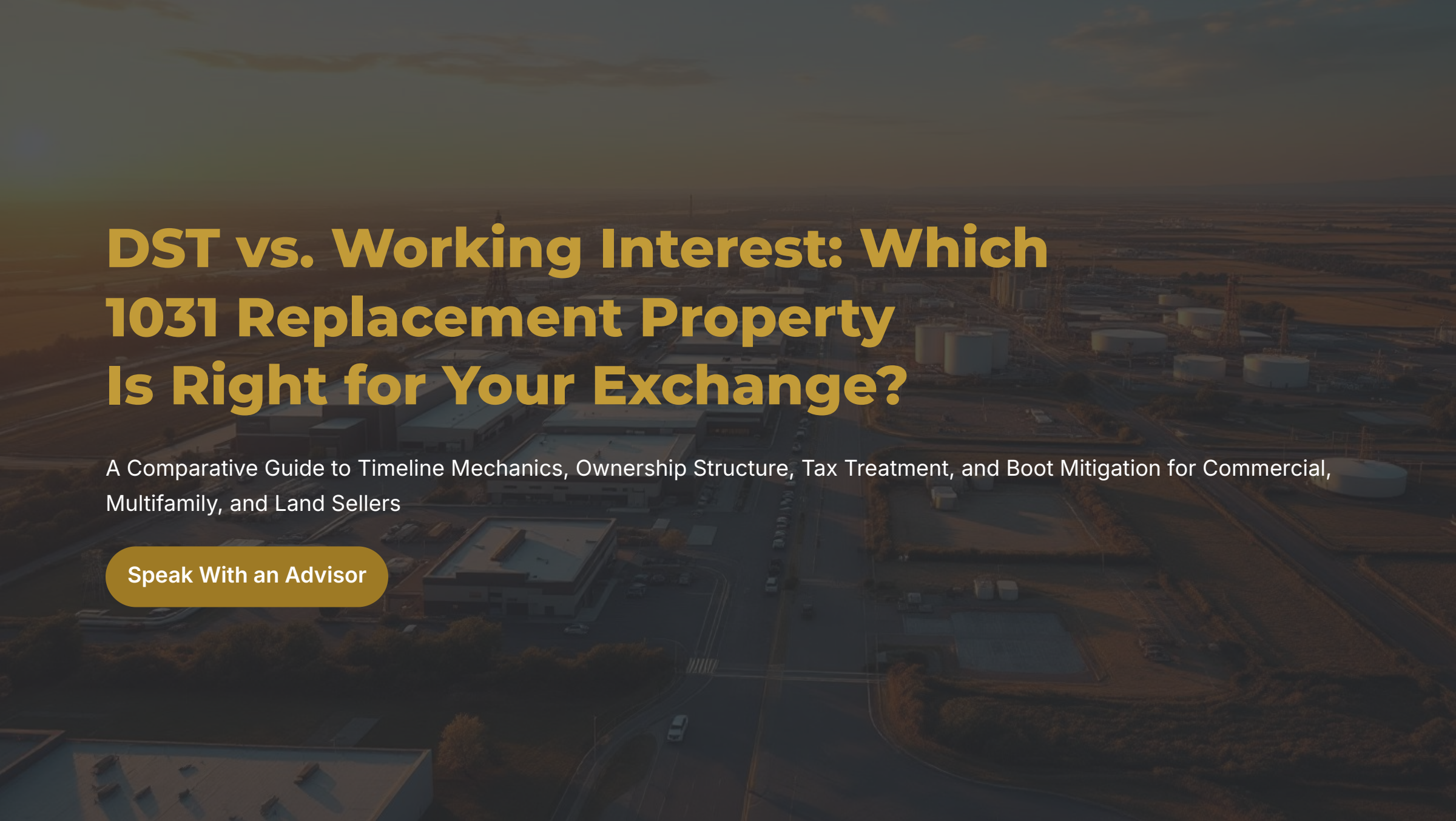


DST vs. Working Interest: Which 1031 Replacement Property Is Right for Your Exchange?

