

The background of the slide is a dark, atmospheric photograph of an industrial oil field. In the foreground, a complex network of pipes and metal structures is visible. In the mid-ground, a large oil pumpjack (jack-o'-lantern) stands prominently. The background features several tall industrial smokestacks and more refinery structures under a hazy, orange-tinted sky, suggesting a sunset or sunrise. The overall mood is industrial and somewhat somber.

# Working Interest Ownership vs. Passive Real Estate vs. Securities

A Comparative Guide to Ownership Structure, Tax Treatment, Liquidity, and Capital Deployment Options for Business Owners After a Sale, Recapitalization, or Distribution Event

COMPARATIVE GUIDE

FOR EXITING OPERATORS

# Introduction: The Post-Exit Capital Decision

A business owner who has just closed a sale, completed a private equity recapitalization, or taken a large year-end distribution faces a decision that most W-2 earners never face: where does concentrated capital go next, and under what tax classification will it sit. For years, the operator's net worth lived inside one operating company they controlled directly. Once that capital converts to cash, three broad destinations dominate the conversation among exiting and post-exit founders, active CEOs preparing for a liquidity event, and PE-backed operators receiving recapitalization proceeds: direct working interest ownership in oil and gas assets, passive real estate positions, and public securities.

These three paths are not interchangeable. They differ in how the tax code classifies the activity, how much operational involvement and governance access the owner retains, how liquid the position is, and how exposed the owner remains to concentration risk after already building and selling one concentrated asset. This guide compares the three structures on the criteria that matter most to a business-minded operator: ownership and control, tax treatment, participation requirements, liquidity, and capital efficiency. It is built for evaluation, not persuasion. Every tax mechanic described here should be confirmed with a qualified CPA or tax attorney before any capital is deployed.

## Three Paths for Exiting Capital

01

### Option A

Direct Working Interest Ownership in oil and gas

02

### Option B

Passive Real Estate via LP, REIT, or rental property

03

### Option C

Public Securities in a standard brokerage account

# What Is Compared: The Three Options

Six factors drive the comparison in this guide. Understanding what each option actually represents — legally and structurally — is the essential starting point before evaluating tax treatment or returns.

|                                                                                                                                                                                                                                                                        |                                                                                                                                                                                                                 |                                                                                                                                                                                       |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p><b>Option A: Direct Working Interest Ownership</b></p> <p>The operator holds a direct working interest in an oil and gas drilling or development program, typically through an entrepreneurial joint venture structure that does not limit the participant's liability, preserving operator-level tax treatment under the Internal Revenue Code.</p> | <p><b>Option B: Passive Real Estate</b></p> <p>The operator allocates capital to real estate through a limited partnership syndication, a real estate investment trust, or a directly owned rental property held without material, regular, and continuous personal involvement in operations.</p> | <p><b>Option C: Public Securities</b></p> <p>The operator allocates capital to publicly traded equities, bonds, mutual funds, or exchange-traded funds through a standard brokerage account, with no operational role and no claim on any underlying physical asset.</p> |

## Six Evaluation Criteria

|                                            |                           |                                       |                  |
|--------------------------------------------|---------------------------|---------------------------------------|------------------|
| <b>Ownership &amp; Legal Structure</b>     | <b>Tax Classification</b> | <b>Participation &amp; Governance</b> | <b>Liquidity</b> |
| <b>Concentration &amp; Diversification</b> |                           | <b>Complexity &amp; Reporting</b>     |                  |

# Option A: Direct Working Interest Ownership

A working interest is a direct ownership stake in the mineral and operating rights to an oil and gas property. Under 26 CFR 1.612-4(a), an operator for purposes of Internal Revenue Code Section 263(c) is defined as one who holds a working or operating interest, either as a fee owner or under a lease or any other form of contract granting working or operating rights. That operator classification is what allows the election to currently deduct intangible drilling costs — the labor, fuel, chemicals, and drilling services that have no salvage value — as distinguished from tangible drilling costs such as casing, tubing, and wellhead equipment that retain salvage value and are typically depreciated.

The structural feature that separates a working interest from every passive alternative is Internal Revenue Code Section 469(c)(3)(A), which states that the passive activity classification 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 plain terms, a working interest held directly, or through an entrepreneurial joint venture structure that does not cap the participant's liability, is statutorily excluded from passive activity treatment regardless of how many hours the participant spends on operations. This is a **classification-based exception, not an hours-based test**, which is the single largest structural difference from the real estate alternative described below.

