

Energy Working Interest Integration

A Strategic Briefing on Direct Working Interest Ownership, Statutory Tax Mechanics, and the Professional Toolkit for High-Income Client Solutions

Prepared for CPAs and tax professionals, Registered Investment Advisors, Qualified Intermediaries, business brokers and M&A advisors, estate planning attorneys, and commercial real estate brokers who advise high-income and high-net-worth clients.

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Executive Summary

This briefing exists for one reason: to give client-facing advisors a clear, statute-grounded understanding of direct energy working interest ownership so it can be evaluated, alongside other planning tools, the next time a client presents a year-end income spike, a narrowing 1031 identification window, or a liquidity event from a business sale.

The core objective is not to position Summit Ventures as a product to be sold. It is to walk through the mechanics of IRC Section 263(c), IRC Section 469(c)(3)(A), and Revenue Ruling 68-331 with the same precision you would expect from a peer, so that when a client's situation intersects with one of these statutory provisions, you already understand the structural requirements well enough to know what questions to ask and what documentation to request.

Three Client Scenarios That Recur Most Often

Year-End Income Spike

A compensation or K-1 spike that has already happened and cannot be undone through standard deferral vehicles.

Closing 1031 Window

A 1031 exchange where the 45-day identification window is closing faster than suitable replacement property can be located.

Business Sale Proceeds

A business sale where a meaningful portion of proceeds will be taxed as ordinary income rather than capital gains.

Direct working interest ownership intersects with all three, through different statutory mechanisms, and this briefing separates those mechanisms clearly rather than treating them as one undifferentiated "tax benefit."

Context and Market Environment

A Proven Statutory Framework

Direct participation in domestic oil and gas development is not a novel or untested category. The deduction for intangible drilling costs traces to a 1916 Treasury regulation and was codified as IRC Section 263(c) in the Internal Revenue Code of 1954. It has remained in the code through every major tax reform cycle since, including the Tax Cuts and Jobs Act and the 2025 One Big Beautiful Bill Act (OBBBA), which also made 100 percent bonus depreciation under IRC Section 168(k) permanent for qualifying tangible drilling cost property acquired after January 19, 2025.

Domestic Production Backdrop

The domestic production backdrop is relevant context for any advisor evaluating whether this category belongs in a serious planning conversation.

13.6M

Barrels Per Day

U.S. crude oil production record in 2025, confirmed by the U.S. Energy Information Administration.

10.6M

U.S. Jobs Supported

Oil and natural gas industry jobs reported by the American Petroleum Institute, 2023 data.

$2.1T

Economic Contribution

Total U.S. economic contribution from oil and natural gas industry, 2023 data.

This is a mature, heavily regulated domestic industry with a well-established statutory tax framework, not a speculative or exotic asset class. What has changed is accessibility and documentation quality. The friction that historically kept energy working interests out of mainstream advisory conversations — inconsistent K-1 timing, thin engineering documentation, and unclear entity structuring — is precisely the operational gap institutional-grade partners are built to close.

Key Challenges for Advisors

Advisors face a structural problem that has nothing to do with whether energy assets are a sound category and everything to do with trust and documentation. Three dynamics make this difficult in practice.

Reputational Exposure

Recommending a poorly structured, non-compliant, or speculative program can cost an advisor far more than a single client relationship. A K-1 that arrives late, is restated, or cannot withstand IRS scrutiny becomes the advisor's problem, not just the sponsor's.

Structural Literacy Gap

Most advisors who are technically fluent in IRC Section 263(c) are not equally fluent in IRC Section 469(c)(3)(A), the working interest exception to the passive activity loss rules. These are two different statutory questions. Section 263(c) governs whether intangible drilling costs may be expensed in the year incurred rather than capitalized. Section 469(c)(3)(A) governs whether the resulting loss can offset active income — such as W-2 wages, 1099 income, or K-1 distributions — at all. Conflating the two, or assuming the second automatically follows the first, is the single most common technical error advisors make when a client raises this category.

The Entity Trap

The 469(c)(3)(A) exception applies only when the interest is held directly or through an entity that does not limit the taxpayer's liability. A working interest held through an LLC or limited partnership that shields the investor from liability does not qualify, and the loss reverts to passive treatment, available only to offset passive income. An advisor who does not confirm how an interest is held before recommending it is taking on unnecessary professional risk.

Key Findings

Four findings anchor this briefing and are useful to carry into any client conversation.