A Comparative Guide to Timeline Mechanics, Ownership Structure, Tax Treatment, and Boot Mitigation for Commercial, Multifamily, and Land Sellers

Speak With an Advisor

The Question and the Clock

If you have sold, or are under contract to sell, a commercial building, a multifamily asset, or a parcel of land, you are operating against two fixed deadlines the moment your sale closes: **45 days to identify replacement property** in writing to your Qualified Intermediary, and **180 days total to close** on that replacement property. Neither window pauses for market conditions, financing delays, or a seller's uncertainty about where to redeploy capital. Missing either deadline does not create a penalty. It collapses the exchange entirely, converting a deferred gain into an immediately taxable event layered with federal and state capital gains tax, depreciation recapture, and potentially the Net Investment Income Tax.

Most sellers entering this window already know about Delaware Statutory Trusts (DSTs) as a passive, professionally managed path to satisfying the like-kind requirement. Fewer know that direct working interests in oil and gas real property have carried the same like-kind qualification since 1968, under Revenue Ruling 68-331, and that this second path solves a different problem entirely: what to do when the exchange cannot be completed in time, or when boot is unavoidable.

This guide compares both paths side by side, not to declare a universal winner, but to give commercial, multifamily, and land sellers a structured framework for evaluating which replacement property category, or combination of the two, fits their timeline, their tolerance for continued real estate management, and their tax exposure.

Day 1–45

Identify replacement property in writing to your Qualified Intermediary

Day 1–180

Close on replacement property before the total window expires

Miss Either

Exchange collapses — gain becomes immediately taxable with recapture and NIIT

What Is Being Compared

OPTION A

Delaware Statutory Trust (DST)

A DST is a separate legal trust entity that holds title to real property — commonly multifamily, industrial, net-lease retail, or self-storage assets — on behalf of multiple beneficial owners. Since Revenue Ruling 2004-86, a beneficial interest in a properly structured DST has been treated by the IRS as direct ownership of real property for Section 1031 purposes, making it eligible like-kind replacement property.

OPTION B

Direct Working Interest in Oil and Gas Real Property

A working interest is a direct ownership stake in the mineral and operating rights of a producing well, held outright or through a structure that elects out of partnership tax treatment under Section 761(a). Revenue Ruling 68-331 holds that a working interest in oil and gas in place constitutes real property for like-kind exchange purposes, and the companion Revenue Ruling 68-226 confirms that a lessee's interest in oil and gas in place is itself real property under the applicable state-law test later codified in Treasury Regulation 1.1031(a)-3.

Both categories can, in principle, satisfy the 45-day identification and 180-day closing requirements of a standard deferred exchange. They differ substantially, however, in ownership structure, participation, cost drag, liquidity, and what happens if the exchange timeline itself breaks down.

Evaluation Criteria

Before comparing the two options directly, sellers should evaluate any replacement property category against seven questions:

1	**Like-Kind Qualification** Does it unambiguously qualify as like-kind real property, with a specific IRS revenue ruling or regulation behind it, or does it rely on a less direct chain of legal reasoning?
2	**Participation & Governance** How much participation and governance does the owner retain versus delegating entirely to a sponsor or manager?
3	**Realistic Timeline to Close** What is the realistic timeline to close, given the 180-day constraint?
4	**Total Cost Drag** What is the total cost drag — acquisition load, ongoing management fees, disposition costs — over the hold period?
5	**Liquidity** How liquid is the position if circumstances change before the hold period ends?
6	**Tax Treatment** What is the tax treatment, both during the hold and in the event the exchange cannot be completed as planned?
7	**Administrative Complexity** What is the administrative and reporting complexity the owner will carry forward?

Option A: Delaware Statutory Trusts

DSTs became the dominant passive 1031 replacement vehicle after Revenue Ruling 2004-86 gave the industry a clean, IRS-blessed packaged-offering framework. For a seller who is simply done with "toilets, tenants, and trash," the appeal is straightforward: a sponsor has already acquired, financed, and manages institutional-quality real estate, and the investor purchases a beneficial interest, often within days, since the sponsor already owns the property and no purchase-and-sale negotiation is required. **Closing speed is typically three to five business days**, which is a meaningful advantage inside a tight 180-day window.

That packaged simplicity comes with structural trade-offs defined by what the industry calls the **"seven deadly sins"** of DST structuring — the restrictions the IRS imposed in Revenue Ruling 2004-86 to preserve the trust's single-owner tax status:

No New Capital

A DST trustee cannot accept new capital contributions from investors once the offering closes.

