

Working Interest Ownership vs. Passive Real Estate vs. Securities

A Decision Stage Comparison Guide for Exiting Founders, Active CEOs Approaching Liquidity, and PE Backed Operators Evaluating Where Post-Exit Capital Should Go

SUMMIT VENTURES

2026 TAX YEAR

Introduction

An operator who has spent a career building enterprise value faces a narrow window after a sale, a recapitalization, or a large distribution. The proceeds are concentrated, the tax bill is immediate, and the next capital decision is rarely given the same rigor that built the business in the first place. Three structures dominate the conversation among exiting operators and their advisors: direct working interest ownership in oil and gas properties, passive real estate ownership, and public securities. Each structure moves capital out of a single concentrated asset. Each is taxed differently. Each demands a different level of ongoing involvement.

This guide compares the three on the criteria that matter most to a business minded decision maker: ownership structure, participation requirements, governance and control, liquidity, tax treatment, exposure and limitations, and administrative complexity. The goal is not to declare a universal winner. The goal is to give an exiting operator and their CPA or advisor a clear, evidence based framework for evaluating which structure, or combination of structures, fits a specific liability picture and a specific appetite for involvement.

Option A

Direct Working Interest in Oil & Gas Properties

Option B

Passive Real Estate Ownership

Option C

Public Securities

What Is Compared & Evaluation Criteria

The Three Paths

This guide evaluates three capital deployment paths commonly considered by operators and founders after a liquidity event or a year of concentrated ordinary income:

1 Direct Working Interest

Ownership in oil and gas properties, held directly or through an entity that does not limit the owner's liability, consistent with IRC Section 469(c)(3)(A).

2 Passive Real Estate

Rental property, syndications, or real estate limited partnerships in which the owner does not meet the material participation or real estate professional standard.

3 Public Securities

Common stock, exchange traded funds, index funds, and corporate bonds held in a standard brokerage or retirement account.

Each path is evaluated as it actually functions under current tax law and market conditions, not as it is marketed. Figures and statutory citations reflect 2026 tax year rules unless otherwise noted, and all tax outcomes depend on the taxpayer's specific facts, basis, and at-risk amount. Nothing in this guide should be read as a substitute for review by a qualified CPA or tax attorney.

Evaluation Criteria

A business minded operator evaluating these three structures should apply the same discipline used to evaluate an acquisition target or a capital project:

Ownership Structure

What is actually owned — a direct interest in a producing asset, a fractional real property interest, or a claim on a pooled entity's future cash flows.

Participation

What level of involvement, reporting, and decision making rights come with the position.

Governance & Control

Who makes operating decisions, and what rights does the capital holder retain.

Liquidity

How quickly and at what cost can the position be converted back to cash.

Tax Treatment

How income, loss, and eventual sale proceeds are classified and taxed, and whether losses can offset active income or only passive income.

Exposure & Limitations

What structural caps, phase-outs, or concentration factors apply.

Complexity

What ongoing administrative, filing, and professional coordination burden the structure creates.

Option A: Direct Working Interest Ownership

A direct working interest is an ownership position in the oil and gas property itself, including the right to the hydrocarbons produced and the obligation to pay a proportionate share of drilling, development, and operating costs. Under 26 CFR 1.612-4(a), the operator for purposes of 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." This is a legal classification, not a marketing label, and it is the foundation for how the position is taxed.

The defining tax mechanic is IRC Section 469(c)(3)(A), which states that the passive activity rules "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." This is the single structural fact that separates a working interest from both passive real estate and a pooled fund organized as an LP or LLC: there is no hours test, no material participation test, and no income based phase out.

Costs on a working interest fall into two categories. Intangible drilling costs — items with no salvage value such as labor, fuel, chemicals, and drilling services — are generally eligible for a current year deduction election under Section 263(c). Tangible drilling costs — items with salvage value such as casing, tubing, and wellhead equipment — are capitalized and depreciated, and are eligible for bonus depreciation treatment under IRC 168(k), which was made permanent at 100 percent for property placed in service after January 19, 2025 under the One Big Beautiful Bill Act. The actual percentage of a given project's costs classified as intangible versus tangible is determined by the well's engineering design and the specific Authorization for Expenditure, not by a flat industry figure, and the usable deduction in any tax year is governed by the owner's basis and at-risk amount under IRC 465. Up to 100 percent of eligible intangible drilling costs can qualify for a current year election, though the actual figure for any specific project depends on that well's engineering design, the participant's basis and at-risk position, and individual tax circumstances, and should always be confirmed against the applicable AFE with a qualified CPA before any election is made.

