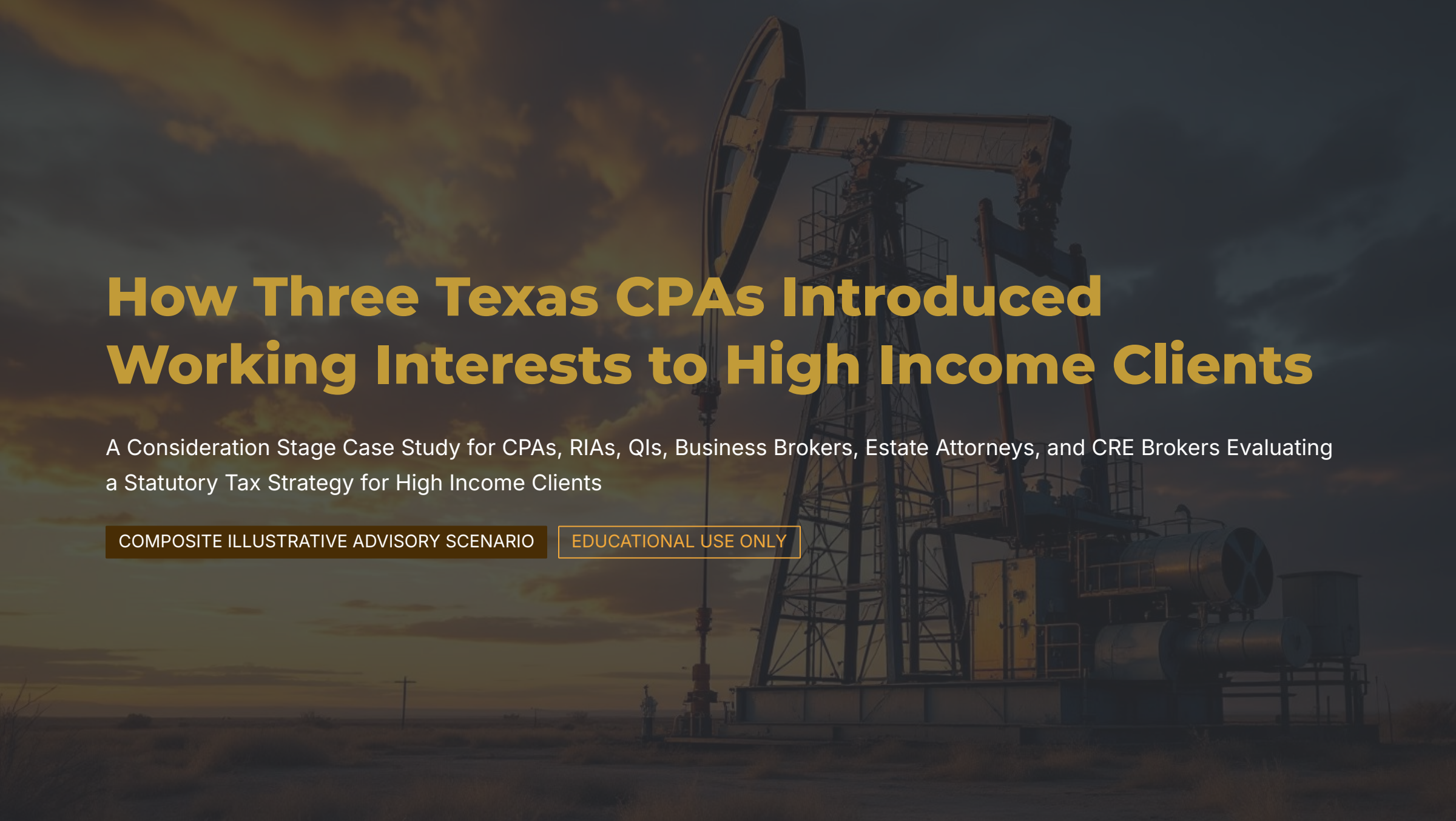


How Three Texas CPAs Introduced Working Interests to High Income Clients

A Consideration Stage Case Study for CPAs, RIAs, QIs, Business Brokers, Estate Attorneys, and CRE Brokers Evaluating a Statutory Tax Strategy for High Income Clients

COMPOSITE ILLUSTRATIVE ADVISORY SCENARIO

EDUCATIONAL USE ONLY

Case Classification & At a Glance Summary

CASE TYPE

Composite, illustrative advisory scenario. This case study combines three anonymized, representative practice situations drawn from common patterns seen across independent Texas CPA firms. No individual client, firm name, or dollar outcome described below is a verified or actual result. It is intended strictly as an educational illustration of how the decision process unfolds, not as a projection of tax savings, deduction amounts, or investment performance.

