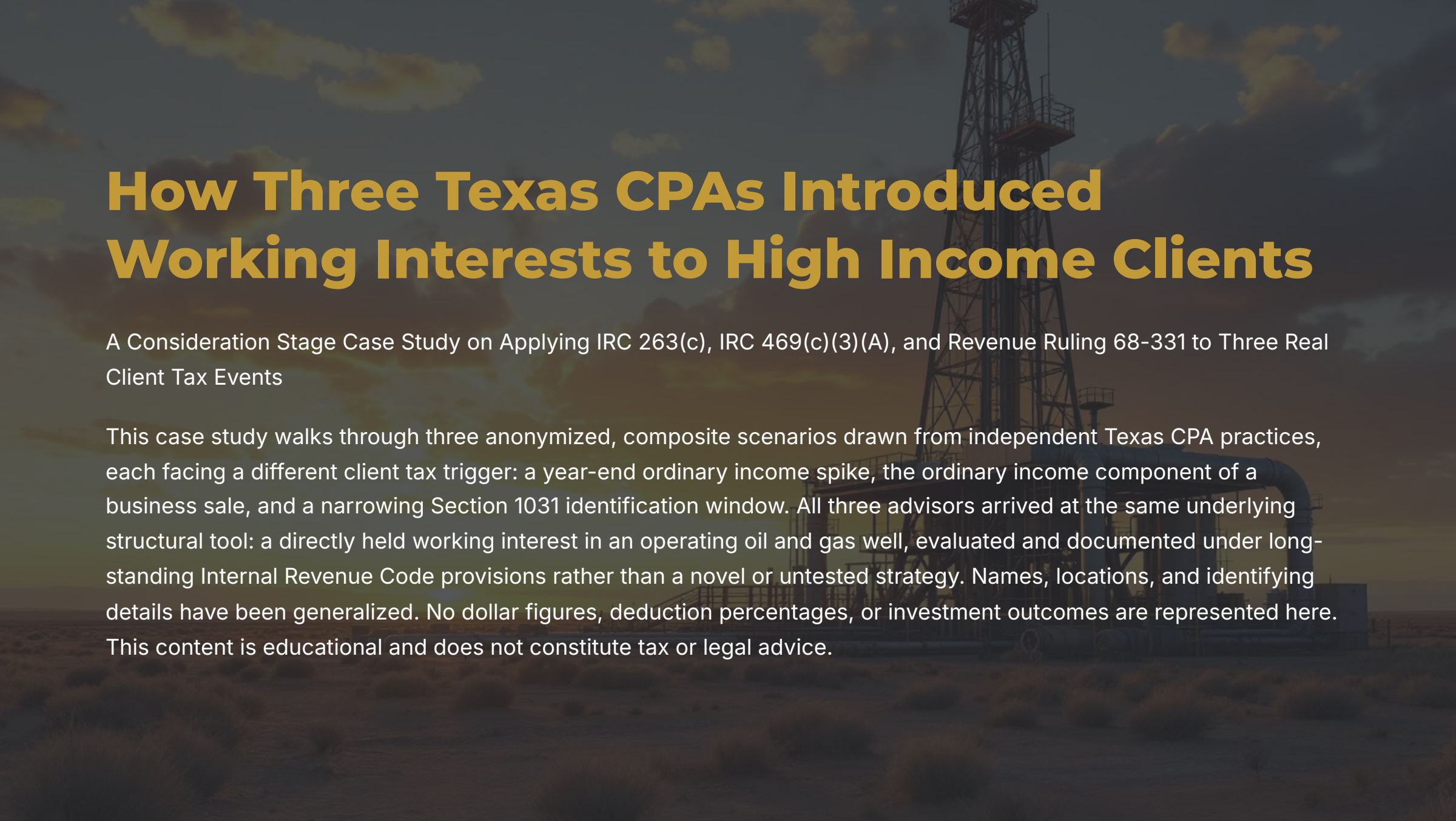


The background of the slide is a photograph of an oil drilling rig in a desert landscape. The rig is a tall, dark metal structure with various platforms and ladders. The sky is a mix of orange, yellow, and blue, suggesting a sunset or sunrise. The ground is flat and sandy with some sparse vegetation.

How Three Texas CPAs Introduced Working Interests to High Income Clients

A Consideration Stage Case Study on Applying IRC 263(c), IRC 469(c)(3)(A), and Revenue Ruling 68-331 to Three Real Client Tax Events

This case study walks through three anonymized, composite scenarios drawn from independent Texas CPA practices, each facing a different client tax trigger: a year-end ordinary income spike, the ordinary income component of a business sale, and a narrowing Section 1031 identification window. All three advisors arrived at the same underlying structural tool: a directly held working interest in an operating oil and gas well, evaluated and documented under long-standing Internal Revenue Code provisions rather than a novel or untested strategy. Names, locations, and identifying details have been generalized. No dollar figures, deduction percentages, or investment outcomes are represented here. This content is educational and does not constitute tax or legal advice.