AMT Guardrail — IRC 57(a)(2)

Excess intangible drilling costs can become an alternative minimum tax preference item, though an independent producer exception generally limits the AMT impact so that drilling deductions cannot reduce alternative minimum taxable income below roughly 60 percent of what it would otherwise be.

Percentage Depletion — IRC 611 & 613A

Once a property reaches production, the owner may be eligible for a 15 percent percentage depletion allowance — a continuing tax benefit tied to ongoing production income rather than the initial drilling year.

Governance via JOA

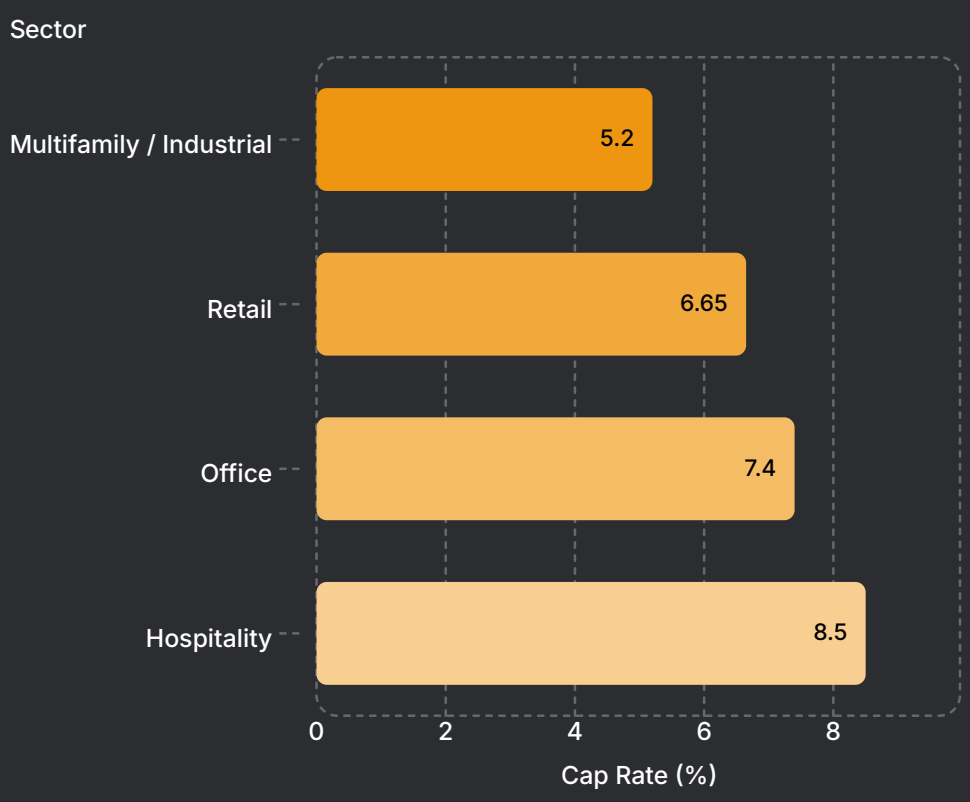
Governance flows through a Joint Operating Agreement, which spells out the operator's authority, the non-operating owners' consent rights on major decisions, and the cost sharing mechanics for every phase of the well's life. The owner receives operational reporting and holds a direct claim on the asset.

Option B: Passive Real Estate Ownership

Passive real estate, for the purposes of this comparison, means rental property, a real estate syndication, or a real estate limited partnership in which the capital holder does not meet the IRS standard for material participation or real estate professional status. This is the most common real estate position held by an operator who still runs an active business, because the 750 hour and more than 50 percent of personal service time test required for real estate professional status is, by definition, incompatible with running a separate operating company full time.

Without that status, real estate losses are governed by the passive activity loss rules under IRC Section 469 — the same framework from which working interests are specifically excluded. A narrow exception, the active participation special allowance under IRS Publication 925, permits up to $25,000 of real estate losses to offset other income, but this allowance phases out at 50 cents per dollar of modified adjusted gross income above $100,000 and is fully eliminated at $150,000 MAGI. An exiting operator who has just closed a sale or taken a large distribution will, in the large majority of cases, have income well above this threshold in the relevant tax year, which means the $25,000 allowance is unavailable precisely when the tax liability is largest. Real estate losses in that scenario are suspended and carried forward until there is passive income to absorb them or the property is disposed of in a fully taxable transaction, not applied against the active income or business proceeds that created the original tax exposure.