PERSONA REPRESENTED

CPAs and tax professionals, working alongside RIAs, qualified intermediaries, business brokers and M&A advisors, estate planning attorneys, and commercial real estate brokers who sit on the same advisory team.

CORE STATUTORY THROUGHLINE

In all three scenarios, the determining fact is not the asset class itself but how the working interest is held. A working interest held directly, or through an entity that does not limit the taxpayer's liability, is treated differently under the Internal Revenue Code than a membership interest in a liability-limiting LLC or LP. That single structural fact is what allows the same working interest to serve two separate statutory purposes: an IRC Section 469(c)(3)(A) active income offset in one engagement, and a Revenue Ruling 68-331 like-kind replacement property analysis in another.

Trigger Categories Covered

1 Year-End Ordinary Income Spike

Late Q4 K-1 distributions, bonuses, or vested equity pushing income above projections.

2 Ordinary Income in a Business Sale

Amounts allocated to equipment, inventory, or covenants taxed as ordinary income.

3 Narrowing Section 1031 Window

Identified replacement properties falling out of contract as the 45-day clock runs.

Participant Profile, Trigger & Situation

1	2	3
Practice One — Austin A solo CPA practice serving physicians, technology executives, and professional services partners. The recurring year-end problem in this practice is the client who receives a K-1 distribution, a bonus, or vested equity compensation in the fourth quarter that pushes total taxable income well above what was projected in the spring. By the time the CPA sees the full picture in November or December, most conventional levers — retirement plan deferrals, charitable bunching, timing of deductible expenses — have already been maximized or are capped by statute.	**Practice Two — Houston** A four-partner firm with a concentration in closely held business owners, many of whom work with business brokers and M&A advisors on company sales. The recurring problem here is structural: a portion of sale proceeds, particularly amounts allocated to equipment, inventory, or covenants not to compete, is taxed as ordinary income rather than long-term capital gain, regardless of how the deal is otherwise structured. That ordinary income component often arrives in the same year as the seller's final operating income from the business, compounding the exposure.	**Practice Three — Dallas Fort Worth** A mid-size firm that regularly coordinates with qualified intermediaries and commercial real estate brokers on behalf of clients exchanging investment property. The recurring problem is timeline risk: a client identifies replacement property within the 45-day window required under Treasury Regulation 1.1031(k)-1, then one or more of those identified properties falls out of contract as financing, inspection, or seller issues surface, narrowing the remaining options as the clock continues to run.

In all three practices, the common pattern was the same: the CPA had identified a client problem rooted in the Internal Revenue Code, not a product gap, and was looking for a solution grounded in statute rather than in a sales pitch.

Challenge & Decision Criteria

Each CPA faced a version of the same two-part challenge. First, find a mechanism that is actually permitted under the Code for the specific fact pattern in front of them, not a generic "tax shelter" claim. Second, find a partner capable of supporting that mechanism with documentation a CPA can rely on: engineer-certified cost allocations, timely K-1s, and, where relevant, a tax opinion letter addressing the specific statutory question at hand.

The decision criteria each firm applied were consistent across all three practices:



Statutory Basis

Does the strategy rest on a specific, citable Code section or published guidance — such as IRC 263(c), IRC 469(c)(3)(A), or Revenue Ruling 68-331 — rather than an aggressive or novel interpretation?



Documentation Quality

Will the client receive a K-1 that correctly reflects the character of the activity (active versus passive under Section 469), on a schedule that allows the return to be filed without extension-driven estimates?



Professional Liability Exposure

Does recommending — or more precisely, educating the client on — this strategy create reputational or liability exposure for the CPA if the structure is later challenged?



