

A Dallas Manufacturing CEO Becomes a Working Interest Owner

A 90-Day Capital Allocation Case Study — Evaluating Direct Energy Participation After a Business Exit, From Closing Day to Entrepreneurial Joint Venture Capital Contribution

- ❏ This is an illustrative, composite case profile built to demonstrate a recurring decision pattern among exiting operators. It does not describe an actual named Summit Ventures participant, and no dollar figures, deduction amounts, or rates of return are claimed as factual outcomes. All tax mechanics referenced are grounded in the statutory and regulatory sources cited at the end of this piece, and any participant considering a similar structure should confirm applicability with a qualified CPA and tax counsel before acting.

Case Classification & At-a-Glance Summary

Case Overview

Case type: Illustrative composite, post-exit capital allocation decision.

Industry: Precision industrial manufacturing, Dallas, Texas.

Transaction structure: Asset sale to a strategic acquirer, generating a blended mix of ordinary income (equipment and inventory recapture) and long-term capital gain.

Funnel stage: Consideration, evaluating available approaches rather than finalizing a structure.

Decision window: Roughly 90 days from closing to capital contribution.

Core Mechanism Evaluated

Direct working interest participation structured to preserve the **IRC Section 469(c)(3) working interest exception**, paired with an **IRC Section 263(c) intangible drilling cost (IDC) election**.

State Context

Texas imposes no state income tax, so the federal long-term capital gains rate plus the **3.8 percent Net Investment Income Tax** under IRC Section 1411 represented the full stacked exposure on the capital gain portion of proceeds.

Participant Profile, Trigger & Situation

The composite participant is the founder and CEO of a mid-market industrial manufacturing company based in the Dallas-Fort Worth area, built over more than two decades. The business was sold through an asset sale to a strategic acquirer, a structure that typically produces a mix of ordinary income from recaptured depreciation and inventory, alongside long-term capital gain on goodwill and other qualifying assets.

Before the transaction, the overwhelming majority of the founder's net worth was concentrated in the operating company itself, a pattern widely documented in business-owner wealth literature, which commonly places **80 to 90 percent of a founder's net worth inside a single illiquid operating asset** prior to sale.

Concentration Risk Converted

At closing, that concentration risk did not disappear. It converted into a different form: a large cash position sitting in an interim sweep account, fully exposed to federal capital gains tax, NIIT, and, on the ordinary income component, the founder's top marginal rate.

The Highest-Risk Window

Advisory literature on post-exit wealth management consistently identifies the **twelve months following a liquidity event** as the highest-risk period for erosion of sale proceeds, driven by rushed reinvestment decisions, underestimated tax exposure, and lifestyle-related cash drag.

Challenge & Decision Criteria

The founder's advisory team identified three distinct risks to manage simultaneously.

- 1

Concentration Recreated

A pure reinvestment into another single operating business would simply recreate the same concentration exposure the sale was meant to resolve.
- 2

Diversification Without Offset

Parking proceeds into a conventional diversified securities and bond allocation would address diversification but would do nothing to offset the current-year ordinary income and capital gain exposure already triggered by the sale.
- 3

The 30-Day Regret Pattern

Moving too quickly without full tax and structural analysis carried its own documented risk: industry research from **Cerulli Associates** found that **68 percent of business sellers who deployed proceeds within 30 days of closing later regretted the pace of that decision.**

Working with counsel and a CPA, the founder set four evaluation criteria before committing any capital:

- 1

Current-Year Statutory Offset

A current-year mechanism with statutory support for offsetting active or ordinary income, not only passive investment income.
- 2

Direct Asset Ownership

Direct asset ownership with operational visibility and governance participation, rather than a hands-off limited partnership unit.
- 3

Sector Diversification

Diversification into a sector and asset class structurally uncorrelated to industrial manufacturing.
- 4

Long-Duration Income

A long-duration income profile that did not depend on equity market timing.

Options Evaluated & The Chosen Approach

Three paths were evaluated side by side over the decision window.

❌ Path 1: Another Operating Business

Redeploying capital into another privately held operating business was set aside quickly because it reproduced the single-asset concentration problem the exit was meant to solve.

❌ Path 2: Conventional Portfolio

A conventional diversified portfolio of public securities and fixed income addressed diversification but offered no mechanism to offset the ordinary income and capital gain already recognized in the year of sale. Any reinvestment through a C-corporation vehicle would introduce a separate double-taxation layer on future dividends.

