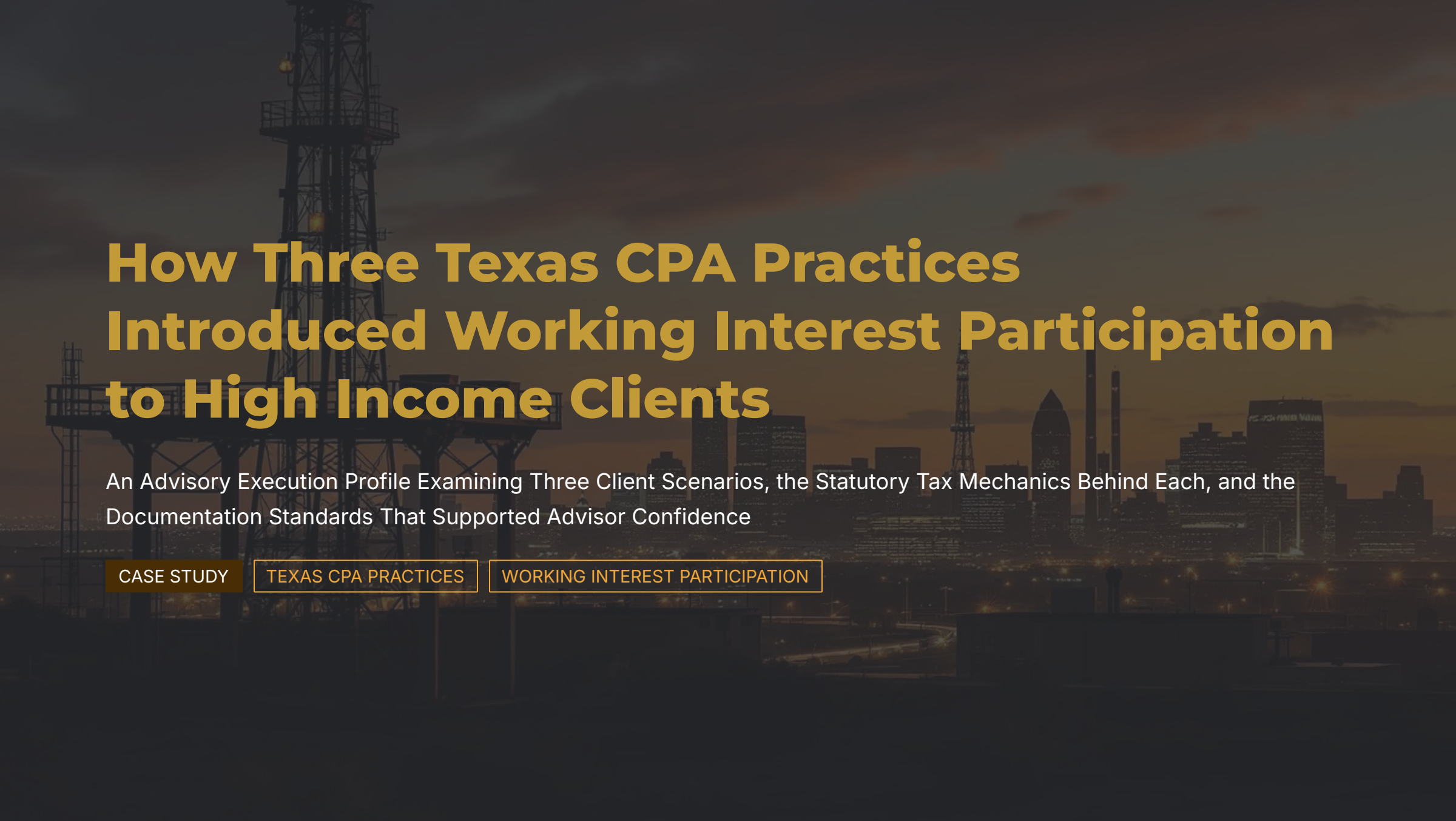




How Three Texas CPA Practices Introduced Working Interest Participation to High Income Clients

An Advisory Execution Profile Examining Three Client Scenarios, the Statutory Tax Mechanics Behind Each, and the Documentation Standards That Supported Advisor Confidence

CASE STUDY

TEXAS CPA PRACTICES

WORKING INTEREST PARTICIPATION

Case Classification & At-a-Glance Summary

Case type: Composite, illustrative advisory execution profile built from recurring patterns across independent CPA practices. This is not a performance case study. No financial outcomes, rates of return, or dollar figures are reported, implied, or guaranteed anywhere in this material.