Current Cap Rate Environment (Mid-2026)



Source: CBRE H1 2026 Cap Rate Survey. Only 5–15 bps of further compression projected for the year.

Key Limitations for Exiting Operators

Loss Allowance Phase-Out

The $25,000 special allowance phases out between $100,000 and $150,000 MAGI — unavailable to most exiting operators in the year they need it most.

Suspended Losses

Real estate losses are carried forward until passive income exists to absorb them or the property is disposed of in a fully taxable transaction.

Section 1250 Recapture

At sale, depreciation is subject to unrecaptured Section 1250 gain treatment, capping the federal rate on the recapture portion at 25 percent — materially higher than long-term capital gains brackets.

Sponsor-Controlled Governance

A syndication investor is structurally a capital provider to a sponsor who makes operating decisions, sets refinancing and disposition timing, and controls reporting cadence.

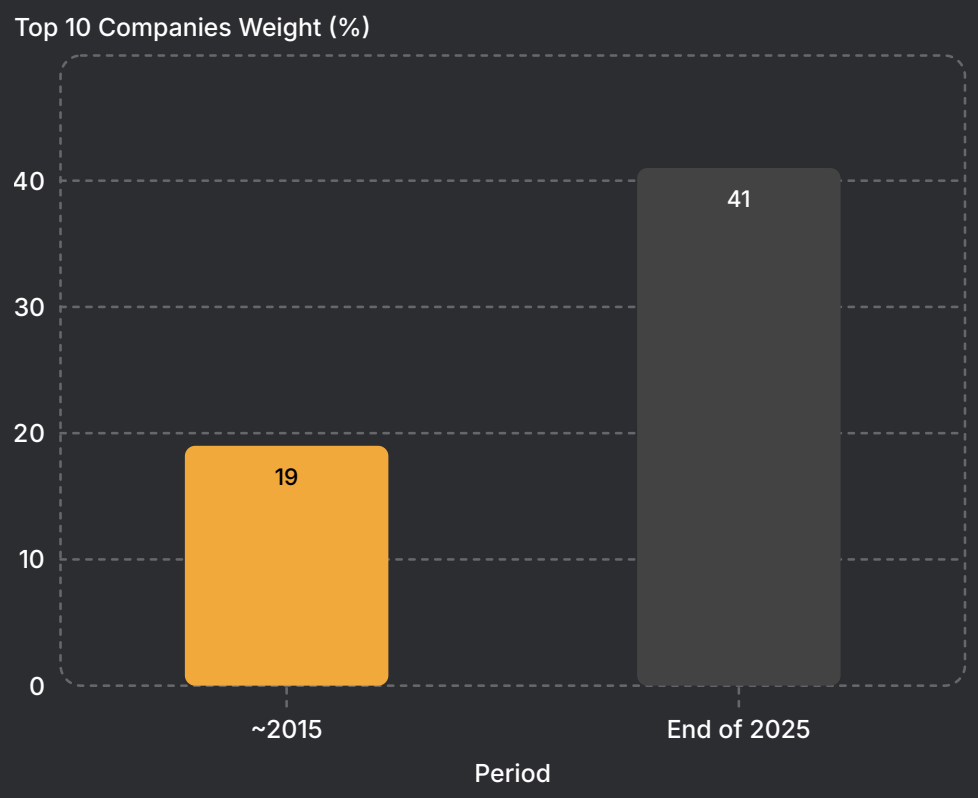
Option C: Public Securities

Public securities — meaning common stock, index funds, exchange traded funds, and corporate bonds — offer the structure most familiar to an exiting operator's broader financial team and the highest degree of day to day liquidity among the three options. Shares can generally be bought or sold within a trading day, custody is institutional, and reporting is standardized.

The trade-offs sit in tax treatment, concentration, and control. A C-corporation's earnings are taxed at the 21 percent corporate rate before any distribution reaches the shareholder. A qualified dividend is then taxed again at the shareholder level at 0, 15, or 20 percent, plus the 3.8 percent Net Investment Income Tax for income above the applicable threshold, producing a combined effective rate that can reach approximately 23.8 percent on top of the 21 percent already paid at the entity level, and considerably higher on non-qualified dividend income. This double layer of taxation applies regardless of whether the underlying business is capital intensive or asset light, and it is structurally different from the single layer of tax treatment available to a direct working interest owner.