No New Leases

The trust cannot renegotiate or enter new leases except on the same terms as an existing lease, absent tenant bankruptcy or insolvency.

No New Financing

The trustee cannot obtain new financing or refinance existing debt, except in cases of tenant default.

Cash Restrictions

Cash held between distributions can only be placed in short-term, low-risk instruments.

No Reinvestment

The trust cannot reinvest sale proceeds if the underlying property is sold during the trust's life.

Limited CapEx

Limited to capital expenditures that are normal repair and maintenance or legally required.

No Investor Vote

Investors have no active management or voting authority over the trustee's decisions.

Because of this reinvestment prohibition, when a DST asset is eventually sold, proceeds must be distributed to beneficiaries, who can then choose to complete a further 1031 exchange into a new vehicle if they want continued deferral. The investor has no say in the timing of that sale and no ability to direct capital improvements that might increase the property's value before it happens.

Cost structure matters just as much as governance. Independent industry sources place total DST fee drag, inclusive of upfront sponsor load, ongoing asset and property management fees, and back-end disposition costs, in the range of **10 to 15 percent upfront** and **25 to 35 percent cumulative** over the life of the investment, with minimum investments typically between $100,000 and $250,000 and participation generally limited to accredited investors. Liquidity before the trust's planned disposition is limited. DST interests are not freely tradable, and when a secondary buyer can be found at all, resale commonly requires a discount of 20 to 50 percent to book value. Hold periods typically run five to ten years. DST investors receive a grantor trust letter rather than a partnership K-1, and depreciation flows through based on each beneficiary's own carried-over basis rather than being reported at the trust level.

Market context is useful here. DST equity raised reached roughly $9 billion in 2022, up from about $7.2 billion in 2021, before settling near $5.04 billion in 2023, reflecting broader capital markets conditions rather than any change to the underlying tax mechanics. Separately, 2025 transaction data shows overall 1031 exchange volume down 4.4 percent year over year even as total sales value rose nearly 20 percent, indicating fewer but larger exchanges industry-wide — a dynamic that increases pressure on sellers with bigger gains to find qualified replacement property that can actually absorb the full exchange value inside the statutory window.

Option B: Direct Working Interest in Oil and Gas Real Property

A direct working interest in a producing well is ownership of the operating and mineral rights themselves, not a security representing a fractional trust beneficiary interest. Revenue Ruling 68-331 is the specific, long-standing authority that classifies this ownership as real property for like-kind exchange purposes, and it has never been revoked or narrowed. Because there is no equivalent "packaged offering" revenue ruling for working interests the way Revenue Ruling 2004-86 exists for DSTs, the structure instead relies on case law and the state-law real-property test now codified in Treasury Regulation 1.1031(a)-3, combined with Section 1031(a)(2)'s flush language and a Section 761(a) election. That election allows participants to be treated as holding a direct, divided interest in the underlying real property rather than an interest in a partnership or fund — which is the critical structural requirement: to preserve like-kind classification, and separately to preserve eligibility for certain tax elections described below, the working interest must be held directly or through a structure that has validly elected out of Subchapter K, not through a standard limited partnership or LLC fund interest.

This is the structural distinction a seller should understand clearly before comparing the two paths on tax treatment. A working interest owner who holds directly, or who participates through a properly structured general partnership-style joint venture rather than a passive LP or LLC fund unit, retains a different character of ownership than a DST beneficiary. Working interest owners typically retain governance rights tied to operating decisions under a joint operating agreement — a materially different participation model than a DST's no-vote trustee structure. Summit Ventures structures participation as an entrepreneurial joint venture, with working interest owners positioned as active JV members and business participants in the underlying asset, rather than as holders of a packaged security.

On the timeline question, working interest acquisition timing depends on well availability and documentation readiness rather than a sponsor's existing title, so sellers evaluating this path during an active 45-day identification window should coordinate early with their Qualified Intermediary and confirm documentation requirements well before the clock runs out.

Section 263(c) — IDC Deduction

Allows a taxpayer with a working interest to elect to currently deduct Intangible Drilling Costs — labor, fuel, drilling preparation — rather than capitalizing and depreciating them over time.

