

The background of the entire page is a dark, atmospheric photograph of an oil pumpjack (jackal) in silhouette. The pumpjack is positioned on the left side of the frame, with its long walking beam extending towards the top right. The sky is a gradient of dark orange and brown, suggesting a sunset or sunrise. The overall tone is industrial and professional.

How Oil and Gas Working Interests Qualify as 1031 Replacement Property

A Step-by-Step Qualified Intermediary Coordination Guide for Commercial Real Estate, Multifamily, and Land Sellers
Racing the 45-Day and 180-Day Clock

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Purpose & Scope

Why This Guide Exists

If you have sold, or are under contract to sell, a commercial property, a multifamily asset, or a land parcel, the IRC Section 1031 clock does not wait for you to find the perfect replacement. From the day your relinquished property closes, you have **45 calendar days** to identify replacement property in writing and **180 calendar days** to close on it. There are no extensions for a slow market, a competitive bidding process, or a lender that moves too slowly, except in the narrow case of a federally declared disaster.

This guide explains, in sequence, how a direct working interest in a producing oil and gas lease qualifies as like-kind replacement property under Revenue Ruling 68-331, how to coordinate that acquisition through your Qualified Intermediary (QI) within the statutory window, and what to do if the exchange cannot be completed in time.

Two Clearly Defined Paths Forward

Path 1: Direct 1031 Like-Kind Replacement

Acquisition of a working interest as qualifying replacement property within the statutory window.

Path 2: Tax Boot Mitigation

A direct capital contribution supporting an IRC Section 263(c) intangible drilling cost (IDC) deduction when a full exchange is not achievable.

Scope

This guide applies to exchangers who have already engaged, or are about to engage, a Qualified Intermediary for the sale of real property held for investment or use in a trade or business. It covers the identification mechanics, the documentation a working interest requires to qualify as "unambiguously described" replacement property, and the division of responsibilities between the exchanger, the QI, the tax advisor, and Summit Ventures as the entrepreneurial joint venture partner facilitating the working interest acquisition.

It does not cover general 1031 education on traditional real estate replacement property, nor does it address state-specific transfer tax or recording requirements, which should be confirmed with local counsel.

Prerequisites

Before beginning this process, confirm the following are in place:

1 Relinquished Property Status

The relinquished property has either closed or is under a binding contract with a closing date set.

2 QI Engaged Before Closing

A Qualified Intermediary has been engaged **before** the relinquished property closes. This is the single most time-sensitive prerequisite: if the exchanger receives or controls the sale proceeds even briefly before a QI is in place, the exchange is disqualified in its entirety.

3 CPA / Tax Advisor Confirmation

The exchanger has confirmed with a CPA or tax advisor that the relinquished property qualifies as held for productive use in a trade or business or for investment under Section 1031(a).

4 Direct Ownership Requirement

The exchanger understands that replacement property must be held directly, not through a partnership, LLC, or fund unit, in order to retain real property classification for exchange purposes.

Required Inputs & Tools

Exchange Agreement

Exchange Agreement and Assignment Agreement with the Qualified Intermediary

Identification Notice

Written Identification Notice, signed by the exchanger

Working Interest Docs

Lease name, well name or proposed well name, API number where assigned, and county and state of the underlying mineral acreage

JOA & Division Orders

Joint Operating Agreement (JOA) and division order materials from Summit Ventures

IRS Form 8824

Prepared in coordination with the exchanger's tax advisor

Exchange Calendar

Tracking Day 1 (closing), Day 45 (identification deadline), and Day 180 (replacement closing deadline) — all running concurrently

Process Overview

The 45-day and 180-day periods are **not sequential**. Both begin on the same day — the closing date of the relinquished property — and both run on calendar days with no allowance for weekends or holidays.

A working interest acquisition can move through this process faster than a traditional real estate purchase because the underlying asset, documented by lease name, well identification, and API number, can often be identified and placed under agreement well inside the 45-day window once the QI relationship and Summit Ventures coordination are established early.