Case Classification & At-a-Glance Summary

Case Type

Composite, illustrative, anonymized. Not a verified client testimonial.

Participants

Three independent CPA practices: Practice A (Austin), Practice B (Houston), and Practice C (Dallas–Fort Worth).

Trigger Events

- Year-end equity and bonus compensation spike
- Ordinary income component of a lower middle market business sale
- Narrowing 45-day identification window within a Section 1031 exchange

Structure Evaluated

A direct working interest in an operated United States oil and gas well, held by the client directly or through an entity that does not limit liability, consistent with the requirement under IRC 469(c)(3)(A).

Statutory Anchors Reviewed

IRC 263(c) & Treas. Reg. 1.612-4

The intangible drilling cost election

IRC 469(c)(3)(A)

The working interest exception to the passive activity loss rules

IRC 465

The at-risk limitation

IRC 57(a)(2)(B)

The excess IDC alternative minimum tax preference exception

IRC 611 & 613A

Percentage depletion

IRC 461(h)

Economic performance and 90-day drilling exception

Rev. Rul. 68-331 & 78-135

Real property classification and direct holding requirement relevant to Section 1031 analysis

 **Financial outcome represented: none.** This case study intentionally omits dollar figures, deduction percentages, and return figures. Actual tax treatment depends on the specific facts, the client's full tax position, and the determination of the client's own CPA and legal counsel.

Participant Profiles, Triggers & Situations

1

Practice A — Austin

The client was a corporate executive whose year-end equity vesting and cash bonus pushed taxable ordinary income well above prior year levels. Qualified retirement plan contributions were already maxed for the year, and the practice had exhausted its usual year-end planning checklist weeks before the client's bonus was finalized. The CPA needed an option that could still be implemented before December 31 and that would hold up if examined.

2

Practice B — Houston

The client sold a services business sourced through a business broker. A portion of the sale proceeds was structured as ordinary income — through a consulting agreement and a covenant not to compete — rather than capital gain. Ordinary income at the federal level can reach materially higher marginal rates than long-term capital gain, which tops out at 20 percent federally before the 3.8 percent net investment income tax, so the ordinary income slice of the transaction carried a meaningfully different tax profile than the capital gain portion the client had already planned around.

3

Practice C — Dallas–Fort Worth

The client was mid-exchange on the sale of a commercial property. Two of the three replacement properties identified within the 45-day window fell out of contract as financing and inspection issues emerged, narrowing the field of qualifying like-kind replacement property options with the identification period closing. The client's qualified intermediary and the CPA needed to evaluate remaining options quickly.

Challenge & Decision Criteria

Each practice faced a version of the same advisory problem. The client needed a credible, statute-grounded answer to a specific and time-sensitive tax question, and the conventional toolkit — additional retirement deferral, generic alternative funds, a later-filed extension — either was not available or did not fit the client's facts. Across all three practices, the decision criteria were consistent:



Statute-Grounded Position

The strategy needed to rest on long-standing Internal Revenue Code provisions rather than an aggressive or novel position.



Defensible Documentation

The strategy needed to produce documentation the CPA could defend if the return were examined.



Implementable Within Deadline

The strategy needed to be implementable within the applicable deadline: calendar year-end for Practice A, the return filing position for Practice B, and the 45-day identification window for Practice C.



Scope-Appropriate for the CPA

The CPA needed to avoid any appearance of acting as an investment adviser or recommending a specific financial product, since none of the three practices are registered to do so.



Reconcilable K-1

The resulting K-1 needed to be reconcilable without extraordinary effort during a compressed filing season.