Section 469(c)(3) — Passive Loss Exception

Excludes working interests in oil and gas properties from passive activity loss limitations — but only where the taxpayer's form of ownership does not limit liability the way a standard limited partnership interest does.

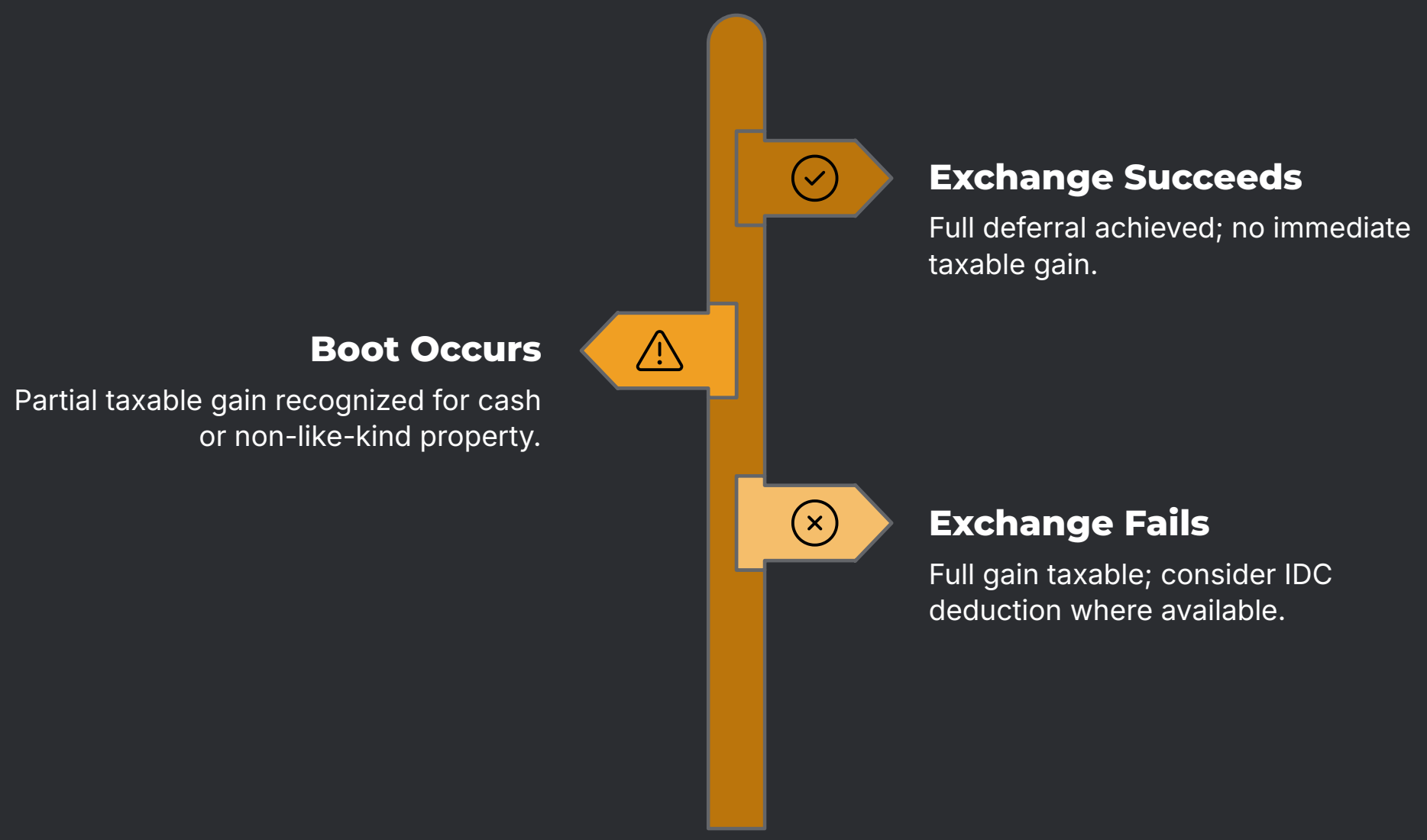
Section 761(a) — JV Election

Allows participants to be treated as holding a direct, divided interest in the underlying real property rather than an interest in a partnership or fund — preserving both like-kind status and favorable tax elections.