Day 0

Relinquished property closing date



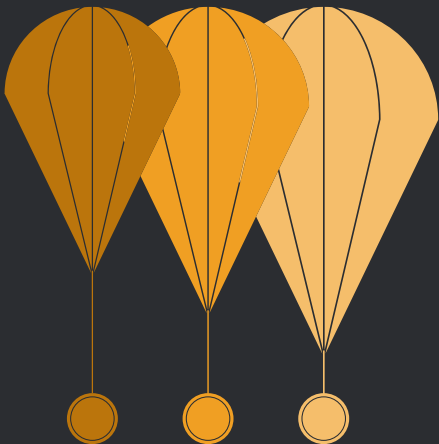
45-Day Window

Identification deadline for replacements



180-Day Window

Replacement closing deadline



Step-by-Step Process



Step 1: Engage the QI Before Closing

Contact and formally engage a QI prior to the closing of the relinquished property. The QI must receive the sale proceeds directly at closing. Confirm the QI has experience with resource-based or working interest exchanges, since many intermediaries have only handled traditional real estate replacements and may be unfamiliar with how to document a lease and well as "unambiguously described" property.



Step 3: Identify the Working Interest Within 45 Days

The identification notice must be in writing, signed by the exchanger, and delivered to the QI or another non-disqualified party before midnight on Day 45. A disqualified person includes the exchanger's attorney, CPA, employee, real estate agent, or relative who performed services within the prior two years. The notice must describe the working interest unambiguously — meaning the lease name, well name, API number if assigned, and county and state.

Apply one of the three identification rules depending on how many properties are being identified: the **Three-Property Rule** (up to three properties regardless of value), the **200 Percent Rule** (any number of properties, provided their combined fair market value does not exceed 200 percent of the relinquished property's value), or the **95 Percent Rule** (any number of properties, but the exchanger must ultimately acquire at least 95 percent of the identified value), which carries the highest risk of disqualification and should be treated as a last resort.



Step 5: Close on the Working Interest Within 180 Days

The QI transfers exchange funds directly for the acquisition of the working interest. The assignment of the working interest should run directly to the exchanger, consistent with standard delayed exchange practice in which the QI facilitates the transaction without taking title itself. This closing must occur no later than Day 180, or the earlier due date of the exchanger's tax return for the year of the relinquished property sale, including extensions.



Step 2: Close the Relinquished Property

At closing, proceeds are routed directly to the QI's exchange account. This date becomes **Day 0** for both the 45-day and 180-day clocks.



Step 4: Coordinate Working Interest Documentation with Summit Ventures

Once identified, Summit Ventures provides the lease, well, and title documentation, along with the Joint Operating Agreement that defines the exchanger's rights and obligations as a working interest owner and active joint venture participant. The QI and the exchanger's counsel review this documentation to confirm direct ownership of the working interest, rather than an interest in a fund, limited partnership, or other pooled entity, since only direct title to the real property interest retains like-kind eligibility.



Step 6: File IRS Form 8824

Working with the tax advisor, the exchanger reports the exchange on Form 8824 for the applicable tax year, documenting the relinquished property, the identified replacement property or properties, and the realized and recognized gain, if any.

Parallel Path: Tax Boot Mitigation

If the 45-day identification window cannot be met, if no suitable like-kind replacement is identified, or if a portion of proceeds (boot) remains taxable after a completed exchange, a direct capital contribution into a working interest outside the exchange structure may still support a current-year IRC Section 263(c) election for intangible drilling costs.

 This is not a substitute for a completed exchange and does not defer the original gain — but it allows the exchanger to direct capital toward an asset that can generate a deduction applied against the taxable boot or gain in the year it is recognized.

The specific percentage of costs eligible for this treatment, the interaction with the at-risk rules under IRC Section 465, and any alternative minimum tax preference under IRC Section 57(a)(2) depend on the specific drilling cost structure, the exchanger's individual tax circumstances, and the elections made, and should be confirmed directly with a qualified tax professional before proceeding.



IRC Section 263(c)