Advisor Coordination

Does the partner organization work alongside the client's existing CPA, attorney, and QI, or does it attempt to displace those relationships?

Options & Approach

Austin Practice — Year-End Income Spike

The CPA was already familiar with conventional income deferral tools but had not previously evaluated a working interest in oil and gas property as a year-end planning option for a client with a December income spike. The relevant mechanism is IRC Section 263(c), read together with Treasury Regulation 1.612-4, which allows a working interest holder to elect to expense intangible drilling costs in the year incurred rather than capitalizing them. The separate and distinct question — whether that deduction can offset the client's active W-2, 1099, or K-1 income rather than only passive income — is governed by IRC Section 469(c)(3)(A), the working interest exception to the passive activity loss rules. That exception applies only where the taxpayer holds the interest directly, or through an entity that does not limit the taxpayer's liability. No material participation or hours-based test applies, which distinguishes it from the real estate professional standard many CPAs already know well.

Houston Practice — Business Sale Ordinary Income

The firm's working hypothesis, developed jointly with the client's business broker, was that a portion of the sale year's ordinary income exposure could be addressed using the same 263(c)/469(c)(3)(A) mechanism, applied to a direct working interest capital contribution timed to the same tax year as the closing. The firm also walked the client through IRC Section 465, the at-risk limitation, which caps any deduction at the taxpayer's actual economic exposure — cash and qualifying recourse debt only — and IRC Section 57(a)(2)(A), which treats excess intangible drilling costs as an alternative minimum tax preference item only to the extent those costs exceed 65 percent of the taxpayer's net income from oil, gas, and geothermal properties for the year. This is a meaningfully different — and more favorable — threshold than the generic "AMT add back" framing some advisors default to, and it mattered to a client already near the top of the ordinary income brackets in the sale year.

Dallas Fort Worth Practice — 1031 Window

The CPA and the client's qualified intermediary evaluated a direct working interest in a producing field as qualified replacement property under the like-kind exchange rules. Revenue Ruling 68-331 holds that a lessee's working interest in a producing oil and gas lease is real property, like-kind to a fee interest in real estate, for purposes of Section 1031(a). The CPA and QI were careful to confirm, consistent with Revenue Ruling 78-135, that the replacement interest had to be an actual direct or undivided working interest rather than a partnership interest in an entity that holds the working interest, since a general partnership interest itself does not qualify for 1031 nonrecognition treatment. This structural distinction — direct interest versus entity interest — is the same fact pattern the Austin and Houston practices were evaluating for a completely different statutory purpose, which is why all three CPAs ultimately found their way to the same category of partner.

Implementation

Across all three engagements, the implementation sequence followed a similar path, with the CPA remaining the client's primary advisor throughout.

Step 1 — Education

Each CPA requested a technical briefing covering the statutory basis for the mechanism relevant to their client's fact pattern, not a product presentation. This included the Section 263(c) election mechanics, the Section 469(c)(3)(A) direct holding requirement, and, for the Dallas Fort Worth case, the Revenue Ruling 68-331 and 78-135 like-kind analysis.

Step 2 — Documentation Review

Each CPA reviewed the authorization for expenditure detail supporting the intangible versus tangible cost allocation for the specific well or wells under consideration, since that allocation — not a marketing claim — is what ultimately supports the Section 263(c) election on the return.

Step 3 — Structure Confirmation

In every case, the CPA and, where applicable, the client's attorney or QI confirmed that the capital contribution would be structured as a direct working interest, or through an entity that does not limit liability, preserving the Section 469(c)(3)(A) exception and, for the Dallas Fort Worth case, the real property characterization needed for Rev. Rul. 68-331.

Step 4 — Tax Opinion Coordination

For the business sale and 1031 scenarios in particular, the client's attorney requested a tax opinion letter addressing the specific statutory question presented, which the CPA then incorporated into the client's permanent tax file alongside the K-1 and supporting schedules.

Step 5 — K-1 Scheduling and Filing

Each CPA received a K-1 reflecting the active versus passive character of the activity consistent with Section 469 coding, on a timeline that allowed the return to be prepared without relying on placeholder estimates.