Geography: Three independent Texas CPA practices located in the Austin, Houston, and Dallas Fort Worth metro areas.

Primary persona: CPAs and tax professionals. Each practice also coordinates periodically with a Registered Investment Advisor, a Qualified Intermediary, or a business broker already serving the same client relationship.

Trigger events addressed: A year end concentration of K-1 and bonus driven active income, an ordinary income component embedded inside a business sale, and a narrowing Section 1031 identification window.

Structure evaluated in all three scenarios: Direct working interest ownership in operated oil and gas properties, held directly by the client and not through a fund, limited partnership, or LLC membership interest that would limit liability.

Statutory Anchors Referenced

- IRC Section 263(c) and Treas. Reg. 1.612-4
- IRC Section 469(c)(3)(A)
- IRC Section 465
- IRC Section 57(a)(2)
- IRC Sections 611 and 613A
- Revenue Ruling 68-331

Participant Profile, Trigger & Situation

The three practices in this profile share a common starting point. Each is an independent or small firm CPA practice serving high income individuals, business owners, and professionals in Texas, and each was approached by a client with a time sensitive tax planning question that fell outside the firm's typical toolkit of retirement deferral, charitable bunching, and entity structuring strategies.

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Practice One — Austin A client, a physician partner in a multi location practice, received a K-1 allocation late in the fourth quarter that materially increased taxable active income for the year. The client's CPA had already exhausted standard deferral vehicles and was searching for a statutory, direct participation strategy that could still be executed before year end.	Practice Two — Houston A client was finalizing the sale of a lower middle market business facilitated by a business broker. A meaningful portion of the proceeds was structured as ordinary income — specifically a working capital true up and a covenant not to compete payment — rather than capital gain. The client's CPA needed a legitimate, IRS recognized mechanism to address the active income component in the same tax year the proceeds were received.	Practice Three — Dallas Fort Worth A client working with a Qualified Intermediary on a Section 1031 exchange saw two of three identified replacement properties fall out of contract as the 45 day identification window narrowed. The client's CPA and the QI needed to evaluate whether a direct working interest in a producing oil and gas lease could be considered within the exchange conversation, consistent with the client's existing identification strategy, and wanted independent, documented tax guidance before advising the client either way.

Challenge & Decision Criteria

Across all three practices, the CPA's evaluation criteria were nearly identical, which is itself a useful finding for this profile. Each advisor needed to confirm the following:



Statutory Grounding

Whether the strategy was grounded in existing statutory authority rather than a marketing claim.



Entity Structure Qualification

Whether the entity structure available to the client would actually qualify for the tax treatment being discussed, since both the IRC 469(c)(3)(A) working interest exception and the Revenue Ruling 68-331 like kind analysis depend on the interest being held directly, or through an entity that does not limit the holder's liability, rather than through a fund or LLC membership interest.



K-1 Reporting Compatibility

Whether the resulting K-1 reporting would arrive in a format and on a timeline the practice could reconcile during an already compressed filing season.



Independent Written Guidance

Whether independent, written tax guidance existed that the CPA could review and keep in the client file, rather than relying solely on a sponsor's internal description of the structure.



Client Suitability

Whether the client's own risk tolerance, liquidity needs, and overall financial picture — matters squarely within the CPA's existing fiduciary and professional responsibility — supported moving forward at all.

Goals & Approach

The CPA's Goal

Each CPA's goal was not to become an energy specialist. It was to responsibly evaluate one additional, statutorily grounded planning option for a client whose circumstances warranted it, document that evaluation, and preserve the advisory relationship regardless of outcome.

Summit Ventures' Goal

Summit Ventures' goal was to function as a technical resource and back office partner rather than a product being pitched, consistent with the standing guidance that this category should never substitute for the CPA's own judgment.

Options on the Table

In each case, the CPA's starting option was to continue working within familiar tools — retirement plan maximization, timing elections, entity restructuring, or in the Dallas Fort Worth scenario, continuing to search for a conventional replacement property before the identification window closed. These remained on the table throughout.

Direct working interest participation was introduced as an **additional option to evaluate**, not a replacement for the advisor's existing recommendations.

Statutory Mechanics by Scenario

The relevant statutory frameworks differed by scenario. Each CPA conducted an independent review of the applicable code sections before advising their client.

Practice One & Two — Austin & Houston

IRC Section 263(c) allows a working interest holder to elect to expense intangible drilling costs in the year incurred rather than capitalizing them.