Because the position is excluded from passive treatment, qualifying losses generated through the current-year intangible drilling cost election can offset active income, including W-2 wages, 1099 income, and active business distributions, subject to the taxpayer's at-risk basis under Internal Revenue Code Section 465 and the four-layer loss limitation order that applies to every taxpayer: basis, then at-risk limitation, then passive activity limitation, then the excess business loss limitation under Section 461(l), which for 2026 is set at **256,000 dollars for single filers** and **512,000 dollars for those filing jointly**. The actual percentage of a given capital contribution that qualifies as an intangible cost depends entirely on the specific well's engineering design, the authorization for expenditure, and the participant's individual tax position, and that figure should always be confirmed with a qualified CPA before an election is made rather than assumed from a generic industry range.

Once a well reaches production, independent producers may also claim percentage depletion under Internal Revenue Code Sections 611 and 613A, a statutory allowance of **15 percent against gross income** from the property, distinct from and in addition to the intangible cost election. Excess intangible drilling costs can become an alternative minimum tax preference item under Section 57(a)(2)(A), but only to the extent the excess exceeds 65 percent of the taxpayer's net income from oil, gas, and geothermal properties for the year, and independent producers have a separate election under Section 57(a)(2)(E) to disregard all or part of that preference in computing alternative minimum taxable income, subject to a cap of 40 percent of AMTI.

Governance under this model runs through an operating agreement that specifies the participant's rights to production reporting, well-level financial statements, and decision input on major capital events such as recompletions or workovers. This is a genuinely active-member structure. The participant is a business participant in a joint venture, not a passive unit holder waiting on a quarterly distribution notice from a fund manager.

## IRC §469(c)(3)(A)

Working interest is **statutorily excluded** from passive activity classification — regardless of hours worked.

## Intangible Drilling Costs

Current-year election to deduct labor, fuel, chemicals, and drilling services with no salvage value against active income.

## Percentage Depletion

15% statutory allowance against gross income from the property under IRC §§611 and 613A — separate from the IDC election.

## Four-Layer Loss Limitation

Basis → At-Risk (§465) → Passive Activity → Excess Business Loss (§461(l), \$256K/\$512K for 2026).

## Active Governance

Operating agreement grants production reporting access and input on major capital events — a true business participant structure.

# Option B: Passive Real Estate

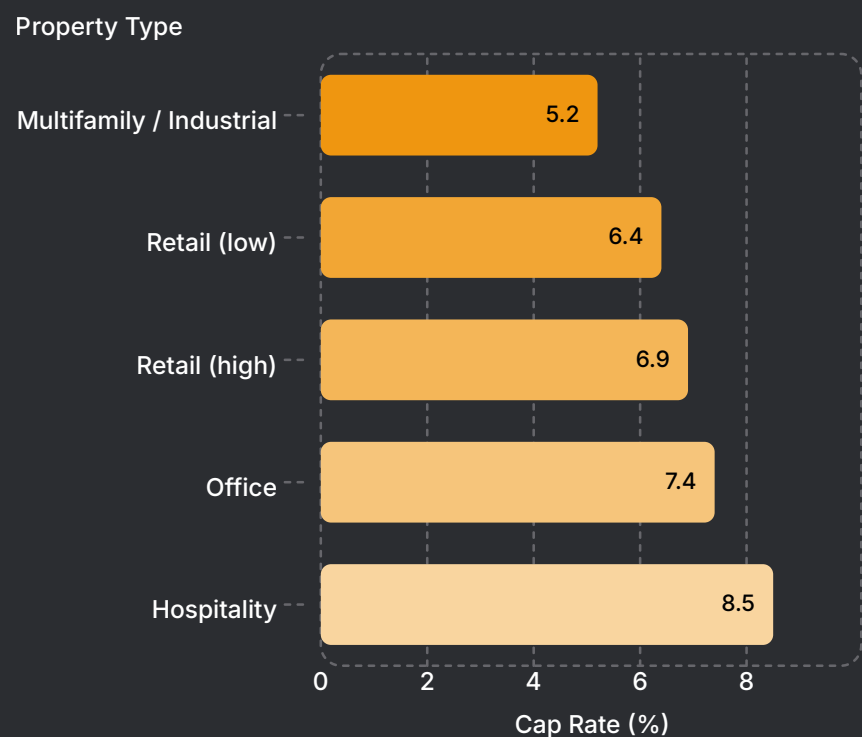
Passive real estate, whether held through a syndicated limited partnership, a real estate investment trust, or a directly owned rental property managed by a third party, sits on the opposite side of the participation spectrum from a working interest. The investor's tax treatment depends heavily on the level of personal involvement, and the bar to escape passive classification is substantially higher than most owners expect.

