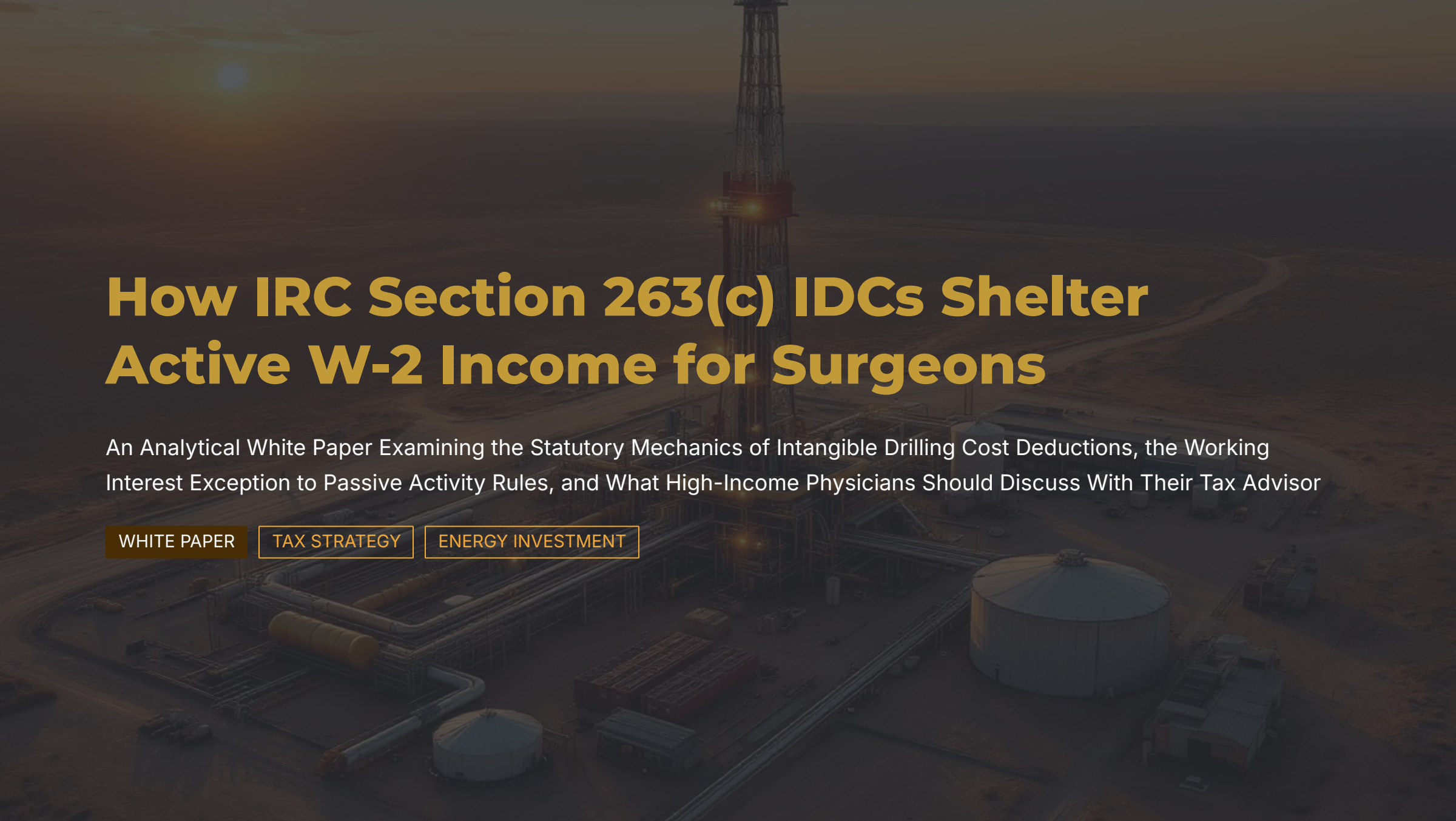


The background of the entire page is a dark, atmospheric photograph of an industrial oil and gas facility. In the center, a tall drilling rig stands prominently against a twilight sky. Below and around the rig, there are various industrial structures, including large cylindrical storage tanks, a network of pipes, and several semi-trailers parked in a lot. The lighting is dim, with some artificial lights from the facility creating small glows, giving the scene a somber and industrial feel.