✅ Path 3: Direct Working Interest

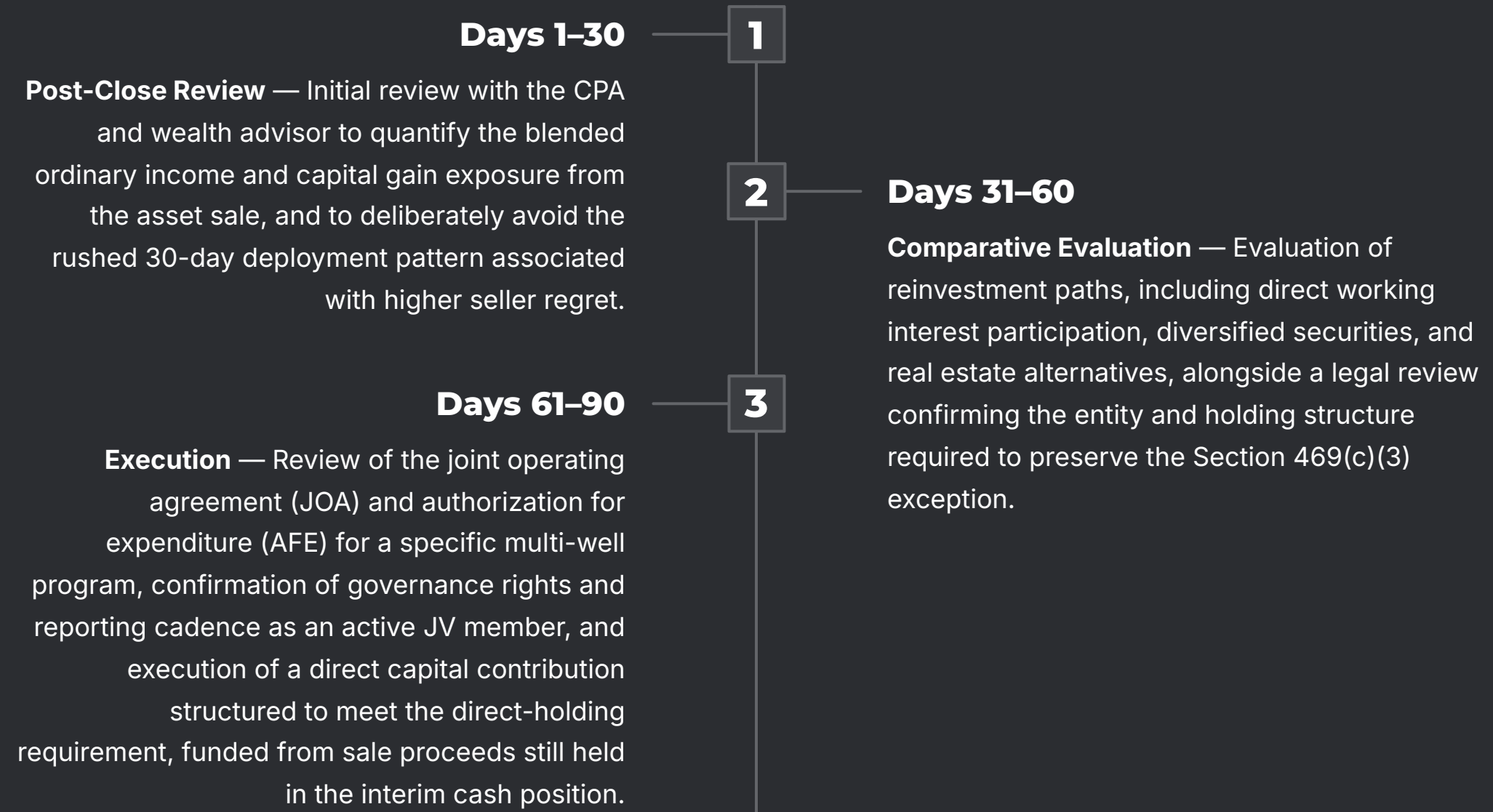
A direct working interest capital contribution into an operating oil and gas program was evaluated closely because of a specific statutory interaction — the combination of IRC Section 263(c) and IRC Section 469(c)(3)(A).

IRC Section 263(c), governed by Treasury Regulation 1.612-4, allows a working interest holder to elect to expense intangible drilling costs in the year incurred rather than capitalizing them. On its own, Section 263(c) governs only the timing and classification of that deduction. The provision that determines whether the resulting loss can offset active or ordinary income — rather than being trapped as a passive loss usable only against passive income — is **IRC Section 469(c)(3)(A), the working interest exception to the passive activity loss rules**. That exception applies only when the interest is held directly or through an entity that does not limit the taxpayer's liability, such as a general partnership, and explicitly does not require a material participation or hours-based test, unlike the real estate professional standard.