Under the general passive activity rules, a real estate investor who does not materially and regularly participate can deduct only a limited special allowance of up to **25,000 dollars in passive losses** against nonpassive income, and that allowance is reduced by 50 cents for every dollar of modified adjusted gross income above 100,000 dollars, phasing out entirely at 150,000 dollars of MAGI, according to IRS Publication 925. For an exiting operator who has just realized a large capital gain, MAGI in the year of sale will almost always exceed this threshold, eliminating the allowance entirely in the year it would matter most.

The only path to full, unlimited deduction of real estate losses against other income is the real estate professional status test under Internal Revenue Code Section 469(c)(7), which requires **more than 750 hours of personal service** in real property trades or businesses during the year, and more than half of the taxpayer's total personal service time across all trades or businesses. For an active CEO or an exiting founder who is managing a transition, raising capital, or beginning a new venture, clearing this hours test is operationally very difficult, and it must be met every single year the deduction is claimed, not just once.

On the return side, commercial real estate cap rates in mid-2026 range broadly by property type, with multifamily and industrial assets trading near 5.2 percent, retail near 6.4 to 6.9 percent, office near 7.4 percent, and hospitality near 8.5 percent. Industry surveys project only modest cap rate compression of roughly 5 to 15 basis points through 2026, meaning returns in the current cycle are driven primarily by in-place income rather than appreciation. When a leveraged real estate position is eventually sold, any gain attributable to prior depreciation deductions is recaptured as unrecaptured Section 1250 gain, which is capped at a **25 percent federal rate**, a materially higher rate than the 20 percent top long-term capital gains rate that applies to most other asset sales.

## Mid-2026 Commercial Cap Rates



⚠ The \$25,000 passive loss allowance phases out entirely above \$150,000 MAGI — the year of a liquidity event almost always eliminates this benefit.

# Option C: Public Securities

Public securities, held through a standard brokerage account, require no operational participation, no governance rights, and no claim on any physical underlying asset. The owner holds a liquid claim that can typically be sold within a single trading day, which is the structure's clearest advantage over both working interest ownership and real estate.

That liquidity comes with two tradeoffs that matter specifically to an exiting operator. First, concentration risk does not disappear simply because the asset is public and tradable. According to RBC Wealth Management's analysis of index composition, the ten largest companies in the S&P 500 represented approximately **41 percent of the index's total weight** at the end of 2025, roughly double the concentration of about 19 percent a decade earlier. An owner who diversifies out of one concentrated private business and into a broad market index may still be carrying meaningful concentration exposure to a small number of mega-cap names inside that index.

Second, for income-producing securities held through a C corporation structure rather than a pass-through entity, dividend income is subject to double taxation: corporate earnings are first taxed at the 21 percent federal corporate rate, and the remaining amount is taxed again at the shareholder level at qualified dividend rates of 0, 15, or 20 percent plus the 3.8 percent Net Investment Income Tax under Internal Revenue Code Section 1411, producing an effective combined rate of up to **23.8 percent on qualified dividends** and up to **40.8 percent on non-qualified dividends**, stacked on top of the tax already paid at the corporate level.

Over long periods, the S&P 500 has returned approximately 10 percent annually on average since 1957, according to Fidelity's historical data, though that figure reflects a long-run average across many market cycles rather than a guaranteed or predictable annual outcome, and securities carry no tax mechanism comparable to the working interest's current-year cost election or the depletion allowance available to independent producers.

## Liquidity Advantage

Positions can typically be sold within one business day — the clearest structural advantage over both alternatives.

## Hidden Concentration Risk

Top 10 S&P 500 names = ~41% of index weight at end of 2025, up from ~19% a decade earlier (RBC Wealth Management).

## Double Taxation (C-Corp)

Corporate rate (21%) + qualified dividend rate (up to 20%) + 3.8% NIIT = effective combined rate up to 23.8% on qualified, 40.8% on non-qualified dividends.

## No Income Offset Mechanism

Securities provide no current-year deduction against ordinary income or active distributions in the year of purchase.

## Historical Return

~10% average annual return since 1957 (Fidelity) — a long-run average, not a guaranteed annual outcome.