Public equities also carry no active offset mechanism comparable to Section 469(c)(3)(A). Capital losses on securities offset capital gains and, beyond that, only $3,000 of ordinary income per year, with any excess carried forward. There is no deduction category analogous to intangible drilling costs that can be elected in the year the capital is deployed.

S&P 500 Index Concentration Risk



Source: RBC Wealth Management, "The Great Narrowing." An operator moving concentrated business wealth into an index fund today is, in practice, taking on a meaningfully more concentrated bet on a small number of large technology-dependent companies than the "diversified index" label suggests.

Key Characteristics

✓ Highest Liquidity

Positions can typically be converted to cash within a single trading day.

✓ Lowest Admin Burden

Standard 1099 reporting through a brokerage account.

✗ Double Taxation

Combined effective rate on qualified dividends can reach ~23.8% on top of the 21% already paid at the entity level.

✗ No Active Offset

Capital losses limited to $3,000/year against ordinary income. No IDC-equivalent deduction available.

✗ No Governance

No operating role, no seat at the table on capital allocation decisions beyond a shareholder vote.

Side-by-Side Comparison

The following table compares all three structures across the seven criteria that matter most to a business-minded decision maker.

Criterion	Working Interest	Passive Real Estate	Public Securities
Ownership	Direct ownership of the oil and gas property and its production, classified as real property interest under the Internal Revenue Code.	Fractional or direct ownership of real property, often structured through a syndication or limited partnership.	A claim on a corporation's future earnings and assets, held as shares, with no direct ownership of underlying operating assets.
Participation	Active JV member status under a Joint Operating Agreement, with defined consent rights on major operating decisions.	Minimal to none for a syndication investor; direct owners of a single rental property retain landlord level decisions only.	None beyond periodic shareholder votes; the holder has no operational role.
Governance & Control	Operator and non-operating owners share decision authority per the JOA; the owner receives direct operational reporting.	Sponsor or general partner controls refinancing, disposition timing, and reporting cadence.	Corporate board and management control all decisions; individual shareholders have no practical influence.
Liquidity	Illiquid in the short term; value is realized through production cash flow and eventual sale of the interest or the underlying property.	Illiquid; exit generally requires sale of the underlying property or a discounted secondary transfer.	Highly liquid; positions can typically be converted to cash within a trading day.
Tax Treatment	Excluded from passive activity treatment under IRC 469(c)(3)(A); eligible IDC may be electable in the current year subject to basis and at-risk limits; percentage depletion available under IRC 611/613A once producing; excess IDC AMT preference under IRC 57(a)(2) with an independent producer exception.	Subject to passive activity loss rules under IRC 469; the $25,000 special allowance phases out between $100,000 and $150,000 MAGI; unrecaptured Section 1250 gain capped at 25 percent federal rate at sale.	C-corporation earnings taxed at 21 percent at the entity level, then again at the shareholder level on distribution; combined effective rate on qualified dividends can reach approximately 23.8 percent; capital losses limited to $3,000 per year against ordinary income.
Exposure & Limitations	Concentration in a single asset class and commodity price exposure; deduction magnitude depends on basis, at-risk amount, and the specific well's engineering design.	Illiquidity, sponsor dependent outcomes, and a loss allowance that is unavailable to most high income exiting operators in the year they need it most.	Index concentration risk, with the ten largest S&P 500 names now representing roughly 41 percent of total index weight, and no mechanism to direct capital into a specific asset or decision.
Complexity	Requires AFE review, JOA literacy, and coordination with a CPA on the IDC election, basis tracking, and depletion calculations.	Requires sponsor due diligence and ongoing K-1 or Schedule E tracking; passive loss carryforwards require long term record keeping.	Lowest administrative burden; standard 1099 reporting through a brokerage account.

Advantages, Limitations & Best Fit Scenarios

Advantages & Limitations by Structure

1

Working Interest

Advantages: A statutory, classification-based tax mechanism that does not phase out with income, a direct governance role through the JOA, and continuing depletion treatment once a well produces.

Limitations: Illiquidity, commodity price exposure, and a genuine requirement to understand the AFE and the specific well's cost structure before committing capital.

2

Passive Real Estate

Advantages: A tangible, familiar asset class and depreciation-driven tax shelter during the hold period.

Limitations: Its loss allowance is structurally capped and phased out at income levels an exiting operator will likely exceed, and its governance is ceded to a sponsor.

3

Public Securities

Advantages: Unmatched liquidity and the lowest administrative burden of the three.