- ❏ This single structural fact — **how the interest is held** — became the center of the founder's due diligence. A fund or LLC membership interest would have limited liability and forfeited the 469(c)(3) exception, converting any resulting loss into a passive one. A direct working interest, structured as an entrepreneurial joint venture rather than a liability-shielded fund vehicle, preserved it.

Implementation: The 90-Day Timeline

The founder's path from closing to capital contribution unfolded across three phases:



By day 90, the founder had transitioned from sole operator of a single manufacturing business to an active working interest owner across a multi-well energy program, with the capital contribution and IDC election made in time to apply against current-year income, consistent with the **IRC Section 461(h) economic performance rules** governing when drilling-related costs may be currently deducted.

Explanation & Reported Outcomes

☐ This section describes the mechanism and reported experience of the illustrative composite participant. It is not a performance claim and should not be read as a projection of results for any other participant. Actual tax treatment, deduction amounts, and timing depend entirely on the specific AFE for a given well program, the ratio of intangible to tangible costs, the participant's individual tax position, and confirmation by a qualified tax professional.

Within this framework, the participant reported four qualitative outcomes:



Current-Year IDC Election

The current-year IDC election under Section 263(c), preserved by the direct-holding structure required under Section 469(c)(3), provided a statutory mechanism to apply against the active and ordinary income components of the sale year, up to whatever percentage the specific AFE and the participant's own tax position supported.



Diversification Achieved

The capital contribution shifted a portion of net worth out of a single-industry operating exposure and into a multi-well, multi-basin energy program, addressing the diversification criterion directly.



Governance & Transparency

Because the structure was a direct working interest rather than a fund interest, the participant retained governance rights and access to operational reporting, including AFE visibility and joint operating agreement terms, rather than relying on a manager's discretion.



Percentage Depletion

Once wells reach production, the participant becomes eligible for percentage depletion under IRC Sections 611 and 613A, a recurring deduction against gross income from the property that, for independent producers, continues even after the participant's cost basis in the property has been reduced to zero.

Two additional statutory considerations were tracked rather than ignored. The **at-risk limitation under IRC Section 465** caps deductible losses at the cash actually contributed, with no credit for non-recourse financing. And excess IDC can become an **alternative minimum tax preference item under IRC Section 57(a)(2)(A)**, though independent producers may elect limited relief under Section 57(a)(2)(E), subject to a cap tied to alternative minimum taxable income. Both were reviewed by the participant's CPA as part of the pre-contribution analysis, not discovered afterward.

Illustrative Mechanics Summary

The table below maps each decision factor to the mechanism applied and its statutory or structural basis.

Decision Factor	Mechanism Applied	Statutory or Structural Basis
Ordinary income exposure from the asset sale	Current-year intangible drilling cost election	IRC Section 263(c); Treas. Reg. 1.612-4
Need to offset active, not only passive, income	Direct holding structure, not a liability-limited fund interest	IRC Section 469(c)(3)(A)
Capital at risk and deductible loss ceiling	Cash capital contribution, no leverage assumed	IRC Section 465 at-risk limitation
Alternative minimum tax exposure on excess IDC	Independent producer relief monitored by CPA	IRC Section 57(a)(2)(A) and 57(a)(2)(E)
Tangible completion equipment cost recovery	Bonus depreciation election on qualifying tangible costs	IRC Section 168(k), made permanent under OBBBA
Long-duration income once wells produce	Percentage depletion against gross income from the property	IRC Sections 611 and 613A
Diversification away from single operating company	Multi-well, multi-basin working interest allocation	Entrepreneurial joint venture structure
State-level tax exposure	No state income tax layer	Texas residency, federal 20% long-term capital gains plus 3.8% NIIT stack only

Key Takeaways & Questions for Evaluation

"I was not looking for a passive write-off. I had just spent twenty-four years building and operating something I controlled directly, and I wanted the same thing on the other side of the sale: a structure where I could see the AFE, understand the governance rights, and know exactly how the deduction was earned rather than taking someone's word for it. The ninety days gave us time to confirm the structure actually preserved the active-income offset before a dollar moved."