# Side-by-Side Comparison

The table below summarizes how each structure performs across the six evaluation criteria most relevant to an exiting operator.

| Category                    | Working Interest                                                                                                | Passive Real Estate                                                                                   | Public Securities                                                                                          |
|-----------------------------|-----------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------|
| Ownership & Legal Structure | Direct working/operating interest, typically unlimited liability, operator status under Treas. Reg. 1.612-4(a)  | LP unit, REIT share, or titled property; liability generally limited by entity structure              | Shares, bonds, or fund units in a brokerage account; no claim on any physical asset                        |
| Participation               | Active business participant with well-level operating data and capital decision input                           | Typically passive unless 750-hour real estate professional test (§469(c)(7)) is met every year        | No operational participation of any kind                                                                   |
| Governance & Control        | Rights defined in joint operating agreement, including reporting access and input on major capital events       | Governance held by GP, sponsor, or REIT management; limited partner input only                        | Shareholder voting rights only; no influence over day-to-day operations                                    |
| Liquidity                   | Illiquid; tied to productive life of the well and terms of the joint venture                                    | Illiquid in syndications (multi-year lockups); more liquid for publicly traded REIT shares            | Highly liquid; generally tradable within one business day                                                  |
| Tax Treatment               | Excluded from passive activity (§469(c)(3)(A)); current-year IDC election; percentage depletion (§§611, 613A)   | Passive losses capped at \$25K (phase-out \$100K–\$150K MAGI); unrecaptured §1250 gain at 25% on sale | Cap gains and qualified dividend rates (0/15/20%) + 3.8% NIIT; C-corp dividends subject to double taxation |
| Risk & Exposure             | Geological, commodity price, and operational execution risk; unlimited liability absent entity-level protection | Interest rate sensitivity, local market and vacancy risk, sponsor and management execution risk       | Market volatility and index concentration risk; limited protection against broad market drawdowns          |
| Complexity                  | Schedule C or partnership-level reporting; AFE and JOA review; ongoing operational reporting                    | K-1 reporting for syndications; annual hours tracking if pursuing real estate professional status     | Simplest reporting; standard 1099 and brokerage statements                                                 |

# Advantages, Limitations & Best-Fit Scenarios

## Advantages & Limitations by Structure

### Working Interest

**Advantage:** Tax classification advantage that does not depend on the owner's income level or hours worked — uniquely valuable to a high-income exiting operator in the year of a sale.

**Limitation:** Illiquidity and exposure to commodity price and well-level execution risk, which requires real due diligence on the operator running the program and the specific asset being developed.

### Passive Real Estate

**Advantage:** Tangible, inflation-sensitive collateral and a long history of institutional acceptance.

**Limitation:** Tax advantages are largely unavailable to an owner who cannot clear the 750-hour material participation bar in the same year a liquidity event inflates their income. Depreciation recapture at sale also claws back some of the benefit that made the position attractive in the first place.

### Public Securities

**Advantage:** Same-day liquidity and the simplest reporting burden of the three options.

**Limitation:** No mechanism to offset ordinary income or active distributions in the year they are purchased, and broad market exposure has not eliminated concentration risk — it has simply relocated it inside a small number of index constituents.

## Best-Fit Scenarios

### Working Interest Is the Clearest Fit When...

An operator has just closed a sale or received a large recapitalization distribution and needs a current-year offset against active income or ordinary gain — provided they can tolerate illiquidity and are willing to review the operating agreement and the specific authorization for expenditure with their tax advisor.

### Passive Real Estate May Be Suitable When...

An owner already has real estate operating experience, available hours to dedicate to property management, and a longer time horizon before needing liquidity — particularly if they can realistically pursue real estate professional status.

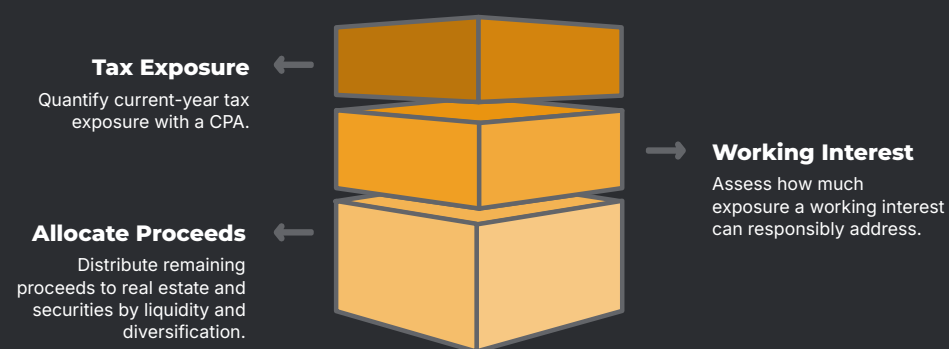
### Public Securities Make Sense When...