IRC Section 469(c)(3)(A) — the working interest exception to the passive activity loss rules — is unavailable if the interest is held through an entity that limits the holder's liability. A direct working interest is not automatically subject to passive loss treatment, meaning the deduction can offset active income such as W-2 wages, 1099 income, or K-1 distributions, without the material participation hours test that applies to real estate professional status.

IRC Section 465 caps the usable deduction at the client's actual economic exposure. **IRC Section 57(a)(2)** treats excess intangible drilling costs as an AMT preference item for independent producers above certain thresholds, with a further exception tied to alternative minimum taxable income.

Practice Two — Houston (Additional)

The same 263(c) and 469(c)(3)(A) mechanics applied to the ordinary income component of the business sale. The CPA's additional diligence point was confirming, in writing, that the working interest would be held directly by the client rather than through the entity used to hold the sale proceeds, since an intervening liability limiting entity would have unwound the active income offset entirely.

Practice Three — Dallas Fort Worth

Revenue Ruling 68-331 holds that a lessee's working interest in a producing oil and gas lease is treated as an interest in real property — like kind to a fee interest in other real property — for purposes of Section 1031.

Revenue Ruling 78-135 clarifies that a general partnership interest itself does not qualify, reinforcing that the direct, undivided nature of the interest is what matters, not participation in a pooled vehicle.

The CPA and the QI requested a tax opinion letter from qualified counsel addressing the like kind characterization before advising the client to include the interest among identified replacement property. Summit Ventures did not make the 1031 qualification determination — that determination remained with the client's own counsel and the QI.

Implementation Sequence

Each engagement followed a similar sequence once the CPA decided the option merited a closer look.



Step 1 — Educational Conversation

An educational conversation — not a sales conversation — walked through the statutory basis for the strategy, the direct holding requirement, and the expected K-1 reporting, before any capital contribution was discussed.



Step 2 — Independent Structural Confirmation

The CPA independently confirmed, using the actual operating agreement and subscription documents, that the structure offered was a direct working interest rather than a fund, limited partnership, or LLC membership interest that would limit liability — since that single structural fact determines eligibility for both the 469(c)(3)(A) active income offset and the Revenue Ruling 68-331 analysis.



Step 3 — Tax Opinion Letter (1031 Scenarios)

Where a 1031 related question was in play, qualified independent tax counsel issued a tax opinion letter addressing the like kind characterization, placed in the client file alongside the QI's own identification documentation.



Step 4 — Full Document Review

Before any capital contribution was finalized, the client's CPA and, where applicable, attorney reviewed the full set of governance and offering documents, consistent with the standing instruction that Summit does not provide legal conclusions and expects independent professional review.



Step 5 — K-1 Delivery & Support Line

A standardized K-1 delivery schedule was confirmed in advance, and a direct CPA support line was established for reconciliation questions during filing season.

Explanation & Outcome

☐ This section is illustrative only. It describes the documented process outcome across the three composite scenarios, not a financial result, a rate of return, or a guaranteed tax benefit, and no such figures should be inferred from it.

In all three scenarios, the CPA's independent structural review confirmed direct working interest ownership, consistent with the holding requirement under both IRC Section 469(c)(3)(A) and Revenue Ruling 68-331. Each client's K-1 arrived on the schedule communicated in advance, ahead of each firm's extended filing deadline, allowing the respective CPA to reconcile the allocation within its normal workflow rather than as a last minute item.

In the Dallas Fort Worth scenario, the qualified intermediary and the client's attorney reviewed the tax opinion letter as part of the broader identification decision — a decision that remained theirs to make. In no case did Summit Ventures represent a specific deduction amount, percentage, or investment outcome to the advisor or the client. Actual tax treatment in every instance depended on the client's individual facts, at risk basis, alternative minimum tax position, and the independent conclusions of the client's own CPA and legal counsel.

Category	Observation
Independent Texas CPA practices represented	Three, across Austin, Houston, and Dallas Fort Worth
Entity structure confirmed in each scenario	Direct working interest, confirmed against operating and subscription documents prior to capital contribution
Statutory frameworks evaluated	IRC 263(c), IRC 469(c)(3)(A), IRC 465, IRC 57(a)(2), IRC 611/613A, Revenue Ruling 68-331, Revenue Ruling 78-135
Independent documentation obtained	Tax opinion letter obtained for the 1031 adjacent scenario, reviewed by client's own counsel and QI
K-1 delivery	Delivered on a pre communicated schedule, ahead of each firm's extended filing deadline, in all three scenarios
Advisor support structure used	Direct CPA support line for reconciliation questions during filing season
Financial outcome represented	None reported. No deduction amount, percentage, or rate of return is stated or implied for any scenario

Key Takeaways & Evaluation Questions

Assumptions & Key Takeaways

This profile is built on illustrative, composite client situations. No specific individuals, firms, or dollar amounts are represented as factual. Several assumptions apply throughout and should be treated as conditions for evaluation rather than conclusions.