Options & Approach

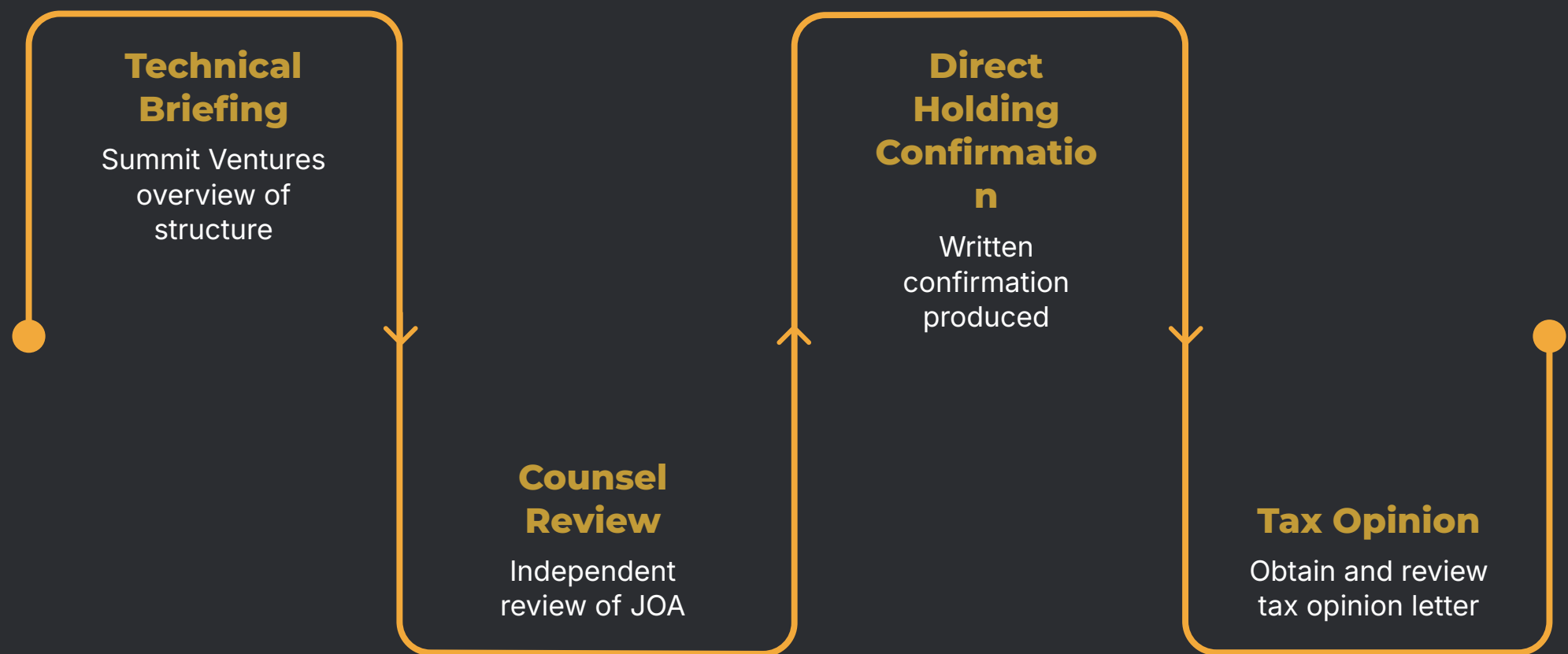
Practice A evaluated the remaining year-end options available to a W-2 and equity-compensated executive. Additional qualified plan deferral was unavailable because contribution limits were already reached. A direct working interest, structured to meet the IRC 469(c)(3)(A) requirement that the interest be held directly or through an entity that does not limit liability, was evaluated because the intangible drilling cost election under IRC 263(c) can be used against active income without the hours-based material participation test that applies to real estate professional status. The CPA also reviewed IRC 461(h), since a cash contribution made in December against a well that will not begin drilling for many months can run into the economic performance timing rule; the 90-day drilling exception was discussed directly with Summit's technical team before year-end, so the client's contribution and the well's anticipated spud date lined up with the statute rather than against it.

Practice B evaluated whether the ordinary income portion of the sale could be offset in the same tax year it was recognized. Because the consulting income and non-compete payments were active ordinary income, not passive income, the same IRC 469(c)(3)(A) working interest exception applied. The practice coordinated with the client's transaction counsel to confirm the ordinary income character of each payment stream before finalizing the working interest contribution amount and timing.

Practice C faced a different statutory question entirely. With the identification window narrowing and no extension available outside of formal IRS disaster relief, the QI and the client's tax counsel discussed whether a working interest in a producing well could serve as replacement property. Revenue Ruling 68-331 classified a lessee's working interest in a producing oil and gas lease as real property, like-kind to a fee interest in real estate, under the 1954 Code's Section 1031(a). The team also reviewed Revenue Ruling 78-135, which holds that a general partnership interest itself does not qualify for Section 1031 nonrecognition, meaning only a direct, undivided working interest — not a fund or partnership membership share — could be considered. Summit did not make the qualification determination; that determination rested entirely with the client's own QI and counsel, who reviewed the specific facts, the exchange documentation, and the timing before reaching their own conclusion.