Limitations: Double taxation at the corporate and shareholder level, no active income offset mechanism, and a level of single sector and single stock concentration inside "diversified" index products that is higher today than it has been in over a decade.

Best Fit Scenarios

1 **Working Interest Is the Clearest Fit When...**

An operator has just recognized a large spike in ordinary income — whether from an asset sale, a PE recapitalization, or a year-end distribution — and wants a current year deduction mechanism that is not phased out by income level. Evaluate direct working interest participation alongside your CPA.

2 **Passive Real Estate Complements When...**

An operator already holds real estate professional status, has substantial passive income from other sources to absorb real estate losses, or specifically wants exposure to rental cash flow and depreciation over a multi-year hold, particularly where cap rate and yield assumptions have already been underwritten.

3 **Public Securities Are Weighted More Heavily When...**

An operator places the highest value on same-day liquidity, wants to rebuild a diversified public market position gradually, or needs a parking place for capital that may be redeployed into a new venture within a short time horizon — with the understanding that today's index concentration and double taxation mechanics are part of that trade-off.

Most exiting operators do not choose a single structure in isolation. The more common pattern is a deliberate allocation: a portion of proceeds addressing the current year tax liability through a working interest position, a portion held in liquid securities for near term flexibility, and a portion considered for real estate once passive income capacity exists to use its loss allowance effectively.

Decision Guidance & Questions for Advisor Discussion

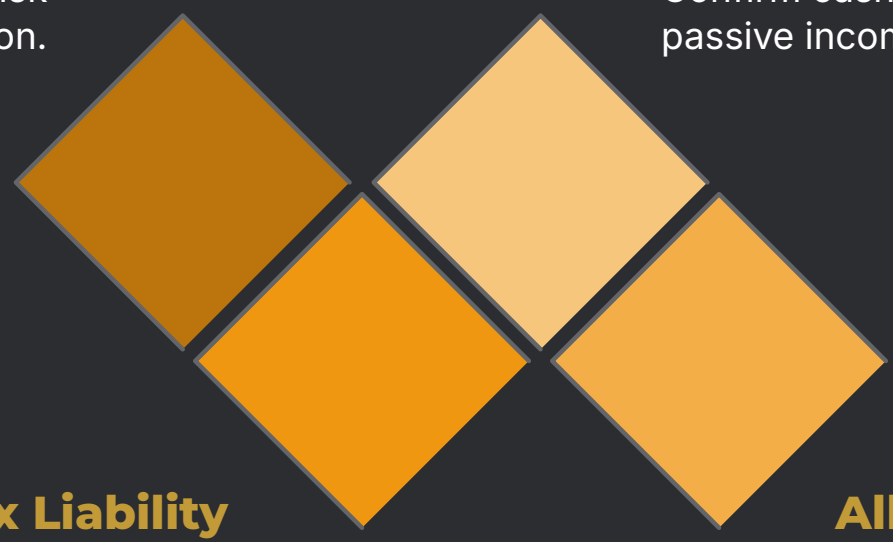
The starting question is not which asset class performs best in isolation, but what the tax liability looks like this year and what the capital needs to do over the next one to three years. An operator with a large current year ordinary income event and meaningful at-risk basis to deploy should direct their CPA's attention first to the 469(c)(3)(A) classification question, because it is the only one of the three structures where the tax treatment attaches to how the asset is classified rather than to the owner's income level or hours worked. From there, liquidity needs, existing passive income capacity, and appetite for direct operational involvement should determine how the remaining capital is allocated between real estate and securities.

Evaluate Basis & IDC

Calculate basis and at-risk for IDC election.

Determine Liquidity Needs

Confirm cash needs and passive income capacity.



Assess Tax Liability

Review current year tax and income event.

Allocate Capital

Split capital across interest, real estate, securities.

Questions for Advisor Discussion

01

Projected Taxable Income

What is this year's projected taxable income, and does the timing of any capital deployment decision need to occur before year end to affect the current tax year?

02

Basis & At-Risk Amount

What is my current basis and at-risk amount available to support an IDC election, and how does that interact with the specific AFE for a given well?

03

Passive Income Sources

Do I have, or am I likely to generate, passive income from other sources that could make a passive real estate loss allowance usable despite the MAGI phase out?

04

Liquidity Needs

What portion of my proceeds genuinely need same day liquidity versus what portion can tolerate a multi-year hold in exchange for a different tax treatment?

05

Four-Layer Loss Limitation

How does the four-layer loss limitation order — basis, at-risk under 465, passive activity under 469, and the 2026 excess business loss threshold under 461(l) of $256,000 single or $512,000 joint — apply to my specific deduction amount?