How IRC Section 263(c) IDCs Shelter Active W-2 Income for Surgeons

An Analytical White Paper Examining the Statutory Mechanics of Intangible Drilling Cost Deductions, the Working Interest Exception to Passive Activity Rules, and What High-Income Physicians Should Discuss With Their Tax Advisor

WHITE PAPER

TAX STRATEGY

ENERGY INVESTMENT

Executive Summary

Physicians and surgeons in peak earning years face a structural problem that standard retirement planning cannot solve: the tools built to help most taxpayers save — the 401(k), the backdoor Roth, the backdoor IRA — were never designed to scale against \$400,000 to \$2,000,000 or more in annual taxable income. A surgeon who maximizes every available deferral vehicle in 2026, including the \$24,500 employee deferral limit and the \$72,000 combined employee and employer limit under current IRS guidance, is still sheltering a small fraction of total compensation once wages climb into the top federal bracket. For 2026, that top 37 percent marginal rate begins above \$640,600 of taxable income for a single filer and \$768,600 for a married couple filing jointly — a structure the One Big Beautiful Bill Act (OBBBA) made permanent rather than letting it revert to the prior 39.6 percent rate.

This white paper examines a statutory mechanism that was written into the Internal Revenue Code specifically to address large, concentrated outlays of active capital: the election to currently deduct Intangible Drilling Costs (IDCs) under IRC Section 263(c), paired with the working interest exception to the passive activity loss rules found in IRC Section 469(c)(3). Used correctly, and held in the correct legal structure, this combination allows a business participant who directly holds a working interest in an oil and gas well to apply a current-year deduction against active income — the same W-2 wages, 1099 income, or K-1 distributions that make up the bulk of a surgeon's tax exposure.



This is not a workaround or a loophole. It is a long-standing, codified preference that Congress has preserved through every major tax reform since its origin in 1916 Treasury guidance, later codified as Section 263(c) of the Internal Revenue Code of 1954.

The purpose of this paper is education: to explain how the mechanism works, what structural conditions must be met for it to apply to active income, and what questions a physician should bring to their own CPA or tax attorney before evaluating a working interest structure.

\$72K

2026 Max 401(k)

Combined employee and employer contribution ceiling — a small fraction of seven-figure compensation

37%

Top Federal Rate

Marginal rate on income above \$640,600 (single) or \$768,600 (MFJ), made permanent by OBBBA

1916

Origin Year

IDC deductibility first established in Treasury guidance — surviving every major tax reform since

13.6M

Barrels/Day

Record U.S. crude oil production in 2025, per the Energy Information Administration

Introduction: When Standard Planning Hits Its Ceiling

Most high-income professionals discover the limits of conventional tax planning the same way: by watching a strong year become a disappointing one after the tax bill arrives. A 401(k), even maximized, caps out at a combined employee and employer contribution of \$72,000 for 2026. A Roth IRA, even if a physician could use the backdoor method, phases out entirely as a direct contribution once modified adjusted gross income exceeds \$168,000 for a single filer or \$252,000 for a married couple filing jointly. None of these figures move meaningfully against seven-figure compensation.

The result is a familiar frustration: professionals who have spent a decade or more in training, who manage enormous personal and professional risk daily, find that their single largest annual outlay is not malpractice insurance, overhead, or staffing. It is the federal and state tax liability sitting on top of their own labor.

The tax code does contain provisions written for exactly this kind of concentrated, active income, but they tend to sit outside the paths most CPAs are trained to search first. CPAs are generally trained in compliance and audit defense — filing accurately and defending positions already taken — rather than in proactively identifying statutory elections tied to asset classes outside their typical client base. Intangible Drilling Costs under Section 263(c) are one of the clearest examples: a provision that has existed for more than a century, survived every tax reform since, and still applies narrowly enough that it is rarely the first idea raised in a year-end planning call. This paper walks through the mechanics in full, not as a product pitch, but as the kind of technical grounding a physician should have before raising the topic with their own advisor.