1 No Material Participation Hours Test

The active-income offset under Section 469(c)(3)(A) has no material participation or hours test, unlike real estate professional status, which can require 750 or more hours annually. A busy client — including a physician, attorney, or business owner with no time for a second occupation — can still qualify, provided the interest is held in a liability-unlimited structure.

2 At-Risk Rules Cap Deductions at Real Exposure

The at-risk rules under IRC Section 465 cap any deduction at the client's actual cash plus recourse debt exposure. Nonrecourse financing does not count toward the at-risk basis. This is a meaningful guardrail that keeps the mechanism tethered to real economic exposure rather than paper losses.

3 Two Distinct AMT Thresholds

Excess intangible drilling cost deductions can trigger an alternative minimum tax preference item under IRC 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. A separate provision, Section 57(a)(2)(E), allows independent producers to elect to limit this preference, subject to its own 40 percent of alternative minimum taxable income cap. These are two distinct statutory thresholds, not interchangeable figures, and both should be confirmed against the client's specific return rather than generalized.

4 Revenue Ruling 68-331 and Its Companion Caution

Revenue Ruling 68-331 classifies an operating working interest in a producing oil and gas lease as real property, like-kind to a fee interest in real estate, under the statutory predecessor to Section 1031. Revenue Ruling 78-135 is the companion caution: a general partnership interest itself, as distinct from the underlying working interest, does not qualify for 1031 nonrecognition. The distinction between owning the asset and owning an interest in an entity that owns the asset is the same structural thread that runs through both the 469(c)(3)(A) active-income question and the Section 1031 replacement-property question.

Statutory and Regulatory Evidence

The statutory and regulatory record supporting these mechanics is well documented and available for independent review by any advisor or their own research team.

IRC § 263(c) & Treas. Reg. 1.612-4

Permit a working interest holder to elect to expense intangible drilling costs — meaning labor, fuel, drilling mud, site preparation, and similar non-salvageable costs — in the year incurred rather than capitalizing them. Tangible drilling costs, such as casing and wellhead equipment, are capitalized and depreciated, now eligible for 100 percent bonus depreciation under the OBBBA's permanent extension of Section 168(k).

IRC § 469(c)(3)(A)

States that passive activity "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 exact statutory language is the basis for the active-income offset and is worth quoting directly to a skeptical client or a reviewing CPA.

IRC § 461(h)

Applies the economic performance rule to intangible drilling cost timing, with a 90-day drilling exception that governs how late in the year a client can contribute capital and still support a current-year deduction — a detail that becomes especially relevant in year-end planning conversations.

IRC §§ 611 & 613A

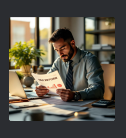
Provide a 15 percent percentage depletion allowance on gross income from production for independent producers — an ongoing benefit once a well reaches production, separate from the upfront intangible drilling cost deduction.

Revenue Rulings 68-331 & 78-135

Revenue Ruling 68-331 (1968) and the related Treasury guidance under Section 1031(k)-1 establish the real property classification. Revenue Ruling 78-135 establishes the general partnership interest exclusion from Section 1031 treatment.

Analysis by Advisory Discipline

Each advisory discipline encounters this category through a different client trigger, and the technical emphasis should shift accordingly.



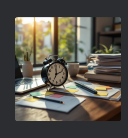
CPAs and Tax Professionals

The conversation is usually reactive: a client's year-end K-1 or bonus income has already landed, and standard deferral vehicles, retirement contributions, or timing elections are exhausted or inapplicable. The relevant mechanics are Section 263(c) election timing, the Section 461(h) 90-day drilling exception, and confirmation that the holding structure preserves Section 469(c)(3)(A) treatment before any deduction is modeled on a return.



Registered Investment Advisors

The conversation is usually proactive, arising from a client's broader demand for diversification away from public market concentration and correlated asset classes. The relevant emphasis is on working interest ownership as a structurally distinct, direct real asset position, governed by its own statutory framework, rather than another security wrapped around the same market risk already present in a client's portfolio.



Qualified Intermediaries

The conversation is time-constrained. A client in an active 45-day identification window needs to understand, quickly and accurately, that Revenue Ruling 68-331 supports working interest as qualified like-kind replacement property, while Revenue Ruling 78-135 confirms that a partnership interest in the entity that holds the working interest does not. QIs should never make the qualification determination themselves; a tax opinion letter from the client's own counsel remains the appropriate mechanism for that confirmation.



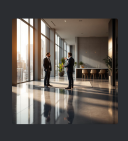
Business Brokers and M&A Advisors

The conversation follows the close of a transaction, when a seller is facing a meaningful ordinary-income component of total proceeds and needs a capital deployment option that can offset that specific income character, not just defer or reduce capital gains.