06

Governance & JOA Terms

What governance rights, reporting cadence, and JOA terms apply to a specific working interest opportunity, and how do they compare to the sponsor-controlled terms of a real estate syndication?

Closing Perspective

> Every exiting operator eventually confronts the same question: where does concentrated, hard-earned capital go once the business that built it has been sold, recapitalized, or has produced an outsized distribution.

Public securities offer liquidity but tax the same dollar twice and concentrate risk inside a smaller number of names than the index label suggests. Passive real estate offers a tangible, familiar asset but limits its own loss allowance precisely at the income levels where an exiting operator needs it most. Direct working interest ownership offers a different mechanism entirely — one defined by statute rather than by income level, paired with genuine governance participation through a Joint Operating Agreement.

None of these structures is correct for every operator in every situation, and the right allocation depends on current year income, available basis, liquidity needs, and risk tolerance. The next step is a direct conversation with a CPA or tax attorney who can model each structure against the specific numbers from the sale, the recapitalization, or the distribution, and a review of the AFE and JOA terms for any working interest opportunity under consideration before capital is committed.

About Summit Ventures

Summit Ventures operates as a direct oil and gas entrepreneurial joint venture platform, structuring participation as a working interest position rather than a fund interest, so that participants retain the governance rights, direct asset ownership, and 469(c)(3)(A) classification described above. Participants review the AFE and JOA before capital is contributed, receive direct operational reporting as active JV members, and work with their own CPA to confirm the specific tax treatment applicable to their situation before any election is made.

Explore Working Interest Opportunities at Summit Ventures

Sources & References

1. Cornell Legal Information Institute, 26 U.S.C. Section 469(c)(3)(A): statutory exclusion of working interests held directly or through an unlimited liability entity from passive activity treatment.
2. Cornell Legal Information Institute, 26 CFR 1.612-4(a): definition of an operator for purposes of IRC Section 263(c), as one holding a working or operating interest as fee owner or under a lease or contract granting operating rights.
3. Internal Revenue Code Section 465: at-risk limitation governing the amount of loss a taxpayer may currently deduct.
4. Internal Revenue Code Section 57(a)(2): alternative minimum tax preference treatment for excess intangible drilling costs, with an independent producer exception limiting the AMT impact.
5. Internal Revenue Code Sections 611 and 613A: percentage depletion allowance of 15 percent for independent producers on producing properties.
6. Internal Revenue Code Section 168(k), as amended by the One Big Beautiful Bill Act (signed July 4, 2025), per Grant Thornton's 2025 legislative alert: 100 percent bonus depreciation made permanent for qualifying property placed in service after January 19, 2025.
7. IRS Publication 925, Passive Activity and At-Risk Rules: the $25,000 real estate active participation special allowance and its phase out at 50 cents per dollar of modified adjusted gross income between $100,000 and $150,000.
8. Internal Revenue Code Section 461(l) and related 2026 guidance: excess business loss threshold of $256,000 single and $512,000 married filing jointly for the 2026 tax year.
9. Thomson Reuters and related CPA guidance on unrecaptured Section 1250 gain: 25 percent federal rate cap on the depreciation recapture portion of a real estate sale gain.
10. CBRE H1 2026 Cap Rate Survey and Outlook: mid-2026 core cap rates of approximately 5.2 percent for multifamily and industrial, 6.4 to 6.9 percent for retail, 7.4 percent for office, and 8.5 percent for hospitality, with 5 to 15 basis points of further compression projected for the year.
11. Legal and tax guidance on C-corporation double taxation mechanics: 21 percent corporate tax rate followed by shareholder level taxation of qualified dividends at 0, 15, or 20 percent plus the 3.8 percent Net Investment Income Tax.
12. Fidelity Investments: S&P 500 average annual return of approximately 10 percent since 1957.
13. RBC Wealth Management, "The Great Narrowing": concentration of the ten largest S&P 500 companies at approximately 41 percent of total index weight at the end of 2025, compared with approximately 19 percent a decade earlier.
14. U.S. Energy Information Administration, Short-Term Energy Outlook: record United States crude oil production forecast for 2026, supporting continued domestic activity in the operating environment relevant to working interest participation.
15. U.S. Securities and Exchange Act of 1933, Rule 501 of Regulation D: definition of an accredited investor referenced for context on eligibility standards applicable to certain pooled investment structures, provided for informational comparison only.