❏ **The structural throughline:** The same requirement — that the interest be held directly rather than through a liability-limiting LLC or LP membership share — independently supports the IRC 469(c)(3)(A) active income offset analysis used by Practice A and Practice B, *and* the real property-style classification relevant to the Section 1031 analysis used by Practice C.

Implementation



Each practice began with a technical briefing from Summit Ventures covering how the entrepreneurial joint venture structure is documented: the direct, undivided nature of the working interest position, the governance rights attached to it, and the mechanics of the capital contribution itself. In each case, the client's own counsel reviewed the joint operating agreement independently before the contribution was finalized.

A written confirmation of direct holding status — meaning the interest was not routed through an entity that would limit the client's liability — was produced for the file in all three scenarios. This single document supported the IRC 469(c)(3) (A) analysis for Practice A and Practice B and the Revenue Ruling 68-331 analysis for Practice C. A tax opinion letter was obtained in each case and reviewed by the client's own counsel rather than relied upon as a substitute for independent advice.

Summit's standardized K-1 schedule was delivered ahead of each practice's filing deadline, with ordinary income, intangible drilling cost, and percentage depletion figures broken out as separate line items rather than bundled into a single fund-level number. Each practice used Summit's direct CPA support line to walk through reconciliation questions before filing, which each practice reported as materially less time-consuming than the generic fund-level reporting they had encountered with other alternative asset structures in prior years.

For Practice C specifically, the final determination of whether the exchange qualified was made entirely by the client's own qualified intermediary and tax counsel, based on the specific facts of the transaction, the timing of the identification, and the nature of the replacement interest. This case study does not assert that a narrowing identification window can always be resolved this way, and the outcome described below is illustrative only.

Explanation & Outcome

☐ *Illustrative, not an actual client result.* The following describes the qualitative process outcome of each engagement, not a financial result, deduction amount, or guaranteed tax position.

In each of the three scenarios, the CPA was able to bring the client a statutorily grounded option, supported by a written tax opinion letter and a direct holding confirmation, within the applicable deadline, without the CPA personally recommending a specific financial product or acting outside the scope of their license. Each practice reported that the line-item separation on Summit's K-1 schedule — ordinary income, IDC, and depletion stated individually — made the return preparation process more straightforward than generic fund-level reporting they had previously reviewed for other clients.

For Practice C, the client's QI and counsel determined, based on the specific facts of that transaction, that the working interest met their criteria as replacement property. This case study does not claim that outcome is typical or guaranteed in every narrowing identification window scenario; each exchange depends on its own facts and the independent judgment of the client's own QI and counsel.

Practice A — Austin

CPA delivered a statute-grounded year-end option within the December 31 deadline, with IRC 461(h) timing confirmed before contribution.

Practice B — Houston

Ordinary income character of each payment stream confirmed with transaction counsel before working interest contribution was sized and timed.

Practice C — Dallas–Fort Worth

Client's own QI and counsel independently determined the working interest met their criteria as replacement property based on the specific facts of that exchange.

"What mattered to us was not a product pitch — it was a structure we could stand behind if a client's return were ever examined. Having the direct holding confirmation and the tax opinion letter in the file before we filed changed the entire conversation with the client, and the K-1 came through clean enough that we were not reverse engineering a fund statement during the busiest weeks of the season."

— Composite statement reflecting themes raised across the three practices. Illustrative, not a verified testimonial.

Metrics Comparison Across All Three Practices

Metric	Practice A — Austin	Practice B — Houston	Practice C — Dallas–Fort Worth
Trigger Event	Year-end equity and bonus income spike	Ordinary income component of a business sale	Narrowing Section 1031 identification window
Primary Statute Reviewed	IRC 263(c) and IRC 469(c)(3)(A)	IRC 263(c) and IRC 469(c)(3)(A)	Revenue Ruling 68-331 and Revenue Ruling 78-135
Timing Consideration Reviewed	IRC 461(h) economic performance, 90-day drilling exception	Matching ordinary income character to contribution timing	45-day identification window
Documentation Delivered	Tax opinion letter, direct holding confirmation, standardized K-1 schedule	Tax opinion letter, direct holding confirmation, standardized K-1 schedule	Tax opinion letter, direct holding confirmation, joint operating agreement review
Final Determination Made By	Client's own CPA	Client's own CPA and transaction counsel	Client's own qualified intermediary and tax counsel
Financial Outcome Represented	None stated	None stated	None stated

Assumptions, Key Takeaways & Questions for Advisors

This case study assumes each client met the applicable eligibility and suitability requirements for the structure, that the client's CPA and legal counsel independently reviewed the facts and documentation before any filing position was taken, and that the working interest was held directly or through an entity that does not limit liability, consistent with IRC 469(c)(3)(A). No universal outcome is implied, and no two client facts are identical.