Estate Planning Attorneys

The working interest conversation fits inside a broader asset structuring discussion, where a direct real property interest with its own depletion schedule and K-1 reporting may interact with trust structures, buy-sell provisions, or wealth transfer planning in ways that merit documentation review rather than a blanket recommendation.

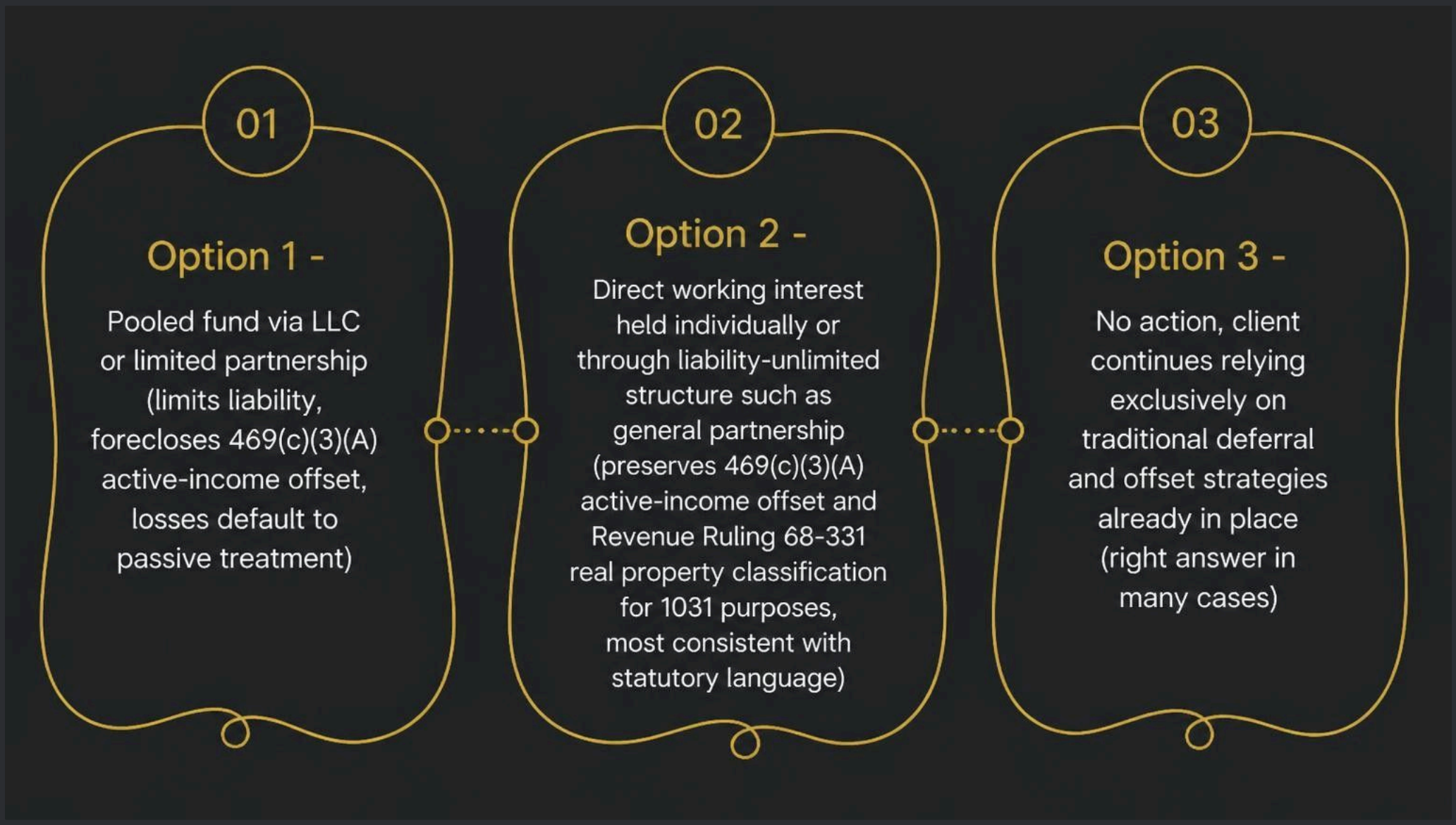


Commercial Real Estate Brokers

The relevant bridge is the Section 1031 exchange itself. When a seller's 45-day window is closing without a suitable traditional replacement property identified, or when boot is unavoidable, a direct working interest is a category worth including in the replacement-property conversation precisely because it carries its own statutory real property classification.