Current-year deduction of intangible drilling costs

IRC Section 465

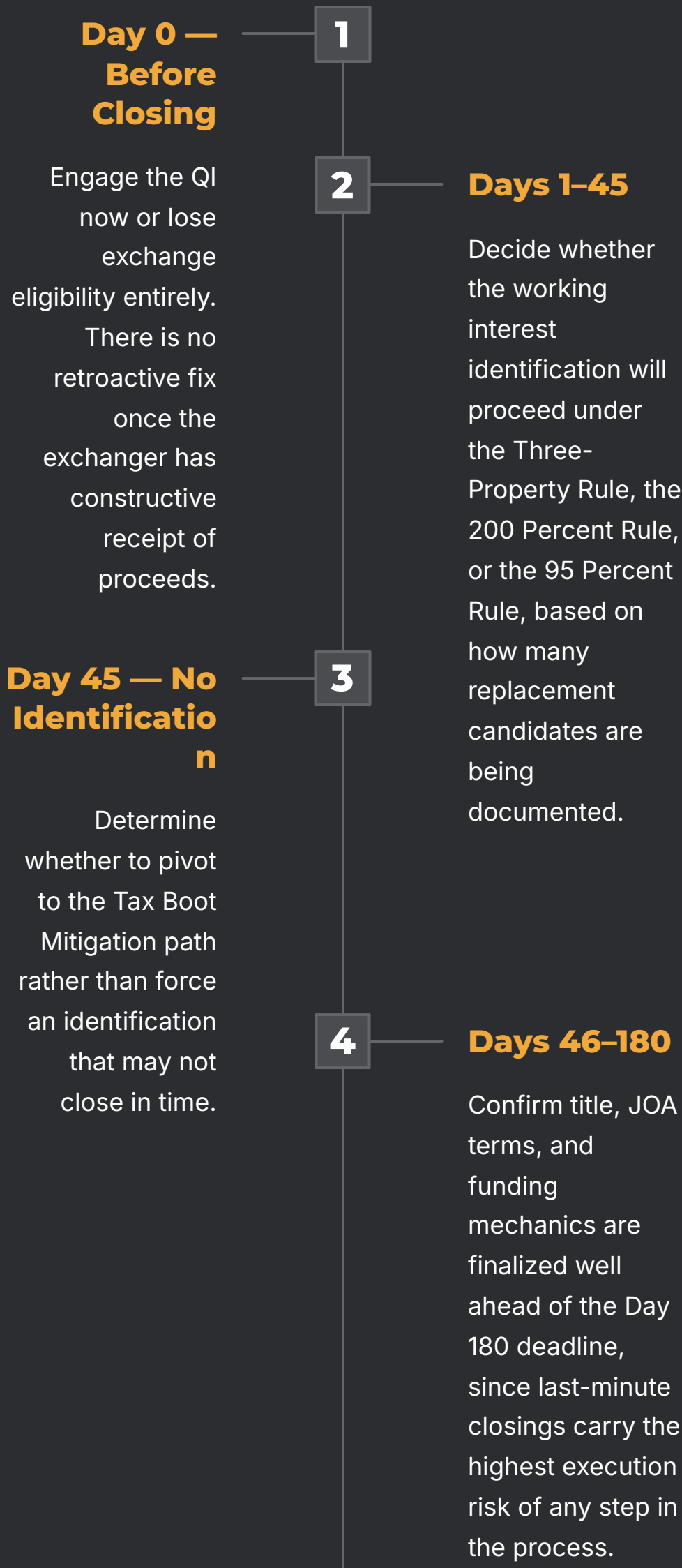
At-risk rules — review with tax advisor

IRC Section 57(a)(2)

AMT preference for excess intangible drilling costs

Decision Points & Roles

Critical Decision Points



Roles & Responsibilities


Exchanger (Seller)

Engages the QI before closing, signs and delivers the identification notice, reviews working interest documentation with counsel, and files Form 8824.


Qualified Intermediary

Holds exchange proceeds, receives and holds the identification notice as a non-disqualified party, and coordinates the direct transfer of funds at the replacement closing. The QI holds no economic interest in the transaction beyond its exchange fee.


Tax Advisor / CPA

Confirms the relinquished and replacement property both qualify, advises on Form 8824 reporting, and evaluates the 263(c), 465, and 57(a)(2) implications of the boot mitigation path if applicable.


Summit Ventures

Provides lease, well, and title documentation for the working interest, structures the acquisition as direct ownership rather than a pooled fund interest, and supports the exchanger's transition into an active joint venture participant with governance rights and operational transparency.


Closing Attorney / Title Company

Confirms the assignment of the working interest runs directly to the exchanger and that all recording requirements specific to the county and state are satisfied.

Common Problems to Avoid

QI Engaged After Closing

Engaging the QI after closing, or after the exchanger has touched the proceeds, disqualifies the entire exchange and cannot be corrected after the fact.

Defective Identification Notice

An identification notice that is verbal, unsigned, or delivered only to a disqualified person — such as the exchanger's own CPA or attorney acting in that capacity — will not satisfy the statutory requirement.

Ambiguous Property Description

An ambiguous property description that omits the lease name, well identification, or API number leaves the identified replacement property subject to IRS challenge.

Exchanging into an Entity Interest

Attempting to exchange into a partnership, LLC, or fund interest rather than a directly held working interest. Entity interests do not qualify for 1031 treatment even when the entity itself owns qualifying real property.

Underestimating Due Diligence Time

Underestimating how long traditional real estate due diligence takes, which leaves the 45-day window exposed. A directly documented working interest, with lease and well records already assembled, can often be identified faster than a comparable real estate parcel still in negotiation.