Tax treatment under IRC Sections 263(c), 469(c)(3)(A), 465, and 57(a)(2) depends on the client's specific facts, including how the interest is held, the client's at risk basis, and the client's overall alternative minimum tax position. A CPA's independent review of the actual operating and subscription documents remains necessary in every case, since the direct holding requirement is a structural fact, not a marketing description.

Like kind characterization under Revenue Ruling 68-331 is a specific, fact dependent legal question. A tax opinion letter supports the client's and QI's own evaluation. It does not substitute for that evaluation, and Summit Ventures does not make the qualification determination on the client's behalf.

Standardized K-1 scheduling and a direct advisor support line address a frequently cited practical barrier — the concern that energy related K-1s arrive too late or in a format that complicates an already compressed filing season. This is an operational commitment, not a tax outcome.

Across all three scenarios, the advisory relationship — not the specific transaction — remained the CPA's primary asset. The strategy was introduced as one additional, properly sourced option within a broader planning conversation the client was already having with their own advisor.

"What mattered to me was not the tax benefit itself — it was whether I could defend the structure to my own satisfaction before I ever mentioned it to a client. Once I confirmed the holding was direct, not a fund interest, and saw that the K-1 would arrive on a schedule I could actually plan around, this became a normal part of how I evaluate options for clients with these kinds of income years."

— *Illustrative composite perspective from recurring advisor conversations*

Questions for Evaluation

Before introducing direct working interest participation to a client, a CPA or advisor may want to confirm the following:

- Does the offering document describe a direct working interest held by the client, or an interest in a fund, limited partnership, or LLC that would limit the client's liability and therefore affect eligibility under IRC 469(c)(3)(A) and Revenue Ruling 68-331?
- What is the actual K-1 delivery schedule, and how does it compare to the firm's own extended filing timeline?
- Is independent, written tax guidance — such as a tax opinion letter — available for review by the client's own counsel when a 1031 related question is involved?
- What is the client's at risk basis under IRC Section 465, and has the client's overall alternative minimum tax exposure under IRC Section 57(a)(2) been modeled before any capital contribution is finalized?
- Does the client's overall liquidity position, risk tolerance, and planning horizon support this option, independent of any tax characteristics being discussed?

Closing Perspective & Sources

The pattern across these three Texas practices is less about oil and gas itself and more about how a CPA evaluates any new planning option introduced into a long standing client relationship. Direct working interest participation sits on well established statutory ground — IRC Section 263(c), IRC Section 469(c)(3)(A), and Revenue Ruling 68-331 have existed for decades — yet remains underused in many practices simply because the entity structure questions, the K-1 timing questions, and the documentation questions had not previously been addressed in a way that let the advisor complete an independent review with confidence.

For CPAs, RIAs, Qualified Intermediaries, business brokers, estate planning attorneys, and commercial real estate brokers evaluating this category on behalf of high income clients, the governing question is the same one each of these three practices asked first: **is the structure direct, is the documentation independently verifiable, and does the reporting arrive in a form the advisor can actually use.**

Cornell Legal Information Institute

26 U.S.C. Section 469(c)(3)(A) — working interest exception to passive activity loss rules, statutory text confirming the direct holding or unlimited liability entity requirement.

IRC Sections 263(c), 465, 57(a)(2), 611 & 613A

Intangible drilling cost election mechanics; at risk limitation on allowable deductions; AMT treatment of excess IDCs for independent producers; percentage depletion allowance for independent producers.

Revenue Rulings 68-331 & 78-135

Working interest in a producing oil and gas lease as real property for Section 1031 purposes; clarification that a general partnership interest does not independently qualify for Section 1031 treatment.

Additional References

Anchor1031 — educational guidance on tax opinion letters supporting working interest to replacement property characterization. U.S. Energy Information Administration, Annual Energy Outlook 2026. American Petroleum Institute, industry economic contribution data, 2023.

❏ This profile is illustrative and educational. It is not tax, legal, or financial advice, and it does not represent a guarantee of any tax treatment, deduction, or financial outcome for any client. Every CPA, advisor, and client should reach their own conclusions, in consultation with qualified tax and legal counsel, based on their specific facts and circumstances.

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