Three Structural Paths

Advisors generally encounter three structural paths when this category surfaces in a client conversation, and distinguishing them clearly is the most useful technical service an advisor can provide before any capital moves.



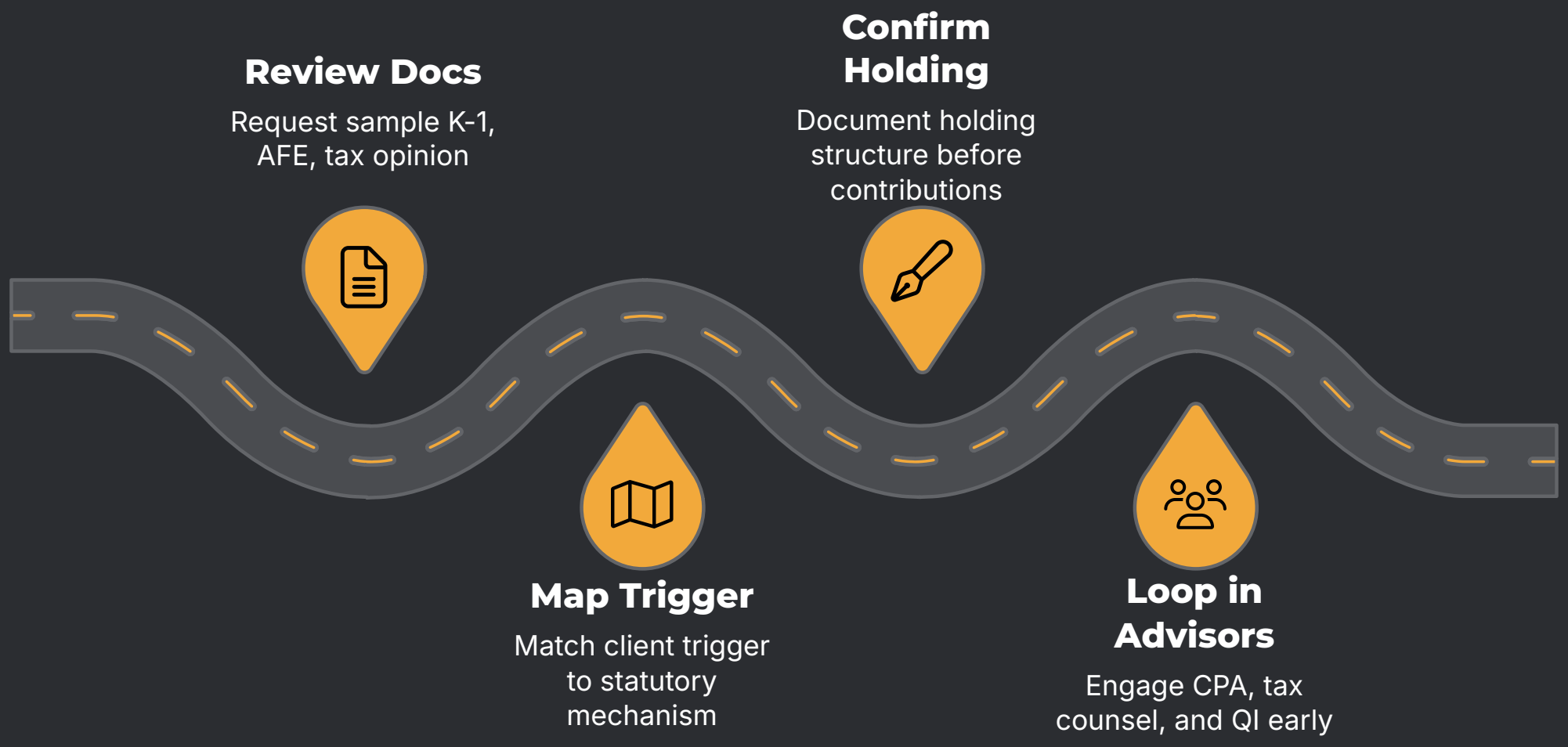
⚠ A working interest held through an LLC or limited partnership that shields the investor from liability does not qualify for the 469(c)(3)(A) active-income offset — losses revert to passive treatment. Confirm the holding structure in writing before any recommendation is made.

The purpose of laying out these three paths is to equip advisors to recognize, structurally, which category a given client opportunity falls into before any recommendation or referral discussion occurs.