The Problem: Income That Has Outgrown the Standard Toolkit

The core issue is not a lack of financial sophistication among physicians and surgeons. It is a mismatch between income concentration and the deduction ceilings built into conventional retirement and tax-deferral vehicles. Three structural pressures compound this mismatch:

Deferral Vehicles Are Capped by Design

The 2026 limits — a \$24,500 employee deferral and an \$8,000 catch-up for those 50 and older (rising to an \$11,250 super catch-up for ages 60 through 63) — were set to serve a broad population of W-2 earners, not a surgeon whose compensation may be five to ten times the national median.

The Top Bracket Applies to a Wide Band of Income

Every additional dollar of active compensation above \$640,600 (single) or \$768,600 (MFJ) is taxed at 37 percent federally before state tax and, where applicable, the 3.8 percent Net Investment Income Tax are layered on top.

Alternative Strategies Often Classify Losses as Passive

Most real estate or fund-based products still classify losses as passive under IRC Section 469 unless the owner meets a material participation test requiring roughly 500 hours of direct involvement — a standard simply incompatible with the schedule of a practicing surgeon, a CFO, or any other entrepreneur already working well past a standard full-time week.

The result is a persistent gap: professionals who want a compliant, current-year method to reduce the tax drag on active income, without taking on a second job's worth of hours-tested participation, and without exposing themselves to the audit risk associated with aggressive or poorly documented shelters.

Background: What Intangible Drilling Costs Actually Are

When a working interest owner participates in drilling an oil or gas well, the total cost of that well splits into two categories under long-standing Treasury guidance, now codified at Treasury Regulation 1.612-4 under IRC Section 263(c).

Intangible Drilling Costs (IDCs)

The non-salvageable expenditures: labor, fuel, drilling mud and chemicals, site preparation, and hauling. These costs have no resale value if the well is unsuccessful or once the equipment is installed — which is precisely why Congress and the Treasury Department chose to allow them to be expensed in the year incurred rather than capitalized and depreciated over time.

Tangible Drilling Costs

The physical equipment with resale value — casing, wellhead equipment, storage tanks — are capitalized and depreciated under standard MACRS schedules, typically over seven years under IRC Section 168.

The exact allocation between intangible and tangible costs for any given well is documented in that well's **Authorization for Expenditure (AFE)**, the engineering and cost breakdown prepared before drilling begins, and confirmed well by well rather than assumed as a universal ratio.

Historical Durability

This deduction mechanism did not emerge from recent tax legislation. Treasury guidance from **1916** first permitted operators to expense these costs rather than capitalize them — a policy preserved through every subsequent recodification and formally written into Section 263(c) of the Internal Revenue Code of 1954.

It has survived:

- The Tax Reform Act of 1986, which eliminated many other tax preferences
- The 2017 Tax Cuts and Jobs Act
- The One Big Beautiful Bill Act (2025)

The IDC election under Section 263(c) was never on any phase-down schedule. It has remained a distinct, standalone statutory election for more than a century.

- ① A business participant evaluating a specific working interest should request and review the underlying AFE with their CPA rather than relying on any general industry figure, since the actual current-year deduction depends on the specific cost structure of that well, the participant's individual tax circumstances, and the applicable tax treatment elected — a determination that should always be confirmed with a qualified tax professional.

Analysis: Why Structure — Not Just Asset Class — Determines the Tax Outcome

The single most important technical point in this entire topic — and the one most frequently blurred by generic marketing material in this asset class — is that Section 263(c) only governs the **timing and classification** of the deduction. It does not, by itself, determine whether that deduction can offset active W-2 or 1099 income. That second and separate question is governed by **IRC Section 469(c)(3)**, the working interest exception to the passive activity loss rules.

Under the general passive activity framework established by Section 469, losses from an activity in which the taxpayer does not materially participate can typically only offset passive income, not active wages. Section 469(c)(3)(A) carves out a specific exception: passive activity treatment *"shall not include any working interest in any oil or gas property which the taxpayer holds directly or through an entity which does not limit the liability of the taxpayer,"* in the exact language of the statute.