The specific percentage of a given well's costs that qualify as IDC, and the resulting deduction amount, depends on each well's engineering and cost structure and each participant's individual tax situation, and should always be confirmed with a qualified tax professional before any capital contribution decision is made.

Tax Boot Mitigation: When the Timeline or the Match Does Not Work

Not every exchange closes cleanly. A seller may run out of time to identify suitable like-kind property within the 45-day window. A seller may identify property but be unable to close within 180 days. A seller may find replacement property of lower value than the relinquished property, creating **boot** — the taxable difference that does not qualify for deferral even within an otherwise successful exchange. In any of these scenarios, the result is the same: a tax bill for capital gains, depreciation recapture, and potentially the Net Investment Income Tax, calculated on whatever portion of the gain was not successfully deferred.



This is the second decision path this guide is built around, and it operates independently of the 1031 timeline itself. A seller who has already triggered boot, or who has already missed the exchange window entirely and is now simply looking to redeploy taxable proceeds, can still deploy capital directly into working interests and elect the IDC deduction available under Section 263(c) in the same tax year. That deduction does not reverse a failed exchange. It is a separate mechanism that can offset ordinary and other income in the year the capital is deployed, reducing the net tax impact of the gain or boot that became taxable. Because this path is not constrained by the 45-day or 180-day exchange clock, it remains available to a seller evaluating options after those deadlines have already passed — which makes it a meaningful fallback discussion to have with a tax advisor before, not after, a seller concludes an exchange cannot be saved.

⚠ The exact deduction amount available in any individual case depends on the specific well's cost structure, the taxpayer's ownership form, and the taxpayer's broader tax position. Actual tax treatment should always be confirmed with a CPA or tax attorney before capital is committed.

Side-by-Side Comparison

Category	DST	Direct Working Interest
Like-kind authority	Revenue Ruling 2004-86, packaged-offering framework	Revenue Ruling 68-331 and 68-226, state-law real property test under Treas. Reg. 1.1031(a)-3
Ownership structure	Beneficial interest in a trust holding title to real estate	Direct ownership of operating/mineral rights, or JV interest preserving direct-ownership character under a Section 761(a) election
Participation	No active management; trustee controls all decisions	Governance rights under a joint operating agreement; active JV member participation
Governance and control	Investor has no vote on leasing, financing, capital improvements, or sale timing	Participants retain defined rights tied to operational decisions
Timeline fit	Fast close, often 3–5 days, since sponsor already holds title	Timing depends on well/documentation readiness; requires early QI coordination
Liquidity	Illiquid prior to planned disposition; secondary resale commonly at a 20–50% discount to book value	Illiquid; tied to the producing life and operating agreement of the underlying asset
Tax treatment (ongoing)	Grantor trust letter; depreciation based on each beneficiary's carried-over basis	Potential current deduction of IDC under Section 263(c); working interest exception to passive loss rules under Section 469(c)(3) when properly structured
Tax treatment (failed exchange/boot)	No independent boot-mitigation mechanism; boot is simply taxed	IDC deduction can be elected independently of the 1031 timeline to help offset taxable gain or boot
Cost structure	Approximately 10–15% upfront load; estimated 25–35% total fee drag over the hold period	Capital deployed directly into the asset; costs tied to well development and operating expense rather than a layered sponsor-fee structure
Complexity	Lower day-to-day complexity; higher structural restriction (the "seven deadly sins")	Requires direct or JV-structured holding to preserve like-kind status and favorable tax elections; more active participation expected
Minimum participation	Typically $100,000 to $250,000; accredited investor standard common	Varies by well and offering structure

Advantages, Limitations & Best-Fit Scenarios

DST Advantages

- Fast closing speed well suited to a compressed 180-day window
- No active management burden
- IRS revenue ruling built specifically around the packaged-offering structure
- Non-recourse debt typically held at the trust level rather than attaching to the individual investor

DST Limitations

- No voice in leasing, financing, capital improvement, or disposition decisions
- Mandatory distribution of sale proceeds rather than reinvestment
- Meaningful cumulative fee drag
- Limited liquidity with steep resale discounts if a sale is needed before the trust's planned exit