Recommendation and Implementation Roadmap

The recommendation from this briefing is procedural, not promotional: before any client capital is deployed into a working interest structure of any kind, confirm in writing how the interest is held, request the AFE (authorization for expenditure) breakdown between intangible and tangible drilling costs, and request a tax opinion letter addressing the specific statutory question relevant to the client's situation — whether that is 469(c)(3)(A) active-income treatment or Section 1031 replacement-property qualification.

Summit Ventures operates as an entrepreneurial joint venture platform built around this exact documentation standard. Active JV members hold a direct working interest position, supported by standardized K-1 scheduling, written confirmation of the holding structure, and tax opinion letter coordination available to the client's own CPA or counsel. This is offered as a resource for advisors who want a documented, verifiable structure to evaluate, not as a substitute for the advisor's own independent review.



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Request Documentation

Expected Impact, Compliance Safeguards & Closing Perspective

Expected Impact

For the advisor, the expected impact of understanding this category thoroughly is professional, not financial: the ability to answer a client's question about energy working interests accurately, in statutory terms, rather than deferring entirely or relying on a sponsor's marketing material. That distinction is what separates a trusted advisor from a referral conduit.

For the client, the potential impact depends entirely on individual facts, including their specific AFE-confirmed intangible drilling cost allocation, their at-risk basis under Section 465, and their total AMT exposure under Section 57(a)(2). No specific deduction percentage, return outcome, or tax savings figure should be presented as typical or guaranteed, and this briefing deliberately avoids doing so. The honest and professionally defensible statement is that direct working interest ownership offers up to full statutory tax treatment on qualifying intangible drilling costs, subject to the client's specific structure, documentation, and individual tax circumstances, confirmed by their own qualified tax advisor.

Compliance and Regulatory Safeguards

- **Written tax opinion letter** addressing the specific statutory question at issue — active-income offset, 1031 replacement property, or both — should be obtained from qualified counsel before the advisor relies on any characterization of the tax treatment.
- **Written confirmation of the holding structure** — direct ownership or a liability-unlimited entity — should be part of the client file, since this single fact determines whether the 469(c)(3)(A) exception and the Revenue Ruling 68-331 classification both apply.
- **Standardized, audit-ready K-1 scheduling** with Box 1, 12, 13, and 20 entries that correctly reflect active rather than passive classification for a qualifying working interest, confirmed with the issuing sponsor before tax season, not during it.
- **Direct line to the sponsor's tax and operations team**, available to the client's CPA for questions during return preparation or in the event of IRS inquiry — a reasonable baseline expectation for any institutional-grade partner in this category.

> The purpose of this briefing was to separate three statutory questions that are too often treated as one: whether a cost can be expensed under Section 263(c), whether the resulting loss can offset active income under Section 469(c)(3)(A), and whether the underlying interest qualifies as replacement property under Revenue Ruling 68-331. Each turns on how the interest is held, and that single structural fact is the thread connecting every advisory discipline represented in this briefing.

None of this replaces the advisor's own judgment or the client's independent tax and legal counsel. It is offered as a technical foundation so that when a client's year-end income, 1031 clock, or business exit intersects with this category, the advisor is equipped to ask precise questions and request the right documentation before any recommendation is made. Summit Ventures remains available as an institutional resource for that documentation and education, structured for advisors who hold their own professional standards to the same statutory precision reflected in this briefing.

Key Sources and References

- IRC Section 263(c) and Treasury Regulation 1.612-4 (intangible drilling cost election and operator definition)
- IRC Section 469(c)(3)(A), confirmed via Cornell Legal Information Institute (working interest exception to passive activity loss rules)
- IRC Section 465 (at-risk limitation rules)
- IRC Section 57(a)(2)(A) and 57(a)(2)(E) (excess intangible drilling cost AMT preference and independent producer exception)
- IRC Sections 611 and 613A (percentage depletion allowance)
- IRC Section 461(h) (economic performance rule and 90-day drilling exception)
- Revenue Ruling 68-331, 1968-1 C.B. 352 (working interest classified as like-kind real property)
- Revenue Ruling 78-135 (general partnership interest excluded from Section 1031 treatment)
- Treasury Regulation 1.1031(k)-1 (like-kind exchange identification and timing rules)
- One Big Beautiful Bill Act (2025), permanent 100 percent bonus depreciation under IRC Section 168(k)
- U.S. Energy Information Administration, record U.S. crude oil production of 13.6 million barrels per day in 2025
- American Petroleum Institute, 10.6 million jobs and 2.1 trillion dollars in U.S. economic contribution, 2023 data

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