Favorable Consequence Unlike real estate professional status, the Section 469(c)(3) working interest exception carries no material participation or hours-tested requirement. A surgeon or CFO does not need to document 500 or 750 hours of direct involvement in a calendar year to qualify. The exception applies based on how the interest is held, not how many hours the owner personally logs managing it.	Critical Disqualifying Condition The exception requires the interest be held directly, or through an entity that does not limit the owner's liability, such as a general partnership. If the same economic exposure is instead packaged inside an LLC, a limited partnership, or a pooled fund structure — structures used by many competing offerings specifically because they limit personal liability — the working interest exception is forfeited and losses revert to passive treatment.
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Additional Statutory Layers

Two additional statutory layers shape the full picture and deserve equal attention rather than being left out of the conversation.

- 1

At-Risk Limitation — IRC Section 465

Caps any deduction at the owner's actual economic exposure — cash contributed and recourse debt the owner is personally liable for. Non-recourse debt, common in real estate financing, does not count toward at-risk basis in this context.
- 2

Alternative Minimum Tax — IRC Section 57(a)(2)(A)

Excess IDC can become a preference item under the AMT framework, but only to the extent the excess exceeds 65 percent of the taxpayer's net income from oil, gas, and geothermal properties for that year. A separate exception under Section 57(a)(2)(E) applies for independent producers, subject to its own cap limiting the AMTI reduction to 40 percent of alternative minimum taxable income determined before that adjustment. In plain terms, IDC deductions cannot reduce a participant's alternative minimum taxable income below roughly 60 percent of their pre-deduction figure in a given year.
- 3

Percentage Depletion — IRC Sections 611 and 613A

Once a well begins producing, percentage depletion — generally 15 percent of gross income from the property for independent producers — continues as an annual benefit even after the participant's cost basis in the well reaches zero, unlike depreciation, which stops once an asset is fully written down.
- 4

Economic Performance — IRC Section 461(h)

Requires economic performance before costs can be deducted, meaning a December capital contribution into a well that will not begin drilling for months generally cannot support a current-year IDC election, subject to a limited 90-day drilling exception. This is a timing detail that should be confirmed against the specific well's drilling schedule well before year-end planning conversations begin.

Solution Framework: What Properly Structured Participation Looks Like

Bringing these statutory pieces together produces a coherent framework rather than a single tax trick. A business participant evaluating current-year deductibility against active income should expect — and should confirm with their own advisor — the following structural elements:

1

Direct Ownership Structure

Direct ownership of the working interest itself, or ownership through a general partnership structure that does not limit the participant's liability, preserving eligibility under IRC Section 469(c)(3)(A).

2

Well-Specific AFE Documentation

A well-specific Authorization for Expenditure that documents the actual split between intangible and tangible costs for that particular well, rather than a marketing estimate applied uniformly across unrelated projects.

3

IRC 461(h) Timing Alignment

Timing aligned with IRC Section 461(h), meaning the capital contribution and the well's actual drilling commencement fall within the same tax year or qualify under the 90-day exception.

4

At-Risk Basis Tracking

At-risk basis tracking under IRC Section 465 that distinguishes cash contributed and any personally guaranteed recourse debt from non-recourse financing that will not support the deduction.

5

Correct K-1 Reporting

K-1 reporting that correctly codes the participant's share of income, deductions, and credits — typically reflected across Box 1, Box 12, Box 13, and Box 20 — with nonpassive, active coding consistent with the Section 469(c)(3) exception, rather than the generic passive coding used for most fund-style products.

6

Ongoing Percentage Depletion

An ongoing percentage depletion calculation under Sections 611 and 613A applied once the well reaches production, extending the tax-advantaged treatment well beyond the initial current-year deduction.

For a physician, dentist, attorney, or financial professional accustomed to reviewing structured legal and financial frameworks in their own practice, this should read less like a sales proposition and more like a compliance checklist — because that is precisely what it is. This is also why Summit Ventures structures business participant capital contributions as direct working interest ownership positions, supported by well-specific AFE documentation, K-1 reporting aligned to active income coding, and governance rights consistent with an active-member entrepreneurial joint venture, rather than as shares in a pooled fund or liability-limited entity that would forfeit the very statutory exception this entire framework depends on.