Key Takeaways for Advisors Evaluating a Similar Structure

One Structural Requirement, Two Statutory Analyses

The same structural requirement — direct holding rather than a liability-limiting entity — supports both the IRC 469(c)(3)(A) active income offset and the Revenue Ruling 68-331 real property classification relevant to Section 1031.

Timing Mechanics Matter as Much as the Statute

IRC 461(h) and its 90-day drilling exception can determine whether a year-end contribution is respected, independent of whether the IRC 263(c) election itself is sound.

Professional Judgment Stays with the Advisor

The CPA, attorney, or QI retains the final filing or exchange position in every case. An institutional partner can provide documentation, education, and standardized reporting, but the professional judgment stays with the client's own advisor.

Line-Item K-1 Reporting Reduces Reconciliation Burden

Standardized, line-item K-1 reporting — with ordinary income, IDC, and depletion stated separately — removes a substantial amount of the reconciliation burden that generic fund-level statements often create during filing season.

Questions Every Advisor Should Ask Before Proceeding

1. Does the client's current or proposed holding structure limit liability in a way that would disqualify the interest under IRC 469(c)(3)(A)?
2. Has the timing of any year-end capital contribution been checked against IRC 461(h) and the 90-day drilling exception before year-end, rather than after?
3. For a business sale, has transaction counsel confirmed which proceeds are properly characterized as ordinary income versus capital gain before a working interest contribution is sized?
4. For a 1031 scenario, has the client's own QI and counsel independently reviewed Revenue Ruling 68-331 and Revenue Ruling 78-135 against the specific facts of the exchange, rather than relying on a general industry assumption?
5. Does the K-1 the client will receive separate ordinary income, intangible drilling costs, and percentage depletion as distinct line items, or will the practice need to reconstruct those figures from a bundled fund statement?
6. Is there a written tax opinion letter in the file, reviewed by the client's own counsel, supporting the position taken?

Sources, References & Next Steps

Sources & References

- Internal Revenue Code Section 263(c) and Treasury Regulation 1.612-4, governing the election to expense intangible drilling costs.
- Internal Revenue Code Section 469(c)(3)(A), the working interest exception to the passive activity loss rules, requiring direct holding or holding through an entity that does not limit liability.
- Internal Revenue Code Section 465, the at-risk limitation on deductibility.
- Internal Revenue Code Section 57(a)(2)(B), the alternative minimum tax exception for excess intangible drilling costs that do not exceed 65 percent of net income from oil and gas properties for the year.
- Internal Revenue Code Sections 611 and 613A, governing percentage depletion for independent producers.
- Internal Revenue Code Section 461(h), the economic performance rule, including the 90-day drilling exception relevant to year-end timing.
- Revenue Ruling 68-331, 1968-1 C.B. 352, classifying a lessee's working interest in a producing oil and gas lease as real property, like-kind to a fee interest in real estate, under Section 1031(a) of the 1954 Code.
- Revenue Ruling 78-135, holding that a general partnership interest does not itself qualify for Section 1031 nonrecognition.
- One Big Beautiful Bill Act, signed July 4, 2025, making 100 percent bonus depreciation under Internal Revenue Code Section 168(k) permanent for qualified property.
- 2026 federal long-term capital gains rate thresholds and the 3.8 percent net investment income tax, used here only to illustrate the rate differential between ordinary income and long-term capital gain referenced in the Practice B scenario.
- BassEXP, *K-1 Tax Reporting for Oil and Gas Investors*, referenced for general K-1 line-item mechanics description only, not for any dollar figures or outcome claims.

The Shared Structural Lesson

Three different Texas practices, three different triggers, and one shared structural lesson: the mechanics of IRC 263(c), IRC 469(c)(3)(A), and Revenue Ruling 68-331 have been part of the Internal Revenue Code and federal tax guidance for decades, and the advisors who can explain them clearly — with documentation ready before a deadline rather than after — are the ones who turn a client's year-end, exit, or exchange problem into a conversation they can lead with confidence.

None of the three CPAs needed to become an investment adviser or an oil and gas operator to do this. They needed a working technical understanding of the statute, a dependable source of documentation, and a K-1 they could actually reconcile.

Advisors evaluating a similar scenario for their own clients are encouraged to request Summit Ventures' technical briefing materials and a sample K-1 schedule, and to review both with their own compliance standards before any client conversation.

Request Summit Ventures' Technical Briefing

[Request Technical Briefing & Sample K-1](#)