Working Interest Advantages

- Long-standing, specific revenue ruling confirming like-kind status
- Active governance participation rather than a passive trustee relationship
- Distinct and well-established IDC deduction mechanism under Section 263(c)
- Path to tax mitigation that functions independently of whether the 1031 exchange itself succeeds
- No "seven deadly sins" style restriction on reinvestment or capital decisions once properly structured

Working Interest Limitations

- Requires direct or carefully structured JV participation rather than a simple LP/LLC fund unit
- Timing depends on well and documentation availability rather than a sponsor's already-titled inventory
- Specific deduction amount varies by well and individual tax circumstance, requiring professional tax guidance

Best-Fit Scenarios

1

DST May Fit Better When

The seller wants zero ongoing participation of any kind, the exchange is well inside its timeline with ample runway to complete sponsor due diligence, and the seller's priority is matching the exact dollar value of the relinquished property as efficiently as possible to avoid boot.

2

Working Interest May Fit Better When

The seller wants to retain some governance participation, is specifically seeking the IDC tax mechanics under Section 263(c), or has already incurred boot or missed the exchange window and needs a tax mitigation strategy that does not depend on 1031 timing at all.

3

A Combined Approach May Fit When

A seller is identifying multiple replacement properties within the 45-day window and wants to diversify between a professionally managed real estate vehicle and a direct energy participation, balancing passive simplicity against active governance and the added IDC consideration.

Decision Guidance & Questions for Your Advisory Team

Start with the calendar, not the asset class. Confirm exactly how many days remain in the 45-day identification window and how many days remain to the 180-day closing deadline, and share both dates with the Qualified Intermediary handling the exchange before evaluating any replacement property in detail. From there, map the seller's actual goal: is the priority eliminating property management entirely, in which case a DST's packaged structure deserves serious evaluation, or is the priority retaining some operational participation while also accessing a distinct tax mechanism, in which case a direct working interest structured to preserve 263(c) and 469(c)(3) eligibility deserves equal evaluation.

If the exchange has already failed, or boot is already unavoidable, the decision shifts entirely. At that point the 45-day and 180-day clock is no longer the constraint, and the relevant question becomes which capital deployment options can still reduce the current year's tax exposure — a question where the IDC deduction mechanism under Section 263(c) becomes directly relevant regardless of 1031 status.

In every scenario, confirm with a CPA, tax attorney, and the Qualified Intermediary how a specific replacement property or boot-mitigation strategy applies to the seller's individual facts before committing capital. Tax treatment depends on the specific structure used, the timing of the election, and each participant's broader tax position.

1 Identification Window Status

How many days remain in my identification window, and has my Qualified Intermediary confirmed receipt of any identification notice in writing?

2 DST Restrictions

If I choose a DST, what specific restrictions under Revenue Ruling 2004-86 apply to this trust, and who controls the decision to sell the underlying property?

3 Working Interest Structure

If I choose a direct working interest, is the offering structured to preserve direct-ownership character under Section 761(a), and has my tax advisor confirmed this structure supports both like-kind treatment and the Section 469(c)(3) exception?

4 Closing Timeline

What is the realistic, documented timeline to close on this specific replacement property within my remaining 180 days?

5 Total Cost Drag

What is the total cost drag — upfront and cumulative — associated with this replacement property over its expected hold period?

6 Boot Mitigation Plan

If my exchange does not close in time, or results in boot, what is my specific plan to evaluate the Section 263(c) IDC deduction as a separate tax mitigation strategy this tax year?

7 Governance Rights

What governance rights, if any, do I retain once capital is committed, and how does that compare to my current level of involvement as a property owner?

> Sellers facing an active 45-day clock rarely have the luxury of exploring every replacement property category in depth before a decision is required. Understanding, in advance, that DSTs and direct working interests solve different problems — one built for passive simplicity inside a tight exchange timeline, the other built around active participation and a tax mechanism that remains useful even if the exchange itself does not succeed — allows a seller to move faster and with more clarity when the clock is already running. The right next step is a direct conversation with a Qualified Intermediary and a tax advisor, armed with the specific framework above, to determine which path, or combination of paths, matches the remaining days on the calendar and the actual outcome the seller is trying to achieve.

Ready to evaluate your options before the clock runs out?

Speak With a Summit Ventures Advisor Learn More