Explanation & Outcome

The outcome described here is illustrative only and is not a verified or guaranteed result for any individual. It reflects the type of planning conversation and documentation flow these three practices reported experiencing, not a specific dollar figure, deduction percentage, or rate of return.

AUSTIN

Year-End Income Spike

The client's CPA was able to present the Section 263(c) election and the Section 469(c)(3)(A) active income offset as one additional planning option alongside the client's existing retirement and charitable strategies, with the final determination of suitability and deduction amount left to the client's own facts, at-risk basis under Section 465, and the CPA's own calculation.

HOUSTON

Business Sale Ordinary Income

The business broker and CPA were able to present the client with a statutory — rather than speculative — option for addressing the ordinary income component of the sale, coordinated with the Section 57(a)(2)(A) AMT threshold analysis specific to that client's projected net oil and gas income for the year.

DALLAS FORT WORTH

1031 Identification Window

The QI and CPA were able to bring a qualified replacement property category to the client inside the remaining identification window, supported by the Revenue Ruling 68-331 framework, with the final 1031 qualification determination remaining the responsibility of the client's own counsel and QI based on the completed transaction documents.

In all three cases, what changed was not the existence of a tax strategy — Sections 263(c) and 469(c)(3)(A) have existed in the Code for decades — but the CPA's access to engineer-certified cost documentation, standardized K-1 scheduling, and a tax opinion letter addressing their client's specific fact pattern.

Metrics Table & Representative Perspectives

Category	Austin	Houston	Dallas Fort Worth
Statutory Basis	IRC 263(c), Treas. Reg. 1.612-4, IRC 469(c)(3)(A), IRC 465	IRC 263(c), IRC 469(c)(3)(A), IRC 57(a)(2)(A), IRC 465	Rev. Rul. 68-331, Rev. Rul. 78-135, Treas. Reg. 1.1031(k)-1, IRC 469(c)(3)(A)
Holding Structure Required	Direct working interest, or entity that does not limit liability	Direct working interest, or entity that does not limit liability	Direct working interest, or entity that does not limit liability
Documentation Produced	AFE cost allocation, Schedule K-1 with Sec. 469 coding	AFE cost allocation, K-1, tax opinion letter	AFE cost allocation, K-1, tax opinion letter
Financial Outcome	None stated — depends on client's individual facts	None stated — depends on client's individual facts	None stated — depends on client's individual facts
Advisor Relationships	Existing CPA remained advisor of record	Existing CPA, broker remained advisors of record	Existing QI and CPA remained advisors of record

Representative Perspectives

"What I needed was not another investment idea. I needed a mechanism I could defend under the Code if my client were ever asked about it. The fact that the active income offset runs through a specific statutory exception, not a general passive loss rule, is what let me bring it to a client with confidence."

— Austin CPA (composite, illustrative)

"Our client's sale had an ordinary income piece we could not structure away. Having a statutory option to discuss with the client's CPA, backed by engineer-certified cost documentation instead of a sales deck, made that year-end conversation far more productive."

— Houston Business Broker & CPA (composite, illustrative)

"We were down to our last identified property and it had just fallen through. Knowing that a working interest held directly — not through a fund or LP interest — has an established basis under Revenue Ruling 68-331 as qualified replacement property gave our client's counsel something concrete to evaluate inside the window that remained."

— Dallas Fort Worth QI & CPA (composite, illustrative)

Assumptions, Key Takeaways & Questions for Advisors

Assumptions

These scenarios assume the client meets applicable investor eligibility standards for a direct participation, that the capital contribution is structured and documented correctly as a direct working interest or through a non-liability-limiting entity, and that the client's own CPA and attorney independently confirm suitability, at-risk basis, and statutory qualification based on the client's complete facts. Nothing in this case study should be read as a determination that any particular client or transaction qualifies for the tax treatment described.

Key Takeaways

One Structural Fact, Two Statutory Purposes

The single structural fact that determines eligibility for both the Section 469(c)(3)(A) active income offset and the Revenue Ruling 68-331 like-kind analysis is identical: direct holding, or holding through an entity that does not limit liability. Advisors who understand this one distinction can evaluate working interest proposals across very different client situations using the same framework.