— *Illustrative Composite Participant*

Explicit Assumptions

This case rests on several explicit assumptions. It assumes a composite participant, not an actual identified individual, whose circumstances are illustrative of a recurring pattern rather than a guaranteed template. It assumes the actual IDC and TDC split, deduction amount, and resulting tax effect are determined entirely by the specific AFE of a given well program and the participant's own return position, not by any fixed percentage. It assumes professional CPA and legal review occurred before the capital contribution, not after. And it assumes the holding structure was confirmed, in writing, to meet the direct-ownership or unlimited-liability-entity standard required by Section 469(c)(3) before any funds were contributed.

Key Takeaways for Operators Evaluating a Similar Sequence

- **Order of operations matters:** Tax and legal confirmation of the holding structure should precede capital deployment, not follow it.
- **Entity form is decisive:** The entity form, not the asset class alone, is what determines whether a working interest loss can offset active income or is trapped as passive.
- **90 days is not delay:** A deliberate 90-day evaluation window is the time required to confirm structure, review the AFE, and coordinate advisors — it stands in contrast to the documented pattern of regret associated with 30-day rushed deployment.
- **Active participation has value:** Working interest ownership exchanges some liquidity for active participation, governance rights, and operational transparency that a passive fund interest does not provide.
- **The mechanism is statutory, not seasonal:** The tax mechanism itself is classification-based and statutory, though the timing of a specific well's spud date and the Section 461(h) economic performance rules can affect which tax year a given cost is properly deductible in.

Questions for Evaluation

Before pursuing a comparable structure, operators and their advisors should work through several questions. Does the proposed holding form — direct ownership or an entity that does not limit liability — actually preserve the Section 469(c)(3) exception, or does it default to a liability-limited fund or LLC interest that would not? What does the specific AFE show for the intangible versus tangible cost split on the well program under consideration, and has that been confirmed in writing rather than assumed? How does the IRC Section 465 at-risk basis, limited to cash actually contributed, align with the participant's broader liquidity needs over the next several years? What governance rights, reporting cadence, and operational transparency accompany the working interest, and how does that compare to a passive fund structure? How does the capital contribution interact with the participant's overall alternative minimum tax position under Section 57(a)(2)? And has state residency and entity structure been reviewed for any state-specific tax treatment beyond the federal mechanics described here?

Closing Perspective & Next Steps

The decision pattern illustrated here is not about chasing a deduction. It is about recognizing that the moment of maximum tax exposure — the year a business is sold — is also the moment when a statutory, classification-based mechanism exists to redirect a portion of that exposure into direct ownership of a different kind of asset, one with its own operational transparency, governance rights, and long-duration income profile.

The founders who evaluate this path carefully, with their CPA and legal counsel engaged from day one rather than day thirty, are positioned to make an informed decision about whether entrepreneurial joint venture participation in a working interest fits their own circumstances. Readers evaluating a similar sequence should treat this case as a starting framework for that conversation, not a substitute for it, and should bring the questions above directly to their own professional advisors before any capital contribution is made.

Sources & References

- [1] Modern Wealth — business owner concentration risk, 80–90% of net worth in a single illiquid asset.
- [2] Wiss — twelve-month post-liquidity-event wealth erosion window; NIIT under IRC Section 1411.
- [3] Morgan Stanley — post-exit concentration and reliance on sale proceeds.
- [4] Wealth Enhancement Group — asset sale vs. stock sale ordinary income and capital gains distinction.
- [5] CT Acquisitions — Cerulli Associates 2024: 68% of sellers who deploy within 30 days report regret.
- [6] WalletGrower — Texas has no state income tax layer on capital gains.
- [7] ustax.tools — 2026 long-term capital gains brackets; NIIT stacking effect.
- [8] Cornell LII — 26 U.S.C. Section 263(c); Treas. Reg. 1.612-4.
- [9] Cornell LII — 26 U.S.C. Section 469(c)(3)(A), working interest exception.
- [10] AE Tax Advisors / Anchor1031 — IDC vs. TDC definitions; IRC Section 461(h).
- [11] 26 U.S.C. Section 465; Section 57(a)(2)(A) and 57(a)(2)(E).
- [12] 26 U.S.C. Sections 611 and 613A — percentage depletion for independent producers.
- [13] Grant Thornton — 2025 One Big Beautiful Bill Act; permanent 100% bonus depreciation under IRC Section 168(k).

Ready to evaluate whether a direct working interest structure fits your post-exit capital allocation?

Bring this framework to your advisors — and start the conversation with Summit Ventures.

Explore Working Interest Participation at Summit Ventures