Related-Party Issues Under Section 1031(f)

Related-party identification issues under Section 1031(f) can retroactively disqualify an exchange if the replacement property is acquired from a related party and disposed of within two years.

Quality Checks & Expected Outcomes

Quality Checklist

- ☐ Confirm in writing that the QI was engaged, and the exchange agreement executed, before the relinquished property closed.
- ☐ Confirm the identification notice is signed, dated, and was delivered to the QI or a verified non-disqualified party before Day 45.
- ☐ Confirm the working interest description includes lease name, well name, API number where available, and county and state.
- ☐ Confirm the acquisition structure is direct working interest ownership, documented through the JOA and assignment, not a fund or partnership unit.
- ☐ Confirm the replacement closing date falls before Day 180 and before the exchanger's tax filing deadline, including extensions.
- ☐ Confirm Form 8824 has been reviewed with the tax advisor before filing.

Key Questions to Answer

- Has the Qualified Intermediary been formally engaged, and is the exchange agreement signed, before the relinquished property closes?
- Does the QI have documented experience handling resource-based or working interest replacement property, or will this be their first exchange of this kind?
- Is the identification notice drafted with enough specificity — lease name, well name, API number, county, and state — to withstand IRS scrutiny?
- Which identification rule — Three-Property, 200 Percent, or 95 Percent — fits the number and value of properties being identified?
- Has counsel confirmed that the working interest will be held directly, and not through a partnership, LLC, or fund interest, in order to preserve like-kind treatment?
- If the 45-day window is at risk of passing without a qualifying identification, has the Tax Boot Mitigation path been discussed with a tax advisor as a parallel option?
- Has the CPA reviewed how the 263(c) IDC election interacts with the at-risk rules under Section 465 and the alternative minimum tax preference under Section 57(a)(2) for this specific situation?

Expected Outcomes

Path 1: Direct 1031 Like-Kind Replacement

The exchanger defers recognition of the capital gain, state and federal tax exposure, and depreciation recapture that would otherwise be triggered by the sale, while stepping into a directly held working interest position as an active joint venture participant with governance rights and visibility into operational decisions, replacing day-to-day property management responsibilities with a defined working interest ownership structure.

Path 2: Tax Boot Mitigation

The exchanger directs capital into a working interest outside the exchange structure and positions a current-year IDC deduction to offset the taxable boot or gain that resulted from an incomplete or partial exchange.

Working through this process with a Qualified Intermediary who understands resource-based exchanges, and with lease, well, and title documentation prepared well before Day 45, is what separates a completed exchange from a missed deadline. The statutory clock does not pause for due diligence, financing, or negotiation.

Exchangers who engage each of these parties early retain the greatest number of options, including the ability to pivot to the Tax Boot Mitigation path without losing time if a qualifying identification proves difficult to complete.

Sources & References

The following statutory authorities, regulatory provisions, and industry practice standards form the legal and procedural foundation for this guide.

1	Revenue Ruling 68-331 (1968-1 C.B. 352) Holds that the exchange of a lessee's working interest in a producing oil lease, held for productive use in a trade or business or for investment, for a fee interest in real estate, qualifies as like-kind exchange property under Section 1031(a).
2	IRC Section 1031(a) and Treasury Regulation 1.1031(k)-1 Statutory and regulatory basis for the 45-day identification period and 180-day exchange period, both running concurrently from the closing date of the relinquished property, with the only extension available under Revenue Procedure 2007-56 and Revenue Procedure 2018-58 for federally declared disasters.
3	IRC Section 1031(a)(2) and Section 761(a) Confirm that partnership, LLC, and fund interests do not qualify as like-kind property, and that direct holding of the underlying real property interest, including a working interest, is required to retain exchange eligibility.
4	IRC Section 263(c) Governs the current-year deduction of intangible drilling costs as the basis for the Tax Boot Mitigation path when a full exchange cannot be completed.
5	IRC Section 465 and Section 57(a)(2) At-risk rules and alternative minimum tax preference for excess intangible drilling costs — relevant limitations and considerations for the boot mitigation path, to be reviewed individually with a tax professional.
6	IRS Form 8824 and Instructions The required reporting mechanism for like-kind exchanges, documenting the relinquished property, identified replacement property or properties, and the realized and recognized gain, if any.

Ready to explore how a working interest fits your 1031 exchange strategy? Connect with Summit Ventures to review your timeline, documentation requirements, and acquisition options before your 45-day clock expires.