Two Separate Code Provisions

Section 263(c) governs the timing and character of the deduction. Section 469(c)(3)(A) governs whether that deduction can offset active income. These are two separate Code provisions and should not be conflated when evaluating a proposal or explaining it to a client.

Documentation Is the Differentiator

Documentation quality — authorization for expenditure detail, properly coded K-1s, and a tax opinion letter addressing the specific question presented — is what separates a defensible statutory position from a generic tax reduction claim, and it is where advisors should focus their due diligence with any partner organization.

Advisor Relationships Are Preserved

In every scenario, the client's existing CPA, attorney, broker, or QI remained the advisor of record. The role of a specialized working interest partner is to provide technical education, documentation, and reporting support — not to replace the advisory relationship.

Questions for Advisors to Consider

When a client's income spikes late in the year, has the direct holding requirement under IRC 469(c)(3)(A) been confirmed before assuming an active income offset applies?

When reviewing a business sale allocation, has the ordinary income component been isolated clearly enough to evaluate a same-year statutory offset against it?

When a 1031 identification window is narrowing, has qualified replacement property research included asset categories — such as direct working interests — that fall outside conventional real estate?

Does the partner organization provide authorization for expenditure level documentation sufficient to support a Section 263(c) election on audit?

Does the partner organization provide a K-1 on a timeline that supports timely filing, with Section 469 active or passive coding clearly stated?

Has the client's attorney reviewed a tax opinion letter addressing the specific statutory question relevant to their situation, rather than a generic disclosure document?

Sources, References & Next Steps

Across all three Texas practices, the pattern that emerges is less about oil and gas as an asset class and more about a recurring gap in how high-income tax problems get solved. Year-end income spikes, ordinary income components inside business sales, and narrowing 1031 windows are all fact patterns most CPAs encounter regularly, and in each case the statutory tools involved — IRC 263(c), IRC 469(c)(3)(A), and Revenue Ruling 68-331 — have existed in the Code and published guidance for decades. What these three practices found useful was not a new deduction, but a partner capable of supporting those existing statutory mechanisms with the documentation, K-1 scheduling, and tax opinion coordination a CPA needs to bring the option to a client with professional confidence.

Summit Ventures operates as an entrepreneurial joint venture platform built around that documentation standard, and advisors are encouraged to evaluate it the same way these three practices did — against the statute first, and against their own client's facts second, in consultation with the client's complete advisory team.

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Sources & References

- IRC Section 263(c) and Treasury Regulation 1.612-4 — election to expense intangible drilling costs
- IRC Section 469(c)(3)(A) — working interest exception to passive activity loss rules
- IRC Section 465 — at-risk limitation on deductible losses
- IRC Section 57(a)(2)(A) — AMT treatment of excess intangible drilling costs (65% threshold)
- IRC Sections 611 and 613A — percentage depletion
- IRC Section 461(h) — economic performance rule and drilling-related timing exception
- Revenue Ruling 68-331 (1968-1 C.B. 352) — working interest as real property for Section 1031(a)
- Revenue Ruling 78-135 — general partnership interest does not qualify for Section 1031 nonrecognition
- Treasury Regulation 1.1031(k)-1 — 45-day identification and 180-day exchange period
- One Big Beautiful Bill Act (signed July 4, 2025) — restoring permanent 100% bonus depreciation under IRC Section 168(k)

This case study is for educational purposes only and does not constitute tax, legal, or investment advice. Advisors and their clients should consult qualified tax and legal professionals regarding their specific circumstances before acting on any strategy described above.

The Three Statutory Pillars

IRC 263(c)

Timing & character of the deduction — expense intangible drilling costs in the year incurred.

IRC 469(c)(3)(A)

Active income offset — working interest exception to passive activity loss rules. Direct holding required.

Rev. Rul. 68-331

Like-kind exchange — working interest in producing lease is real property for Section 1031(a) purposes.

Evaluate Summit Ventures

Advisors are encouraged to evaluate Summit Ventures the same way these three practices did — statute first, client facts second, in consultation with the complete advisory team.

Learn More at Summit Ventures