An owner is prioritizing liquidity above all else, has already addressed the current-year tax exposure through other means, and may allocate a portion of proceeds for simplicity and same-day access to capital — understanding that this allocation does nothing to offset the tax liability generated by the exit itself.

# Decision Guidance & Questions for Professional Advisors

## The Practical Decision Sequence

The decision should start with the tax year in question, not the asset class. An owner facing a large taxable event in the current year has a narrow window in which only the working interest structure offers a current-year, income-level-independent deduction mechanism. Real estate and securities may both belong in a longer-term allocation, but neither addresses the immediate tax exposure the way a properly structured working interest position can.



## Questions for Professional Advisors

- What is my projected marginal and effective tax rate in the year of sale or distribution, including the Net Investment Income Tax and any state-level exposure?
- How much at-risk basis would I have in a specific working interest program, and how does that basis interact with the Section 461(l) excess business loss limitation given my other income this year?
- What percentage of a specific authorization for expenditure is classified as intangible versus tangible cost, and how was that determination made?
- If I am considering passive real estate, can I realistically meet the 750-hour real estate professional test this year, and what documentation would I need to support that claim?
- How does my current securities allocation expose me to index concentration risk, and does that exposure conflict with my diversification goals after exiting a concentrated business?
- What governance rights, reporting cadence, and liability structure apply to any working interest program I am evaluating, and who is the operator of record?

# Closing Perspective & Next Steps

A business owner who has spent years building and controlling a single concentrated asset is rarely well served by simply trading one form of concentration for another without first understanding how each structure treats the current tax year. Working interest ownership, passive real estate, and public securities each solve a different part of the post-exit capital allocation problem, and the right answer for most exiting operators involves more than one of them, sequenced deliberately around the tax calendar rather than chosen by habit or familiarity.

Summit Ventures operates as an entrepreneurial joint venture platform built specifically around the working interest structure described in this guide, offering business participants direct capital contribution opportunities with operational transparency and governance rights. We encourage any operator evaluating this path to review the specific joint operating agreement and authorization for expenditure with a qualified CPA before making a capital contribution decision.

## Sources & References

[1] Cornell LII, 26 U.S.C. 469(c)(3)(A) — working interest exclusion from passive activity classification. [2] Cornell LII, 26 CFR 1.612-4(a) — operator definition under Section 263(c). [3] 26 U.S.C. 465 — at-risk limitation on deductible losses. [4] 26 U.S.C. 57(a)(2)(A) and 57(a)(2)(E) — AMT treatment of excess IDCs and independent producer exception.

[5] 26 U.S.C. 611 and 613A — percentage depletion allowance for independent producers. [6] IRS Publication 925 — Passive Activity and At-Risk Rules. [7] 26 U.S.C. 469(c)(7) — real estate professional status test. [8] 26 U.S.C. 461(l) — excess business loss limitation, 2026 thresholds.

[9] Thomson Reuters and The Real Estate CPA — unrecaptured Section 1250 gain. [10] CBRE H1 2026 Cap Rate Survey and Outlook. [11] RBC Wealth Management, "The Great Narrowing" — S&P 500 index concentration analysis. [12] Fidelity — historical S&P 500 average annual return data since 1957.

[13] Legal and tax analysis of C-corp dividend double taxation mechanics, including NIIT stacking under 26 U.S.C. 1411. [14] Grant Thornton — One Big Beautiful Bill Act alert on permanent 100% bonus depreciation under 26 U.S.C. 168(k). [15] IRS Revenue Procedure 2025-32 — 2026 long-term capital gains brackets. [16] American Petroleum Institute — U.S. oil and natural gas industry economic contribution data. [17] U.S. Energy Information Administration — 2026 U.S. natural gas production outlook.

Ready to evaluate a direct working interest opportunity with full operational transparency and governance rights?

Explore Summit Ventures Working Interest Opportunities

All tax mechanics described in this guide should be confirmed with a qualified CPA or tax attorney before any capital is deployed. This document is built for evaluation, not persuasion.