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Recommendations and Implications

For a surgeon or other high-income professional evaluating this category, three practical steps follow directly from the analysis above.

→ **Bring Specific Statutory Citations to Your Advisor**

Bring IRC 263(c), Treasury Regulation 1.612-4, IRC 469(c)(3)(A), and IRC 465 to your CPA or tax attorney before evaluating any specific working interest opportunity, and ask them directly whether the proposed legal structure preserves direct or general-partnership-style ownership rather than a liability-limiting entity.

→ **Request the Well-Specific Authorization for Expenditure**

Request the Authorization for Expenditure for the specific well under consideration rather than accepting a general industry percentage, since the actual intangible versus tangible cost split and the resulting current-year deduction will vary well by well and should be confirmed against that documentation and your own individual tax position.

→ **Model AMT Exposure and At-Risk Basis Before Year-End**

Model the interaction with your personal Alternative Minimum Tax exposure and at-risk basis before the end of the tax year, since both IRC 57(a)(2) and IRC 465 cap the usable deduction regardless of the underlying well's cost structure.

The broader implication for this income tier is straightforward: tax strategies that scale with seven-figure active income are structurally different from the deferral tools built for a broader population of W-2 earners, and they require the same diligence a physician already applies to clinical decisions — verifying the underlying mechanism, confirming the documentation, and involving a qualified professional before committing capital.

The current macro backdrop reinforces why this category remains active rather than theoretical: the U.S. Energy Information Administration confirmed that domestic crude oil production set a new record of **13.6 million barrels per day in 2025**, with the Permian Basin alone contributing roughly 48 percent of that volume, underscoring that direct participation in producing-asset development remains an active part of the broader U.S. energy and capital landscape, separate from any specific return expectation.

Questions for Discussion With Your Advisor

A physician who brings these specific statutory questions into a conversation with their own CPA or tax attorney is equipped to evaluate this category on its actual legal merits rather than on marketing language alone. Use the checklist below as your starting point.

1	Legal Structure of the Working Interest Does the specific legal structure being proposed hold the working interest directly, or through a general partnership that does not limit liability — or does it route through an LLC, LP, or pooled entity that would forfeit the Section 469(c)(3) exception?
2	Authorization for Expenditure Review Has the Authorization for Expenditure for the specific well been reviewed, and does it document the actual intangible versus tangible cost allocation rather than a general industry assumption?
3	AMT Interaction Modeling How does a current-year IDC election interact with your personal Alternative Minimum Tax exposure under IRC 57(a)(2), and has that interaction been modeled against your full tax picture for the year?
4	At-Risk Basis Composition What portion of your at-risk basis under IRC 465 reflects cash actually contributed versus any recourse debt, and how does that affect the deductible amount?
5	Economic Performance Timing Does the timing of the capital contribution align with the well's actual drilling commencement under the economic performance rules of IRC 461(h), or does it rely on the 90-day exception?
6	K-1 Reporting Classification How will the K-1 reporting code your share of income and deduction — active and nonpassive consistent with Section 469(c)(3), or passive?

Closing Perspective

The tax code rarely hands high-income professionals a simple answer, and this topic is no exception. What it does offer is a century-old, statutorily defined mechanism — distinct from exotic or aggressive shelters — that was built specifically to address the kind of concentrated, active income a surgeon or senior partner generates once standard deferral vehicles are maxed out.

The deduction itself under Section 263(c) is well documented. The part that actually determines whether it reaches a physician's active W-2 or 1099 income is the structural question under Section 469(c)(3): **how the interest is held, not merely what industry it sits in**. A physician who brings these specific statutory questions — direct versus liability-limited ownership, AFE-confirmed cost allocation, AMT interaction, at-risk basis, and K-1 coding — into a conversation with their own CPA or tax attorney is equipped to evaluate this category on its actual legal merits rather than on marketing language alone.

That is the entire point of treating a tax strategy with the same rigor already applied to every other high-stakes decision in professional life.

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Ready to explore whether a working interest structure is appropriate for your tax situation?

[Explore Summit Ventures Working Interest Opportunities](#)

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